WASHINGTON, DC - Congressman Robert C. “Bobby” Scott (D-VA-03) released the following statement today after voting No on the Senate version of the Emergency Economic Stabilization Act of 2008 (H.R. 1424). The bill passed on a vote of 263 -171.

“We obviously have a crisis in the financial markets. Major firms have failed and others are failing. We are in an economic downturn with people losing their homes, businesses going under, and credit drying up for small businesses and consumers.

The current crisis is the predictable consequence of the failed economic policies of the last eight years.

These policies are the ones that have produced record budget deficits, the worst job growth since the Great Depression – including our ninth consecutive month of job losses – and the worst Dow performance in over three decades.

Congress should address the crisis with appropriate legislation.

“The Senate bill that we considered today is not fundamentally different from the bill we voted on Monday, although some have attempted to change the name of the package from a ‘bailout’ to a ‘rescue’. The foundation of the bill remained the outlay of $700 billion for the purchase of worthless assets. On balance, the final version of the bill was still not a good deal for taxpayers.

“Whether or not the bailout act we voted on today was a ‘good’ deal rises and falls on the issue of fair value. You cannot rationally determine the worthiness of a

purchase, without first assessing what the fair value is, and whether you are paying more or less than that fair value. If the bailout legislation included a provision that would provide that the Federal Government would pay no more than the good faith estimate of the fair value for the assets, then it would be a good deal.

Some of the assets we will be asked to buy are options, derivatives, and other exotic speculative investments that are in fact worthless.

There is no public policy rationale to bail investors out of speculative securities that did not pay off.

S
ince there is no commitment to calculating a good faith fair value price, and to paying no more than that price, this is a bad deal for the American people, because we will undoubtedly overpay for these assets. Therefore, the worthiness of the deal rises or falls on the commitment to limit payments to a fair value.

“I am not suggesting that establishing a fair value of these assets will be easy. Bu t there are well established factors in other situations to determine the value of assets when selling prices or bid and asked prices are not available.

And it is our obligation as protectors of the US Treasury to require that no funds should be spent without a reasonable assessment of what we are buying.

“Furthermore we should not give unlimited discretion to buy assets at prices obviously higher than fair value to an Administration frequently accused of cronyism and favoritism.

"We are dealing with three separate problems: illiquidity in the credit market; insolvency of some financial institutions; and the hardship of homeowners. Offering fair value prices for assets will address the issue of liquidity. If we limited purchasing prices to fair value, we could purchase assets, re-establish confidence, wait for the markets to reinvigorate and the private sector could then buy assets back from the government.

Even if it took more than $700 billion, as long as we were paying fair value, and receiving assets earning more than our borrowing costs, we could be confident that, in the long run, this solution would at least break even, and would likely make money for the taxpayer even if we held the assets to maturity.

But since the bill provides no limit on the price we pay for assets, we will undoubtedly overpay, and lose money on the deal. If we paid fair value, we could solve the liquidity crisis without any likely cost to the taxpayers.

Unfortunately, there is nothing in the Act to restrict payments for assets to their fair value.

"The problem with illiquidity which affects credit relates to lending institutions holding valuable but temporarily illiquid assets on their books. While there is no market for those assets, accounting regulators require the assets to be valued at virtually zero.

Since lending authority is directly related to the institution's capital, this markdown significantly reduces lending authority, which leads to the credit crunch.

This problem can be solved either by the government purchasing the assets at fair value or by a change in accounting regulations to allow assets to be booked at "fair economic value" rather than "market value".

This administrative change in the "mark to market" rule would significantly increase lending authority at no cost to the taxpayer.

In addition there are a handful of banks that have sufficient capital but not enough deposits to sustain lending authority; in those few cases, simply depositing federal funds in the bank would

increase lending capacity.

“Another factor affecting credit is the reluctance that banks have to lend money to other banks; for fear that the other bank might go broke without notice as several recently have done. This problem can be cured by the issuance of “net worth certificates” which would guarantee the net worth of a bank, for a fee which would insure that there would be no net cost to the taxpayer. This has been done successfully in the past.

“There are other ways to instill confidence in financial institutions without spending any of the taxpayer’s money. William Isaac, former head of the FDIC, has suggested that FDIC exercise the powers already granted to it by Congress. The FDIC can take emergency action and declare that no general creditor of a failed bank will suffer a loss if the bank fails. That declaration, when coming from the FDIC would, by statute, be backed by the full faith and credit of the United States. T his action would be a signal to the worldwide market that the full faith and credit of the United States stands behind our banks, and an influx of capital would soon follow.

Another FDIC change would be to increase the limit at which FDIC insures deposits from $100,000 to $250,000.

This would limit the destabilizing impact of major withdrawals from banks.

This provision is not controversial and is actually in the bill.

“Another factor which affects capital and therefore lending authority is the downward pressure on stock prices caused by short selling. Administrative action has already been taken to prohibit “naked short sales” and to restore the “uptick” rules.

“After the bill was defeated on Monday, I worked with other members who were skeptical of the bill, to propose cost-effective solutions to the crisis. Rep. Peter DeFazio has a produced a bill, the No BAILOUTS (Bringing Accounting, Increased Liquidity, Oversight and Upholding Taxpayer Security) Act, that outlines administrative changes that could be implemented at no cost to the taxpayer. The bill directs the Administration to implement a net worth certificates program, adjust mark to market valuation rules, increase FDIC insurance limits, and regulate short sales. These no-cost changes would be more likely to have an impact on the domestic credit crunch than spending $700 billion purchasing worthless assets from all over the world.

“Some argue that overpaying for assets will help solve the second problem of the crisis, the insolvency of some financial institutions, by providing capital to these institutions. I believe that we should help financially troubled companies that have a good chance of stabilizing and coming back with our help. Unfortunately, there is nothing in the bill to stop companies in no distress, or companies that are hopelessly insolvent, from selling their toxic assets to the government, and any overpayment for assets those companies sell will provide no value to the taxpayer. There are more efficient ways of targeting financial assistance to appropriate companies than making overpayments to all companies.

“Congress does have an interest in assisting homeowners, but homeowners struggling to pay mortgages will find little comfort in this legislation. We should have included meaningful assistance for struggling homeowners in the bill.

All homeowners would benefit because homeowners who are paying their mortgages on time have been hurt by home prices collapsing because of the flurry of foreclosures, and perspective homeowners are having difficulty finding new

mortgages.

The bill directs the Treasury Secretary to implement a plan to decrease foreclosures, “to the extent that the Secretary acquires mortgages”.

The problem is that the toxic securities that the Treasury is being asked to buy are not individual mortgages, but options, derivatives and other securities comprised of portions of hundreds and sometimes thousands of different individual mortgages. It is therefore unlikely that the Secretary will have the authority to change the mortgage terms and help prevent foreclosure in any significant number of actual mortgages.

“There are many effective ways to actually help homeowners. In November 2007, Rep. Joe Baca introduced HR 4135, the Family Foreclosure Rescue Corporation (FFRC). Rep. Baca’s bill is based on the concept of the Home Owner’s Loan Corporation (HOLC). During the Great Depression, this government entity was created to buy troubled mortgages, and then refinance the mortgages at rates the homeowners could afford, preventing more foreclosures and stabilizing housing prices. When HOLC ended operations in 1951, it had turned a profit to the taxpayer. HR 4135 would create the Family Foreclosure Rescue Corporation (FFRC) to refinance loans for people currently in foreclosure or in serious default. Families will be able to refinance their mortgage through a government administered loan with a set interest rate. FFRC would assist homeowners paying on the mortgages that back many of the toxic assets the Treasury is being asked to buy. Providing stability in the mortgage market is a much more direct solution to the foreclosure problem than overpaying for worthless options and derivatives backed by the bad mortgages, and this strategy is much more likely to help struggling homeowners.

The HOPE for Homeowners program, a federal program established by the housing bill passed earlier this year, is another program designed to directly assist homeowners, and Congress could do more to encourage mortgage holders assist their mortgage payers and themselves by utilizing the program.

Changes to bankruptcy rules that would allow homeowners to renegotiate the loan on their primary residence would be another provision that would help homeowners.

"Although the major assessment of the core provisions of the bill rises and falls on the issues of fair price valuation and actual assistance to homeowners, there are other issues addressed in the legislation. The media has reported that there are provisions in this bill to limit executive compensation and to protect the taxpayer. The actual language in this bill does not support these reports. There are huge loopholes in the bill that allow companies to continue to pay executives exorbitant salaries.

And, the taxpayer protections in the bill are flimsy.

If the bailout does not pay for itself, the bill leaves it to a future Administration to propose a bill to tax financial institutions to raise the money taxpayers have lost.

In a Congress where there is outrage against any new tax proposal, if there is no political will to pay for the bailout in the middle of the crisis, there will be even less political will to raise taxes on financial institutions that may still be struggling in the future.

"The failure of the bill to limit the purchase of any assets to the fair value of those assets means that the bill will not effectively address the underlying issues: purchasing worthless assets adds nothing to general liquidity; overpaying for assets from all companies is an inefficient way to help those companies who only need temporary assistance to survive; and overpaying for assets does nothing for homeowners. Furthermore, this bill will fail to instill confidence in the market when it becomes apparent that the language of the bill is unlikely to match the public description of the bill on CEO compensation, foreclosure prevention and protection of the taxpayer. For those reasons, I regret that I was unable to support the bill.

“We should have drafted a new bill with the inclusion of many of the alternative proposals I have laid out in this statement. The result would have been a comprehensive bi-partisan bill which targets our federal assistance to the goals we need to address: illiquidity in the market, solvency for appropriate businesses, and assistance to homeowners.

“By spending $700 billion ineffectively on this crisis now, we will not have funds to respond to the next phase of our financial crisis in the future. For example, homeowners are continuing to lose their homes, and we have done very little to stem the tide of that problem. And because of today’s vote, we will have fewer resources to address that problem in the future.

Furthermore, we must not forget that the underlying problem is that we are in an economic downturn, and our actions must be deliberate and measured if we are going to steer our way out of this mess.

Unfortunately, we now have $700 billion less to address our economic situation.

“There are many administration initiatives that require virtually no taxpayer money, which would have a huge impact on the banking crisis, the solvency of businesses, and the challenges of homeowners. We should have begun with proposing those no cost administrative changes, before we authorized the expenditure of $700 billion on a plan unlikely to make any difference at all.”

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