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U.S. Pledges Top $7.7 Trillion to Ease Frozen Credit (Update2)

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By Mark Pittman and Bob Ivry

Nov. 24 (Bloomberg) -- The U.S. government is prepared to provide more than $7.76 trillion on behalf of American taxpayers after guaranteeing $306 billion of Citigroup Inc. debt yesterday. The pledges, amounting to half the value of everything produced in the nation last year, are intended to rescue the financial system after the credit markets seized up 15 months ago.

The unprecedented pledge of funds includes $3.18 trillion already tapped by financial institutions in the biggest response to an economic emergency since the New Deal of the 1930s, according to data compiled by Bloomberg. The commitment dwarfs the plan approved by lawmakers, the Treasury Department's $700 billion Troubled Asset Relief Program. Federal Reserve **lending** last week was 1,900 times the weekly average for the three years before the crisis.

When Congress approved the **TARP** on Oct. 3, Fed Chairman **Ben S. Bernanke** and Treasury Secretary **Henry Paulson** acknowledged the need for transparency and oversight. Now, as regulators commit far more money while refusing to disclose loan recipients or reveal the collateral they are taking in return, some Congress members are calling for the Fed to be reined in.

"Whether it's lending or spending, it's tax dollars that are going out the window and we end up holding collateral we don't know anything about," said Congressman **Scott Garrett**, a New Jersey Republican who serves on the House Financial Services Committee. "The time has come that we consider what sort of limitations we should be placing on the Fed so that authority returns to elected officials as opposed to appointed ones."

Too Big to Fail

Bloomberg News tabulated data from the Fed, Treasury and Federal Deposit Insurance Corp. and interviewed regulatory officials, economists and academic researchers to gauge the full extent of the government's rescue effort.

The bailout includes a Fed program to buy as much as $2.4 trillion in short-term notes, called commercial paper, that companies use to pay bills, begun Oct. 27, and $1.4 trillion from the FDIC to guarantee bank-to-bank loans, started Oct. 14.

William Poole, former president of the Federal Reserve Bank of St. Louis, said the two programs are unlikely to lose money. The bigger risk comes from rescuing companies perceived as "too big to fail," he said.

'Credit Risk'

The government committed $29 billion to help engineer the takeover in March of Bear Stearns Cos. by New York-based **JPMorgan Chase & Co.** and $122.8 billion in addition to TARP allocations to bail out New York-based American International Group Inc., once the world's largest insurer.

Citigroup received $306 billion of government guarantees for troubled mortgages and toxic assets. The Treasury Department also will inject $20 billion into the bank after its stock fell 60 percent last week.

"No question there is some credit risk there," Poole said.

Congressman **Darrell Issa**, a California Republican on the Oversight and Government Reform Committee, said risk is lurking in the programs that Poole thinks are safe.

"The thing that people don't understand is it's not how likely that the exposure becomes a reality, but what if it does?" Issa said. "There's no transparency to it so who's to say they're right?"

The worst financial crisis in two generations has erased $23 trillion, or 38 percent, of the **value** of the world's companies and brought down three of the biggest Wall Street firms.

Markets Down

The **Dow Jones Industrial Average** through Friday is down 38 percent since the beginning of the year and 43 percent from its peak on Oct. 9, 2007. The **S&P 500** fell 45 percent from the beginning of the year through Friday and 49 percent from its peak on Oct. 9, 2007. The **Nikkei 225 Index** has fallen 46 percent from the beginning of the year through Friday and 57 percent from its most recent peak of 18,261.98 on July 9, 2007. **Goldman Sachs Group Inc.** is down 78 percent, to $53.31, on Friday from its peak of $247.92 on Oct. 31, 2007, and 75 percent this year.

Regulators hope the rescue will contain the damage and keep banks providing the credit that is the lifeblood of the U.S. economy.

Most of the spending programs are run out of the New York Fed, whose president, **Timothy Geithner**, is said to be President- elect **Barack Obama**'s choice to be Treasury Secretary.

'They Got Snookered'

The money that's been pledged is equivalent to $24,000 for every man, woman and child in the country. It's **nine times** what the U.S. has spent so far on wars in Iraq and Afghanistan, according to **Congressional Budget Office** figures. It could pay off more than half the country's mortgages.

"It's unprecedented," said **Bob Eisenbeis**, chief monetary economist at Vineland, New Jersey-based Cumberland Advisors Inc. and an economist for the Atlanta Fed for 10 years until January. "The backlash has begun already. Congress is taking a lot of hits from their constituents because they got snookered on the TARP big time. There's a lot of supposedly smart people who look to be totally incompetent and it's all going to fall on the taxpayer."

President **Franklin D. Roosevelt**'s New Deal of the 1930s, when almost 10,000 banks failed and there was no mechanism to bolster them with cash, is the only rival to the government's current response. The savings and loan bailout of the 1990s cost $209.5 billion in inflation-adjusted numbers, of which $173 billion came from taxpayers, according to a July 1996 **report** by the U.S. General Accounting Office, now called the Government Accountability Office.

'Worst Crisis'

The 1979 U.S. government bailout of Chrysler consisted of bond guarantees, adjusted for inflation, of $4.2 billion, according to a Heritage Foundation **report**.

The commitment of public money is appropriate to the peril, said **Ethan Harris**, co-head of U.S. economic research at Barclays Capital Inc. and a former economist at the New York Fed. U.S. financial firms have taken writedowns and losses of $666.1 billion since the beginning of 2007, according to Bloomberg data.

"This is the worst capital markets crisis in modern history," Harris said. "So you have the biggest intervention in modern history."

Bloomberg has requested details of Fed lending under the U.S. Freedom of Information Act and filed a federal lawsuit against the central bank Nov. 7 seeking to force disclosure of borrower banks and their collateral.

Collateral is an asset pledged to a lender in the event a loan payment isn't made.

'That's Counterproductive'

"Some have asked us to reveal the names of the banks that are borrowing, how much they are borrowing, what collateral they are posting," Bernanke said Nov. 18 to the **House Financial Services Committee**. "We think that's counterproductive."

The Fed should account for the collateral it takes in exchange for loans to banks, said **Paul Kasriel**, chief economist at Chicago-based Northern Trust Corp. and a former research economist at the Federal Reserve Bank of Chicago.

“There is a lack of transparency here and, given that the Fed is taking on a huge amount of credit risk now, it would seem to me as a taxpayer there should be more transparency,” Kasriel said.

Bernanke’s Fed is responsible for $4.74 trillion of pledges, or 61 percent of the total commitment of $7.76 trillion, based on data compiled by Bloomberg concerning U.S. bailout steps started a year ago.

“Too often the public is focused on the wrong piece of that number, the $700 billion that Congress approved,” said J.D. Foster, a former staff member of the Council of Economic Advisers who is now a senior fellow at the Heritage Foundation in Washington. “The other areas are quite a bit larger.”

Fed Rescue Efforts

The Fed’s rescue attempts began last December with the creation of the Term Auction Facility to allow lending to dealers for collateral. After Bear Stearns’s collapse in March, the central bank started making direct loans to securities firms at the same discount rate it charges commercial banks, which take customer deposits.

In the three years before the crisis, such average weekly borrowing by banks was $48 million, according to the central bank. Last week it was $91.5 billion.

The failure of a second securities firm, Lehman Brothers Holdings Inc., in September, led to the creation of the Commercial Paper Funding Facility and the Money Market Investor Funding Facility, or MMIFF. The two programs, which have pledged $2.3 trillion, are designed to restore calm in the money markets, which deal in certificates of deposit, commercial paper and Treasury bills.

Lehman Failure

“Money markets seized up after Lehman failed,” said **Neal Soss**, chief economist at Credit Suisse Group in New York and a former aide to Fed chief **Paul Volcker**. “Lehman failing made a lot of subsequent actions necessary.”

The FDIC, chaired by **Sheila Bair**, is contributing 20 percent of total rescue commitments. The FDIC’s $1.4 trillion in guarantees will amount to a bank subsidy of as much as $54 billion over three years, or $18 billion a year, because borrowers will pay a lower interest rate than they would on the open market, according to Raghu Sundurum and **Viral Acharya** of New York University and the London Business School.

Congress and the Treasury have ponied up $892 billion in TARP and other funding, or 11.5 percent.

The Federal Housing Administration, overseen by Department of Housing and Urban Development Secretary **Steven Preston**, was given the authority to guarantee $300 billion of mortgages, or about 4 percent of the total commitment, with its Hope for Homeowners program, designed to keep distressed borrowers from foreclosure.

Federal Guarantees

Most of the federal guarantees reduce interest rates on loans to banks and securities firms, which would create a subsidy of at least $6.6 billion annually for the financial industry, according to data compiled by Bloomberg comparing rates charged by the Fed against market interest currently paid by banks.

Not included in the calculation of pledged funds is an FDIC proposal to prevent foreclosures by guaranteeing modifications on $444 billion in mortgages at an expected cost of $24.4 billion to be paid from the TARP, according to FDIC spokesman **David Barr**. The Treasury Department hasn’t approved the program.

Bernanke and Paulson, former chief executive officer of Goldman Sachs, have also promised as much as $200 billion to shore up nationalized mortgage finance companies Fannie Mae and Freddie Mac, a pledge that hasn’t been allocated to any agency. The FDIC arranged for $139 billion in loan guarantees for General Electric Co.’s finance unit.

Automakers Struggle

The tally doesn’t include money to General Motors Corp., Ford Motor Co. and Chrysler LLC. Obama has said he favors financial assistance to keep them from collapse.

Paulson told the House Financial Services Committee Nov. 18 that the $250 billion already allocated to banks through the TARP is an investment, not an expenditure.

“I think it would be extraordinarily unusual if the government did not get that money back and more,” Paulson said.

In his Nov. 18 testimony, Bernanke told the House Financial Services Committee that the central bank wouldn't lose money.

"We take collateral, we haircut it, it is a short-term loan, it is very safe, we have never lost a penny in these various **lending programs**," he said.

A haircut refers to the practice of lending less money than the collateral's current market value.

Requiring the Fed to disclose loan recipients might set off panic, said **David Tobin**, principal of New York-based loan-sale consultants and investment bank **Mission Capital Advisors LLC**.

'Mark to Market'

"If you mark to market today, the banking system is bankrupt," Tobin said. "So what do you do? You try to keep it going as best you can."

"Mark to market" means adjusting the value of an asset, such as a mortgage-backed security, to reflect current prices.

Some of the bailout assistance could come from tax breaks in the future. The Treasury Department changed the tax code on Sept. 30 to allow banks to expand the deductions on the losses banks they were buying, according to **Robert Willens**, a former Lehman Brothers tax and accounting analyst who teaches at Columbia University Business School in New York.

Wells Fargo & Co., which is buying Charlotte, North Carolina-based Wachovia Corp., will be able to deduct $22 billion, Willens said. Adding in other banks, the code change will cost $29 billion, he said.

"The rule is now popularly known among tax lawyers as the 'Wells Fargo Notice,'" Willens said.

The regulation was changed to make it easier for healthy banks to buy troubled ones, said Treasury Department spokesman **Andrew DeSouza**.

House Financial Services Committee Chairman **Barney Frank** said he was angry that banks used the money for acquisitions.

"The only purpose for this money is to lend," said Frank, a Massachusetts Democrat. "It's not for dividends, it's not for purchases of new banks, it's not for bonuses. There better be a showing of increased lending roughly in the amount of the capital infusions" or Congress may not approve the second half of the TARP money.

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