



October 7, 2008 3:00 am

The mystery of why the \$700bn Tarp was given the go-ahead by US Congress

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From Mr Daniel J. Aronoff.

Sir, There is a mystery about why the US Congress last week approved the \$700bn Tarp (troubled asset relief programme), the largest government expenditure in history, authorising the purchase of so-called toxic assets.

On the surface, it seems clear a majority in Congress felt the measure required immediate action, in light of a dire warning of impending financial and economic collapse should the government fail to act to revive bank lending, issued from the plan's architects Ben Bernanke, the Fed chairman, and Treasury secretary Hank Paulson. Indeed, there has been no credible challenge to that warning.

But the so-called Paulson plan is disliked by a large number of US citizens who believe it unfairly saddles the taxpayer with financial risk in bailing out the banking sector, and it has received almost universal disapprobation from academic economists and financial market participants, who believe taxpayer dollars could be more effectively deployed by directly recapitalising banks. By creating some form of claim on banks, this would also provide protection for taxpayers.

Indeed, in his testimony before the US Senate last week, George Soros, the financier, reflected this consensus view by warning Congress that Tarp would not provide the capital to enable insolvent banks to lend and that direct investment in banks would have a leverage effect of some 12 times lending for each dollar invested as opposed to a maximum effect of one dollar lent for each dollar of toxic assets purchased.

Yet Congress, including many Democrats sympathetic to Mr Soros's ideas in general, dismissed his recommendations as if he were an impractical dreamer, as they rushed to pass a plan devised by the unpopular Bush administration. Congress did not even bother to ask Mr Bernanke and Mr Paulson to comment on the academic and practitioner consensus view. The mystery is why they did not do so.

If, after a \$700bn expenditure, Tarp does not save the banking system, the US government may lack the capacity to launch another far-reaching fiscal initiative and find itself impotent in the face of a meltdown. Then today's self-congratulating congressmen, who believe they have secured "prosperity in our time", may find their careers and their reputations in ruins. We must all pray that their gamble pays off.

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