Birthday For A Bailout

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TARP turns a year old Saturday. Despite its problems, it could live to see its second birthday.

WASHINGTON -- As of Saturday, it will have been a year since the U.S. Congress created the $700 billion Troubled Asset Relief Program, originally intended as a bailout just for the financial system.

Emphasis might be placed on the word "Troubled," as TARP has been plagued by controversy since conception. For the past year, the Bush and Obama administrations have used the program as a bailout smorgasbord, with entrees for the auto and mortgage industries, the securitization market for consumer goods, American International Group (See "What AIG Really Owes Taxpayers") and the banking sector at large. Toxic assets remain on bank balance sheets, Congress is still busy plugging TARP's holes on executive compensation limits and the program is a significant part of the country's projected $1.6 trillion deficit for 2009.

Treasury Secretary Tim Geithner must decide by Dec. 31, when the TARP is scheduled to expire, whether to extend it for another year. He doesn't need congressional approval, but it's a no-win decision--in many ways, it's not politically popular to continue the program. However, it's a powerful weapon against another economic catastrophe.

"[TARP] got us off the verge of complete financial calamity," says Lily Fu Claffee, an attorney at Jones Day in Washington and a former Treasury official who left the Bush administration in mid-2008. "Its very existence is stabilizing."

TARP is only part of a suite of government rescue efforts within the last year, including a $787 billion stimulus package and trillions of dollars in emergency actions by the Federal Reserve and Federal Deposit Insurance Corp. But with other government programs expiring and growing concerns about a new wave of bank foreclosures, there's a strong argument for keeping TARP alive. The Treasury still has about $135 billion allocated for new programs, including $70 billion already repaid by the likes of Goldman Sachs, Bank of New York Mellon and JPMorgan Chase. Treasury officials haven't said what they plan to do with these funds.

"My understanding is that the administration would like to use it for another rainy day," says Harvard law professor Hal Scott, who also directs the independent Committee on Capital Markets Regulation. "I think that would be wise." If another big bank were on the brink of collapse, he says, there might no other alternative than to use TARP funds to keep it from pulling down the economy.

Despite signs of recovery, the economy is by no means on stable footing. The FDIC now thinks U.S. bank failures will balloon to $100 billion in losses through 2013, rather than the previous estimate of $70 billion. (See "FDIC: Get Ready For Failure Flood.") The housing sector remains troubled and could be for some time to come. (See "Reasons To Remain Wary About Housing.")

The commercial real estate market seems next in line for a spell of misery. (See "Big Troubles, Small Bailout.")

At the same time, however, the government's economic rescue options are dwindling. Given the controversy over the $787 billion stimulus bill in February, concerns about government encroachment and a looming election year, it's unlikely that that administration has the political capital to ask Congress for a second stimulus. Early next year the Federal Reserve will end its $1.45 trillion effort to prop up the mortgage market. (See "Stopping The Presses.") Treasury's guarantee program for money market mutual funds ended earlier this month, and the FDIC's debt guarantee program is scheduled to expire Oct. 31. Congress has already removed from the federal budget the $250 billion "placeholder" the Obama administration requested to prop up financial markets if necessary.

If Geithner decides to extend TARP, the move will only give the administration the ability to create new programs with the money already allocated--not to spend additional taxpayer money. Firms that have received TARP money don't have to pay it back by Dec. 31, if the program expires on schedule; they just won't be able to receive any more from this particular bailout kitty.

But there's a growing chorus on Capitol Hill to end the bailouts once and for all. Rep. Jeb Hensarling, R-Texas, a member of the TARP Congressional Oversight Panel, has introduced a bill that would end the program by the year's end. It also requires the Treasury to liquidate its stake in a bank once a company repays its TARP obligations.

"TARP today does more harm than good," says Hensarling. He thinks the program is "clearly being abused" and argues that the fact that it's still around causes private capital to sit on the proverbial sidelines wondering who's going to receive the next bailout. If the administration needs emergency funding, Hensarling says, the Fed has the authority to administer it, or the White House can ask Congress for more.

Expect a full-fledged fight on Capitol Hill this fall over what to do. Although it's been reported that the repaid TARP funds have produced a 17% profit for Uncle Sam, there's no telling what the return will be for the hundreds of other firms that have accepted money from the program. TARP's official watchdog, Neil Barofsky, says it's "extremely unlikely that the taxpayer will see a full return on its TARP investment."

In addition, there are doubts about the rescue initiatives' effectiveness in modifying mortgages and their ability to cleanse balance sheets of sour assets. Since TARP props up the biggest banks, it may have inadvertently exacerbated the "too big to fail" problem, and some worry that it helps to perpetuate a culture of bailouts.

"I'm afraid they've learned that being generous to the financial system is the most effective way to get things back on their feet quickly," says Columbia University finance professor David Beim.

Maybe so, but a bailout culture is the leading cause of bailout attention fatigue. And that might be the deciding factor in letting TARP live until its second birthday.