Discussion

The financial crisis bailouts: What they cost taxpayers and who reaped the direct benefits by Deborah Lucas, MIT

Eduardo Dávila

Yale University and NBER

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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

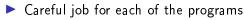
	Costs	Benefits
Direct	Taxpayers	Transfers/Guarantees
Indirect	Ex-ante distortions	Panic Avoidance/Macro Impact

Main Results

	Cost (billions USD)
Fannie/Freddie	311
TARP	90
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- 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 xⁱ_{t+1} 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 {xⁱ_{t+1}} and α in a very nonlinear form (e.g., bank run, macro impact, etc)

\blacktriangleright Let's vary the size of the bailout α

$$\frac{dW^{i}}{d\alpha} = \mathbb{E}_{0} \left[\sum_{t} \beta^{t} u_{i}^{\prime} \left(c_{t}^{i} \right) \underbrace{\left(\underbrace{\frac{dv_{t}}{d\alpha} x_{t}^{i} + \frac{dp_{t}}{d\alpha} \left(x_{t}^{i} - x_{t+1}^{i} \right)}_{= \frac{dc_{t}^{i}}{d\alpha}} + \tau^{i} \right)}_{= \frac{dc_{t}^{i}}{d\alpha}} \right]$$

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Normalize and focus exclusively on direct effects

$$\frac{\frac{dW^{i}}{d\alpha}}{u_{i}^{\prime}\left(c_{s}^{i}\right)} = \mathbb{E}_{0}\left[\sum_{t} \underbrace{\frac{\beta^{t}u_{i}^{\prime}\left(c_{t}^{i}\right)}{u_{i}^{\prime}\left(c_{s}^{i}\right)}}_{=m_{ts}^{i}} \tau^{i}\right]$$

Direct effects

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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?