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Bailouts: The Ultimate Double Standard

di Robert Kuttner

Imagine if the automakers had been offered the same kind of government assistance as the banks. Detroit's Big Three would each get new government capital totaling many tens of billions to replace their lost equity, as well as government guarantees running into the hundreds of billions. And government, oddly, would ask almost nothing in return. There would be no "car czar" to supervise Detroit's management, no wage and benefit cuts for employees, no review of product lines, and no government-mandated restructuring plan. A pretty sweet deal.

But that's basically what the banks got. You might think that the banks had some friends in high places -- friends like Treasury Secretary Hank Paulson, former CEO of Goldman Sachs where Robert Rubin once was co-chairman; or Tim Geithner, president of the New York Federal Reserve Bank and treasury-secretary designate, a protégé of the same Robert Rubin who now is a senior executive of Citigroup.

The contrast between the proposed auto bailout and the bank bailout gives new meaning to the term "double standard." And the case of Citigroup is a very instructive place to begin.

Citigroup, once a trillion dollar behemoth, is one of America's largest three banks (the other two are JP Morgan Chase and Bank of America), and by any normal measure Citigroup is insolvent. Without the extraordinary infusions of government funds that Citigroup has received, it would be out of business.

Under the $750 billion bank bailout legislated by Congress at Paulson's urgent request, the initial idea was to buy up toxic securities clogging the balance sheets of banks, Paulson resisted the idea of giving the Treasury authority to aid the banks directly. In fact, the Democrats added this provision to the emergency law over Paulson's objection. Paulson, however, soon found that his half-baked plan to take securities off the banks' hands was unworkable. So he quickly reverted to the direct aid that he had opposed.

Citigroup got an initial $20 billion; then when its collapse seemed imminent it got another $25 billion in late November. Its stock price, which had been hammered, briefly doubled. The idea behind the bailout was to enable banks to resume normal lending, but so far the main beneficiaries have been bank stockholders and executives. In addition, Citigroup got another $306 billion in guarantees of those toxic securities. If they turn out to be worthless, the taxpayer pays.

What did the taxpayer get in return? Precious little. Citigroup has temporarily suspended paying dividends, and its executive compensation plan must be reviewed and approved by the Treasury. But there is no across-the-board pay cutting, no talk of top management giving up perks or working for a dollar a year, no government seats on Citigroup's board. And the Treasury is startlingly incurious about how Citigroup is running its business. There is to be no comprehensive review or restructuring along the lines of what is in store for automakers.

Citigroup will probably be back for more aid. But few commentators have been asking the question that is so widely posed when it comes to the auto industry: What if Citigroup went bust?

It would be a calamity if Citigroup just collapsed, the way the smaller Lehman Brothers did in September, triggering the stock market crash. But if the government were to conclude that Citigroup was insolvent rather than just throwing money at it, and sold off its healthy pieces to other banks while disposing of its devalued securities, the real world consequences would be fairly minor. Mainly, Citigroup's shareholders would be wiped out, but they have already lost most of their investment.

Indeed, one could make a good case that the effects of the auto industry collapsing would be far more serious than the orderly liquidation of Citigroup. In the case of Citigroup, other banks would simply pick up the business. But the auto industry is one of the two linchpins of American manufacturing, the other being aerospace. The spillover consequences to the economies of several states would be immense.

So why is the government indiscriminately throwing money at Citigroup while it is putting the auto industry through the wringer for a far smaller sum? The answer is that Wall Street enjoys far more political influence than any manufacturing industry. And as a consequence of that outsized influence, politicians, especially the crew currently running the Treasury (who come from Wall Street and will return to it), are largely passive when comes to insisting on changes in bank's business as usual. By contrast, most politicians will not give aid to automakers without a good hard look under the hood.

This saga suggests two policy conclusions. First, there needs to a single standard for all industries getting government aid, with plenty of accountability. Deciding just to let these wounded industries collapse may seem smart on the Wall Street Journal editorial page (which has now been proven utterly wrong in its extreme faith in markets) but it would be a disaster for the real economy. However with taxpayer aid must come greater accountability.

And that leads to the second conclusion. It's time for some serious public institution building. The Treasury has neither the will nor the competence to closely monitor and restructure Citigroup and other large banks now getting emergency aid because of the misfeasance of their executives. Not does the government have the capacity to help Detroit restructure the auto industry (An ad hoc "car czar" just won't do it, any more than Hank Paulson's ad hoc bank ubailouts have done it.)

We need something like the Reconstruction Finance Corporation of the 1930s, which did not just put money into failing corporations and banks, but actively managed turnarounds. And this, gentle reader, takes us into the long-forbidden territory of industrial policy -- a concept that both Republicans and Democrats, for thirty years, have been dismissing as a sin against free markets. How could the government possibly know enough to "pick winners"? That was the job of the free market, so the argument went.

Thanks to the general hostility to industrial policy, we have lost one industry after another and sent others offshore. And we are losing competitive races in industries like renewable energy where American technology was once the pioneer. Many of America's success stories, like aerospace and biotech and the internet, have in fact been the result of unacknowledged industrial policies; spinoffs of defense spending or biomedical research. These government policies did not pick winners; they created winners. But that result had to be incidental, because it was ideologically forbidden for industrial success to be the goal.

Lately the free market has been picking losers, big time. Worse, it has been creating losers, often out of once-sound enterprises. And the much maligned government has been picking winners.

Actually it has been picking survivors in a helter-skelter process of triage, ever since Paulson and Fed Chairman Ben Bernanke began their spree of emergency interventions in the summer of 2007.

Bear Stearns going down the tubes? Yes, let that one live, but with a shotgun merger. Here's $29 billion. Lehman Brothers? Absolutely not, time to draw the line. Oops, better save A.I.G. before it takes the whole economy down Here's another $85 billion. Better make that $135 billion. Citigroup? Whatever it takes.

The problem is not that government, in an emergency, is picking winners. With the economy tottering on the edge of a depression, there's no good alternative. The problem is that Paulson and company, who do not really believe in government, have been doing a lousy job at it.

The new Obama administration has to create a lot of government capacity and competence if it is to save the private sector from its self-inflicted wounds. And it needs a single standard.