

Discussion

The financial crisis bailouts: What they cost taxpayers and who reaped the direct benefits

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Summary

- ▶ **Bailout Policy:** central issue in macro-finance regulation
- ▶ How costly are bailouts? Who benefits and loses?
- ▶ How to structure implicit and explicit guarantees?

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- ▶ **Bailout Policy:** central issue in macro-finance regulation
- ▶ How costly are bailouts? Who benefits and loses?
- ▶ How to structure implicit and explicit guarantees?
- ▶ **This paper**
 - ▶ Lays out economic framework for measurement
 - ▶ Carefully measures direct costs of intervention in 2009
- ▶ **Headline number for cost of bailouts**
 - ▶ \$500bn, around 3.5% of 2009 GDP
 - ▶ Significant

Roadmap

1. Main results
2. An interpretation via welfare calculations
3. Further thoughts

Main Results

- ▶ What is a bailout? *Net government transfer or guarantee*
 - ▶ Guarantees are “future transfers”
 - ▶ Mispriced insurance included too
 - ▶ Financial regulation context

	Costs	Benefits
Direct	Taxpayers	Transfers/Guarantees
Indirect	Ex-ante distortions	Panic Avoidance/Macro Impact

Main Results

	Cost (billions USD)
Fannie/Freddie	311
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- ▶ Careful job for each of the programs
 - ▶ Assumptions are needed
 - ▶ Mix of direct injections (TARP/SBLF) with free and mispriced guarantees
 - ▶ Fannie/Freddie + TARP accounts for 80%
- ▶ Debtholders benefit, not equityholders
 - ▶ We may want to capitalize their ex-ante gain

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- ▶ Think of x_{t+1}^i as a vector (many portfolio decisions)
- ▶ The payoff v_t can take many forms in equilibrium
 - ▶ Example: p_t and v_t may depend on $\{x_{t+1}^i\}$ and α in a very nonlinear form (e.g., bank run, macro impact, etc)

Conceptual Framework

- ▶ Let's vary the size of the bailout α

$$\frac{dW^i}{d\alpha} = \mathbb{E}_0 \left[\sum_t \beta^t u'_i(c_t^i) \underbrace{\left(\overbrace{\frac{dv_t}{d\alpha} x_t^i + \frac{dp_t}{d\alpha} (x_t^i - x_{t+1}^i)}^{\text{Indirect Effects}} + \tau^i \right)}_{= \frac{dc_t^i}{d\alpha}} \right]$$

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- ▶ Normalize and focus exclusively on direct effects

$$\frac{\frac{dW^i}{d\alpha}}{u'_i(c_s^i)} = \mathbb{E}_0 \left[\sum_t \underbrace{\frac{\beta^t u'_i(c_t^i)}{u'_i(c_s^i)}}_{= m_{ts}^i} \tau^i \right]$$

Conceptual Framework

▶ Direct effects

$$\frac{dW^i}{d\alpha} = \mathbb{E}_0 \left[\sum_t m_{ts}^i \tau^i \right]$$

▶ Remarks

1. Fair value

- ▶ Measure with individual SDF's (paper uses market values as best estimates, correct under complete markets)

2. Consistent numeraire

- ▶ Ex-ante vs interim vs ex-post cost computations

3. Wrong ex-post measures

- ▶ Equivalent to looking at realized returns to measure asset management performance

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5. Political impact?