# Inevitable Bailouts: Prioritizing Democratic Capitalism in Times of Crisis

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There's no crying in capitalism. Market competition and innovation that are often adversarial fuel creative destruction in capitalist economies – there won't be progress without a little pain. The best firms capture the most profits, weaker firms are lost in the churn, and economic dynamism ultimately bends society towards development and advancement. Unbridled capitalism loves winners and does not endure losers. But in a democratic society, the people on the losing side of this economic dynamism will not suffer in silence, and a government that's responsive to the needs of the people will insert itself into the economy to mitigate the damage.

In a capitalist democracy like the United States, the federal government regularly engages in economic interventionism on behalf of the public, often to encourage growth and promote essential industries. American agriculture, energy, trade, housing, transportation, and healthcare are all supported by significant government subsidies.[1] In periods of significant financial and economic calamity, the government may go even further to support the economy – by "bailing out" industries or firms whose collapse have major ramifications on the broader society. These public bailouts can come in the form of loans, bond or stock purchases, or outright cash infusions to private entities.[2]

Since the United States government first intervened in the financial crisis of 1792 under Treasury Secretary Alexander Hamilton, the U.S. has had a long history of economic bailouts.[3] By the early 2000s, the federal government had stepped up to support failing railroad companies, banks, car companies, savings and loan institutions, airlines, and New York City.[4] Recently, the federal role in supporting the country's financial and corporate infrastructure changed dramatically. During the instability of the Great Recession, the government expended over $1 trillion to rescue the U.S. housing market, auto industry, and financial system.[5]

Despite the consistency and history of government bailouts, the practice has been subject to criticism for offending principles of capitalism and democracy alike. Bailouts favor the status quo of the markets, because by nature they focus on the biggest and most entrenched companies, the ones that are "too big to fail," that imperil the economic system. Bailouts by definition also reward failing firms which, in a free market economy, should be permitted to perish as a result of their poor business decisions. Additionally, the understanding that companies have an implicit lifeline from the government in periods of acute distress can create a moral hazard that incentivizes risky behavior over prudent business practices that could prevent the need for a bailout in the first place.[6]

In bailing out companies and propping up markets during times of crisis, the government also runs the risk of alienating the public from the broader financial system, especially when average Americans suffer the consequences of economic fallout. While trillions of dollars supported struggling companies and

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[1] Kimberly Amadeo, What Are Government Subsidies? (The Balance, 2022)
[2] Alexandra Twin, What Is a Bailout? (Investopedia, 2021)
[3] Marc Davis, U.S. Government Financial Bailouts (Investopedia, 2021)
[4] Jesse Nankin, Eric Umansky, Krista Kjellman Schmidt, and Scott Klein, History of U.S. Government Bailouts (ProPublica, 2008)
[5] *Id*.
[6] Bailout Takeover (CFI, 2022)

markets in the last two decades, millions of Americans lost their homes[7] and their jobs.[8] The perspective that American firms enjoy excessive private profits while socializing their losses with taxpayer money has contributed to institutional distrust and social unrest.[9]

Despite these concerns, when the going gets tough the government will likely get spending. Whether withholding bailout support is healthier for the economy in the long run is not a risk that decision-makers in Washington are willing to test in the midst of a crisis. After spending a little more than $1 trillion a decade ago in response to the global Financial Crisis, the federal government expended over $4 trillion to support firms and markets in response to the COVID-19 pandemic.[10] Bailouts are likely going to continue to feature in national crises going forward.

**Not If, But When – Considerations for Future Bailouts**

Much of the debate and policy reform of the 20th century regarding government bailouts has been preventative – focused on *avoiding* the need to rescue the economy in times of calamity. Addressing "too big to fail," developing a more sustainable model of capitalism, and structuring a more resilient financial system are crucial for the long-term health of the American economy. But it is also important that lawmakers and business leaders consider how to respond to the worst-case scenarios while maintain and preserving the values of democratic capitalism.

Improving government bailouts is not a revolutionary concept. Recent bailout packages have protected workers from layoffs, prohibited stock buybacks and share dividends, and restricted executive compensation with taxpayer money.[11] The financial safety net deployed in response to the COVID-19 pandemic was far more comprehensive than the response to the Financial Crisis, with small businesses and the broader public receiving significant support from the federal government.[12] But even this more recent approach has been criticized as hurried, with limited oversight and billions lost to fraud – normal criticisms of hurried action.[13] Instead of improvising trillion-dollar bailout strategies by trial and error during periods of crisis, we must repair the roof while the sun is shining – and consider how a preemptive and systemic bailout strategy *today* can be applied in response to tomorrow's challenges.

Planning the government's response to economic crises not only provides more time for decision-makers to strategically layout policy guidelines, it can also help clarify the implementation of policy to improve the speed and coordination of the response.

A preemptive bailout strategy would manage stakeholder expectations and could be used to address the challenges related to moral hazard and risk incentives. A preemptive bailout strategy could condition economic aid not only in how corporations can use the federal financial support, but also which firms are even eligible for bailout support. Eligibility could be contingent on business practices that benefit the

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[7] Tommy Andres, Divided Decade: How the Financial Crisis Changed Housing (Marketplace, 2018)
[8] Tracking the COVID-19 Economy's Effects on Food, Housing, and Employment Hardships (Center on Budget and Policy Priorities, 2022)
[9] Joan C. Williams and Ro Khanna, It's Time to End Slash-and-Burn Capitalism (Harvard Business Review, 2020)
[10] The Federal Response to COVID-19 (USASpending.gov)
[11] David Slotnick, Airlines Get $60 Billion Coronavirus Bailout, With Strings Attached (Business Insider, 2020)
[12] Neel Kashkari, Banks Cannot Expect Government to Bail Them out of Every Crisis (Federal Reserve Bank of Minneapolis, 2021)
[13] Ken Dilanian and Laura Strickler, 'Biggest Fraud in a Generation:' The Looting of the Covid Relief Plan Known as PPP (NBC News, 2022)

economy and the public, such as adherence to the tenants of stakeholder capitalism[14], appropriate capitalization and risk management,[15] commitment to responsible tax policies,[16] or prioritization of ESG and impact investing.[17] Creating clear eligibility conditions for bailout support prior to a crisis would give companies the opportunity to federally insure themselves against systemic shocks and allow the market to price companies that disregard the option of a government lifeline accordingly.

Planning a policy response in advance of a crisis event also creates opportunities for decision-makers to make future economic recoveries more holistic for the broader American public. Creative policy solutions like sovereign wealth fund investing,[18] baby bonds,[19] or variations of government equity ownership in private corporations could accomplish this, but there is evidence that bailouts have the potential to provide safe returns on investment. Following the Financial Crisis, the federal government *made* over $100 billion from money returned and paid to the Treasury as interest, dividends, fees, or to repurchase stock warrants – a surplus that would translate to over $10,000 for every taxpayer today.[20] If federal bailouts were structured as investments that provided long-term returns to individuals, Americans would receive continued stimulus from the corporations their tax dollars kept alive.

However a bailout strategy is structured to align with the values of democratic capitalism, the necessary dialogue, policy development, and strategy implementation **must happen before action** is required. In an ideal economy, a resilient and dynamic economy that accounts for risk and can survive the failure of individual firms, bailouts would not be necessary. Until we create such an economy, we should do better to prepare for the worst.

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[14] Dame Vivian Hunt, Putting Stakeholder Capitalism into Practice (McKinsey, 2022)
[15] Giovanni Dell'Ariccia and Lev Ratnovski, Bailouts and Systemic Insurance (IMF, 2013)
[16] Lucinda Pearson, Why Business Bailouts Must Be Conditional on Responsible Tax Commitments (Transparency International EU, 2020)
[17] Sophia Fossali, Understanding ESG: Where to Start? (The Denny Center, 2022)
[18] Eric Estevez, Sovereign Wealth Fund (SWF): Definition, Examples, and Types (Investopedia, 2020)
[19] Kilolo Kijakazi and Alexander Carther, How Baby Bonds Could Help Americans Start Adulthood Strong and Narrow the Racial Wealth Gap (Urban Institute, 2020)
[20] Paul Kiel and Dan Nguyen, Bailout Tracker (ProPublica, 2022)