Troubled Asset Relief Program: Year-End Review
December 9, 2009

Today, Treasury Secretary Tim Geithner requested that the Troubled Asset Relief Program (TARP) be renewed through October 3, 2010. This request will automatically renew TARP unless overridden by Congress.

Also today, the Congressional Oversight Panel (COP) released its year-end report evaluating the effectiveness of the program.

Congress created TARP in October of 2008 on the heels of the largest financial crisis since the great depression, and gave the Department of the Treasury broad authority to spend up to $700 billion to promote financial market stability.

Originally intended to purchase so-called "toxic-assets" and take them off banks' balance sheets, TARP has been used much more broadly by both the Bush and Obama administrations. It has utilized a combination of equity purchases, loans, and guarantees to stabilize the financial sector, and it also has expanded its reach to the auto industry and small businesses.

Secretary Geithner has announced his intent to begin winding down many TARP programs, while focusing on mortgage relief, assistance for small banks and businesses, and support for the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF).

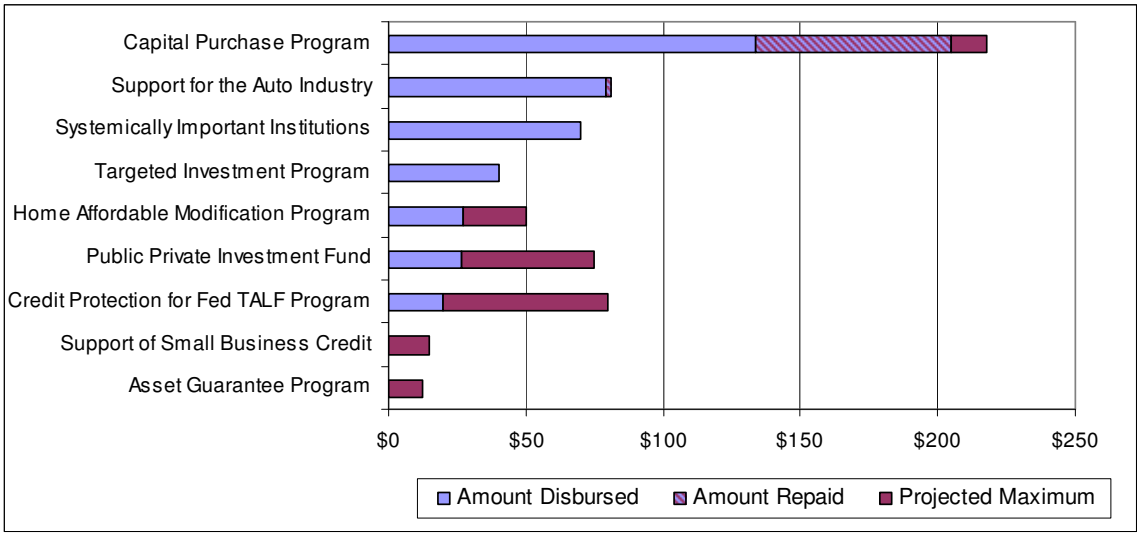
In evaluating TARP's effectiveness so far, the COP found that the program has helped to stabilize financial markets and the real economy. This is consistent with other recent findings.

Yet, while the financial sector is stronger today than a year ago, it still remains weak and its outlook uncertain. There may be strong arguments to continue the program for another year. However, we strongly believe these funds should not be diverted to other purposes, such as a financial reform bill or unemployment legislation (read http://crfb.org/blogs/tarp-offset-or-gimmick).

How Has TARP Been Used?

The Committee for a Responsible Federal Budget has been tracking TARP spending over the last year, and continues to do so at http://www.stimulus.org. Since TARP began, the Treasury has established 11 programs and committed as much as $566 billion of the program's $700 billion (some programs originally committed more, and have since been reduced).

Fig. 1: TARP Spending and Announced Commitments (billions)



Source: U.S. Department of the Treasury and Stimulus.org.

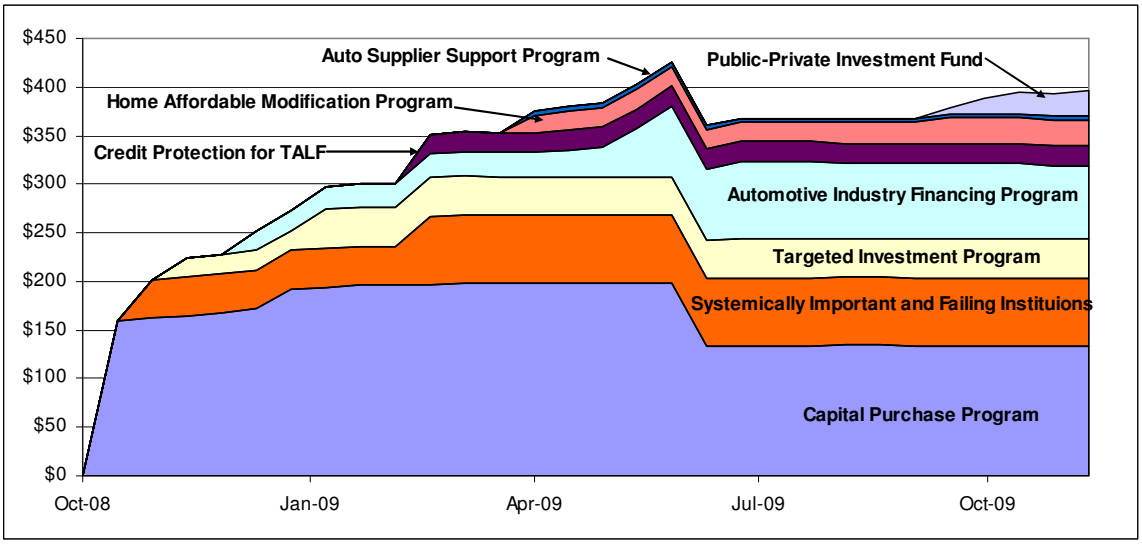
TARP began by investing billions of dollars in bank equity stakes through a $250 billion Capital Purchase Program (CPP). The maximum size of the program was later revised downward to $218 billion – of which $134 billion (on net) has been spent. Among the largest purchases of stock were $25 billion each in J.P.Morgan Chase, Wells Fargo, Citigroup, and Bank of America, along with $10 billion each in Goldman Sachs, and Morgan Stanley. Outside of the CPP, the Treasury provided additional support to three institutions—Bank of America, Citigroup, and IAG—deemed vital for financial markets.

TARP has since expanded its reach, providing loans and equity purchases for the auto industry both before and through the bankruptcies of Chrysler and General Motors in April and June, respectively. It has also offered support for homeowners and small businesses, provided certain asset guarantees, and has helped foster the purchase of "toxic assets" and other asset-backed securities.

The Costs of TARP

On net, TARP has used $386 billion to date. This includes $467 billion of spending, offset by the $71 billion in investments brought back to the program and the $10 billion TARP has received in dividends.

Fig. 2: TARP Spending by Program Over Time (billions)



Source: U.S. Department of Treasury and Stimulus.org.

Since these funds have been used to purchase assets and issue loans of value, their budgetary impact is measured on a risk-adjusted present value basis. In other words, the program's deficit impact depends on the *net cost* of each transaction, factoring in the value to the government of each asset or loan held and adjusting to account for risk.

In measuring deficit impact, the Congressional Budget Office (CBO) assigns a "subsidy rate" for each program. Some programs, like the Targeted Investment Program, are believed to have high value, and therefore low subsidy rates (10 percent in this case). For other programs, such as the Automotive Industry Financing Program, the opposite is true (this program has a 73 percent subsidy rate).

Based on CBO-calculated subsidy rates, we estimate TARP's deficit impact to be about $167 billion so far.

Looking forward, the cost of future TARP spending will depend both on the types of spending undertaken (and their subsidy rates) and the total amount of the $700 billion program used. The CBO estimates TARP ultimately will spend about $600 billion for a cost of $242 billion. Secretary Geithner, this morning estimated the program would spend $550 billion at a final cost of about $140 billion.

Fig. 3: TARP Program Descriptions and Costs

TARP Program	Maximum Amount	Net Disbursal	Deficit Impact	Purpose
Capital Purchase Program (CPP)	$218.0	$133.7[&]	$24.1	To purchase equity shares from banking institutions to increase liquidity in the financial system
Targeted Investment Program (TIP)	$40.0	$40.0	$4.0	To provide "exceptional assistance" to Bank of America and Citigroup, which were deemed vital for financial markets
Asset Guarantee Program (AGP)	$12.5	$0.0	$6.0	To assist in a multi-agency guarantee of $425 billion in Citigroup and Bank of America assets
Systemically Important and Failing Institutions (SIFI)	$70.0	$69.8	$35.0	To provide assistance to AIG based on the determination that its failure would create enormous financial disruptions
Automotive Industry Financing Program (AIFP)	n/a	$75.4	$56.2	To assist the automobile industry and manage bankruptcies by providing loans and equity purchases
Auto Supplier Support Program (ASSP)	$5.0	$3.5	$2.8	To provide guarantees for payments owed to auto suppliers from automakers participating in AIFP
Credit Protection for Federal Reserve TALF Program	$80.0	$20.0	$2.0	To provide credit protection for the Fed's Term Asset-Backed Securities Loan Facility (TALF), which offers loans to purchase certain asset-backed securities
Public-Private Investment Program (PPIP)	$75.0	$26.7	$9.6[^]	To facilitate the private purchase of the "toxic assets" on many banks' balance sheets
Home Affordable Modification Program (HAMP)	$50.0	$27.4	$27.4	To stabilize the housing market and stem foreclosure rates by reducing mortgage payments and refinancing GSE loans
Support of Small Business Credit	$15.0	$0.0	$0.0	To purchase existing Small Business Administration-backed securities
Capital Assistance Program (CAP)	n/a (program closed on November 9 having made no investments)	$0.0	$0.0	To provide additional capital buffers against larger than expected future losses, if conditions supported such actions
Total	$698.8*	$386.4[+]	$167.1	

[&]Net of $81.1 billion in buy backs.
^ CBO has not yet calculated a subsidy rate for this program. We assume the overall TARP subsidy rate.
*Includes uncommitted funds. A small portion of the $700 billion authorized for TARP was reduced to finance the Helping Families Save Their Homes Act.
[+]Net of $10.1 billion in dividends.
Source: U.S. Department of the Treasury and Stimulus.org.
Note: Visit http://www.stimulus.org for expanded descriptions of TARP programs, updated regularly.

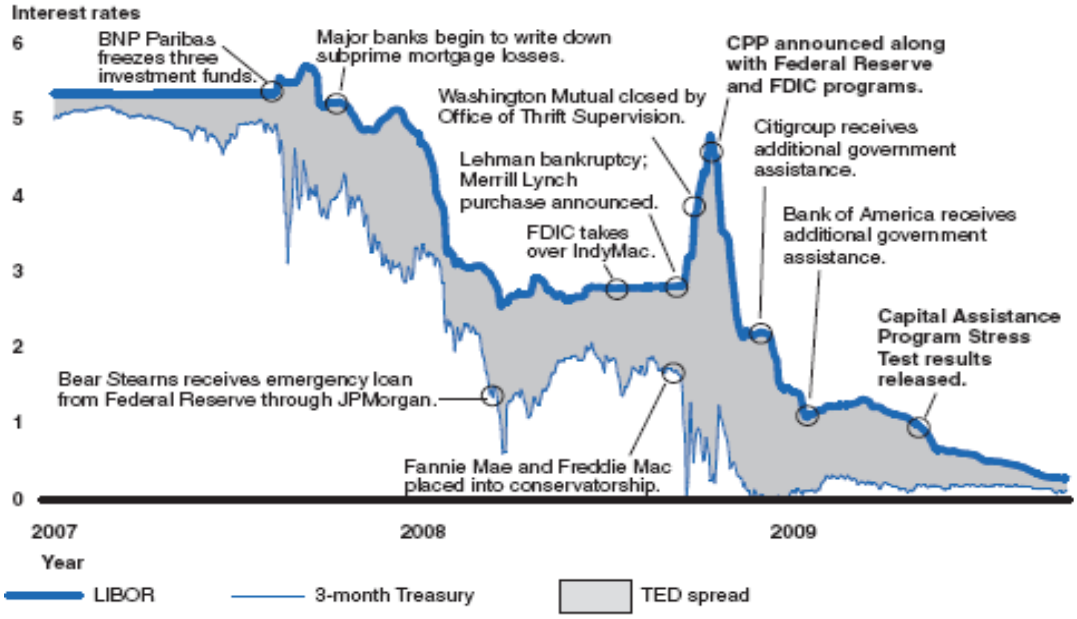
Evaluating TARP's Effectiveness

In its year-end report this morning, the Congressional Oversight Panel (COP) found that TARP played an important role in the government's broader efforts to stabilize financial markets and restore the flow of credit. This is in line with earlier findings from both the Special Inspector General for TARP (SIGTARP) and the Government Accountability Office (GAO). Yet the COP also agreed with GAO and SIGTARP that weaknesses remain, and it is unclear whether or not banking institutions will be able to perform sufficiently once TARP benefits are withdrawn.

Some of the metrics of improvement include:

TED - One of the clearest indicators of improvement in financial markets is the TED spread -- the difference between the interest rates on interbank loans and short-term U.S. government debt – which is considered a gauge of credit risk that measures the willingness of banks to lend to other banks. After peaking at 4.65% in October 2008, the spread has narrowed to only 0.21% -- in line with pre-crisis levels.

Fig. 4: GAO Graph of TED Spread, 3-Month LIBOR, and 3-Month Treasury Bill Yield



Source: Government Accountability Office (http://www.gao.gov/new.items/d1016.pdf).

Raising Capital - The activities since the "stress tests" of the nation's 19 largest banks last May seem to confirm the financial sector is improving. Of the 10 banks shown to be in need of additional capital buffers from the original stress tests, the Federal Reserve recently found that only one – GMAC – has failed to raise this capital. And GMAC will continue to access TARP's Automotive Industry Financing Program for support.

Lending - Lending by some of TARP's largest participants has improved since the program began investing in banks last October. According to GAO, the 21 largest banks in the Capital Purchase Program (CPP) have extended more than $2.2 trillion in new loans since receiving TARP funds – including $579 from Bank of America—which is considered to be fairly strong given the severity of the recession. Participating banks saw a much greater improvement in their capital positions than banks outside the program.

Government Repayments - Many of these banks also have been able to return government funds. So far, more than 50 banks have re-purchased $71 billion of their own stock. Bank of America plans to join this list, having recently announced its intent to buy back the $45 billion of equities currently held by TARP in the CPP and TIP.

It is important to note that the causes of improvements cannot be attributed to TARP alone. Actions taken by the Federal Reserve, FDIC, Treasury Department, and other agencies also likely played a role (CRFB tracks many of these efforts at http://www.stimulus.org). Unrelated improvements in the real economy also could have contributed to the improvements.

Moreover, not all metrics of financial sector health and aspects of TARP are doing as well:

Loan Demand - While bank lending has returned to more stable levels, financial institutions have reported slight deteriorations in loan demand as overall lending still remains subdued. Federal Reserve district banks have reported particularly weak demand for home mortgage loans.

Bank Failures - Even though more than 700 banks have accessed TARP funds through CPP, bank failures continue to rise. In a typical year, only a handful of banks usually fail. Since the beginning of the financial crisis, about 160 banks have failed. The significant majority of these failures—130—have occurred in 2009, *after* TARP investments began making their way through the economy.

Continued weakness of AIG – Recently, AIG, which holds roughly $70 billion in TARP funds, failed to make its last quarterly payment on the Senior E preferred stock held by the government, and the company's long-term viability has been reported to depend on "market conditions and government support." The federal government has had to ease the terms of the company's repayment three times due to its inability to pay.

Continued weaknesses in the auto industry - The auto industry also appears to be doing poorly, and its loans are very unlikely to be recouped in full. Full repayment of

the $50 billion invested in General Motors, for example, would require the company's stock value to rise almost ten-fold, and it is not clear whether GM will remain viable, even without repaying these investments.

Foreclosures - On the mortgage front, Treasury officials have reported that the Home Affordable Modification Program has permanently reduced monthly mortgage payments on more than 650,000 mortgages, saving families an average of about $575 in monthly payments. Yet, mortgage delinquencies have continued to rise, reaching 14.4 percent recently – the highest ever recorded.

Though TARP has helped the financial sector and economy, it has also imposed a burden on the taxpayer. True, the cost has come down from earlier estimates – the CBO now believes it will cost $242 billion rather than roughly $350 billion in March. However, CBO still puts its overall subsidy rate at around 36 percent. That means the taxpayer is likely to lose about one third of its TARP investment (on a risk-adjusted present value basis).

TARP also has imposed non-budgetary costs. In particular, bailing out the banking industry has created a "moral hazard" whereby an implicit government guarantee may encourage future risky behavior. Repairing this damage will not be an easy task, and policymakers and experts have yet to form a consensus on how to prevent financial companies from taking on too much risk.

Where We Go From Here

The evidence suggests TARP has helped stabilize the financial sector. Policymakers must now work carefully to begin unwinding some support, shaking out moral hazard, and laying the ground work for future debt reduction. Failure to accomplish these goals could lead to a new crisis in the near future.

The Administration and Congress should *not* repurpose TARP to be used for the policy de jour. The funds were provided on a deficit basis because of their urgent nature and the desirability of deficit-financed stimulus at the time. And in fact, the legislation establishing TARP called for policymakers to ultimately pay for any losses the program incurred.

The fact that TARP is now expected to add less to the deficit than previously thought should not be an excuse for using the difference to add to the deficit through other means. This is the case particularly since current budget conventions allow Congress to

calculate savings against the older and more generous baseline rather than the newer and more realistic one.

Regarding TARP's future more generally, the Administration is walking a tightrope. Winding down the program too early could derail the nascent economic recovery, but continuing the extraordinary actions taken to stabilize the economy for too long could precipitate a new crisis.

Ultimately, there are many tough decisions to be made. And there is not necessarily a strong economic consensus of what should be done. But decisions must be made on policy grounds, not political grounds. And policymakers must not lose sight of our debt crisis when making these decisions.

The Committee for a Responsible Federal Budget will continue to track TARP on a regular basis at http://www.stimulus.org.

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