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CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Kenneth Troske

Congressional Oversight Panel Hearing on the TARP's Impact on Financial Stability

March 4, 2011

Thank you, Senator Kaufman.

I would like to start by thanking the witnesses for appearing before the panel today. I recognize that all of you are very busy people with a number of other responsibilities, so I appreciate you taking time to come here and help us with our oversight responsibilities.

Given the focus of this, our last Oversight Panel hearing, it seems appropriate to comment on the overall impact of TARP and the financial rescue in general. I was recently asked by a reporter whether my assessment of TARP would be different if TARP had ended up costing $356 billion, as was originally estimated, instead of the current estimate of $25 billion. I answered that any complete assessment of the success of TARP needed to take into account a number of factors, such as the role TARP played in preventing a financial collapse, the risk taxpayers were exposed to at the time TARP was enacted, the long-run impact TARP had on the market, and TARP's effect on the likelihood of future financial crises. So while the actual cost of TARP is an important component, it is only one factor that affects one's evaluation of the success or failure of TARP. So my answer to the reporter was, yes, I could still view TARP as a success even if the program had cost taxpayers $356 billion.

Throughout the financial crisis, the government's actions were circumscribed by the expectations of the market that, in the event of a financial crisis, the government would bail out firms whose bankruptcy threatened to increase systemic risk—expectations that were based on past government bailouts of large financial firms. In fact, as I have argued before, these expectations affected the severity of the financial crisis since the market responded to these expectations by encouraging firms to grow until they became too big to fail, thereby increasing the number of large firms, and in turn increasing the amount of money needed to stem the financial crisis. Also, once they'd attained too-big-to-fail status, the bailout guarantee provided these firms gave them the incentive to increase their risky behavior, thus increasing the likelihood of a financial crisis. Ultimately, the success or failure of TARP in particular, and the overall financial rescue in general, will hinge on whether we are able to eliminate the problem that caused this crisis:—too-big-to-fail firms. Unfortunately, at least so far, it does not appear that we have taken the necessary steps to end too big to fail.

In my opinion, the first step in fixing the problem of too-big-to-fail firms is defining exactly what we mean by systemically important firms or systemically important risks. That way the market has a clear understanding of which firms will receive support in the next financial crisis and which will not. Then the government needs to start charging market-based fees to these firms for the insurance provided to them, through substantially higher reserve requirements, which have been advocated by Professor Meltzer among others; by requiring firms to hold additional alternative reserves against their systemically risky holdings, as has been proposed by Professor Zingales; by charging firms for the bailout insurance along the lines proposed by the President of the Federal Reserve Bank of Minneapolis; or through some alternative mechanism which forces these firms to pay for the cost of the insurance that is currently being paid for by the American taxpayers. Only by ending the taxpayer-funded survival guarantee to large firms, both domestic and foreign, will we return basic market discipline to Wall Street and ensure that large financial firms face the same competitive pressures faced by firms operating on Main Street. In turn, this will ensure that future financial crises will be much less severe and the fixes to these crises will not involve putting trillions of taxpayer dollars at risk.