
Government's TARP and Stimulus Programs Are Earning Good Returns on Investment

by Matthew Raskind, August 2010

The extensive media coverage of the government's rescue and stimulus programs during the recession has faded away, with far less coverage of their outcomes. Unless an individual is willing to devote an extended period of time to digging through government websites and trawling for useful data in reports, it is quite difficult to extract the effects of the government's investments during the recent economic crisis. Despite the lack of publicity these programs are receiving, it appears that the investments have been quite effective and some have even recognized a quality return on the funds spent. More importantly, with the notable exceptions of the automotive industry and AIG, most of these programs have either run their course or are in their twilight, suggesting that these investments were targeted and sized appropriately. When all of the costs and benefits are tallied, it seems as though the programs under the Troubled Asset Relief Program (TARP), the American Reinvestment and Recovery Act (ARRA), and the Federal Reserve have proven valuable in efforts to stem the financial crisis and to spur the economic recovery.

Perhaps the most misleading figure attached to the TARP is \$700 billion, the amount of money in total the government appropriated towards the recovery program. Much more apt is the number \$109 billion; this is the total amount, as estimated by the Congressional Budget Office (CBO), that the investments in TARP are expected to cost the American taxpayers when all is said and done. These unrecovered funds stem primarily from three components of the program: 1) financial assistance to AIG; 2) financial assistance to Chrysler and GM (also known as the Automotive Industry Financing Program, or AIFP), and; 3) the Home Affordable Modification Program (HAMP). Cumulatively, these programs are expected to lose \$92 billion. These losses are defrayed somewhat by the Capital Purchase Program (CPP) and the assistance to Bank of America and Citigroup through the Targeted Investment Program (TIP) and the Asset Guarantee Program (AGP), which cumulatively provided a net return of \$7 billion on the government's investments. Note that these numbers do not account for the financial stability that resulted from this injection of capital, thus understating the true returns to the American and world economies. Analysts and politicians differ on the degree of benefits from the various programs; in this article we'll review the facts as well as some assessments of the outcomes of the government spending.

The Capital Purchase Program, which invested in 707 banks and other financial institutions through the purchase of preferred shares paying dividends at set rates, is the largest TARP program in terms of total cash invested, as over \$200 billion has been invested to date. As of mid-February 2010, \$130 billion of this stock had been repurchased by 70 institutions, thus indicating that they no longer need the infusion. According to an estimate by the CBO, approximately \$2 billion in "profit" is expected from this program from dividends and disposition of warrants, despite the fact that certain participants went bankrupt (such as CIT Group) or were

taken over by the FDIC (such as Pacific Coast National Bancorp). Thus, not only did this program encourage new lending and help to provide liquidity for banks, it also provided a small financial return to the government to help cover the costs of other TARP programs.

Similar to the CPP, the government's assistance to Bank of America and Citigroup not only helped to stabilize the financial system but also yielded a monetary return for the Treasury. Each of these institutions received \$47.5 billion in capital through the CPP, TIP, and AGP. All of the investment has been repaid, and the Treasury has realized a gain of \$6 billion dollars from assistance provided to these two banks under just the AGP and TIP.

In addition to making the phrase "too big to fail" a permanent fixture in the public lexicon, the government assistance to AIG through TARP is likely to be the program that ends up realizing the biggest loss on its investment. The Treasury purchased \$40 billion in preferred stock from AIG and has created an additional \$30 billion preferred line of credit on which \$7.5 billion has been drawn. As of mid-February 2010, AIG had not repurchased any of the preferred stock, and, even more troubling, the firm had not paid its quarterly cash dividends on these investments. The Treasury is currently considering a plan to convert their preferred shares to common stock and to sell the holdings over two years to the public. The CBO estimates that the program will involve a subsidy rate of approximately 50%, or a \$36 billion loss to taxpayers. In addition, the Federal Reserve of New York invested approximately \$182.3 billion in AIG through a line of credit, investment in preferred shares of American Insurance Association (AIA) and American Life Insurance Co. (ALICO), and the Maiden Lane II and III investment vehicles. Since the beginning of the second quarter of 2010, the company has paid back \$3.5 billion on the line of credit, decreasing its debt in that area to \$23.4 billion from about \$27 billion. AIG has also recently sold its ALICO division to MetLife for \$15.5 billion. Following a failed deal with Prudential, it is preparing for a public offering of AIA; the proceeds from these divestitures will go to repay significant portions of the debt. Since AIG plans to repay the Federal Reserve portion of its debt first, the Fed does not plan to realize a loss on its investment.

Of the various programs under TARP, the AIFP has perhaps received the most publicity. The support given to GM, Chrysler, their associated financing agents (GMAC and Chrysler Financial, Inc.), and to their parts manufacturers totals approximately \$85 billion, of which \$64 billion went directly to GM and Chrysler. Between them, GM and Chrysler have paid back \$3 billion of their support, while Chrysler Financial has repaid its debt in full. These investments are expected to come at a subsidy rate of 41%, costing taxpayers approximately \$34 billion. GM's earnings in the second quarter of 2010 totaled \$1.3 billion and represented the second straight quarter of positive earnings, while Chrysler posted a \$174 million loss. On August 18th, GM filed the first set of paperwork required to hold an initial public offering, which people close to the situation expect to raise up to \$20 billion, according to Reuters. This cash will go towards repurchasing shares from the Treasury, which is expected to become a minority shareholder in the company by decreasing its current 61% stake.

In addition to the TARP funds put forth by the Treasury, the Federal Reserve System has implemented several programs to increase liquidity in the financial markets; these programs are currently in the process of being shut down now that the markets are functioning more normally. In addition to the previously discussed assistance to AIG, the Fed reduced the fed funds rate to a target of 0-25 basis points and narrowed the spread of the discount rate (the rate at which the Fed lends to depository institutions through its discount window)

over the federal funds rate from 100 basis points to 25 basis points. The maximum maturities of these loans were also extended to 90 days. An exit strategy for this program is being implemented, as the maximum maturities of loans through the discount window have been cut back to 28 days. In order to deal with the so-called "stigma problem," wherein banks would be reluctant to borrow from the discount window due to the risk of being perceived as financially insecure, the Fed set up the Term Auction Facility, which auctioned off borrowing rights for depository institutions. The Fed also provided funding for the Term Asset Loan Facility, another TARP program, while the Treasury assumed the credit risk for those loans. As of June 30, 2010, both windows had been closed. The Fed provided further support to the financial sector by purchasing \$300 billion in Treasury securities, \$1.25 trillion in agency mortgage-backed securities, and \$175 billion of agency debt. More recently, the Fed has launched incentives for banks to reduce their reserves and increase lending activities.

The last section of government investment to mitigate the most recent financial crisis is the direct investment in individuals, state and local governments, nonprofits, and small businesses under the American Reinvestment and Recovery Act (ARRA), better known as the stimulus package. These outlays take the form of grants, contracts, loans, and tax reductions, totaling \$787 billion; \$480 billion of this had been spent or used as tax reductions as of a report on July 14, 2010, with another \$147 billion dedicated to various projects but not spent. According to the Council of Economic Advisors (CEA), the effects of this spending have been drastic, as GDP growth has been 2.7% to 3.2% higher than it would have been without the bill with 2.5 to 3.6 million jobs either saved or created through the second quarter of 2010. This concurs with some academic estimates made before the bill was passed, which predicted 2.5 to 3 million jobs saved or created. Assuming the numbers are correct, this program has already had a tremendous impact and \$150 billion dollars are still available to help bring these programs to a gradual end and to ensure that economic growth can be sustained.

Most of these programs have either been completed or are beginning to reach their final phase and (with some exceptions) recoup their investment. This begs an important question: can the government, through the Treasury, the Federal Reserve, and ARRA, end these programs without severely hampering the progress that has been spurred? Fortunately, the ARRA still has considerable uncommitted funds that can be targeted for economic growth. The Treasury, on the other hand, has fewer options in attempting to reduce its losses in AIG and the auto companies and is struggling with reduced revenues due to the recession. Meanwhile, the Federal Reserve may decide that it needs to maintain its extended balance sheet longer than hoped due to the lack of robustness in the economic recovery; as well, its large stake in AIG may prove to be one of the most difficult investment programs to conclude.

So, now that we have a lot of numbers, what do they mean? Although it is difficult to disentangle the unique effects of each program because of their overlap, a few reasonable estimates have been made as to the impact of these investments on employment and the overall economy. Most of these estimates center around ARRA, as it is the most isolated of these programs and lends itself to cleaner calculations. As stated above, research conducted by the Council of Economic Advisors (CEA) has concluded that the direct effects of ARRA were an increase in GDP of between 2.7-3.2% and an increase in employment of 2.5-3.6 million jobs relative to what they would have been without this act in place. These results already are in line with President Obama's stated goal of 3 million jobs created or saved by such a stimulus bill by the end of 2010, and the program still has both \$150 million in funds that have not been committed and \$147 billion in funds that have been committed but not spent.

However, in contrast to the CEA report, a study by former Fed Vice Chairman Alan Blinder and Moody's chief economist Mark Zandi estimates that the stimulus program boosted GDP by only about 1.5% compared to what it would have been without the program but that it saved or created 4 million jobs. The Blinder and Zandi report also includes estimates of the effects of the financial stabilization measures, which they claim increased GDP growth by approximately 2.5% and created or saved 6 million jobs. Blinder and Zandi conclude that President Obama's stimulus program is quite expensive relative to the growth provided; however, they note that the combined impacts of the policies cannot be compared to the sum of the impacts of each program, as there are significant interactional effects between the two programs. In total, the authors of this paper estimate that the governmental programs, as a whole, have added 6.5% to GDP and 8.5 million jobs relative to a scenario without these investments.

Ultimately, Blinder and Zandi put it best: "While the effectiveness of any individual element can certainly be debated, there is little doubt that in total, the policy response was highly effective." While the econometric models and results vary regarding the magnitude of benefits from the government spending, there is a broad-based agreement that the government's investments helped to stabilize and recharge the United States economy. The debate primarily centers on the magnitude of these effects and their cost relative to the benefit to the economy. In this regard, both the CEA and the CBO seem to agree with Blinder and Zandi that the investments in the economy by the United States government were an appropriate and necessary policy response to the recent recession.

About the Author

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