Seeing Bailouts Through Rose-Colored Glasses

By GRETCHEN MORGENSON, *The New York Times*
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THE multibillion-dollar trading loss at JPMorgan Chase has revived the idea of paring down banks that are too big to manage. That's a good thing, if we ever hope to get off the boom-bust-bailout track.

As the battles over financial regulation rage in Washington, it's crucial that American taxpayers understand the costs associated with rescuing behemoth institutions. Getting a straight answer on this question can be tough, given the politics now surrounding the bailouts that occurred in 2008.

The total cost of those salvage efforts isn't yet known. The problems at the mortgage giants Fannie Mae and Freddie Mac have not been resolved, and the taxpayers' current $151 billion bill will undoubtedly shift in size.

Nevertheless, an accurate accounting of the 2008 rescues should include the value of the bailout subsidy provided by the taxpayers, as well as a hard-nosed cost-benefit analysis. Unfortunately, neither was included in a recent United States Treasury analysis of the various rescue programs, including TARP.

That didn't stop the Treasury from crowing: "The latest available estimates indicate that the financial stability programs are likely to result in an overall positive financial return to taxpayers in terms of direct fiscal cost." These returns are expected to exceed the costs at Fannie and Freddie, the Treasury added.

It's enough to make you want to break out the Champagne.

But the rosy scenario, delightful though it may be, is incomplete. And the first clue is that the return estimated by the Treasury Department is based on "the direct fiscal cost."

The indirect costs of the rescue efforts, including subsidies provided to the recipients by taxpayers, loom large. But they are unmeasured in this analysis.

This point was made in Washington this month by a group of respected economists, who also contend that a large portion of the payments that the Treasury said will accrue to taxpayers should not be included.

Edward J. Kane, a professor of finance at Boston College and an authority on analyzing subsidies, was one of those economists. In an interview last week, he called the Treasury's analysis deficient.

First, Mr. Kane objected to the Treasury's inclusion of $179 billion in interest income that it expects the Federal Reserve to generate on investments through 2015. These include Treasury securities and other assets bought by the Fed under various rescue programs.

Including such income is improper, Mr. Kane said, because — from the taxpayers' point of view — the Fed's balance sheet and income statements should be consolidated with those of the Treasury. When the Fed receives income on its government securities, for example, that money comes from the Treasury. Characterizing that as a gain for the taxpayer is a reach, he said.

AN even larger problem with the Treasury analysis, Mr. Kane said, is its failure to calculate the value of the subsidy that taxpayers provided to rescue recipients. "You would not pass Economics 101," he said, "if you didn't understand the opportunity costs involved in providing the subsidy."

The programs provided enormous amounts of money at below-market terms for extended periods, he said. Had those guarantees been priced at their true market value — what a private investor would have charged to lend during those dire days — taxpayers should have received far higher returns.

Timothy G. Massad, assistant Treasury secretary for financial stability, said: "We believe the fact that we took strong, forceful action resulted in us preventing significant economic costs, including the risk of a second Great Depression. But a

specific counterfactual analysis is something that can be done in a variety of ways, and for the government to endorse one particular approach is not something we think is appropriate in this case."

Charles W. Calomiris, is a professor at Columbia Business School, as well as Columbia's School of International and Public Affairs, and a research associate at the National Bureau of Economic Research. He worked with Mr. Kane on the critique of the Treasury's analysis and said in an interview last week: "Pretending that when providing these subsidies all you have to do is get your money back and not get an adequate return accounting for risk — that is not a good accounting for cost."

Another problem with the Treasury's presentation is that it does not give taxpayers a cost-benefit analysis. "We are not saying that the benefits weren't there," Mr. Calomiris said. "We're not saying that it wasn't worthwhile to create these programs. Maybe it was, maybe it wasn't. But it requires a fuller analysis of what the benefits were."

When the subject of bailout benefits comes up, policy makers usually characterize them in broad and nebulous terms. The rescues avoided another Great Depression, as Mr. Massad said, or staved off Armageddon.

This is insufficient, in Mr. Calomiris's view. "It's not good enough to say it would have been the end of the world," he said. "If you do a cost-benefit analysis you have to take into account all relative alternatives."

Better to estimate the damage that would have been done to the economy as a whole if the rescues hadn't taken place and then argue that the amount spent was worthwhile.

"If you think you avoided a major credit contraction and you have some model of what the disruption would have been to gross domestic product," Mr. Calomiris added, "that might tell you the benefits were far in excess of the costs."

Recognizing all the costs associated with bailouts and formulating an estimate of the benefits provided by those costs is something that taxpayers have a right to expect from their government. Being honest about the costs and benefits is the only way we can analyze the response to the crisis and correct any mistakes that were made.

Focusing on whether the programs made money misses the point, Mr. Kane said. “The real issue,” he said, “is how well the government used the money and what are the lessons.”

We’re still waiting for that.

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