Congressional Oversight Panel Assesses the TARP on the Eve of Its Expiration

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For Immediate Release

Finds Major Economic Weaknesses, Stigma, and Moral Hazard Remain

WASHINGTON, D.C. - The Congressional Oversight Panel today released its September oversight report, "Assessing the TARP on the Eve of Its Expiration." The Panel found that, although the Troubled Asset Relief Program (TARP) provided critical support to the financial markets at a time when market confidence was in freefall, the program has been far less effective in meeting its other statutory goals, such as supporting home values, retirement savings, and economic growth.

Under its original authorization, the TARP would have expired at the end of 2009. Late last year, however, 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 the final expiration of the TARP's most significant authorities, the Panel explored the program's overall effectiveness. The Panel found that:

Although the TARP quelled the financial panic in the fall of 2008, severe economic weaknesses remain even today. Since the TARP was authorized in October of 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. Given that Treasury was mandated by law to use the TARP to address these measures of the economy, their lingering weakness is cause for concern.

The TARP's extension served primarily to extend the implicit guarantee of the financial system. When the Secretary extended the TARP, he stated that any new use of funds would be limited to providing mortgage foreclosure relief, extending capital to small and community banks, and supporting the securitization market. He also noted that extending the TARP would preserve his authority to intervene swiftly in the event of another financial crash -- essentially prolonging the government's "implicit guarantee" of the financial system. In practice, this second justification proved by far the more significant, as Treasury did not add any additional funding to any programs intended to address the specific economic weaknesses identified by the Secretary.

The TARP's "stigma" has grown and may prove an obstacle to future financial stability efforts. Treasury's policy choices have been increasingly constrained by public anger about the TARP. For example, the TARP is today so widely unpopular -- due in part to shortcomings in Treasury's transparency and its implementation of TARP programs -- that some banks refused to participate in the Capital Purchase Program for fear of losing customers. The unpopularity of the TARP may mean that the government will not authorize similar policy responses in the future. Thus, the TARP's greatest consequence may be that the government has lost some of its ability to respond to financial crises.

Economists surveyed by the Panel raised severe concerns about moral hazard. The Panel sought the input of four prominent economists on the effectiveness of the TARP. These experts generally agreed both that the TARP was necessary to stabilize the financial system and that it had been mismanaged and could pose significant costs far into the future. Further, the economists unanimously felt that the program created significant moral hazard. TARP offered its funding on relatively generous terms, without requiring participating institutions to enter liquidation or receivership, remove failed managers, or wipe out existing shareholders. The fact that the government chose not to impose such stringent costs meant that the TARP's moral hazard costs were much greater than necessary.

The full report is available at http://cop.senate.gov/. The Congressional Oversight Panel will continue to issue monthly reports evaluating the TARP until the Panel's statutory authority expires on April 3, 2011.

The Congressional Oversight Panel was created to oversee the expenditure of the Troubled Asset Relief Program (TARP) funds authorized by Congress in the Emergency Economic Stabilization Act of 2008 (EESA) and to provide recommendations on regulatory reform. The Panel members are: J. Mark McWatters; Richard H. Neiman, Superintendent of Banks for the State of New York; Damon Silvers, Policy Director and Special Counsel for the AFL-CIO; Kenneth Troske, William B. Sturgill Professor of Economics at the University of Kentucky; and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School.