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CONTINGENT LIABILITIES: MORE BAILOUTS TO COME?

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SUMMARY

Even with the government already assuming unprecedented levels of deficits and debt, and Congress considering a new health care entitlement likely to exceed $1 trillion, taxpayers face hundreds of billions of dollars in additional risks not fully reflected in the customary budget presentations. When these “contingent liabilities” are taken into account, taxpayers’ potential exposure is far greater than typically acknowledged. To summarize:

- The current year’s deficit is estimated to exceed $1.8 trillion, a record level, and the debt is projected to nearly triple over the next decade under the President’s budget.
- These deficit and debt levels do not include the unfunded liabilities of Social Security and Medicare, which government actuaries estimate to exceed $43 trillion in today’s dollars.
- In addition to projected deficits, debt, and unfunded liabilities, the government has “contingent liabilities” that represent trillions of dollars in outstanding potential obligations. They pose a serious risk of requiring taxpayer bailouts to cover losses that could approach $1 trillion. The discussion below describes 11 such programs, their financial conditions, and the taxpayer exposures they are creating (see Table 1).
- Taxpayers are usually unaware of the potential financial exposure at stake in these programs until it becomes explicit – and by then the Federal Government has little choice but to fund a costly bailout.
- As Congress and the administration pursue major interventions in the economy – especially their plan to initiate a takeover of the health care sector, one sixth of the economy, and create a huge new health entitlement – this paper reflects the costly difficulties government has in managing programs that are less complex and that, in some cases, date back to the country’s origin.

INTRODUCTION: WHAT ARE CONTINGENT LIABILITIES?

As noted, the government’s fiscal situation already is severe. Even under current policies, the debt will soar to 100 percent of gross domestic product [GDP] by 2022 and exceed the country’s all-time peak 3 years later.[1] The main component of this is the looming entitlement crisis: without

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[2] Congressional Budget Office, *The Long-Term Budget Outlook*, 25 June 2009.

serious reforms, Medicare and Social Security pose a combined unfunded liability of more than $43 trillion over the next 75 years. These dire circumstances face an economy that already has suffered serious blows from collapses in the financial sector.

But these figures do not include additional potential costs, what are frequently referred to as "contingent liabilities." According to the Congressional Budget Office [CBO], *contingent liabilities* are cash flows based on the government's assumption of risk that are unknown in size and timing. In contrast, an *unfunded liability*, the term applied to Medicare and Social Security, represents the imbalances between particular cash flows – in other words, debts that are not covered by assets or returns of equal value.

An analysis of these contingent liabilities provides two kinds of information: first, it highlights financial snapshots, shortfall projections, and, where available, the growth of obligations of these programs and institutions; second, it demonstrates the pitfalls of public ownership and certain interventions, and the difficulties of making program reforms and unwinding government involvement.

Table 1: Selected Programs With Contingent Liabilities
(dollars in billions)

Program	Total Size of Portfolio	Estimated Range of Potential Taxpayer Losses
Troubled Assets Relief Program	700[a]	159-301[b]
Federal Reserve	2,043[c]	0[d]
Fannie Mae/Freddie Mac	5,274[e]	0-390[f]
Federal Housing Administration	627[g]	na
Ginnie Mae (excluding FHA loans)	129[h]	na
Federal Deposit Insurance Corporation	5,059[i]	0-59[j]
United States Postal Service	55[k]	0-43[l]
Pension Benefit Guaranty Corporation	72[m]	0-47[n]
National Flood Insurance Program	1,100[o]	0-19[p]
Highway Trust Fund	116[q]	0-116
Yucca Mountain	11[r]	11-?
Low-End Potential Losses		**170**
High-End Potential Losses		**986**

Source: Estimates by the Republican staff of the Committee on the Budget, U.S. House of Representatives.

Note: Discrepancies in numerical comparisons may exist due to differences in "cash basis" and "credit reform basis" reporting, as well as differences in time horizons.

[a] The sum of $700 billion is the authority to deploy funds under the Emergency Economic Stabilization Act of 2008. As of 17 June 2009, $369 billion had been deployed, according to the Congressional Budget Office [CBO].
[b] A $301-billion loss assumes the statutory limit of $700 billion is invested at CBO's current 43-percent subsidy rate.
[c] Federal Reserve H.4.1, 2 July 2009.
[d] The Federal Reserve's balance sheet does not currently contain contingent liabilities potentially affecting taxpayers. Every year, the Fed remits a percentage of earnings to the Treasury. This number is expected to be reduced due to lower earnings from increased interest payments.
[e] Represents the total "book of business" for Fannie Mae and Freddie Mac, as reported in each firm's Monthly Summary, May 2009.

continued on next page

Table 1: Selected Programs With Contingent Liabilities (continued)

[f] CBO estimates about $390 billion in losses, resulting from losses embedded in Fannie's and Freddie's books of business when they entered conservatorship, plus a 10-year estimate of losses due to factors in the housing market.
[g] Office of Management and Budget [OMB], *Budget of the U.S. Government – Fiscal Year 2010: Analytical Perspectives*, FHA MMI Guaranteed Loan Financing Account, Outstandings, 2009 Estimate.
[h] Ginnie Mae securitizes 90 percent of FHA loans, so by rough estimate, 81.4 percent of the amount Ginnie Mae securitizes is in FHA loans. To avoid double-counting of loans outstanding, $129 billion reflects a rough estimate of only non-FHA loans in Ginnie Mae's book of business. Loans outstanding found in OMB's *Analytical Perspectives*, "Guarantees of Mortgage-Backed Securities Financing Account," 2009 estimate.
[i] Number reflects $4.76 trillion of FDIC-insured deposits as of 31 December 2008, plus $335 billion in debt outstanding through the Temporary Liquidity Guarantee Program as of 20 May 2009.
[j] Rough estimate of the difference between the Deposit Insurance Fund [DIF] statutory requirement of 0.15 percent of insured deposits and the current level of the DIF. Does not include any losses from lending facility.
[k] Obligations of capital leases, operating leases, retiree health benefits, rental expenses, and contingent liabilities from claims and lawsuits, as reflected in United States Postal Service Form 10-Q, second quarter 2009.
[l] The sum of $43 billion represents the unfunded liability of retiree health benefits by 2017.
[m] As of 30 September 2008, the PBGC single-employer program had liabilities of $72.3 billion according to the corporation's annual report.
[n] As reported in the 2008 financial statements: "PBGC's best estimate of the total underfunding in plans sponsored by companies with credit ratings below investment grade, and classified by PBGC as reasonably possible for termination as of September 30, 2008, was $47 billion."
[o] Government Accountability Office letter to Financial Services Committee Chairman Frank, 27 February 2009.
[p] A sum of $19.2 billion is the amount NFIP owed to the Treasury as of January 2009.
[q] Cumulative shortfall of Highway Trust Fund (Highway Account and Mass Transit Account) under CBO projections for the 2010-19 period.
[r] Current liabilities from delaying storage at Yucca, with an operational date of 2020. Delay beyond 2020 costs $500 million per year.

BLACK HOLES: HOW MUCH CAN TAXPAYERS EXPECT TO RECOVER FROM TARP?

The Troubled Assets Relief Program [TARP] currently has seven official programs, each carrying a different amount of risk for the taxpayer. In its latest re-estimate, the CBO applies a 43-percent weighted-average subsidy rate – the proportion of funds invested that are expected to be beyond recovery – to the $369 billion allocated so far.[2] Under TARP, the Department of the Treasury has the authority to make commitments of up to $700 billion; Assistant Treasury Secretary Allison has estimated the Department has budgeted to spend about $643 billion.[3] At the time TARP was introduced, it was expected that, eventually, funds would flow back to the Treasury as assets were sold and a good portion of the tax dollars invested would be recouped.[4] Some even suggested that the government might make a profit.

While the TARP is often evaluated as a single entity, it is becoming more diverse. It has expanded in scope from its original mission, which was purchasing toxic assets to prevent a systemic meltdown in the financial services sector. Several large banks receiving equity infusions under TARP's oldest program, the Capital Purchase Program [CPP], have raced to raise enough

[2] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009*, June 2009.

[3] Testimony of Herbert M. Allison, Assistant Secretary of the Treasury for Financial Stability, at a hearing of the Committee on Financial Services, U.S. House of Representatives, 23 July 2009.

[4] Speech on the financial crisis, President Bush, 24 September 2008.

private capital to buy back preferred shares from the government. On 17 June 2009, ten of the largest institutions repaid close to $70 billion in CPP funds, after being told by regulators that they were healthy enough to do so.[5]

This raises the question of what the administration will do with money the banks repay. At a 20 May 2009 Senate Banking Committee hearing, Treasury Secretary Geithner said reimbursed TARP funds could be recycled, potentially through 30 September 2010. Although the Emergency Economic Stabilization Act [EESA] stipulates that revenues and proceeds from the sale of TARP assets must go into the Treasury general fund for debt reduction,[6] Treasury has noted that repayments at the same time create headroom under the $700 billion limit. Yet funds recovered from TARP may be redeployed at a greater cost to the taxpayer. The CPP currently carries one of the lowest subsidy rates: 18 percent, according to CBO.[7] The estimated subsidy for CPP shrinks as banks repay capital. Several of the new or expanded TARP investments are increasingly risky and not accompanied by a clear exit strategy. These include:

- *Housing Programs.* CBO estimates the administration's Homeowner Affordability and Stability Plan, which finances loan modifications for at-risk borrowers, carries a subsidy rate of 100 percent. By this calculation, it is an outlay, meaning that every dollar invested will not be recouped. A total of $50 billion from TARP has been committed so far.

  As part of this effort, the administration established its largest loan modification plan, the Home Affordable Modification Program [HAMP]. When it was launched, Treasury said it would help 3 million to 4 million homeowners. But as of 20 July 2009, the program had served only 180,000 borrowers, according to GAO.[8]

- *Auto Industry Financing.* In its latest report on the program, CBO estimates the TARP auto program carries about a 73-percent subsidy rate for the taxpayer – a rate calculated *before* much of the bankruptcy assistance was provided for General Motors and Chrysler, and *before* any loans have been converted into what will amount to common stock in the transformed companies. The government has received about a 61-percent initial ownership stake in GM in exchange for $50 billion of TARP funds committed so far. After Chrysler emerges from bankruptcy, the government will own up to a 10-percent share in exchange for at least $12 billion in financing. The administration will invest an additional $7.5 billion in GMAC, on top of $5 billion in existing assistance, to "support GMAC's ability to originate new loans to Chrysler dealers and consumers and help address GMAC's capital needs."[9] Adding up all of the preliminary auto industry financing equals a commitment of just under $75 billion.

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[5] "JP Morgan and 9 Other Banks Repay TARP Money," *The New York Times, DealBook*, 17 June 2009.

[6] Public Law 110-343, the Emergency Economic Stabilization Act, section 106(d), 3 October 2008.

[7] CBO TARP Report through June 17, 2009.

[8] Government Accountability Office, *Troubled Assets Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, 23 July 2009.

[9] U.S. Department of the Treasury, Press Release, 21 May 2009: "Treasury Announces Additional Investment in GMAC LLC."

- *American International Group [AIG]*. It is no surprise that the financial rescue of AIG, the sole recipient of the "Systemically Significant Failing Institutions" program within TARP, is a grim scenario for recovery of government funding. In March of this year, Treasury announced it would provide $30 billion more from TARP to aid AIG, raising this investment to $70 billion. CBO's latest report assumes a subsidy rate for AIG TARP assistance of 50 percent. The administration's budget estimates a huge subsidy rate of 83 percent. The true cost is ambiguous, especially because neither calculation incorporates AIG's latest Securities and Exchange Commission [SEC] disclosure that the fair value of its credit default swap portfolio liability was $393 billion on 31 March 2009.[10]

  Treasury has provided little detail on how it plans to unwind its 77.9-percent ownership stake of the insurance giant. Even AIG CEO Edward M. Liddy acknowledged at a recent meeting of shareholders that government ties to the insurer could be permanent, admitting: "I can give you no assurances that it will ever change."[11]

  The combined Treasury and Federal Reserve support of AIG – which includes loans, mortgage-backed securities purchases, preferred stock purchases, and additional lines of credit – totals $182.5 billion.[12]

In addition, to get an idea of the magnitude of interventions in the financial system, it should be noted that the Federal Reserve has taken "extraordinary" measures to provide liquidity to the financial system. It has also financed the rescue of systemically important financial institutions. Some of its programs, such as the Term Asset-Backed Securities Loan Facility [TALF], have operated hand-in-hand with TARP. On 11 September 2008, the size of the Fed's balance sheet was $932 billion.[13] By 18 December 2008 – with the addition of several loan facilities, a large asset purchase program (including mortgage backed securities, Treasuries, and the like) and vehicles to assume the obligations of Bear Stearns, AIG and Lehman Brothers in response to the financial crisis – the Fed's balance sheet had increased almost 250 percent, to $2.3 trillion.[14] It currently sits at just more than $2 trillion.[15] Although the Federal Reserve is an independent, off-budget entity, each year it remits to Treasury a percentage of its earnings. CBO estimates that, because the Fed now pays higher interest on required and excess bank reserves (a new tool that helps the Fed better manage the growth of its balance sheet with its overall monetary policy objectives), this remittance to Treasury could be reduced by around $90 billion from 2010 through 2018 due to lower earnings.[16]

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[10] "AIG Signals More Losses on Derivatives Portfolio," *The Wall Street Journal*, 1 July 2009.

[11] "AIG annual meeting a short, relatively calm affair," the Associated Press, 30 June 2009.

[12] Government Accountability Office, *Preliminary Observations on Assistance Provided to AIG*, 18 March 2009.

[13] Federal Reserve, H.4.1, 11 September 2008.

[14] Federal Reserve, H.4.1, 18 December 2008.

[15] Federal Reserve, H.4.1, 2 July 2009.

[16] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2009-2019*, January 2009.

Although it has never happened in the Fed's almost 100-year history, if its assets were insufficient to covers its liabilities, it can only be assumed that the Treasury – that is, the taxpayers – would take on the Fed's losses.

FANNIE AND FREDDIE IN CONSERVATORSHIP: A TALE OF TWO GSEs

As the housing market faces "the worst of times," two of the biggest players in the financial crisis continue to grow in size and scope. On 6 September 2008, Treasury put the Federal National Mortgage Association [Fannie Mae] and the Federal Home Loan Mortgage Corporation [Freddie Mac] into conservatorship under the Federal Housing Finance Agency [FHFA]. This action effectively has meant that taxpayers have assumed the potential liabilities of these two corporations' huge portfolios, which amount to at least $5.27 trillion[17] when mortgage-backed securities and other guarantees, as well as gross mortgage portfolions, are accounted for. When Treasury was given the authority to provide assistance to the two government-sponsored enterprises[18] [GSEs] in the summer of 2008, CBO estimated the cost to the taxpayers would be $25 billion. At a July 2008 Senate Banking Hearing, then-Treasury Secretary Paulson said it was unlikely that cost would materialize, claiming: "If you've got a bazooka, and people know you've got it, you may not have to take it out."

In less than a year, according to CBO's revised projections, the losses embedded in Fannie Mae's and Freddie Mac's books at that time were a staggering $248 billion. That estimate does not, however, take into account the firms' financial deterioration since September, which CBO indicates it will re-estimate at $292 billion for 2009, with an additional 10-year cost of $98 billion.

Expansion of Fannie and Freddie is occurring despite the poor health of their financials, and Treasury continues to provide capital in the face of mounting losses. Fannie and Freddie have received $84.9 billion in equity injections as part of Treasury's preferred share program. The GSEs' net losses for the first quarter of 2009 total $33 billion, in addition to about $109 billion in losses for 2008.[19]

Since 2006, when the GSEs accounted for roughly 39 percent of mortgage origination, and the Federal Housing Administration [FHA] accounted for roughly 3 percent, the market has shifted greatly toward mortgages that receive government backing.[20] During the first quarter of 2009, about 72 percent were backed by Fannie and Freddie, while about 22 percent were backed by FHA.[21] There is no question the two GSEs provide important liquidity to housing finance,

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[17] Monthly Summary, Fannie Mae, May 2009; Monthly Summary, Freddie Mac, 2009.

[18] A simplified definition of a government-sponsored enterprise is a private firm created by a government charter to achieve a public purpose.

[19] As reported in Fannie Mae and Freddie Mac Forms 10-Q to the SEC.

[20] Inside Mortgage Finance.

[21] Inside Mortgage Finance.

especially because they are now effectively the only entities securitizing mortgages. Yet the extent of their current obligations remains uncertain.

For instance, CBO and the Office of Management and Budget [OMB] have two different approaches to the budgetary treatment of Fannie and Freddie. CBO has placed the two GSEs on budget, using credit reform scoring – which incorporates the net present value of discounted cash flows over time – with an adjustment for market risk. OMB continues to reflect Fannie and Freddie as off-budget entities.

Different accounting policies make it hard to ascertain the GSEs' true financial condition, and also make policy decisions more challenging. The Housing and Economic Recovery Act of 2008 [HERA] established the authority for Treasury to purchase preferred stock in Fannie and Freddie in an amount it deems necessary. Although authority technically expires on 31 December 2009, the limit may be increased to any level through the expiration date. After the sunset, Treasury can continue to provide funds to the GSEs until it reaches the limit. The administration has already doubled the size of its preferred stock agreements from $200 billion to $400 billion. The situation raises questions concerning whether Treasury will increase the limit further; when government involvement in Fannie and Freddie will taper off; and what the exit strategy will be.

In addition, the administration has made Fannie and Freddie a centerpiece of its housing policies. Treasury's HERA authority to buy preferred shares is being used to fund the administration's loan modification program, Making Home Affordable, which is part of the Homeowner Affordability and Stability Plan. As mentioned above, $50 billion for this program will come from TARP; the other $25 billion will come from HERA. Hence yet another question arises: how many new housing programs will be funded using Treasury's line of credit to Fannie Mae and Freddie Mac?

As long as the two GSEs remain under conservatorship, taxpayers bear the burden of supporting their dominant role in the housing market – which carries exposure to risk that is only growing.

HOUSING HEADACHES CONTINUE: FHA AND GINNIE MAE

It appears the FHA, in the Department of Housing and Urban Development [HUD], may have initially avoided problems caused by the housing crash. The FHA provides mortgage insurance on loans made by approved lenders, and the loans require, by industry standards, only a minimal down payment of 3.5 percent. Recent economic conditions have driven up the demand for government-backed home loans as other sources have run dry. As mentioned, this has led to a multiplying of FHA's market share from about 3 percent to 22 percent.[22]

At a Financial Services Committee hearing, HUD's Inspector General, Kenneth M. Donohue, recently testified that FHA – which received $13 billion from the American Recovery and Reinvestment Act in addition to its $45-billion budget – has been overtaxed by the problems of the housing crisis. According to Donahue: "FHA will be challenged to handle its expanded workload or new programs that require the agency to take on riskier loans than it historically has

[22] "U.S. Government Watchdog To Repeat Warnings About FHA," *The Wall Street Journal*, 17 June 2009.

had in its portfolio . . . the surge in FHA loans is likely to overtax the oversight resources of the FHA, making careful and comprehensive lender monitoring difficult."[23]

What is worse, the heavy demands for FHA loans are also causing collateral damage to mortgage bonds of the Government National Mortgage Association [Ginnie Mae]. Ginnie Mae creates a secondary market by providing guarantees that allow mortgage lenders to offer loans to low- and moderate-income households at reduced prices. These include loans insured by FHA, the Department of Veterans Affairs, the Department of Agriculture's Rural Housing Service, and HUD's Office of Public and Indian Housing. In June 2009, Ginnie Mae issued $43.5 billion in securitized loans, which represents the first time monthly volume has exceeded $40 billion.[24]

In May 2009, the percentage of high-risk, delinquent loans at the FHA rose to 7.42 percent, compared to 6.47 percent a year ago.[25] Not only do less stringent financing requirements for homeowners lead to higher FHA delinquencies, but government actions to loosen pressures in the housing market, according to Inspector General Donahue, have also opened the door to fraud and abuse. FHA may not have adequate resources to properly screen lenders.

By the end of 2008, FHA's fund to cover losses had been depleted almost 40 percent, to $12.9 billion, largely due to rising defaults. Last week, the House approved an expansion of FHA's fiscal year 2009 commitment authority, from $315 billion to $400 billion. As IG Donahue said: "[W]hile the goal to help homeowners in distress is important, relaxing qualification requirements for borrowers and lenders may create a situation that could be exploited by fraud perpetrators to take advantage of desperate homeowners, at risk-lenders, and the FHA insurance fund."[26]

HOW MANY REPRIEVES FOR THE FDIC?

According to the mission statement of the Federal Deposit Insurance Corporation [FDIC]: "[T]he FDIC receives no Federal tax dollars – insured financial institutions fund its operations." But the financial crisis has put a strain on existing FDIC resources and caused it to open huge new lending facilities, potentially putting the taxpayer at risk.

The Helping Families Save Their Homes Act, S. 896, recently signed into law, will permanently expand the FDIC's line of credit to the Treasury more than threefold, from $30 billion to $100 billion. The legislation also contains a provision that allows the FDIC to expand this line even further – to up to $500 billion – until 31 December 2010. S. 896 also raises the deposit insurance coverage limit from $100,000 to $250,000. The White House website says the expanded borrowing authority to $100 billion, and possibly $500 billion, will "allow the FDIC to spread out

[23] Donohue testimony to the Financial Services Subcommittee on Oversight and Investigations, U.S. House of Representatives, 18 June 2009.

[24] "FHA Loans Set New Record in June," *The Wall Street Journal*, 20 July 2009.

[25] "FHA Loans Set New Record in June," *The Wall Street Journal*, 20 July 2009.

[26] Donohue, op. cit.

premium increases over time."[27] CBO estimates the increase in the coverage limit will boost direct spending by $10.1 billion over the 2009-14 period, even though this money is assumed to be recouped beginning in 2014, with savings in later years.[28]

FDIC outlays to cover deposits are recorded in the Federal budget, but should be offset, by either asset sales or higher deposit insurance premiums in the future. The President's budget calls the 5-year hiatus from deficit considerations, until higher fees kick in, a "reprieve."

Yet other pressures beg the question of how great a "reprieve" from its obligations the FDIC ultimately will need. Due to 25 bank failures and costs associated with the financial crisis, the FDIC deposit insurance fund [DIF] lost $33.5 billion in 2008.[29] So far in 2009, 69 banks have been added to the "FDIC failed bank list," depleting the fund further.[30] In just the first week of July 2009, six banks from Illinois failed, costing the DIF $267 million.[31] The FDIC's reserve fund must remain at a level between 1.15 percent and 1.5 percent of all insured deposits.[32] As of 31 March 2009, the DIF was just 0.27 percent of insured deposits.[33] Without further assessments, FDIC Chair Sheila C. Bair acknowledged: "[T]he deposit insurance fund could become insolvent this year."[34]

But the FDIC has also expanded its reach in unprecedented ways to address problems in the banking sector. It opened the FDIC Temporary Liquidity Program to guarantee new issuance of senior, unsecured debt for a variety of financial companies, not limited to FDIC-insured institutions. This wide-reaching program can guarantee up to $785 billion of assets, of which $335 billion has been used so far.[35]

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[27] http://www.whitehouse.gov/the_press_office/reforms-for-american-homeowners-and-consumers-president-obama-signs-the-helping-families-save-their-homes-act-and-the-fraud-enforcement-and-recovery-act/, accessed 25 June 2009.

[28] Congressional Budget Office, Cost Estimate for the Helping Families Save Their Homes Act of 2009, 18 June 2009.

[29] Also, the 2008 Financial Report of the U.S. Government shows a huge jump in contingent insurance liabilities of the FDIC from $1.8 billion in 2007 to $12.1 billion in 2008. Most of this increase is attributed to depository institutions that will likely fail within a year.

[30] Data as of 4 August 2009.

[31] "Hybrid Securities Doomed Six Banks," *The Wall Street Journal*, 7 July 2009.

[32] The Federal Deposit Insurance Reform Act of 2005, which became part of Public Law 109-171, stipulates that the reserve ratio may not exceed 1.5 percent of estimated insured deposits and may not be less than 1.15 percent of estimated deposits.

[33] FDIC, *Quarterly Banking Profile*, First Quarter 2009.

[34] "No-Risk Insurance at F.D.I.C.," *The New York Times*, 7 April 2009.

[35] FDIC Monthly Report, ending 30 August 2009.

The FDIC has also agreed to guarantee $10 billion of Citigroup assets and $3 billion of Bank of America assets as part of the "ring-fencing" conducted jointly by the Federal Reserve, Treasury, and FDIC. In addition, the FDIC now runs a loan modification program for the mortgages it acquired as part of the takeover of IndyMac Federal Bank, which depleted the insurance fund of up to $9.4 billion.[36] There is also Treasury's public-private investment program for loans, of which the FDIC was to play a key role guaranteeing up to 85 percent of what could have been hundreds of billions of dollars in loans.[37] The launch of this program has been delayed, mainly because of financial institutions' unwillingness to remove from their books loans that can be held to maturity until market conditions improve.

Even though uncertainties exist in measuring the full extent of the FDIC's obligations, there is no question it has the weight of multiple programs and guarantees on its shoulders; and the liabilities ultimately rest with the taxpayer.

THE UNITED STATES POSTAL SERVICE: SIGNED, SEALED, DELIVERED – BUT NOT FUNDED

The internet and email, along with innovations by companies such as Federal Express and United Parcel Service, have had a dramatic impact on the delivery of correspondence and other goods. Due to an antiquated and bureaucratic structure, the United States Postal Service [USPS] has faced financial difficulties for decades. The problems have mounted in recent years. According to its fiscal year 2009 second-quarter financial statements, USPS has incurred a loss of almost $2 billion during the first 3 months of 2009 alone.[38] These statements show an existing balance-sheet deficit since USPS' reorganization in 1971 of almost $7 billion, which is only partly offset by capital contributions of the government.[39] Notes to the financial statements report an "unprecedented decline in mail volume," which led to an 8.3-percent decrease in revenue during just the 6 months prior to 31 March 2009.

Indeed, the Government Accountability Office [GAO] said in 2008 that mail volume fell by 9.5 billion pieces, or 4.5 percent.[40] This alone led to a net loss for that year of $2.8 billion. The drop in mail volume is expected to more than double this year, with declines between 10 percent and 12 percent.[41] Single-piece first-class mail volume has fallen from about 60 billion pieces in 1990 to about 38.6 billion pieces in 2008. GAO reports a projected 2009 net loss of $6 billion, which

[36] FDIC Press Release, "FDIC Board Approves Letter of Intent to Sell IndyMac Federal," 2 January 2009.

[37] The entire public-private investment program was to have a maximum of $1 trillion.

[38] Form 10-Q, United States Postal Regulatory Commission, *Statement of Operations*, Second Quarter, Fiscal Year 2009.

[39] Form 10-Q, United States Postal Regulatory Commission, *Balance Sheets*, Second Quarter, Fiscal Year 2009.

[40] Government Accountability Office, *U.S. Postal Service: Network Rightsizing Needed to Help Keep USPS Financially Viable*," 20 May 2009.

[41] Ibid.

will mean the postal service will not have sufficient cash to cover workers' compensation and future retiree health benefits. To continue operations, USPS' statutory debt limit of $3 billion per year (up to a maximum of $15 billion) will probably need to be increased.[42]

What are producing these shortfalls, besides declining mail volume?

Compensation and benefits make up almost 80 percent of USPS costs. Recently, GAO testified before the House Oversight and Government Reform Committee that "USPS continues to pay a higher share of employee health benefit premiums than other Federal agencies." Even if 2 years of relief were given to USPS for retiree health benefits, it would face an unfunded liability of $43 billion for these alone by 2017.[43] Some 290,000 workers will become eligible for retirement during 2009-13.

High overhead costs are also a big part of the mail carrier's solvency problems. The postal service currently has 37,000 post offices and retail branches. The number of post offices named through legislation has more than doubled, from 50 in the 106th Congress to 109 in the 110th Congress.[44] In addition, the USPS faces numerous supply chain issues that lead to excess capacity, such as a reduced need for bulk mail facilities due to increases in destination-entered facilities (where senders physically deliver mail closer to its ultimate destination).

On 28 July 2009, the USPS joined GAO's "high-risk" list as a Federal area "in need of transformation" that must make serious structural changes.[45] Difficult choices lie ahead for this U.S. icon, whose core businesses could fast become relics of the past.

THE PENSION BENEFIT GUARANTY CORPORATION: NO GUARANTEE OF SOLVENCY

Many private corporations have been dragged down by the costs of defined benefit pensions, or have transitioned to defined contributions plans. The Pension Benefit Guaranty Corporation [PBGC], which is wholly owned by the government, provides mandatory insurance to companies to prevent losses of defined pension benefits due to terminations of single-employer plans or the inability of multiemployer plans to pay. Given labor market forces, it is no surprise the PBGC is on a continued path of significant and mounting losses. Although its main source of funding comes from premiums paid by the sponsors of benefit plans, because it is owned by the Federal Government, there is clear commitment that the government stands behind PBGC liabilities.

In May this year, PBGC Director Vincent K. Snowbarger announced a $33.5-billion deficit for the first half of 2009 – a staggering $22.5 billion over last year's shortfall. Part of this is the

[42] Ibid. The report says that a $3-billion increase in outstanding debt will bring USPS' total debt to $13.2 billion, which is only $1.8 billion below the $15 billion ceiling set by law.

[43] Ibid.

[44] Congressional Research Service, *Naming Post Offices Through Legislation*, 5 June 2009.

[45] Government Accountability Office, "GAO Adds Postal Service's Financial Condition to 'High-Risk' List," 28 July 2009.

$10.7-billion deficit from satisfying claims for pension plan terminations through 2008.[46] On 22 July 2009, the PBGC announced it would assume responsibility for the pensions of 70,000 current and retired employees of the auto parts producer Delphi Corp. This will cost the PBGC $6.2 billion.[47] Exposure to losses, where insured benefits exceed assets in the plan, continues to grow for likely terminations.

A recent press release said PBGC estimates of exposure to contingent losses from reasonably possible terminations was approximately $47 billion on 30 September 2008.[48] Not only has the macroeconomic environment worsened since then, but the report suggests that further workforce reductions could add at least $8 billion to the deficit figure. For example, PBGC estimates that auto pensions are underfunded by $77 billion, with $42 billion of that amount guaranteed. PBGC will accept responsibility for the covered amount of Chrysler's pension fund, which is underfunded by about $10 billion. In addition, the corporation says layoffs in the airline industry have only been deferred since 2006.

PBGC is at the mercy of economic fluctuations and changing interest rates. Current low rates have increased PBGC's deficit. While the President's budget shows a $9.7-billion surplus in 2000, the period of 2001 through 2006 saw huge terminations and losses from underfunded pension plans, largely driven by the airline and steel industries. Although the 2008 deficit improved by $2.4 billion over the prior year, the budget states: "[PBGC's] long-term exposure and flawed funding system continue to threaten its financial sustainability."

THE NATIONAL FLOOD INSURANCE PROGRAM: IS IT UNDER WATER?

The National Flood Insurance Program [NFIP], part of the Federal Emergency Management Agency [FEMA], was established in 1968 to provide lower-than-market-cost flood insurance to homeowners, renters, and business owners in communities that adopt and enforce the NFIP's floodplain management ordinances.[49] On average, an NFIP policy costs roughly 56 percent of a comparable private sector residential policy.[50] According to GAO, the NFIP insures about 5.6 million policyholders for a total of roughly $1.1 trillion.[51]

Insurance claims from the infamous 2005 hurricane season have put the NFIP on shaky ground. As of January 2009, it owed $19.2 billion to the Treasury. On top of supporting the spikes in costs due to large-scale disasters, the NFIP continues to accumulate debt because it does not

[46] Snowbarger testimony to the Special Committee on Aging, United States Senate, 20 May 2009.

[47] PBGC press release, "PBGC to Assume Delphi Pension Plans," 22 July 2009.

[48] Pension Benefit Guaranty website, press releases.

[49] Federal Emergency Management Agency website, ERLINK"http://www.fema.gov/about/programs/nfip/index.shtm, accessed July 8, 2009.

[50] GAO, briefing to the House Financial Services Committee, 28 January 2009.

[51] GAO, letter to Financial Services Committee Chairman Frank, 27 February 2009.

charge high enough risk premiums to offset even the expected losses. The NFIP's subsidized premiums only cover 35 percent to 40 percent of the costs of full-risk premiums. In addition, the program operates in markets that private sector providers do not find profitable. For example, private insurers will often find it a worthwhile investment to market "excess coverage" policies to homes worth more than $1 million, a value far above NFIP limits.[52]

FEMA and the Department of Homeland Security said this obligation was more than the sum of all previous losses since the program began more than 40 years ago.[53] Ironically, the NFIP owed interest on its debt to Treasury of $730 million per year as of October 2008, which it had to borrow from Treasury and, thus, incurred more debt.

GAO placed the NFIP on its "high-risk" list, going so far to say: "[I]t is unlikely that NFIP will ever be able to repay the entire debt."[54] If NFIP does not generate the premium income necessary to pay off its obligations, then responsibilities lie, again, with the taxpayer.

THE HIGHWAY TRUST FUND: IS THERE A ROAD TO RECOVERY?

Highways are a critical component of the Nation's economy and a key national priority. In 1956, Congress enacted the highway program and established a trust fund financed with dedicated taxes to pay for Federal spending on highway construction and repairs. But with the enactment of the 1998 surface transportation authorization bill – the Transportation Equity Act for the 21st Century (Public Law 105-178) – and with its successor, the 2005 highway bill, spending was increased above the gasoline tax collections coming into the Highway Account of the Highway Trust Fund [HA-HTF].

As the CBO has explained in its testimony before the House Budget Committee in May 2008: "[S]pending from the trust fund started to increase rapidly in 1999 because of changes enacted in the Transportation Equity Act for the 21st Century [TEA-21]." CBO further notes that "[S]pending generally has exceeded revenues since 2001 . . . ."[55]

This spending, combined with weakening gasoline tax collections, has led to funding shortfalls in the Highway Trust Fund. In September 2008, cash in the HA-HTF reached zero and a transfer of $8 billion – which increased the general fund deficit – was required to provide the trust fund with the resources to pay its bills in a timely way. A similar shortfall has been projected for fiscal year 2009, requiring a transfer of $5 billion to $7 billion from the general fund to prevent the highway account from going broke. Another $10 billion to $12 billion will be needed for the first part of fiscal year 2010.

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[52] GAO briefing.

[53] GAO letter to Chairman Frank.

[54] Ibid.

[55] Congressional Budget Office testimony to the Committee on the Budget, U.S. House of Representatives, 8 May 2008.

Moreover, under the current 2009 CBO baseline projections, this gap between the Federal Government's likely spending from the Highway Account and its ability to pay for it grows over the fiscal year 2010-19 period, with a cumulative shortfall of $79 billion. A similar structural mismatch between spending and revenues exists in the HTF's Mass Transit Account [MTA-HTF] which finances Federal expenditures for light rail, commuter rail, buses and similar forms of public transportation. Again, under the current CBO baseline, the MTA-HTF is projected with a cumulative shortfall of $37 billion. Taken together, and assuming only baseline commitments, the Highway Trust Fund will lack a total of $116 billion in new resources over the next decade to pay for this spending.

THE YUCCA MOUNTAIN OF DEBT

Since 1978, Yucca Mountain, NV, has been studied as a site for the country's first remote, long-term repository for spent nuclear fuel, which is now being held temporarily in 120 locations across 39 States.[56] It has been a long road to getting Yucca Mountain ready, involving 20 years of analysis and experimentation to show the repository is safe under the most extreme conditions. This has cost more than $10 billion.[57]

The Yucca Mountain facility is funded partly through fees generated for the Nuclear Waste Fund, which comes from fees paid by utilities – and ultimately, consumers – that equal one-tenth of a cent per kilowatt-hour of nuclear-generated electricity.[58] In exchange for these fees, the Federal Government is legally bound to take responsibility for this waste. As of the end of 2008, this fund held payments and interest of $29.6 billion. It is growing at a rate of $2.0 billion a year.[59] The facility also receives funds through the Defense Nuclear Waste Fund, which is financed by general appropriations. This has ranged from approximately $200 million to $350 million in recent years. It is estimated that were the Yucca project made operational, it would cost $96 billion throughout its 150-year lifecycle.

But right now, the development of Yucca Mountain is frozen as the debate continues to heat up in Congress. The administration wants to shut it down permanently, as affirmed in the President's fiscal year 2010 budget, which says: "[D]eveloping a repository at Yucca Mountain is not a workable option and . . . the Nation needs a better solution for nuclear waste disposal." Because the site failed to begin receiving nuclear waste in 1998, as required by law, 71 lawsuits have been filed against the government for breach of contract – most of which have not been resolved.

Although Secretary of Energy Chu has said Yucca is "not an option," previously the Department of Energy [DOE] set a deadline of 2020 for transport of spent nuclear fuel. Even if the repository were to open by 2020, DOE estimates it will accrue more than $12 billion in liabilities from

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[56] U.S. Department of Energy, "Questions and Answers on the Yucca Mountain Repository," http://www.ocrwm.doe.gov/repository/index.shtml#0, accessed on July 8, 2009.

[57] Congressional Research Service, *Civilian Nuclear Waste Disposal*, 7 October 2008.

[58] Department of Energy.

[59] Office of Management and Budget, *Budget of the U.S. Government – Fiscal Year 2010: Appendix.*

delaying storage beyond the timetable set by the Nuclear Waste Policy Act [NWPA].[60] A recent Congressional Research Service report observed: "Abandonment of Yucca Mountain would probably further delay the Federal Government's removal of nuclear waste from reactor sites and therefore increase the government's liabilities for missing the NWPA deadline."[61]

Both CBO and DOE estimate it will cost taxpayers an additional $500 million for each year beyond 2020 the opening of Yucca is delayed. The ultimate cost of keeping the Yucca project in a holding pattern until an alternative and permanent solution is ultimately approved by Congress is unknown. But based on the history of Yucca's protracted and costly journey, it can be assumed that taxpayers will face billions of dollars in obligations.

CONCLUSION

Current debt levels place the government in a precarious position, which will worsen if interest rates rise. According to CBO, overall debt levels will increase by at least $1.2 trillion if interest rates increase under three likely scenarios.[62] Also, Treasury's creation of a "Plan C" – a contingent plan to identify lingering threats to the financial system,[63] such as possible waves of commercial real estate defaults – could signal that additional government rescues may be forthcoming.

Along with the mammoth obligations of Social Security, Medicare, and Medicaid, the contingent liabilities of the programs discussed in this paper must be addressed if the Federal Government is to chart a path fiscal stability. As it is, they only contribute to the vicious cycle of rising borrowing costs and rising debt levels that will be a burden for generations to come. They demonstrate the great difficulty and cost of the government's current responsibilities, and serve as a warning with respect to the expansion of government – in the health care sector and elsewhere – currently under consideration.

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[60] Congressional Research Service, *Nuclear Waste Disposal: Alternatives to Yucca Mountain*, 6 February 2009.

[61] Ibid.

[62] Congressional Budget Office, letter to House Budget Committee Ranking Member Ryan, 30 June 2009.

[63] "Treasury Works on 'Plan C' To Fend Off Lingering Threats," *The Washington Post*, 8 July 2009.