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Action on Financial Rescue Plan Urgently Needed

Stuart M. Butler, Ph.D., and Edwin Meese III

A revised so-called "bailout" package is being readied for a Senate vote and subsequent action in the House. Action on this rescue package is urgently needed. Households across the nation are beginning to see the leading edge of the storm that is already roiling credit markets here and around the world. The sudden and dramatic drop in the value of retirement accounts after the House's initial refusal to agree to the package was just one symptom of what is to come. Even more important, however, is the continued deterioration of the credit system. Without action, ordinary Americans will face the effects of a dramatic economic contraction, including sharp increases in unemployment.

Lawmakers in the Senate are considering additions and changes to the original House package. A relatively clean bill might have been a better approach, with appropriate regulatory actions left to the proper agencies and additional actions taken more deliberately in later legislation. But the reality of Capitol Hill is that changes in the package are needed to achieve sufficient support for the core features that are desperately needed.

Some changes in the measure apparently being considered by the Senate will actually help strengthen the economy and help the package to be more effective. One important change is the increase in FDIC insurance on bank deposits from $100,000 to $250,000, which would reduce the risk of bank runs such as those that hit Wachovia and Washington Mutual. The legislation also includes an extension of the AMT "patch," thereby preventing a $64 billion tax hike on some 20 million American taxpayers. The measure also includes a number of other perennial tax "extenders" such as the R&D tax credit. Even more encouraging, the Senate apparently chose not to use the occasion of extending these provisions as an excuse to raise taxes. The bill could prevent a tax hike of nearly $100 billion over the next two years.

In contrast, some other changes in the measure are bad policy, such as adding the simplistic mental health parity—which will further overregulate and federalize health coverage—and a new layer of earmarks.

Noxious though some of these provisions are, taken together with the improvements they are not sufficient to risk the enormous economic damage that would ensue from the failure of Congress to enact the core economic features of the package.

Congressional action on the central steps, moreover, will be enhanced by administrative features being put into place. Action by the Financial Accounting Standards Board and the Security and Exchange Commission on the problematic "mark-to-market" rules will help considerably, as will the temporary program to provide deposit insurance to some money market mutual fund assets.

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So the main economic features of the package continue to be acceptable and likely to accomplish the goal of restoring functioning credit markets while providing reasonable protections for the taxpayer.

As in the negotiated measure rejected by the House, there are still serious constitutional concerns with the pending bill (described in more detail in *WebMemo* 2086, "The Housing Bailout: Constitutional Infirmities Remain, but a Ray of Hope"[1] and *WebMemo* 2089, "An Initial Review of the Bailout Agreement"[2]), such as the extraordinary delegation of authority to the secretary of the Treasury without sufficiently specific direction and the Financial Stability Oversight Board containing members not subject to or removable by the President.

Both concerns could be (and should be) remedied, first by providing greater guidance and guidelines to the secretary regarding his new authority—sufficient that a reasonable person would be able to determine what acts would be lawful and which acts undertaken by the secretary would be unlawful—and second, ideally, by either removing the oversight board entirely or limiting its role to an advisory one.

Features of the proposed new rescue package thus continue to raise concern and would lead to some bad policy changes. But the economic consequences of inaction by Congress in such a grave and urgent crisis means that troubling features in the measure will have to be accepted, as will a short-term increase in federal involvement in the economy that in normal times should never be considered.

—Stuart M. Butler, Ph.D., is Vice President for Domestic and Economic Policy Studies and Edwin Meese III is Ronald Reagan Distinguished Fellow in Public Policy and Chairman of the Center for Legal and Judicial Studies at The Heritage Foundation.

1. Andrew M. Grossman, Robert Alt, and Todd F. Gaziano, "The Housing Bailout: Constitutional Infirmities Remain, but a Ray of Hope," Heritage Foundation *WebMemo* No. 2086, September 26, 2008, at *http://www.heritage.org/Research/Economy/wm2086.cfm.*
2. Alison Acosta Fraser and Todd F. Gaziano, "An Initial Review of the Bailout Agreement," Heritage Foundation *WebMemo* No. 2089, September 28, 2008, at *http://www.heritage.org/Research/Economy/wm2089.cfm.*