MEASURING THE TRUE COST OF GOVERNMENT BAILOUT

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Government intervention to assist individual businesses and industries during the 2008–2009 economic crisis was extraordinary in variety and scope. Despite official protestations of "no more bailout" in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, future government interventions are inevitable, should economic circumstances become sufficiently dire. Moreover, even if Congress eliminates overt bailout-type interventions, indirect forms of public bailout are likely to continue. Understandably, taxpayers have been concerned about the cost. A simple tally of dollars authorized or disbursed is wholly inadequate to accurately assess the costs of various interventions. This Article addresses the challenges of providing reasonable budgetary information with respect to different types of bailout expenditures. In addition to looking at costs for the more obvious bailout programs, the analysis explores the special cost estimation challenges for other more covert actions, such as special tax breaks or relief from burdensome regulation, that serve a "bailout" function. The Article also takes issue with the fragmentation of intervention efforts among different "on-budget" and "off-budget" entities and with some of the methodologies used by the government to value assets obtained in its bailout efforts, arguing that decision making about the appropriate allocation of aggregate resources is hampered when some expenditures are "off-budget" altogether and when even "on-budget" agencies use different accounting methods. Finally, the Article calls for transparency and budget accounting for public bailouts accomplished more indirectly through the tax system and other regulatory regimes. Adequate and transparent budget accounting for bailout costs requires greater consistency in valuation and accounting methods, and a more unified presentation of aggregate information in the budget with respect to all government bailout-type activities.

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I. INTRODUCTION AND BRIEF HISTORY

A. Introduction

When the American Dialect Society tallied votes for its nineteenth annual "word of the year," the clear victor for 2008 was "bailout."[1] The economic crisis that began in 2007 and escalated through 2009 led even those who are ordinarily free-market purists to concede the need for government intervention. Not since the Great Depression had the United States experienced such a severe economic downturn affecting virtually all sectors of the economy.[2]

Although the extent and variety of recent government bailouts have been extraordinary, the "bailout phenomenon" is nothing new. History offers numerous illustrations of government intervention to assist individual businesses in financial distress, including the Chrysler Corporation,[3] Lockheed Aircraft Corporation,[4] New York City,[5] Penn Central, and other struggling northeastern railroads.[6] Congress has also provided industry-wide assistance, including legislation to aid the airline

1. Press Release, Am. Dialect Soc'y, "Bailout" Voted 2008 Word of the Year by American Dialect Society (Jan. 9, 2009), *available at* http://www.americandialect.org/2008-Word-of-the-Year-PRESS-RELEASE.pdf.

2. After meeting by conference call on November 28, 2008, the National Bureau of Economic Research (NBER), a private, nonprofit, nonpartisan research organization, officially declared that the domestic economy had been in recession since December 2007. NAT'L BUREAU OF ECON. RESEARCH, DETERMINATION OF THE DECEMBER 2007 PEAK IN ECONOMIC ACTIVITY (2008), *available at* http://www.nber.org/dec2008.pdf. According to the NBER, "[a] recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." NAT'L BUREAU OF ECON. RESEARCH, THE NBER'S RECESSION DATING PROCEDURE (2003), *available at* http://www.nber.org/cycles/recessions.html. By conference call on September 19, 2010, the NBER officially determined that the recession ended in June 2009 and declared it the longest of any recession since World War II. NAT'L BUREAU OF ECON. RESEARCH, BUSINESS CYCLE DATING COMMITTEE (2010), *available at* http://www.nber.org/cycles/sept2010.html.

3. Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. No. 96-185, 93 Stat. 1324 (1980).

4. Emergency Loan Guarantee Act, Pub. L. No. 92-70, 85 Stat. 178 (1971). Although this Act was general in scope, its passage was motivated by the financial problems of the Lockheed Aircraft Corporation. H.R. REP. NO. 92-379, at 1272 (1971).

5. New York City Loan Guarantee Act of 1978, Pub. L. No. 95-339, 92 Stat. 460; New York City Seasonal Financing Act of 1975, Pub. L. No. 94-143, 89 Stat. 797.

6. *See, e.g.*, The Emergency Rail Services Act of 1970, Pub. L. No. 91-663, 84 Stat. 1975 (providing federal loan guarantees to bankrupt railroads); Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, § 301, 87 Stat. 985, 1004 (1974) (creating Conrail as a private, government-sponsored corporation to provide railroad services); *see also* Reg'l Reorganization Act Cases, 419 U.S. 102 (1974) (upholding constitutionality of the Regional Rail Reorganization Act of 1973); *Id.* at 109 n.3 (listing individual bankrupt railroads); Henry H. Perritt, Jr., *Ask and Ye Shall Receive: The Legislative Responses to the Northeast Rail Crisis*, 28 VILL. L. REV. 271 (1983).

industry, hard hit by the aftermath of the 2001 terrorist attacks.[7] Until the most recent bailouts, perhaps the most costly industry-wide government intervention in modern memory was the savings and loan bailout in the late 1980s.[8]

As events evolved in 2008 and 2009, voters became increasingly angry about lax regulatory oversight of Wall Street and the escalating cost of government-funded bailouts.[9] This Article focuses on issues related to providing accurate cost assessments and budget accounting for bailouts in general and for recent bailouts in particular. Congress has since passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[10] This historic financial regulatory reform bill begins with a preamble declaring a firm purpose to "end 'too big to fail'" and "to protect the American taxpayer by ending bailouts."[11] With this legislation, Congress announced that there will be no more government-funded rescues of private industry. At the same time, the legislation seeks to prevent—or at least mitigate—potential future economic crises by providing government "authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States."[12] Expenses incurred in connection with the government's orderly liquidation authority are not to be paid from general revenues, but instead from a new "orderly liquidation

7. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001); *see also* Margaret M. Blair, *The Economics of Post-September 11 Financial Aid to Airlines*, 36 IND. L. REV. 367 (2003); Tara Branum & Susanna Dokupil, *Security Takeovers and Bailouts: Aviation and the Return of Big Government*, 6 TEX. REV. L. & POL. 431 (2002).

8. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183; *see also* BAIRD WEBEL, N. ERIC WEISS & MARC LABONTE, CONG. RESEARCH SERV., RS22956, THE COST OF GOVERNMENT FINANCIAL INTERVENTIONS, PAST AND PRESENT 6 (2008) (reporting a $150 billion final cost to the Treasury Department for the savings and loan bailouts).

9. Media coverage of congressional financial regulatory reform debates often referred to public anger over bailouts, Wall Street, and government regulators. *See, e.g.*, Jackie Calmes, *Democrats Seize on Oversight*, WASH. POST, Apr. 19, 2010, at A1 (referring to increased confidence among Democrats about prospects for financial regulatory reform given "voter anger at big banks and bailouts"); Jim Puzzanghera, *Debate Begins on Final Overhaul Reform*, CHI. TRIB., June 11, 2010, at C31 (quoting Rep. Paul Kanjorski as saying, "[f]eelings of anger, frustration and rage justifiably hang over this proceeding because of the recklessness of financial whiz kids, the greediness of Wall Street bankers and the shortsightedness of our economic regulators").

10. Pub. L. No. 111-203, 124 Stat. 1376. Congress's recent passage of this Act was a remarkable political and policy achievement, which—among many other things—provided new consumer protections, *id.* tit. X, and reforms to increase Wall Street transparency and accountability, *id.* tit. VII. The Act was signed into law just as this Article entered final editing. The voluminous Act covers many areas that are beyond the scope of this Article. Aspects of the legislation that are significant to the discussion are considered briefly throughout the Article. *See also* discussion *infra* Part VI.

11. *Id.* (preamble).

12. *Id.* tit. II, § 204(a). The legislation provides detailed procedures for making a formal "systemic risk determination," *id.* § 203, and a court order appointing the Federal Deposit Insurance Corporation (FDIC) as receiver. *Id.* § 202.

fund" to be maintained by the Treasury Department for the Federal Deposit Insurance Corporation (FDIC).[13] For purposes of this fund, the FDIC has authority to borrow by issuing obligations.[14] To ensure that funds necessary to repay these obligations not be taken from general revenue, the legislation gives the FDIC further authority to impose a risk-based assessment on large bank holding companies and nonbank financial companies under supervision of the Federal Reserve Bank.[15] Lest there be any doubt, Congress also included an explicit declaration that "taxpayers shall bear no losses from the exercise of any authority under this title."[16] As he signed the Wall Street Reform legislation, President Obama asserted that "because of this law, the American people will never again be asked to foot the bill for Wall Street's mistakes. *There will be no more tax-funded bailouts—period.*"[17]

If such legislative and executive branch claims of "no more taxpayer-funded bailout" are accurate, one might think that the budgetary accounting issues addressed in this Article are moot. Yet, bailout cost measurement concerns remain relevant for several reasons. If nothing else, the public is entitled to some reasonable assessment of how much has already been spent for bailout-type government interventions. In addition, federal loan and loan guarantee programs for struggling small businesses are likely to continue as an important part of our economic landscape. And, the government continues to hold conservatorship interests in mortgage giants Fannie Mae and Freddie Mac, the value of which should be monitored for budgetary purposes.[18] More importantly, political "no more bailout" assertions—even those ultimately included in statutory text—simply are not credible as precommitment devices. Statutory declarations can always be amended. As much as Congress would like to eliminate any "too-big-to-fail" policy, the reality is that there may—and probably will—come a time when the failure of a particular firm or industry would be so economically devastating that Congress would step in to save it, despite earlier protestations to the contrary.[19] In addition, the

13. *Id.* § 210(n) (establishing an "Orderly Liquidation Fund").

14. *Id.* § 210(n)(5).

15. *Id.* § 210(o) (providing for risk-based assessments on bank holding companies with total consolidated assets equal to or greater than $50 billion and on certain nonbank financial companies).

16. *Id.* § 214(c).

17. Remarks on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 DAILY COMP. PRES. DOC. 617 (July 21, 2010) (emphasis added).

18. *See infra* notes 24–25, 89–94, 175–82 and accompanying text.

19. For similar observations, see Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. (forthcoming 2011) (manuscript at 4–5), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_

legislative orderly liquidation procedures are limited to financial companies, insurance companies, and certain brokers and dealers.[20] Thus, the legislation does not apply to potential bailouts of the automotive industry, airlines, or any other companies or industries whose failure might create systemic risk. Perhaps most importantly, the reform legislation does not address the many ways in which Congress provides potentially costly bailout-type relief through indirect or covert interventions.

This Article explores the challenges involved in providing reasonably accurate budgetary information with respect to different types of overt and covert bailout expenditures. Despite the challenges, it is important that every effort be made to record the budgetary impact of each type of government intervention as accurately as possible. As one analyst recently noted,

> [i]t will be critical to economic recovery and the long-term health of our financial system that we allocate money to the different rescue programs in a way that maximizes the "bang for the buck[,]" [which is] best done by comparing the expected costs of various programs, rather than focusing on their maximum possible losses.[21]

A reasonable assessment of the relative costs of different approaches is essential to enable legislators, administrators, and regulators to make informed policy choices about the best use and allocation of resources. Finally, reasonable estimation of the costs of various "rescue" efforts is important if overall budgetary information is to reflect a reasonably accurate picture of the nation's overall short- and long-term fiscal health.

In addition to analyzing cost assessment challenges presented by the more obvious bailout programs, this Article explores the special cost estimation challenges for other, more covert, actions that serve a "bailout" function. Part II will first briefly address the distinction between bailout and stimulus and misconceptions about the ways in which government economic rescue efforts may or may not impose costs on the general taxpaying public. Part III identifies concerns with "off-budget" bailout-type expenditures and considers the proper location in the federal budget

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id=1548787 ("Bailouts are an inevitable feature of modern economies, where the interconnectedness of firms means that the entire economy bears the risk of individual firms' failure. . . . Any prefixed resolution regime will be abandoned whenever it cannot provide acceptable distributional outcome. In such cases, bailouts are inevitable.").

20. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, §§ 204, 205, 124 Stat. 1376, 1454–58.

21. DOUGLAS J. ELLIOTT, BROOKINGS INST., MEASURING THE COST OF THE TARP 7 (2009).

for reporting various types of government bailout interventions. One question considered in this Part, for example, is the proper budgetary treatment of Federal Reserve, as opposed to Treasury Department, bailout-type actions. Part IV considers budgetary challenges in proper accounting and cost estimation for different types of overt government bailouts. Finally, Part V explores similar questions with respect to more covert bailouts.

For purposes of this Article, my working definition of "bailout" is one that I developed in my earlier work: "a form of government assistance or intervention specifically designed or intended to assist enterprises facing financial distress and to prevent enterprise failure."[22] This working definition does not include government assistance to individuals facing economic distress. Although there certainly are overlaps in the types of budgetary issues raised in the business and personal settings, my focus is on government intervention to assist financial or business entities.

B. Brief History of Recent Events

Public awareness of the recent downward economic spiral perhaps became most widespread in March 2008, with dramatic reports of emergency meetings at which the then Treasury secretary Henry Paulson, Federal Reserve Board Chairman Ben Bernanke, and other officials assisted in brokering J.P. Morgan's acquisition of Bear Stearns—a deal that would not have closed without the New York Federal Reserve's guarantee to absorb $29 billion in losses on Bear Stearns' riskiest assets.[23] In July 2008, as housing and financial markets declined, the Treasury Department successfully sought congressional authority to seize control of troubled mortgage finance giants Fannie Mae and Freddie Mac.[24] By September 2008, the federal government held Fannie Mae and Freddie Mac in conservatorship and had itself become a preferred shareholder.[25] At

22. Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951, 960 (1992) [hereinafter Block, *Bailouts*].

23. Details of the transaction were reported by the Federal Reserve in *Legal Developments: Second Quarter, 2008*, FED. RES. BULL., Aug. 2008, at 73, 78–81; *see also* GARY SHORTER, CONG. RESEARCH SERV., RL34420, BEAR STEARNS: CRISIS AND "RESCUE" FOR A MAJOR PROVIDER OF MORTGAGE-RELATED PRODUCTS (2008). For Treasury Secretary Paulson's personal perspective, see HENRY M. PAULSON, JR., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 90–121 (2010).

24. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 1117, 122 Stat. 2654, 2683–88.

25. Press Release, U.S. Dep't of the Treasury, Statement by Secretary Henry M. Paulson, Jr., on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers

about the same time, the Federal Reserve authorized a loan of up to $85 billion to stave off the imminent collapse of American International Group (AIG), the nation's largest insurance company, and took warrants that, if converted into common stock, would give the government an approximately 80% equity interest in the insurance giant.[26] Shortly thereafter, the Federal Reserve expanded its assistance to AIG, authorizing a cash infusion of up to an additional $37.8 billion, in exchange for AIG securities through a newly created Securities Borrowing Facility (SBF) and another $14 billion through another new facility, the Commercial Paper Funding Facility (CPFF).[27] Further assistance followed when the Federal Reserve created special entities, referred to as "special purpose vehicles" or SPVs, for the sole purpose of acquiring AIG troubled assets.[28]

By late September 2008, it had become clear to members of both parties that more systemic intervention was needed. In response to the Treasury Department's request for greater authority, Congress enacted the Emergency Economic Stabilization Act of 2008 (EESA),[29] creating a new Troubled Asset Relief Program (TARP),[30] which quickly became popularly referred to as the "$700 billion bailout."[31] In addition to direct

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(Sept. 7, 2008), *available at* http://ustreas.gov/press/releases/hp1129.htm; *see also* N. ERIC WEISS, CONG. RESEARCH SERV., RL34661, FANNIE MAE'S AND FREDDIE MAC'S FINANCIAL PROBLEMS: FREQUENTLY ASKED QUESTIONS (2008). For further discussion of the Fannie Mae and Freddie Mac takeover and its budget implications, see *infra* notes 182–88 and accompanying text.

26. For a detailed description of the Federal Reserve Loan to AIG, see BAIRD WEBEL, CONG. RESEARCH SERV., R40438, ONGOING GOVERNMENT ASSISTANCE FOR AMERICAN INTERNATIONAL GROUP (AIG) (2009); Press Release, Bd. of Governors of the Fed. Reserve Sys. (Sept. 16, 2008).

27. BAIRD WEBEL, CONG. RESEARCH SERV., R40438, ONGOING GOVERNMENT ASSISTANCE FOR AMERICAN INTERNATIONAL GROUP (AIG) 5 (2009). Provisions in the 2010 Wall Street Reform Act create a new loan guarantee program to provide emergency financial stability to solvent depository institutions, but the guarantee "may not include the provision of equity in any form." Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1105, 124 Stat. 1376, 2121–25.

28. BAIRD WEBEL, CONG. RESEARCH SERV., R40438, ONGOING GOVERNMENT ASSISTANCE FOR AMERICAN INTERNATIONAL GROUP (AIG) 7–8 (2009).

29. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (to be codified at 12 U.S.C. §§ 5201–5261).

30. *Id.* tit. I, §§ 101–136 (to be codified at 12 U.S.C. §§ 5211–5241). Originally scheduled to expire on December 31, 2009, TARP was extended through October 3, 2010, pursuant to EESA authority granted to the Treasury Secretary. *Id.* § 120(b). *See also* Press Release, U.S. Dep't of the Treasury, Treasury Department Releases Text of Letter from Secretary Geithner to Hill Leadership on Administration's Exit Strategy for TARP (Dec. 9, 2009), *available at* http://financialstability.gov/latest /pr_12092009. html.

31. EESA authorized the Treasury Department to establish an Office of Financial Stability (OFS) to purchase troubled assets using three "tranches" of funding totaling $700 billion. Emergency Economic Stabilization Act of 2008 §§ 101(a), 115(a). The $700 billion total authority was subsequently reduced by $1.24 billion to offset the costs of program changes. *See* Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 202(b), 123 Stat. 1632, 1643. TARP authority

assistance from the Federal Reserve, AIG also benefitted from the TARP program, through which the Treasury Department purchased $40 billion in preferred AIG stock and extended a $30 billion line of credit.[32]

The economic crisis was not limited to financial industries. Faced with a twenty-six-year low in sales, automobile industry executives lobbied heavily in September 2008 for $25 billion in immediate direct federal loans.[33] When Congress failed to authorize loans through the 2007 Energy Independence and Security Act (EISA),[34] the Bush administration instead assisted the auto industry through a new Automotive Industry Financing Program (AIFP) created under the TARP umbrella.[35]

A concerned public began tallying the remarkable bailout costs to the taxpayer: a $700 billion TARP program, $29 billion in financing for the Bear Stearns acquisition, $85 billion and counting to AIG, and still more for the automobile industry.[36] As the saying goes, add all this together and, pretty soon, you're talking about real money. Some headlines declared, "Total Bailout Cost Heads Towards $5 Trillion."[37] Others placed the

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was later further reduced to $475 billion. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 1302.

32. *See* CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2010 TO 2020, at 12–13 (2010); *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-975, TROUBLED ASSET RELIEF PROGRAM: STATUS OF GOVERNMENT ASSISTANCE PROVIDED TO AIG (2009).

33. STEPHEN COONEY ET AL., CONG. RESEARCH SERV., R40003, U.S. MOTOR VEHICLE INDUSTRY: FEDERAL FINANCIAL ASSISTANCE AND RESTRUCTURING 1 (2009); Frank Ahrens, *Ailing Auto Industry Sends in Its Pitchman: CEO of GM Leads Lobby of Lawmakers for Loans*, WASH. POST, Sept. 12, 2008, at D1.

34. Energy Independence and Security Act of 2007, Pub. L. No. 110-140, § 136, 121 Stat. 1492, 1514–16. Explaining and describing the Energy Independence Act, as amended, the House Agriculture Committee reported that the act's loan and loan guarantee programs were designed to assist auto manufacturers with the costs of acquiring fuel-efficient parts and developing advanced vehicle technology systems. H.R. REP. NO. 110-933, at 42–44 (2009). As one report stated, "[t]his program has been widely misinterpreted as a broad 'bailout' . . . [but] the language in these laws indicates the intent of Congress that the loans are for the purpose of enabling the U.S. auto industry to produce more fuel-efficient vehicles." STEPHEN COONEY & BRENT D. YACOBUCCI, CONG. RESEARCH SERV., RL34743, FEDERAL LOANS TO THE AUTO INDUSTRY UNDER THE ENERGY INDEPENDENCE AND SECURITY ACT 1 (2008). Congress rejected use of EISA funds for the auto industry bailout. Auto Industry Financing and Restructuring Act, H.R. 7321, 110th Cong. (2d Sess. 2008) (passed by the House, but never adopted by the Senate).

35. As described by the OFS, the objective of the Automotive Industry Financing Program was "to help prevent a significant disruption of the American automotive industry, which would have posed a systemic risk to financial market stability and had a negative effect on the economy." OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, AGENCY FINANCIAL REPORT: FISCAL YEAR 2009, at 33 (2009); *see also* CONG. OVERSIGHT PANEL, SEPTEMBER OVERSIGHT REPORT: THE USE OF TARP FUNDS IN THE SUPPORT AND REORGANIZATION OF THE DOMESTIC AUTOMOTIVE INDUSTRY 6 (2009) (reporting the broadening of TARP activities).

36. Costs of loans and other types of financial assistance to the auto makers are incorporated in TARP totals.

37. *See* Steve Watson, *Total Bailout Cost Heads Towards $5 TRILLION*, INFOWARS.NET (Oct.

figure at more than $7 trillion.[38] Some reporters dramatically estimated the "per taxpayer" costs. One such report calculated the total bailout cost as $61,871 per taxpayer.[39] And, these early estimates do not include the $787 billion stimulus legislation later passed by Congress and signed into law by President Obama in February 2009.[40]

A simple tally of dollars authorized or disbursed, of course, is wholly inadequate to accurately assess the ultimate taxpayer cost of government bailouts. In some cases, the intervention simply authorized the government to take specified actions, as needed, at a later date. At least initially, the $700 billion bailout fell into this category, as the legislation did not provide immediate authority for access to funds. Upon enactment of TARP, the Treasury Secretary was authorized to purchase up to $250 billion of troubled assets.[41] This authorization was increased to $350 if the President certified to Congress the need to purchase additional troubled assets,[42] with the remaining funds to be released upon the President's submission of a detailed written plan to Congress.[43] In the end, although Presidents Bush and Obama requested authorization for release of the full $700 billion, "improved financial conditions and careful stewardship of the program" led the Treasury Department to announce in December 2009 that it did not expect to use more than $550 billion in TARP funds "unless necessary to respond to an immediate and substantial threat to the economy stemming from financial instability."[44]

At the end of the day, the actual long-term cost for TARP and other bailout-type disbursements will vary dramatically, depending upon particular use of the funds. Different types of government assistance will require different cost estimation methodologies. Government purchase of troubled assets, for example, may have a very different short- and long-

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15, 2008), http://www.infowars.net/articles/october2008/151008Bailout_figures.htm.

38. David Goldman, *Bailouts: $7 Trillion and Rising*; CNNMONEY.COM (Nov. 28, 2008), http://money.cnn.com/2008/11/26/news/economy/where_bailout_stands/index.htm.

39. *See* Alexis Leondis, *Tallying Trillions in Bailout, Bankruptcy: Commentary*, BLOOMBERG (Dec. 31, 2008), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aYwo1tZqGFgA.

40. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

41. 12 U.S.C. § 5225(a)(1) (2006).

42. 12 U.S.C. § 5225(a)(2) (2006). President Bush subsequently certified the need for release of the second "tranche" of funds. Letter from George W. Bush, U.S. President, to U.S. Congress (Jan. 12, 2009), *available at* http://financialservices.house.gov/TARP011209.pdf.

43. 12 U.S.C. § 5225(a)(3) (2006). President-elect Obama's administration subsequently submitted the required plan to Congress for release of the third "tranche." Letter from Lawrence Summers, Dir.-designate, Nat'l Econ. Council, to the leaders of the U.S. House of Representatives & U.S. Senate (Jan. 12, 2009) *available at* http://www.cbsnews.com/htdocs/pdf/011209_summers.pdf?tag=contentMain;contentBody.

44. Press Release, Dep't of the U.S. Treasury, *supra* note 30.

term budgetary impact than extensions of direct loans or loan guarantees. In fact, government loan guarantees involve no immediate release of funds, yet may impose significant long-term costs. Government intervention may also take the form of special tax breaks or relief from burdensome regulatory obligations.[45] As difficult as it may be to measure the costs of overt bailouts, assessing the costs of these more subtle or hidden government actions that may serve a bailout function will present even greater challenges.

II. MISCONCEPTIONS ABOUT BAILOUTS AND BAILOUT COSTS

A. Bailout v. Stimulus

1. Differences in Definition

Reports of government responses to economic turmoil often loosely use the terms "bailout" and "stimulus," suggesting, perhaps, that the two are synonymous. Although the definitional boundary can be fuzzy in some cases, government bailout-type actions differ from government stimulus efforts along a number of different dimensions. Along the temporal dimension, bailouts generally are immediate, emergency efforts to prevent imminent collapse, or backward-looking attempts to rescue private entities from economic damage that has already occurred. Stimulus, on the other hand, tends to be forward looking, designed to spark economic growth or redevelopment.

Such stimulus legislation may come in a number of different flavors. Even in times of reasonable economic health, Congress may enact stimulus legislation simply to spur general economic growth. For instance, Congress adopted the Accelerated Cost Recovery System (ACRS) of depreciation to allow more rapid write-offs of certain business expenses, thus stimulating economic investment.[46] Stimulus legislation also may be passed in advance of potential economic decline in an effort to prevent future crisis, rather than to provide assistance at a moment of immediate crisis. In the alternative, stimulus legislation may be enacted immediately after a crisis to spur economic redevelopment of areas hard hit by

45. *See* discussion *infra* notes 262–72, 306–23, 328–32 and accompanying text.

46. *See* STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981, at 75 (Comm. Print 1981) ("The Congress concluded that prior law rules for determining depreciation allowances and the investment tax credit needed to be replaced because they did not provide the investment stimulus that was felt to be essential for economic expansion.").

economic or natural disaster. For example, Congress created special "New York Liberty Zones" to spur investment in lower Manhattan following the collapse of the World Trade Towers[47] and special "Gulf Opportunity Zones" to spur investment in areas of the Gulf Coast affected by the devastating 2005 hurricane season.[48] These stimulus provisions are distinct from other relief efforts designed to offer more immediate assistance to disaster victims.

In scope, bailout tends to be narrower than stimulus. Congress might provide general economic stimulus, for example, through broad-based tax rate cuts. On the other hand, it is hard to imagine describing any government action as a "general economic bailout." At the other end of a continuum, bailout-type government actions may be specific to a particular business entity in a way that stimulus is not. It makes sense, for instance, to refer to "bailing out," but not to "providing a stimulus for," the Chrysler corporation. Between the general economy and firm-specific extremes, the distinction between bailout and stimulus can be fuzzier. Both stimulus and bailout efforts can be focused on particular industries such as savings and loan institutions, banks, airlines, or automotive manufacturers. One recent stimulus that some might think of as a bailout was the so-called "Cash for Clunkers" program, which, for a short time, offered government cash rebates to consumers when they traded an old vehicle upon purchase of a new, more fuel-efficient one.[49] A substantial factor motivating this legislation surely was the desire to provide assistance to small car dealerships, which had been experiencing an increasing number of bankruptcies.[50] Since the legislation incorporated

47. This special zone was defined to include only specified portions of lower Manhattan: "the area located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan in the City of New York, New York." Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147 § 301(h), 116 Stat. 21, 39 (codified at 26 U.S.C. § 1400L(h) (2006)).

48. A "Gulf Opportunity Zone," or "GO Zone," includes "that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina." Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, § 101(a), 119 Stat. 2577, 2578 (codified at 26 U.S.C. § 1400M(1) (2006)).

49. Consumer Assistance to Recycle and Save Act of 2009, Pub. L. No. 111-32, tit. XIII, 123 Stat. 1859, 1909.

50. Although the legislation, on its surface, was a stimulus and environmental measure, several legislators and members of the press saw it as just another auto industry bailout. *See, e.g.*, 155 CONG. REC. S8955 (daily ed. Aug. 6, 2009) (statement of Sen. Richard Shelby) ("The Cash for Clunkers Program is simply another bailout to prop up a struggling industry wrapped in the political guise of an environmentally friendly program."); 155 CONG. REC. S6790 (daily ed. June 18, 2009) (statement of Sen. John McCain regarding "Cash for Clunkers") ("We now own two automotive companies . . . Why do we need another bailout for the auto industry?"); Dan Becker & James Gersenzang, *Cash for*

stimulus features—and as bailout was becoming an increasingly pejorative term—it was probably more politically expedient to sell this legislation as stimulus.

Perhaps the most important features often distinguishing bailouts and stimulus are policy goals and institutional design. Bailouts tend to offer immediate infusions of government funds through direct or guaranteed loans, or government purchase of debt or equity instruments. In contrast, stimulus legislation is generally designed to provide *incentives* for businesses or individuals to engage in particular desired behaviors. Most often, the goal is to stimulate investment, either generally or in specific types of assets or investments.[51] The institutional design most frequently adopted in stimulus legislation is a special tax deduction or credit.[52]

2. Differences in Cost Assessment

At the margins, one might debate whether a particular piece of legislation represents bailout or stimulus. For purposes of this Article, however, the key question is whether there is any budgetary difference in measuring the costs imposed by bailout as opposed to stimulus legislation. Since bailouts generally involve immediate expenditures, it might appear that bailout costs are easier to measure than stimulus costs. However, simply tallying total disbursements on a cash-flow basis will not provide an accurate picture of the long-term costs of bailouts. Some government loans will be repaid, but others will not. Although one cannot know in advance the precise percentage of businesses that will ultimately default, economists have developed sophisticated, risk-based models that permit reasonable estimation of long-term credit program costs.[53] Budget rules enacted in 1990 require the use of accrual, rather than cash-method, accounting for federal credit programs.[54]

Clunkers is Bait and Switch, WASH. POST, May 17, 2009, at A35 ("The automakers are filling up again at the Capitol Hill bailout pump. The latest idea is 'cash for clunkers.'").

51. Stimulus provisions may also be designed to encourage employers to hire or retain workers. *See, e.g.*, Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 102, 124 Stat. 71, 75 (2010) (Business Credit for Retention of Certain Newly Hired Individuals in 2010).

52. *Id.*; *see also id.* § 201 (Increase in Expensing of Certain Depreciable Business Assets).

53. Although the federal government generally uses a Treasury market rate to calculate the net present value of assets, the EESA actually requires use of a risk-based rate for purposes of computing the value of TARP assets held by the government. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (to be codified at 12 U.S.C. §§ 5201–5261); *see* discussion *infra* notes 233–44 and accompanying text.

54. Federal Credit Reform Act of 1990, Pub. L. No. 101-508, § 13201(a), 104 Stat. 1388, 1388-609 (codified at 2 U.S.C. § 661 (2006)). For further discussion of cash versus accrual accounting methods, see *infra* notes 219–32 and accompanying text.

By institutional design, stimulus legislation relies heavily on incentives to taxpayers, provided through special tax deductions and credits. The total actual cost of such legislation to the government, in terms of revenue foregone, will depend upon how much taxpayers choose to use the incentives. To some, this is the beauty of tax incentives: taxpayers effectively "vote" on how much will be spent by either taking advantage of the incentive or not. Difficulties in determining in advance the extent to which taxpayers will take advantage of particular incentives make long-term budgeting for such incentives difficult. It might appear that stimulus costs for any given year are reasonably simple to measure by summing the total deductions or credits actually taken on filed tax returns. Here too, however, a simple tally will not provide an accurate assessment. Some taxpayers would have engaged in the desired behavior in any event. In such cases, taxpayers get a windfall, and the government has made a needless expenditure, paying taxpayers to do something they would have done anyway. To determine the real stimulus budget cost and the amount overpaid, one would need to segregate deductions taken by those who were truly motivated by the tax incentive to engage in the desired activity from those who would have engaged in the activity in any event. To my knowledge, there are no strong empirical research models to measure this windfall effect.

B. Classifying Bailout Types by Cost

1. Profitable Bailouts

Government bailouts that provide genuine assistance to troubled enterprises do not necessarily involve expenditures of general tax revenue. In some instances, the government might even profit. As the direct loan transaction was structured in the Chrysler bailout in the late 1980s, for example, most or all federal administrative costs were covered by interest and fees, and with the loans repaid in full,[55] the government reaped an approximately $300 million profit from the sale of warrants it had taken to

55. 129 CONG. REC. 19,286 (1983) (statement of Sen. Carl Levin) ("I want to commend the Chrysler Corp.'s decision to repay the remaining $800 million of federally guaranteed debt . . . 7 years ahead of schedule. . . . Chrysler's success was made possible by passage of the Chrysler Loan Guarantee Act of 1979, which allowed the company to borrow up to $1.2 billion backed by federal guarantees.").

secure its risk.[56] Similar warrants taken as collateral for direct loans to Lockheed generated a $31 million profit for the federal government.[57]

The overall budgetary impact of the 2008–2009 government bailout activity is likely to be an increased deficit. As of the end of fiscal year 2009, however, the Treasury Department Office of Financial Stability (OFS) reported $19.5 billion in net income or profit—primarily from interest, dividends, fees, and warrant repurchases—from four of its "bailout" programs.[58] OFS also reported both that it had spent less TARP money than anticipated and received a return higher than expected from its TARP investments.[59] These two factors, combined with general economic improvement, resulted in a smaller projected deficit impact from TARP than previously anticipated. In the end, even though some TARP programs were profitable, aggregate TARP bailout actions are expected to contribute $116.8 billion to the federal deficit.[60]

2. Low- or No-Cost Bailouts

Although they may not result in profit, many government bailout-type interventions involve little or no expenditure of general revenue. In some cases, the government simply may facilitate private-market solutions without placing any federal resources at risk. In 1998, for example, the Federal Reserve Bank facilitated meetings to bring private lenders and investors together to work out a rescue plan for Long Term Capital Management (LTCM), a major U.S. hedge fund faced with imminent

56. As part of its effort to protect itself from risk, the Treasury Department received warrants to purchase Chrysler stock at $13 per share. As Chrysler recovered financially, the stock value increased substantially above the warrant price. The government ultimately sold the warrants to the highest bidder (Chrysler itself) and made a $311.1 million profit. R. REICH & J. DONAHUE, NEW DEALS: THE CHRYSLER REVIVAL AND THE AMERICAN SYSTEM 254–57 (1985); *see also* BAIRD WEBEL, N. ERIC WEISS & MARC LABONTE, CONG. RESEARCH SERV., RS22956, THE COST OF GOVERNMENT FINANCIAL INTERVENTIONS, PAST AND PRESENT 5 (2008).

57. WEBEL, WEISS & LABONTE, *supra* note 56, at 6.

58. OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, AGENCY FINANCIAL REPORT: FISCAL YEAR 2009, at 13 (2009) (referring to the Capital Purchase, Targeted Investment, and Asset Guarantee Programs and the Consumer and Business Lending Initiative). At the same time, however, OFS reported net losses of $60.9 billion from assistance to the automotive industry and to insurance giant AIG. *Id.*

59. *Id.* at 3.

60. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 40–41 tbl.4-7 (2010) (discussing a projected TARP deficit impact of $116.8 billion, $224.1 billion lower than the earlier mid-term budget projection).

collapse.[61] In other cases, the government may place itself at some risk initially but, ultimately, bear no expense. With federal loan guarantee programs, for example, the government simply acts as guarantor in the event that the private borrower covered by the program defaults on obligations to a nongovernment lender. If administration of the program is covered by fees and the government guarantee is never called, the intervention falls into the "no- or low-cost bailout" category.[62]

3. Nongeneral Revenue or "Special Fund" Bailouts

Many bailout-type interventions, of course, ultimately do impose real costs. Understandably, taxpayers are concerned about the burdens such costs impose upon them. Although many bailout-type programs are funded through general revenues, bailout intervention need not necessarily impose a direct burden upon general taxpayers. An alternative approach is to impose bailout costs on some narrower subset of taxpayers.

Under a benefit theory of taxation, "an equitable tax system is one under which each taxpayer contributes in line with the benefits which he or she receives from public services."[63] In some cases, however, the benefit approach seems inappropriate. For example, it would be counterproductive to tax the poor on benefits received in the form of government-provided food stamps. Thus, modern tax policy generally has rejected this benefit theory of taxation in favor of one based more on ability to pay.[64] Nevertheless, "practical applications of benefit taxation may be found in specific instances where particular services are provided on a benefit basis. This may be the case where direct financing is made via fees, user charges, or tolls."[65] For instance, fuel taxes paid by drivers are

61. STEPHEN H. AXILROD, INSIDE THE FED: MONETARY POLICY AND ITS MANAGEMENT, MARTIN THROUGH GREENSPAN TO BERNANKE 145–50 (2009) (describing Federal Reserve involvement in efforts to save LTCM). For a colorful report on LTCM's rise and fall, see generally ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT (2001). For further discussion of the Federal Reserve's role in the LTCM bailout, see *id.* at 185–218.

62. Government assistance that ultimately results in a profit or no cost to the government should still be regarded as a bailout because the outcome is a gamble. The government assumes a risk that commercial lenders are unwilling to take based upon standard lending principles. General tax revenues and substantial taxpayer dollars are at risk in a way that they would not be in a private bailout through reorganization in bankruptcy.

63. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 219 (5th ed. 1989).

64. *See, e.g.*, HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 3–5 (1938).

65. MUSGRAVE & MUSGRAVE, *supra* note 63, at 221.

used to fund highway maintenance and other transportation-related programs.[66] In this way, the cost of the government service is imposed more directly upon those who benefit.

At first blush, the bailout setting might not appear well suited to the benefit approach. To impose costs on those who receive bailout assistance simply would dig struggling businesses receiving assistance deeper into a financial hole. On the other hand, the federal deposit insurance system is structured upon similar benefit-like principles. Among other things, the FDIC has authority to take receivership interests in failed banks,[67] establish and operate "bridge banks" using the failed banks' assets, and ultimately transfer ownership of the "bridge banks" to new private owners.[68] Resources to cover bank rescue efforts and depositor insurance claims come from funds in bank insurance pools collected ex ante through assessments and contributions from banks participating in the insurance programs, not from general tax revenues.[69] Participating banks provide the funding for the government insurance program since they make up the group or class that stands to benefit from the government program, which offers reassurance to bank customers and other mechanisms to provide bank stability. For example, the FDIC maintains a Deposit Insurance Fund (DIF) available to depositors in the event that one of its insured banks fails.[70] Even when general tax revenues are not used, government-facilitated rescues should be regarded as bailouts. In each case, the government has intervened to provide assistance to a failing private enterprise. I refer to interventions in this category as "special fund bailouts."

When insurance pool funds are insufficient, the FDIC has authority to impose an additional "systemic risk special assessment" and to call for bank prepayments of future assessments.[71] As a backstop, the FDIC has authority to borrow up to $100 billion from the Treasury Department and

66. Federal-Aid Highway Act of 1956, Pub. L. No. 84-627, 70 Stat. 374 (establishing the Highway Trust Fund from gasoline excise taxes); *see* PAMELA J. JACKSON, CONG. RESEARCH SERV., RL30304, THE FEDERAL EXCISE TAX ON GASOLINE AND THE HIGHWAY TRUST FUND: A SHORT HISTORY (2006).

67. 12 U.S.C. § 1819(a) (2006).

68. 12 U.S.C. §§ 1821(m), (n) (2006).

69. 12 U.S.C. § 1817(b) (2006) (FDIC's risk-based assessment rules).

70. 12 U.S.C. § 1815(d) (2006). Although the direct beneficiary of this insurance is the individual depositor, insurance programs also serve a bailout function. *See* Block, *Bailouts*, *supra* note 22, at 973–74.

71. One report described a recently FDIC-imposed $45 billion in prepaid annual assessments as a "plan financed by the industry to rescue the ailing insurance fund that protects bank depositors," i.e., a bailout of the FDIC itself. Stephen Labaton, *Banks to Rescue Depleted F.D.I.C.*, N.Y. TIMES, Sept. 30, 2009, at A1.

even more in certain emergency circumstances.[72] In the end, of course, if the FDIC cannot meet its obligations or if additional resources are necessary to maintain bank stability, there remains an implicit guarantee that Congress will come to the rescue by authorizing the use of general revenues. Congress provided such financial supplements, for example, when insurance pools proved inadequate in the 1980s savings and loan crisis.[73]

In the case of ex ante insurance funds, such as the DIF maintained by the FDIC, those eligible to benefit from future bailout funding must make advance contributions to an insurance pool. In contrast, the EESA legislation enacted in 2008 uses an ex post collection model. If TARP has a net shortfall at the end of five years from the date of enactment, the statute requires "the President . . . [to] submit a legislative proposal that *recoups from the financial industry* an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt."[74] Based on this mandate, at least in theory, the Obama administration proposed a controversial "financial crisis responsibility fee" on large banks and financial institutions in order to recoup bailout costs from TARP.[75] This proposal called for a fee on large financial institutions, even if they already repaid TARP funds received or received no TARP funds at all. At the same time, some large nonfinancial entities that received TARP funds would not be required to pay. Needless to say, financial institutions that generated a profit for the government by repaying the TARP assistance they received with interest, fees, and warrants, resented the recoupment proposal.[76] The logic behind the collection-model special fund bailout approach was that large financial

72. The FDIC's borrowing authority was increased from $30 to $100 billion by the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 204(c), 123 Stat. 1632, 1649. The Act also provided temporary authority for borrowing of up to $500 billion upon written recommendation from the Federal Reserve and Secretary of the Treasury in consultation with the president. *Id.* (to be codified at 12 U.S.C. § 1824(a)(3) (2006)). The FDIC insisted that its request for additional borrowing authority was simply prudent planning, given that the banking industry's assets had tripled since the last increase in borrowing authority. *Promoting Bank Liquidity and Lending Through Deposit Insurance, Hope for Homeowners, and Other Enhancements: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 8–9 (2009) (statement of John F. Bovenzi, Chief Operating Officer, FDIC). Bovenzi added that the FDIC did not expect to use the money. *Id.* at 10.

73. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183.

74. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 134, 122 Stat. 3765, 3798 (to be codified at 12 U.S.C. § 5239) (emphasis added).

75. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 174 (2010).

76. *See, e.g.*, Eric Dash, *Wall St. Weighs a Constitutional Challenge to a Proposed Tax*, N.Y. TIMES, Jan. 18, 2010, at B1.

entities—even those that did not participate in TARP—benefitted most from the governments' propping up of failing banks. Assuming that a much larger systemic financial breakdown would have occurred absent government intervention, the largest financial firms were those with the most at stake and, hence, the most to gain from avoidance of a financial meltdown. In addition, the largest financial institutions are thought to be those best able to pay.

Congress never enacted the president's proposed "financial crisis responsibility fee," but the 2010 Wall Street Reform Act did adopt a benefit-like, ex post "collection model," permitting the FDIC—if necessary—to impose risk-based assessments on bank holding companies with $50 billion or more in consolidated assets to contribute to a new "orderly liquidation fund."[77] This technically is not a "bailout" fund since it is not available to assist or rescue private firms faced with economic distress or imminent failure,[78] but instead to provide an orderly process for shutting down failing financial institutions. At the same time, the idea behind the orderly liquidation process is to save the economy from the chaos and distress that would otherwise result from the disorderly failure of a systemically important financial firm. Ideally, the costs of orderly liquidation will be covered by the government's careful management of the failed financial company's assets as receiver. If this should prove insufficient, the legislation imposes the burden of paying for orderly liquidation on a subset of taxpayers—large financial institutions—rather than the general public.

4. General Revenue Bailouts

One major concern raised by the extraordinary government bailout interventions throughout the 2008–2009 economic crisis was the message effectively sent by the government that it was available as an economic safety net for private industry. The perception that government assistance will be forthcoming in the event of economic failure encourages private businesses to take greater risks than they would in the absence of such a safety net. Under the circumstances, perhaps it was prudent for Congress and the President to declare forcefully that there will be "no more

77. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1105, 124 Stat. 1376, 2121–25, *supra* note 10, § 210(o); *see also supra* notes 12–16 and accompanying text.

78. *See* Block, *Bailouts*, *supra* note 22.

government-funded bailouts," in order to limit this type of moral hazard.[79] Realistically, however, future bailouts are inevitable in the event that economic circumstances become sufficiently dire and the "tough love" approach of simply allowing weak firms to collapse becomes politically unpalatable.

Special funds may not always be desirable or available for such bailouts, resulting in interventions that require the expenditure of general revenue. I use the term "general revenue bailouts" to refer to bailouts for which costs are broadly spread among the general taxpaying public. Funds for such general revenue bailouts come from general Treasury Department accounts. Although minds may differ on accounting and valuation methodology and on precisely where the information should appear, these general revenue expenditures are typically visible somewhere in the federal budget and government financial statements. In other cases, the source of funds is the Federal Reserve Bank and not the Treasury Department's general revenue fund. Even though these costs do not appear directly as general revenue expenditures, they indirectly reflect revenue costs because they reduce funds that would otherwise be paid to the general Treasury through Federal Reserve remittances.[80]

5. Combination Bailouts

Bailouts also can be funded through a combination of special funds and general revenues. For example, FIRREA established a rather complex mechanism to provide funding for the 1980s savings and loan bailout. Funds for the bailout theoretically were to come from the sale of assets taken from banks in receivership, the sale of nonvoting capital stock to Federal Home Loan Banks, assessments against certain savings and loan banks, and the issuance of obligations.[81] In each case, however, it was recognized that the "special fund" might not be sufficient to cover all bailout costs; Congress authorized supplemental general revenue funding from the Treasury Department.[82] Similarly, although the FDIC generates

79. For further discussion of moral hazard issues, see *infra* notes 333–36 and accompanying text.

80. For a discussion of the Federal Reserve and its surplus remittances to the Treasury, see *infra* notes 130–33, 147–51 and accompanying text.

81. For a comprehensive treatment of the savings and loan bailout structure and funding mechanisms provided by FIRREA, see JAMES R. BARTH, THE GREAT SAVINGS AND LOAN DEBACLE 79–99 (1991); Marirose K. Lescher & Merwin A. Mace III, *Financing The Bailout Of The Thrift Crisis: Workings Of The Financing Corporation And The Resolution Funding Corporation,* 46 BUS. LAW. 507 (1991); Michael P. Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation*, 50 OHIO ST. L.J. 1117 (1989).

82. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73,

funds through the collection of fees from covered banks, these fee-generated "special funds" may be insufficient, requiring the FDIC to turn to general revenues.

Various responses to the 2008–2009 economic crisis also adopted a mixed-resource approach. In November 2008, for example, Citicorp received an assistance package including Treasury Department funds through TARP, along with guarantees from the FDIC and the Federal Reserve.[83] In another program, the Treasury Department protected the Federal Reserve by agreeing to cover the first $20 billion in Federal Reserve loans through the latter's Term Asset-Backed Securities Loan Facility (TALF).[84]

III. BAILOUT COSTS: WHERE IN THE BUDGET?

A. Introduction

One long-standing debate in budget circles has been the scope of the federal budget; in other words, the extent to which government expenditures should be "on-budget" or "off-budget." In 1967, an influential report of the President's Commission on Budget Concepts argued that the budget should be "unified," meaning that "the budget should, as a general rule, be comprehensive of the full range of Federal activities. Borderline agencies and transactions should be included in the budget unless there are exceptionally persuasive reasons for exclusion."[85] The basic logic of the unified budget is that it "facilitates use of the budget as an instrument of economic policy, and it enables the government to

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§ 211 103 Stat. 183, 218–22 (codified at 12 U.S.C. § 1821(a)(6)(F), (J)(ii) (2006)). Congress provided backup Treasury funding to permit payment of interest on obligations for the RTC and FSLIC Resolution Fund. *See, e.g.*, *id.* § 511 (codified at 12 U.S.C. § 1441(b), (f)(2)(E) (2006)).

83. BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS 51 (2009); *see also* Press Release, U.S. Dep't of the Treasury, Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup (Nov. 23, 2008), *available at* http://www.ustreas.gov/press/releases/hp1287.htm (describing package of guarantees, liquidity access, and capital in exchange for which Citigroup issued preferred stock to the Treasury, FDIC, and the Federal Reserve).

84. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 27–28 (2010). For detailed discussion of Federal Reserve bailout actions, see *infra* notes 105–29 and accompanying text. For another example of a joint effort bailout, see the Public-Private Investment Fund (PPIF)/Legacy Loan Program described in DARRYL E. GETTER & OSCAR R. GONZALES, CONG. RESEARCH SERV., R40413, THE FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): EFFORTS TO SUPPORT FINANCIAL AND HOUSING MARKETS 5 (2009).

85. PRESIDENT'S COMM'N ON BUDGET CONCEPTS, REPORT OF THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS 25 (1967).

establish priorities among programs financed by different sources."[86] Put more colloquially, in order to make better allocative policy choices, everything should be on the table for discussion.

Budget figures today are presented in a variety of different, and sometimes schizophrenic, accounts.[87] In addition to "unified" or "consolidated" accounts, budget figures include "on-budget" and "off-budget" totals.[88] Complicating matters further, many government or government-supported activities are conducted through separate entities, which include wholly and partially government-owned corporations, as well as privately owned, government-sponsored enterprises (GSEs).[89] Although technically private, GSEs are federally chartered corporations entitled to certain privileges and subject to limitations not otherwise applicable to private corporations.[90] Perhaps the most well-known GSEs are housing and mortgage loan giants Fannie Mae and Freddie Mac.

Activities of wholly owned government corporations are technically part of the federal budget.[91] Because they use different accounting and financial standards, however, their financial information is presented separately and cannot be readily incorporated into regular budget schedules. On the other hand, GSEs and partially government-owned corporations do not appear at all in any of the various budget accounts, unified or not. Depending upon the extent of government involvement, however, some of these partially owned government entities and GSEs are engaged in activities that arguably should be part of the overall federal

86. ALLEN SCHICK, THE FEDERAL BUDGET: POLITICS, POLICY, AND PROCESS 42–43 (3d ed. 2007).

87. For a discussion of the off-budget device and the variety of budget accounts, see Cheryl D. Block, *Congress and Accounting Scandals: Is the Pot Calling the Kettle Black?*, 82 NEB. L. REV. 365, 429 (2003) [hereinafter Block, *Accounting Scandals*]; *see also* Cheryl D. Block, *Budget Gimmicks*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY 39, 46–47 (Elizabeth Garrett et al. eds., 2008).

88. At least technically, the term "off-budget" refers only to the two social security programs and the postal service trust fund that are statutorily excluded from the budget. Budget Enforcement Act of 1990, Pub. L. No. 101-508, § 13301, 104 Stat. 1388, 1388–623 (codified at 2 U.S.C. § 632(a) (2006)) (making social security program "off-budget"); Omnibus Budget Reconciliation Act, Pub. L. No. 101-239, § 4001(a), 103 Stat. 2106, 2133 (1989) (codified at 39 U.S.C. § 2009a (2006)) (making the postal service trust fund "off-budget").

89. For a discussion of the differences among these various entities, see Block, *Accounting Scandals*, *supra* note 87, at 432–42.

90. *See id.* at 435–39; *see also GSEs: Recent Trends and Policy: Hearing Before the Subcomm. on Capital Mkts., Sec. and Gov't Sponsored Enters. of the H. Comm. on Banking and Fin. Servs.,* 105th Cong. 1 (1997) (statement of James L. Bothwell, Chief Economist). For further discussion of the housing GSEs, see *infra* notes 179–87 and accompanying text.

91. Examples include the Pension Benefit Guarantee Corporation, the Commodity Credit Corporation, and the Federal Crop Insurance Corporation.

budget. To the extent that such entities are not so reflected, I refer to them as "off-off budget." In fact, the move to privatize many government functions might skeptically be viewed as a budget gimmick to move activities off-off budget and reduce the apparent size of the deficit. This phenomenon is not limited to the United States. Governments faced with increasing risks and fiscal uncertainties have turned to privatizing many state functions, accompanying this privatization with implicit or explicit state guarantees. According to one economist, "[t]hese off-budget programs and obligations involve hidden fiscal costs, with implicit and contingent liabilities that may result in excessive requirements for public financing in the medium and long term."[92] A true reflection of the budget deficit would require some mechanism to incorporate these entities, along with the implicit and contingent liabilities they impose.[93]

Various "off-off-budget" entities have played a significant role in recent government bailout activities. The government's substantial investments in the housing-related GSEs' financial instruments, and the conservatorship of Fannie Mae and Freddie Mac, raise questions about the extent to which these otherwise nongovernment entities should be incorporated into the budget.[94] In addition, the Federal Reserve, in particular, played an extraordinary and unprecedented role in recent government bailout interventions. The sections that follow begin by briefly discussing the Federal Reserve's general authority and operations, followed by an examination of the Federal Reserve Bank's recent actions and their budget implications. This Part closes with a brief exploration of the bailout-related interventions involving housing-related GSEs.

B. The Federal Reserve

1. The Federal Reserve and Monetary Policy

One "off-off-budget" entity that stands in a class by itself is the Federal Reserve Bank, a uniquely independent government agency responsible for managing monetary policy. The Federal Reserve Bank was initially established as the nation's central bank by the Federal Reserve Act of 1913.[95] Although subject to congressional oversight, the Bank is an

92. Hana Polackova Brixi, *Government Contingent Liabilities: A Hidden Risk to Fiscal Stability*, 13 J. OF PUB. BUDGETING, ACCT. & FIN. MGMT. 582, 582 (2001).

93. For further discussion of budgeting for implicit guarantees, see *infra* notes 334–36 and accompanying text.

94. *See infra* notes 183–94.

95. Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 251 (codified as amended at 12

independent agency and does not receive appropriations from Congress. Three component parts make up the Federal Reserve System: (1) a central Board of Governors in Washington, D.C.; (2) twelve regional Federal Reserve Banks; and (3) member banks.[96] The Federal Reserve is charged with four major responsibilities: (1) formulating and implementing monetary policy; (2) supervising and regulating banks; (3) serving as the "lender of last resort" for banks and otherwise containing systemic risks in the financial system; and (4) serving as a "fiscal agent for the [federal] government and clearinghouse for private sector financial transactions."[97]

Formation and implementation of monetary policy are probably the most important, and certainly the most closely watched, of the Federal Reserve's regular activities. The primary functions of monetary policy are to control the supply and cost of money and credit and to promote stable prices and maximum sustainable economic growth.[98] Three traditional monetary policy tools are available to the Federal Reserve. First, the Bank uses daily open-market transactions to indirectly manage the supply and demand for money and credit. These daily morning transactions involve the purchase and sale of U.S. Treasury securities between the New York Federal Reserve Bank and eligible "primary dealers." The quantities and terms of these transactions are driven by the "federal funds rate target,"[99] set by the Federal Open Market Committee (FOMC), the policymaking arm of the Federal Reserve. The idea effectively is for the Bank to use its "monopoly power" to move the market interest rate for intrabank loans to its desired target. Additional regular monetary policy tools available to the Federal Reserve include its authority to establish discount rates at which it will extend short-term credit to eligible banks, and its power to alter the cash reserve amounts required to be maintained at the Bank by depository institutions.[100]

U.S.C. § 343 (2006)). Throughout this Article, the Federal Reserve Bank will alternatively be referred to as "the Bank" or "the Federal Reserve."

96. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS 3 (9th ed. 2005) [hereinafter PURPOSES AND FUNCTIONS]. Member banks include all nationally chartered banks and eligible nonnational banks that elect to join. *Id*. at 12.

97. *Id.* at 1; *see also* PAULINE SMALE, CONG. RESEARCH SERV., RS20826, STRUCTURE AND FUNCTIONS OF THE FEDERAL RESERVE SYSTEM 1 (2005).

98. MARC LABONTE, CONG. RESEARCH SERV., RL30354, MONETARY POLICY AND THE FEDERAL RESERVE: CURRENT POLICY AND CONDITIONS 1 (2009).

99. The federal funds rate is the rate at which commercial banks will lend to one another. *Id.*

100. *Id.* at 2. For a useful and accessible account of the Federal Reserve's traditional roles and its expanded actions in response to financial crisis, see Stephen G. Cecchetti, *Crisis and Responses: The Federal Reserve in the Early Stages of the Financial Crisis*, 23 J. ECON. PERSP. 51 (2009).

2. The Federal Reserve Bank's Role in Recent Bailout Activity

One unusual feature of the 2008–2009 federal government rescue effort is the extent to which bailout funding was provided through the Federal Reserve Bank, rather than the Treasury Department. As the Federal Reserve's response to economic crisis has expanded to include new and innovative approaches, many of its actions more closely resemble fiscal policy than monetary policy.[101] This transition from monetary to fiscal policy occurs when the Bank moves from actions simply intended to provide liquidity to actions intended to provide capital assistance to struggling firms. The Bank's targeted assistance to individual firms or industries fits within my working definition of bailout as "a form of government assistance or intervention specifically designed or intended to assist enterprises facing financial distress and to prevent enterprise failure."[102] Indeed, several of the Federal Reserve's direct loan and loan guarantee arrangements with individual private entities appear very similar in structure to some of the direct loans and loan guarantees from the Treasury Department through TARP. Some are even joint efforts involving the Federal Reserve *and* TARP funds.[103] To the extent that the Federal Reserve makes loans or troubled asset acquisition arrangements similar to those otherwise available through the Treasury Department, taxpayers may be exposed to risk beyond statutory limits authorized by Congress under the EESA and other legislative rescue programs. This, of course, raises questions about the extent to which the Federal Reserve should be authorized to institute such programs in the first place without specific congressional authority. As fascinating as these questions are, they are generally beyond the scope of this Article, which focuses primarily on federal budget implications of various bailout-like interventions.[104]

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101. Fiscal policy generally "is concerned with the determination of tax rates and the level of government spending and is the joint responsibility of Congress and the President." GEOFFREY WOGLOM, MODERN MACROECONOMICS 5 (1988). In contrast, monetary policy "is concerned with settling the level of money supply and is the responsibility of the Federal Reserve System." *Id*.; *see also* MARC LABONTE, CONG. RESEARCH SERV., RL30354, MONETARY POLICY AND THE FEDERAL RESERVE: CURRENT POLICY AND CONDITIONS 1–2 (2009) ("Broadly speaking, monetary policy is any policy related to the supply of money. . . . The dominant influence on the U.S. money supply . . . comes from the policies of the nation's central bank, the Federal Reserve . . . .").

102. *See supra* text accompanying note 22 (definition of bailout).

103. *See* discussion *infra* notes 126–29 and accompanying text.

104. The 2010 financial reforms made several changes to the Federal Reserve's authority. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, tit. XI, 124 Stat. 1376, 1596–1641 (Federal Reserve System Provisions). Some of these are considered at notes 111, 167, 341–46 and accompanying text.

3. Expansion of Federal Reserve Activity in Response to Crisis

Monetary policy, of course, is the Federal Reserve's ongoing, regular focus. Times of economic stress, however, call upon the Bank's responsibility to "contain financial disruptions and [prevent] their spread outside the financial sector."[105] Even in difficult economic times, the Bank typically turns first to its traditional monetary policy toolbox. For example, the Federal Reserve can increase liquidity and make credit more freely available through reductions in the federal funds rate target or discount rate. These traditional tools were used early on and increasingly throughout the economic downturn that began in the summer of 2007. Federal Reserve Chairman Bernanke reported that the Bank "responded forcefully" by dramatically reducing the federal funds rate target, noting that by "historical comparison, this policy response stands out as exceptionally rapid and proactive."[106] Beginning in 2008 and continuing through much of 2010, the FOMC "maintained a target range of 0 to 1/4 percent for the federal funds rate."[107]

Economic crises severely test the limits of traditional monetary policy. Traditional tools have little or no continued impact when the Federal Reserve has already reduced interest rates to virtually zero, when the threat of systemic economic failure extends beyond financial industries into the broader economy and when the cure for a substantial number of distressed firms demands more than just short-term liquidity assistance. By all accounts, economic events in 2008 and 2009 were extraordinary. Chairman Bernanke himself observed that "[e]xtraordinary times call for extraordinary measures. Responding to the very difficult economic and financial challenges we face, the Federal Reserve has gone beyond traditional monetary policy making to develop new policy tools to address the dysfunctions in the nation's credit markets."[108]

From mid-2007 through 2009, this response included an unprecedented and dizzying array of new programs or "facilities," creating a veritable

105. PURPOSES AND FUNCTIONS, *supra* note 96, at 16.

106. Ben S. Bernanke, Chairman, Fed. Reserve, Federal Reserve Policies to Ease Credit and Their Implications for the Fed's Balance Sheet, Speech at the National Press Club Luncheon (Feb. 18, 2009) [hereinafter Bernanke, Press Club Speech], *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20090218a.htm.

107. BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS (2009); Press Release, Bd. of Governors of the Fed. Reserve Sys. (Dec. 16, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081216b.htm (FOMC statement announcing decisions to reduce the federal funds target rate to 0 to 1/4 percent).

108. Bernanke, Press Club Speech, *supra* note 106.

"alphabet soup" of new acronyms.[109] With such extraordinary new activities, Chairman Bernanke was moving the Bank into uncharted waters.[110] As authority for much of this extraordinary action, the Bank turned to a provision in the Federal Reserve Act granting expanded emergency lending authority in "unusual and exigent circumstances."[111] Until the latter part of 2008, this extraordinary emergency power had not been used by the Federal Reserve to extend credit since the Great Depression.[112] Some Federal Reserve actions taken pursuant to its emergency authority provided targeted assistance to specific firms or facilitated specific acquisition transactions,[113] while others created lending

109. Some of the new programs introduced or announced in 2007 and 2008 include a Term Auction Facility (TAF) (Dec. 2007); Liquidity Swap Lines (Dec. 2007); Terms Securities Lending Facility (TSLF) (Mar. 2008); Primary Dealer Credit Facility (PDCF) (Mar. 2008); Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) (Sept. 2008); Commercial Paper Funding Facility (CPFF) (Oct. 2008); Money Market Investor Funding Facility (MMIFF) (Oct. 2008); Term Asset-Backed Securities Loan Facility (TALF) (Nov. 2008). *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS 47–50 (2009). In light of financial improvements, many of the new programs have expired or been closed. BD. OF GOVERNORS OF THE FED. RESERVE SYS., CREDIT AND LIQUIDITY PROGRAMS AND THE BALANCE SHEET: THE FEDERAL RESERVE'S RESPONSE TO THE CRISIS (2010), *available at* http://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm (describing expiration or closing of MMIFF, AMLF, CPFF, and TSLF programs).

110. *See, e.g.*, AXILROD, *supra* note 61, at 155 ("In the end, the innovative measures eventually put in place by the Fed were path breaking."); ETHAN S. HARRIS, BEN BERNANKE'S FED: THE FEDERAL RESERVE AFTER GREENSPAN 178 (2008) (referring to Bank actions in 2008 as including "the fastest policy change in the modern history of the Fed" and "an unprecedented array of new programs to directly add liquidity to credit markets").

111. Federal Reserve Act of 1913, Pub. L. No. 63-43, § 13(3), 38 Stat. 251, 264 (codified at 12 U.S.C. § 343 (2006)) (emergency power added to the Federal Reserve Act in 1932) ("In *unusual and exigent circumstances*, the Board of Governors of the Federal Reserve System . . . may authorize any Federal reserve bank . . . to *discount for any individual, partnership, or corporation*, notes, drafts, and bills of exchange . . . [p]rovided, [t]hat . . . the Federal reserve bank [obtains] evidence that such *individual, partnership, or corporation* is unable to secure adequate credit accommodations from other banking institutions." (emphasis added)) (prior to amendment by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010). The 2010 Act replaced the statutory references in this emergency power provision to "individual, partnership, or corporation" with references to "participant in any program or facility with broad-based eligibility." *Id.* § 1101(a)(2)–(5). This change is an attempt to hold the Federal Reserve more closely to its monetary policy functions. The Federal Reserve can no longer use its emergency power "for the purpose of assisting a single and specific company avoid bankruptcy." *Id.* § 1101(a)(6).

112. *An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis: Hearing Before the H. Comm. on Financial Servs.*, 111th Cong. 8 (2009) (statement of Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys.).

113. For a description of some of these specifically targeted assistance efforts, see BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS 50–51 (2009) (description of Federal Reserve actions to assist Bear Stearns, AIG, Citicorp, and Bank of America). Such Federal Reserve assistance to individual firms is no longer permitted. *See supra* note 111.

facilities and programs that were made more broadly available.[114]

Most of the Federal Reserve's unprecedented new programs or facilities in 2008 and 2009 shared several features.[115] Notable patterns reflected in the recent Federal Reserve responses include (1) an expansion of the class of institutions to which assistance is offered;[116] (2) a move from extremely short-term (i.e., overnight) loans to longer-term loans;[117] (3) a willingness to provide specifically targeted assistance to individual firms or specific industries threatened with economic failure;[118] (4) a dramatic expansion of the types of collateral that the Bank is willing to accept;[119] and (5) a willingness to act jointly with the Treasury Department and the FDIC.[120]

In some cases, the expansion of acceptable collateral led the Bank to use new and complex funding devices. Rather than hold collateral directly, the Bank in some cases established separate entities—referred to as Special Purpose Vehicles (SPVs)—to hold the assets. This creative device

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114. *See supra* note 109.

115. In addition to the Federal Reserve's BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS (2009), useful sources for more detailed information on the 2007–2008 new programs include OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 27–28 (2010); MKTS. GROUP, FED. RESERVE BANK OF N.Y., DOMESTIC OPEN MARKET OPERATIONS DURING 2008, at 19–25 (2009).

116. Although the Federal Reserve typically extends loans only to banks, the TSLF and PDCF, both established in March 2008, made loans available to primary dealers. For a brief description of these programs, see BD. OF GOVERNORS OF THE FED. RESERVE SYS., 95TH ANNUAL REPORT 52–53 (2008) [hereinafter FEDERAL RESERVE 2008 ANNUAL REPORT]. The TALF later made loans even more broadly available to holders of certain securities backed by student, auto, and other loans. For a brief description, see *id.* at 55. *See also* OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, INITIAL REPORT TO CONGRESS 81–83 (2009).

117. Although the Federal Reserve typically extends only overnight loans, special facilities created during the recent economic crisis provided longer terms. For example, TSLF loans were available for a 28-day term. FEDERAL RESERVE 2008 ANNUAL REPORT, *supra* note 116, at 52. A more dramatic expansion was the TALF program, which made loans available for three, and in some cases up to five, years. *See Term Asset-Backed Securities Loan Facility: Frequently Asked Questions*, FED. RESERVE BANK OF N.Y. (Apr. 1, 2010), http://www.newyorkfed.org/markets/talf_faq.html.

118. For example, the Federal Reserve, in 2008, provided assistance to Bear Stearns, American International Group, Citigroup, and the Bank of America. FEDERAL RESERVE 2008 ANNUAL REPORT, *supra* note 116, at 56–57. Subsequently enacted provisions now prohibit the Federal Reserve from providing such assistance to individual companies. *See supra* note 111.

119. For a discussion of Federal Reserve's broadening of acceptable collateral through its 2008 new facilities, see NEW YORK FEDERAL RESERVE OPEN MARKET OPERATIONS, *supra* note 115, at 19–25.

120. For example, TALF was a joint project with the Treasury Department in which the former agreed to absorb the first $20 billion in losses on TALF loans. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 27–28 (2010). Another collaborative government intervention effort was the joint Treasury Department, FDIC, and Federal Reserve assistance to Citigroup. *Id.* at 28.

was first used in connection with Bank efforts to facilitate J.P. Morgan's acquisition of the ailing Bear Stearns.[121] As the potential bankruptcy of Bear Stearns—then the nation's fifth-largest banking firm—loomed in March 2008, the Federal Reserve determined that "a disorderly failure of Bear Stearns would [threaten] overall financial stability and would most likely have significant adverse implications for the U.S. economy."[122] J.P. Morgan was interested in an acquisition, but reluctant to assume Bear Stearns's risky investment portfolio, made up substantially of mortgage-backed securities and other housing-related investments. To assist with the $30 billion acquisition of Bear Stearns, the Federal Reserve created Maiden Lane, a new Delaware-based Limited Liability Company (LLC) to be wholly owned by the Bank. Immediately after it was formed, the LLC received a $29 billion nonrecourse loan from the Federal Reserve and a $1 billion subordinate loan from J.P. Morgan, which it then used to purchase $30 billion in assets from Bear Stearns. These assets were the sole collateral backing for the loans, which the LLC was expected to repay through subsequent liquidation of the assets. As a result of this transaction structure, the first $1 billion in risk of loss was borne by J.P. Morgan and the remaining risk borne by the Federal Reserve. Although the Federal Reserve does not hold a *direct* interest in the high-risk assets associated with Bear Stearns, it owns them indirectly through its 100% ownership interest in Maiden Lane.

The Federal Reserve's decision to intervene in the Bear Stearns case was unprecedented in a number of ways. First, the Bank had not previously "committed to 'bailing out' a financial entity that was not a commercial bank."[123] Second, to my knowledge, it had not previously agreed to take an interest in troubled assets as collateral for a loan. Third, the Bank had not previously used an intermediary entity through which to funnel loans. The Bank has since used this intermediary vehicle approach more broadly for other new lending programs. In October 2008, for example, the Bank created a similar LLC to implement its new Commercial Paper Funding Facility (CPFF), which was created to improve liquidity and availability of credit for households and

121. For a description of events leading up to the Bear Stearns assistance and the transactions themselves, see GARY SHORTER, CONG. RESEARCH SERV., RL34420, BEAR STEARNS: CRISIS AND "RESCUE" FOR A MAJOR PROVIDER OF MORTGAGE-RELATED PRODUCTS (2008).

122. BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS 50 (2009).

123. GARY SHORTER, CONG. RESEARCH SERV., RL34420, BEAR STEARNS: CRISIS AND "RESCUE" FOR A MAJOR PROVIDER OF MORTGAGE-RELATED PRODUCTS 1 (2008).

businesses.[124] The Bank lent money to the LLC, which, in turn, used the funds to acquire three-month (short-term) commercial paper from eligible issuers. Later in the same month, the Bank created additional LLCs for purposes of implementing a new Money Market Investor Funding Facility (MMIFF), which used funds loaned by the Bank to acquire various eligible money market instruments.[125]

One of the most dramatic new Federal Reserve programs was the TALF, created by the Bank in November 2008, also pursuant to its emergency authority.[126] Under expanded eligibility rules, this facility was made available to "any U.S. company that owns eligible collateral[,] . . . provided the company maintains an account relationship with a TALF Agent."[127] Categories of acceptable collateral were also expanded to include securities backed by eligible auto loans, student loans, credit card loans, or small business loans guaranteed by the Small Business Administration. As originally announced, the program was to make available up to $200 billion in one-year nonrecourse loans. Subsequent announcements extended the loan term to three years, expanded the types of eligible collateral, and indicated that the Federal Reserve was prepared to expand the size of the program to as much as $1 trillion.[128] Another unusual feature of the program was the participation of the U.S. Treasury, which provided $20 billion in credit protection to the New York Federal Reserve Bank using funds authorized under TARP.[129] Through these various new programs, the Federal Reserve clearly moved far beyond its traditional role of issuing overnight loans to banks.

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124. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Oct. 7, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm (announcing creation of CPFF facility).

125. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Oct. 21, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081021a.htm (announcing creation of MMIFF facility).

126. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Nov. 25, 2008), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081125a.htm.

127. *Term Asset-Backed Securities Loan Facility: Terms and Conditions*, FED. RESERVE BANK OF N.Y. (Nov. 13, 2009), http://www.newyorkfed.org/markets/talf_terms.html.

128. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Feb. 10, 2009), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20090210b.htm.

129. *Id.*; *see also* BD. OF GOVERNORS OF THE FED. RESERVE SYS., CREDIT AND LIQUIDITY PROGRAMS AND THE BALANCE SHEET: OTHER LENDING FACILITIES (Feb. 5, 2010), *available at* http://www.federal reserve.gov/monetarypolicy/bst_lendingother.htm.

4. Budget Implications of Federal Reserve Programs

a. The Federal Reserve and Its Balance Sheets

To understand the budget implications of the Federal Reserve's extraordinary bailout-like interventions, it will be helpful first to consider how the Bank maintains its balance sheets. The Federal Reserve's balance sheet is usually straightforward and not subject to dramatic changes; until recently, changes from month to month or even year to year have not been especially remarkable. Total assets on the Federal Reserve balance sheet between December 2000 and December 2007, for example, increased at a rather steady rate of nine to ten percent each year, ending 2007 at approximately $900 billion.[130] U.S. Treasury securities typically made up the bulk of the Federal Reserve's assets. From the beginning of 2000 until the end of 2007, for instance, the proportion of Federal Reserve assets held outright as U.S. Treasury securities remained relatively constant at approximately eighty to eighty-five percent.[131] Most of the Bank's income derives from interest on securities acquired through the open market, "interest on foreign currency investments," "loans to depository institutions" and other borrowers, and fees charged for its services to depository institutions or for other services.[132] Historically, the Federal Reserve has not only been financially self-sustaining, but has generated surplus, which is remitted to the Treasury and reflected in the federal budget as revenue. Annual surplus income transferred from the Federal Reserve to the Treasury has typically ranged from $20 to $30 billion.[133]

As some colloquially put it, the Federal Reserve has the unlimited and extraordinary power to "make" or "print" money. The Bank effectively can increase the money supply simply by expanding its lending activity. For example, if the Bank extends an additional loan to one of its depository institutions, the increased loan amount is reflected on the liability side of the Federal Reserve's balance sheet as an increase in the

130. CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE'S ACTIONS DURING THE FINANCIAL CRISIS 4 fig.1 (2010).

131. Data was derived by comparing the last weekly Federal Reserve release for each year from 2000 through 2007. *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE, http://www.federalreserve.gov/releases/h41 (last visited Aug. 22, 2010).

132. PURPOSES AND FUNCTIONS, *supra* note 96, at 11.

133. *The Budget and Economic Outlook: Fiscal Years 2009 to 2010: Hearing Before the S. Comm. on the Budget*, 111th Cong. 35 (2009) (statement of Robert A. Sunshine, Acting Director, Cong. Budget Office); *see also* CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE'S ACTIONS DURING THE FINANCIAL CRISIS 11 (2010) (reporting annual remittances between $19 and $34 billion for fiscal years 2000–2008).

borrowing institution's "bank account," i.e., liquid funds now available for immediate disbursement to the borrowing institution. The same amount is included as a loan on the asset side of the balance sheet, i.e., as an amount that the Federal Reserve is entitled to be repaid.

When the Federal Reserve expands its lending activity, it increases the cash or money supply. Without any offsetting moves, such Federal Reserve action would create the risk of inflation. Given such concerns, the Bank does not often expand its lending activities without taking some type of "sterilizing" action such as simultaneous sales of U.S. Treasury securities. Through such sales, the Bank simultaneously decreases the amount of Treasury securities and increases the amount of loans on the asset side of the balance sheet. Assuming the amounts are the same, the two transactions "neutralize" each other, leaving the aggregate assets and liabilities—or bottom line—of the Bank's balance sheet unchanged.

Such simultaneous "neutralizing" transactions may not change the overall size of the Federal Reserve's balance sheet, but they *do* change the composition of its asset portfolio. After the transactions, the balance sheet will reveal a greater proportion of assets in the form of loans and a lesser proportion in U.S. Treasury securities. To the extent that the Bank has a smaller proportion of generally secure Treasury securities and a larger proportion of loans, its overall portfolio is riskier. A comparison of Federal Reserve balance sheet information from 2007 and 2008, for example, reveals a dramatic shift in the makeup of Federal Reserve assets. At year end 2007, Treasury securities held outright constituted approximately eighty-two percent of total assets, while loans constituted approximately seven percent of total assets.[134] These relative proportions were consistent with prior years.[135] By year end 2008, however, Treasury securities held outright had declined to only twenty-two percent of total assets.[136] In addition, the categories of assets listed had expanded dramatically to include entries for a variety of new lending programs.[137] More than fifty percent of total assets at year end 2008 represented some

134. Data was derived from *H.4.1*: *Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE (Dec. 27, 2007), http://www.federalreserve.gov/releases/h41/20071227. For purposes of these computations, I consolidated repurchase agreements, term auction credit, and other loans together as "loans."

135. Data was derived by comparing year-end H.4.1. Federal Reserve Statistical Releases, available at *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE, http://www.federalreserve.gov/releases/h41.

136. *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE (Dec. 29, 2008), http://www.federalreserve.gov/releases/h41/200812278.

137. *Id.*

type of loan.[138] Nonetheless, economic improvements and repayments through the end of 2009 improved the composition of the Federal Reserve's balance sheet; the proportion of assets in less risky Treasury securities held outright by that time had returned to approximately eighty-one percent.[139]

Early on in the crisis, new Federal Reserve programs were structured to "neutralize" any increases in Federal Reserve lending with offsetting reductions in U.S. Treasury security holdings. In other words, the Federal Reserve maintained the overall size of the balance sheet or "money supply." For example, despite the introduction of several new programs in the latter half of 2007, total assets on the Federal Reserve's balance sheet at the end of 2007 were approximately $930 billion, only a 9.8% increase from the previous year.[140] Beginning in the fall of 2008, however, Federal Reserve actions began to dramatically expand the overall balance sheet. By the end of 2008, total assets had increased to approximately $2.3 trillion.[141] To allow further expansion of the balance sheet without "printing money," the Federal Reserve also sought assistance from the Treasury Department, which agreed to sell additional U.S. Treasury securities directly to the public through a temporary Supplemental Financing Program.[142] Funds from the security sales pursuant to this program were kept in a separate U.S. Treasury supplemental account maintained at the Bank.[143] Although the composition of the Federal Reserve's balance sheet returned to its precrisis proportionate amount of

138. *Id.* For purposes of these computations, I also included amounts from new lending facilities and programs. *See also* Ben S. Bernanke, Chariman, Fed. Reserve, The Federal Reserve Balance Sheet, Speech at the Federal Reserve Bank of Richmond 2009 Credit Markets Symposium (Apr. 3, 2009) [hereinafter Bernanke, Richmond Speech], *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20090403a.htm (indicating that short-term loans to financial institutions then made up 45% of the total balance sheet, and direct lending to borrowers and investors constituted 12.5%).

139. Data was derived from *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE (Dec. 31, 2009), http://www.federalreserve.gov/releases/h41/20091231.

140. *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE (Dec. 27, 2007), http://www.federalreserve.gov/releases/h41/20071227.

141. Data was derived by comparing "total factors supplying reserve funds" entry on the Federal Reserve's weekly balance sheet statements from Dec. 29, 2008, and Dec. 27, 2007. *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE, http://www.federalreserve.gov/releases/h41.

142. Press Release, U.S. Dep't of the Treasury, Treasury Announces Supplementary Financing Program (Sept. 17, 2008), *available at* http://www.ustreas.gov/press/releases/hp1144.htm.

143. Press Release, Fed. Reserve Bank of N.Y., Statement Regarding Supplementary Financing Program (Sept. 17, 2008), *available at* http://www.newyorkfed.org/markets/statement_091708.html.

about eighty percent in Treasury securities, the size of the Bank's balance sheet remains at approximately $2.3 trillion.[144]

b. The Impact of the Federal Reserve Bank's Actions on the Federal Budget

Federal Reserve Chairman Bernanke began a 2009 speech to the Federal Reserve Bank of Richmond, recognizing,

> [i]n ordinary financial and economic times, my topic, "The Federal Reserve's Balance Sheet," might not be considered a "grabber." But these are far from ordinary times. To address the current crisis, the Federal Reserve has taken a number of aggressive and creative policy actions, many of which are reflected in the size and composition of the Fed's balance sheet.[145]

Since the Bank is an "off-off budget" agency, its expenses are not reflected *at all* in the federal budget. Taxpayers and legislators understandably should be concerned about what Federal Reserve bailout-type actions are likely to cost the public, in addition to funds already explicitly authorized by Congress for TARP and other statutory programs.[146]

In the end, the answer is, perhaps, nothing. The Federal Reserve has not experienced an annual net operating loss since 1915,[147] and despite its recent forays into new programmatic territory, has taken various precautions such that an annual net operating loss in the near future appears unlikely.[148] Indeed, the worst now appears to be over, and the Federal Reserve has terminated many of its emergency facilities created in 2008.[149] Since the Federal Reserve Bank is self-supporting and actually remits revenues to the general Treasury, one might be tempted to be unconcerned about the cost of recent Federal Reserve programs to general

144. *H.4.1: Factors Affecting Reserve Balances*, FEDERAL RESERVE STATISTICAL RELEASE (Dec. 31, 2009), http://www.federalreserve.gov/releases/h41/20091231.

145. Bernanke, Richmond Speech, *supra* note 138 (emphasis added).

146. *See, e.g.*, *Challenges Facing the Economy: The View of the Federal Reserve: Hearing Before the H. Comm. on the Budget*, 111th Cong. 18 (2009) (statement of Rep. Doggett in questioning Federal Reserve Chairman Ben Bernanke) ("[R]elying upon the Federal Reserve instead of the Treasury for bailouts can also mask the true cost to the public in terms of our soaring national debt.").

147. U.S. GEN. ACCOUNTING OFFICE, GAO-02-939, FEDERAL RESERVE SYSTEM: THE SURPLUS ACCOUNT 11 (2002).

148. CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE'S ACTIONS DURING THE FINANCIAL CRISIS 11 (2010).

149. *See supra* note 109 (referring to Federal Reserve emergency programs that have expired or been closed).

taxpayers. After all, taxpayers will not be called upon to foot the bill for any Federal Reserve loan defaults or loss in value of other Federal Reserve assets unless aggregate Bank losses exceed earnings. Chairman Bernanke is careful to stress that most of the Bank's new approaches are reasonably low risk. For example, he notes that the Bank's direct loans tend to be overcollateralized and often made with recourse to the borrower's other assets in the event of nonpayment.[150] Several programs charge fees, in addition to interest, in order to make the program less attractive and, hence, "the last rather than the first resort" for borrowing.[151]

Despite Chairman Bernanke's assurances, there are reasons for concern. For a period of time in 2008, the Federal Reserve's balance sheet was heavily weighted to higher-risk assets, rather than the more secure U.S. Treasury issues it usually holds.[152] Its assets also continue to include net portfolios held through the Bank's interest in numerous SPVs, including three different Maiden Lane LLCs and a CPFF LLC.[153] Chairman Bernanke concedes high risk with respect to some assets, but argues that the proportion of the Bank's assets that are high risk is extremely low.[154]

Even though risks may be reasonably low for the moment, future borrower defaults and declines in value of Bank assets held as collateral may result in lower Federal Reserve net earnings and, consequently, lower remittances to the general Treasury.[155] The amount lost to general revenues from such reduced remittances would represent real taxpayer cost. Moreover, if the Bank *had* incurred substantial losses, taxpayers would be on the line to cover them through general revenues. Although the extremes are unlikely, Federal Reserve bailout-type actions do have

150. Ben S. Bernanke, Chairman, Fed. Reserve, The Crisis and the Policy Response, Speech at the Stamp Lecture London School of Economics (Jan. 13, 2009) [hereinafter Bernanke, London Speech], *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm. In fact, however, many of the loans extended under more recent Federal Reserve programs are nonrecourse. *See, e.g.*, OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, INITIAL REPORT TO CONGRESS 67 (2009) (discussing nonrecourse TALF loans).

151. Bernanke, Richmond Speech, *supra* note 138.

152. CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE'S ACTIONS DURING THE FINANCIAL CRISIS 2–5 (2010).

153. *See supra* notes 122–25 and accompanying text.

154. Bernanke, London Speech, *supra* note 120.

155. Perhaps surprisingly, CBO recently estimated that the Federal Reserve's expanded activity to stabilize the financial system in 2007–2009 may actually result in *increased* remittances to the U.S. Treasury. CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE'S ACTIONS DURING THE FINANCIAL CRISIS 4–5, 11 (2010). At the same time, however, the report stresses that these projections are now more uncertain because "the system's asset holdings are now riskier, exposing the central bank to a considerably greater possibility of losses than its usual holdings . . . ." *Id.* at 5.

potential costs to the taxpayer that are less visible but, nevertheless, quite real.

To be fair, the Federal Reserve Bank, under the strong leadership of Chairman Bernanke, has done its best under difficult conditions to act as a good-faith and careful steward of monetary policy and to contain systemic financial risk. Still, the Federal Reserve's recent bailout-like actions may impose costs on the general public even if the Bank continues to generate surplus that it remits to the general Treasury. The fact remains that the Federal Reserve has unlimited authority to continue lending and to continue expanding the money supply. Despite the best of intentions, the real cost of the Bank's rescue efforts in the long run could be increased inflation. With respect to the Bank's balance sheet, the FOMC has noted that "it expects the size of the balance sheet to remain at a high level for some time as a result of open market operations and other measures to support financial markets and to provide additional stimulus to the economy."[156] While aware of traditional inflationary concerns that might be raised by an enlarged balance sheet, the FOMC notes that inflation is expected to remain low through 2011.[157] Although inflation ultimately was not a problem in the most recent spate of Federal Reserve activity, it remains a possibility with respect to future Federal Reserve actions.

5. Federal Reserve Bank Budget Status and Reporting

The Federal Reserve is historically and uniquely an "off-off budget" independent government agency. Other than a one-line entry under "Miscellaneous Receipts" for "Deposits of Earnings by Federal Reserve Banks," the federal budget does not include information about Federal Reserve Bank revenues and expenditures. Annual federal budget appendices typically note that "[t]he Board of Governors of the Federal Reserve System's transactions are not included in the Budget because of its unique status in the conduct of monetary policy."[158]

The 1967 President's Commission on Budget Concepts, which otherwise recommended a completely unified budget, acknowledged the unique nature of the Federal Reserve. Citing the "vital flexibility and

156. BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONETARY POLICY REPORT TO THE CONGRESS 2 (2009).

157. *Id.* at 2–3.

158. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2009 app. at 1273 (2008). For informational purposes, however, the budget appendix generally does include a broad summary of the Board of Governor's administrative budget. *Id.* app. at 1274.

independence" of the Federal Reserve's monetary policy and the different nature of the Bank's receipts and expenditures, the Commission recommended that "[t]he payment of excess Federal Reserve profits to the Treasury should continue to be treated as a federal budget receipt. But other receipts and expenditures of the Federal Reserve banks should continue to be excluded from the budget."[159]

Despite continued recognition of the importance of the Federal Reserve's independence as the agency responsible for monetary policy, concerns have been raised from time to time about the Bank's "off-off budget" status and the need to make information about its activities more freely available. However, the most recent serious questions raised in Congress about the Bank's budgetary status were in 1985, when Representative Lee Hamilton introduced legislation that would have required the President to include in every budget "estimated receipts and expenditures of the Board of Governors of the Federal Reserve System and all Federal Reserve banks in the fiscal year for which the budget is submitted and the two fiscal years after that year."[160] In other words, the proposed legislation would have included the Federal Reserve in the unified budget. At the request of the Congressional Joint Economic Committee, the Congressional Budget Office (CBO) prepared a report on the Federal Reserve's budget status.[161] Responding to the argument that the Federal Reserve's annual report should be sufficient public information, the CBO Report noted that the annual report receives much less public attention than the Budget and does not include information comparable to budget information provided for other independent agencies included in the federal budget appendix. In addition, the Federal Reserve's annual report's different accounting practices, including use of a calendar rather than a fiscal year, make it difficult to comparatively assess the Bank's annual report information.[162]

The then CBO director Rudolph Penner subsequently testified:

> The current budgetary presentation of the Federal Reserve's finances is incomplete compared with that of other independent government agencies. . . .
>
> . . . .

159. PRESIDENT'S COMM'N ON BUDGET CONCEPTS, REPORT OF THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS 29 (1967).

160. H.R. 1659, 99th Cong. (1st Sess. 1985).

161. CONG. BUDGET OFFICE, THE BUDGETARY STATUS OF THE FEDERAL RESERVE (1985).

162. *Id.* at 40–44.

> On its face, the current budgetary treatment of the Federal Reserve violates a basic principle of budgeting: namely that the budget document should be comprehensive about government operations and should facilitate cost comparisons among agencies and activities. More particularly, the reporting of net earnings provides little information about financial performance or operating characteristics of an agency with the power to create money.[163]

Even though the CBO Report itself and Dr. Penner's testimony offered several possible answers to policy and accounting questions that would be raised by bringing the Federal Reserve System "on-budget," Dr. Penner did not express a firm opinion with respect to the proposed legislation, preferring to leave the matter to congressional judgment.[164] The then Federal Reserve chairman Paul Volcker, on the other hand, took the firm position that the "legitimate objectives of disclosure and public accountability can be best achieved by retaining independent budgetary reporting for the Federal Reserve (with our net earnings, as at present, reflected in the regular budget document.)"[165] In the end, Congress did nothing, leaving the then Federal Reserve Bank chairman Volcker with the independence he was anxious to preserve.

Many improvements have occurred since 1985, of course. Congress requires the Federal Reserve to release substantial information, including a publicly available annual report.[166] In fact, the Bank has voluntarily released more than the required material. The Bank makes its weekly balance sheet available to the public online and is working to improve website accessibility and transparency of information.[167] The concern, then, is not so much that information is unavailable, but rather that because of the Federal Reserve's unique "off-off budget" status, the potential costs of its bailout-type activities are not reflected anywhere in the federal budget and not taken into account more generally as

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163. *The Budgetary Status of the Federal Reserve Systems: Hearing Before the Subcomm. on Econ. Goals and Intergovernmental Policy of the J. Econ. Comm.*, 99th Cong. 1–3 (1985) (statement of Rudolph G. Penner, Director, Cong. Budget Office).

164. *Id.*

165. *Id.* at 154 (statement of Paul A. Volcker, Chairman, Fed. Reserve).

166. *See, e.g.*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., ANNUAL REPORT: BUDGET REVIEW (2008).

167. The 2010 Wall Street Reform Act now subjects the Federal Reserve to additional audit and transparency requirements. *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1102, 124 Stat. 1376, 2115–17 (special provisions authorizing the Comptroller General to audit certain Federal Reserve credit facilities); *id.* § 1103 (additional public access to information); *id.* § 1109 (one-time audit by the General Accounting Office of loans and other financial assistance extended by the Federal Reserve from December 1, 2007, through July 2010).

policymakers attempt to allocate the use of budgetary resources. While Federal Reserve financial information is available to those who seek it out, legislators and the general public simply do not consider this information with the same degree of attention they pay to the federal budget. Different accounting procedures also make the figures difficult to compare with other budgetary information.

With its new programs over the past several years, the Federal Reserve has moved substantially beyond its regular monetary policy role and has begun to engage in bailout-type government interventions similar to those undertaken by the Treasury Department or other government agencies. Budgetary information on bailout costs is incomplete to the extent that it does not include Federal Reserve bailout-type activities similar to those of the Treasury Department under the EESA. For example, special budget-related provisions in the EESA require that OMB report semiannually to the President and to Congress on the cost of troubled assets and troubled asset guarantees and include a description of methods used to derive such cost estimates.[168] These budget provisions further require a CBO assessment of these OMB reports.[169] Beginning with its second report, OMB is directed to explain any differences between its own and CBO estimates.[170] In addition, budget rules, as amended by EESA, require the President's budget to include two *different* sets of cost estimates for assets purchased and sold pursuant to EESA "troubled asset" programs—one using a net present value and the other a cash-basis method of accounting.[171] Despite the Federal Reserve's acquisition of unusual assets through devices quite similar to those used by the Treasury Department, these new budgetary rules do not apply to the "off-off budget" Federal Reserve.

The extraordinary and complex array of new Federal Reserve programs has begun to blur the traditional boundary between the traditionally fiercely independent Federal Reserve Bank and the Treasury Department. Indeed, Chairman Bernanke has conceded, in particular, that "CPFF and the TALF are rather unconventional programs for a central bank to undertake."[172] An unusual joint Federal Reserve-Treasury Department

168. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 202(a), 122 Stat. 3765, 3832–33 (to be codified at 12 U.S.C. §§ 5201–5261).

169. *Id.* § 202(b).

170. 12 U.S.C. § 5252 (Supp. 2009).

171. 31 U.S.C. 1105(a) (2006 & Supp. 2009). See *infra* notes 222–44 and accompanying text for further discussion of the debate over net present value versus cash-method accounting for purposes of estimating bailout costs.

172. Bernanke, Richmond Speech, *supra* note 138.

press release issued in March 2009 suggests that both agencies are acutely aware that recent events have tested traditional boundaries.[173] The joint statement announces several broad principles upon which the two agencies agree, including the need for an early government response framework to address potential failure of systemically critical financial institutions and the need for such framework legislation to "spell out to the extent possible the expected role of the Federal Reserve and other U.S. government agencies."[174]

Although bringing the Federal Reserve fully "on-budget" or subjecting its actions to the congressional appropriations process may be too extreme, the budget should at least reflect extraordinary Federal Reserve actions that involve fiscal, as opposed to traditional, monetary policymaking. Moreover, the Bank and the Treasury Department should use consistent methodologies to value collateral backing loans and troubled assets held outright. Even if no general taxpayer dollars were ultimately "spent" as a result of the Federal Reserve's bailout-like interventions, amounts disbursed by *all* federal agencies involved in providing bailout-like assistance should be aggregated and reported in a consistent fashion so that all bailout-type government intervention risks and costs can be meaningfully assessed and compared.

C. Other "Off-Budget" Bailout Issues

1. Housing-Related GSEs

One of the most dramatic episodes in the recent bailout crisis was the government takeover of the "off-off budget GSEs," Fannie Mae and Freddie Mac.[175] Both of these independent housing entities were created by federal charter to "provide liquidity and stability in the home mortgage market, thereby increasing the flow of funds available to mortgage borrowers."[176] Because of the important public good they were expected to provide for home mortgage markets, Fannie Mae's and Freddie Mac's congressional charters gave them various advantages, including exemption from certain income taxes, exemption from Securities and Exchange

173. Press Release, Bd. of Governors of the Fed. Reserve Sys., The Role of the Federal Reserve in Preserving Financial and Monetary Stability (Mar. 23, 2009), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20090323b.htm.

174. *Id.*

175. *See supra* notes 24–25, 89–94 and accompanying text; *infra* notes 175–82 and accompanying text.

176. CONG. BUDGET OFFICE, FEDERAL SUBSIDIES AND THE HOUSING GSES 1 (2001).

Commission (SEC) registration, lower costs for credit ratings, and access to Treasury Department lines of credit.[177] Perhaps the most important advantage, however, was the implicit government guarantee.[178] Despite explicit disclaimers and disclosures stating that the obligations were *not* backed by the U.S. government, investor perception—in retrospect, proven to have been accurate—has always been that the federal government would bail out Fannie Mae and Freddie Mac in the event of economic collapse.

2. Government Takeover of Fannie Mae and Freddie Mac

When the then Treasury secretary Henry Paulson went to Congress in July 2008 seeking authority to take control of Fannie Mae and Freddie Mac, he claimed that he expected not to use the authority, but hoped that simply having the authority would restore confidence to the markets.[179] In response to Paulson's request, Congress created the Federal Housing Finance Agency (FHFA), a new independent GSE regulator with authority to take control of the housing-related GSEs, if needed, along with authority to purchase GSE debt and securities and other actions necessary to restore the GSEs to sound financial condition.[180]

Not long thereafter, on September 7, 2008, Secretary Paulson stood with Jim Lockhart, the director of the new FHFA, to announce that the FHFA was taking Fannie Mae and Freddie Mac into conservatorship, thus transferring complete control of the GSEs from the shareholders to the government. Government ownership, in this instance, was intended to be temporary, with the conservatorship ending once the corporations returned to a stable financial condition. Along with the FHFA conservatorship, the Treasury Department announced that it would: (1) purchase up to $100 billion of senior preferred stock from each of the two entities, with warrants to purchase up to 79.9% of GSE common stock; (2) purchase

177. In its careful study, the Congressional Budget Office attempted to quantify direct and indirect federal subsidy benefits to the housing GSEs. *Id.* at 34; *see also* CONG. BUDGET OFFICE, CBO'S BUDGETARY TREATMENT OF FANNIE MAE AND FREDDIE MAC 10–13 (2010).

178. For a general discussion of the advantages and implicit guarantees related to GSEs, see, for example, Block, *Accounting Scandals, supra* note 87, at 435–39; *see also infra* notes 333–36 and accompanying text for a discussion of budgetary implications of implicit guarantees.

179. *GSE Initiatives: Hearing Before the S. Banking Comm.*, 110th Cong. 1 (2008) (statement of Henry M. Paulson, Jr., Secretary, U.S. Treasury).

180. *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654; *see also Oversight Hearing to Examine Recent Treasury & FHFA Actions Regarding the Housing GSEs: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 11 (2008) (statement of James B. Lockhart III, Director, Fed. Housing Fin. Agency); MARK JICKLING, CONG. RESEARCH SERV., RS22950, FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP 3–4 (2008).

Fannie Mae and Freddie Mac mortgage-backed securities (MBSs), essentially "troubled assets," through the open market; and (3) extend short-term loans to the GSEs, permitting them to post MBSs as collateral.[181] At about the same time, additional government intervention came from the Federal Reserve, which, in November 2008, announced programs to purchase up to $100 billion in direct obligations of housing-related GSEs and up to $500 billion in MBSs backed by Fannie Mae, Freddie Mac, and others.[182]

3. Budget Implications of the GSE Takeover and Other Housing-Related Government Interventions

Federal conservatorship and other government interventions to assist the housing-related GSEs raise several major questions about how government interventions on behalf of GSEs should be reflected in the federal budget. The first concerns the government purchase of GSE equity interests and government lending to the GSEs. Surely, housing-related GSE equity acquisitions and lending costs should be reflected in the budget in the same way that other similar transactions are handled. A second, and more difficult, question relates to the business operations and assets and liabilities of the GSEs themselves. Given the magnitude of special GSE advantages and implicit government guarantees, ongoing subsidies and potential government costs arguably should have been incorporated in the federal budget all along.[183] The case for including these entities on the federal budget becomes stronger, of course, when the government intervenes to take control. Speaking about this issue before the Senate Budget Committee, Acting CBO Director, Robert Sunshine, returned to one of the basic principles expressed in the 1967 President's Commission report: "[b]orderline agencies and transactions should be included in the budget unless there are exceptionally persuasive reasons

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181. *See* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 30, 350–52 (2010).

182. FEDERAL RESERVE 2008 ANNUAL REPORT, *supra* note 116, at 55–56. The housing-related GSEs also received indirect bailout-type assistance through special tax breaks permitting certain taxpayers to reflect certain losses on the sales of Fannie Mae and Freddie Mac preferred stock as ordinary loss. *See infra* notes 279–82 and accompanying text.

183. JAMES M. BICKLEY, CONG. RESEARCH SERV., RL30346, FEDERAL CREDIT REFORM: IMPLEMENTATION OF THE CHANGED BUDGETARY TREATMENT OF DIRECT LOANS AND LOAN GUARANTEES 14–15 (2003) ("[P]roponents argue that credit reform should cover the subsidy costs to taxpayers of GSEs."); *see also* Block, *Accounting Scandals*, *supra* note 87, at 438–39; *infra* notes 333–36 and accompanying text (discussing budgetary implications of implicit guarantees).

for exclusion."[184] According to the report, criteria for making this determination include: (1) the extent to which the government owns an entity and selects its managers; (2) whether Congress and the President have control over the entity's program and budget; and (3) whether policies are set to accomplish a broad, public purpose rather than respond to the interests of private owners.[185] Based upon the "degree of management and financial control that the federal government currently exercises over Fannie Mae and Freddie Mac," the CBO concluded that the two GSEs should be included in the federal budget.[186] Although the Obama administration OMB announced plans to include GSEs in future budgets, it has yet to do so.[187]

The question of whether and when to include a particular nongovernmental business entity's finances in the federal budget is not limited to Fannie Mae and Freddie Mac, however. Such questions might be raised, for example, with respect to the federal government's unprecedented 2009 day-to-day involvement with the General Motors and Chrysler corporations. As a condition of receiving federal government assistance, the two auto companies were required to submit "viability plans," which were evaluated by a presidential Task Force on the Auto Industry.[188] On the one hand, the Task Force was directed "to avoid intervening in day-to-day corporate management and refrain from becoming involved in specific business decisions."[189] At the same time, however, the Task Force engaged in significant and detailed reviews of business operations, clearly pressuring the companies to make certain

184. *The Budget and Economic Outlook: Fiscal Years 2009 to 2019: Hearing Before the S. Comm. on the Budget* 26 (Jan. 8, 2009) (statement of Robert A. Sunshine, Acting Director, Cong. Budget Office).

185. *Id.* (referring to the PRESIDENT'S COMM'N ON BUDGET CONCEPTS, REPORT OF THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS (1967)).

186. CONG. BUDGET OFFICE, A PRELIMINARY ANALYSIS OF THE PRESIDENT'S BUDGET AND AN UPDATE OF CBO'S BUDGET AND ECONOMIC OUTLOOK 9 (Mar. 2009); *see also* CONG. BUDGET OFFICE, CBO'S BUDGETARY TREATMENT OF FANNIE MAE AND FREDDIE MAC 6–7 (2010).

187. The Obama OMB cited the complexity of making a change of this type in the short time available to complete the budget for fiscal year 2010 as its reason for not making the change immediately. H. COMM. ON THE BUDGET, SUMMARY AND ANALYSIS OF THE PRESIDENT'S DETAILED FISCAL YEAR 2010 BUDGET REQUEST 30 (2009). Although CBO now treats the housing-related GSEs as budgetary, the president's 2011 fiscal year budget continues to classify Fannie Mae and Freddie Mac as nonbudgetary, noting that "further review of which approach better fits both legal considerations and goals of budgetary accounting is ongoing." OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 140 (2010).

188. CONG. OVERSIGHT PANEL, SEPTEMBER OVERSIGHT REPORT: THE USE OF TARP FUNDS IN THE SUPPORT AND REORGANIZATION OF THE DOMESTIC AUTOMOTIVE INDUSTRY 10–11 (2009).

189. *Id.* at 34.

business decisions in exchange for continued government assistance.[190] As further illustration of the federal government's unprecedented involvement, President Obama announced that the federal government would "stand behind" Chrysler's and General Motors's warranties as the companies went through the restructuring process.[191] When the automobile manufacturers emerged from bankruptcy later in 2009, the federal government took an approximately eighty percent equity interest in the reorganized Chrysler, and an approximately sixty-one percent interest in the new General Motors.[192] Under the bankruptcy plan, the Treasury Department is entitled to appoint directors to both corporations.[193]

Depending upon the extent of government control and the period of time over which it will be exercised, individual firms receiving government assistance should be included in the federal budget. With respect to the automotive industry, the Treasury Department plans only to retain the government's equity interests "for a limited period of time" and "to dispose of them 'as soon as practicable.'"[194] As such, the recent automotive industry episode may not be one that calls for inclusion of the individual companies' financial information in the federal budget. On the other hand, a case for budgetary inclusion might arise for future interventions in the event that the government takes a longer-term equity or conservatorship interest in a private firm.

Secretary Tim Geithner recently testified on behalf of the Treasury Department that our financial system has fundamentally failed and needs "comprehensive reform, not modest repairs at the margin, but new rules of the game."[195] The Treasury Department's subsequent report on financial reform noted that during a financial crisis, large, interconnected financial

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190. As just one example, the Task Force's critical assessment of General Motor's viability plan, submitted to meet government-assistance conditions, noted that "while the Chevy Volt holds promise, it will likely be too expensive to be commercially successful in the short-term." PRESIDENTIAL TASK FORCE ON THE AUTO INDUSTRY, GM FEBRUARY 17 PLAN: VIABILITY DETERMINATION 1 (Mar. 30, 2009), *available at* http://www.whitehouse.gov/assets/documents/GM_Viability_Assessment_FINAL.pdf.

191. Barack Obama, U.S. President, Remarks by the President on the American Automotive Industry (Mar. 30, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-American-Automotive-Industry-3/30/09.

192. CONG. OVERSIGHT PANEL, SEPTEMBER OVERSIGHT REPORT: THE USE OF TARP FUNDS IN THE SUPPORT AND REORGANIZATION OF THE DOMESTIC AUTOMOTIVE INDUSTRY 14, 20 (2009) (reporting equity stake in Chrysler and General Motors, respectively).

193. *Id.* at 16, 20.

194. *Id.* at 36.

195. *Addressing the Need for Comprehensive Regulatory Reform: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 7 (2009) (statement of Timothy Geithner, Secretary, U.S. Dep't of the Treasury).

companies have faced "only two untenable options: obtain emergency funding from the US government . . . , or file for bankruptcy. . . . Neither of these options is acceptable for managing the resolution of the firm efficiently and effectively in a manner that limits the systemic risk with the least cost to the taxpayer."[196] As an alternative, the Obama administration proposed a "special resolution regime," including procedures under which the government could establish a conservatorship or receivership for a systemically important failing firm.[197] Tools available to the government under the proposal included "the ability to stabilize a failing institution . . . by providing loans to the firm, purchasing assets from the firm, guaranteeing the liabilities of the firm, or making equity investments in the firm."[198] Depending on its duration or extent, government seizure of control or operation of a systemically important firm surely would raise questions about the budgetary status of the seized firm.

Although modeled after the administration's financial reform report, the Wall Street Reform Act ultimately enacted by Congress provided more limited government authority than the original proposal to deal with financial institutions whose failure would present systemic risk. For example, the legislation provides that the Corporation [FDIC][199] "*shall*, as receiver . . . , liquidate and wind-up the affairs of a covered financial company. . . ,"[200] and "shall . . . not take an equity interest in or become a shareholder of any covered financial company . . . ."[201] The question of whether the assets and liabilities of a failing company under government receivership belong in the federal budget is less likely to arise to the extent that the government's authority truly is limited to supervising the orderly liquidation of systemically important financial institutions. The issue remains important, however, in the context of the housing-related GSE conservatorships and any other more substantial bailout-type interventions that might occur outside the scope of the Wall Street Reform Act. In addition, the budgetary treatment issue might conceivably arise even under the Wall Street Reform Act in the event that the FDIC uses its authority as

196. U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 76 (2010).

197. *Id.*

198. *Id.* at 77.

199. The term "Corporation" is defined by the Act to mean the FDIC. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 2(7), 124 Stat. 1376, 1387.

200. *Id.* § 210(a)(1)(D) (emphasis added).

201. *Id.* § 206(6).

receiver to transfer assets and liabilities of the failed company to a "bridge financial company" over which it retains substantial control.[202]

A third budgetary concern applicable to the housing-related GSEs, in particular, but also to government bailout actions more generally, is the fragmented nature of the interventions. If Congress is to make informed decisions about future financial assistance or other housing-related GSE policies, it should have at least a general sense of the aggregate government resources already devoted to these GSEs. There is no one place to look for this information. A substantial proportion of the recent GSE support came from the Federal Reserve, which is entirely "off-budget."[203] Additional bailout-type programs were funded by the Treasury Department, and still others by the Federal Housing Administration.[204] This information is not only fragmented, but may also be difficult to compare to the extent that different government agencies adopt different accounting methodologies.[205] In addition to making changes to the Federal Reserve's financial reporting requirements and budget status suggested above,[206] Congress should work more broadly toward an inclusive budget. Decisions about whether to include such entities in the budget should not be left to the individual discretion of different presidential administrations. Congress should establish clear standards for determining when various entities should be brought "on budget." Moreover, Congress should develop consistent accounting mechanisms to enable more useful comparisons of various related bailout-type government activities.

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202. The FDIC's authority as receiver to "liquidate and wind-up" includes the power to transfer assets of a covered financial company to a bridge financial company. *Id.* § 210(a)(1)(D). Statutory provisions regarding the charter and establishment of bridge financial companies give the FDIC signicant control over bridge companies, including appointing of directors, *id.* § 210(h)(2)(B), specifying terms of the company's articles of association, *id.* § 210(h)(2)(C), authorizing and providing terms and conditions for the issue of stock or securities, *id.* § 210(h)(2)(G)(iii), or making funds available for the bridge company's operations, *id.* § 210(h)(2)(G)(iv).

203. *See supra* notes 158–65 and accompanying text.

204. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 346–48 (2010).

205. *See, e.g.*, CONG. OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT: GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS 11 (2009) (noting the three different types of budget treatment for the Treasury Department, the Federal Reserve, and the FDIC).

206. *See supra* notes 174–75 and accompanying text.

IV. ESTIMATING THE COSTS OF OVERT BAILOUTS

A. Introduction: Budget Accounting for Contingent Risks and Uncertain Valuations

Whether "on-budget" or "off-budget," a substantial portion of the government response to economic crisis has been pursuant to statutes or regulations that overtly authorize particular types of federal bailout expenditures. Overt authorization occurs where there is a formal government program explicitly designed to provide assistance to failing businesses or to prevent economic failure or collapse. In this sense, an overt program still might be "off-budget," or details of its operation or finances otherwise might not be fully transparent. A government program is overt simply if it serves an express bailout-type function. Some overt programs are more transparent than others. Media headlines and public conversation about massive bailouts tend to focus on dollar amounts authorized by recent legislation, such as the $700 billion in TARP funds authorized by EESA.[207] Countless other federal programs, including the various Federal Reserve initiatives discussed earlier, also provided bailout-type relief.[208] As one commentator noted, "TARP is massive, but it gets disproportionate attention relative to the size of other government programs that did not require legislation. It is just one part of a governmentwide [sic] effort to support and stabilize the financial system."[209]

Assessing the true costs of even the most overt government bailout interventions is far more complex than a simple tally of total disbursements from the federal fisc. Borrowers may not repay amounts received as direct government loans, and the government may not ultimately be obliged to make payments pursuant to loan guarantee programs. Also, the government might lose with respect to its equity or troubled asset investments in connection with particular failing companies. Risk levels vary dramatically for different types of loan and investment programs and vary from borrower to borrower or investment to investment. The sections that follow explore the budget accounting challenges presented by various types of government economic intervention.

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207. *See supra* notes 28–31 and accompanying text.

208. *See supra* notes 105–29 and accompanying text.

209. Lee A. Sheppard & Martin A. Sullivan, *Taxing Financial Pollution,* 2010 TAX NOTES 697, 699 (Feb. 8, 2010).

B. Direct Loans, Loan Guarantees, and Other Contingent Liabilities

1. Federal Government Loan and Insurance Programs

The federal government routinely operates numerous direct federal loan and loan guarantee programs, included among them several designed to assist students,[210] small businesses,[211] rural utility services,[212] and home buyers.[213] In addition, the federal government provides federal bank deposit insurance, along with a number of other federal insurance programs.[214] One common government response to economic crisis is to increase authority for already existing direct loan, loan guarantee, or insurance programs, or to create new ones. Such actions made up the bulk of the government's response to the 2008–2009 economic crisis. One feature of the recent EESA bailout legislation, for example, was an increase in the insurance coverage cap from $100,000 to $250,000 for accounts maintained at FDIC-insured depository institutions.[215] More

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210. The federal government began its direct student loan programs with the National Defense Education Act of 1958, Pub. L. No. 85-864, § 201, 72 Stat. 1580, 1583. For the current direct loan programs, see 20 U.S.C. §§ 1087a–1087j (2006) (William D. Ford Federal Direct Loan Program); 20 U.S.C. §§ 1087aa–1087vv (2006) (need-based federal Perkins loans). Federal student loan guarantees and federal student loan insurance programs began with the Higher Education Act of 1965, Pub. L. No. 89-329, § 421, 79 Stat. 1219, 1236. For the current student loan guarantee and insurance programs, see 20 U.S.C. § 1071 (2006) (Robert T. Stafford Federal Student Loan Program).

211. The Small Business Administration (SBA), created by the Small Business Act, Pub. L. No. 85-536, 72 Stat. 384 (1958), has authority to extend direct loans and loan guarantees to qualified small businesses. *Id.* § 7. For current SBA loan authority, see, for example, 15 U.S.C. § 636 (2006) ("loans to small business concerns").

212. The Department of Agriculture was empowered, for example, to extend loans to develop electrical and telephone infrastructure in rural areas. Rural Electrification Act of 1936, Pub. L. No. 74-605, 49 Stat. 1363 (codified as amended at 7 U.S.C. §§ 902–950aaa (2006)).

213. Eligible home buyers may receive federally guaranteed mortgages through the Federal Housing Administration (FHA). *See* 12 U.S.C. §§ 1707–1715 (2006); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 346 (2010). In addition to the FHA, Congress created GSEs Fannie Mae and Freddie Mac to provide guarantees on mortgage-backed securities. *See supra* notes 175–78 and accompanying text.

214. The Federal Deposit Insurance Corporation (FDIC), established by the Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, provides insurance for accounts maintained at insured depository institutions. 12 U.S.C. § 1821 (2006). *See also* Agricultural Adjustment Act of 1938, Pub. L. No. 75-430, tit. V, 52 Stat. 1938 (1956) (Federal Crop Insurance Act) (codified at 7 U.S.C. §§ 1501–1524 (2006)); Federal Flood Insurance Act of 1956, Pub. L. No. 84-1016, 70 Stat. 1078 (codified at 42 U.S.C. §§ 4001–4129 (2006)).

215. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 136, 122 Stat. 3765, 3799 (to be codified at 12 U.S.C. §§ 5201–5261). Although the increase was originally scheduled to expire at the end of 2009, the $250,000 coverage amount was extended through the end of 2013, Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 204(a)(1), 123 Stat. 1632, 1648–49, and later made permanent by the Dodd-Frank Wall Street Reform and Consumer Protection

significantly, much of the recent bailout response involved new loan, loan guarantee, and other similar programs. Several of these recent programs technically took the form of government purchases of preferred stock or other equity interests in exchange for capital infusions from the government.[216] For purposes of assessing bailout cost, however, these federal purchases can be viewed as loan-type transactions. In most cases, the government did not mean to take a long-term shareholder interest, but intended to sell its equity stake back to the firms receiving the capital as soon as it was financially prudent for the firms to redeem or repurchase the stock or warrants. The firms' redemption or repurchase of government-held equity is essentially equivalent to repayment of a government loan.[217] In several cases, the government profited when participating corporations repurchased their own equity at a higher price than the capital initially contributed by the government. As noted by the OFS, "disposition of warrants has succeeded in significantly increasing taxpayer returns on the CPP preferred investments that have been repaid. As of December 31, 2009, Treasury has received $4 billion in gross proceeds on the disposition of warrants in 34 banks . . . ."[218]

2. Cash v. Accrual Accounting for Loans and Other Credit Programs

Before the Federal Credit Reform Act (FCRA) of 1990,[219] the federal budget generally recorded expenditures for federal credit programs using a cash method of accounting. Under this method, expenditures are recorded for the budget year in which funds are paid out, and income is recorded for the budget year in which funds are received.[220] Thus, a direct government loan was reflected as cost when funds were disbursed, even if it was likely

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Act of 2010, Pub. L. No. 111-203, § 335, 124 Stat. 1376, 1540 (to be codified as amended at 12 U.S.C. § 1821(a)(1)(E)).

216. For example, the TARP Capital Purchase Program (CPP) and Targeted Investment Program (TIP) were equity investment programs.

217. *See* CONG. OVERSIGHT PANEL, JULY OVERSIGHT REPORT: TARP REPAYMENTS, INCLUDING THE REPURCHASE OF STOCK WARRANTS 10 (2009) ("In the same way that loans are repaid, preferred shares are 'redeemed' by the institution paying back the 'liquidation' amount of the shares, equivalent to the principal amount of a loan.").

218. OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, WARRANT DISPOSITION REPORT 1 (2009).

219. Federal Credit Reform Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (codified at 2 U.S.C. § 661 (2006)).

220. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-734SP, A GLOSSARY OF TERMS USED IN THE FEDERAL BUDGET PROCESS 27–28 (2005) (defining cash method as a "system of accounting in which revenues are recorded when cash is actually received and expenses are recorded when payment is made without regard to the accounting period in which the revenues were earned or costs were incurred").

to be repaid. On the other hand, even if the borrower was likely to default, a government loan guarantee did not appear as budget cost until the borrower defaulted and the government was actually required to make good on the guarantee. As a result, direct government loan budget costs were overstated, and loan guarantee costs were understated. Moreover, the apparently lower price tag for loan guarantees created a policy bias in favor of guarantee over direct loan programs, without genuine policy consideration of the advantages and disadvantages of the different approaches.

Concern over these budgetary distortions led Congress to adopt FCRA, which requires accrual accounting for most direct loan and loan guarantee programs.[221] Under this method, the value of a loan or loan guarantee is determined first by estimating all expected cash inflows and outflows for the duration of the transaction. Those projections are then consolidated and expressed as a single figure, using present-value calculations. Computing present value requires use of an interest—or discount—rate to determine the value today of an expected future payment or the amount that must be set aside today in order to meet a future obligation.[222]

Most would probably agree that accrual-basis reforms mandated by FCRA have improved the accuracy of federal budget reporting for loans and loan guarantees.[223] Still, some accuracy and consistency issues remain. First, FCRA was not comprehensive in its scope. Although most credit programs now are governed by accrual accounting rules, the statute explicitly exempts entitlement programs and credit programs of the Commodity Credit Corporation.[224] In addition, FCRA does not apply to credit or insurance activities of the FDIC and certain other deposit insurance programs.[225] In the end, different budget accounting rules may

221. 2 U.S.C. § 661a(5)(A) (2006) (defining "cost" to mean "the estimated long-term cost to the Government of a direct loan or loan guarantee or modification thereof, *calculated on a net present value basis*, excluding administrative costs . . . .") (emphasis added). The President is directed to include such costs of direct loans and guarantees, along with planned levels of new loan obligations or guarantees, in the President's annual budget. *Id.* § 661c(a).

222. For a simple description and example, see CONG. BUDGET OFFICE, ESTIMATING THE VALUE OF SUBSIDIES FOR FEDERAL LOANS AND LOAN GUARANTEES 2 n.4 (2004).

223. *See, e.g.*, *id.* at 2 ("[C]redit-reform accounting provides more useful cost estimates than did the cash-basis accounting it replaced. The current approach is forward looking for the life of the loan; it accounts for the time value of money; and it generally assigns the same budgetary cost to equivalent loans and loan guarantees.").

224. 2 U.S.C. § 661c(c) (2006).

225. 2 U.S.C. § 661e(a) (2006) (exempting the FDIC, along with the "National Credit Union Administration, Resolution Trust Corporation, Pension Benefit Guaranty Corporation, National Flood Insurance, National Insurance Development Fund, Crop Insurance, [and] Tennessee Valley Authority"). The CBO was directed to study and report back to Congress on whether federal deposit

apply depending on the particular agency source of the federal lending or guarantee activity. Federal Reserve loan-related activities are generally entirely "off-budget."[226] Moreover, even though all Treasury Department programs are governed by FCRA's accrual reporting requirements, TARP expenditures that are used for some Treasury Department bailout-type interventions are subject to special risk-based accounting rules that do not apply to other Treasury Department expenditures.[227] On the other hand, FDIC bailout-type actions are reported for budget purposes through cash-method accounting.[228]

At a minimum, these different approaches create consistency problems, making it difficult to compare the budget consequences of lending activities undertaken by different government agencies. In turn, these difficulties complicate policy choices regarding the most efficient use and source of government loans and guarantees.

A second remaining potential accuracy and consistency problem under FCRA relates to setting an appropriate interest or discount rate to compute net present value. Although the concept of discounting to net present value is straightforward, choosing the appropriate rate requires insight into future general economic conditions and market risk. FCRA explicitly resolves the issue by requiring use of "the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."[229] These FCRA present-value calculations, based upon risk-free Treasury security rates, differ from those used by private lenders in that the government estimates "exclude the cost of market risk—the compensation that investors require for the uncertainty of expected but risky cash flows."[230]

Critics charge that the effect of using Treasury rates, rather than market risk-based rates, to calculate net present value "is to overstate the value of

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insurance programs should use similar accrual accounting methods for budget purposes. 2 U.S.C. § 661e(b). In its report, CBO was critical of existing federal budget accounting for deposit insurance programs, but noted both advantages and disadvantages to switching to accrual budget accounting. CONG. BUDGET OFFICE, BUDGETARY TREATMENT OF DEPOSIT INSURANCE: A FRAMEWORK FOR REFORM, at x–xiii (1991).

226. *See supra* notes 158–74 and accompanying text.

227. *See infra* notes 233–36 and accompanying text.

228. CONG. OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT: GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS 11 (2009) (noting the three different types of budget treatment for the Treasury Department, the Federal Reserve, and the FDIC).

229. 2 U.S.C. § 661a(5)(E) (2006).

230. CONG. BUDGET OFFICE, ESTIMATING THE VALUE OF SUBSIDIES FOR FEDERAL LOANS AND LOAN GUARANTEES 1–2 (2004).

federal direct loans and understate the value of government guarantees, relative to the price that would be observed in competitive financial markets."[231] A CBO study of the issue reached a similar conclusion:

> [I]gnoring the cost of risk understates the federal cost of credit assistance, potentially biasing the allocation of budgetary resources. For example, excluding the cost of risk from budget and program decisions may mislead policymakers by suggesting that some federal credit programs provide financial resources to the government at no cost to taxpayers. It also encourages reliance on credit rather than other policies that might be more efficient in achieving particular goals.[232]

3. TARP, Credit Reform, and Asset Valuation

Substantive legislation often fails to include details on how to reflect programmatic expenses and revenues in the budget. Congress was explicit in EESA, however, when it required that "the costs of purchases of troubled assets . . . and guarantees of troubled assets . . . , and any cash flows associated with [various authorized TARP activities] shall be determined as provided under the Federal Credit Reform Act of 1990."[233] In other words, budget accounting for TARP programs must be done on an accrual rather than a cash-flow basis. More specifically, Congress responded to FCRA critics by explicitly requiring that discount rate calculations used to determine net present value for EESA purposes be adjusted for market risk.[234] In other words, Congress instructed the Treasury Department not to use Treasury rates, but instead to use a "new and improved" FCRA accounting method with respect to TARP activities.[235] Assuming that the risk-based discount rates utilized are

231. Deborah Lucas & Marvin Phaup, *Reforming Credit Reform,* 28 PUB. BUDGETING & FIN. 90, 91 (2008).

232. CONG. BUDGET OFFICE, ESTIMATING THE VALUE OF SUBSIDIES FOR FEDERAL LOANS AND LOAN GUARANTEES 2–3 (2004).

233. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 123(a), 122 Stat. 3765, 3790 (to be codified at 12 U.S.C. §§ 5201–5261).

234. *Id.* § 123(b)(1) ("[T]he cost of troubled assets and guarantees of troubled assets shall be calculated by adjusting the discount rate in . . . 2 U.S.C. § 661a(5)(E) for market risks.").

235. The Bush administration initially took the position that EESA's statutory reference to the Credit Reform Act applied only to direct loans and loan guarantees and thus budgeted for other types of TARP disbursements using the cash method. The CBO, in contrast, computed net present value costs for all TARP activities. CONG. BUDGET OFFICE, THE TROUBLED ASSET RELIEF PROGRAM: REPORT ON TRANSACTIONS THROUGH DECEMBER 31, 2008, at 4 (2009) (contrasting OMB and CBO

reasonably accurate, the new and improved TARP accrual reporting should provide a more accurate picture of long-term budgetary costs.

Despite EESA's statutory emphasis on acquiring troubled assets, the Treasury Department quickly "abandoned its original strategy of purchasing 'troubled' mortgage and other assets from the nation's financial institutions, deciding instead to invest money directly into those institutions."[236] In most cases, the government transferred cash to struggling financial institutions in exchange for equity interests—in the form of preferred stock and warrants—that were specifically tailored for the TARP program and for which there was no public market. Thus, TARP's net-present-value approach to valuing assets is relevant not just for budget purposes. Before considering budget reporting issues, the Treasury Department needed to use net-present-value judgments to determine the appropriate price to pay for various equity interests.

One of the largest TARP programs was the Capital Purchase Program (CPP), through which the Treasury Department purchased senior preferred equity and subordinated debentures.[237] According to the Treasury Department, this program was designed to "directly infuse capital into healthy, viable banks with the goal of increasing the flow of financing available to small businesses and consumers."[238] In addition to programs designed to ensure the stability of otherwise healthy financial institutions in a down economy, the Treasury Department created similar programs to invest in struggling businesses. Through the Systemically Significant Failing Institutions program, for example, the government purchased ten percent of senior preferred AIG stock in order to provide needed capital to the ailing insurance giant.[239]

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accounting). The Obama administration has since adopted CBO's net-present-value accounting for all TARP activities.

236. CONG. OVERSIGHT PANEL, FEBRUARY OVERSIGHT REPORT: VALUING TREASURY'S ACQUISITIONS 4 (2009).

237. OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, AGENCY FINANCIAL REPORT: FISCAL YEAR 2009, at 14–15 (2009).

238. Press Release, U.S. Dep't of the Treasury, Treasury Provides Funding to Bolster Healthy, Local Banks: Capital Purchase Program Funds 23 Banks to Help Meet Lending Needs of Local Consumers, Businesses (Jan. 27, 2009), *available at* http://www.ustreas.gov/press/releases/tg03.htm. At about the same time, the Treasury Department also created the Targeted Investor Program (TIP), designed to provide funding to large financial institutions thought to be systemically important to financial system functioning. Press Release, U.S. Dep't of the Treasury, Treasury Releases Guidelines for Targeted Investment Program (Jan. 2, 2009), *available at* http://www.ustreas.gov/press/releases/hp1338.htm. This program apparently was focused on Citigroup. *See id.*

239. U.S. DEP'T OF THE TREASURY, TARP AIG SSFI INVESTMENT SENIOR PREFERRED STOCK AND WARRANT: SUMMARY OF SENIOR PREFERRED TERMS (2008), *available at* http://www.ustreas.gov/press/releases/reports/111008aigtermsheet.pdf (last visited May 15, 2010). *See also supra* note 32 and accompanying text.

As mandated by EESA, the Treasury Department is required to use risk-based net-present-value accounting for valuing these purchases. But conceptualizing risk-based net-present-value discounting is far easier than implementing it. Ideally, each investment should be carefully analyzed on a case-by-case basis, taking into account specific details about default and other risks with respect the particular investment. The congressional oversight panel established to conduct monthly reviews of Treasury Department activity under the TARP program recently reported that the "Treasury paid substantially more for the assets it purchased under the TARP than their then-current market value." Instead of a case-by-case analysis, the Treasury Department adopted a "one-size-fits-all investment policy,"[240] making equity investments on similar terms in both so-called "healthy" and "weaker institutions."[241] One particular concern with a "one-size-fits-all" approach is that it creates differential subsidy rates. In one report, for example, CBO estimated a seventy-three percent subsidy for auto-related government assistance, but only a two percent subsidy for bailout transactions with certain financial institutions.[242] In addition, by some estimates, the cost of assistance to AIG per dollar committed was double the cost of similar support to Citigroup.[243] The Treasury Department might defend itself, in part, by arguing that the government ultimately profited from many of its TARP investments. Under these circumstances, however, one might question how much *more* profit the government would have earned if it had not overpaid for many of these investments. This question is all the more apt when the country is facing such extraordinary federal deficits. Differential subsidy rates are not necessarily wrong as a policy matter. The problem with the current approach is that subsidy differences do not appear to be the result of measured policy judgments, but instead an almost accidental outcome of different accounting methodologies used for different government programs and a one-size-fits-all approach to valuation for very different transactions within the same programs.

Congress must refine its budget accounting by using market-risk analysis to more systematically compute net present value. To do this, Congress could establish an independent valuation entity with expertise in

240. CONG. OVERSIGHT PANEL, FEBRUARY OVERSIGHT REPORT: VALUING TREASURY'S ACQUISITIONS 2 (2009).

241. *Id.* at 8.

242. CONG. BUDGET OFFICE, THE TROUBLED ASSET RELIEF PROGRAM: REPORT ON TRANSACTIONS THROUGH JUNE 17, 2009, at 3–4 (2009).

243. ELLIOTT, *supra* note 21, at 4 (referring to CBO report).

market-based risk assessment. To make informed decisions about the most efficient allocation of bailout resources, Congress must be able to compare the extent to which different government interventions involve different "subsidy rates."

Another significant problem may simply be that some valuations are just fuzzier or more uncertain than others. Congress must give up the "illusion of precision"[244] and instead work within confidence ranges, or at least indicate some measure of the degree of certainty behind particular valuations. Alternatively, budget accounts might isolate the more uncertain figures into a separate set of accounts.

4. Mission Fragmentation

Many of the government's 2008–2009 interventions were "combination bailouts,"[245] or joint efforts involving the cooperation of multiple agencies in the same program.[246] When so many different agencies are simultaneously engaged in similar types of bailout-like interventions, fragmentation can make it difficult to absorb even information that *is* reflected in the budget. For one thing, the information for each agency appears in separate agency accounts and may be difficult to consolidate.[247] Second, agencies use different methods of accounting, making it difficult to compare and assess the efficiency of one program over another.[248] Non-TARP credit programs governed by FCRA use accrual-method accounting, but are not required to use market-risk-based discount rates. On the other hand, TARP-based Treasury Department programs are directed to use the new and improved market-risk-based discount rates.[249] This can lead to odd results given that a significant portion of the Treasury Department's bailout intervention was not under the TARP umbrella. Similar bailout-type programs, even within the same agency, may reflect different methods of accounting. For example, when

244. Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 613 (1995).

245. *See supra* notes 81–84 and accompanying text.

246. *See supra* notes 83–84, 128–29 and accompanying text.

247. Mission fragmentation is certainly not limited to bailout programs. Then comptroller general David Walker testified about "widespread mission fragmentation and program overlap throughout major mission areas at the federal level. . . . Even more broadly, many missions are characterized by the presence of multiple tools, such as tax expenditures, grants, loans, and direct federal spending programs." *The Office of Management and Budget: Is OMB Fulfilling Its Mission?: Hearing Before the Subcomm. on Gov't Mgmt., Info. and Tech. of the H. Comm. on Gov't Reform,* 106th Cong. 75 (2000) (prepared statement of David M. Walker, U.S. Comptroller Gen.).

248. *See supra* notes 223–28 and accompanying text.

249. *See supra* notes 233–43 and accompanying text.

asked to report on a proposed $34 billion bridge loan to the auto industry, CBO estimated only a fifty percent subsidy rate for a non-TARP program, but a seventy percent subsidy rate for the *same* loan under TARP because the latter "program's accounting requires an adjustment to reflect market risk."[250]

The extent to which government bailout interventions can be fragmented is further illustrated by actions taken by the FDIC during the 2008–2009 economic crisis. Unlike Fannie Mae and Freddie Mac, the FDIC is a government-owned independent agency, established by the Banking Act of 1933 to insure bank deposits.[251] Hence, the FDIC is an "on-budget" agency. Like the Federal Reserve,[252] the FDIC has authority—albeit infrequently used—to take certain emergency actions to avoid or mitigate systemic risk.[253] Just weeks after Congress passed its substantial EESA bailout package, the FDIC announced its own Temporary Liquidity Guarantee Program, under which it would guarantee senior unsecured debt instruments.[254] According to presidential budget documents, this was the first time that the FDIC guaranteed bank and bank holding company debt.[255] Since the authority for these FDIC actions did not come from the TARP legislation, the FDIC is not statutorily bound to use risk-based accrual accounting. In fact, the FDIC is not governed at all by the accrual-reporting FRCA requirements.[256] As reported by the TARP Oversight Committee, "[o]nly the cash flows associated with the FDIC guarantees are reflected in the federal budget, not the discounted present value of those flows. This means that no 'cost' is recorded for the FDIC

250. Letter from Robert A. Sunshine, Acting Dir., Cong. Budget Office, to John M. Spratt, Chair, Comm. on the Budget, U.S. House of Representatives (Dec. 5, 2008).

251. Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified at 12 U.S.C. § 1811 (2006)).

252. *See supra* notes 111–14 and accompanying text.

253. 12 U.S.C. § 1823(c)(4)(G) (2006).

254. Temporary Liquidity Guarantee Program, 12 C.F.R. § 370 (2008); *see also* DARRYL E. GETTER & OSCAR R. GONZALES, CONG. RESEARCH SERV., R40413, THE FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): EFFORTS TO SUPPORT FINANCIAL AND HOUSING MARKETS 4–5 (2009); FED. DEPOSIT INS. CORP., 2008 ANNUAL REPORT 25–26 (2009).

255. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 28 (2010). The FDIC also participated with the Treasury Department and Federal Reserve in providing assistance to Citigroup and Bank of America. *See* CONG. OVERSIGHT PANEL, NOVEMBER 2009 OVERSIGHT REPORT: GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS 16–20 (2009); *see also* DARRYL E. GETTER & OSCAR R. GONZALES, CONG. RESEARCH SERV., R40413, THE FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): EFFORTS TO SUPPORT FINANCIAL AND HOUSING MARKETS 6 (2009) (describing joint Public-Private Investment Fund (PPIF) with the U.S. Treasury and the Federal Reserve).

256. 2 U.S.C. § 661(e)(a) (2006); *see also supra* notes 224–25 and accompanying text.

guarantees . . . unless there is an actual default and payment of a guarantee . . . ."[257]

In sum, Federal Reserve actions do not appear at all in the budget, TARP transactions may use different types of accrual-accounting methodologies, and the FDIC uses cash-method budget accounting.[258] These inconsistencies are especially troubling when different agencies are cooperating in joint administration of the same bailout program.

Congress should consolidate the authority and budget reporting requirements for bailout-like interventions and, to the extent possible, make all such intervention "on-budget." Adding to the fragmentation problem, many bailout-type programs are delivered through the tax system in the form of special exclusions, deductions, or credits.[259] The costs incurred as a result of revenue lost from these provisions are not included in the regular budget.[260] As one Government Accounting Office report observed, "mission fragmentation and program overlap can create an environment in which programs do not serve participants as efficiently and effectively as possible. Like spending programs, tax expenditures may reduce government effectiveness to the extent that they duplicate or interfere with other federal programs."[261] The sections that follow consider the potentially hidden costs of various tax-related and other more "covert" bailout-type government activities.

V. ESTIMATING THE COSTS OF COVERT OR HIDDEN BAILOUTS

A. Relief Through Tax Expenditures

1. In General

In times of economic stress, government assistance can be provided through indirect payments in the form of temporary tax exclusions, deferrals, deductions, or credits, sometimes referred to as "tax

257. CONG. OVERSIGHT PANEL, NOVEMBER 2009 OVERSIGHT REPORT: GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS 11 (2009).

258. As the TARP oversight panel observes, "[f]rom a consolidated, government-wide perspective, the federal budget treats the guarantee transactions of the three agencies in three different ways." CONG. OVERSIGHT PANEL, NOVEMBER 2009 OVERSIGHT REPORT: GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS 11 (2009).

259. *See infra* notes 266–82 and accompanying text.

260. *See infra* notes 264–65 and accompanying text.

261. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-690, GOVERNMENT PERFORMANCE AND ACCOUNTABILITY: TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED 51 (2005).

expenditures."[262] In addition to direct spending legislation, Congress often turns to this tax-expenditure toolbox to provide bailout-type relief. Any reduction in tax liability to the struggling business is revenue foregone to the federal fisc and thus a cost imposed upon general taxpayers. It is well accepted that special tax deductions, credits, exclusions, and deferrals that reduce government receipts generate real budget costs that can be measured in estimated foregone revenue.[263] Since 1974, federal budget rules have required that the president's budget and the congressional budget resolution include such estimates of revenue foregone as a result of tax expenditures.[264] Accordingly, some tax expenditure data is available. Still, this information is not otherwise incorporated into the federal budget.[265] A true measure of aggregate costs demands better budgetary incorporation of bailout-type costs incurred through tax expenditures. The sections that follow offer illustrations of substantial government bailout-type intervention through tax expenditures that are not reflected in the regular budget.

2. Net Operating Loss (NOL) Carryovers: Internal Revenue Code § 172

One tax-expenditure approach to providing bailout-type relief is to extend business taxpayers' ability to deduct losses for federal income tax purposes beyond what would otherwise be permitted. In general, business taxpayers are entitled to deduct all of their ordinary and necessary business

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262. The concept of a "tax expenditure budget" is generally first attributed to Professor Stanley Surrey. STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES 1–14 (1973); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 1–6 (1985). For additional sources on tax expenditures in general, see Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155 (1988). For a more recent and excellent account of the tax expenditure budget and the relationship between taxing and spending programs, see David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending* Programs, 113 YALE L.J. 955 (2004).

263. *See* sources cited *supra* note 262.

264. Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3, 88 Stat. 297, 299 (codified in part at 2 U.S.C. § 632(e)(2)(E) (2006)) (defining "tax expenditure" as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability"). The Joint Committee on Taxation regularly publishes estimates on tax expenditure costs. *See, e.g.*, STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2006–2010 (Comm. Print 2006). The President's annual budget also includes tax expenditure estimates. *See* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT FISCAL YEAR 2011, at 207–23 (2010).

265. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-690, GOVERNMENT PERFORMANCE AND ACCOUNTABILITY: TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED (2005).

expenses from their gross receipts.[266] For businesses suffering a net loss, however, the government does not issue refunds. The tax return of a "loss business" simply reports an overall net loss and does not reflect any tax liability. In other words, a business with a net loss cannot "use" its loss for beneficial tax purposes in the taxable year in which the loss was incurred. Absent special rules permitting taxpayers to carry such a loss back to offset income from a prior year's tax return or forward to offset income on a future year's return, taxpayers would be denied the opportunity to ever deduct losses resulting from their "net loss" years.[267] Fortunately for taxpayers, Congress has adopted special NOL carryover rules, which generally authorize taxpayers to carry net operating losses back to two preceding taxable years and forward to twenty subsequent years.[268]

Imagine, for example, a business that paid federal income tax in prior profitable years, but now faces substantial economic losses. Carrying current losses back to prior profitable years will result in tax refunds for those earlier years, thus providing the struggling business with much-needed cash. By expanding the number of prior years to which taxpayers can carry back losses, Congress can put more cash in eligible taxpayers' hands, thus providing bailout-type relief. This is precisely what Congress did with the American Recovery and Reinvestment Act of 2009, when it permitted small business taxpayers to carry back their 2008 net operating losses for up to five, rather than two, years.[269] Congress later extended the temporary five-year loss carryback to cover both 2008 and 2009 net operating losses and expanded it to cover taxpayers generally, rather than limiting it to small businesses.[270] As one tax watchdog group noted, although the legislation was billed overall as a "stimulus" package, the NOL provision simply made it "easier for corporations to use tax losses to

266. 26 U.S.C. § 162 (2006) (permitting deductions for ordinary and necessary business expenses).

267. In *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359 (1931), the Supreme Court reaffirmed the federal tax regime's strict adherence to a rigid annual accounting system, rejecting the taxpayer's argument that disallowing the loss deduction resulted in an unconstitutional tax on receipts that were not "income" as defined in the Sixteenth Amendment. Congress responded by statutorily overruling the result in *Sanford & Brooks* with special net operating loss provisions. Internal Revenue Code of 1954, Pub. L. No. 83-591, 68A Stat. 3 (codified at 26 U.S.C. § 172) (2006)).

268. 26 U.S.C. § 172(b) (2006). A "net operating loss" is defined as "the excess of the deductions allowed . . . over gross income." 26 U.S.C. § 172(c) (2006).

269. Pub. L. No. 111-5, § 1211, 123 Stat. 115, 335 (to be codified at 26 U.S.C. § 172(b)(1)(H)). Congress had previously enacted a permanent rule permitting a five-year net operating loss carryback for "qualified disaster losses." Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 708, 122 Stat. 3765, 3924–25 (to be codified at 26 U.S.C. § 172(b)(1)(J), (j)).

270. Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, § 13, 123 Stat. 2984, 2992 (to be codified as amended at 26 U.S.C. § 172(b)(1)(H)).

get a refund of taxes paid in prior years (i.e., to get a check from the IRS) while doing nothing to change companies' incentives to invest or create jobs."[271] The NOL extension provision was more bailout than stimulus. The inclusion of a special provision disallowing the expanded five-year carryback to those otherwise receiving TARP assistance confirms the bailout focus of this legislation.[272]

3. Loss Limitations Following Corporate Ownership Changes: Internal Revenue Code § 382

Tax expenditure bailout-type relief also includes relaxation of loss limitation rules that would otherwise apply following a corporate acquisition. Those seeking investment opportunities sometimes counterintuitively target struggling, rather than healthy, businesses for acquisition. A struggling corporation's NOLs can be attractive to a potential buyer if those NOLs can be used to offset the acquiring corporation's income from other sources. Similarly, a troubled corporation's "built-in" losses from decline in the value of its assets can be attractive to a purchaser if those built-in losses can later be used to offset gains from other sources. Congress responded to this type of "loss trafficking" with complex loss limitation rules in § 382 that apply following certain ownership changes.

The general issue addressed by § 382 is the extent to which a corporation's existing losses may continue to offset income following a significant ownership change. Most often, the primary concern of § 382 is the extent to which an acquiring business may use losses or other tax attributes of the acquired "loss company."[273] Prohibiting any future use of such losses might deprive the acquired company, under new ownership, of losses to which it would have been entitled had it not been acquired. On the other hand, unrestricted future use of such losses would encourage "loss trafficking." Congress responded with a compromise that uses a

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271. CITIZENS FOR TAX JUSTICE, THE SIX WORST TAX CUTS IN THE SENATE STIMULUS BILL 4 (2009), *available at* http://www.ctj.org/pdf/sixworsttaxcuts.pdf. Another bailout-like provision in the so-called stimulus legislation was a temporary rule allowing taxpayers to elect to spread the reporting of discharge of indebtedness income over a five-year period. Pub. L. No. 111-5, § 1231, 123 Stat. 115, 338 (to be codified at 26 U.S.C. § 108(i)).

272. Worker, Homeownership, and Business Assistance Act of 2009 § 13(f).

273. The § 382 loss restrictions are not limited to major corporate acquisitions, however. They are triggered by any "ownership change," defined to include any increase by more than fifty percentage points of any five-percent shareholder, within a specified testing period. 26 U.S.C. § 382(g) (2006).

mathematical formula to impose limits on the use of a "loss corporation's" NOLs and other built-in losses following a major ownership change.[274]

Given the potential future value of a troubled corporation's NOLs and built-in losses, it is not surprising that "loss corporations"—along with their potential investors—are intensely interested in the extent to which the NOLs and built-in losses survive an acquisition or a restructuring in bankruptcy. Absent special statutory relief, one particular concern through the 2009 economic turmoil surrounding General Motors, for example, was that the Treasury Department's ultimate sale of GM stock received in the bankruptcy restructuring would constitute an "ownership change," thus triggering § 382 NOL loss limitation rules.[275] Congress responded by adding a new subparagraph to § 382, providing that its loss limitation rules do not apply to an ownership change "pursuant to a restructuring plan" that was "required under a loan agreement or a commitment for a line of credit entered into with the Department of Treasury" under EESA.[276] The provision's narrow terms made it clear that it had been specifically drafted to provide additional bailout-type relief for General Motors.[277] The Joint Committee on Taxation (JCT) estimated that the revenue foregone from this tax expenditure over the period from 2009–2019 would be approximately $3.2 billion.[278]

4. Reporting Ordinary Losses From Fannie Mae and Freddie Mac Stock Sales

Corporate taxpayers ordinarily may deduct capital losses only to offset capital gains;[279] a corporation with no capital gains cannot deduct capital

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274. 26 U.S.C. § 382 (2006).

275. In a critical determination for General Motors as it emerged from bankruptcy, the Bankruptcy Court found that its "net operating loss carryforwards ('NOLs') and certain other tax attributes . . . [were] property . . . protected by . . . the Bankruptcy Code." *Final Order Pursuant to 11 U.S.C. sections 105(a) and 362 Establishing Notification Procedures and Approving Restrictions on Certain Transfers of Interests in the Debtors' Estates*, *In re* General Motors Corp., No. 09-50026 (Bankr. S.D.N.Y. June 25, 2009), *available at* 2009 TAX NOTES TODAY 131–19.

276. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1262, 123 Stat. 115, 225, 343–44. Using its interpretive authority, the Treasury Department issued similar announcements regarding the use of NOLs and built-in losses in other transactional contexts. *See infra* notes 306–23 and accompanying text.

277. *See, e.g.*, David M. Herszenhorn, *Even After the Deal, Tinkering Goes On*, N.Y. TIMES, Feb. 13, 2009, at A20 (reporting the new provision as a "tax break specifically intended for the failing auto giant General Motors").

278. JOINT COMM. ON TAXATION, JCX-18-09, ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN THE "AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009" (Feb. 12, 2009).

279. 26 U.S.C. § 1211(a) (2006). Stock held for investment generally is considered a capital asset.

losses from its ordinary income. As a consequence, corporate taxpayers may find themselves with "unused capital losses," much in the same way that they may have unused NOLs.[280] In addition to relaxing NOL deduction restrictions, Congress has provided bailout-type assistance through exceptions to otherwise applicable limitations on capital-loss deductions. During the 2008–2009 economic crisis, for example, many financial institutions held Fannie Mae and Freddie Mac preferred stock that had substantially decreased in value. Absent a special rule, they would not have been able to deduct capital losses resulting from the sale of this stock to offset ordinary income. Congress stepped in with a temporary tax break, permitting financial institutions selling certain Fannie Mae and Freddie Mac preferred stock within a specified time frame to treat those sales as generating ordinary loss.[281] The revenue foregone for 2008–2012 as a result of this specially-targeted tax break was estimated by the JCT at approximately $3.4 billion.[282]

5. Budgetary Concerns

Given that tax expenditure information is available but not otherwise incorporated into the federal budget, tax expenditures are, in general, more hidden than other budgetary costs. This, in itself, is troublesome. Along these lines, the Government Accountability Office has recommended more broadly that tax expenditures be presented "in the budget together with related outlay programs to show a truer picture of the federal support within a mission area."[283]

Of special concern in the bailout setting is that most of the tax expenditures discussed in the preceding sections are targeted provisions, designed to assist a particular business or industry in economic distress. Although always important, transparency and accounting accuracy should be especially emphasized when individual businesses or select industries

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See 26 U.S.C. § 1221(a) (2006).

280. *See supra* notes 266–68 and accompanying text. As with NOLs, Congress has provided limited rules for capital loss carrybacks and carryforwards. 26 U.S.C. § 1212 (2006).

281. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 301(a), 122 Stat. 3765, 3802 (to be codified at 12 U.S.C. §§ 5201–5261 (2006)); *see also id.* § 301(b)(2) (defining eligible preferred stock to include Fannie Mae and Freddie Mac stock held by a qualified financial institution on September 6, 2008, or sold or exchanged on or after January 1, 2008, and before September 7, 2008).

282. STAFF OF THE J. COMM. ON TAXATION, 110TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2008–2012 (Comm. Print 2008).

283. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-690, GOVERNMENT PERFORMANCE AND ACCOUNTABILITY: TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED 73 (2005).

receive targeted assistance. Moreover, the addition of tax expenditure bailout-type relief to the already-fragmented assortment of other direct spending bailout programs makes it even more difficult for Congress or the Treasury Department to realize how much is spent on related efforts. Before providing additional assistance, those with power over the various purses should have information on aggregate government resources already devoted through tax expenditures and other devices. Absent such information, different units of government effectively issue checks on different accounts without the ability to balance the overall checkbook or see the total picture.

B. Relief Through Tax Administration and Regulations

1. Bailout Through Relaxed Agency Interpretation of Tax Provisions

Government bailout-type assistance can also be provided through regulatory or interpretive actions of administrative agencies. This more covert type of bailout raises dual concerns. First, the existence of such government intervention is less visible to the public. Second, the costs of such intervention can be difficult to measure and will not be reflected in budgetary and agency financial documents. Unlike legislatively enacted tax expenditures, for which there is at least some budgetary information, nothing in the budget captures the costs of such administrative action.

The Treasury Department is probably the agency most able to provide economic assistance to struggling businesses through administrative action.[284] When statutory language lends itself to alternate meanings, most probably assume that the IRS will choose the approach that generates the greatest tax revenue. This is not always so. By relaxing its interpretation or application of tax rules in the taxpayer's favor, the Treasury Department can—and often does—reduce tax liability for certain taxpayers, thus offering bailout-type relief. Particularly during the latter part of 2008 through 2009, an empathetic IRS issued a number of pronouncements that significantly reduced tax liability for a number of taxpayers.[285] By many accounts, the IRS, in some cases, went beyond simply choosing between

284. The Chief Counsel's office within the IRS generally issues regulatory and other interpretative guidance, along with the Treasury Department Office of Tax Policy. *See* INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL §§ 32.1.1.1, 32.1.1.3.1 [hereinafter IRS MANUAL]. For purposes of discussing agency interpretations of the Internal Revenue Code, this Article uses the terms IRS and Treasury Department interchangeably.

285. For a detailed discussion of bailout-type Treasury Department interpretations of loss rules, see *infra* notes 306–23 and accompanying text.

plausible, alternative meanings of statutory text and instead made pronouncements that were inconsistent with the statute and contrary to congressional intent.[286] Whether or not the IRS, in fact, exceeded its authority, these recent events provide an important reminder of the ways in which administrative action can provide bailout-type assistance. The sections that follow first provide some background on procedural rules applicable to the Treasury Department's exercise of its interpretative authority before turning to discussion of specific Treasury Department bailout-like actions during the 2008–2009 economic crisis.

2. IRS Interpretive Authority and the Administrative Procedure Act

Congress has delegated authority to execute and enforce the Internal Revenue Code to the Treasury Department,[287] which exercises this authority through different types of IRS pronouncements, including formal regulations, revenue rulings, revenue procedures, and notices.[288] For purposes of promulgating rules, the IRS is generally subject to the same procedural requirements applicable to all executive agencies under the Administrative Procedure Act (APA).[289] Among other mandates, the APA generally requires agencies to issue notices of proposed rulemaking and provide an opportunity for public comment, a process often referred to as "informal rulemaking."[290] In addition to the statutory APA requirements, agencies are required by presidential executive order to carefully consider the costs and benefits of proposed rules or regulations.[291] A formal,

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286. *See, e.g.*, Lawrence Zelenak, *Can Obama's IRS Retroactively Revoke Massive Bank Giveaway?*, 122 TAX NOTES 889, 889 (2009) (describing one such notice as providing "no explanation of the legal basis for its exemption of banks from the strictures of section 382, and no such basis is apparent on the face of the statute, in the legislative history, in judicial interpretations, or in prior administrative interpretations").

287. 26 U.S.C. § 7805(a) (2006) (granting general Treasury Department authority to promulgate "all needful rules and regulations for the enforcement" of the Internal Revenue Code).

288. For a useful description of these different types of pronouncements, see Irving Salem et al., *ABA Section of Taxation: Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717, 728–32 (2004) [hereinafter *Task Force Report*]; *see also* MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE (rev. 2d ed. 2003).

289. Administrative Procedure Act, Pub. L. No. 79-404, 60 Stat. 237 (1946) (codified as amended at 5 U.S.C. §§ 552–596.

290. Formal rulemaking, which has become increasingly rare, applies only to agency action required by statute to be made "on the record after opportunity for an agency hearing." 5 U.S.C. §§ 553(c), 556, 557 (2006). For a general description of informal and formal rulemaking, see RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 7.2 (4th ed. 2002).

291. Such requirements were initially introduced by President Reagan, Exec. Order No. 12,291, 3 C.F.R. 127 (1981) (Reagan administration order on agency regulations). President Clinton subsequently revoked and replaced the Reagan administration order with Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993). The Clinton order, which is still in effect, reaffirmed most of the

documented cost-benefit assessment is required for any "significant regulatory action,"[292] including actions that may have "an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, [or] jobs . . . ."[293]

One major statutory exception to APA procedural requirements is provided for "interpretative rules," as opposed to "legislative rules."[294] Courts and commentators have struggled in the absence of a statutory definition of "interpretative rule" for purposes of this exception. Modern administrative law principles suggest that the most important distinguishing feature of legislative rules is that they are legally binding or have the force of law.[295] The IRS takes the position that most of its regulations are interpretative and not subject to formal APA rules.[296] Even though it is not required to do so, however, the IRS claims that it usually follows APA procedures with respect to regulations that it considers to be interpretative.[297] Many recent bailout-like Treasury Department actions were achieved not through regulations, rulings, or procedures, but instead through more informal notices.[298] According to the Internal Revenue Manual, "[a] notice is a public pronouncement that may contain guidance that involves substantive interpretations of the Internal Revenue Code . . . ."[299] Such a pronouncement may provide "final guidance" upon which

important features of the earlier executive rules. For a discussion of the evolution of these rules, see PIERCE, *supra* note 290, § 7.9 ("Executive Control of Rulemaking").

292. Exec. Order No. 12,866, 58 Fed. Reg. at 51,741.

293. *Id.* at 51,738. These administrative requirements apply to proposed "regulations" or "rules," broadly defined to mean "agency statement[s] of general applicability and future effect, *which the agency intends to have the force and effect of law*, that [are] designed to implement, interpret, or prescribe law or policy . . . ." *Id*. at 51,737 (emphasis added).

294. 5 U.S.C. § 553(b)(3)(A) (2006). Another exception applies "when the agency for good cause finds . . . that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." *Id.* § 553(b)(3)(B).

295. *See, e.g.*, PIERCE, *supra* note 290, § 6.3 (stating that "valid legislative rule has the same binding effect as a statute"); *see also id.* § 6.4; William Funk, *A Primer on Nonlegislative Rules,* 53 ADMIN. L. REV. 1321, 1324–25 (2001).

296. *Contra Task Force Report*, *supra* note 288, at 741 (arguing that all IRS regulations should be considered legislative); *see* Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack Of) Compliance With Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1794 (2007) (arguing that most IRS regulations are legislative). Based upon her empirical study of regulatory projects between 2003 and 2005, Professor Hickman concludes that the IRS frequently violates APA requirements. *Id.*

297. IRS MANUAL, *supra* note 284, § 32.1.5.4.7.5.1 ("Although most IRS/Treasury regulations are interpretative, and therefore not subject to [notice and comment] provisions of the APA, the IRS usually solicits public comment on all [Notices of Proposed Rulemaking].").

298. For detailed discussion, see *infra* notes 306–23 and accompanying text.

299. IRS MANUAL, *supra* note 284, § 32.2.2.3.3.

taxpayers may rely and which precludes IRS attorneys from making a contrary argument.[300] To my mind, these notices have the force of law and should be classified as "legislative," therefore subject to formal APA and additional executive order requirements.[301] In contrast to its "voluntary" use of notice and comment for regulatory projects, the IRS does not even purport to follow such procedures for revenue rulings, procedures, or notices. Congress should amend the APA to clarify that Treasury Department interpretations—which bind the IRS and upon which taxpayers may rely—require notice and comment, as well as cost-benefit analysis. This clarification rule should include an exception, however, for emergency circumstances requiring a rapid agency response.

3. Cost-Benefit Analysis and the IRS

Whether it takes the form of a regulation, revenue ruling, or notice, tax consequences resulting from particular events or transactions can differ dramatically depending upon the particular IRS interpretation of statutory language. Imperfect as they are, the tax expenditure budget rules applicable to legislative actions at least provide some mechanism for reflecting the federal budgetary impact of special tax breaks. Tax breaks that result from "taxpayer-friendly" IRS statutory interpretations may cost as much in foregone revenue as legislated tax expenditures; yet, these costs are not reflected anywhere in budgetary documents or agency financial statements. Moreover, the IRS generally does not offer any cost-benefit analysis as it promulgates regulations, rulings, notices, or other pronouncements.

To be sure, taxpayer-friendly interpretative rules are not necessarily always bad. Some Treasury Department determinations may well reflect good policy choices. At the same time, there are reasons for concern. At a minimum, administrative agencies should not be authorized to provide relief when their actions would be inconsistent with existing statutory rules. Administrative intervention clearly should not be used as a device to bypass Congress to implement changes that should be enacted through the legislative process. As a procedural matter, the IRS should be required to report the costs of revenue foregone when it implements a significant taxpayer-friendly change in statutory interpretation or regulatory implementation. In fact, to the extent practicable, the IRS should engage in a cost-benefit analysis of significant pronouncements, as envisioned by the

300. *See Task Force Report*, *supra* note 288, at 730–31.
301. *See supra* notes 294–95 and accompanying text.

executive orders that apply to administrative agencies generally. In some respects, requiring cost-benefit analysis may be less burdensome for the IRS than for other agencies, which often confront hard-to-value costs and benefits—the cost of illness or loss of human life or the benefits of cleaner air, for example.[302] In contrast, the financial costs and benefits the IRS would consider should be easier to monetize.[303]

Application of cost-benefit analysis in the context of bailout-type administrative agency intervention and, in particular, a focus on government costs might appear to be somewhat unusual. There is a tendency to consider regulatory cost-benefit analysis as focused on whether the benefits of burdensome regulation justify the costs imposed on private individuals or business. For example, a cost-benefit analysis of a rule proposing stricter pollutant emission limits would ask whether the health and other environmental benefits of the proposed rule sufficiently justify the costs imposed upon manufacturers and consumers.[304] But a full cost-benefit analysis should require examination of the costs and benefits to all, including the government.[305]

4. A Case Study of Hidden Bailout and the Need for Cost-Benefit Analysis

a. Relaxed IRS Loss Restriction Rule Interpretations

During the 2008–2009 economic turmoil, the IRS became active in "bailout-type administrative intervention" through a series of notices announcing the Treasury Department's relaxed position in applying § 382 loss limitation rules. These Treasury Department § 382 interpretations fall

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302. *See, e.g.*, Richard A. Posner, *The Rise and Fall of Administrative Law*, 72 CHI.-KENT L. REV. 953, 957 (1997) (discussing the adequacy of normative economics to measure nonmonetary costs, such as health).

303. For a similar argument for imposing stricter cost-benefit analysis requirements upon financial regulators, including the Securities and Exchange Commission, see Edward Sherwin, *The Cost-Benefit Analysis of Financial Regulation: Lessons from the SEC's Stalled Mutual Fund Reform Effort*, 12 STAN. J.L. BUS. & FIN. 1 (2006).

304. The tendency to think of cost-benefit analysis in light of the burdens imposed by heavy regulation is reflected in the OMB guidelines to agencies, which instruct that there should be a "presumption against certain types of regulat[ion]" which might be unintentionally harmful or impede market efficiency. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR A-4: REGULATORY ANALYSIS 6 (2003).

305. One study of government agency cost-benefit analysis found that agencies generally estimate the cost of regulations on producers, but often do not estimate costs to the federal or state governments. Robert W. Hahn & Patrick M. Dudley, *How Well Does the U.S. Government Do Cost-Benefit Analysis?* 10 (AEI-Brookings Joint Ctr. for Regulatory Studies, Working Paper No. 04-01, 2007).

into two categories. First, several pronouncements address ownership changes from transfers of stock and warrants acquired by the Treasury Department itself under various TARP programs. For example, the Treasury Department announced that a § 382 "ownership change" would not be triggered when a corporation that received a capital infusion from certain TARP programs in exchange for preferred stock or warrants repaid the government through a later redemption or repurchase of those shares or warrants.[306] Subsequent rulings expanded the exemption from § 382 to cover other TARP programs and to cover redemption or purchase of common stock and indebtedness.[307] In another notice, apparently issued with Citigroup in mind, the IRS announced that the Treasury Department's sale of stock earlier acquired under TARP would not trigger a § 382 "ownership change" even if the sale was to public shareholders.[308] The latter notice "attracted criticism as an additional subsidy to Citigroup and a loss to the taxpayers."[309] One tax expert remarked, "I've been doing taxes for almost 40 years, and I've never seen anything like this, where the IRS and Treasury acted unilaterally on so many fronts."[310]

Critical assessment of the Treasury Department's § 382 TARP interpretations is difficult. On the one hand, transfers covered by the IRS notices fit the literal statutory "change of ownership" definition. Yet, applying loss limitation rules to changes of *government* stock ownership pursuant to TARP is arguably inconsistent with the underlying congressional purpose—to prevent trafficking. Ultimate cost to the taxpayer is also difficult to measure. In the case of Citigroup, application of the § 382 loss limitation rules would have restricted the company's ability to deduct losses, which would have increased its tax liability, thus reducing its capital. As an equity investor, the U.S. government itself was concerned with potential declines in stock value. It is difficult to calculate whether any loss of value in the government's Citigroup stock resulting

306. I.R.S. Notice 2008-100, 2008-1 C.B. 1081 ("Application of Section 382 To Loss Corporations Whose Instruments Are Acquired By The Treasury Department Under The Capital Purchase Program Pursuant To The Emergency Economic Stabilization Act of 2008").

307. *See, e.g.*, I.R.S. Notice 2009-38, 2009-1 C.B. 901; I.R.S. Notice 2009-14, 2009-1 C.B. 516.

308. I.R.S. Notice 2010-2, 2010-2 I.R.B. 251; *see also* CONG. OVERSIGHT PANEL, JANUARY OVERSIGHT REPORT: EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS 16–22 (2010) (discussing § 382 tax issues and Treasury Department rulings under TARP).

309. CONG. OVERSIGHT PANEL, JANUARY OVERSIGHT REPORT: EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS 20 (2010). A Senate bill was even introduced to legislatively rescind the notice. S. 2916, 111th Cong. (2009).

310. Binyamin Appelbaum, *Tax Deal is Worth Billions to Citigroup; Deal Made to Recover Bailout Firms Exempted from Rule When U.S. Sells its Stake*, WASH. POST, Dec. 16, 2009, at A1 (quoting Robert Willens).

from § 382 restrictions would have exceeded the revenue foregone from the § 382 exemption. Still, exempting Citigroup and other TARP-participant stock sales from § 382 loss limitation rules might have been an attempt to protect the value of the government's investment.

Even though there may be reasonable policy justifications for the Treasury Department's actions, its declaration of § 382 exemptions by fiat is still troubling because it suggests differential access to the government for quick tax relief. Although the individual notices did not mention particular taxpayers by name, most were triggered at the behest—or, at least, in the interests—of individual large financial institutions. Smaller, less influential taxpayers may not have access to similar relief. In addition, as the TARP Oversight Panel observed, "the EESA notices, however sound in themselves, illustrate again the inherent conflict implicit in Treasury's administration of TARP. In this case the conflict is a three-way one, pitting Treasury's responsibilities as TARP administrator, regulator, and tax administrator against one another."[311] Most significant from the budgetary perspective, the notices announcing exemptions from § 382 loss limitation rules clearly involved cost to the government in revenue foregone. If such relief had been achieved through legislation, Congress would have had access to information from the JCT's estimates of revenue foregone. Instead, this indirect bailout was accomplished through agency action, without budgetary impact estimates, notice-and-comment procedures, or cost-benefit analysis.

A second, and more troubling, category of § 382 relief announced through Treasury Department notices did not involve TARP or other government assistance programs. Instead, the Treasury Department stepped in to facilitate private acquisition of certain troubled banks by making the acquisitions less expensive. Toward the end of 2008, merger-and-acquisition activity dramatically increased as apparently healthier institutions—with some government prodding—acquired banks and other financial entities faced with potential collapse. Not surprisingly, the § 382 loss limitation rules were of tremendous interest to potential acquirers. A bank acquisition surely is more attractive when the purchaser is assured that it can use the distressed bank's losses to offset future income.

Notice 2008-83 announced that the IRS would not consider a bank deduction for losses on loans or bad debts following an ownership change as a built-in loss for purposes of the § 382 restrictions.[312] In other words,

311. CONG. OVERSIGHT PANEL, JANUARY OVERSIGHT REPORT: EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS 22 (2010).

312. I.R.S. Notice 2008-83, § 2, 2008-42 I.R.B. 905.

an acquiring bank was permitted to deduct the built-in losses of the acquired bank. Taxpayers were advised that they could "rely on the treatment set forth in this notice, unless and until there is further guidance,"[313] language suggesting a "legislative" pronouncement, at least arguably subject to APA notice and cost-benefit analysis rules.[314] Responding to a Washington Post reporter, one Treasury Department spokesman described the notice as "part of our overall effort to provide relief" and conceded that the Department did not estimate the costs of the tax change.[315] Assuming that these comments accurately reflect IRS views, it seems clear that the Treasury Department was consciously and deliberately providing bailout-type relief through changes in its interpretation of the tax law—a "hidden" bailout.

At the time this notice was released, Congress was debating emergency bailout legislation, and Citigroup and Wells Fargo were competing to acquire control of Wachovia. Before the notice, it appeared that Wells Fargo's bid had failed and that Citigroup would acquire Wachovia.[316] According to observers, the tax savings from this dramatic change in IRS interpretation of the § 382 loss limitation rules enabled Wells Fargo, which had actively lobbied for the change, to make a new and successful bid.[317] Other banks subsequently took advantage of the ruling. Some estimated that the overall cost to taxpayers would be between $100 and $140 billion.[318]

The Institute of Foreign Bankers, hoping to take advantage of the relaxed loss limitation rule, quickly wrote to Treasury Secretary Paulson, urging expansion of the ruling to non-U.S.-headquartered financial institutions.[319] Angry members of the House Ways & Means Committee

313. *Id.* § 3. This Article focuses only on Notice 2008-83 by way of illustration. The IRS issued numerous other taxpayer-favorable notices during 2008. For a description of these other actions, see, for example, Amy S. Elliott, *Year in Review: Treasury Provides Certainty and Relief in Economic Crisis*, 122 TAX NOTES 47 (Jan. 5, 2009). *See also* Stephen Gandel, *New Tax Rules: The Hidden Corporate Bailout*, TIME, Dec. 10, 2008, http://www.time.com/time/printout/0,8816,1865315,00.html.

314. *See* discussion *supra* notes 294–97 and accompanying text.

315. Amit R. Paley, *A Quiet Windfall for U.S. Banks: With Attention on Bailout Debate, Treasury Made Change to Tax Policy*, WASH. POST, Nov. 10, 2008, at A1 (internal quotation marks omitted).

316. *See* Eric Dash & Ben White, *Wells Fargo Swoops In*, N.Y. TIMES, Oct. 4, 2008, at C1 (describing Wells Fargo's outbidding of Citigroup for Wachovia after a "little-noticed move . . . by the Internal Revenue Service, which restored tax breaks for banks that take big losses on bad loans inherited through acquisitions").

317. *See* Paley, *supra* note 315 (quoting the Jones Day law firm as saying that the ruling "could be worth about $25 billion for Wells Fargo").

318. *Id*. (estimates from corporate tax expert Robert Willens and the Jones Day law firm).

319. Letter from Lawrence R. Uhlick, Chief Exec. Officer, Inst. of Int'l Bankers, to Henry Paulson, Sec'y of the Treasury (Nov. 10, 2008), *reprinted in* 2008 TNT 224–25.

wrote to oppose such expansion of the IRS "backdoor bailout."[320] An even angrier Senator Chuck Grassley, Senate Finance Committee ranking minority member, requested that the Treasury Department Inspector General look into possible conflicts of interest.[321]

The saga of Notice 2008-83 continued, leading to a remarkable statutory rebuke of the Treasury Department in a provision labeled a "clarification," which was included in the stimulus package passed by Congress in early 2009:

> (a) FINDINGS.—Congress finds as follows:
>
> (1) The delegation of authority to the Secretary of the Treasury under section 382(m) of the Internal Revenue Code of 1986 does not authorize the Secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers.
>
> (2) Internal Revenue Service Notice 2008-83 is inconsistent with the congressional intent in enacting such section 382(m).
>
> (3) The legal authority to prescribe Internal Revenue Service Notice 2008-83 is doubtful.[322]

Congress clearly disagreed with the IRS interpretation in Notice 2008-83 and even questioned its legal authority. At the same time, Congress felt it necessary to protect reliance interests of taxpayers who completed or made binding bank acquisition contracts on the strength of the IRS notice. Thus, the legislative clarification provided that Notice 2008-83 would have the force and effect of law only for ownership changes that took place before January 16, 2009, and to ownership changes after this date that were pursuant to a written binding contract before then.[323] In other words, the rules included a "grandfather" clause, giving the benefit of the Treasury Department's favorable interpretation to existing contracts—the Wells Fargo transaction, in particular.

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320. Letter from Ways & Means Comm. Members to Henry Paulson, Secretary of the Treasury (Dec. 4, 2008), *reprinted in* 2008 TAX NOTES TODAY 235–19 (Dec. 5, 2008).

321. Letter from Chuck Grassley, U.S. Senator, to Eric M. Thorson, Inspector Gen., U.S. Dep't of the Treasury (Nov. 14, 2008), *reprinted in* 2008 TAX NOTES TODAY 222–73 (Nov. 17, 2008).

322. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1261(a), 123 Stat. 115, 342–43.

323. *Id.* § 1261(b).

b. Estimating the Costs and Lessons From Notice 2008-83

Although it is but one incident, the Notice 2008-83 hidden bailout saga offers important lessons for the future. First, it illustrates that the IRS engages in more "legislative"-type regulation than it publicly acknowledges. Whether through regulation, ruling, or notice, the IRS should comply with informal rulemaking requirements whenever it announces a significant change in interpretation of the tax code. Second, in the narrow context of bailouts, the story confirms that regulatory agencies engage in bailout-like activities through their administrative actions. Third, a specific targeted change in IRS interpretation of the tax code can actually decrease tax liabilities for the parties to particular economic transactions. Although the precise federal revenues to be gained or lost from a particular interpretive change may sometimes be difficult to estimate, a reasonable estimation of the cost or benefit will often be possible. Surely individual taxpayers who stood to benefit from Notice 2008-83's relaxation of § 382 loss limitations had some notion of the tax break's approximate value.[324] This value to the targeted beneficiaries, of course, is foregone revenue to the government. The revenue foregone as a result of Notice 2008-83 is an example of a very real government expense not reflected anywhere in agency financial statements or the federal budget.

Whether through statutory amendment or executive order, I believe that the Treasury Department should be required to comply with statutory APA requirements, including cost-benefit analysis. At a minimum, the IRS should be required to generate cost-benefit estimates of its major pronouncements and make them available to Congress and to the public. In emergency circumstances leaving little time for cost-benefit analysis, even after-the-fact estimates could, at least, increase transparency and enable Congress to make its policy decisions about future bailout efforts with more complete information.

Setting aside the question of whether Notice 2008-83 was within the IRS's authority, a full cost-benefit analysis would have enabled the Department to make a better-informed policy decision. Albeit unlikely, economic analysis might have revealed that relaxing § 382 loss limitation rules would produce revenue to the extent that failing firms were thereby rescued and strengthened. The best possible cost-benefit information should be available and shared among the various units of government that

324. *See* Paley, *supra* note 315.

are involved in bailout relief efforts. Only in this way can policymakers make informed choices regarding appropriate aggregate expenditure amounts and appropriate aggregate allocations to individual firm or industry recipients.

c. Notice 2008-83 and Budget Scoring

Problems with accurately measuring the budgetary impact of Notice 2008-83 were dramatically exacerbated by revenue estimates accompanying the American Recovery and Reinvestment Act's "clarification" provision, through which Congress effectively "revoked" the Treasury Department notice. The JCT is required to provide revenue estimates for proposed legislation—referred to as the legislation's score.[325] In this case, the JCT scored the clarification provision limiting the force and effect of Notice 2008-83 as *raising* revenue.[326] This is just bizarre. The congressional "clarification" provision simply declared that the IRS interpretation was wrong, thus reinstating the status quo. The initial cost of the IRS rule change was never taken into budgetary account. Yet, since Notice 2008-83 was never formally declared invalid, JCT revenue estimators started from the assumption that this Notice was the law.[327] In other words, estimators assumed, as a baseline, that acquiring companies could use preacquisition losses. To generate revenue estimates for the statutory clarification provision in the stimulus bill, estimators next worked from assumptions about economic growth and levels of anticipated future merger-and-acquisition activity and calculated how much additional revenue the IRS would receive if purchasing companies were not allowed to use the preacquisition losses of the acquired company.

Revenue estimating and scoring rules that treat the stimulus bill's "clarification" provision as raising revenue are problematic. Before scoring the reversal of a rule change as a revenue raiser, estimators should have taken into account the cost of the initial change. The stakes here are high: provisions that are scored as raising revenue can be used under various "pay-as-you-go" budget rules or other congressionally determined offset requirements to "pay for" other measures that increase spending or decrease revenue. This in turn increases the potential for budget

325. 2 U.S.C. § 601(f) (2006).

326. JOINT COMM. ON TAXATION, JCX-18-09, ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN THE "AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009" (2009).

327. Telephone Interview with Edward Kleinbard, Chief of Staff, Joint Comm. on Taxation (Mar. 6, 2009) (notes on file with author).

gimmicking. Mechanisms should be included in scoring procedures and rules to free estimators from some of the constraints imposed under the existing procedure's definition of what constitutes current law. Scoring rules in this instance should not have required estimators to assume that Notice 2008-83 was valid law for purposes of estimating the budgetary impact of its reversal. This is not to suggest, however, that estimators should have free reign with respect to defining baselines. To the extent that estimators are given discretion in defining baselines, checks would need to be in place to avoid any abuse of such discretion.

C. Other Hidden Bailout Costs

1. Nontax Regulatory Relief

Another form of covert or hidden bailout is to provide businesses with exemptions from their obligations to comply with otherwise burdensome and costly regulatory requirements. Automobile manufacturers, for instance, often complain that the cost of complying with increasingly stringent environmental regulation is a major contributing factor to their financial woes.[328] During the late 1980s, the Environmental Protection Agency (EPA), apparently responding to complaints of financial distress, granted General Motors and other automobile manufacturers a waiver from their obligation to comply with carbon monoxide emissions standards.[329] Based on financial distress within the industry, the steel industry similarly obtained a legislative exemption from Clean Air Act obligations.[330] As another example, in the aftermath of the devastating 2005 hurricane season on the Gulf Coast, the EPA announced temporary waivers from gasoline and diesel fuel standards,[331] and legislation was introduced that would have permitted more extensive waivers from

328. *See, e.g.*, *The Chrysler Corporation Financial Situation: Hearings Before the Subcomm. on Econ. Stabilization of the H. Comm. on Banking, Fin. and Urban Affairs*, 96th Cong. 86–87 (1979) (testimony of Lee Iacocca).

329. *E.P.A. Lifts Deadline on Pollution Limits,* N.Y. TIMES, Jan. 8, 1981, at D24 (reporting EPA grant of two-year delay to certain "financially troubled" automakers in implementing exhaust emission standards).

330. Steel Industry Compliance Extension Act of 1981, Pub. L. No. 97-23, 95 Stat. 139 (repealed 1990). The House Report explained that "[t]he Committee is proposing that the extension be limited solely to the steel industry since no other industry is experiencing such unique hardships." H.R. REP. NO. 97-121, at 9 (1981). For discussion of other relief from compliance obligation-type bailouts, see Block, *Bailouts*, *supra* note 22, at 970–72.

331. Pamela Najor, *Nationwide Waiver on Fuel Specification Granted by EPA Due to Hurricane*, [2005] 169 Daily Env't Rep. (BNA), at A-1 (Sept. 1, 2005) (reporting temporary EPA Clean Air Act waivers).

otherwise-applicable environmental regulations.[332] Although the stated rationale for these measures was to protect the fuel supply, government bailout-type assistance to a potentially economically threatened fuel industry also played an important part.

Not surprisingly, the budget does not include the costs of such compliance waivers or exemptions. It would be difficult to measure the net discounted present value of health costs imposed by a two-year delay in implementation of air pollution standards. Nevertheless, some effort should be made to include these costs.

2. Moral Hazard and Implicit Guarantees

Like it or not, extraordinary government interventions to rescue troubled financial institutions and other business entities have changed public expectations. Having set this precedent, Congress will find it more difficult to ignore pleas for future assistance. This notion of "implicit guarantee" is hardly new. Despite disclaimers and disclosures to the contrary, investors in GSEs, Fannie Mae and Freddie Mac historically persisted in their beliefs—since proven to be accurate—in an implicit federal government guarantee.[333] Although there is some disagreement over accounting methodology, reasonable estimates of GSE implicit guarantees are available, and such figures arguably should have been included in the federal budget.[334] TARP and other recent government interventions surely have expanded the scope of such implicit guarantees. As noted by the TARP Congressional Oversight Panel, TARP's legacy is "an implicit government guarantee, the limits of which are unknown and the reasons for which are not fully articulated**."**[335] And, despite all the congressional "too big to fail" and "no more taxpayer-funded bailout" clamor included in recent financial reform legislation, bailouts in the future are likely if circumstances become sufficiently severe.

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332. *See, e.g.*, S. 1711, 109th Cong. (2005).

333. For general discussion of the implicit GSE guarantee, see Carol J. Perry, Note, *Rethinking Fannie and Freddie's New Insolvency Regime,* 109 COLUM. L. REV. 1752, 1760–61 (2009); David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab,* 42 GA. L. REV. 1019 (2008). *See also* discussion *supra* notes 175–206 and accompanying text.

334. *See, e.g.*, Michael T. Gapen, *Evaluating the Implicit Guarantee to Fannie Mae and Freddie Mac Using Contingent Claims*, 10 INT'L FIN. REV. 329 (2009); Deborah Lucas & Robert McDonald, *Valuing Government Guarantees: Fannie and Freddie Revisited*, *in* MEASURING AND MANAGING FEDERAL FINANCIAL RISK 131 (Deborah Lucas ed., 2010); Wayne Passmore, *The GSE Implicit Subsidy and the Value of Government Ambiguity,* 33 REAL EST. ECON. 465 (2005).

335. CONG. OVERSIGHT PANEL, JANUARY OVERSIGHT REPORT: EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS 14 (2010).

At least with respect to the large financial entities that are "too big to fail" or those that present "substantial systemic risk," the government should assign values to contingent future bailout costs. Noting that the valuation process has become much more sophisticated over the last decade, one government guarantee expert argues that recognizing the cost now really is "the only way to prepare for a contingency like a meltdown of the financial system."[336]

VI. WALL STREET REFORM ACT—A POSTCRIPT

Congress passed the Wall Street Reform Act, which became law in July 2010,[337] in direct response to the economic crisis that reached its peak in 2008 and 2009. The heart of the Act's response to potential future economic crisis is an institutional framework contained in two of the Act's sixteen titles.[338] Title I, the Financial Stability Act of 2010,[339] creates a new Financial Stability Oversight Council,[340] charged with identifying financial stability risks, promoting market discipline by eliminating any expectation of government bailouts, and responding to emerging threats to stability of the financial system.[341] This title includes procedures for official Council or Federal Reserve Board determinations regarding threats to financial stability posed by nonbank financial companies or bank holding companies.[342] Once made, an official threat determination may trigger early regulatory intervention, application of more stringent regulatory standards than those otherwise applicable, or placement of a nonbank financial company under the supervision of the Federal Reserve.[343] Government actions envisioned under the Financial Stability Act in title I are focused on stepping in with enhanced regulatory oversight in order to prevent the potential threat to financial stability from triggering

336. *See* Gretchen Morgenson, *Future Bailouts of America*, N.Y. TIMES, Feb. 14, 2010, at B1 (quoting Marvin Phaup, George Washington University research scholar and former CBO researcher).

337. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1105, 124 Stat. 1376, 2121–25.

338. *Id.* tit. I (Financial Stability); tit. II (Orderly Liquidation Authority).

339. *Id.* § 101 (short title).

340. *Id.* § 111(a). Voting members of the Council include the Treasury Secretary, Federal Reserve Board Chair, Comptroller of the Currency, the heads of other banking and investment-related federal agencies, and an independent member with insurance expertise appointed by the president. *Id.* § 111(b).

341. *Id.* § 112(a). The Act establishes an Office of Financial Research at the Treasury Department, *id.* § 152(a), whose function is to provide research support for the Council, *id.* § 153(a).

342. *Id.* § 113 (Council "threat" determination procedures and considerations); *id.* § 121 (Federal Reserve Board "grave threat" determination procedures and considerations).

343. *Id.* §§ 114, 155, 166, 121.

an actual systemic crisis. Although it also establishes procedures for an official determination, which then triggers government intervention, the title II orderly liquidation procedure involves the government at a later stage—when the financial company is in default or danger of default and the failure of the company "would have serious adverse effects on financial stability . . . ."[344] There is no turning back after a title II "systemic risk determination"; the determination triggers appointment of the FDIC as receiver[345] and begins the orderly liquidation process. Thus, the Act does not give the government the option to stabilize a failing institution through loans or equity investments.

Lest there be any doubt about the future of taxpayer-funded bailouts, the statute repeatedly says: "no more."[346] In the event that the title II orderly liquidation fund is insufficient, the FDIC is authorized to charge assessments against nonbank financial companies supervised by the Federal Reserve and bank holding companies with total combined assets of $50 billion or more.[347] Although this assessment is not the ex ante "rainy day" fund that some might have preferred, it does impose the burden of paying for the orderly liquidation on a subset of taxpayers, rather than the general public.[348]

Although I believe that more could have been achieved, I applaud Congress for coming together to enact major financial reform legislation in a difficult, partisan environment. Hopefully the economic monitoring and orderly liquidation provisions in the Wall Street Reform Act will be effective in preventing or mitigating any future grave economic distress. I fear, though, that this is wishful thinking. Efforts to impose bailout costs on a particular subgroup—rather than the general public—may not be effective, either because that subgroup itself has insufficient assets or because the subgroup has the political lobbying power to fight the

344. *Id.* § 203(b)(2).

345. Once the systemic risk determination is made, the company will either consent to the appointment of the FDIC as receiver, or the Treasury Secretary will petition the district court for an order to place the company under FDIC receivership. *Id.* § 202(a)(1)(A).

346. *See, e.g.*, *supra* note 11 and accompanying text (Act preamble); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 § 112(a)(1)(B) (Council's purpose is to eliminate expectations that government will shield companies from loss in the event of failure); *id.* § 166 (authorizing regulations for early remediation of a Federal Reserve-supervised bank holding company, "except that nothing in this subsection authorizes the provision of financial assistance from the Federal Government"); *id.* § 204(a)(1)(orderly liquidation authority to be exercised so that "creditors and shareholders will bear the losses of the financial company"); *id.* § 214(c) ("Taxpayers shall bear no losses from the exercise of any authority under this title.").

347. *Id.* § 210(o)(1)(A), (B). *See also supra* notes 77–78 and accompanying text.

348. *See supra* notes 63–78 and accompanying text.

imposition of a special burden. Given what I see as the inevitability of at least some future general revenue bailouts—albeit very rare events—the "head-in-the-sand" approach taken by Congress is unfortunate. Pretending that there will never be another bailout simply leaves us less prepared when the next severe crisis hits. The challenge is to develop a procedure that leaves the government prepared, without creating any additional moral hazard.

VII. CONCLUSION

The federal government's ad hoc and fragmented approach has made it extremely difficult to get a clear picture of aggregate spending dedicated to bailout-type relief. To make informed decisions about allocation of government bailout resources, policymakers should work with a federal budget that includes complete information about the relative costs of overt government bailout-type programs. Such complete budget information would include financial information for all overt programs, whether implemented through "on-budget," "off-budget," or "off-off budget" entities. When rescue efforts include a long-term government ownership interest of particular companies, those companies should be incorporated into the budget. Also, to the extent possible, the accounting methodologies of different government agencies and programs should be harmonized so that Congress can make fair comparisons.

In addition to preparing more inclusive and methodologically consistent budgets, Congress needs to improve its valuation methodologies. Some government programs involve greater financial risk than others, and some involve different subsidy rates. A one-size-fits-all approach to valuing troubled assets and government equity investments does not sufficiently account for variations in risk and does not indicate variations in the proportionate government subsidy cost for different programs or different beneficiaries within the same program. For programs that present greater valuation challenges, some budget accounting mechanism should be incorporated to reduce the pretense of precision and to acknowledge that some numbers are "fuzzier" than others.

With regard to more covert bailouts, Congress must first acknowledge and identify the various ways in which the federal government provides hidden bailouts, such as legislatively enacted tax expenditures, taxpayer-friendly IRS interpretations, and other federal agency-provided regulatory relief. Once these more covert bailouts are identified, they too should be included in the federal budget. In addition to providing a truer measure of

bailout costs, this information will make the budget more transparent and expose potential inequities in the distribution of economic relief.