Bailouts

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Issues

- Jobs: direct & indirect.
- Communities.
- Consumers.
- Taxpayers.
- Moral hazards.
- Global stability: Contagion.

Robert Reich vs. Laura Tyson

- Reich: Ownership does not matter; the issue is *where* jobs are created.
- Tyson: Ownership matters for both strategic and practical reasons.

Tyson vs. Guillén

Four Cases

- AEG-Telefunken.
- British Leyland.
- Toyo Kogyo (Mazda Corporation).
- Chrysler.

Source: Robert B. Reich, “Bailout: A Comparative Study in Law and Industrial Structure.” *Yale Journal on Regulation* 2 (1984-1985):163-224.

Bailout Methods

- Chapter 11 vs. Chapter 7.
- Debtor-in-possession bankruptcy.
- Loan guarantees.
- Unloading liabilities (e.g. pension funds).
- Unloading ‘toxic’ assets.
- Capital injections.
- Nationalization.

January 1980

Common Patterns

- Highly successful in the past.
- Rapid expansion.
- Difficulties digesting growth.
- Vulnerable to forces beyond their control.
- Lack of transparency.
- Major regional employers: Niedersachsen, Midlands, Hiroshima, Great Lakes.
- Shortage of cash as the trigger.
- Bailouts take years to implement.

Source: Robert B. Reich, “Bailout: A Comparative Study in Law and Industrial Structure.” *Yale Journal on Regulation* 2 (1984-1985):163-224.

Contextual Factors

- Overall state of the economy.
- Bank ownership of equity.
- Fragmentation of debt holding.
- Strength and type of labor unions.
- Collective bargaining: fragmented or central?
- Policymaking apparatus.
- Party in power (?).

Source: Robert B. Reich, “Bailout: A Comparative Study in Law and Industrial Structure.” *Yale Journal on Regulation* 2 (1984-1985):163-224.

Solutions

- Bank-led or government-led bailout.
- Liquidation (AEG-Telefunken).
- Reorganization & restructuring.
- Layoffs vs. redeployment of labor.
- Extent of shrinkage.
- Ideological debates: SPD vs. Liberals; Conservatives vs. Labour (but remember Thatcher expanded the bailout of BL).
  - Often, sharp departures from party ideology and rhetoric.

Source: Robert B. Reich, "Bailout: A Comparative Study in Law and Industrial Structure." *Yale Journal on Regulation* 2 (1984-1985):163-224.

Update

- **AEG**:
  - 1986: Daimler-Benz acquired AEG for $820 mn.
  - 1990s: GE, Siemens & Electrolux acquired bits & pieces of AEG.
- **Mazda**:
  - 1979: Ford acquired a controlling stake (presently 33%), of which it wants to sell 20% in order to raise cash.
- **Chrysler**:
  - 1990: Kirk Kerkorian acquired 10% for $272 mn.
  - 1995: Failed Kerkorian buyout, valued at $22.8 bn.
  - 1998: “Merger” with Daimler-Benz, valued at $37 bn. (Eaton got $70 mn; Schrempp: “I never thought I was so close to the poverty line.”)
  - 2007: Daimler sold to Cerberus for $7.4 bn, which presently owns 80%.
  - 2008: Plans for a GM-Chrysler merger collapse.
- **British Leyland**:
  - 1989: Ford acquired Jaguar for $2.5 bn.
  - 1994: BMW acquired Rover from BAe (Honda also interested).
  - 2000: Ford acquired Land Rover for $2.7 bn (BMW kept brand until ‘06).
  - 2007: Tata acquired Jaguar & Land Rover for $2.3 bn.

U.S. Automobile Market Shares (%)

Company	Cars		Light Trucks	
	1990	2007	1990	2007
GM	35.6	20.2	35.4	26.9
Toyota	8.4	19.2	6.1	13.4
Honda	9.2	11.2	0.0	8.1
Ford	20.9	10.8	29.9	20.7
Chrysler	9.3	8.4	18.2	17.1
Nissan	4.8	8.1	3.8	5.2
Hyundai-KIA	…	5.8	…	3.8

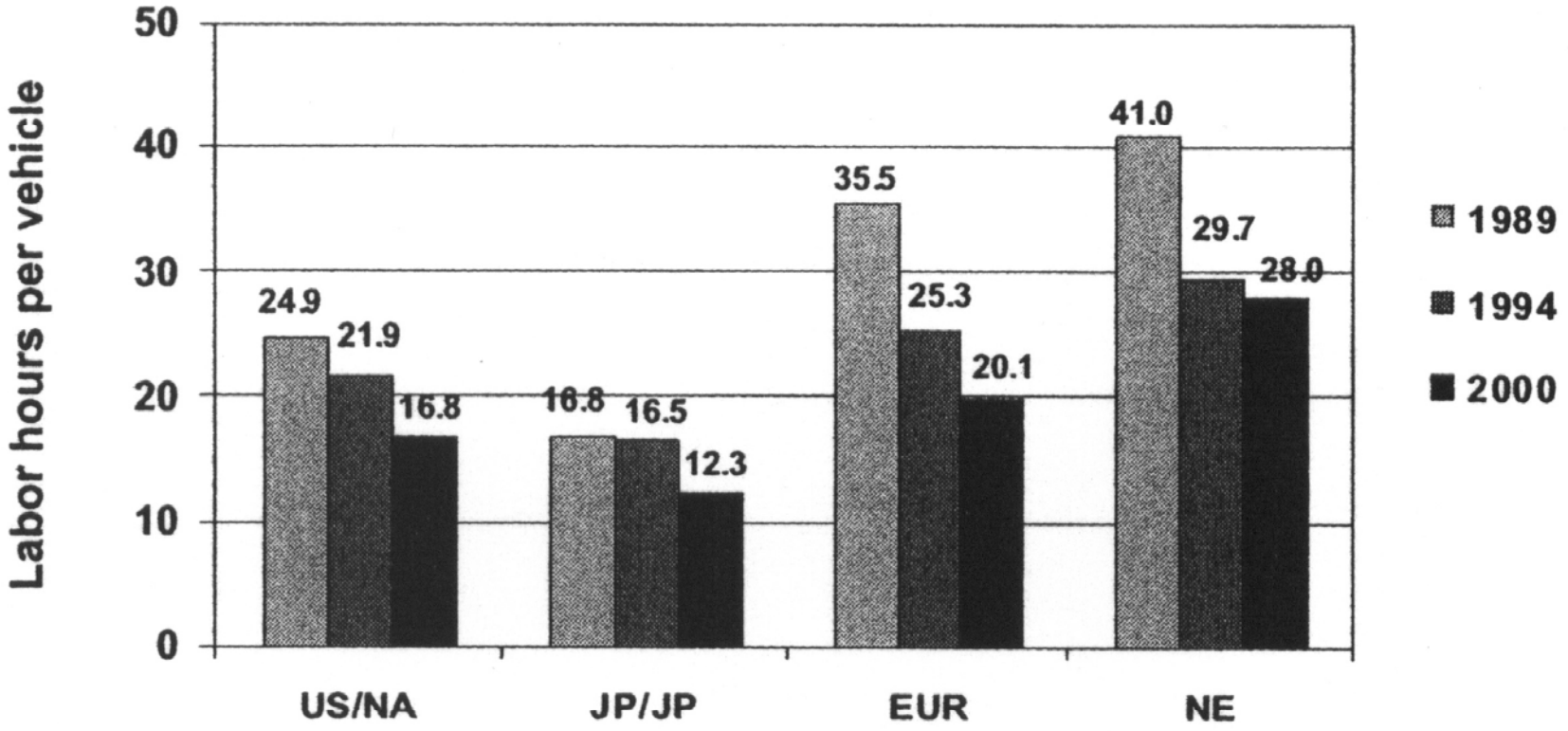


Figure 4.1
Labor hours per vehicle, 1989, 1994, and 2000. All data unmatched and scale-weighted. US/NA: US-owned factories in North America. JP/JP: Japanese-owned factories in Japan. Eur: European factories. NE: factories in new-entrant countries, including Argentina, Australia, Brazil, India, Korea, Mexico, Taiwan, and South Africa. Data for 1989 collected by J. Krafcik and J. MacDuffie; data for 1994 collected by J. MacDuffie and F. Pil. On the history of the assembly-plant study, for data sources, and for methodology, see notes 2 and 3 to this chapter.

Source: Matthias Holweg and Fritz K. Pil, *The Second Century* (MIT Press, 2004).

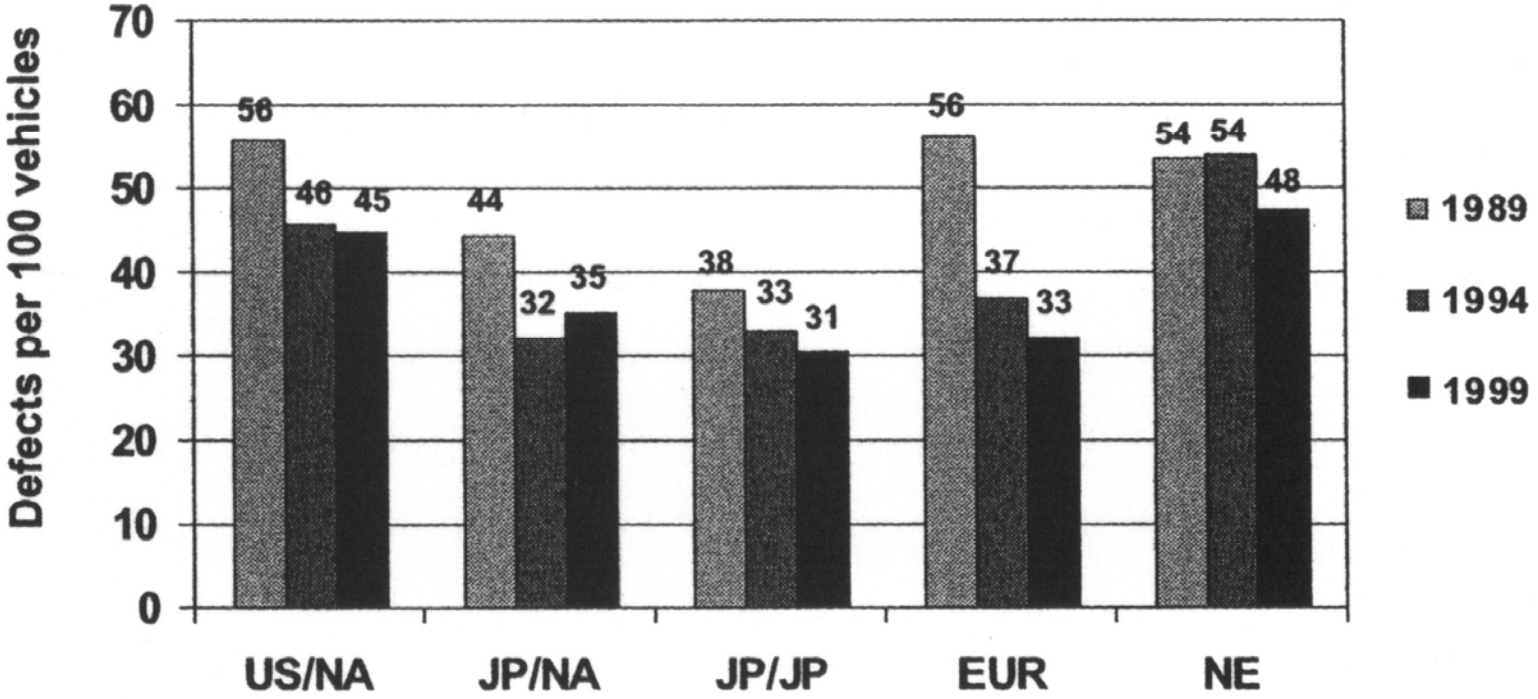


Figure 4.5
Quality across regions, 1989, 1994, and 1999. Regions include domestic US (US/NA), Japanese plants in US (JP/NA), Japanese plants in Japan (JP/JP), European plants (Eur), and plants in new-entrant nations (NE). Only reflects major defects originating in assembly plant, scale-weighted. Matched on time-series questions. Calculations based on J. D. Power and Associates quality data. On the history of the measures, and on the methodology, see note 5 to this chapter.

Source: Matthias Holweg and Fritz K. Pil, *The Second Century* (MIT Press, 2004).

Table 11.1
Workforce organizational trends for four regions in 1994 and 2000. Because our 1994 and 2000 samples are not identical for these measures, the data represent only trends.*

Work organization measure	US		Japan		Europe		New entrants	
	1994	2000	1994	2000	1994	2000	1994	2000
Plants in regions with teams	35%	46%	100%	100%	95%	100%	64%	87%
Workforce in teams	49.4%	24.6%	56.6%	94.7%	68.2%	82.6%	49.8%	62.9%
Workforce in employee involvement or quality circles	32.8%	25.2%	93.9%	99.0%	62.6%	47.0%	88.4%	47.5%
Suggestions per employee	0.3	0.2	69.1	12.9	1.2	8.3	53.8	7.4
Suggestions implemented	41.8%	31.8%	85.6%	95.7%	38.8%	75.2%	50.6%	30.2%
Extent of job rotation in and across work groups on a scale of 1 (none) to 5 (frequent)	2.0	1.8	3.9	4.0	3.6	3.6	3.3	3.3
Responsibility for quality inspection / SPC on a scale of 0 (specialists only) to 4 (production workers only)	2.4	2.1	1.6	2.7	2.4	3.0	2.2	2.1

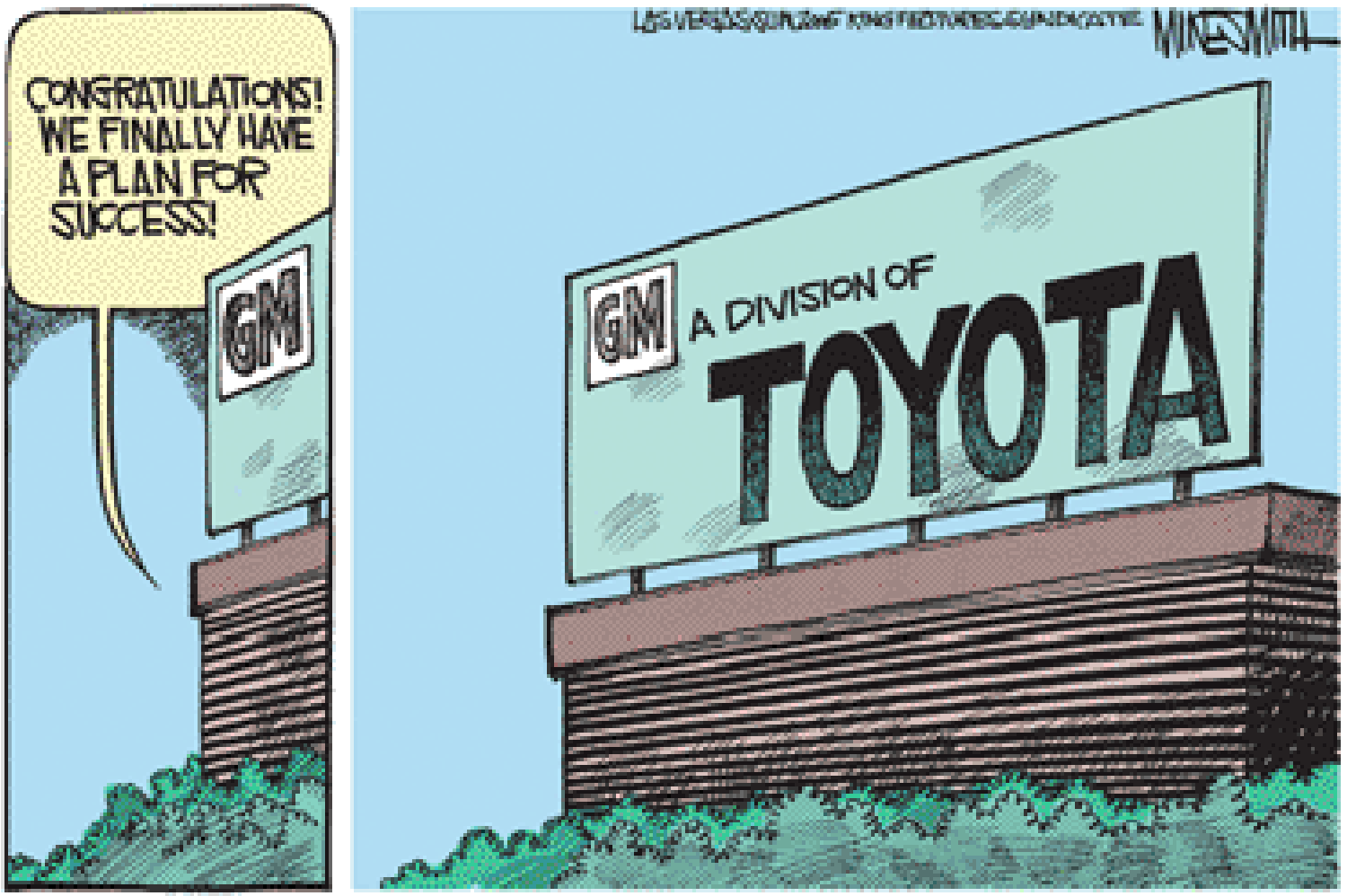
*Data for 1994 from J. MacDuffie and F. Pil, "High-involvement work practices and human resource policies," in *Evolving Employment Practices in the World Auto Industry*, ed. T. Kochan et al. (Cornell University Press, 1997), and from Pil and MacDuffie, "Organizational and environmental factors influencing the use of high-involvement work practices," in *Employment Strategies*, ed. P. Cappelli (Oxford University Press, 1999). Fraction of workforce in teams is based only on plants with teams. The extent of job rotation is scored on a 1–5 scale, and the rotation policies are ordered as follows: 1. workers are trained to do one job and do not rotate to other jobs; 2. Workers are capable of doing other work tasks in their work group (or teams if teams are present), but generally do not rotate jobs; 3. Workers rotate jobs frequently within their group, but not outside their group; 4. Workers rotate jobs within their work groups and across work groups in the same department (body, paint, and assembly), but not across departments, and 5. Workers rotate jobs within the work group, across work groups, and across departments. Responsibility for Quality control looks at 4 areas of responsibility: incoming parts, work-in-progress, finished products, and charting SPC data. At one end of the spectrum, quality control staff can undertake these activities. At the other end of the spectrum, production workers can do them (or no one). Other options include skilled trades, first line supervisors, and engineering staff.

Table 4.2
Automation by region and plant area (all figures weighted by volume).*

	US	Japan	Europe	New entrants
Percentage of all direct production steps that are automated	41.0%	39.6%	36.1%	27.7%
Welding area	94.0%	92.5%	79.6%	65.2%
Paint shop	58.7%	56.0%	52.1%	31.9%
Assembly area	1.5%	2.1%	3.0%	2.8%
Robotic index (robots per vehicle per hour)	5.0	6.8	5.2	5.6
Body shop welding flexibility[a]	84.2%	86.3%	83.5%	94.3%

*Early versions of these metrics were developed by J. Krafcik (A Comparative Analysis of Assembly Automation, International Motor Vehicle Program, MIT, 1989). For a detailed discussion of automation from the 1980s through the mid 1990s, see J. MacDuffie and F. Pil, "From fixed to flexible," in *Transforming Automobile Assembly*, ed. K. Shimokawa et al. (Springer-Verlag, 1997).
a. Percentage of welds by worker or robot, as opposed to inflexible "hard" automation.

Source: Matthias Holweg and Fritz K. Pil, *The Second Century* (MIT Press, 2004).


CONGRATULATIONS! WE FINALLY HAVE A PLAN FOR SUCCESS!
GM
GM
A DIVISION OF
TOYOTA

Stock Performance

The Financial Crisis

- ***Don't panic!*** Between 1970 and 2007 we've seen:
  - 124 systemic banking crises.
  - 208 currency crises.
  - 63 sovereign debt defaults.
- But: they are expensive to solve.
- I do not believe a 'new' global financial architecture (à la Bretton Woods) is needed.
- Need to distinguish between containment & resolution of the crisis.
- We need better (not necessarily more) regulation, and more *supervision*.
- Any financial bailout needs to address:
  - Conflicts of interest.
  - Transparency problems.
  - Moral hazards.

Selected Banking Crises

Country	Initial Year	% Nonperforming Loans at Peak	Gross Fiscal Cost (% GDP)	4-Year Output Loss (% GDP)
Spain	1977	n.a.	5.6	2.2
Egypt	1980	n.a.	38.1	n.a.
Chile	1981	35.6	42.9	92.4
Senegal	1988	50.0	17.0	32.6
USA	1988	4.1	3.7	4.1
Sweden	1991	13.0	3.6	0.0
India	1993	20.0	n.a.	3.1
Brazil	1994	16.0	13.2	0.0
Mexico	1994	18.9	19.3	4.2
Japan	1997	35.0	24.0	17.6
Korea	1997	35.0	31.2	50.1
China	1998	20.0	18.0	36.8
Russia	1998	40.6	6.0	0.0
Turkey	2000	27.6	32.0	5.4
Argentina	2001	20.1	9.6	42.7

Source: Luc Laeven and Fabian Valencia, “Systemic Banking Crises: A New Database.” IMF WP 08/224.

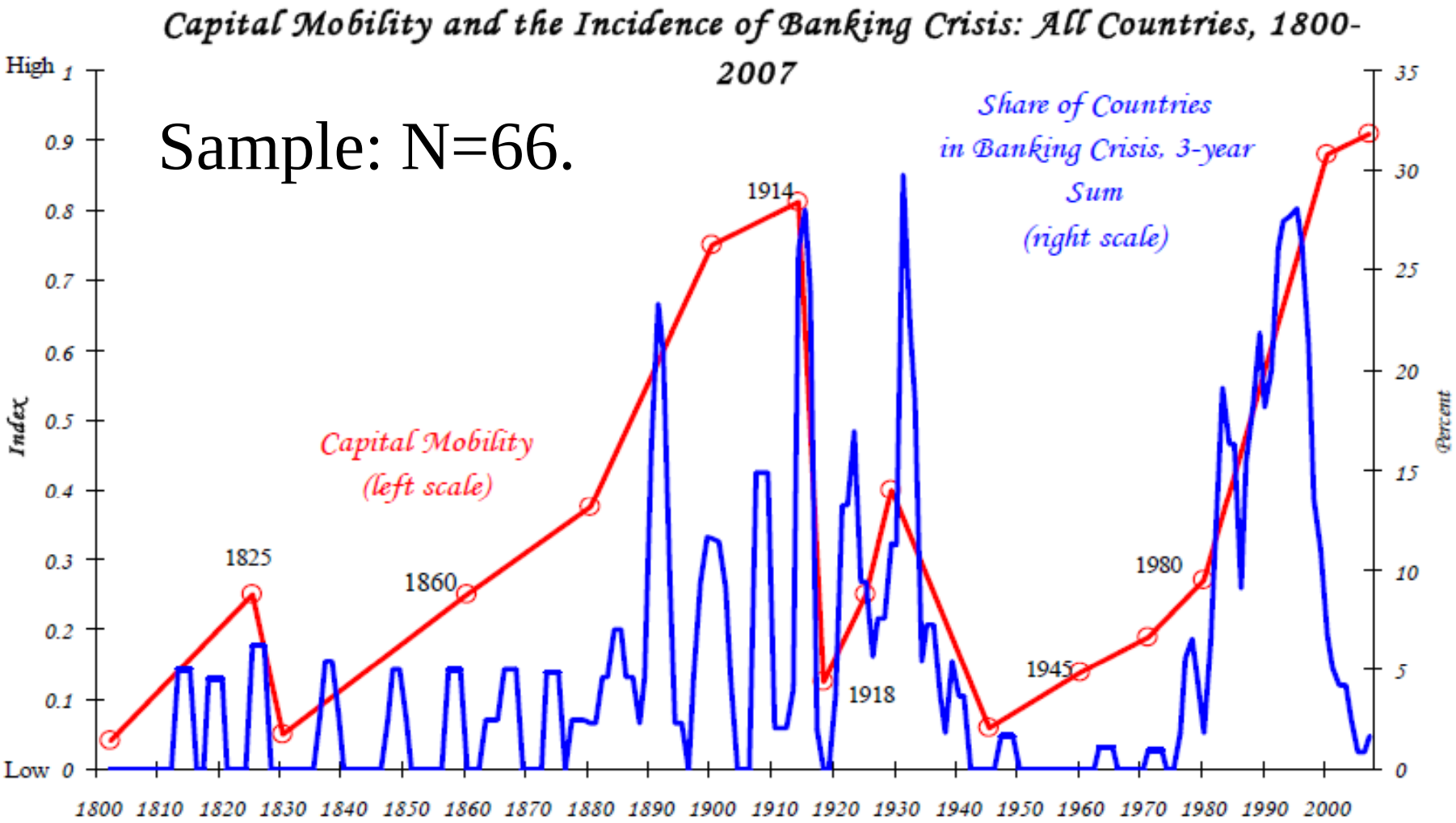
Year	Banking crisis (number)	Currency crisis (number)	Sovereign debt crisis (number)	Twin crisis (number)	Triple crisis (number)
1970		3			
1971		4			
1972		6			
1973		1			
1974		3			
1975		12			
1976	2	6	1		
1977	2	3	1		
1978		7	3		
1979		6	2		
1980	3	2	3	3	
1981	3	45	6	2	1
1982	5	11	9	2	1
1983	7	14	10	2	1
1984	1	9	4		
1985	2	9	3		
1986	1	8	3		
1987	6	13		1	
1988	7	8	1		
1989	4	8	3	1	1
1990	7	10	2	3	
1991	10	14		1	
1992	8	15	1	3	
1993	7	3		1	
1994	11	23		4	
1995	13	8		5	
1996	4	15		2	
1997	7	15		5	
1998	7	6	2	3	3
1999		11	2		
2000	2	7		1	
2001	1	5	2	1	1
2002	1	7	4	1	1
2003	1	3	1	1	1
2004		2	1		
2005		2			
2006		1			
2007	2	1			
Total	124	208	63	42	10

Frequency of Financial Crises

Twin crisis = banking + currency.

Triple crisis = banking + currency + sovereign debt.

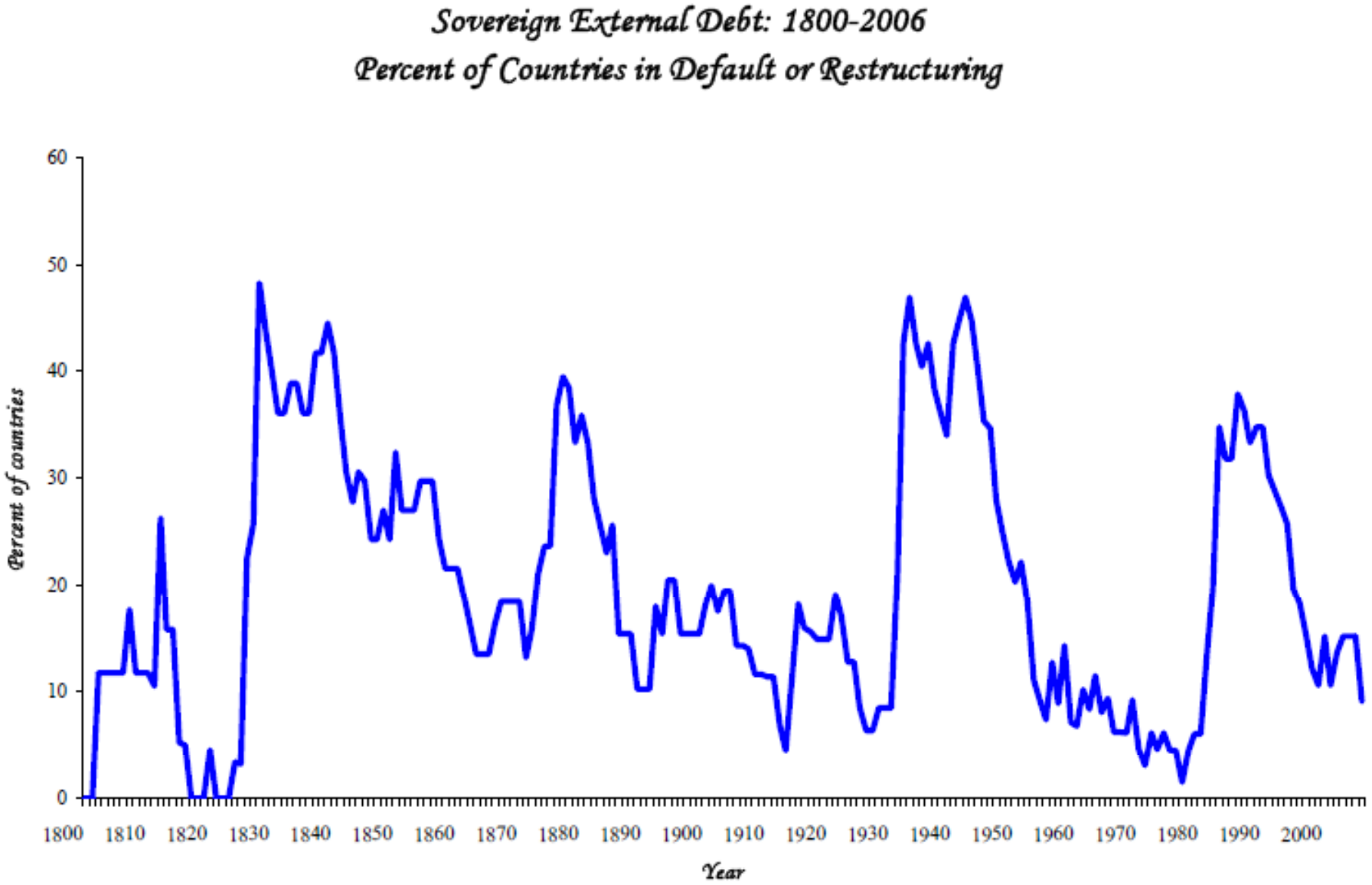
Source: Luc Laeven and Fabian Valencia, “Systemic Banking Crises: A New Database.” IMF WP 08/224.



Sources: Bordo et al. (2001), Caprio et al. (2005), Kaminsky and Reinhart (1999), Obstfeld and Taylor (2004), and these authors.

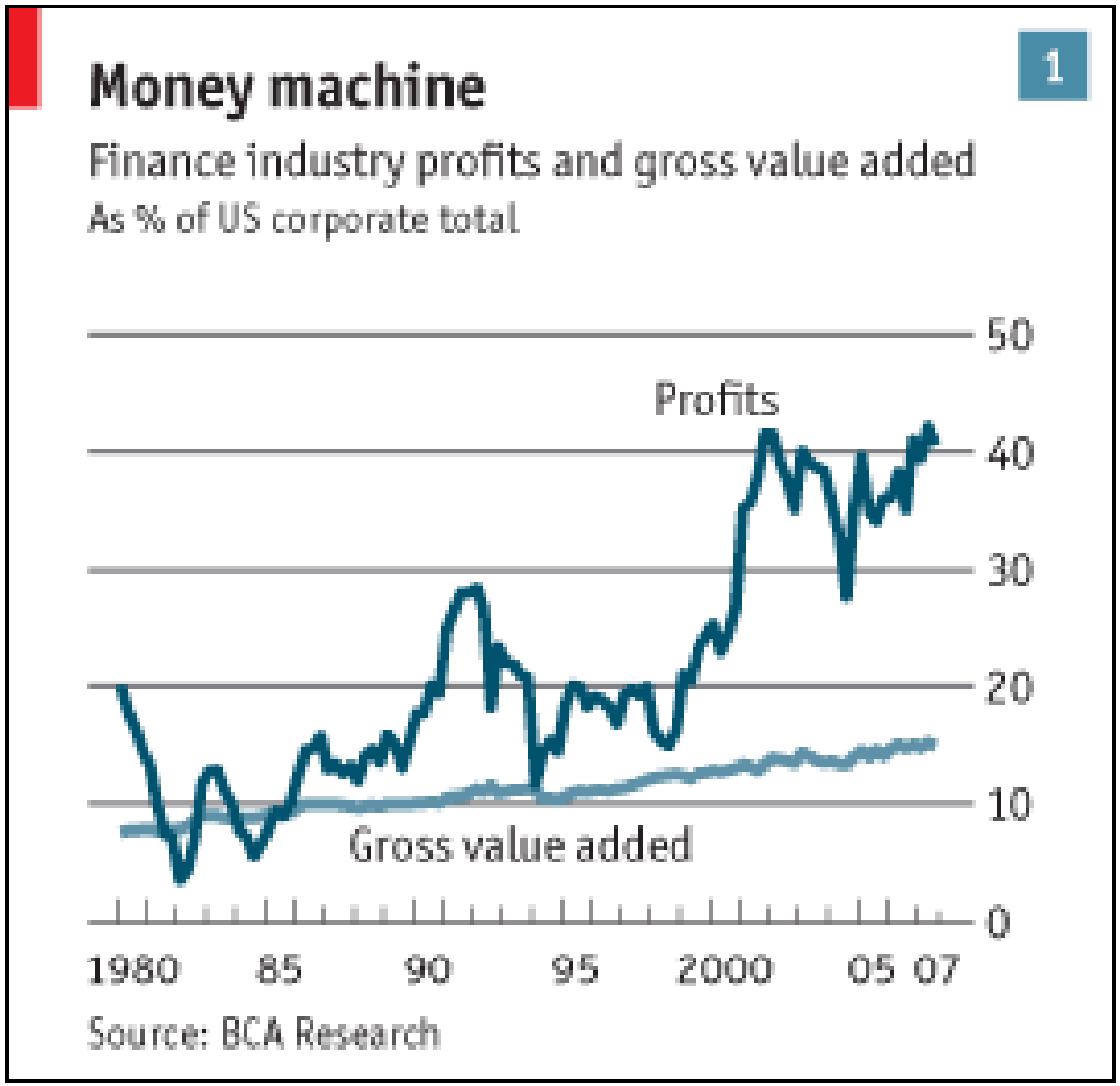
Notes: As with external debt crises, sample size includes all countries, out of a total of sixty six listed in Table 1 that were independent states in the given year. On the right scale, we updated our favorite index of capital mobility, admittedly arbitrary, but a concise summary of complicated forces. The smooth red line shows the judgmental index of the extent of capital mobility given by Obstfeld and Taylor (2003), backcast from 1800 to 1859 using their same design principle.

Source: Carmen M. Reinhardt and Kenneth S. Rogoff, "This Times is Different." NBER WP 13882 (2008).

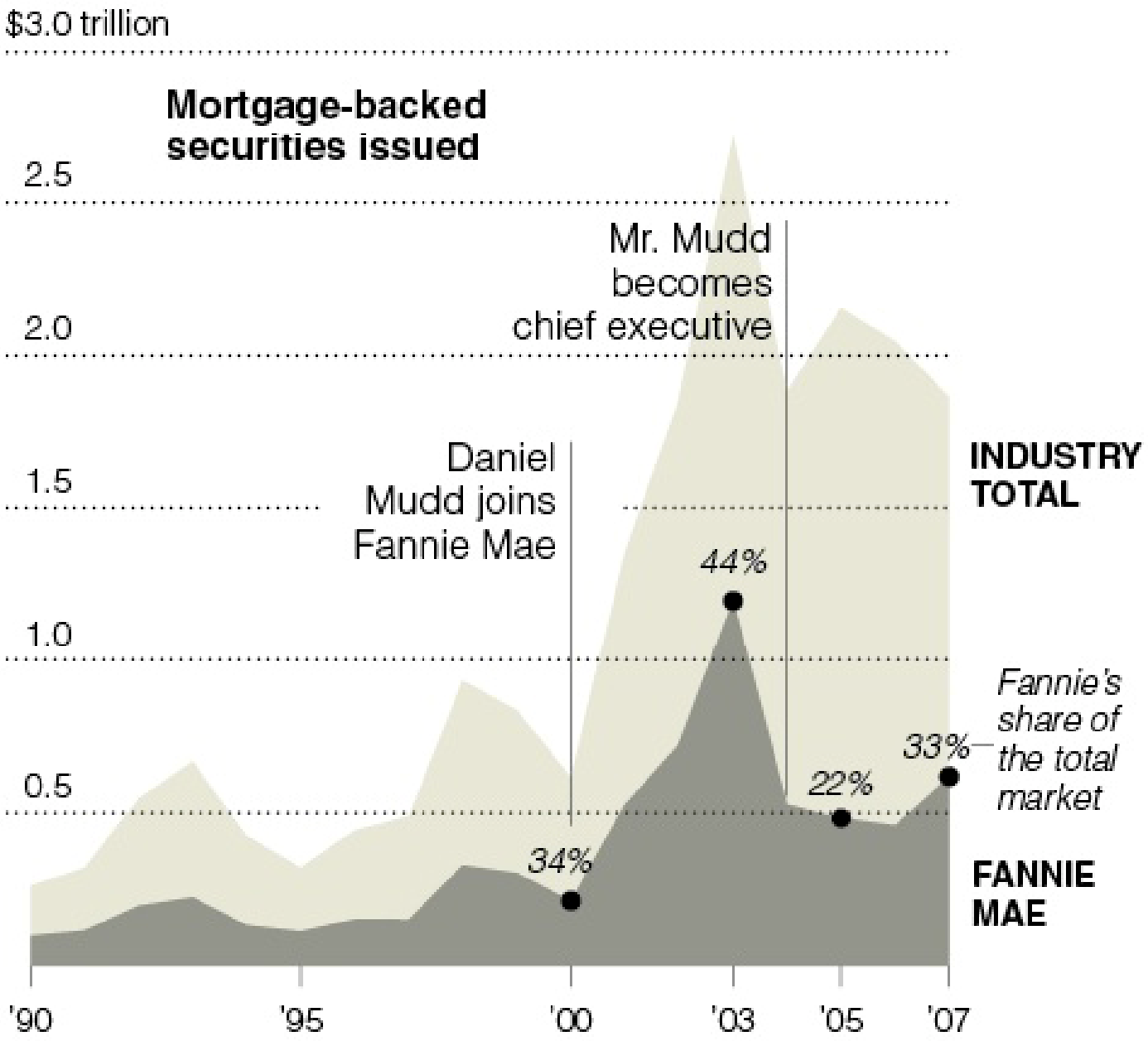


Source: Carmen M. Reinhardt and Kenneth S. Rogoff, “This Times is Different.” NBER WP 13882 (2008).

Growing Importance of Finance

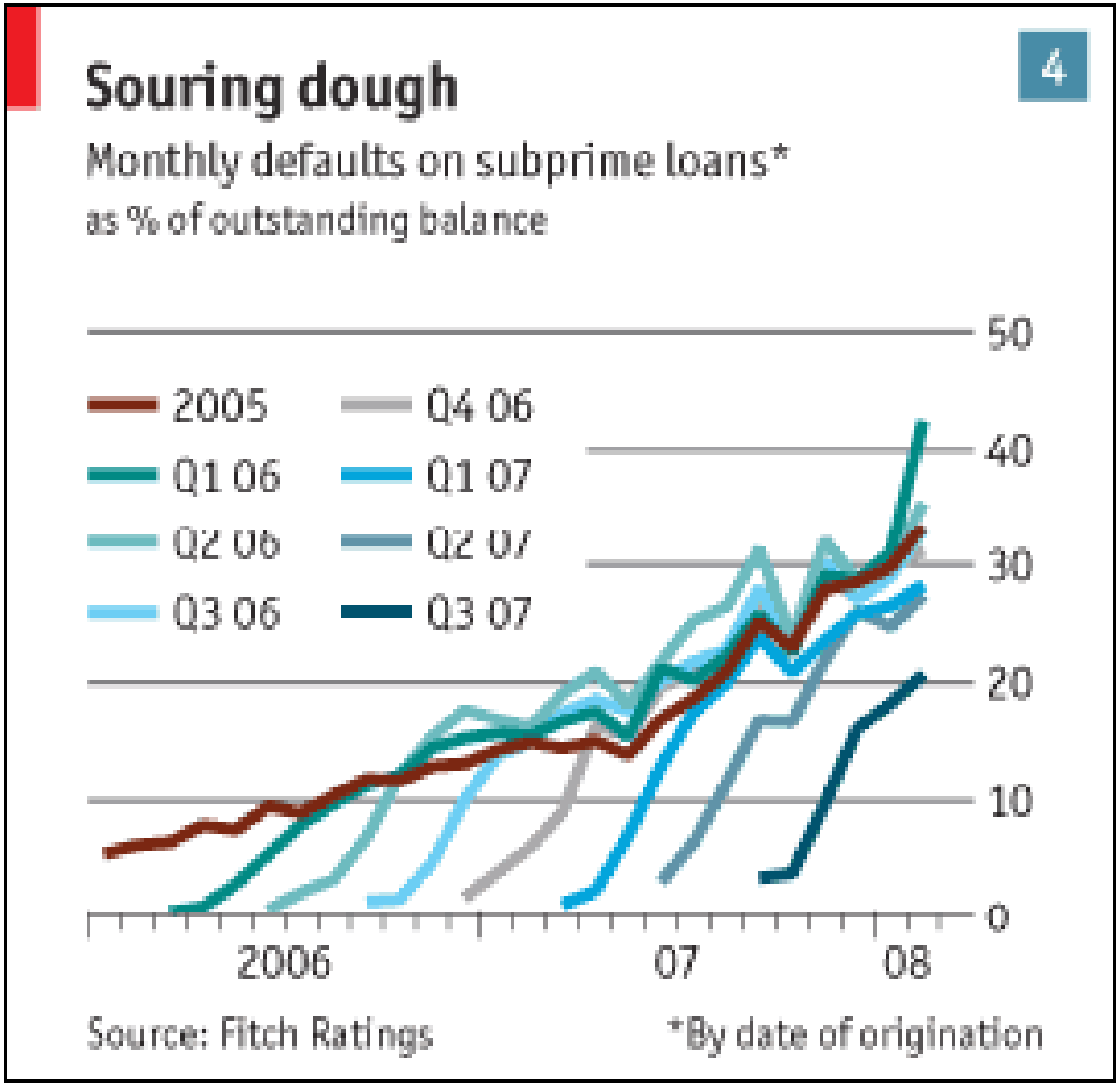


Note: Financial services and insurance accounted for 7.8% of U.S. GDP in 2006.

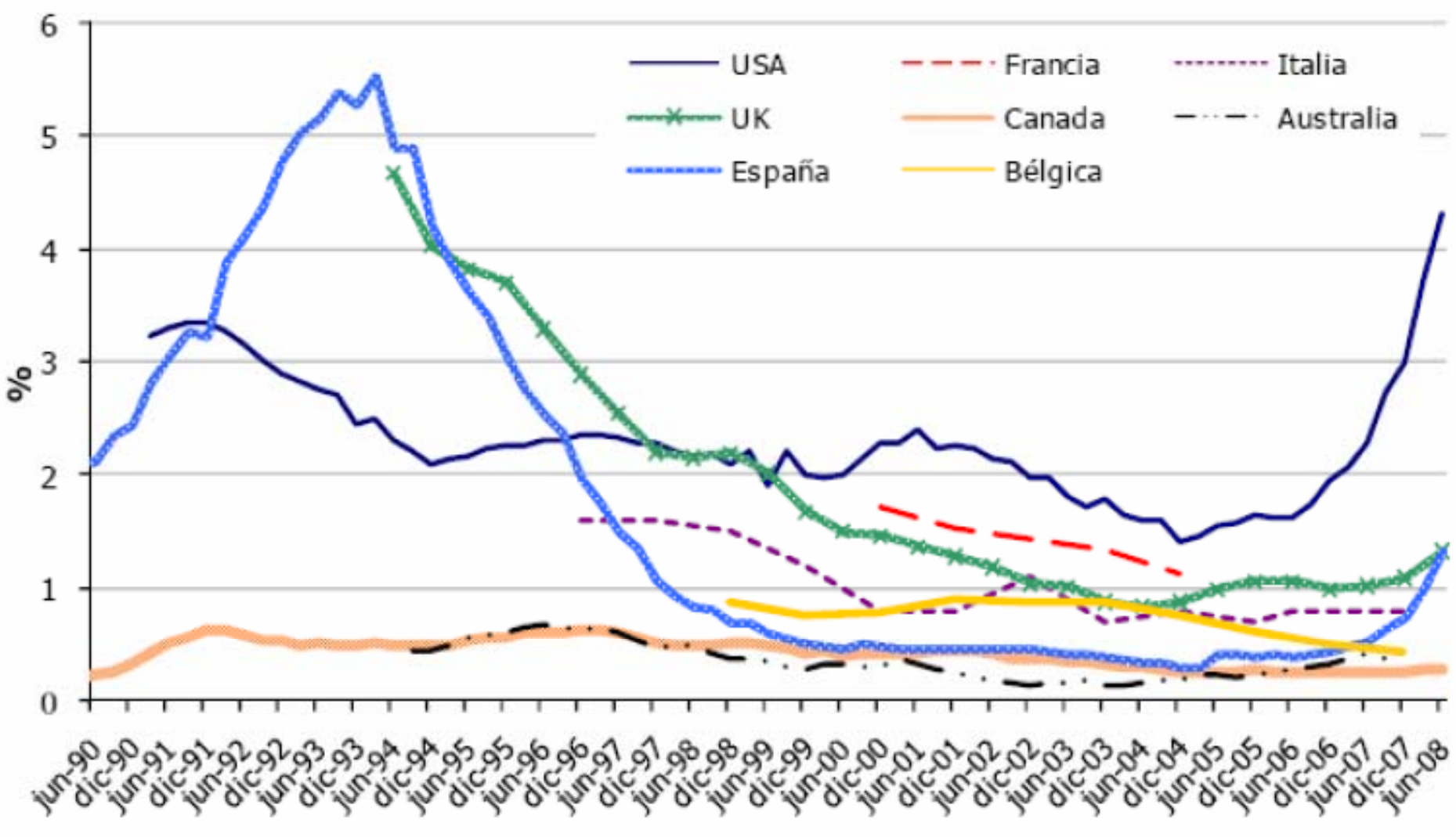


Sources: Inside Mortgage Finance; Fannie Mae company reports

Subprime Defaults



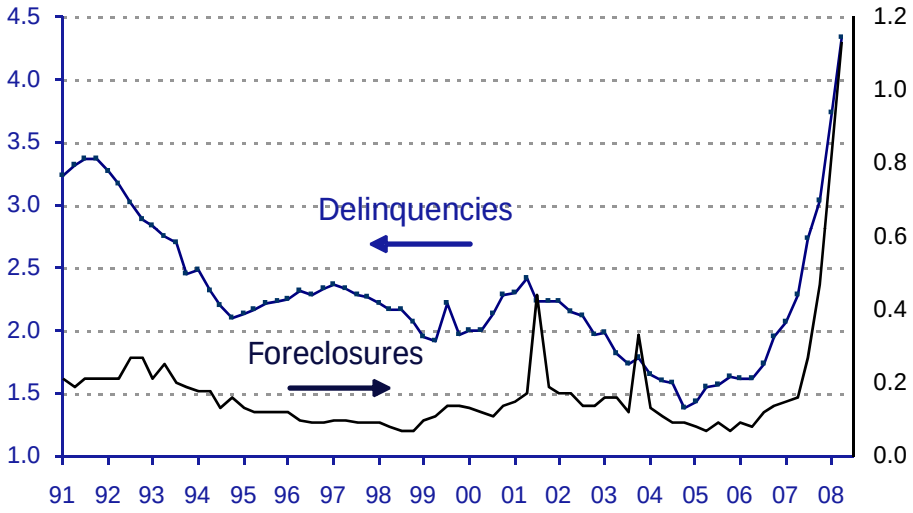
Mortgage Defaults by Country



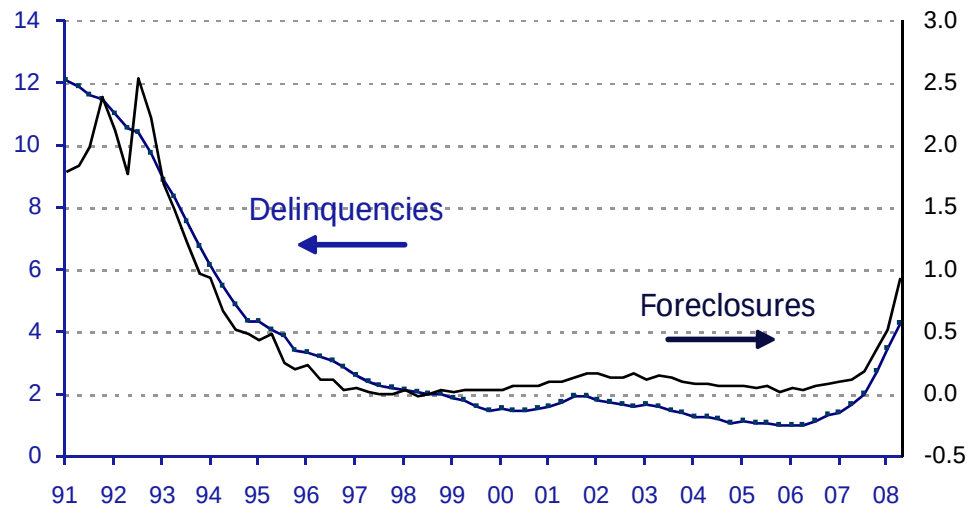
Source: Analistas Financieros Internacionales, based on OECD data.

Defaults in the U.S.

Residential Real Estate, Commercial banks
(Delinquency & charge-off rate, SA,%)

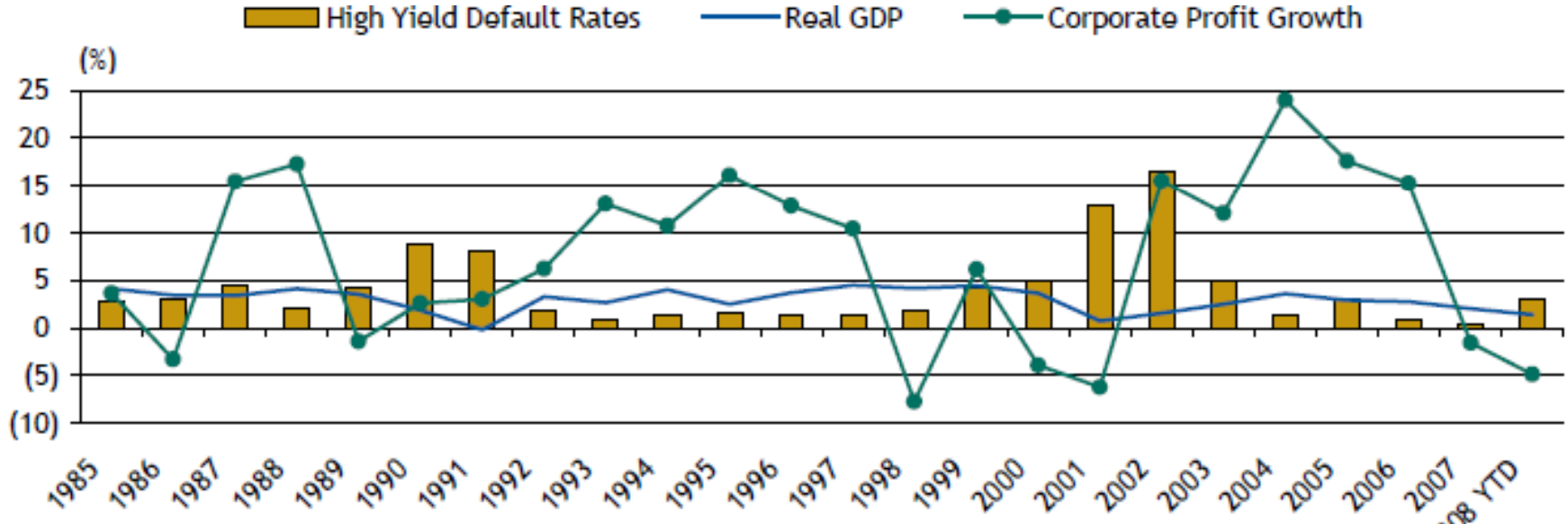


Commercial Real Estate, commercial banks
(Delinquency & charge-off rate, SA,%)



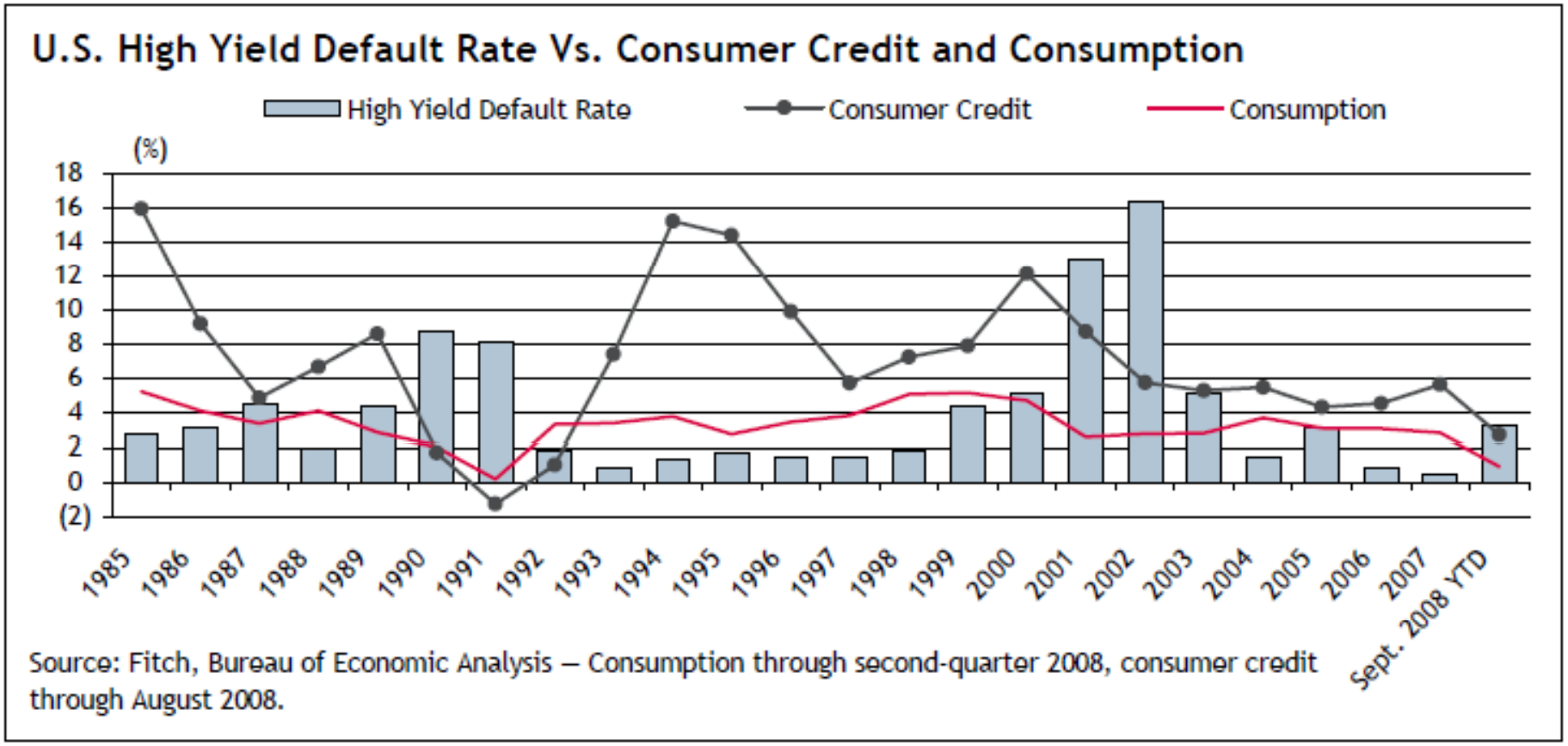
Source: FDIC. 2008 data refer to June 2008.

Corporate Defaults

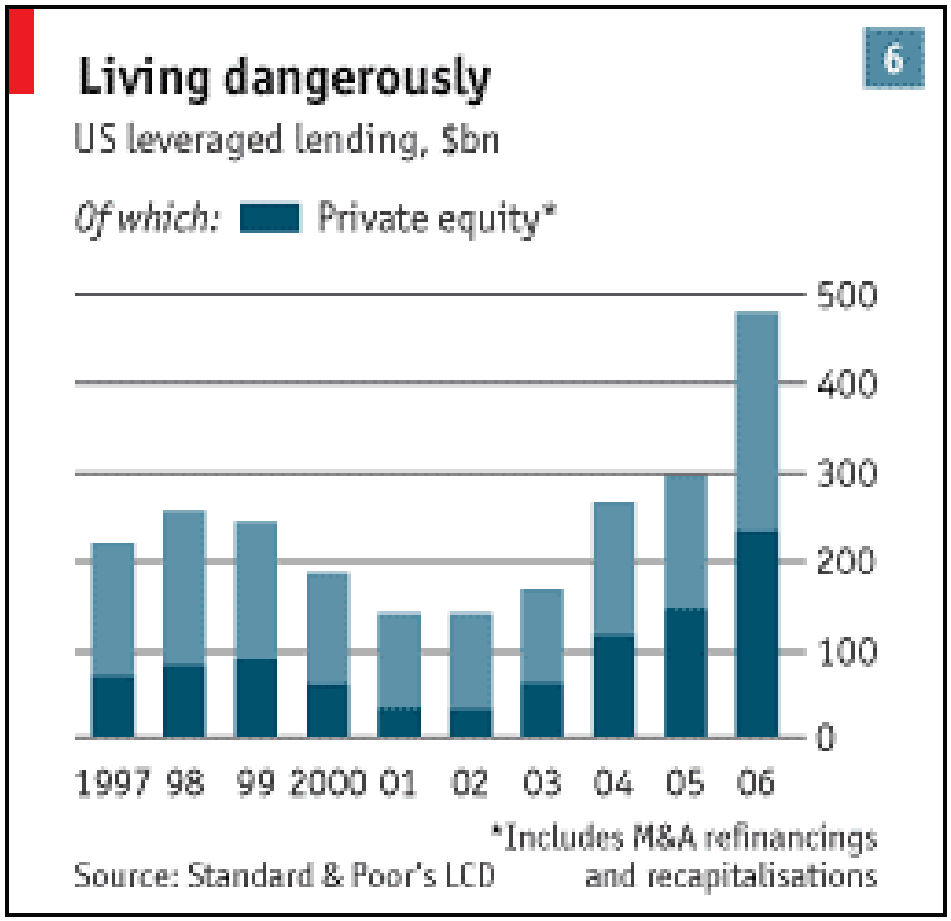


Source: Fitch U.S. High Yield Default Index, Bureau of Economic Analysis – GDP and corporate profit growth through second-quarter 2008.

Consumer Credit & Consumption



Leverage

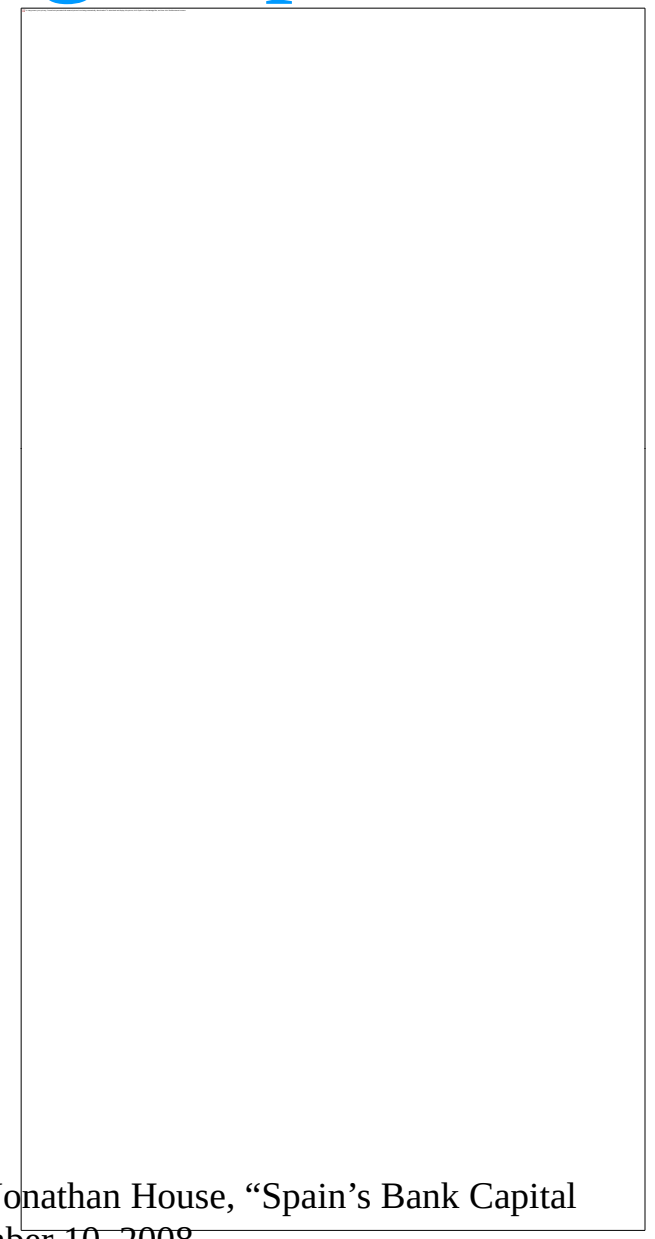

Living dangerously
6
US leveraged lending, $bn
Of which: Private equity*
500
400
300
200
100
0
1997 98 99 2000 01 02 03 04 05 06
*Includes M&A refinancings and recapitalisations
Source: Standard & Poor's LCD


Debt and buried
1
Leverage ratios* at Wall Street banks
Lehman Brothers
Bear Stearns
Morgan Stanley
Goldman Sachs
Merrill Lynch
35
30
25
20
15
2002 03 04 05 06 07
Source: Company reports
*Assets divided by equity

Financial Times, 16 de septiembre de 2008 – The last gasp of the broker-dealer

‘Dynamic Provisioning’: Spain

“Since 2000 the Bank of Spain has had something called a ‘dynamic provisioning’ regime, where bank provisions go up when lending is growing quickly. The scheme is based on the difference between banks’ specific provisions for identified losses in any given year and a ‘statistical’ provisioning amount that reflects average losses on assets over the whole business cycle. Over the cycle the effect is neutral, but the timing of the provisioning should make the troughs less deep and the peaks less vertiginous. ‘There is a gap between when risks are taken and when they materialise which needs to be bridged,’ says Mr Roldán [head of bank supervision at the Bank of Spain].”



Sources: “Spanish Steps.” *The Economist* May 15, 2008; Thomas Catan and Jonathan House, “Spain’s Bank Capital Cushions Offer a Model to Policy Makers.” *Wall Street Journal* November 10, 2008.

Possible Actions: Containment

- Suspension of convertibility of deposits.
- Regulatory capital forbearance.
- Emergency liquidity support.
- Government guarantee of depositors.

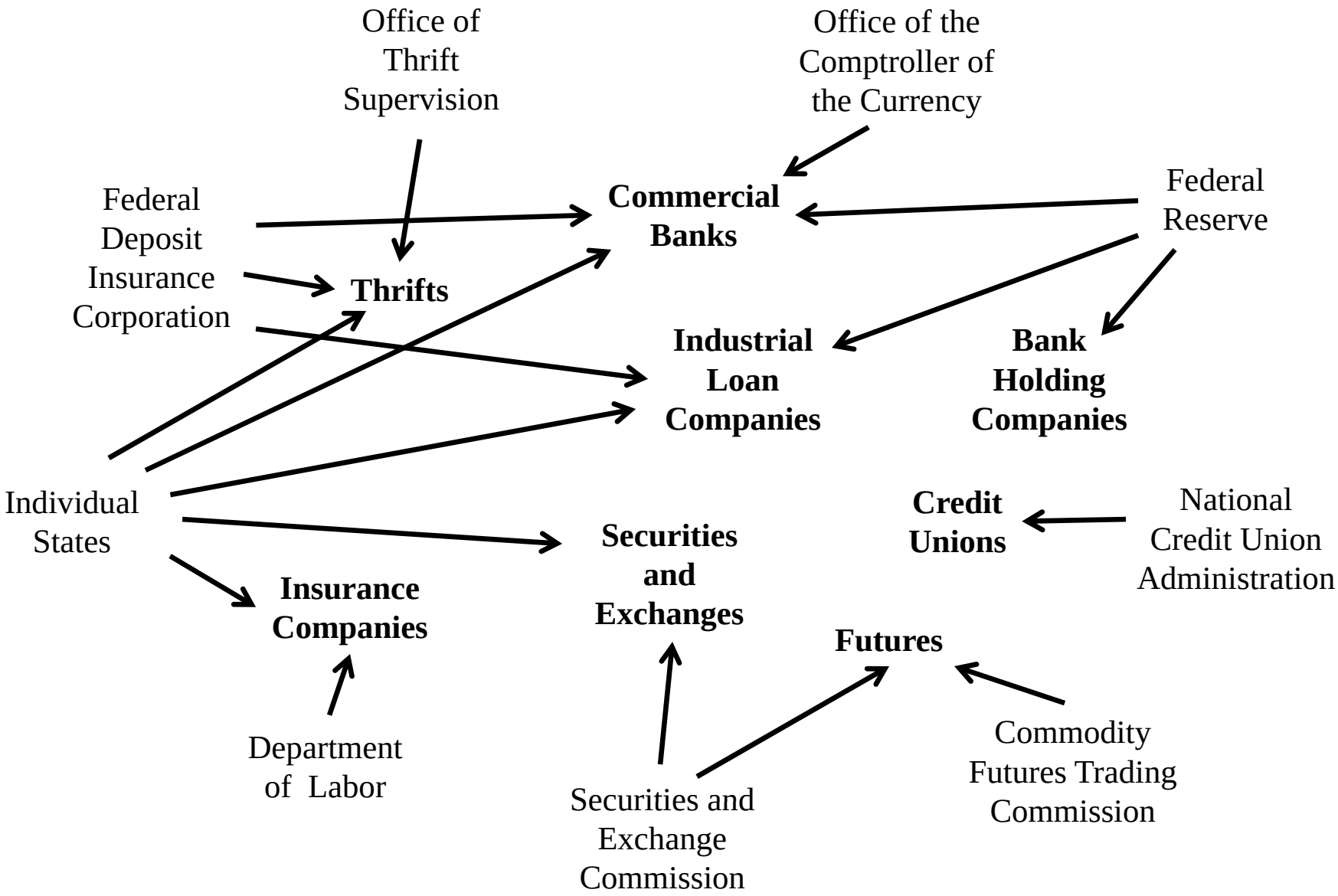
Source: Luc Laeven and Fabian Valencia, “Systemic Banking Crises: A New Database.” IMF WP 08/224.

Possible Actions: Resolution

- Workouts of bad loans and/or debt forgiveness.
- Government insurance of bad debt.
- Transfer of bad debts to a government asset management company.
- Sales of financial institutions to new owners.
- Government intervention and recapitalization of banks:
  - e.g. Spain ’77, Sweden ‘91, Mexico ‘94 Japan ‘97, Korea ‘97, China ’98, Turkey ‘00.
- Bank liquidations:
  - e.g. Spain ‘77, Egypt ’80, Chile ’81, Senegal ‘88, USA ‘88, Sweden ‘91, Japan ’97, Korea ’97, Russia ’98, Turkey ‘00.

Source: Luc Laeven and Fabian Valencia, “Systemic Banking Crises: A New Database.” IMF WP 08/224.

Regulatory Balkanization



Source: *The New York Times,* 5 October 2008, Sunday Business Section, p. 9.

I’m Not Optimistic about Congress…

- ***Spy Magazine:* What should we be doing to stop the ethnic cleansing in Freedonia?**
- Nick Smith (R.-Mich.): “My impression is we’ve got to be very careful, that moving through the United Nations effort has a great deal of merit.”
- James Talent (R.-Miss.): “I think anything we can do to use the good offices of the United States government to assist stopping the killing over there, we should do.”
- Jay Inslee (D.-Wash.): “I’m not familiar with that proposal, urn, but it’s coming to the point now that turning a blind eye to it for the next ten years is not the answer.”

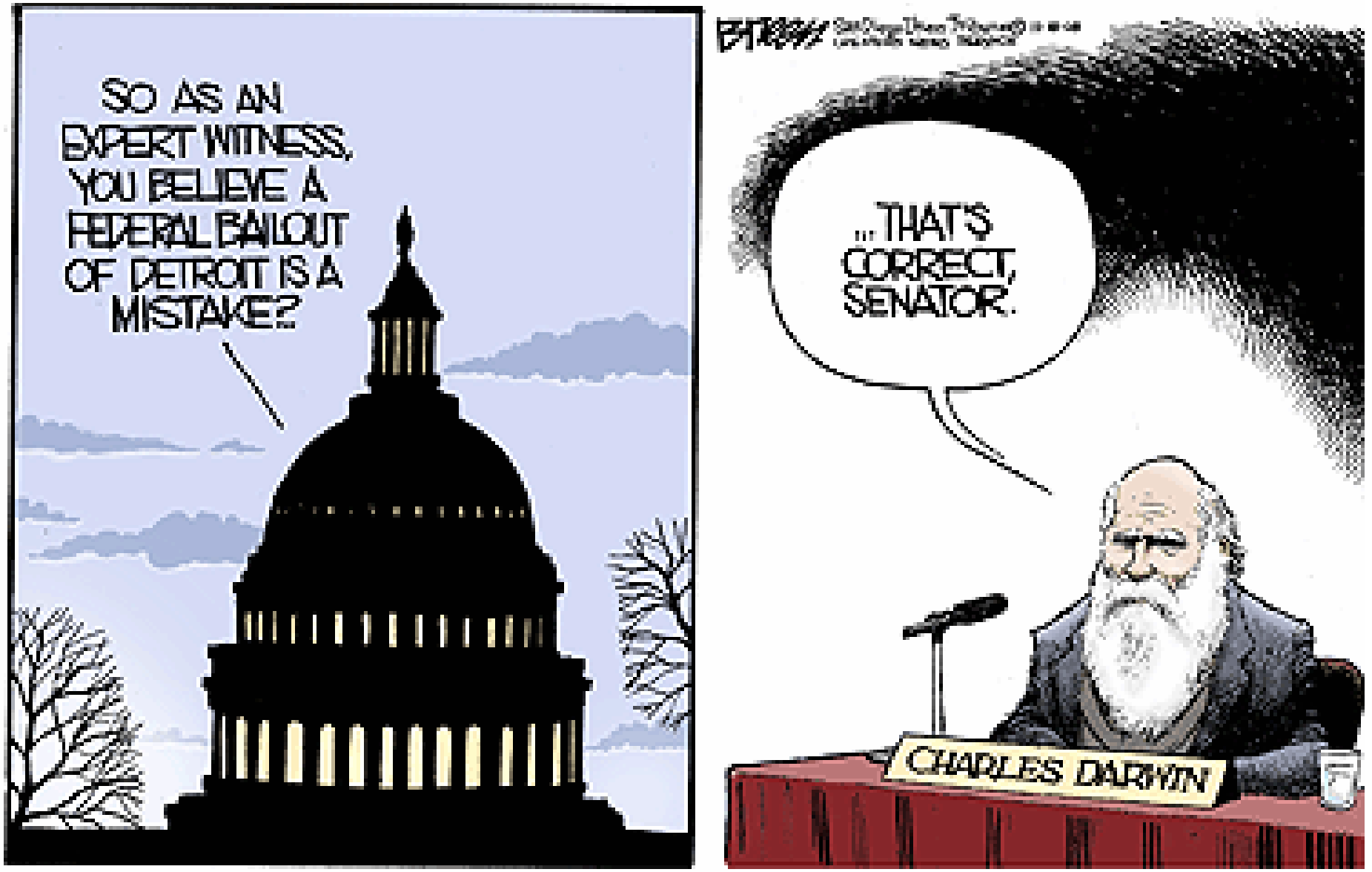
Nota bene: Freedonia, Marx Brothers fans will recall, was the country in which the movie “Duck Soup” was set.

Source: “Parliament of Suckers.” *Spy Magazine*, July-August 1994, Vol. 8, Issue 6.

A Gently Reminder: How Does the Market Work?

- First, by *rewarding* those who are innovative, creative, and efficient.
- Second, by *punishing* those that are not.
- Both are necessary for the market economy to work.
- Let's avoid interfering with these two mechanisms, or else…

Source: Mauro F. Guillén, Lauder Institute & Wharton School.


SO AS AN EXPERT WITNESS, YOU BELIEVE A FEDERAL BAILOUT OF DETROIT IS A MISTAKE?
...THAT'S CORRECT, SENATOR.
CHARLES DARWIN

Exacerbating the Problem

- U.S. policymakers have hesitated and flip-flopped:
  - Summer & fall 2007: Cutting **rates** and injecting **liquidity**.
  - Feb 17, 2008: Britain nationalizes of Northern Rock.
  - March 16: JP Morgan **acquires** Bear Stearns.
  - July 11: Federal regulators **seize** IndyMac.
  - Sept 7: Freddie Mac and Fannie Mae brought under government **conservatorship**.
  - Sept 15: Lehman is let go **bankrupt**.
  - Sept 15: Lifeline for AIG established.
  - Sept 14: Bank of America **acquires** Merrill Lynch.
  - Sept 26: JP Morgan **acquires** WaMu.
  - Sept 28: Britain nationalizes Bradford & Bingley, then sells it to Banco Santander.
  - Sept 29: Citigroup agrees to **acquire** Wachovia.
  - Oct 2: Congress passes the $700-billion **asset relief** bailout.
  - Oct 3: Wells Fargo ends up **acquiring** Wachovia.
  - Oct 13: Britain announces recapitalization plan.
  - Oct 13: **Recapitalization**: Citibank ($25 billion), JPMorgan Chase (25), Bank of America (20), Wells Fargo (20), Goldman Sachs (10), and Morgan Stanley (10).
  - Nov 10: Partial **nationalization** of AIG.
  - Nov 12: Paulson shifts emphasis from asset relief to **consumer relief**.
  - Nov 23: Citigroup is bailed out in an **asset-relief** package worth $306 billion, and a further $20 billion recapitalization (on top of an earlier $25 billion).