TARP inspector says bank bailout has increased danger of new financial crisis

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Neil Barofsky, the special inspector general for the US bank bailout, released his quarterly report to Congress Saturday, saying, “It is hard to see how any of the fundamental problems in the [financial] system have been addressed to date.”

The document claimed that the financial system is more dangerous now than ever before because banks have reason to think the government will step in again when their speculative bets go bad. “Even if TARP saved our financial system from driving off a cliff back in 2008, absent meaningful reform, we are still driving on the same winding mountain road, but this time in a faster car,” Barofsky wrote.

Following the financial meltdown, the biggest banks grew even bigger as they bought up their failed rivals. As Barofsky put it in his report, “To the extent that huge, interconnected, ‘too big to fail’ institutions contributed to the crisis, those institutions are now even larger, in part because of the substantial subsidies provided by TARP and other bailout programs.”

But instead of cracking down on the types of speculation that contributed to the meltdown, the report makes clear that the government has done everything it could to assure the banks that they will receive whatever assistance they ask for in the future. This was accomplished by extending the bailout through October 2010, despite the fact that most banks repaid their TARP money the previous year.

Barofsky questioned the US government’s rationale for allowing banks that “have shown questionable ability to return to profitability” to exit TARP, while losing the ability to control their actions as a holder of preferred stock. Later, Barofsky linked banks’ speedy exit from TARP to their urge to “avoid. .. pay restrictions” for executives and traders.

The report emphasized that, despite the trillions of dollars provided by the bailout, the banks have continued to decrease lending. Barofsky stated, “Although there was this public disclosure that the purpose of these programs was to increase lending, very little, if anything, was done to encourage or direct lending.”

What Barofsky does not admit, however, is that this was the intention of the plan all along. The bank bailout was sold to the American people as a means to put people back to work, and allow individuals and small businesses to borrow. But this was only a cover. The TARP was not conceived chiefly as a way of stabilizing the economic meltdown, but rather a means to cover the bad bets of the banks with taxpayer money.

This is the reason why the government has stood by while banks constrict their lending during the worst economic downturn since the Great Depression. The report notes that a TARP program to provide for small business lending passed nearly a year ago has yet to be implemented.

The report also shows that only a minuscule fraction of the money promised by the Obama administration to help modify home mortgages—$15 million out of $75 billion—had been paid out as of December.

Despite this, the “TARP foreclosure prevention program has only permanently modified a small fraction of eligible mortgages,” Barofsky noted. In fact, fewer than 7 percent of the people who signed up for the program had been helped.

Barofsky warned about the extent to which the US government has intervened in the mortgage market, saying that its intervention risks “re-inflating the bubble” in home prices. The report said the government has increased home values through “purchases and guarantees, either direct or implicit, of nearly all of the residential mortgage market.”

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The report adds, “The Government has done more than simply support the mortgage market, in many ways it has become the mortgage market, with the taxpayer shouldering the risk that had once been borne by the private investor.”

Barofsky’s comments point to the underlying reasons for the slight improvement in home prices in recent months. As consumers have only gotten poorer as incomes fell and unemployment rose, analysts have attributed nearly all increases in demand for homes to government intervention.

The Obama administration’s first-time homebuyer tax credit, which provides $8,000 in tax savings to people buying their first home, has been extended through to this year.

Many analysts caution that housing values have even further to fall. Daniel Alpert, a managing partner of investment bank Westwood Capital, told the *New York Times* that he expects housing values to fall another 8 to 10 percent from their lowest values.

The report also noted a sharp increase in the number of investigations being carried out by Barofsky’s office. Investigations of misconduct related to the TARP have increased by 41 percent from the third to the fourth quarter. Barofsky’s office launched 25 probes in the last three months of the year, and had 77 total active cases.

Barofsky’s office is also investigating the New York Federal Reserve after emails were published last month showing the bank, then under the leadership of present Treasury Secretary Timothy Geithner, instructed AIG executives to conceal details regarding who ultimately received government funds related to the AIG bailout.

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