

Executive Summary*

In December 2009, in anticipation of the scheduled expiration of Treasury's authority under the Troubled Asset Relief Program (TARP) on December 31, 2009, the Panel issued a report that attempted to gauge the program's overall effectiveness. "There is broad consensus that the TARP was an important part of a broader government strategy that stabilized the U.S. financial system by renewing the flow of credit and averting a more acute crisis," the Panel wrote. "Although the government's response to the crisis was at first haphazard and uncertain, it eventually proved decisive enough to stop the panic and restore market confidence. Despite significant improvement in the financial markets, however, the broader economy is only beginning to recover from a deep recession, and the TARP's impact on the underlying weaknesses in the financial system that led to last fall's crisis is less clear."

The TARP did not, however, expire on its original schedule. Shortly after the release of the Panel's report, the Secretary of the Treasury exercised his legal authority to extend the program until October 3, 2010 – the latest date authorized by statute. This month, in anticipation of this final expiration of the program's most significant authorities, the Panel is revisiting and expanding upon its earlier findings about the program's effectiveness. The Panel will continue to explore these broad issues, as well as to evaluate specific TARP programs, in further monthly reports until its statutory authority expires on April 3, 2011.

When the Secretary extended the TARP, he stated that use of TARP funds in the extension period would be limited to three areas: providing mortgage foreclosure relief, extending capital to small and community banks, and increasing support for the securitization market through the TALF. He also noted that by extending the TARP, Treasury was preserving its authority to intervene swiftly in the event that the financial markets showed signs of another meltdown. This second justification ultimately played a much more important role during the extension period, as Treasury did not add any new funding to any programs intended to address foreclosures, small bank capitalization, or the securitization market. Treasury therefore used the TARP's extension more to extend the government's implicit guarantee of the financial system than to address the specific economic problems that the Secretary cited.

Over the last 10 months, Treasury's policy choices have been increasingly constrained by public anger about the TARP. The program is now widely perceived as bailing out Wall Street banks and domestic auto manufacturers while doing little for the 14.9 million workers who are unemployed, the 11 million homeowners who are underwater on their mortgages, or the

*The Panel adopted this report with a 4-0 vote on September 15, 2010.

countless other families struggling to make ends meet. Treasury acknowledges that, as a result of this perception, the TARP and its programs are now burdened by a public “stigma.”

Some of this stigma has arisen due to valid concerns with Treasury’s implementation of TARP programs and with its transparency and communications. For example, Treasury initially insisted that only healthy banks would be eligible for capital infusions under the Capital Purchase Program (CPP). When it became clear that some of these banks were in fact on the brink of failure, all participating banks – even those in comparatively strong condition – became tainted in the public eye. Stigma may also have arisen due to deep public frustration that, whatever the TARP’s successes, it has not rescued many Americans from suffering enormous economic pain. Treasury claims that the pain would have been far worse if the TARP had never existed, but this hypothetical scenario is difficult to evaluate – in part due to regrettable omissions in data collection on Treasury’s part. For example, since the Panel’s second report in January of 2009, it has called for Treasury to make banks accountable for their use of the funds they received. It has also urged Treasury to be transparent with the public, in particular with respect to the health of the banks receiving the funds. The lack of these data makes it more difficult to measure the TARP’s success and thus contributes to the TARP’s stigmatization.

The program is today so widely unpopular that Treasury has expressed concern that banks avoided participating in the CPP due to stigma, and the legislation proposing the Small Business Lending Fund, a program outside the TARP, specifically provided an assurance that it was not a TARP program. Popular anger remains high about taxpayer support of America’s largest banks, and that anger has only intensified in light of the continuing economic turmoil. The TARP’s unpopularity may mean that, unless the program’s effectiveness can be convincingly demonstrated, the government will not authorize similar policy responses in the future. Thus, the greatest consequence of the TARP may be that the government has lost some of its ability to respond to financial crises.

In order to gain a full perspective on the TARP, the Panel consulted with several outside experts: Professors Alan Blinder, Simon Johnson, Anil Kashyap, and Kenneth Rogoff. While differing on numerous points, these economists generally agreed that the TARP was both necessary to stabilize the financial system and that it had been mismanaged and could pose significant costs far into the future. The early change in TARP strategy from asset purchases to capital injections, followed by the rollout of numerous seemingly unconnected programs, combined with largely ineffective communication of the reasoning behind these actions, spread confusion in the public and undermined trust in the TARP. Further, the experts consulted by the Panel unanimously felt that the program created significant moral hazard. After all, the government had alternatives for the form of its intervention. As an alternative to subsidizing large, distressed banks, it had the option of putting them into liquidation or receivership, removing failed managers, and wiping out existing shareholders. The fact that the government

chose not to impose such stringent costs upon TARP recipients meant that the program's moral hazard costs were much greater than necessary.

Ultimately, any evaluation of the TARP must be guided by the program's stated goals. Congress authorized Treasury to use the TARP in a manner that "protects home values, college funds, retirement accounts, and life savings; preserves homeownership and promotes jobs and economic growth; [and] maximizes overall returns to the taxpayers of the United States." But economic weaknesses persist. Since the TARP was authorized in October 2008, 7.1 million homeowners have received foreclosure notices. Since their pre-crisis peaks, home values have dropped 28 percent, and stock indices – which indicate the health of many Americans' most significant investments for college and retirement – have fallen 30 percent. In short, although the TARP provided critical government support to the financial system when the financial system was in a severe crisis, its effectiveness at pursuing its broader statutory goals has been far more limited.