U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON THE BUDGET
House Budget Committee 110th Congress Majority
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House Budget Committee Hearing on Federal Responses to Market Turmoil: What is the Impact on the Budget?

The goal of today's hearing was to assess and weigh the budgetary costs of the Administration's proposal to purchase the troubled assets of faltering banks in order to stabilize the global financial system. Director Peter Orszag of the Congressional Budget Office offered his expert analysis. The Congress is currently engaging in an important discussion about the merits and shortcomings of the Administration's proposal and about ideas for improving that proposal. Following are highlights of Dr. Orszag's testimony. His complete testimony is available at http://budget.house.gov/ . The following are excerpts from his testimony.

On Recent Events and Federal Responses

"Since August 2007, the Federal Reserve and the Treasury have been attempting to address a series of severe breakdowns in financial markets that emanated from the bursting of the housing bubble, leading to substantial losses on mortgage-related securities and great difficulty in accurately ascertaining the financial condition of the institutions holding such securities. Those problems generated significant increases in risk spreads… but, more important, contributed to a broader collapse of confidence, with the result that financial institutions became increasingly unwilling to lend to one another."

On CBO's Scoring Challenges with the Treasury's Bailout Proposal

"At this time, given the lack of specificity regarding how the program would be implemented and even what asset classes would be purchased, CBO cannot provide a meaningful estimate of the ultimate net cost of the Administration's proposal. The Secretary would have the authority to purchase virtually any asset, at any price, and sell it at any future date; the lack of specificity regarding how that authority would be implemented makes it impossible at this point to provide a quantitative analysis of the net cost to the federal government."

"CBO expects that the Treasury would probably fully use its $700 billion authority in fiscal year 2009 to purchase various troubled assets. … [O]ver time, the net cash disbursements under the program would be substantially less than $700 billion, because, ultimately, the government would sell the acquired assets and thus generate income that would offset at least much of the initial cost."

"The federal cost of the proposal could be reflected in the budget either on a cash basis or on a net-expected-cost basis. The proposal would require that the federal budget display the costs of this new activity under the latter approach, using procedures similar to those contained in the Federal Credit Reform Act (but adjusting for market risk in a manner not reflected in that law).

In particular, the federal budget would not record the gross cash outlays associated with purchases of troubled assets but, instead, would reflect the estimated net cost to the government of such purchases (broadly speaking, the purchase cost minus the expected value of any estimated future earnings from holding those assets and the proceeds from the eventual sale of them)."

"In CBO's view, that budgetary treatment best reflects the impact of the purchases of financial assets on the federal government's underlying financial condition. The fundamental idea is that if the government buys a security at the going market price, it has exchanged cash for another asset rather than caused a deterioration in its underlying fiscal position."

On the Risks of Not Acting

"Such a curtailment of credit means that businesses and individuals will find it increasingly difficult to borrow money to carry out their normal activities. In sum, the problems occurring in financial markets raise the possibility of a severe credit crunch, which could have devastating effects on the U.S. and world economies."