Rescue Plan Could Be Less Onerous Than It Looks

Mitigating Factors May Make Package More Palatable

By John D. McKinnon

WASHINGTON—The Bush administration might be seeking $700 billion for its financial rescue plan, but that amount isn't likely to show up in the budget deficit.

"This is not an expenditure of $700 billion," Federal Reserve Chairman Ben Bernanke told senators at a hearing on Tuesday. "This is a purchase of assets, and if auctions are done properly ... the American taxpayer will get a good value for his or her money. And as the economy recovers, most, all, or perhaps more than all of the value will be recovered over time."

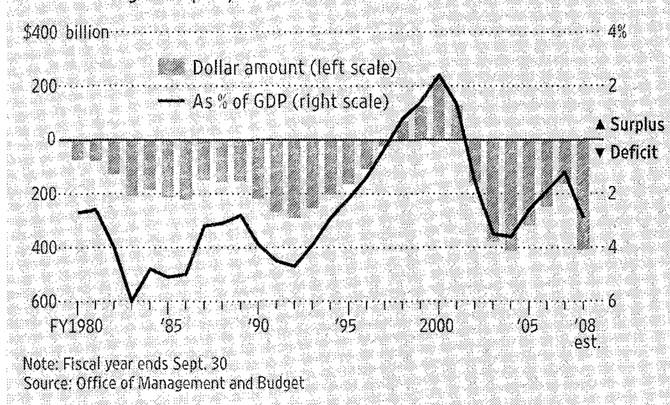
That argument, if it gains traction, could make the package more palatable to skeptical lawmakers and the public.

In fact, there are a few reasons why the government's interventions probably won't be quite as expensive as people think. For starters, some experts say it's far from certain that the U.S. government will even need all the money it has budgeted. They say policy makers set their spending limits on the high side to make clear to investors that the government would do whatever it takes to make financial markets work again. And once the government's rescue program begins to establish prices for currently unmarketable securities, the hope is that the market will start functioning again before the U.S. actually has to buy $700 billion worth of them.

Regardless of how much the government actually spends, the impact on the budget deficit will be further limited because budget rules allow the government to treat such debt as a "means of financing." Only the anticipated losses on the investments, plus interest costs, would show up as additions to the deficit.

Ultimately, as Mr. Bernanke suggested, the government stands to get a lot of its money back on the securities it buys. It can sell them off or hold them as investments, depending on market conditions.

Just how much the government can recover is unclear. The Fed chairman told lawmakers he expects it to be a "substantial amount," and he compared the process to an art auction. "Just as when you sell a painting at Sotheby's, nobody knows what it's worth until the auction is over," Mr. Bernanke said.



At the hearing of the Senate Banking Committee, Treasury Secretary Henry Paulson warned that the cost of inaction could be greater. "These bad loans have created a chain reaction, and last week our credit markets froze—even some Main Street nonfinancial companies had trouble financing their normal business operations," he said.

Mark Zandi of Moody's Economy.com figures the government might pay out a total of $750 billion in all of its financial interventions—about half the maximum $1.4 trillion total that has been allocated for the rescue package, the takeover of mortgage companies Fannie Mae and Freddie Mac, the bailout of insurer American International Group Inc. and the housing bill that Congress passed earlier this year—and will be able to recover most of that. He estimates the total cost to taxpayers at no more than $250 billion, including the losses on the assets plus the interest on the government bonds that must be issued to finance the programs.

It's not entirely clear when those costs will show up in the budget. The deficit for fiscal 2009, which begins Oct. 1, already is expected to reach $500 billion. Adding the full $250 billion in 2009, along with an anticipated dropoff in tax revenues, could bring the deficit close to $1 trillion, Mr. Zandi said. But William Hoagland, a former top budget staffer in the Senate, and others say that a $1 trillion deficit for 2009 is extremely unlikely.

Budget accounting aside, the big U.S. rating agencies say America is reasonably well-positioned for all the new borrowing, despite its great existing debt. Government debt held by the public, excluding obligations to Social Security, totals about $5.5 trillion. Adding even $1 trillion shouldn't affect the U.S. government's AAA credit rating, according to rating services. Moody's Investors Service put out a special comment this week saying that it "continues to view the foundations of the U.S. government rating as unshaken," primarily because of the U.S. economy's wealth and resilience. Moody's added that "there is a large leeway for even a significant increase in debt issuance."

Standard & Poor's analyst John Chambers agreed.

"We think the government still has enough fiscal room to maneuver [so] that this is consistent with the AAA rating with stable outlook," he said. The size of the proposed rescue plan is consistent with S&P's prior estimates, he added.

Worries about the added U.S. debt have dragged down the dollar and put upward pressure on oil prices, as well as fueling public concerns, since the Bush administration announced its financial rescue plan late last week. But the real long-term fiscal concern for the U.S. remains the government's unfunded obligations under Social Security and Medicare, analysts added.

Moody's cautioned that its analysis "is based on the assumption that the dollar and the U.S. government debt will maintain their current status in the world economy. ... Should the dollar lose its standing and the policy response become ineffective, debt affordability would diminish because of higher borrowing costs and an erosion of the revenue base."

Moody's Senior Vice President Guido Cipriani said the agency believes that outcome is unlikely, despite the market's initial reaction on Monday. "We don't worry too much about such near-term volatility," he said. "What we're speaking to is the ability of the U.S. to maintain confidence in the dollar as a global reserve and transaction currency."