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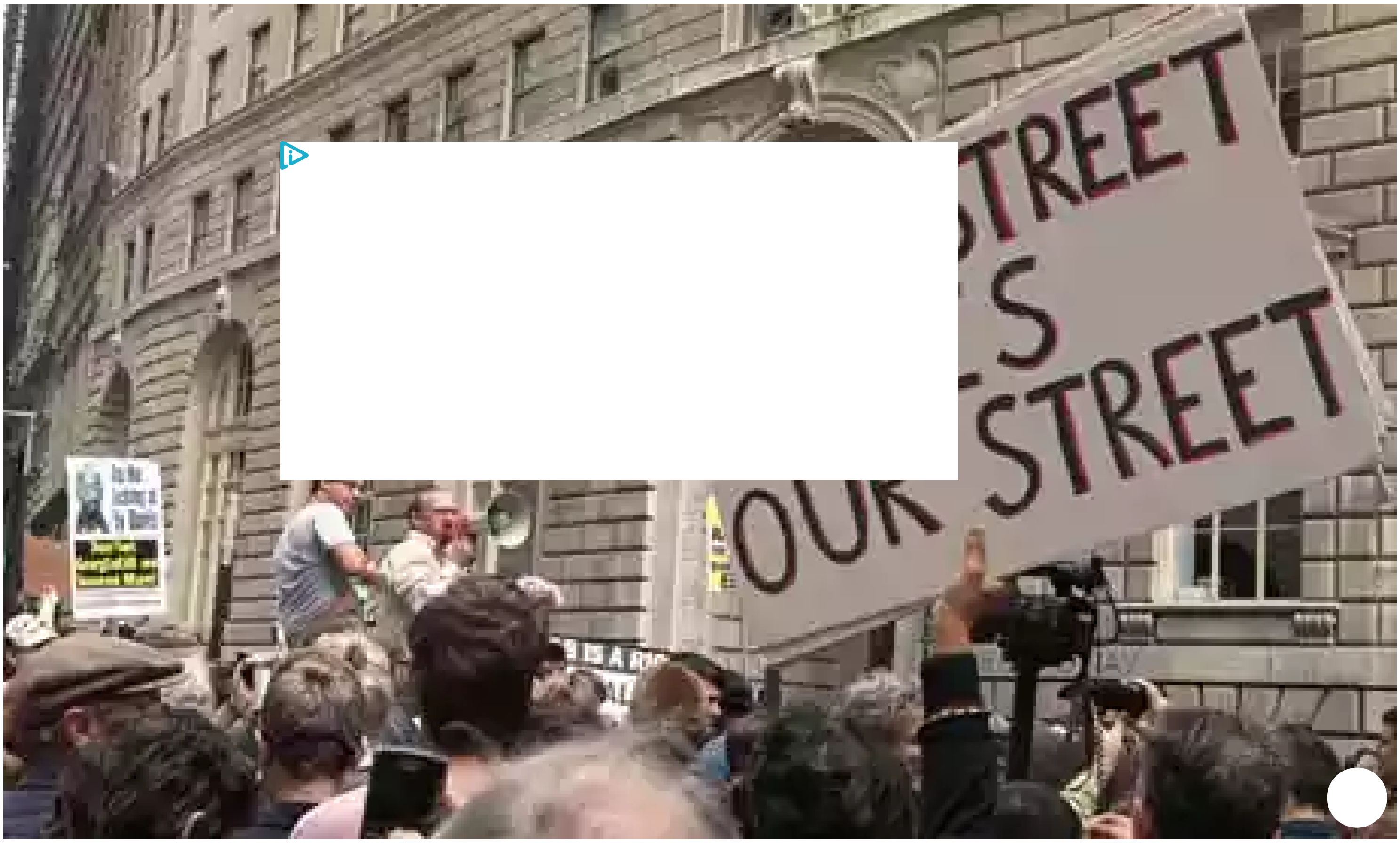

'Tarp's legacy is disturbing' - the bank bailout five years later

Whatever short-term benefits government money had for Wall Street, the precedent has bad tidings for the economy's future

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This is the third in a series looking back on the Troubled Asset Relief Program (Tarp) - the government intervention that sought to calm the financial crisis and restart the economy in 2008.

Anat Admati: "They would prefer us to think everything is fine"

Authorized through Tarp, the US Treasury invested hundreds of billions of funds in financial institutions. Meanwhile, only $8.6bn were directed at the "troubled assets" of distressed homeowners, and some funds were abused.

Combined with many loans and guarantees programs administered by the Federal Reserve, the FDIC and the Federal Reserve Bank of New York, Tarp helped calm the panic that followed Lehman's bankruptcy. The direct cost of Tarp will likely be relatively small, but so were its benefits; it was not the best use of taxpayer money.

For example, Tarp invested about $160bn in the largest 19 US banking institutions, just a bit more than the $131bn payouts that these institutions had made to their shareholders just in 2006-2008 alone. Remarkably, more than $70bn were paid out to shareholders between summer 2007, when problems in mortgage markets were evident, and early 2009, through the worst of the crisis. Had the banks invested this money instead of paying it out, they would have been able to better handle losses, and the credit crunch that motivated Tarp would have been less severe.

Overhanging debt can prevent banks from lending again, in the same way it can cause a distressed homeowner to avoid investing in maintenance. Tarp did little to improve lending because it actually placed more debt burdens on its recipients. Most banks rushed to repay Tarp to avoid the restrictions on executive and shareholder payouts that accompanied it. Remaining highly indebted, banks likely continued denying worthy loans, choosing riskier investments with more "upside" instead.

The Federal Reserve is repeating past mistakes. It's failing to clean up unrecognized losses and ensure that the banking system can better - and more consistently - support the economy, without needing support or causing harm. The banks are not as strong as they, or "stress tests", suggest, and the system is not in good enough shape to deal with crises such as those in Europe, failed municipalities or rising interest rates.

Tarp's legacy is disturbing. Most of those who got into financial trouble because of "troubled assets" suffered severe consequences, and many innocent people are still suffering the collateral damage. Those who aren't are the bankers who took excessive risks and the policymakers who did not control the system effectively. They would prefer us to think that everything is fine now, when in fact much too little has changed.

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