Thank you for this opportunity to share with you my views about the successes and failures of TARP.

TARP and the recovery of troubled assets were not ends in themselves, but means to an end, namely the recovery of the economy. TARP was justified to the American people as necessary to maintain the flow of credit. It was hoped that it would play a pivotal role in dealing with the flood of mortgage foreclosures and the collapse of the real estate market that led to the financial crisis.

In these ultimate objectives, TARP has not only been a dismal failure—four years after the bursting of the real estate bubble and three years after the onset of recession, unemployment remains unacceptably high, foreclosures continue almost unabated, and our economy is running far below its potential, a waste of resources in the trillions of dollars. Lending, especially to SME’s, is still constrained. While the big banks were saved, large numbers of the smaller community and regional banks that are responsible for much of the lending to small- and medium-sized enterprises are in trouble. The mortgage market is still on life support.

I believe the way the program was managed has in fact contributed to the economy’s problems. The normal laws of capitalism, where investors must bear responsibility for their decisions, were abrogated. A system that socializes losses and privatizes gains is neither fair nor efficient. TARP has led to a banking system that is even less competitive, where the problem of too-big-to-fail institutions is even worse.

There were six critical failings of TARP. First, it did not demand anything in return for the provision of funds—it neither restrained the unconscionable bonuses or payouts in dividends, it put no demands that they lend the money that was given to them, it didn’t even restrain their predatory and speculative practices.

Secondly, in giving money to the banks, they should have demanded appropriate compensation for the risk borne. It is not good enough to say that we were repaid, or we will be repaid, or we will be almost repaid. If we had demanded arms-length terms—terms such as those that Warren Buffett got when he provided funds to Goldman Sachs—our national debt would be lower, and our capacity to deal with the problems ahead would be stronger. The fairness of the terms is to be judged ex ante, not ex post, taking into account the risks at the time.

Thirdly, there was a lack of transparency.
Fourthly, there was a lack of concern for what kind of financial sector should emerge after the crisis. There was no vision of what a financial sector should do, and not surprisingly, what has emerged has not been serving the economy well.

Fifthly, from the very beginning TARP was based on a false premise—that real estate markets were temporarily depressed. The reality was that there had been an enormous bubble, for which the financial sector was largely responsible. It was inevitable that the breaking of that bubble—especially given the kinds of mortgages that had been issued—would have enormous consequences that had to be dealt with. Many of the false starts, both in asset recovery and in homeowner programs, have been a result of building on this false premise. Particularly flawed was the PPIP, a joint public-private program designed to have the government bear a disproportionate share of the losses; the private sector, while putting up minimal money, would receive a disproportionate share of the gains. It was sold as helping the market “re-price”—but the prices that would emerge would be prices of options, not of the underlying assets.

The standard wisdom in such a situation is summarized in a single word, restructure. But TARP, combined with accounting changes, made things worse.

The sixth critical failure of TARP was that some of the money went to resurrect securitization (under the TALF program)—without an understanding of the deeper reasons for the failure of mortgage securitization. These attempts to revive the market have failed, and, to me, this is not a surprise.

There were alternative approaches, evident at the time of crisis, and even more so as time went on, that I describe more fully in my written testimony. These approaches, had they been taken, would have led not only to a stronger economy today, but would have led our government to be in a stronger fiscal position.

We might say all of this is water over the dam. But it’s not. We have not repaired our banking system, and indeed, with the enhanced moral hazard and concentration in the financial sector, the economy remains very much at risk, in spite of Dodd-Frank. Our economy is not back to health, and will not be until and unless lending is restored, especially to small and medium enterprises. This means that we need a more competitive financial sector, and one more focused on its core mission of lending. There is a wide array of important activities performed by the financial sector, but not all of them should be undertaken by government-insured banks. Banks won’t focus on lending if they can continue to make more money by publicly-underwritten speculation and trading, or by exploiting market power in the credit and debit card markets. Moreover, too-big-to-fail institutions, whether they be mortgage companies, insurance houses, commercial or investment bank, pose an ongoing risk to our economy and the soundness of government finances.

I want to conclude with two more general comments. First, we should not forget the process by which TARP—and this Oversight Panel—was created. That political process does not represent one of the country’s finest moments. At first, a short, three-page bill
was presented, giving enormous discretion to the Secretary of Treasury, without Congressional oversight and judicial review. Given the lack of transparency and potential abuses to which I have already referred—which occurred even with full knowledge that there was to be oversight—one could only imagine what might have occurred had the original bill been passed. Fortunately, Congress decided that such a delegation of responsibility was incompatible with democratic processes. On the other hand, the political deals required to get TARP passed, with an estimated $150 billion in largely unjustified and unjustifiable tax breaks, do not speak well for our democracy. When we think of the cost of TARP, surely the price tag associated with the tax breaks should be included in the tally.

Nor should we underestimate the damage that the (correct) perception that those who were responsible for creating the crisis were the recipients of the government’s munificence; and the lack of transparency that permeated this and other government rescue efforts has only reinforced public perceptions that something untoward has occurred.

For these, and the other failings of TARP, our economy, and our society, have paid—and will continue to pay-- a very high price.