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Overt and Covert Bailouts: Developing a Public Bailout Policy

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INTRODUCTION

"Bailout" has become an increasingly familiar term in our popular vocabulary. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA),[1] the legislation providing for the bailout of the nation's savings and loan institutions, is one of the more dramatic, controversial, and expensive pieces of federal legislation in our history.[2] Although the term bailout is reasonably new, the "bailout phenomenon" is not. History provides numerous examples, including legislation to assist the Chrysler Corporation,[3] Lockheed Aircraft Corporation,[4] New York City,[5]

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1. Pub. L. No. 101-73, 103 Stat. 183.

2. A precise estimate on the overall cost of the savings and loan bailout is difficult to find. Differing estimates have been done by the Resolution Trust Corporation (RTC), created under FIRREA, the Congressional Budget Office (CBO), and the General Accounting Office (GAO). Figures are updated to reflect changing economic conditions, changing real estate markets, and the number of institutions likely to require assistance. One recent GAO estimate figured cost through 1999 at $335-370 billion. *Resolving Failed Savings and Loan Institutions: Estimated Costs and Additional Funding Needs: Hearings Before the House Comm. on Ways and Means,* 101st Cong., 2d Sess. 1 (1990) [hereinafter *Hearings*] (statement of Charles Bowsher, U.S. Comptroller General).

3. Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. No. 96-185, 93 Stat. 1324 (1980).

4. Emergency Loan Guarantee Act, Pub. L. No. 92-70, 85 Stat. 178 (1971). Although this Act was general in scope, its passage was motivated by the financial problems of the Lockheed Aircraft Corporation. H.R. REP. No. 379, 92d Cong., 1st Sess. 1272 (1971).

5. New York City Loan Guarantee Act of 1978, Pub. L. No. 95-339, 92 Stat. 460; New York City Seasonal Financing Act of 1975, Pub. L. No. 94-143, 89 Stat. 797.

and certain railroads.[6] In each case, the government intervened to assist an industry, individual firm, or municipality in financial distress.

Yet other recent instances of industry or firm failure have not received a particularly sympathetic hearing from the government. In response to requests for assistance from the airline industry, for example, the Federal Aviation Administration responded that "direct financial aid is not called for and would probably do more harm than good to the competitive process."[7] Similarly, requests for government assistance to prevent the imminent bankruptcy of the Drexel Burnham Lambert Group, a major securities firm, fell on deaf ears. Going even further than the FAA, Alan Greenspan, Chairman of the Federal Reserve Board, indicated that federal authorities probably would refuse to rescue even the largest securities firms threatened with such failure.[8]

Industries, individual firms, or municipalities will again appear before Congress to request assistance in times of crisis. Indeed, an emerging crisis already may exist in the insurance industry. A recent report cautioned that "the same early warnings of potential disaster are abundantly evident, as they were 5 years ago in the thrift industry. If such warnings are not heeded, the insurance industry and the nation could face a solvency crisis rivaling the present savings and loan situation."[9] Similar concerns have been raised regarding the nation's pension funds.[10] Assuming that some government

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6. United States Railway Association Amendments Act of 1978, Pub. L. No. 95-565, 92 Stat. 2397; Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, 87 Stat. 985 (1974).

7. *Hearings Before the House Public Works Comm.*, 102d Cong., 1st Sess. (March 5, 1991) (testimony by James Busey, Federal Aviation Administration).

8. When asked if the government would have intervened to assist a larger investment house such as Merrill Lynch or Smith Barney instead of Drexel, Greenspan replied that, regardless of the institution involved, the government actions would have been the same if the financial conditions were all the same. *Leveraged Buyouts and Bankruptcy: Hearings Before the House Subcomm. on Econ. and Commercial Law of the Comm. on the Judiciary,* 101st Cong., 2d Sess. 106 (1990) (testimony of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System). In discussing the controversial "too-big-to-fail" issue as applied to banks, Chairman Greenspan responded that "setting up a system in which commercial banks can be too big to fail is not good policy, needless to say. It is not good for the system, it's not good for the discipline of the system, and . . . it's certainly not equitable." *Id.* at 107.

9. REPORT BY THE SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS OF THE COMM. ON ENERGY AND COMMERCE, 101ST CONG., 2D SESS., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES 2 (Comm. Print 1990). Since this report, several large insurance companies have experienced difficulties necessitating government intervention. *See, e.g., New Jersey Is Preparing to Seize Mutual Benefit, A Large Insurer,* N.Y. Times, July 13, 1991, at A1, col. 1. The National Organization of Life and Health Insurance Guaranty Associations recently coordinated a private industry effort to protect the customers of the failed Executive Life Insurance Company of California. *Aid Planned for Executive Life Customers,* N.Y. Times, Aug. 29, 1991, at D1, col. 2.

10. This concern was raised in a recent Department of Labor report, stating that "an unknown portion of the $1.6 trillion in assets that are currently in private pension plans may be at risk. Unless steps are taken now, today's S & L bail-out may become tomorrow's ERISA

intervention is called for, regulatory efforts to prevent such crises should be the first priority. If such efforts prove unsuccessful, how should Congress respond? Why did Chrysler, Lockheed, and others receive government assistance, while Drexel Burnham Lambert did not?

Given that most bailout scenarios present an impending crisis, responsive legislation may be enacted without adequate deliberation. One is tempted to suggest that Congress or some appropriate agency develop general bailout guidelines or ground rules in a period of more sober reflection.[11] Such guidelines or policies could lead to more carefully designed legislation and might increase public confidence in difficult economic times. On the other hand, publication of such guidelines would give notice to players in the private marketplace, allowing them to take greater risks than they might otherwise, secure in the knowledge that the government will be there to protect them.[12] Some might say that this type of risk-taking behavior is already taking place.[13] Those in the thrift industry arguably were aware of the impending crisis. Nevertheless, they continued to take risks on the assumption that the government would have no choice but to bail them out. One of the goals of this Article is to address this tension between the need for bailout guidelines and the potential for increased risk taking and business failures that such guidelines might produce. More broadly, the goal is to consider the implications of alternative approaches to legislative policy for government decisions to provide financial assistance to troubled firms, municipalities, and industries and the form such assistance should take.

In addition to overt bailouts, numerous illustrations of more subtle assistance in the form of special tax breaks or special relief from burdensome

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nightmare." OFFICE OF THE INSPECTOR GENERAL, U.S. DEP'T OF LABOR, SEMIANN. REPORT 3 (1989). For an in-depth discussion of the pending crisis in the pension area, see Keating, *Pension Insurance, Bankruptcy and Moral Hazard,* 1991 WIS. L. REV. 65.

11. Shortly after the Chrysler bailout, but before the savings and loan crisis, the Comptroller General's Office appealed to the President and Congress to develop policies governing federal assistance to failing firms and municipalities. U.S. COMPTROLLER GENERAL, REPORT TO THE CONGRESS OF THE UNITED STATES: GUIDELINES FOR RESCUING LARGE FAILING FIRMS AND MUNICIPALITIES 5 (1984) [hereinafter COMPTROLLER GENERAL REPORT].

12. Commenting upon the Comptroller General's report, the United States Department of Commerce responded that "developing policy guidelines . . . leaves the impression that such aid is inevitable and encourages firms and municipalities to look to the government for assistance. We should not send this type of signal to firms and municipalities." *Id.* at 79.

13. For example, a recent report on government-sponsored enterprises such as Farm Credit Banks, Federal National Mortgage Association (Fannie Mae), and others indicated that

> enterprise ties with the government have weakened private market discipline to the point that creditors believe the federal government would be likely to assist an enterprise through any financial difficulty. While the government has no legal obligation to protect enterprise creditors, it seems clear that the enterprise's federal ties cause creditors to behave like insured depositors who believe their investments to be very safe.

GENERAL ACCOUNTING OFFICE, GOVERNMENT-SPONSORED ENTERPRISES: A FRAMEWORK FOR LIMITING THE GOVERNMENT'S EXPOSURE TO RISKS 3 (1991).

regulatory statutes may also be regarded as bailouts of a sort. Little effort has been made to identify the many different types of bailouts that exist and to look for unifying principles. With this Article, I hope to bridge that gap. Part I of this Article develops a definition of bailout, as well as several generic typologies or classification models. For illustrative purposes, earlier historical episodes will be fitted into this classification scheme. Part II discusses issues surrounding the development of a consistent public bailout policy. How does and how should Congress decide when to rescue a firm or industry in financial distress? Part III includes a discussion of public interest, pluralist, and distributive justice theoretical approaches to this difficult public policy issue. The Article will draw heavily upon the literature of economics, philosophy, and political science as well as the growing legal literature on the legislative process.[14] Part III provides some suggestions for substantive and procedural development of bailout policy. Finally, Part IV considers issues regarding the proper structure of a bailout once a decision to intervene has been made.

I. Definitions and Classification Models

A. *What Is a Bailout?*

The popular press has thrown the term "bailout" about rather loosely. In a more theoretical setting, however, a workable definition of relevant terms and parameters is critical. Bailout is a form of government intervention in another market arena, in most cases, a private market. One level of government also may intervene in the affairs of another level of government. The federal government, for example, may bail out a state or local government, and a state government may bail out a local government.[15] Most of the ensuing analyses can be applied to bailouts at other levels of government,

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14. In beginning my efforts on this project, I was not conscious of participating in an emerging field of legal scholarship. Nevertheless, this Article fits within the "New Public Law" scholarship recently described in Rubin, *The Concept of Law and the New Public Law Scholarship*, 89 Mich. L. Rev. 792 (1991). The primary audience I hope to reach with this Article consists of legislators, policymakers, and interested scholars. *See id.* at 814. My temporal orientation is toward the future, *see id.* at 818, and I use past events not as authority but as a source of data, *see id.* at 819.

15. In 1975, the federal government provided assistance to New York City in the form of direct short-term loans to allow the city to continue essential services and to prevent default. New York City Seasonal Financing Act of 1975, Pub. L. No. 94-143, §§ 2, 4(b), 89 Stat. 797. In 1978, additional assistance was provided in the form of long-term loan guarantees. New York City Loan Guarantee Act of 1978, Pub. L. No. 95-339, 92 Stat. 460. In 1991, New York City was again in financial crisis and requested bailout assistance from the state. It is also conceivable, albeit unlikely, that a state or local government might be called upon to assist in "bailing out" the federal government.

but this Article will focus primarily on federal government bailout of private industry.[16]

1. Bailout as a Form of Government Subsidy

Bailouts and general government subsidies are members of the same conceptual family and have some overlapping characteristics, but they differ largely as a matter of degree. Bailouts may include fewer beneficiaries than do general government subsidies. For example, bailout assistance to a particular firm provides benefits to a more concentrated group than general subsidies to assist small businesses. More significantly, though, bailouts differ from other government subsidies in focus. Whereas general subsidies tend to encourage a particular desired or favored activity, bailouts are designed to prevent enterprise failure. The focus of bailout is on saving a particular private enterprise or industry from collapse. This focus is distinct from that of three other types of general federal subsidies.

First, "incentive subsidies" are provided to private enterprise to encourage desired behavior. For example, in the interest of preserving free competition, the Small Business Administration may provide assistance to encourage and develop the actual and potential capacity of small businesses.[17] Also, the Internal Revenue Code provides for a targeted jobs credit[18] and numerous other such "incentive subsidies," earmarked for or made available to encourage a specific favored activity. In contrast, bailout subsidies are designed to support survival of the enterprise. Moreover, although the decision to provide "incentive subsidies" may be based on need, incentives are often available without regard to the financial health of a given firm or enterprise.

Second, "relief subsidies," such as federal disaster assistance, generally are provided to individuals and businesses that suffer dramatic losses from natural disasters such as hurricanes, tornadoes, and floods.[19] Relief subsidies resemble bailouts in that they may prevent financial collapse of a business

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16. Doctrines of sovereign immunity and other limitations on federal, state, or local liability might be thought of as reverse bailouts by which private citizens bail out government. Given its focus on *government* bailouts, consideration of reverse bailouts is beyond the scope of this Article.

17. Small Business Act of 1953, Pub. L. No. 163, 67 Stat. 232 (codified as amended at 15 U.S.C. § 631 (1988)).

18. The targeted jobs credit provides employers with a tax credit based upon a percentage of first-year wages paid to individuals hired from certain targeted groups. 26 U.S.C. § 51(a), (b) (1988). These groups include economically disadvantaged youths, supplemental security income recipients, general assistance recipients, and others. *Id.* § 51(d). The Internal Revenue Code also provides special deductions and credits to encourage research and experimental investments. *Id.* §§ 38, 41, 174.

19. 42 U.S.C. §§ 5121-5122 (1988). The Small Business Administration also is authorized to provide some forms of disaster relief to small businesses. 15 U.S.C. § 636(b)(1)(A).

that has suffered loss due to a natural disaster. However, assistance is not limited to those who would be threatened with imminent bankruptcy without federal intervention. Rather, the relief subsidy recognizes that natural disasters strike arbitrarily, imposing costs on the victims from which the rest of us have been spared. When some participants in the private marketplace arbitrarily incur extraordinary expenses due to circumstances beyond their control and the private insurance market is unavailable to cover the loss, communitarian considerations suggest that some type of government assistance should be provided.

Third, "support subsidies," such as price supports for certain agricultural products, are available to assist certain farmers.[20] The initial impetus for agricultural price supports in the 1930s was the "acute economic emergency being in part the consequence of a severe and increasing disparity between the prices of agricultural and other commodities, which disparity ha[d] largely destroyed the purchasing power of farmers for industrial commodities."[21] Although agricultural support subsidies thus had some bailout characteristics, the ongoing rationale for subsidies is primarily the regulation of agricultural markets.[22] Support subsidies are available to farmers who comply with program requirements regardless of the financial health of the particular farming enterprise receiving support. In addition, they are subject to limits and will not necessarily provide a profit or protect a particular farmer from financial collapse.[23]

Any federal assistance to private enterprise, whether through bailout or general subsidy, involves government intervention in otherwise private markets. In either case, the interests to be served by government intervention and assistance must be identified and justified. To be sure, many of the arguments developed in this Article could be extended more generally to other types of subsidies.[24] Despite the similarities between bailouts and other subsidies, this Article takes the position that bailouts deserve special policy consideration, for both substantive and procedural reasons.

On a substantive level, bankruptcy—which bailout seeks to prevent—may well be good for the economy as a way of weeding out inefficient enterprise. Allowing firms to fail may be best for the overall long-run health of the

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20. Price supports are available only for production of specific products. Congress has made price supports mandatory for some agricultural products and discretionary with the Secretary of Agriculture for others. 7 U.S.C. § 1421(b) (1988). Price support programs currently available include government loans, government purchase of commodities, and direct payments to farmers. For a brief description of these three types of programs and farm policy generally, see R. KNUTSON, J. PENN & W. BOEHM, AGRICULTURAL AND FARM POLICY, ch. 10 (1990).

21. Agricultural Adjustment Act of 1933, Pub. L. No. 10, § 1, 48 Stat. 31.

22. Viewed slightly differently, price supports and other indirect subsidies in the form of tariffs or trade quotas simply may be raw protectionist legislation acquired by industry.

23. Limitations on price support receipts are set in 7 U.S.C. §§ 1307-1308.

24. I will limit myself in this Article to consideration of bailout policy and leave for future articles the extent to which the arguments developed here can be applied more broadly.

economy. Moreover, a bailout may protect the "wrong" economic actors. Although bailouts ostensibly may be designed to protect employees from unemployment and innocent customers or depositors from losing their money, the managers and investors or shareholders of the rescued enterprise are often indirect beneficiaries of a bailout. Normally, investors in a business enterprise understand that they risk losing their investment, and the price for stock or other investment takes such risk into account. Bailouts permit investors and managers to shed some of this risk by shifting loss to the community funding the bailout effort.

Bailouts also raise distinct "moral hazard" issues. In the context of accidents and insurance, Dean Guido Calabresi has pointed out that

> [i]n a world where accident costs were totally spread, there would be no financial incentives to avoid accidents other than fear for one's own safety. Even that incentive would be reduced to the extent that the injuries one might suffer could be adequately compensated for financially. . . . A vague kind of moral sense might cause us occasionally to be safety-conscious, but where the less safe acts or activities had any substantial attraction and where the harm to others was not obvious, it would not be a very effective incentive for the mass of people.[25]

Tort liability creates a general deterrence effect that "operates in two ways to reduce accident cost. The first and more obvious one is that it creates incentives to engage in safer activities. . . . The second and perhaps more important way general deterrence reduces accident costs is that it encourages us to make activities safer."[26]

The market generally forces firms to internalize the cost of failure, thus providing a deterrence effect. Internalization of costs will influence the behavior of two significant groups. First, and most important, business managers whose jobs and salaries are affected by business failure will be deterred from excessively risky behavior. Second, investors demand a higher rate of return from risky activities, but, at some point, the rate of return will not be adequate and the investor will be unwilling to take the risk. A society interested in technological innovation and advancement may wish to encourage greater levels of risk taking than would otherwise occur in the

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25. G. Calabresi, The Costs of Accidents: A Legal and Economic Analysis 64-65 (1970). For a more technical economic discussion of moral hazard, see S. Shavell, Economic Analysis of Accident Law 186-261 (1987); Holmstrom, *Moral Hazard and Observability,* 10 Bell J. Econ. 74 (1979); Shavell, *On Moral Hazard and Insurance,* 93 Q.J. Econ. 541 (1979).

26. G. Calabresi, *supra* note 25, at 73. For a general economic argument that this may not always be so, see R.H. Coase, The Firm, the Market, and the Law 95-156 (1988) (originally published as *The Problem of Social Cost,* 2 J.L. & Econ. 1 (1960)). For a more specific critique of Dean Calabresi's approach as applied to motorists, see Blum and Kalven, *The Empty Cabinet of Dr. Calabresi: Auto Accidents and General Deterrence,* 34 U. Chi. L. Rev. 239 (1967).

market and may thus permit the investor to shed some risk.[27] On the other hand, too broad a policy of risk shifting may encourage managers and investors to take excessive risks. A general government policy to bailout failing enterprises would encourage higher levels of risk taking than would be optimal for society or, even worse, might create incentives to incur losses. A thoughtful bailout policy must take this moral hazard problem into account.

On a procedural level, a special bailout policy is necessary to balance the need for careful consideration of the merits of a particular bailout with the need for quick action in a crisis setting. Bailout decisions often responded to a crisis on an ad hoc basis. But, in the heat of crisis, time for deliberation is short and consideration of larger public policy issues difficult. Policy makers should develop a general bailout policy in the absence of immediate crisis. Such a policy should consider the general government or public interest to be served by public bailout intervention in various sectors of the private market and establish some general guidelines as to when intervention would be appropriate. Such guidelines should make it clear that public rescue of private enterprise will be a rare and extraordinary event.[28]

2. A Proposed Definition

a. General Definition

The features distinguishing bailout from the broader class of general government subsidy provide some useful descriptive limits to the bailout

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27. Insurance is an institution developed to permit shifting of risks in the interest of economic development. The market for common stock is a risk-shifting institution as well. For one thing, the corporate form offers the advantage of limited liability to shareholders. The market for shares also permits

> the owner of a business [to] divest himself of some of the risks, permitting others to share in the benefits or losses. Since each individual could now own a diversified portfolio of common stocks, each with a different set of risks attached, he could derive the benefits of a reduced aggregate risk through pooling; thus, the stock market permits a reduction in the social amounts of risk-bearing.

K. Arrow, Essays in the Theory of Risk-Bearing 135 (1971). For further discussion of insurance and moral hazard, see *infra* notes 146-61 and accompanying text. Special tax breaks have often been used to encourage greater levels of investment and risk taking. For example, credits for research and development are designed to encourage investors to develop projects that otherwise might not be undertaken given the speculative prospects for success. 26 U.S.C. § 41 ("Credit for Increasing Research Activities"). For similar reasons, investors in oil and gas wells are permitted to deduct certain drilling and development costs that would otherwise be amortized. *Id.* § 263(c) ("Intangible Drilling and Development Costs in the Case of Oil and Gas and Geothermal Wells"). Finally, reduced rates for capital gains are often justified as a stimulus for the economy generally and to encourage risk taking. *See, e.g.*, Department of Treas., General Explanations of the President's Budget Proposals Affecting Receipts 3-6 (Jan., 1992) (President Bush's proposal for further reducing capital gains rates).

28. For further discussion of general policy guidelines, see *infra* notes 265-88 and accompanying text.

phenomenon under consideration, but none provides a definition that identifies the distinct qualities of the bailout phenomenon as a public policy issue. As a first step toward such a definition, I propose the following: Bailout is a form of government assistance or intervention specifically designed or intended to assist enterprises facing financial distress and to prevent enterprise failure.[29] This definition does not require that the bailout be successful; the business or industry may fail despite government assistance. The crucial element is that the attempt be a form of *government* intervention.[30] Although individuals or other private entities may provide assistance to a failing enterprise, this Article focuses on *governmental* action.

Bailout, as defined, focuses upon assistance *to the enterprise or industry itself.* Some have argued that the popularly described savings and loan bailout is mislabelled since "moneys are being used to satisfy the government's insurance obligations to depositors, not to 'bail out' anyone."[31] Under the proposed bailout definition, this argument initially has some force. On closer examination, however, a bailout surely can be found in the savings and loan story. A federal insurance program may protect customers or depositors, but when the program covers a liability to a customer or depositor for which the business enterprise would otherwise be liable, the payment does provide assistance to the enterprise.[32] The "bailout" in the savings and loan story arguably is not the money *now* being used to satisfy the government's insurance obligation, but the federal deposit insurance system itself, established just after the Great Depression in order to restore consumer confidence, prevent bank runs, and keep the banks operating.

In some sense, the savings and loan episode can be viewed as a *failed* bailout. Earlier attempts to prevent enterprise failure through a federal insurance system were unsuccessful. Nevertheless, the terms of the earlier bailout now require dramatic payments to satisfy the government obligations undertaken. Moreover, in some recent bank failure cases, banking regulators went far beyond government insurance obligations, choosing to protect even

29. Use of the term "intervention" suggests actions of government that are *designed* to have a particular impact. This should be distinguished from other actions of government that may interfere in some way with private action as an unintentional by-product of government activity.

30. The appropriate terminology is really "public bailout." Since most of the discussion in this Article is about government bailouts, *bailout* will be used as a shorthand for public bailout.

31. L. WHITE, THE S & L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION 5 (1991). Professor White concedes that assistance to savings and loan managers, investors, and uninsured depositors might legitimately be referred to as a bailout. He argues, however, that such payments represented a very small percentage of the total "S & L bailout" cost. *Id.* at 161-63.

32. For further discussion of federal insurance programs, see *infra* notes 90-108, 336-38 and accompanying text.

uninsured depositors and to keep some banks operating. These government actions protected managers and investors, as well as customers. A bailout surely is involved when government assistance protects managers and investors and preserves the enterprise as a going concern.

b. *The Concept of Financial Distress*

One challenge presented by the bailout definition will be to establish precisely when an enterprise is facing financial distress or failure. One useful place to look for a definition is the "failing firm defense" to alleged violations of section 7 of the Clayton Act.[33] First recognized by the Supreme Court in *International Shoe Co. v. F.T.C.*,[34] the defense allows an otherwise impermissible anticompetitive merger if one of the merging firms is failing. The failing firm defense has two basic elements. First, one company to the merger must be facing "grave probability of a business failure"[35] and there must be "no other prospective purchaser."[36] Some courts have added as a third element the requirement that prospects for a reorganization in

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33. Clayton Act, ch. 323, § 7, 38 Stat. 730, 731-32 (1914). The current version provides that

> no person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital . . . where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C. § 18 (Supp. 1991).

34. 280 U.S. 291 (1930). The Court upheld the acquisition of a failing company by the nation's largest shoe manufacturer, concluding that

> [i]n the light of the case thus disclosed of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.

Id. at 302-03.

Over the years, some controversy has developed concerning the Court's rationale for the failing firm defense. One rationale reflected in the language quoted in text is that merger of a truly failing firm is not anticompetitive since the firm is about to go out of business anyway. A second rationale also reflected in the Court's language is recognition of the hardship faced by stockholders, employees, and the communities in which firm was operating. For an excellent discussion of these two strands of the failing firm defense, see Friedman, *Untangling the Failing Company Doctrine*, 64 TEX. L. REV. 1375 (1986). For further discussion of the "failing firm defense" as a type of bailout, see *infra* notes 79-81 and accompanying text.

35. *Int'l Shoe Co.*, 280 U.S. at 302.

36. *Id.*

bankruptcy be "dim or nonexistent."[37] The Justice Department has included this third element in its Merger Guidelines, announcing that it is

> unlikely to challenge an anticompetitive merger in which one of the merging firms is allegedly failing when: 1) The allegedly failing firm probably would be unable to meet its financial obligations in the near future; 2) it probably would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and 3) it has made unsuccessful good faith efforts to elicit reasonable alternative offers of acquisition of the failing firm that would both keep it in the market and pose a less severe danger to competition than does the proposed merger.[38]

While the common law failing firm defense requires a *grave* probability of business failure, the Justice Department's standard is a bit looser, requiring only that the firm "probably would be unable to meet its financial obligations in the near future."[39]

For purposes of this Article, I will adopt the Justice Department notion of a failing firm as one unlikely to meet its financial demands in the near future.[40] Adoption of the looser standard will subject more proposals for government intervention to careful scrutiny under strict bailout guidelines developed later.[41] Also, as will be developed further, the requirement that the firm would probably be unable to successfully reorganize in bankruptcy will prove useful in the bailout context.[42]

3. Clarifying Misconceptions: Bailout Costs

Although bailouts provide assistance to troubled enterprises, they do not necessarily involve expenditures of general tax revenue. With regard to cost, bailouts can be broken into five general categories. First, as in some of the

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37. *See, e.g.,* Citizen Publishing Co. v. United States, 394 U.S. 131, 138 (1969).

38. U.S. Dep't of Justice, Merger Guidelines, 49 Fed. Reg. 26,837 (1984) [hereinafter Merger Guidelines], *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103 (1988).

39. *Id.* Looser still is a defense available with respect to bank mergers. Under the Bank Merger Act of 1966, Pub. L. No. 89-356, 80 Stat. 7 (codified at 12 U.S.C. § 1828(c) (1988)), banking regulators were given authority to approve otherwise anticompetitive mergers upon a finding "that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." *Id.* § 1828(c)(5)(B). 12 U.S.C. § 1842(c)(2) is a similar provision regarding mergers of bank holding companies. The bank merger "floundering firm" doctrine was described by the Supreme Court as "related although . . . remotely, to the failing-company doctrine." United States v. First City Nat'l Bank, 386 U.S. 361, 369 (1967).

40. In the bankruptcy context, one commentator recently provided a similar definition for the term "financial distress": "a corporation is in financial distress when it faces actual or anticipated payment demands to which its own response is or is likely to be inadequate . . . . [A] corporation is in financial distress when its own internal mechanisms for adaptation to actual or anticipated payment demands are severely impaired." Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy,* 91 COLUM. L. REV. 717, 764 (1991).

41. *See infra* notes 257-310 and accompanying text.

42. *See infra* notes 62-74 and 258-59 and accompanying text.

more successful bailout illustrations, no government funds may ultimately be expended at all. In the Chrysler Corporation bailout, for example, all government loans to the corporation were repaid in full, and fees charged the corporation covered most or all administrative costs.[43] In fact, in the Chrysler case, the government was rewarded with a profit from the sale of warrants it had taken to secure its risk.[44] This category may be referred to as the "profitable bailout."

One suspects that most bailouts will not be profitable for the government, however. The second category of "no- or low-cost bailouts" includes those bailouts that are not profitable but that involve little or no expenditure of revenues. Loan guarantee programs may fall into this category. In such cases, the enterprise is obligated to repay a private lender, with the government simply acting as guarantor. If administration of the program is covered by fees charged to the enterprise and the government guarantee is never called, the bailout is a no-cost or low-cost bailout.[45]

In contrast to profitable or no-cost bailouts, many bailouts will involve substantial government expenditures. Funding for these bailouts may come from various sources. The third classification of bailouts according to cost includes those bailouts that are funded from sources other than general revenue. For example, banking regulators have discretionary authority to provide assistance to failing banks. Such bailouts are generally funded through special insurance pools under the federal deposit insurance system. The funds in these insurance pools are generated by assessments and contributions from banks participating in the insurance programs, not from general tax revenues.[46] Although general tax revenues are not used, these rescues still can be properly regarded as bailouts. In each case, the government intervenes to provide assistance to a failing private enterprise. Of

43. *Chrysler Corp. Loan Guarantee Board Report to Congress: October 1, 1982 to September 30, 1983* 2 ("Chrysler was able to generate sufficient cash to retire the entire $1.2 billion in guaranteed indebtedness . . . approximately two years in advance of the scheduled repayment and seven years ahead of the time when repayment would have been required.").

44. As part of its effort to protect itself from risk, the Treasury Department received from Chrysler warrants to purchase stock at $13 per share. As Chrysler recovered financially, the stock value increased substantially above this warrant price. The government ultimately sold the warrants to the highest bidder (Chrysler itself) and made a $311.1 million profit. R. REICH & J. DONAHUE, NEW DEALS: THE CHRYSLER REVIVAL AND THE AMERICAN SYSTEM 254-57 (1985). A more complete discussion of the Chrysler bailout follows *infra* notes 63-66 and accompanying text.

45. One may question whether a government assistance program that ultimately results in a profit or no cost to the government should still be regarded as a bailout. The answer, I think, is yes. In the Chrysler, Lockheed, and New York City loan guarantee cases, the government took a gamble and won. Nevertheless, substantial taxpayer dollars were at risk. In each case, the government assumed a risk that commercial lenders were unwilling to take based upon standard lending principles. General tax revenues were at risk in a way that they would never have been in a private bailout through reorganization in bankruptcy, for example.

46. For a further description of federal deposit insurance bailouts, see *infra* notes 90-100 and accompanying text.

course, the cost burdens in such federal insurance cases are more concentrated than in the case of bailouts through general tax revenues. I will refer to cases in this category as "special fund bailouts." In special fund bailouts, those bearing cost burdens are more closely connected with those receiving benefits from the federal program.[47]

Fourth, bailouts may involve expenditures of general tax revenues. This category will be referred to as "general revenue bailouts." Cost burdens are spread broadly among the general tax-paying public. Pure general revenue bailouts will be rather rare, however. More often, bailouts will be funded through a combination of sources. For example, FIRREA established a rather complex mechanism to provide funding for the savings and loan bailout. Theoretically, funds for the bailout were to come from the sale of assets taken from banks in receivership, the sale of nonvoting capital stock to Federal Home Loan Banks, assessments against certain savings and loan banks, and the issuance of obligations.[48] In each case, however, it was recognized that the "special fund" might not be sufficient to cover all bailout costs. Congress authorized supplemental general revenue funding from the Treasury Department.[49] Thus, the savings and loan expenditure

47. For further discussion of the distribution of bailout costs, see *infra* notes 339-46 and accompanying text.

48. Details regarding the jurisdiction over and funding of bank bailouts are quite complex and beyond the scope of this Article. Generally, however, the savings and loan bailout is being handled by three entities. First, banks that were insolvent before January 1, 1988, and thus liabilities of the bankrupt FSLIC are covered by the FSLIC Resolution Fund, which assumed old FSLIC liabilities. FIRREA, *supra* note 1, § 215 (codified at 12 U.S.C. § 1821(a) (Supp. I 1989)). Second, the Resolution Trust Corporation (RTC) was established to resolve those banks placed in receivership between January 1, 1989 and August 9, 1992. *Id.* § 511 (codified at 12 U.S.C. § 1441(b)). Finally, the FDIC retained authority for subsequent bailouts under revised and reformed regulatory provisions of the Act. *Id.* at Titles I and II. Each of these entities has distinct provisions regarding funding sources. The FSLIC Resolution Fund, for example, is funded by the Financing Corporation originally established by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552, § 302 (codified at 12 U.S.C. § 1441(a)). The RTC is funded by the Resolution Funding Corporation, FIRREA, *supra* note 1, § 511 (codified at 12 U.S.C. § 1441(b)). The FDIC is to maintain a Bank Insurance Fund (BIF) and a Savings Association Insurance Fund (SAIF). *Id.* § 211 (codified at 12 U.S.C. § 1821(a)(5), (6)). For a more comprehensive treatment of the savings and loan bailout structure and funding mechanisms provided by FIRREA, see J. Barth, The Great Savings and Loan Debacle 79-99 (1991); Lescher and Mace, *Financing the Bailout of the Thrift Crisis: Workings of the Financing Corporation and the Resolution Funding Corporation,* 46 Bus. Law. 507 (1991); Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation,* 50 Ohio St. L.J. 1117 (1989); *see also infra* note 90.

49. The most dramatic authorization of Treasury payments arises in connection with the SAIF. Congress authorized annual Treasury payments of up to $2 billion for administrative expenses through 1999. In addition, the Treasury is to pay additional amounts not to exceed $16 billion through 1999 when necessary to ensure that SAIF maintains specified minimum net worths for each year. FIRREA, *supra* note 1, § 211 (codified at 12 U.S.C. § 1821(a)(6)(F), (J)(ii)). With respect to the RTC and FSLIC Resolution Fund, Congress provided for backup Treasury funding to permit payment of interest on obligations issued. *See, e.g., id.* § 511 (codified at 12 U.S.C. § 1441(b), (f)(2)(E)).

fits within this fifth category of "combination bailouts," funded through an intricate mix of special funds and general revenues.

4. The Public v. Private Bailout Distinction

a. Reorganization in Bankruptcy as an Alternative

A few important points about the differences between public and private bailout should be made. First, private parties with an economic stake in a particular enterprise may agree voluntarily to make concessions in order to assure survival of the enterprise. Such coordinated efforts often are referred to as informal workouts and involve little or no government intervention. A more formal private bailout mechanism is provided through the bankruptcy regime.

Early federal bankruptcy law provided only for liquidation of a failed enterprise.[50] Beginning with the Chandler Act of 1938,[51] however, federal bankruptcy laws provided for reorganization or rehabilitation as an alternative.[52] Congress provided the reorganization option with the view that rehabilitation of the enterprise might be more productive and better serve the interests of creditors, shareholders, and others than complete liquidation of the business.[53] Today, reorganization under chapter 11 of the Bankruptcy Code[54] is an important option for the failing business.

Chapter 11 permits the debtor to file a voluntary petition for reorganization.[55] The debtor generally may remain in possession of the business and continue operations in the ordinary course of business without court approval.[56] Upon filing the petition, the debtor is entitled to an "automatic

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50. National Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, 545-46 (1898).

51. Pub. L. No. 696, 52 Stat. 840 (1938).

52. *Id.* at 883-905.

53. The House Report on the Bankruptcy Reform Act explained that

> the purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap . . . . If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.

H.R. REP. No. 595, 95th Cong., 1st Sess. 220 (1977).

54. The modern Bankruptcy Code was created by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, which repealed the National Bankruptcy Act of 1898, *supra* note 50, and the Chandler Act of 1938, *supra* note 51.

55. 11 U.S.C. § 301 (1988). Creditors may also file petitions for involuntary reorganizations. *Id.* § 303.

56. *Id.* § 1107. The bankruptcy court may order appointment of a receiver in cases involving "fraud, dishonesty, incompetence, or gross mismanagement" or where "such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." *Id.* § 1104.

stay" against collection of outstanding debts, lawsuits, and lien enforcement[57] and for 120 days has the exclusive right to present a plan of reorganization.[58] In the meantime, committees of creditors and equity holders are established to represent the interest of each class of creditors and interest holders.[59] All "parties in interest" are entitled to be heard.[60] A plan of reorganization must be confirmed either through acceptance by all parties with claims or interests[61] or through a process sometimes referred to as a "cram down." Under that process, if at least one class of impaired creditors agrees, the plan of reorganization can be imposed on the others as long as the plan meets certain requirements and is fair and equitable to the dissenting creditors.[62] As the plan of reorganization evolves under chapter 11, the different classes of creditors negotiate with a view toward reaching a settlement that serves the interests of all classes.

A chapter 11 reorganization, then, may be a private bailout in which those with an economic stake in the troubled enterprise make concessions and sacrifices in order to maintain the firm as a going enterprise. There are limits on the scope of this private bailout, however. Creditors cannot be *required* to make concessions that would cause them to receive any *less* than they would have if the enterprise had been liquidated. The government's involvement in this process is limited to judicially assuring a fair and equitable procedure and result. In contrast, the public bailout envisioned by the bailout definition described previously requires *direct* government involvement in providing assistance to the enterprise. In effect, a public bailout expands the "parties in interest" to include the tax-paying public, whose interest may be impaired in order to assure survival of the enterprise.

b. *Private Concessions as Part of a Public Bailout*

A second important observation about the distinction between public and private bailout is that certain private concessions may be required as a

57. *Id.* § 362.

58. *Id.* § 1121(b). In addition, any party in interest may file a plan of reorganization if and only if a trustee has been appointed, the debtor has not filed a plan within 120 days of the date of order for relief, or the debtor has not filed a plan that has been accepted before 180 days after the date of the order for relief. *Id.* § 1121(c).

59. *Id.* § 1102.

60. *Id.* § 1109.

61. Under this procedure, for each impaired class of claims or interests, each holder of such a claim or interest must accept the reorganization plan. *Id.* § 1129(a)(7). For other classes, the class as a group must accept the plan. *Id.* § 1129(a)(8). For percentages of claimants or interest holders necessary for approval, see *id.* § 1126.

62. Most important, each member of the impaired class cannot receive "less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7." *Id.* § 1129(a)(7)(ii). Thus, the amount that would have been received in liquidation serves as a floor recovery below which no *dissenting* creditor will fall.

component of an otherwise public bailout. For example, the Chrysler Corporation Loan Guarantee Act of 1979 authorized the Chrysler Loan Guarantee Board to guarantee Chrysler's payment of principal and interest on principal amounts up to $1.5 billion,[63] subject to numerous conditions. Most important, Chrysler was required to submit a plan that included at least $1.43 billion in nonfederally guaranteed assistance from "financial commitments or concessions from persons with an existing economic stake in the health of the Corporation."[64] Congress further specified the proportion of this aggregate amount that was to come from concessions of particular groups, including United States banks and financial institutions, foreign banks, union and nonunion employees, suppliers and dealers, and state and local governments.[65]

In many respects, the private concessions made by Chrysler's creditors, suppliers, and others with an economic stake in the enterprise resemble the types of concessions that one would expect in a chapter 11 reorganization. As Reich and Donahue observed in their book on the Chrysler bailout,

> [b]ankruptcy codes have been broadened and extended to bias the process in favor of keeping troubled firms in business, often by compelling a wide circle of constituents to share the cost of recovery. At the same time, unconditional public rescues for failing firms have given way in recent years to more sophisticated interventions that hinge on sacrifice from creditors, employees, and other constituents. Bankruptcy and bailout, at least for large firms, are coming to look much the same.[66]

Despite the similarities between the private concessions arranged in the Chrysler case and those that might be expected in a chapter 11 reorganization, the Chrysler bailout was fundamentally different in that it involved *direct* government intervention or assistance designed to prevent enterprise failure. Instead of limiting itself to an oversight role, the government became a direct participant in the Chrysler rescue.

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63. Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. No. 96-185, § 8(a), 93 Stat. 1324 (1980).

64. *Id.* § 4(a)(4)(A). Congress similarly imposed conditions upon its assistance to New York City, requiring, among other things, that the State provide specified levels of assistance and that the City create a council to explore ways to increase employee productivity. New York City Loan Guarantee Act of 1978 § 103.

65. The breakdown of required concessions was specified in detail in the statute itself. Chrysler Loan Guarantee Act of 1979 § 4(c). Nevertheless, the Chrysler Loan Guarantee Board was authorized to "modify the amounts of assistance required to be provided by any of the categories . . . so long as the aggregate amount of at least $1,430,000,000 in nonfederally guaranteed assistance is provided." *Id.* In the end, the Loan Guarantee Board did modify the breakdown rather substantially. For an excellent report of the negotiations leading up to the Chrysler legislation and the subsequent deals regarding private concessions and approval of guarantees by the Chrysler Loan Guarantee Board, see R. REICH & J. DONAHUE, *supra* note 44.

66. R. REICH & J. DONAHUE, *supra* note 44, at 8.

B. *A Taxonomy of Bailouts*

If one adopts the broad definition of bailout as a form of government intervention designed to prevent enterprise failure, a wide array of government activity will fit the definition. Use of such a broad definition will prove to be an asset in assessing the appropriate public policy approach to economic failure. As a matter of public policy, a consistent, well-developed, and thoughtful approach to economic failure is called for. Hidden bailouts should be exposed and subject to the same kinds of scrutiny and attention given to the more obvious arrangements referred to as bailouts by the popular press. The sections that immediately follow develop a taxonomy or classification of different types of bailouts.

1. Overt v. Covert Bailouts

a. *Overt Bailouts*

By definition, overt bailouts are easy to identify since they are explicit. They usually take the form of direct assistance, loans, or loan guarantees. Many of the instances of bailout that come to mind from recent history, such as the bailouts of Chrysler, Lockheed, and New York City, involved federal loan guarantees. This approach has many possible variations. A loan or loan guarantee may be provided with a minimum amount of government intervention. On the other hand, as illustrated by the Chrysler case, conditions attached to such loans or guarantees may result in a high degree of government intervention and oversight.

b. *Hidden or Covert Bailouts*

Hidden or covert bailouts can be provided in a number of different ways. Assistance may be provided to a troubled enterprise through special tax breaks. Covert bailouts may also be provided in the form of relief from compliance with burdensome regulation. Finally, covert bailouts may be provided through trade restrictions, tariffs, and quotas on foreign imports. Such measures reduce competition and provide domestic producers with a greater share of the market and the power to increase prices.

In the general regulatory setting, tax advantages and subsidies often provide incentives for taxpayers to engage in desired behavior. Although they fit within the general subsidy family, tax subsidies designed as incentives differ slightly from bailouts.[67] In the case of a bailout, the entity may not be in a position to alter behavior in response to incentives. The tax break

67. *See supra* notes 17-18 and accompanying text.

or subsidy operates not as a carrot, but as a lifeline assisting the troubled entity in its struggle to regain financial strength. In the early stages of the savings and loan crisis, for example, Congress provided special tax breaks to encourage the merger of failing thrifts into healthier ones.[68] These special provisions were later repealed[69] and a far more substantial bailout was undertaken.[70]

The safe-harbor leasing provision, enacted in 1981, is another illustration of tax provisions that operated as a form of bailout.[71] Under the safe-harbor leasing rules, a company suffering losses was able to sell its depreciable assets to a buyer that was in a better position to take advantage of accelerated depreciation deductions and immediately lease back the same property.[72] Physical possession of the property did not change hands and business operations were not interrupted. Tax benefits available to the new owner would be reflected in reduced rentals paid by the new lessee. Chrysler, for example, arranged a sale-leaseback transaction with the General Electric Credit Corporation under the safe-harbor leasing rules and reported $68.3 million in gains from these transactions during the years 1981 through 1983.[73]

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68. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 254, 95 Stat. 172 (adding I.R.C. § 368(a)(3)(D)(ii)). This provision relaxed the continuity-of-interest requirement ordinarily required for tax-free reorganization treatment. Tax-free mergers of savings and loans were allowed in an effort to encourage healthy thrifts to takeover ailing thrifts. The tax break here arguably was an indirect bailout benefitting the healthy firm in an effort to provide incentives to assist in the bailout. In addition, the Act provided that financial assistance payments made by the Federal Savings and Loan Insurance Corporation (FSLIC) would be tax-free to the recipient thrift. *Id.* § 244. The General Explanation of the Act states that "Congress concluded that the tax laws should be modified to facilitate providing of financial assistance by the FSLIC and mergers of financially troubled institutions into stronger institutions." STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., 1ST SESS., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981 at 152 (Comm. Print 1981) [hereinafter JOINT COMM. ON TAXATION]. For a discussion of these and other tax provisions enacted in 1981 to assist the failing savings and loan industry, see Spragens, *Saving the Savings and Loan Industry: Tax Consequences of Financial Assistance Payments to Troubled Thrifts,* 15 J. CORP. TAX'N 217 (1989).

69. Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 903-905, 100 Stat. 2085, 2383-87.

70. *See* FIRREA, *supra* note 1 and discussion *supra* notes 48-49 and *infra* notes 224-35 and accompanying text.

71. Economic Recovery Tax Act of 1981, § 201(a). Safe-harbor leasing was part of a government program specifically designed to assist the failing auto industry. *See, e.g., Oversight Hearing on the Chrysler Corporation Loan Guarantee Act and the Status of the U.S. Automobile Industry: Hearings Before the House Comm. on Banking, Finance and Urban Affairs,* 97th Cong., 2d Sess. 79 (1982) [hereinafter *Oversight Hearing*] (statement of Michael Driggs, Deputy Ass't Sec., U.S. Dep't of Commerce). These provisions were later repealed by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 209, 96 Stat. 324, 442 (1982).

72. "[U]nder prior law depreciation rules, many corporations were in a loss position and thus unable to utilize fully the tax benefits of depreciation deductions." JOINT COMM. ON TAXATION, *supra* note 68, at 103.

73. CHRYSLER CORP., 1983 ANNUAL REPORT, *cited in* R. REICH & J. DONAHUE, *supra* note 44, at 243 n.16.

Troubled companies often attribute some portion of their financial problems to the cost of compliance with government regulations. In hearings on the Chrysler bailout, for example, company president Lee Iacocca testified that retooling necessary to comply with new automobile fuel efficiency requirements had been costing the company an average of $160 million a month for two years.[74] Chrysler officials also lobbied White House officials for special relief from rigid deadlines for compliance with environmental regulations.[75] In the end, Chrysler did not receive special relief.[76] Nevertheless, relief from burdensome regulation has been used as a method of bailout in other settings.

Relief is often provided to a particular industry by a regulatory statute itself. For example, Congress in 1981 created specific exemptions for steel industry compliance with Clean Air Act emissions standards based upon economic distress within the industry.[77] In other cases, particular industries or firms obtain relief at the regulatory level. For example, the Environmental Protection Agency sets particular effluent and emissions standards on an industry-wide basis, often providing unique standards for industrial subclassifications. By carving out a narrow industry subclassification and promulgating lower standards for that subclass, the agency can provide a form of bailout relief to a firm in economic distress.[78]

Another significant indirect form of bailout is the "failing firm defense" to compliance with the antitrust laws. In its Merger Guidelines, the Justice Department describes this defense as a "long-established, but ambiguous, doctrine under which an anticompetitive merger may be allowed because one of the firms is failing."[79] The ambiguity referred to reflects the two rationales offered for the failing firm defense. The "competitive rationale" suggests that the merger of a failing firm does not raise significant competitive concerns in any event. There has been significant controversy on

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74. *The Chrysler Corporation Financial Situation: Hearings Before the House Subcomm. on Econ. Stabilization of the Comm. on Banking, Finance and Urban Affairs,* 96th Cong., 1st Sess. 86 (1979) (testimony of Lee Iacocca).

75. R. Reich & J. Donahue, *supra* note 44, at 88.

76. Some industry-wide regulatory relief was later provided, however. *See, e.g., Oversight Hearing, supra* note 71, at 78-79.

77. Steel Industry Compliance Extension Act of 1981, Pub. L. No. 97-23, 97th Cong., 1st Sess. (codified at 42 U.S.C. § 7413(e)). The House Report explained that "[t]he Committee is proposing that the extension be limited solely to the steel industry since no other industry is experiencing such unique hardship." H.R. Rep. No. 121, 97th Cong., 1st Sess. 9 (1981).

78. Association of Pacific Fisheries v. EPA, 615 F.2d 794 (9th Cir. 1980), for example, illustrates the use of industry subclassifications defined so narrowly that they include a very small number of businesses. For example, fish processing regulations include subcategories for Alaskan Hand-Butchered Salmon, Alaskan Mechanized Salmon, West Coast Hand-Butchered Salmon, and West Coast Mechanized Salmon. Environmental Protection Agency Seafood Processing Point Source Categories, 40 Fed. Reg. 55,720, 55,778 (1975).

79. Merger Guidelines, *supra* note 38, at 26,837. See also the earlier use of the failing firm defense to assist in defining bailouts, *supra* notes 33-39 and accompanying text.

this point. The majority of commentators reject this justification, arguing that the merger of failing firms might well have anticompetitive effects.[80] Under the "hardship rationale," mergers of failing firms are permitted in order to ease the suffering of employees, shareholders, and others who would be affected by a firm's collapse. The Justice Department accepts this hardship justification and concedes in its Merger Guidelines that the failing firm defense may "immunize significantly anticompetitive mergers."[81] To the extent that the failing firm defense does significantly immunize anticompetitive mergers that would otherwise be challenged by the Justice Department, the defense can be regarded as a bailout.

Congress more specifically provided relief from antitrust regulation in the case of anticompetitive joint operating agreements between newspapers experiencing economic distress. Congress provided:

> In the public interest of maintaining a newspaper press editorially and reportorially independent and competitive in all parts of the United States, it is hereby declared to be the public policy of the United States to preserve the publication of newspapers in any city, community, or metropolitan area where a joint operating arrangement has been heretofore entered into because of economic distress or is hereafter effected in accordance with the provisions of this chapter.[82]

Technically, this provision meets the definition of bailout as government intervention specifically designed to assist enterprises facing financial distress and to prevent enterprise failure. On the other hand, if one accepts Congress's explanation, the government motivation is not bailout, but rather guaranteeing public access to important news information through an independent and competitive press. Surely, however, the bailout is not an unintentional by-product of regulation.[83]

As another example of potentially hidden bailouts, established procedures under United States international trade law are available through which a

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80. *See, e.g.*, Connor, *Section 7 of the Clayton Act: The Failing Company Myth*, 49 Geo. L.J. 84 (1960); Dooley, Comment, *Failing Company Doctrine: Recent Developments*, 47 Tex. L. Rev. 1437, 1439 (1969); Laurenza, *Section 7 of the Clayton Act and the Failing Company: An Updated Perspective*, 65 Va. L. Rev. 947, 961 (1979); Note, *All the King's Horses and All the King's Men: The Failing Company Defense as a Conditional Defense to Section 7 of the Clayton Act*, 4 Hofstra L. Rev. 643 (1976). For the case on the other side, see Campbell, *The Efficiency of the Failing Company Defense*, 63 Tex. L. Rev. 251 (1984).

81. Merger Guidelines, *supra* note 38, at 26,837. In an earlier version of the guidelines, the Justice Department more explicitly provided that "when the elements of the defense are satisfied, there is a conclusive presumption that the anticompetitive dangers associated with the merger are outweighed by the income losses to creditors, stockholders, and communities associated with the failure of the firm." *Id.* at 28,493, 28,502 n.54, *reprinted in* Trade Reg. Rep. (CCH) ¶ 13,102.

82. Newspaper Preservation Act, Pub. L. No. 91-353, § 2, 84 Stat. 466 (1970) (codified at 15 U.S.C. § 1801 (1988)).

83. For a description of "mixed-motive" bailouts, see *infra* notes 130-33 and accompanying text.

domestic industry faced with serious economic injury can apply for import relief. The "escape clause" procedure permits relief when "an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industry producing an article like or directly competitive with the imported article."[84] The Senate Report to the 1974 Trade Act explains that:

> [t]he rationale for the 'escape clause' has been and remains, that as barriers to international trade are lowered, some industries and workers inevitably face serious injury, dislocation *and perhaps economic extinction.* The 'escape clause' is aimed at providing temporary relief for an industry suffering from serious injury, or the threat thereof, so that the industry will have sufficient time to adjust to the freer international competition.[85]

To obtain relief under the "escape clause," an entity must file a petition with the International Trade Commission (ITC), which will determine after public hearings whether the increased foreign import is a "substantial cause of serious injury, or the threat thereof."[86] If the determination is affirmative, the ITC will report and make recommendations to the President, who is authorized to "take all appropriate and feasible action within his power which . . . [he] determines will facilitate efforts by the domestic industry to make a positive adjustment to import competition and provide greater economic and social benefits than costs."[87]

The "escape clause" mechanism may operate as a bailout of domestic private industry. Although the relief granted generally is industry-wide, narrow conceptions of the relevant industry can result in a firm-specific bailout. For example, the Reagan Administration in 1983, at the request of Harley-Davidson, temporarily imposed quotas and increased tariffs on imports of foreign motorcycles with "engines with total piston displacement over 700 cubic centimeters."[88] Although the firm's name appears nowhere in the presidential proclamation, Harley-Davidson was the only U.S. company at the time manufacturing engines of the type described.[89]

2. Prospective v. Retrospective Bailouts

Most of the bailouts that receive widespread public attention are after-the-fact public rescues of firms or industries already in financial distress.

84. Trade Act of 1974, 19 U.S.C. § 2251(a) (as amended by Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107).

85. S. REP. No. 1298, 93d Cong., 2d Sess. 195 (1974) (emphasis added).

86. 19 U.S.C. § 2252(b) (1988).

87. *Id.* § 2251(a). The President is required to report any such action to Congress. *Id.* § 2253(b).

88. Proclamation No. 5050, 48 Fed. Reg. 16,639 (1983).

89. For a brief discussion of this Harley-Davidson bailout, see R. REICH & J. DONAHUE, *supra* note 44, at 284-85.

Less obvious, perhaps, are ways in which government may provide bailout prospectively. The most obvious examples of prospective bailouts are federal insurance programs, which set aside reserves to provide assistance in times of future financial distress. Although many federal insurance programs were designed primarily to protect customers, they generally were implemented at times of financial crisis and were designed to prevent financial collapse of industries faced with economic hardship.[90] The mission of the FDIC was not only to insure deposits, but also to "reduce the economic disruptions caused by bank failures."[91] Although the customer is the direct beneficiary of many federal insurance programs, the firms or industries saved from financial collapse are surely indirect beneficiaries. More important, perhaps, the presence of federal insurance instills consumer confidence and provides direct and immediate benefits to the industries whose customers are willing to leave higher deposits or invest more funds than they would if uninsured. To the extent that insurance programs provide such benefits to private

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90. The Federal Deposit Insurance Corporation (FDIC) providing insurance for depositors in commercial banks was established by the Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162. Shortly thereafter, the Federal Savings and Loan Deposit Insurance Corporation (FSLIC) was established by the National Housing Act of 1934, Pub. L. No. 479, 48 Stat. 1246, to provide similar protection for savings and loan depositors. The bankruptcy of FSLIC led to the recent savings and loan bailout. The FDIC is currently under similar stress and threatened with collapse. At the direction of Congress, the General Accounting Office recently released a report on reforming the deposit insurance system to prevent this pending crisis. U.S. COMPTROLLER GENERAL, REPORT TO THE CHAIRMAN, HOUSE COMM. ON BANKING, FINANCE AND URBAN AFFAIRS: DEPOSIT INSURANCE: A STRATEGY FOR REFORM (1991) [hereinafter DEPOSIT INSURANCE REFORM]. Since 1989, the FDIC has administered two separate insurance funds. The Bank Insurance Fund (BIF) protects commercial bank deposits while the Savings Account Insurance Fund (SAIF) now protects thrifts. FIRREA, *supra* note 1, § 211 (codified at 12 U.S.C. § 1821(a)(4)-(6)). Finally, the National Credit Union Share Insurance Fund (NCUSIF) protects credit union depositors. National Credit Union Administration Act of 1970, Pub. L. No. 91-206, 84 Stat. 49. Similarly, the Securities Investment Protection Corporation (SIPC) provides insurance protection for securities investors. SIPC was established by the Securities Investment Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636. The House Report accompanying this legislation stated that "[t]he primary purpose of the reported bill is to provide protection for investors if the broker-dealer with whom they are doing business encounters financial troubles." H.R. REP. No. 1613, 91st Cong., 2d Sess. 1 (1970). The Pension Benefit Guarantee Corporation (PBGC), established by the Employee Retirement Income Security Act, Pub. L. No. 93-406, 88 Stat. 829, Title IV (1974), provides similar protection for pension benefits.

91. FEDERAL DEPOSIT INSURANCE CORP., FEDERAL DEPOSIT INSURANCE CORPORATION: THE FIRST FIFTY YEARS—A HISTORY OF THE FDIC 1933-1983, at 3 (1984) [hereinafter FEDERAL DEPOSIT INSURANCE HISTORY]. For another good recent discussion of the history of federal deposit insurance, see U.S. TREAS. DEP'T, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS I-1 to I-45 (1991) [hereinafter MODERNIZING THE FINANCIAL SYSTEM]. The House Report accompanying the Securities Investment Protection Act also reported that the "legislation mandates a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss." H.R. REP. No. 1613, *supra* note 90, at 1.

enterprise managers and owners otherwise threatened with financial difficulty, they should be considered bailouts.[92]

The Federal Crop Insurance Program is more directly focused on preventing enterprise failure. Established by the Agricultural Adjustment Act of 1938,[93] the program was designed "to promote the national welfare by alleviating the economic distress caused by wheat-crop failures due to drought and other causes, by maintaining the purchasing power of farmers, and by providing stable supplies of wheat for domestic consumption and the orderly flow thereof in interstate commerce."[94] The primary beneficiary was the farming enterprise, while the consumer was intended to be a secondary beneficiary.[95]

Most federal insurance programs are funded through contributions made by industry members themselves and thus fall into the category of "special fund" prospective bailouts.[96] For example, the Bank Insurance Fund and the Savings Association Fund, both administered by the FDIC, are funded through annual assessments on insured depository institutions based upon a percentage of estimated insured deposits.[97] In contrast, premiums for some insurance programs are funded only partially through industry contributions with the remainder coming from general revenues. Given the hardship of extremely high premiums, farmer expenses for federal crop insurance are supplemented with a federal premium subsidy,[98] making this prospective program a "combination bailout."[99] However, even insurance pools funded entirely by industry premiums may be inadequate to cover large losses, thus requiring ultimate resort to general revenues. A recent report on deposit insurance observed that "the potential for losses to the taxpayers exists in part because the deposit insurance funds were never intended to be funded

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92. Such immediate benefits to the industry have the elements of a current rather than a prospective bailout.

93. Pub. L. No. 430, 52 Stat. 31.

94. *Id.* § 502, 52 Stat. at 72.

95. The crop insurance program was also to "protect consumers against shortages of food supplies and against extremes of prices." H.R. Doc. No. 150, President's Comm. on Crop Insurance, Report and Recommendations, 75th Cong., 1st Sess. III (1937).

96. *See supra* notes 46-47 and accompanying text.

97. 12 U.S.C. § 1817(b). The annual assessment currently is based upon a flat rate that is the same for all insured banks. Numerous proposals have forcefully argued that deposit insurance should be converted to a risk-based premium structure in order to reduce moral hazard problems. *See, e.g.*, Scott & Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 Stan. L. Rev. 857 (1971). In the aftermath of the savings and loan crisis, Congress finally has directed the FDIC to establish a risk-based assessment system. Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, H.R. Rep. No. 407, 102d Cong., 1st Sess. § 302(a) ("The Board of Directors shall, by regulation, establish a risk-based assessment system for insured depository institutions.").

98. The farmer's premium is supplemented with a 30% premium subsidy "calculated . . . on any coverage under the . . . policy of insurance up to a maximum of 65% of the recorded or appraised average yield, as adjusted." 7 U.S.C. § 1508(e)(3) (Supp. 1991).

99. *See supra* notes 48-49 and accompanying text.

at a level that would create reserves sufficient to cover heavy losses from large numbers of bank failures."[100]

Perhaps an even better example of prospective bailout is the government protection of the nuclear power industry through indemnity and special caps upon potential liability for damages in the event of a nuclear accident. As originally enacted, the Price-Anderson Act[101] required private nuclear power licensees to have and maintain the maximum amount of protection against nuclear accidents available from private insurers, $60 million at the time.[102] In the event of an accident causing damages in excess of insured amounts, the federal government agreed to indemnify the licensee or any other person who might be liable up to a maximum of $500 million.[103] Thus, the Price-Anderson Act limited liability to injured parties in the event of a nuclear accident to a total of $560 million. Beyond this amount, the injured parties themselves effectively bore the costs.[104] Although Congress explicitly mentioned protection of the public as one of the goals behind the Act, protection of the industry appears to have been the primary goal.[105] A majority in Congress in 1957 was committed to the private development of nuclear power technology, and the industry had made it clear to Congress that it could not proceed without protection against potentially bankrupting liabilities

100. DEPOSIT INSURANCE REFORM, *supra* note 90, at 27.

101. Pub. L. No. 85-256, 71 Stat. 576 (1957) (adding § 170 to Atomic Energy Act of 1954).

102. *Id.* § 4.

103. *Id.*

104. Later, in a rare legislative assurance to the public, Congress promised that

> [i]n the event of a nuclear incident involving damages in excess of the amount of aggregate public liability under paragraph (1), the Congress will thoroughly review the particular incident . . . and will . . . take whatever action is determined to be necessary (including approval of appropriate compensation plans and appropriation of funds) to provide full and prompt compensation to the public for all public liability claims resulting from a disaster of such magnitude.

42 U.S.C. § 2210(e)(2) (1988).

105. *Id.* § 2210. The definition of bailout developed earlier explicitly excludes forms of government assistance designed to encourage particular activity such as Small Business Administration assistance. *See supra* notes 17-18 and accompanying text. Although one of the Price-Anderson Act's stated purposes is to encourage private development of nuclear power, the specific relief in the form of liability limitation was driven by a concern for potentially bankrupting liabilities.

Professor Harold Green made this argument rather forcefully in *Nuclear Power: Risk, Liability, and Indemnity,* 71 MICH. L. REV. 479, 498-504 (1973). He argued that Congress did not act prospectively in many other cases of potential catastrophes.

> The fact that atomic energy has been singled out for this unique form of government beneficence must, therefore, be attributable to something more than a general policy of compensating the public for losses sustained in catastrophes for which adequate insurance protection is not available. This suggests that . . . protection of the nuclear industry against bankrupting public liability . . . is the primary consideration underlying the Price-Anderson Act.

Id. at 499-500.

in the event of a catastrophic accident.[106] Effectively, then, the Price-Anderson limitations on liability and provisions for government indemnification against loss provided a prospective bailout of private industry. The original provisions providing government indemnification assured the industry that government resources in the amount of $500 million funded from general revenues would be available in the event of nuclear catastrophe. The Price-Anderson Act protections were designed to be temporary, and its provisions have been extended and amended on numerous instances since 1957. Although liability limitations remain,[107] the government no longer explicitly agrees to indemnify. Instead, current provisions provide for retroactive premiums to be assessed against the industry in the event of a nuclear incident, not to exceed $63 million overall per licensee and not to exceed $10 million for any given year.[108] As a result, the program has been converted from a prospective general revenue bailout to a prospective special fund bailout.

3. Generic v. Specific Bailouts

Bailouts may provide firm-specific, industry-wide, or generic assistance to failing enterprises. Modern examples of government financial assistance to specific firms or municipalities include the bailouts of Chrysler and New York City. The savings and loan industry rescue is an illustration of an industry-wide rescue.[109] Bailout assistance also might be provided generically to any enterprise meeting specified eligibility requirements, regardless of the

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106. During hearings on the Price-Anderson Act, utility company officials testified that they would not enter the nuclear power business without government protections. *Governmental Indemnity and Reactor Safety: Hearings Before the Joint Committee on Atomic Energy,* 85th Cong., 1st Sess. 156-61 (1957) (testimony of Francis K. McCune, Vice President, General Electric Corporation). Later, in a lawsuit challenging the constitutionality of the Price-Anderson liability limitations, the plaintiffs overcame a standing challenge. The district court found that there was a substantial likelihood that the defendant power company would not have completed or maintained the power plants but for the protection provided by the Price-Anderson Act. Carolina Envtl. Study Group v. United States, 431 F. Supp. 203, 220 (W.D.N.C. 1977). The Supreme Court agreed with the district court on the standing issue but nevertheless upheld the constitutionality of the Price-Anderson Act liability limitations. Duke Power Co. v. Carolina Envtl. Study Group, 438 U.S. 59 (1978).

107. Given the private insurance currently available, the retroactive premiums that may be assessed against the industry, and inflation adjustments legislatively provided for those premiums, the cap on liability now exceeds $7 billion. For a description of recent changes to the Price-Anderson Act and its limitations on liability, see Berkovitz, *Price-Anderson Act: Model Compensation Legislation?—The Sixty-Three Million Dollar Question,* 13 HARV. ENVTL. L. REV. 1 (1989).

108. 42 U.S.C. § 2210(b)(1).

109. It should be noted that many savings and loan institutions remain perfectly healthy and need no bailout assistance. By industry-wide rescue, I mean simply that all members of the industry are eligible for assistance should it become necessary; the bailout was not designed to assist specific firms or enterprises.

industry. One would expect such generic bailouts to be extremely rare and few examples come immediately to mind.[110] The Emergency Loan Guarantee Act appears on its face to be a generic bill authorizing federal loan guarantees to all enterprises "that meet the requirements of this chapter."[111] Despite its generic language, the bill was specifically designed as a bailout of the Lockheed Aircraft Corporation. After extensive discussion of Lockheed's troubles, the House Report on the bill noted that

> the Lockheed Aircraft Corporation would be the first applicant for a guaranteed loan under the legislation. . . . It will be argued by some that this bill is for the sole purpose of helping Lockheed. To the contrary, it sets up an orderly and systematic means of providing guaranteed loans to private enterprises that require such loans and meet eligibility requirements provided in the bill.[112]

Two details conspired against the availability of loan guarantees to enterprises other than Lockheed. First, the maximum amount of loan guarantees that could be outstanding at any given time was $250 million.[113] This was precisely the amount that Lockheed was looking for. Moreover, authority of the Emergency Loan Guarantee Board to enter into any guarantee or commitment to guarantee terminated just two years after enactment of the legislation.[114] In fact, no enterprises other than Lockheed ever received assistance under the Emergency Loan Guarantee Act.

4. Regulatory Bailouts

While bailouts may be arranged by Congress through legislative action, bailouts also may be accomplished by action of government regulators under

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110. The closest example might be assistance under the Small Business Act (SBA), but, as noted earlier, such assistance is not limited to enterprises facing financial distress. *See supra* notes 17-18 and accompanying text. The SBA will not extend financial assistance, however, if the applicant can obtain credit elsewhere. *See, e.g.* 15 U.S.C. § 636(a)(1) (Supp. 1991).

111. Emergency Loan Guarantee Act, Pub. L. No. 92-70, § 3, 85 Stat. 178 (1971). The Act created an "Emergency Loan Guarantee Board" authorized to guarantee loans if

> (1) the Board finds that (A) the loan is needed to enable the borrower to continue to furnish goods or services and failure to meet this need would adversely and seriously affect the economy of or employment in the Nation or any region thereof, (B) credit is not otherwise available to the borrower under reasonable terms or conditions, and (C) the prospective earning power of the borrower, together with the character and value of the security pledged, furnish reasonable assurance that it will be able to repay the loan within the time fixed, and afford reasonable protection to the United States; and (2) the lender certifies that it would not make the loan without such guarantee.

Id. § 4.

112. H.R. REP. No. 379, 92d Cong., 1st Sess. 3, *reprinted in* 1971 U.S. CODE CONG. & ADMIN. NEWS 1270, 1272.

113. Emergency Loan Guarantee Act § 8.

114. *Id.* § 13.

their regulatory authority. Like the congressional variety, these bailouts may be overt or covert.

a. Overt Regulatory Bailouts

Modern banking regulation provides an excellent example of overt regulatory bailout authority. The FDIC insures all depositors in "insured depository institutions" up to a maximum deposit of $100,000.[115] In the case of a liquidation or closing of an insured bank, the FDIC is directed by Congress to pay insured depositors "as soon as possible."[116] Arguably, no bailout is involved if the FDIC simply liquidates the bank and pays insured depositors, except to the extent that the bank is relieved of obligations that it would otherwise incur.[117] Beyond this mandate to pay off depositors, the FDIC has discretionary power to provide assistance to insured depository institutions. The FDIC may make loans, deposits, or contributions; purchase assets; or assume liabilities of an insured depository institution.[118] In addition, the FDIC may facilitate the merger, consolidation, or sale of a failing depository institution by guaranteeing the purchasing institution against losses.[119]

These forms of discretionary assistance are subject to some limitations, however. The FDIC is authorized to take such action only to prevent default, to restore a bank already in default, or to lessen risks posed to the FDIC from "severe financial conditions" that might "threaten the stability of a significant number of insured banks."[120] Moreover, under a new standard recently enacted by Congress, the FDIC generally cannot provide discretionary assistance unless assistance "is necessary to meet the obligation of the Corporation to provide insurance coverage" and "the total amount of expenditures . . . and obligations . . . is the least costly to the deposit insurance fund of all possible methods for meeting the Corporation's obligation under this section."[121] In other words, discretionary assistance generally can be provided only when such assistance would be cheaper than closing the bank and paying off depositors.

Congress has left the FDIC with broader discretion in special cases, however. Prior to recently enacted deposit insurance reforms, the FDIC was

115. 12 U.S.C. § 1821(a)(1) (1988 & Supp. II 1989-1991).

116. *Id.* § 1821(f)(1).

117. Corporations generally are protected by limited liability. One might argue, then, that stock banks are not "bailed out" as a result of FDIC payments to depositors. In the case of mutual banks, FDIC payments might be regarded as bailout-like payments to the depositors, who are themselves the investors in the bank.

118. 12 U.S.C. § 1823(c)(1)-(2).

119. *Id.* § 1823(c)(2).

120. *Id.* § 1823(c)(1)(C), (c)(2)(B)(iii).

121. Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, *supra* note 97, § 141, at 86 (amending 12 U.S.C. § 1823(c) (1950)).

free of the cost restriction and had virtually complete discretion to provide assistance to a troubled depository institution if it determined that continued operation of the institution was "essential to provide adequate depository services in its community."[122]

Although the power to make an "essentiality finding" had been available to the FDIC for twenty-one years, the power was not used until the bailout of the minority-owned Unity Bank of Boston in 1971. Irvine Sprague, who served as director or chairman of the FDIC Board during four major bank bailouts, described the agonizing decision to provide the first discretionary bailout under the essentiality doctrine, as a "radical departure" that provided an unintended reprieve for stockholders.[123] Once unleashed, the power to make the "essentiality finding" proved difficult to resist in subsequent cases where much larger banks were threatened with collapse.[124] With the rescue of the Continental Bank of Illinois, the FDIC provided protection for deposits of $30 billion, 90% of which reflected uninsured foreign depositors or large certificates in excess of the $100,000 insured amount.[125]

Congress recently revised the circumstances under which the FDIC will be free of the "lowest cost restriction." Under the new provision, upon a two-thirds vote of *both* the FDIC Board and the Federal Reserve Board, an emergency recommendation can be forwarded to the Secretary of the Treasury. If the Secretary, in consultation with the President, determines that compliance with the lowest cost restriction "would have serious adverse effects on economic conditions or financial stability and . . . any action or

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122. 12 U.S.C. § 1823(c)(4)(A). The FDIC's use of its discretion to protect large banks under this essentiality finding was sometimes referred to as the "too-big-to-fail" doctrine. Assistance provided by the FDIC under any of its discretionary powers was determined by a vote of the FDIC Board and required no further congressional action. No formal hearings or other proceedings were required. When assistance was provided to save failing banks, even deposits in excess of the $100,000 insured amount generally were fully protected. More significant from the bailout perspective, the FDIC decision to save rather than close the bank and pay off depositors inevitably provided protection to shareholders or investors as well.

123. I. SPRAGUE, BAILOUT: AN INSIDER'S ACCOUNT OF BANK FAILURES AND RESCUES 42 (1986). Sprague describes himself as casting the deciding vote in a 2-1 decision of the FDIC. He voted as he did out of fear of riots that might result from a decision not to assist the minority-owned Boston bank. He has stated that

> my vote to make the 'essentiality' finding and thus save the little bank was probably foreordained, an inevitable legacy of Watts. And since mine was the deciding vote, it may not be too much to say that the Watts riots ultimately triggered the essentiality doctrine.

Id. at 48.

124. An "essentiality finding" was later used to justify the bailouts of the Bank of the Commonwealth of Detroit in 1972, the First Pennsylvania Bank of Philadelphia in 1980, and the Continental Bank of Illinois in 1984. For a description of the Unity Bank case as precedent for an essentiality finding for these later bailouts, see *id.* at 48.

125. I. SPRAGUE, *supra* note 123, at 190. A detailed description of the terms of the bailout can be found in Office of Comptroller of the Currency, Federal Deposit Insurance Corporation, and Federal Reserve Board, *Permanent Assistance Program for Continental Illinois National Bank and Trust Co.*, News Release (July 26, 1984) [hereinafter News Release].

assistance . . . would avoid or mitigate such adverse effects, the Corporation may take other action or provide assistance . . . as necessary to avoid or mitigate such effects."[126] Although these changes will make bank bailouts slightly more difficult, Congress still provides an emergency mechanism under which banks may be assisted even when the costs of such assistance exceed those necessary to comply with government insurance obligations to depositors. Such assistance to failing banks surely represents a bailout above and beyond the initial provision of federal insurance.

b. *Covert Regulatory Bailouts*

Government regulators may also provide covert bailouts in the form of regulatory relief.[127] These bailouts generally are provided on an industry-wide basis. A particular statute governing agency action may provide sufficient discretion to the agency to provide firm-specific waivers or delay in the implementation of regulations.[128] Even in the case where Congress has worked out most of the details, substantial discretion may be left to government agencies to structure the bailout. In the Chrysler case, for example, Congress specified the concession amounts to come from each group of interested parties to the bailout, but the Chrysler Loan Guarantee Board had authority to and did modify the terms of the bailout.[129]

5. The Mixed-Motive Bailout

The definition of bailout distinguishes government assistance specifically *designed* to assist troubled enterprises from other types of "incentive assistance" designed to encourage or promote particular activity.[130] Many bailouts, however, will not be designed solely to prevent enterprise failure but instead will have a complex mix of designs or motives. For example, international trade quotas and tariffs may rescue or protect a troubled

126. Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, *supra* note 97, § 141(a)(1)(C) (amending 12 U.S.C. § 1823(c)(4)).

127. For example, the Reagan Administration in 1981 modified its earlier automobile industry "passive occupant restraint system" standards in part "due to changed economic circumstances and, in particular, the difficulties of the automobile industry." Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins., 463 U.S. 29, 34, 38 (1983) (holding that rescission of the passive restraint requirement was arbitrary and capricious).

128. The prospect of regulatory relief to a single enterprise raises a host of administrative law and due process issues that will not be discussed here. For purposes of discussion, it is assumed that the agency in question has complied with the Administrative Procedure Act or the specific authorizing statute and that the firm-specific waiver can withstand any due process challenges raised by competitors.

129. *See supra* note 65.

130. *See supra* notes 17-18, 29-30 and accompanying text.

domestic industry or enterprise.[131] At the same time, the quota or tariff may be designed to implement specific foreign trade policies unrelated to rescue or protection of domestic industry. Although originally instituted to prevent more immediate enterprise failure and provide continuous protection against future failures, crop insurance is part of an overall policy designed to regulate agricultural markets. The Newspaper Preservation Act is designed to assist troubled newspapers and, at the same time, encourage competition among newspapers and protect fundamental free speech interests.[132]

Mixed-motive bailouts raise special concerns and challenges. Focus on other policy objectives can obscure the bailout aspects of the federal program. Special interests seeking bailout assistance may successfully influence the drafting of legislation or regulation so as to hide the potential bailout agenda. The extent to which any federal program is motivated by bailout considerations should therefore be clearly articulated.[133]

II. The Public Policy Debate: To Bail Out or Not To Bail Out?

A. *Alternative Methods for Allocating Risk of Loss*

Bailout decisions involve allocating risk of economic loss. General revenue bailouts, for example, allocate losses to the general taxpaying public. Special fund bailouts allocate losses more narrowly to those contributing to the bailout fund.[134] Before turning to bailout policy, one must consider whether bailout is in fact the appropriate response to the threat of loss. Accordingly, one should consider the available alternative loss allocation possibilities.

1. No Shifting of Loss

One obvious alternative response to threatened enterprise failure is simply to let firms fail. The burden or cost of enterprise failure will then be imposed upon the investors, managers, employees, and others with

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131. For a more detailed discussion of quotas and tariffs as a form of bailout, see *supra* notes 84-89 and accompanying text.

132. The Newspaper Preservation Act as a bailout is discussed more fully *supra* notes 82-83 and accompanying text.

133. Further discussion of the concerns and challenges appears at *infra* notes 311-12 and accompanying text.

134. Not all bailout efforts will be successful. Thus, the enterprise itself continues to bear risk throughout the bailout process. Even after a rescue attempt, the enterprise may fail, resulting in loss to investors, employees, creditors, and others. The loss to the taxpaying public or special fund is limited to the amount committed to the bailout effort. If the government takes an equity interest in the enterprise as part of the bailout, it may gain or lose along with other investors.

relationships to the firm or industry.[135] Losses are left to fall where they may without any shifting of costs. In a capitalist, free-market economy such as ours, this approach to loss is the general rule.

2. Allocation of Loss Through the Tort Regime

An alternative mechanism for imposing costs from losses is through the common law tort system, under which losses resulting from wrongful acts are borne by the wrongdoer. To the extent that wrongdoers can be identified, they should bear the burden of losses. Forcing wrongdoers to internalize such costs is thought to have a positive general deterrence effect.[136]

a. Private Tortfeasors

When the wrongdoer in the tort setting is a private party, injured individuals typically sue privately to recover losses in a civil lawsuit. Where enterprise failure results from fraud or corruption and the class of injured parties is large, it may be appropriate to provide government agencies with authority to prosecute and collect reimbursement for losses on behalf of the consumer. Banking regulators, for example, have authority to prosecute for bank fraud and impose civil and criminal penalties.[137] In such cases, the government's role is limited and does not involve direct or indirect bailout of the failing enterprise itself.

The savings and loan crisis presents a prime example. While the crisis is attributed to numerous events, one substantial cause was "outright fraud and insider abuse."[138] Under a tort approach to loss, which imposes costs

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135. Loss of a firm from the market may burden consumers as well. Bankruptcy of a price-cutting firm, for example, may cause consumer prices to rise. *See* Ayres and Braithwaite, *Partial Industry Regulation: A Monopsony Standard for Consumer Protection,* 80 CAL. L. REV. 13 (1992).

136. *See supra* notes 25-28 and accompanying text.

137. *See, e.g.,* The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, Pub. L. No. 101-647, 104 Stat. 4859 (codified in scattered sections of U.S.C.). The Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of U.S.C.), established the Pension Benefit Guaranty Corporation. 29 U.S.C. § 1302(a). The Pension Benefit Guaranty Corporation and the Pension and Welfare Benefits Administration in the Department of Labor have regulatory and enforcement authority to prosecute for fraud and corruption in pension fund management. 29 U.S.C. § 1303(e) (1988).

138. The House Report on FIRREA identified several causes of the savings and loan crisis, including

> poorly timed deregulation; the dismal performance of some thrift managements; inadequate oversight, supervision and regulation by government regulatory agencies and the Reagan Administration; a regional economic collapse; radical deregulation by several large States; and outright fraud and insider abuse. What emerges all too clearly is that when the savings and loan industry was deregulated,

on the wrongdoer, several cases have been brought against bank owners and managers and others whose fraud contributed to the thrift crisis.[139] To the extent possible, costs attributable to fraud and corruption should be imposed on such wrongdoers. Such an approach prohibits the wrongdoer from externalizing costs imposed by fraud. A vigorous enforcement effort presumably will have a general deterrence effect on those considering future fraudulent activity. More important, it avoids the inequities resulting from imposition of such costs on innocent parties, to the extent possible.

b. Government Tortfeasors

When the government itself allegedly is the wrongdoer, a different set of policy issues emerges.[140] Individuals suffering losses might make direct claims

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> the Reagan Administration, the Congress, several State legislatures, the government agencies assigned to supervise and examine these institutions, and the thrifts themselves badly misjudged the extent of the underlying problems.

H.R. REP. No. 54, 101st Cong., 1st Sess. 294, *reprinted in* 1989 U.S. CODE CONG. & ADMIN. NEWS 86, 90. Kenneth Scott, on the other hand, takes the position that fraud was not a substantial factor. Scott, *Never Again: The S & L Bailout Bill,* 45 BUS. L. 1883, 1892-93 (1990) ("[T]he losses were exacerbated to some extent by fraud and theft. Both the industry and supervisory authorities have found it convenient to try to create the impression that much of the enormous aggregate loss is due to fraud. . . . It seems probable that only rarely was fraud a deliberate strategy . . . .").

139. Among the most notorious cases is the indictment and conviction of Charles H. Keating on bank fraud charges in connection with the Lincoln Savings and Loan failure. *See* Stevenson, *Keating Indicted in Savings Fraud and Goes to Jail,* N.Y. Times, Sept. 19, 1990, § 1, at 1, col. 1; Stevenson, *Keating Convicted of Securities Fraud in S & L's Collapse,* N.Y. Times, Dec. 5, 1991, § 1, at 1, col. 1. Ironically, prior to his indictment, Keating himself tried to pin the blame elsewhere, writing that "[t]he inability of both the Reagan and Bush administrations, as well as Congress, to provide competent leadership for the savings and loan industry has been a cataclysmic failure of the political process." Keating, *Quest for Truth: A Search for Sanity in a $500 Billion Tragedy,* 2 STAN. L. & POL'Y REV. 147 (1990). The Resolution Trust Corporation also filed a civil suit in December, 1991 against Arizona Governor Fife Symington for his alleged involvement in the collapse of Southwest Savings and Loan of Phoenix. Labaton, *Governor of Arizona Challenges S & L Case,* N.Y. Times, Feb. 21, 1991, at D2, col. 5; *see also* FDIC v. Milken, No. 91-0433 (S.D.N.Y. filed Aug. 15, 1991) (FDIC and RTC class action seeking damages for injuries suffered by named savings and loans from defendant's misrepresentations, manipulation of junk bond market, and racketeering activity).

Some believe that the government has not been vigorous enough in its enforcement. A recent bill to provide direct funding to attack fraud in the savings and loan industry found that "[o]nly a minute percentage of bailout costs attributed to criminal activity have been recovered." H.R. 5499, 101st Cong., 2d Sess. § 2(5) (1990). The bill further charged in its findings that the Attorney General has not been vigorously pursuing referrals and complaints relating to savings and loan misconduct. *See id.* §§ 2(6)-(11).

140. Many contend, for example, that the savings and loan crisis is largely attributable to poor or even negligent *government* regulation. H.R. REP. No. 54, *supra* note 138, at 2. The Chairman of the House Committee on Banking Task Force on Urgent Fiscal Issues stated at hearings that regulators "were slow to detect unsafe or unsound practices and were even slower to act to stop such activities. The regulators encouraged weakened thrifts to invest in exceptionally risky ventures designed to enable them to grow their way out of their difficulties." *Financial Institutions Reform, Recovery and Enforcement Act of 1989: Hearings on H.R.*

against the government. Successful claims of this sort would not result in a bailout as defined previously but simply the payment of damages by a government tortfeasor. In any event, plaintiffs alleging direct loss as a result of government negligence will have limited success unless their claim fits within the limited waiver of sovereign immunity under the Federal Tort Claims Act (FTCA).[141] Potential claimants have little cause for hope after *United States v. Gaubert.*[142]

Mr. Gaubert, as chairman of the board and largest shareholder of the Independent American Savings Association in Texas, filed claims against the Federal Home Loan Bank Board and the Federal Home Loan Bank-Dallas for regulatory negligence in selecting new officers and directors and in involvement in the day-to-day management of the thrift. The issue before the Court was whether the government was exempt from liability under the "discretionary function" exemption of the FTCA.[143] This exception is designed to "'prevent judicial 'second-guessing' of legislative and administrative decisions grounded in social, economic, and political policy through the medium of an action in tort . . . [and] protects only governmental actions and decisions based on considerations of public policy.'"[144] Even though the bank regulators were actively involved in the operation of the thrift, the *Gaubert* Court concluded that the "regulatory actions in question involved the kind of policy judgment that the discretionary function exception was designed to shield" and that the "day-to-day 'operational' decisions were undertaken for policy reasons of primary concern to regulatory agencies."[145]

After *Gaubert,* it appears unlikely that individual claims against the government for regulatory negligence will have much success. Accordingly, tort actions against the government are unlikely to be a viable alternative to bailout. In fact, the absence of a tort remedy in such cases will increase pressures on the legislature to provide bailout relief.

3. The Insurance Alternative

A third alternative risk-of-loss approach is the insurance model. Under insurance principles, the allocation of financial loss is determined by private

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1278 Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess. 547 (1989) (report of Rep. Charles E. Schumer). Numerous similar statements are scattered throughout the above cited hearings. *See also* Scott, *supra* note 138, at 1888-89 (discussing techniques employed by Reagan administration to avoid recognition of the S & L crisis).

141. 28 U.S.C. § 1346(b).

142. 111 S. Ct. 1267 (1991), *rev'g* 885 F.2d 1284 (5th Cir. 1989).

143. 28 U.S.C. § 2680.

144. *Gaubert,* 111 S. Ct., at 1273-74 (quoting United States v. S.A. Empresa de Viacao Aerea Rio Grandense, 467 U.S. 797, 814 (1984) and Berkovitz v. United States, 486 U.S. 531, 537 (1988)).

145. *Id.* at 1278.

contract. The private insurer acts as an administrator, managing a resource pool contributed by the many insured. This fund is used to reimburse those among the group who suffer losses. Those with lower than average losses will bear some of the cost of those with higher than average losses.[146] Thus, the insurance alternative permits loss spreading.

To assure profitability, private insurance companies limit insurance coverage to "insurable risks." Under standard insurance principles, "insurable risks" are those in which the following elements are present:

> (1) a large group of homogeneous exposure units must be involved, (2) the loss produced by the risk must be definite, (3) the occurrence of the loss in the individual cases must be accidental or fortuitous, (4) the potential loss must be large enough to cause hardship, (5) the cost of the insurance must be economically feasible, (6) the chance of loss must be calculable and (7) the peril must be unlikely to produce loss to a great many insured units at one time.[147]

By definition though, most cases of enterprise failure considered for bailout relief by government decision makers involve uninsurable losses. For example, when considering federal crop insurance, the President's Committee on Crop Insurance reported that "[p]rivate companies have tried all-risk crop insurance, but after repeated losses have practically retired from the field. Crop insurance on a large scale would probably be a larger enterprise than any one company or group of companies would now desire to underwrite."[148] Similarly, Congress adopted deposit insurance after numerous early failures of private industry co-insurance clearing houses and state insurance plans.[149] Private deposit insurance simply was not considered viable.

Most federal insurance programs involve risks that meet some, but not all, of the "insurable risk" elements. Nevertheless, most bailouts in the form of government insurance have been tailored to satisfy a greater number of the "insurable risk" elements listed above than is possible in the case of more ad hoc after-the-fact bailouts. For example, by focusing insurance programs upon a particular group or industry, the government programs come closer to satisfying the requirement that there be a large group of homogeneous exposure units.

In contrast to prospective bailouts through federal insurance funds, retrospective bailout legislation is a form of federal backup insurance that meets few, if any, of the "insurable risk" elements. Because the types of

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146. These aspects of private insurance are considered in G. CALABRESI, *supra* note 25, at 47-50.

147. R. MEHR & E. CAMMACK, PRINCIPLES OF INSURANCE 34 (1976).

148. H.R. DOC. No. 150, *supra* note 95, at 11.

149. *See* Calomiris, *Success and Failure in Pre-Depression Bank Liability Insurance,* in BANKING SYSTEM RISK: CHARTERING A NEW COURSE 198-220 (Federal Reserve Bank of Chicago 25th Annual Conference on Bank Structure and Competition 1989).

industries and firms that might fail or require assistance is quite diverse, the large homogeneous exposure unit requirement will rarely be met. Given this diversity, predicting the extent of loss will be difficult, if not impossible. Thus, backup insurance in the form of after-the-fact bailout legislation also violates the second test of insurable risk—the risk is not definite.[150]

The third element of accidental or unexpected loss may be missing in the typical bailout case as well. The industry or firm failure may not be accidental but instead result from poor management decisions made along the way or failed efforts at government regulation. When a firm's or industry's failure can be attributed to its own errors in judgment, serious questions arise as to whether federal bailout is appropriate. Costs of wrongdoing generally should be internalized to take advantage of general deterrence effects.[151] At some point, however, the consequences of enterprise failure may be so extreme that bailout is necessary regardless of blame.[152]

In most bailout cases, there should be no problem with the fourth "insurable risk" factor, which requires that the peril "must be capable of producing a loss so large that the insured could not bear it without economic distress."[153] On the other hand, to meet the economically feasible cost factor, the chance of loss must be reasonably small. This certainly will not be the case if the government bailout possibility is used as a fallback insurance policy for many different industries. The sixth insurable risk element is missing from the government-as-insurer model since chance of loss is not readily calculable. Finally, the risk must be "unlikely to produce loss to a great many insured units at the same time."[154] If nothing else, the savings and loan crisis illustrates that no assurances can be provided to the government as insurer on this score.[155]

While federal insurance programs can be designed to satisfy many of the "insurable risk" elements, such programs have been controversial from their inception. Numerous proposals for deposit insurance were rejected by Con-

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150. By after-the-fact bailout, I mean *both* federal rescue efforts for which there was no federal insurance program *and* backup bailouts to cover excess losses where federal insurance was available but was inadequate to fully cover the loss.

151. *See supra* notes 25-28 and accompanying text.

152. This is a variation on the "too-big-to-fail" argument that has been heard recently with regard to the banking industry. For further development of the presumption against bailout and the circumstances under which it may be overcome, see *infra* notes 175-89 and accompanying text.

153. R. MEHR & E. CAMMACK, *supra* note 147, at 35.

154. *Id.* at 34.

155. This last element is perhaps the most significant reason for the absence of private bank insurance. As one banking expert observed, "[t]he critical issue for full private insurance . . . has always been the problem of credibility in terms of its capacity to cover the whole banking system in the event of some major failure of national macroeconomic policy as in a severe depression or inflation." Scott, *Deposit Insurance—The Appropriate Roles for State and Federal Governments,* 53 BROOKLYN L. REV. 27, 35 (1987).

gress between 1886 and 1933.[156] The controversy in part stemmed from concerns with enormous potential costs in the event of widespread bank failures, loss of market discipline resulting from high levels of bank risk taking,[157] and interference with market interest rates that depositors would demand without insurance protection.[158] There appears, then, to be controversy on several fronts. First, one minority view holds that deposit insurance would be unnecessary for sufficiently "narrow banks" whose investments were limited to certain safe and liquid assets.[159] Another minority view holds that the market, left on its own, will provide sufficient protection for depositors and the overall economy.[160] Second, even if deposit insurance is necessary, some economists and banking experts recently have argued that privately capitalized insurance, or at least a partially private bank insurance system, would not only be viable, but also would be preferable to federal insurance in reducing the moral hazard problems and other distortions generated by a federal insurance regime.[161]

This Article will not attempt to address this particular debate in the banking world except to suggest that possibilities for privatization of deposit insurance should be seriously considered. In general where private insurance is available and viable, enterprises should be expected to obtain adequate coverage before any form of bailout should be considered. Private insurance that is appropriately based on risk and otherwise designed to mitigate moral hazard problems is preferable to public bailout.

4. The Bankruptcy Alternative

Modern bankruptcy law provides an opportunity to reorganize a troubled enterprise rather than liquidate it.[162] Successful reorganization in bankruptcy

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156. *See* Federal Deposit Insurance History, *supra* note 91, at 3.

157. For a discussion of moral hazard in the banking context, see Lovett, *Moral Hazard, Bank Supervision and Risk-Related Capital Requirements,* 49 Ohio St. L.J. 1365 (1989). A more general discussion of the problem of "moral hazard" as it applies to bailouts appears *supra* notes 25-28 and *infra* notes 184-85 and accompanying text.

158. For a description of these concerns, see Modernizing the Financial System, *supra* note 91, at I-11 to I-13.

159. *See, e.g.,* R. Litan, What Should Banks Do? (1987).

160. *See, e.g.,* Fama, *Banking in the Theory of Finance,* 1980 J. Monetary Econ. 39.

161. B. Ely, Making Deposit Insurance Safe Through 100% Cross-Guarantees (1990); P. Wallison, Back From the Brink, A Practical Plan for Privatizing Deposit Insurance and Strengthening Our Banks and Thrifts (1990). These proposals are reviewed in Modernizing the Financial System, *supra* note 91, at VII-7 to VII-33.

The availability of insurance, however, may itself undermine the general deterrence effect of the tort regime. Insurance permits the insured to externalize some of the costs of risky behavior. If insurance is readily available at rates that are not risk-based and premiums are not increased in response to claims on the fund, an individual or firm may have incentives to engage in risky behavior. Rather than having a general deterrence effect, such insurance will increase the moral hazard problem.

162. *See supra* notes 52-62 and accompanying text.

eliminates the need for a public bailout. Thus, any well-considered bailout policy must address the bankruptcy alternative.

The purpose and use of bankruptcy laws has been the focus of much recent controversy.[163] One side of the debate argues that bankruptcy law serves only a narrow debt collection function. Dean Thomas Jackson argues that bankruptcy law has the distinct purpose of allocating a debtor's limited common pool of resources among its creditors. He notes that there is

> no correlation between whether firms should stay in business and solving a common pool problem. If it is important for firms to stay in business because of the jobs they save or because of their importance to their communities, that policy should be implemented as a matter of general law . . . . It is wrong to think that there should be an independent substantive policy of reorganization law to give firms breathing space or to reorganize them to preserve jobs.[164]

Thus, while "[b]ankruptcy law can and should help a firm stay in business when it is worth more to its owners alive than dead[,] . . . [n]ot all businesses are worth more to their owners—or to society—alive than dead."[165]

The other side of the debate suggests that bankruptcy law can play a more expansive role. Professor Warren, for example, points out that

> [c]ongressional comments on the Bankruptcy Code are liberally sprinkled with discussions of policies to "protect the investing public, protect jobs, and help save troubled businesses," of concern about the community impact of bankruptcy, and of the "public interest" beyond the interests of the disputing parties. These comments serve as reminders that Congress intended bankruptcy law to address concerns broader than the immediate problems of debtors and their identified creditors; they indicate clear recognition of the larger implications of a debtor's widespread default and the consequences of permitting a few creditors to force a business to close.[166]

In a more recent article, Professor Korobkin challenges Dean Jackson's "economic account" suggesting a competing "value-based account" of bankruptcy law. He argues that:

> Bankruptcy law provides a forum in which competing and various interests and values accompanying financial distress may be expressed and sometimes recognized. Through the bankruptcy process, these com-

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163. Professors Elizabeth Warren and Douglas Baird provide a useful and entertaining "Point-Counterpoint" in a pair of articles. Warren, *Bankruptcy Policy,* 54 U. Chi. L. Rev. 775 (1987); Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren,* 54 U. Chi. L. Rev. 815 (1987).

164. T. Jackson, The Logic and Limits of Bankruptcy 210 (1986). Professor Douglas Baird's arguments are similar. *See, e.g.,* Baird, *The Uneasy Case for Corporate Reorganization,* 15 J. Legal Stud. 127 (1986); Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy,* 51 U. Chi. L. Rev. 97 (1974).

165. T. Jackson, *supra* note 164, at 210.

166. Warren, *supra* note 163, at 788 (citations omitted).

> peting interests are transformed, over time, into a renewed vision of the corporation as a moral, political, social, and economic actor. Bankruptcy law creates the conditions for a special kind of discourse, one that is fundamentally rehabilitative in character. No other legal system responds to the crisis of human values arising in financial distress, or provides for a discourse for rehabilitating these values into an informed and coherent vision of the corporation as personality.[167]

Under this value-based account, bankruptcy law can be viewed as democratizing decision-making authority[168] and permitting a discourse among interested parties to address the problems of financial distress in a private enterprise. To be sure, the Bankruptcy Code provides various protections to assure equitable treatment of all creditors and that no dissenting creditor be *required* to accept less than it would have received upon liquidation of the enterprise.[169] Nevertheless, the bankruptcy process provides an opportunity for dialogue, negotiation, and compromise among interested parties.

Even one who follows the narrow view that bankruptcy law simply is a means of allocating a common pool of resources must concede that chapter 11 reorganization sometimes results in survival of the firm. Better yet, under the broader value-based account, this process may be accompanied by discourse and negotiation among parties most interested in survival of the enterprise. Thus, except in extraordinary circumstance, where a chapter 11 reorganization proceeding is impossible, firms in financial distress should be required to pursue chapter 11 reorganization as a precondition to a public rescue.[170]

In connection with the Chrysler bailout, Congress at least considered the bankruptcy alternative but concluded for several reasons that bankruptcy was not viable. The House report noted that automobiles, unlike goods such as shoes or appliances, constitute

> a typical consumer's second largest investment after a home. Not only must the consumer be conscious of the future reliability of parts and service but also, equally important, he or she is highly sensitive to the future resale or trade-in value of the car. The very word "bankruptcy" could cause a psychological impact of incalculable proportions.[171]

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167. Korobkin, *supra* note 40, at 766.

168. *Id.* at 771.

169. *See supra* notes 62-63 and accompanying text.

170. *See infra* notes 258-59 and accompanying text.

171. H.R. Rep. No. 690, 96th Cong., 1st Sess. 14 (1979). This, of course, was the argument put forward by Chrysler itself. Some of the expert testimony supported Chrysler's concerns. *The Chrsyler Corporation Financial Situation: Hearings on H.R. 5805 Before the Subcomm. on Econ. Stabilization of the House Comm. on Banking, Finance and Urban Affairs,* 96th Cong., 1st Sess. 861 (1979) (testimony of Benjamin Weintraub conceding that "there is much that merits consideration in Mr. Iacocca's aforementioned conclusion since no company of its size has been in a chapter XI case"). Other experts suggested that the chapter 11 reorganization route offered advantages, including the opportunity to examine Chrysler's past management practices, to supervise Chrysler's future operations, to reject unfavorable executory contracts, and to negotiate restructuring of Chrysler's financial situation. *Id.* at 857 (testimony of Dean David Epstein). Chapter 11 also offered the possible advantage of "a more pervasive restructuring, the creation of a long-term solution." *Id.* at 881.

The House report further noted with respect to Chrysler's "enormous, unavoidable investment program to convert its entire product line . . . [that] [b]ankruptcy helps in dealing with old debts, but by itself, it cannot raise huge amounts of new cash."[172] Several witnesses at the hearings testified that a chapter 11 reorganization of Chrysler would have caused such an extreme confidence crisis that the process would quickly have disintegrated into a liquidation of the corporation.[173]

Congressional consideration of the bankruptcy alternative before undertaking the Chrysler bailout was a step in the right direction but did not go far enough. The House report accompanying the bailout legislation first assumed that an attempt to reorganize Chrysler under chapter 11 would inevitably fail, resulting in collapse of the firm. It also concluded that Chrysler's collapse would be unacceptable. This second judgment represents a dramatic policy choice. Why was collapse unacceptable? The House report mentions concern with the psychological impact of bankruptcy and on preserving trade-in values for customers. The passages quoted previously suggest that bailout was preferable to collapse because bailout would help Chrysler to convert its entire product line.

This reasoning strikes one as rather lame. Increased levels of unemployment in and around Detroit as well as the resulting impact on the regional economy were obviously more serious concerns. Whatever the rationale, such a bailout of private industry deserves more thoughtful analysis. Later Parts of this Article will develop a framework for determining when collapse of a firm or industry is unacceptable, and government intervention is required.[174] At a minimum, where reorganization offers some hope for enterprise rehabilitation, attempts to reorganize should be made before resorting to a public rescue.

B. The Free Market Presumption Against Bailout

Fundamental to any public policy toward bailouts should be a clear presumption against intervention that may be overcome only in certain specialized situations. As a general rule, the government should not intervene to bail out private enterprise. Alternative mechanisms for loss allocation generally should be attempted first, with bailout policy only as a last resort.[175]

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172. H.R. REP. No. 690, *supra* note 171.

173. Apparently, this is not an unusual outcome. Empirical evidence suggests that many firms that go through chapter 11 reorganization fail shortly thereafter. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* 57 AM. BANKR. L.J. 99 (1983).

174. *See infra* notes 257-323 and accompanying text.

175. For a discussion of these alternatives, see *supra* notes 134-74 and accompanying text.

In the minds of many, such a presumption probably exists already. Many policy makers undoubtedly view bailout as a solution for only the most extreme cases.[176] At the same time, however, early bailouts set a stage that makes subsequent requests for assistance more difficult to resist. When Congress authorized loan guarantees to the Lockheed Aircraft Corporation in 1971, it set a precedent for later similar guarantees to Chrysler and New York City.[177] The first "essentiality finding" made by the FDIC to save the Unity Bank of Boston[178] set the precedent for subsequent bank bailouts under the discretionary essentiality doctrine.[179] In addition, government reports such as the U.S. Comptroller General Report,[180] imply that further rescues are anticipated. While such forethought and development of guidelines is wise, a formal bailout policy should not leave the impression that bailouts will be easy to come by. To the contrary, a presumption against bailouts should be the first principle in any formal enterprise failure policy.

The first justification for the presumption against bailout is that government intervention to protect private industry violates the free-market principles that generally govern our economy. According to these principles, economic markets operate reasonably efficiently without government intervention. Under ideal competitive conditions, voluntary exchanges of goods and services will achieve efficient outcomes,[181] and prices will reach equilibrium.[182] Conditions are rarely ideal, however. Markets may fail for numerous reasons, including inadequate flow of information, nonexistence of a market for certain goods, concentration of power in the form of monopolies, high transaction costs for certain exchanges, and spillover or externality effects

176. The Bush administration formally takes this general view. For example, in a recent report, the Executive Office stated that "[a]ccording to economic theory, competitive markets generally perform well in supplying the economic goods and services people want. . . . Thus there is *a strong presumption that government intervention should only be undertaken when markets are not working*, that is, where there is a so-called 'market failure.'" OFFICE OF MGMT. AND BUDGET, REGULATORY PROGRAM OF THE U.S. GOVERNMENT: APRIL, 1988-MARCH 31, 1989, at 32-33 (1988) (emphasis added) (footnotes omitted). The need for bailout does not always stem from market failure. Nevertheless, one suspects that the presumption suggested in these comments would apply even more forcefully when the market has not failed.

177. The House report accompanying the Chrysler bailout was careful to state that it did not wish to set a precedent for rescuing failing companies. Nevertheless, the report refers back to both the New York City and Lockheed bailouts. These too were unique according to the report. H.R. REP. No. 690, *supra* note 171, at 13.

178. *See supra* note 123-24 and accompanying text.

179. *See* I. SPRAGUE, *supra* note 123.

180. *Supra* note 11.

181. For these economic market purposes, efficiency is generally thought to be "Pareto efficiency." *See infra* notes 216-27 and accompanying text. The notion of Pareto efficiency suggests that voluntary trades will take place as long as one person can be made better off and no one worse off.

182. A complete discussion of traditional laissez-faire economic analysis is beyond the scope of this Article. For a general discussion of basic principles, see P. SAMUELSON, ECONOMICS (13th ed. 1989).

of individual behavior that the market does not take into account.[183] Government regulation or intervention is frequently necessary to correct for these structural market failures.

In a bailout, government intervention generally is *not* a response to a structural market failure, but rather a response to the economic failure of the enterprise. From a market perspective, leaving the enterprise to fail may well be the most efficient outcome. If there is no market failure justifying government intervention, another rationale for intervention must be articulated. In proposing a general presumption against bailouts, I do not mean to suggest that bailout will never be appropriate. At the same time, there is reason to be especially cautious before making the policy decision to bailout private enterprise.

One reason for caution is the moral hazard problem discussed earlier.[184] A policy of freely provided bailouts would encourage greater levels of risk taking by management than would be societally optimal. Investors in the business enterprise who harbor expectations of a bailout in the event of business failure will have little incentive to monitor risky management activities. Rescue of a failed firm protects these investors at the expense of the larger community bearing the bailout costs.[185]

Another reason to be especially cautious with bailouts is the risk of rent-seeking behavior on the part of firms seeking assistance.[186] A general revenue bailout involves expenditures of tax revenues that are reasonably concentrated and inure to the benefit of management, employees, investors, and others with some relationship to the firm being rescued. These groups will have greater incentives to organize and lobby for the bailout. The tax-paying public that will incur the costs is more dispersed and will have difficulty organizing to oppose the bailout.[187] Although a majority may

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183. For a more complete discussion of the causes of market failure, see S. BREYER, REGULATION AND ITS REFORM 15-35 (1982); E. STOKEY & R. ZECKHAUSER, A PRIMER FOR POLICY ANALYSIS 297-308 (1978).

184. *See supra* notes 25-28 and accompanying text.

185. A carefully structured bailout can limit the benefit flowing to investors by demanding substantial investor contribution toward the bailout cost. This possibility will be discussed further in Part IV on structuring bailouts.

186. Although "rent seeking" is a term economists first used, it is increasingly finding its way into legal literature. As economist Dennis Mueller describes it:

> The government can . . . help create, increase, or protect a group's monopoly position. In so doing, the government increases the monopoly rents of the favored groups, at the expense of the buyers of the group's products or services. The monopoly rents that the government can help provide are a prize worth pursuing, and the pursuit of these rents has been given the name rent seeking.

D.C. MUELLER, PUBLIC CHOICE II 229 (1989). More broadly, a concentrated group seeking favorable treatment such that it would extract benefits (rents) at the expense of other taxpayers is engaged in rent seeking for my purposes. A more detailed discussion of pluralist theories and rent seeking appears at *infra* notes 203-07 and accompanying text.

187. Economist George Stigler, in his classic article on economic regulation, offers several

oppose particular legislation, free-rider problems will make it more difficult for the majority to mobilize into action to oppose legislation demanded by a smaller, more concentrated special interest.[188] Although such rent-seeking behavior can be found elsewhere, the concentrated nature of the benefits and diffuse distribution of the costs in the bailout scenario make it particularly ripe for rent-seeking behavior.[189] Creating a presumption against bailout will increase the cost to private industry of seeking bailout relief and, thus, reduce the number of bailout requests.

While there should be a presumption against bailout,[190] there may be special circumstances under which a bailout is appropriate. In rare cases, it may even be appropriate to resort to bailout before some of the alternative loss allocation regimes. The difficult public policy task is to determine those circumstances in which the presumption may be rebutted. Regardless of the theoretical approach one takes to legislation, most would probably agree with a general presumption against bailout. Disagreements will arise over the conditions under which the presumption should be overcome. The following sections address the different responses that emerge from different theoretical perspectives.

C. *Overcoming the Presumption Against Bailout*

1. The Public Interest v. Pluralist Approaches

a. *The Public Interest Approach*

Several political scientists and theorists subscribe to the view that there exists a public interest distinct from the aggregated interests of individuals.[191]

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explanations for why a majority votes to impose costs upon themselves in order to provide benefits to others. First of all, voters must "employ representatives with wide discretion and must eschew direct expressions of marginal changes in preferences. This characteristic also implies that the political decision does not predict voter desires and make preparations to fulfill them in advance of their realization." Stigler, *The Theory of Economic Regulation,* 2 BELL J. OF ECON. & MGMT. SCI. 3, 10 (1971). In other words, legislators' votes do not and cannot always reflect the preferences of the majority of the voters themselves. In addition, many or most voters are uninterested in particular issues before the legislature. As Stigler points out, "the expressions of preferences in voting will be less precise than the expressions of preferences in the marketplace because many uninformed people will be voting and affecting the decision." *Id.* at 11-12.

188. A theory of "latent groups" and the free-rider difficulties they face in mobilizing to oppose smaller, more powerful special interests is developed in M. OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1971).

189. For an analysis of legislative markets distinguishing the supply and demand for legislation based upon the distribution of anticipated costs and benefits, see M. HAYES, LOBBYISTS AND LEGISLATORS: A THEORY OF POLITICAL MARKETS 98-127 (1981). Professors Eskridge and Frickey build on this Hayesian model to develop a "taxonomy of supply of legislation based on benefits and costs." W. ESKRIDGE & P. FRICKEY, CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 55, 611 (1988).

190. There are practical as well as principled reasons for a presumption against bailouts. The cost of bailouts can be large and difficult to estimate. The savings and loan bailout comes to mind as the most obvious example. Factoring bailout costs into the budget will add tremendous complexity and uncertainty to an already complex and uncertain process.

191. In Federalist 10, where James Madison expressed his concern with the dangers of

In the philosophical and legal literature, a group sometimes known as the "civic virtue" school contends that although self-interest often motivates political behavior, citizens can, and sometimes do, act out of a concern for the greater good. Several civic virtue writers take the position that, with a little prodding, the legislative process itself can be made more public-regarding. Cass Sunstein, for example, suggests a return to Madisonian republicanism, which seeks to reach an idealist common good through a process of deliberation.[192] Sunstein argues for a strengthened judicial review that arguably would cause policymakers to deliberate more fully and would result in more public interest legislation.[193] Although he might not label himself a "civic virtuist," Professor Frank Michelman expresses his faith in "jurisgenerative politics" by which political persons can reach normative consensus through "effectively persuasive, dialogic relation with each other."[194] He envisions a process whereby genuine shifts in understanding are possible without coercion, invasion, or violation of individual freedom.[195]

In addition to the public interest political scientists and theorists, the early welfare economists also can be placed within the "public interest"

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factions, he wrote that a majority faction might "sacrifice to its ruling passion or interest both the public good and the rights of other citizens," thus suggesting that there is such a thing as the "public interest." THE FEDERALIST No. 10, at 57 (J. Madison) (E. Earle ed. 1976). Political scientist Glendon Schubert describes Madison as an idealist or one who sees the legislator's role as finding a direct channel to "Wisdom, Truth and the Public Good" by referring to natural law. G. SCHUBERT, THE PUBLIC INTEREST: A CRITIQUE OF THE THEORY OF A POLITICAL CONCEPT 79 (1960). This view of Madison is not uniformly accepted. *See, e.g.*, R. DAHL, A PREFACE TO DEMOCRATIC THEORY 4-33 (1956) (viewing Madison as a pluralist whose primary concern was tyranny of the majority). Viewed slightly differently, the public interest is a set of values or interests that citizens hold in common. This notion can be traced to Rousseau's *Social Contract.* Although private interests will inevitably clash, there are some interests that we all have in common. According to Rousseau, "It is what is common in these different interests that forms the social bond; and if there was not some point in which they all unanimously centered, no society could exist. It is on the basis of this common interest alone that society must be governed." J. ROUSSEAU, BOOK II in THE SOCIAL CONTRACT 23.

192. Sunstein, *Interest Groups in American Public Law,* 38 STAN. L. REV. 29 (1985). In a variation on the civic virtue approach, Professor Fitts recommends increasing powers of political parties and the presidency, which attract support for larger groups of otherwise powerless groups in the legislative process. Fitts, *The Vices of Virtue: A Political Party Perspective on Civic Virtue Reforms of the Legislative Process,* 136 U. PA. L. REV. 1567 (1988).

193. Sunstein, *supra* note 192, at 69-72. In an earlier article, Professor Mashaw made similar arguments for strengthened judicial review in constitutional cases to ensure that public legislation provides for the public welfare. Mashaw, *Constitutional Deregulation: Notes Toward a Public, Public Law,* 54 TUL. L. REV. 849 (1980).

194. Michelman, *Law's Republic,* 97 YALE L.J. 1493, 1513 (1988). Michelman himself describes his notion of "republican or jurisgenerative politics" as parallel to Professor Ackerman's notion of "constitutional politics." *Id.* at 1520. Professor Ackerman describes a "dualist conception" of political life made up of both "normal" self-interested politics and extraordinary "constitutional moments" when citizens rise above self-interest and act out of concern for the common good. Ackerman, *The Storrs Lectures: Discovering the Constitution,* 93 YALE L.J. 1013, 1038 (1984).

195. Michelman, *supra* note 194, at 1526-27.

camp. These economists were suspicious of laissez-faire philosophy as the answer to all questions of public economic policy and believed in more substantial government intervention than the laissez-faire approach would support. Early welfare economists, such as Pigou, are credited with developing the justification for substantial government intervention in the marketplace.[196] Pigou went further than simply suggesting government intervention to correct for market failures, arguing that "[i]n any industry, where there is reason to believe that the free play of self-interest will cause an amount of resources to be invested different from the amount that is required in the best interest of the national dividend, there is a prima facie case for public intervention."[197]

Virtually all legislative histories include some discussion of the public interest or general welfare. Bailout legislation is no exception. For example, the history of the Emergency Loan Guarantee Act expresses concern for the economy and the potential costs "in terms of jobs destroyed, confidence impaired, income lost, and goods not produced."[198] Similarly, the House Banking, Finance and Urban Affairs Committee reported in connection with the Chrysler bailout that "a Chrysler failure would create consequences of an entirely different order of magnitude from the normal experience. There is, therefore, a presumption that such widespread human suffering should be avoided if that is reasonably possible."[199] In its Declaration of Policy for the Regional Rail Reorganization Act of 1973, Congress declared that "public convenience and necessity require adequate and efficient rail service in this region and throughout the Nation to meet the needs of commerce, the national defense, the environment, and the service requirements of passengers, United States mail, shippers, States and their political subdivisions, and consumers."[200] The declaration also concluded the

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196. A.C. Pigou, The Economics of Welfare ch. XX (4th ed. 1938); *see also* W.J. Baumol, Welfare Economics and the Theory of State (1952).

197. A.C. Pigou, *supra* note 196, at 331. Professor Herbert Hovenkamp chronicles the early development of such economic philosophy in Hovenkamp, *The First Great Law & Economics Movement*, 42 Stan. L. Rev. 993 (1990). With regard to the utilitarian approach used by the early welfare economists, he observes that

> [t]his concept of welfare helps to explain the high degree of statism among the economists of the material welfare school, who comprised the first great law & economics movement. They were Progressives, who believed that social welfare could be increased by minimum wage laws, graduated income taxes, subsidized public education, welfare payments to the poor, taxes upon monopoly profits, and other devices by which the relatively wealthy were required to finance the provision of goods and services to the relatively impoverished . . . The beneficiaries of these forced transfers were perceived to gain more utility than the involuntary grantors lost.

Id. at 1002.

198. H.R. Rep. No. 379, 92d Cong., 1st Sess. 2 (1971).

199. H.R. Rep. No. 690, *supra* note 168, at 10.

200. Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, § 101, 87 Stat. 985, 986 (1974) (codified at 45 U.S.C. § 701 (1988)).

"preservation and maintenance of adequate and efficient rail service is in the national interest."[201]

Followers of the public interest or civic virtue political school undoubtedly would agree that, despite the general presumption against it, there will be circumstances in which bailout will serve the public interest. The difficulty, of course, will be to identify those special cases where public interest concerns trump the presumption against bailout. Statements of the sort found in the bailout legislative histories have significant rhetorical force. At the same time, we are all aware that legislators and their staffs are quite adept at composing such "public interest" language for political purposes. Some substantive and procedural standards will be necessary to more genuinely identify the public interest to be served by any bailout.[202]

b. The Pluralist Approach

Many political scientists, economists, and legal scholars have argued that there is no such thing as a "social will" or "public interest."[203] These pluralists, or "interest group" theorists,[204] view politics as the clash and ultimate compromise among individuals or interest groups, each seeking his or her own presumably rational self-interest. Occasionally, individual interests will converge and consensus may emerge. More often, however, differing

201. *Id.*

202. Subsequent sections of this Article develop such standards. *See infra* notes 265-323 and accompanying text.

203. For example:

> The use of the phrase "social will" gives us, in exchange for all the little tautologies which we found in feelings and ideas, one huge tautology. But if we believe it carries us to the explanation of social happenings, we are simply lulling ourselves to sleep with a huge draught of the "psychic" opiate.

A. BENTLY, THE PROCESS OF GOVERNMENT (1908); *see also* J.A. SCHUMPTER, CAPITALISM, SOCIALISM AND DEMOCRACY 251 (1942) ("There is . . . no such thing as a uniquely determined common good that all people could agree on or be made to agree on by the force of rational argument."); Downs, *The Public Interest: Its Meaning in a Democracy,* 29 SOC. RESP. 1-2 (1962):

> [T]he term public interest is constantly used by politicians, lobbyists, political theorists, and voters, but any detailed inquiry about its exact meaning plunges the inquirer into a welter of platitudes, generalities, and philosophic arguments. It soon becomes apparent that no general agreement exists about whether the term has any meaning at all, or if it has, what the meaning is . . . .

204. Political scientist Arthur Bently is one of the early parents of pluralism. A. BENTLY, *supra* note 203. Buchanan and Tullock acknowledge their debt to the school of pluralists following Bently. J. BUCHANAN & G. TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY 9 (1965). Although economically oriented writers acknowledge their debt to the early pluralists in the political science field, there is a sense of rivalry between the two disciplines. Posner, for example, says that economic theory involves more "than merely a recasting of the work of political scientists. The economic theory is more precise and hard-edged—easier to confront and test with a body of data—than the political theory (which, as I pointed out, is not really a theory at all)." Posner, *Theories of Economic Regulation,* 5 BELL J. ECON. & MGMT. SCI. 335, 343 (1974).

interest groups will clash, and compromise will be necessary to resolve disputes. Pluralist or public choice theory[205] thus rejects the notion of a general public interest and assumes that the state and the market are similar devices through which individuals cooperate in order to further their own interests.[206] Just as self-interested economic players enter into agreements in the economic marketplace, political players enter into similar kinds of agreements and compromises in the political marketplace.[207]

Public choice theorists would argue that the real explanation for bailout legislation lies in the economic bargain struck by the relevant players. In the case of a bailout, the individual firm or industry and its customers, creditors, and employees usually benefit. Public interest rhetoric may be scattered throughout the Chrysler bailout legislative history, but a public choice analysis would conclude that the bailout simply was a deal struck between the Chrysler Corporation and Congress. Although one of the major

205. Public choice theory, which has become so popular in the legal literature, is simply an outgrowth of pluralism. Public choice theory also goes by the names social choice and collective choice. The terms appear to be used interchangeably, except that social choice and collective choice seem to be used more frequently in the literature dealing with procedures for aggregating individual preferences. A recent article described the "theory of choice" as the latest legal fad. Nagel & Nagel, *Theory of Choice,* NEW REPUBLIC, July 23, 1990, at 15. For a general description of the public choice theory of legislation, see D. FARBER & P. FRICKEY, LAW AND PUBLIC CHOICE (1991); R. MCCORMICK & R. TOLLISON, POLITICIANS, LEGISLATION, AND THE ECONOMY: AN INQUIRY INTO THE INTEREST-GROUP THEORY OF GOVERNMENT (1981); McChesney, *Rent Extraction and Rent Creation in Economic Theory of Regulation,* 16 J. LEGAL STUD. 101 (1987) Tollison, *Public Choice and Legislation,* 74 VA. L. REV. 339 (1988) (describing the economic supply and demand of legislation). A substantial body of literature uses this public choice theory to explain particular pieces of legislation or regulation. *See, e.g.* Doernberg & McChesney, *Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986,* 62 N.Y.U. L. REV. 891 (1987); Haddock & Macey, *Regulation on Demand: A Private Interest Model With an Application to Insider Trading Regulation,* 30 J.L. & ECON. 311 (1987); Miller, *Public Choice at the Dawn of the Special Interest State: The Story of Butter and Margarine,* 77 CALIF. L. REV. 83 (1989) (Oleomargarine Act of 1886). A good, but critical, review of the literature is provided in Farber & Frickey, *The Jurisprudence of Public Choice,* 65 TEX. L. REV. 873 (1987).

206. Public choice theory presents a rather pessimistic view of the traditional democratic process through which decisions are made by majority vote. This pessimism can, in part, be attributed to the work of economist Kenneth Arrow. K. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1963). Arrow explored the processes by which individuals, each with an outcome preference, aggregate those individual preferences to arrive at a social preference. In his famous "impossibility theorem," Arrow established that there is no mechanism through which the rational preferences of individuals can be converted into a rational collective choice or preference. Arrow's impossibility theorem was a devastating blow to democratic theory. He established that legislative outcomes will vary depending upon the order in which legislative options are presented for voting. Those who control the legislative agenda will have tremendous influence over legislative outcomes. For an "Arrow-based" discussion of agenda control theory and some illustrations of the ways in which outcomes can be affected, see, for example, W. RIKER, THE ART OF POLITICAL MANIPULATION (1986).

207. The market analogy is ever-present in pluralist theory. *See, e.g.,* J. BUCHANAN & G. TULLOCK, *supra* note 204; R. DAHL & C. LINDBLOM, POLITICS, ECONOMICS AND WELFARE (1963); C. LINDBLOM, POLITICS AND MARKETS: THE WORLD'S POLITICAL ECONOMIC SYSTEMS (1977).

"public interest" arguments for the Chrysler bailout was preservation of jobs, the number of employees at Chrysler was reduced dramatically as a result of plant closings and other cost-cutting measures imposed as conditions for the bailout assistance. The shareholders were the true beneficiaries of the efforts of Chrysler's powerful lobbyists.

c. *Contrasting Public Interest and Pluralism*

Behind the debate between public interest and pluralist theorists lie some fundamental differences in assumptions about human nature and behavior. The pluralists assume that political behavior is almost entirely self-interested, whereas public interest adherents believe that political behavior can be public-spirited or altruistic.[208] Recent critics bemoan the separation of morality and ethics from economics and challenge the assumption that rational individuals always seek to promote their self-interest.[209]

Given the fundamental differences in underlying assumptions between public interest and pluralist thinking, one suspects that agreement between the two camps would be rare. There may be some common ground, however. Even under a pluralist view, society might arrive at a list of preferences that each of its members shares in common.[210] In addition, if individuals are provided with more information and an opportunity for deliberation, they may find that their self-interest as originally perceived will change and

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208. Pluralists have encountered difficulty in explaining certain kinds of behavior under their rational self-interest assumption. For example, those ascribing to the pure rational self-interest view of political behavior have trouble explaining the paradox of voting. Why do voters go to the polls at all given the low probability that their votes will affect the outcome? For a good discussion of the literature on this paradox of voting, see D.C. MUELLER, *supra* note 186, at 348-69.

209. *See, e.g.*, A. SEN, ON ETHICS AND ECONOMICS (1987).

> The self-interest view of rationality involves *inter alia* a firm rejection of the "ethics-related" view of motivation. Trying to do one's best to achieve what one would like to achieve can be part of rationality, and this can include the promotion of non-self-interested goals which we may value and wish to aim at. To see any departure from self-interest maximization as evidence of irrationality must imply a rejection of the role of ethics in actual decision making.

Id. at 15. A number of others have similarly argued that altruistic motives sometimes may drive political behavior. *See, e.g.*, T. NAGEL, THE POSSIBILITY OF ALTRUISM (1970); THE POWER OF PUBLIC IDEAS 1-4 (R. Reich ed. 1988); T. SCHELLING, MICROMOTIVES AND MACROBEHAVIOR (1978). For a more recent treatment, see A. ETZIONO, THE MORAL DIMENSION: TOWARD A NEW ECONOMICS (1988). See also a recent series of essays in BEYOND SELF-INTEREST (J. Mansbridge ed. 1990).

210. As Judge Posner has pointed out, "there is no necessary incompatibility between the public interest and interest group theories. . . . The interest group theory does not deny the possibility that a large group—perhaps the whole society—occasionally might procure legislation on its own behalf." Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263, 269 (1982).

that greater consensus may emerge.[211] Moreover, one can accept the public choice description of legislature as marketplace and still object that the market is unfair. Where benefits are concentrated and costs diffuse, small rent-seeking groups will evolve to lobby for such benefits. The larger community that will bear the costs has little incentive to organize. Bargaining power in the legislative market ideally should be made more equal. Procedures to provide a greater voice to the disempowered groups should be devised.

From this perspective, implications of the public interest and public choice models begin to merge to some extent. Deliberative reforms called for by the public interest approach would also serve to provide greater voice to the larger community left out of the political market. In the bailout context, the industry requiring assistance and its employees are likely to be reasonably organized and concentrated in their efforts. The larger, more diffuse group that will be called upon to pay the expenses is not likely to be as well organized. Efforts to provide a greater voice for consumer groups likely to bear the bulk of these expenses would be useful.[212]

2. The Distributive Justice Approach

a. Allocative v. Redistributive Choices

Distributive justice analysis is a third theoretical approach that will prove useful in analyzing bailout policy. Legislation, particularly economic legislation such as a bailout, allocates or redistributes wealth. However, the two concepts are distinguishable. Redistribution assumes a transfer of existing wealth from some members of the group to others. Legislation may be designed deliberately to redistribute wealth so as to alleviate existing income inequalities[213] or it may be unintentionally redistributive. Legislators may be aware of the redistributive quality of legislation but unaware of the direction or extent of the redistribution. Allocation, on the other hand, assumes *new* wealth that is to be distributed (as opposed to *re*distributed) to members of the group.

Both redistribution and allocation raise distributive concerns. Any redistributive choice will result in winners and losers; some will gain at the

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211. A distinction can be made between an individual's actual preferences and those ideal preferences that she might come to if she were ideally informed. For a discussion of these ideas, see Gibbard, *Interpersonal Comparisons: Preference, Good and the Intrinsic Reward of a Life,* in FOUNDATIONS OF SOCIAL CHOICE THEORY 165 (J. Elster & A. Hylland eds. 1986).

212. Recommendations for reform are developed more fully at *infra* notes 311-23 and accompanying text.

213. The progressive income tax is often justified on this basis, for example. *See, e.g.,* W. BLUM & H. KALVEN, THE UNEASY CASE FOR PROGRESSIVE TAXATION 70-100 (1953); H. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 18-19 (1938).

expense of others. Since allocation simply involves the distribution of new wealth, there should be no losers, but allocative decisions involve distributive elements as well. If the entire community wins from a legislative decision, a second-level decision must be made regarding the appropriate sharing of the gains; some may gain more than others.

The first and perhaps most obvious basis for making allocative or redistributive decisions is overall wealth. In the case of redistributive choices, wealth may be taken from the well-to-do and distributed to the less wealthy. In allocative decisions, the choice might be to provide those at the lower end of the wealth scale with a greater share of the newly created benefits. In the case of successful rent-seeking activity, wealth may be redistributed from diffuse disinterested groups to concentrated interest groups.

Distributive decisions may also be based on other needs-based criteria. Wealth may be redistributed from the healthy to the sick, from those without disabilities to those suffering from disabilities, and the like. Allocations of newly-found wealth may similarly be distributed disproportionately to those in need. Distributive decisions may also be based upon demographic considerations, for example, the age of the population.[214] More broadly, legislation might result in redistribution from living to future generations.[215] Another demographically based distribution criterion is geography.

b. Economic Analysis of Distributive Decisions

Economists study distributions in terms of efficiency. Pareto efficiency is one such common economic measure. A change is Pareto efficient if it makes one person better off and no one worse off. In other words, the pie is enlarged and no one suffers. In contrast, a situation is Pareto optimal if no such changes can be made; that is, there is no way to make one person better off without causing some other person to be worse off.[216] Under this view, only allocative distributions will be efficient. Some are made better off and none are made worse off. To say that a situation is Pareto optimal, however, is not to say much, for by definition a redistribution cannot be a Pareto improvement. Imagine a two-person world of finite resources in which one person has one million dollars and the other has nothing. Giving one of the millionaire's dollars to the pauper will make the pauper better

214. Some have charged that the savings and loan bailout distributes wealth from younger to older citizens. *See, e.g.*, Hill, *The S & L Bailout: Some States Gain, Many More Lose, 33 Challenge,* MAG. OF ECON. AFF. 37, 39 (1990).

215. For a theoretical discussion of justice between generations, see J. RAWLS, A THEORY OF JUSTICE 284-93 (1971).

216. The notion of Pareto efficiency was developed by French economist Vilfredo Pareto in V. PARETO, COURS D'ECONOMIE POLITIQUE (1896). A good discussion of the Pareto criterion can be found in chapter 2 of A. SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE 21-27 (1979).

off and simultaneously make the millionaire worse off. A statute that required the millionaire to transfer one dollar to the pauper, thus, would not be considered efficient.[217]

An alternative measure of economic efficiency developed by British economists Nicholas Kaldor and Sir John Hicks responds to some of the Pareto concept's limitations.[218] Kaldor-Hicks efficiency requires only that the winners *could theoretically* compensate the losers so that no one would be worse off. It does not require that compensation actually be paid. Under this approach, some redistributive transfers will be considered economically efficient. Thus, Kaldor-Hicks analysis is described as the "maximize-net-benefits approach to social policy. Gains and losses in welfare are added up for all of society and whichever policy produces the largest net increase in total effective income is chosen."[219]

Bailouts surely involve distributions of wealth. Whether these distributions represent allocations or redistributions may be subject to debate, however. Federal deposit insurance arguably redistributes wealth among participating banks. Given current flat-rate premiums imposed upon depository institutions, banks with higher risk investments benefit at the expense of those with lower risk investments.[220] Bank rescues that go beyond the government's insurance obligation benefit customers who otherwise would have lost their deposits and employees who otherwise would have lost their jobs. Investors or shareholders may also benefit. In addition, the community may receive spillover economic benefits or positive externalities from the rescue effort.[221] If the benefits to the community are such that everyone either benefits or remains neutral, the bailout is an allocative distribution.[222] It will be Pareto efficient.

More likely, a general revenue bailout will reflect redistribution, as opposed to allocation, of income from the general tax-paying public to the direct beneficiaries of the legislation, without any increase in net welfare.

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217. Given a finite set of resources, there will be many possible Pareto efficient distributions. As one economist noted, "If preventing the burning of Rome would have made Emperor Nero feel worse off, then letting him burn Rome would have been Pareto-optimal. In short, a society or an economy can be Pareto-optimal and still be perfectly disgusting." A. SEN, *supra* note 209, at 22.

218. The Kaldor-Hicks efficiency concept was developed in two early articles. Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696 (1939); Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939).

219. E. STOKEY & R. ZECKHAUSER, *supra* note 186, at 279.

220. *See supra* notes 97-98 and *infra* notes 337-38 and accompanying text.

221. A sound and healthy banking system and public confidence in it arguably are fundamental to the national economy. Even accepting this assertion, the banking crisis that led to FIRREA, at least initially, was limited to the *thrift* industry. Other commercial banks remained sound.

222. If this is an accurate description, the bailout might be described as pie-enlarging or "public-regarding" in Judge Easterbrook's terminology. *See infra* notes 252-53 and accompanying text.

The public interest rhetoric may simply be disguising a bargain struck by and for the exclusive benefit of special interest groups. Such a bailout surely should not be undertaken. On the other hand, if benefits to the community overall exceed costs to the community overall, and those that receive benefits could compensate the losers, there will be an increase in net welfare and the bailout will be Kaldor-Hicks efficient. It does not necessarily follow, however, that the bailout should be undertaken under those circumstances.

As philosopher John Rawls and others have pointed out, "the principle of efficiency cannot serve alone as a conception of justice."[223] Pareto and Kaldor-Hicks efficiency notions ignore important equitable considerations. A bailout may be Kaldor-Hicks efficient, but if beneficiaries fall disproportionately in the upper income categories, it may well be regressive. Although there may be some increase in overall welfare, this increase may be borne on the backs of the less well-to-do who are not directly sharing in the benefit.

c. *Assessing the Redistributional Effects of Bailouts*

Much empirical work regarding the distributional effects of bailouts remains to be done. The outcome of this analysis of course will vary depending upon the industry and the structure of the bailout plan. In any given bailout, it may be difficult to measure the amount, and perhaps even the direction, of redistribution. One suspects, however, that most bailouts are redistributive rather than allocative. Because a bailout should not be measured by efficiency alone, a closer look will be necessary to determine who the winners and losers from redistribution are or how gains from allocations are distributed.

The recent savings and loan bailout has been criticized by some as a regressive redistribution of wealth from the poor to the rich.[224] An important consideration must be kept in mind when examining redistributive conse-

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223. J. RAWLS, *supra* note 215, at 71. His discussion of efficiency can be found at *id.* at 67-75; *see also* A. SEN, *supra* note 216; Hovenkamp, *Positivism in Law & Economics,* 78 CALIF. L. REV. 815 (1990); Hovenkamp, *Legislation, Well-Being, and Public Choice,* 57 U. CHI. L. REV. 63 (1990). Even the Bush administration concedes that "a strict regulatory decision framework designed to maximize net benefits does not take such distributional effects into account." EXECUTIVE OFFICE OF THE PRES., REGULATORY PROGRAM OF THE UNITED STATES GOVERNMENT: APRIL 1, 1990-MARCH 31, 1991 39 (1990) [hereinafter REGULATORY PROGRAM: APRIL 1, 1990-MARCH 31, 1991]. For further discussion of this problem, see *infra* notes 295-304 and accompanying text.

224. Professor Edward Hill recently prepared an analysis focusing primarily on regional redistribution involved in the savings and loan bailout. As an aside in this study, he also observed that "money will be coming directly and indirectly from taxpayers and being awarded to savers. Savers, on the average, tend to be better-off than the average taxpayer. This means that the less wealthy will be subsidizing the wealthier through the bailout." Hill, *supra* note 214, at 44.

quences, though. To the extent that current payments are simply satisfying prior government insurance obligations, the redistributive consequences may be unavoidable. Ideally, policymakers should consider the potential future redistributive consequences when initially undertaking insurance obligations. Realistically, however, this will be difficult, to say the least. With respect to discretionary bank bailouts beyond the government's formal insurance obligation, on the other hand, redistributive consequences should be carefully considered.

Another redistributive critique of the savings and loan payout is that it will involve a dramatic geographic redistribution of wealth. Using data from the Congressional Budget Office, Professor Edward Hill first determined the distribution of bailout costs among different regions of the country. He then traced the flow of funds to the same regions, identifying winners and losers. He concluded that

> the benefits and costs of the bailout will not be spread evenly throughout the nation. Those states and regions with large numbers of problem thrifts will be receiving infusions of cash to support their assets and secure their liabilities. This injection of money will help hold off regional recessions, while other states and regions will be footing the bill.[225]

Professor Hill's data suggest that benefits from the bailout went disproportionately to thirteen states, predominantly in the south, southwest, and west, where most of the failed thrifts are located.[226]

This geographical redistribution study is somewhat flawed, however, and it is in these flaws that the analytical difficulties arise. Professor Hill traces the flow of bailout funds based upon the location of the failed thrifts themselves. He acknowledges, however, that many of the depositors who benefitted from the bailout of these thrifts may have been from other locations.[227] In addition, a given thrift's assets were not necessarily located in-state. Failed thrifts in the northeast, for example, may have received bailout funds related to assets in the south or southwest.[228] Another problem with Professor Hill's analysis is its focus on the flow of funds. Let us assume, for the moment, that a greater proportion of bailout money in the savings and loan crisis in fact went to thirteen states. To focus on the flow

225. *Id.* at 37.

226. *Id.* at 42. (Table 5 identifies thirteen states that are net beneficiaries of the bailout: Texas, New Mexico, Arkansas, Arizona, Alaska, Kansas, Louisiana, Nebraska, Minnesota, Colorado, Utah, Mississippi, and Missouri.) At least one recent bill was introduced in Congress to require those states receiving disproportionate benefits from the savings and loan bailout to pay a "State thrift deposit insurance premium." S. 995, 102d Cong., 1st Sess., 137 CONG. REC. S5167 (1991).

227. Hill, *supra* note 214, at 42 ("Many of the thrifts that are bankrupt depend heavily on brokered deposits. These are large denomination certificates of deposit that pay high rates and are purchased nationally. The depositors could be out-of-state insurance companies, investment firms, or wealthy personal depositors.").

228. *Id.*

of *funds* is too narrow. Rather, one must focus upon the flow of benefits more generally identified. The savings and loan bailout might be justified despite the geographic redistribution of funds if one can make a case that the nation as a whole benefits from making these particular regions stronger.

The discretion provided to banking regulators in addressing bank failures is another more subtle example of redistribution and thus of more subtle analytical problems. The Federal Deposit Insurance Corporation is obligated only to insure depositors up to the amount of $100,000. Nevertheless, the FDIC, Federal Reserve Board, and Office of Comptroller of the Currency have protected depositors beyond this insurance obligation and, in the cases of certain large banks, also protected bank investors along the way. In a recent controversial set of cases, federal regulators followed a too-big-to-fail policy in deciding to bail out some banks and not others.[229] When the Bank of New England failed in January, 1991, federal regulators "protected all depositors because it was the judgment of [the FDIC] board that financial conditions in the area required stabilization and one of the ways to stabilize them was to provide insurance for all depositors, not only depositors insured to $100,000."[230] The FDIC solicited bids from buyers and arranged to keep the bank in operation.[231] In contrast, when the Freedom National Bank of Harlem failed in November, 1990, the same regulators allowed the bank to close its doors and did not protect uninsured depositors. "In the case of Freedom Bank," FDIC Chairman Seidman testified, "we had no basis to make a finding that the conditions in New York where that bank was located were such that it required us to protect uninsured depositors in that *small* bank."[232]

Choices such as those made in the Bank of New England and Freedom National Bank episodes involve redistributions of wealth. Wealth is distributed to depositors and indirectly to others connected with large banks and away from depositors in smaller banks. Assessing the redistributional effects

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229. For a discussion of the too-big-to-fail policy, see, for example, Kaufman, *Implications of Large Bank Problems and Insolvencies for the Banking System and Economic Policy,* SM-85-3 (Federal Reserve Bank of Chicago, Series of Occasional Papers in Draft Form by Members of the Research Department). For a more thorough and recent discussion, see Wilmarth, *Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks,* 77 Iowa L. Rev. ___ (1992) (forthcoming).

230. *Failure of the Bank of New England: Hearings Before the House Comm. on Banking, Finance and Urban Affairs,* 102d Cong., 1st Sess. 7 (1991) [hereinafter *Bank of New England Hearings*] (testimony of William L. Seidman, Chairman, Federal Deposit Insurance Corporation).

231. The FDIC accepted a bid from the Fleet/Norstar Financial Group to purchase the Bank of New England. The purchaser received substantial funding assistance from Kohlberg, Kravis, Roberts & Co., a nonbanking investment company. *FDIC Selects Fleet/Norstar Financial Group as Winning Bidder for Bank of New England,* (PR Newswire, Apr. 22, 1991) (LEXIS, Nexis library, Wire file); *Fleet/Norstar, Aided by KKR, Wins Bidding Battle for Bank of New England,* Wall St. J., Apr. 23, 1991, at A3, col. 1.

232. *Bank of New England Hearings, supra* note 230, at 7.

of these decisions will require further exploration. First, information about those with deposits in excess of $100,000 will be necessary. One's initial instincts may not be sympathetic to wealth transfers among depositors who are so well-endowed that they have exceeded the $100,000 insurable amount. Upon closer examination, though, serious redistributive issues emerge. In the case of Freedom National Bank, for example, many of the large uninsured depositors were nonprofit organizations providing services to the community.[233] Uninsured depositors in smaller banks may also be small businesses with lower income employees. In short, decisions to bail out in some circumstances and not in others involve serious equitable and redistributive issues. In the banking context, these choices are made by the FDIC Board with little or no congressional oversight or other procedural safeguards.[234]

Although the data may be controversial in any given case, the point is that bailouts can involve geographical and wealth redistribution. Careful attention must be given to such effects and to designing studies that avoid the types of design flaws present in Professor Hill's research. To the extent possible, Congress should be aware of the redistributional consequences of its bailouts. In addition, agencies and regulators making significant bailout decisions should be subject to greater congressional oversight or procedural safeguards.[235]

d. *Procedural Approaches to Allocation and Redistribution*

Some public choice commentators argue that different procedural rules should apply to allocative, as opposed to redistributive, collective choices. Dennis Mueller, attributing the initial insight to economist Knut Wicksell,

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233. Goodstein, *Nonprofit Groups Sue FDIC over N.Y. Bank Insurance; Double Standard Cited at Freedom National*, Washington Post, Mar. 6, 1991, at C11. The Senate version of the recent Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991 contained a provision specifically declaring that deposits of charitable organizations with Freedom National Bank of New York should be considered insured deposits. 137 CONG. REC. S17985-86 (daily ed. Nov. 23, 1991). This provision does not appear in the bill ultimately enacted. *See supra* note 97.

234. For a brief discussion of the bailout discretion provided to banking regulators, see *supra* notes 115-27 and accompanying text. At least one recent article in connection with the Bank of New England failure pointed out the tremendous FDIC discretion in banking cases. Gerth, *Unguarded Guardians: A Special Report, F.D.I.C. Wields Power in Deals with Few Checks and Balances*, N.Y. Times, June 13, 1991, at A1, col. 4 ("This case and others illustrate how the FDIC has come to operate in a world with a range of discretionary powers and exemptions from Federal checks and balances that is extraordinary in the United States Government."). Recent changes to statutory provisions reduce to some extent the carte-blanche discretion previously available to the FDIC. *See supra* notes 126-27 and accompanying text. Even under the new provisions, there remains no congressional oversight of bank bailout decisions.

235. Some general proposals for reform along these lines will be developed further. *See infra* notes 311-23 and accompanying text.

suggests that redistributional collective choices should be made unanimously whereas allocative choices can appropriately be made through alternative voting procedures.[236] According to this view, redistributive action—including bailouts—should not be taken unless the *losers* unanimously agree to go along.[237] Given the high decision-making costs of achieving unanimity, something less than perfect unanimity is acceptable to such theorists as a practical expedient,[238] perhaps super majority rule. The theory behind super majority voting requirements is that some decisions are so fundamental that a majority vote should not suffice.

Even philosopher John Rawls, who can hardly be regarded as a public choice theorist, would support the Wicksellian unanimity rule under certain circumstances. In *A Theory of Justice,* Rawls indicates his support for a unanimity or near-unanimity rule under certain conditions. He suggests the possibility of an "exchange branch" of government that could decide to make expenditures for public goods above and beyond the necessary minimum.[239] Bailout might be thought of for these purposes as a public good.[240] The exchange branch, according to Rawls, would be a

> special representative body taking note of the various social interests and their preferences for public goods. It is authorized by the constitution to consider only such bills as provide for government activities independent from what justice requires, and these are to be enacted only when they satisfy Wicksell's unanimity criterion.[241]

Adopting super majority rule for redistributive decisions generally, and bailout decisions in particular, would be a dangerous road to travel. First

236. D.C. MUELLER, *supra* note 186, at 459-65. Knut Wicksell proposed in 1896 that tax matters should be decided by unanimous vote of affected taxpayers. Wicksell, *A New Principle of Just Taxation,* in CLASSICS IN THE THEORY OF PUBLIC FINANCE 72-118 (R.A. Musgrave & A. Peacock eds. 1967) (translating and reprinting substantial portions of K. WICKSELL, FINANZTHEORETISCHE UNTERSUCHUNGEN (1896)).

237. This reasoning seems to bring one full circle back into the public choice discussion of Arrow's impossibility theorem. *See supra* note 206. Given the irrationality of most social welfare functions, including majority rule, several public choice theorists suggest that unanimity or near-unanimity ideally should be the norm. *See, e.g.,* J. BUCHANAN & G. TULLOCK, *supra* note 204, at 96.

238. Buchanan and Tullock, for example, conclude that "[a]t best, majority rule should be viewed as one among many practical expedients made necessary by the costs of securing widespread agreement on political issues when individual and group interests diverge." J. BUCHANAN & G. TULLOCK, *supra* note 204, at 96.

239. Rawls' proposal for this "exchange branch" assumes four "background institutions" of government are necessary. First, an "allocation branch" is necessary to "keep the price system workably competitive and to prevent the formation of unreasonable market power." J. RAWLS, *supra* note 215, at 276-77. Second, a "stabilization branch" is required to "bring about reasonably full employment." *Id.* Third, a "transfer branch" assures a certain "social minimum" to each individual, and finally, a "distribution branch" to "preserve an approximate justice in distributive shares by means of taxation and the necessary adjustments in the rights of property." *Id.*

240. For further discussion of bailout as a public good, see *infra* notes 276-87 and accompanying text.

241. J. RAWLS, *supra* note 215, at 282.

of all, legislatures are called upon to make numerous important decisions, not the least of which is determination of the overall budget, military expenditures, and the like. Many of these decisions are likely to be redistributive. As a logistical matter, one would need to decide which legislative decisions are significant enough to require more than a simple majority vote,[242] but even for those, the decision-making costs of achieving super majority agreement would be prohibitive. Much more importantly, however, Rawls conditioned his support for such a rule on the assumption of "the justice of the existing distribution of income and wealth, and of the current definition of the rights of property."[243] The unanimity principle is sound, according to Rawls, *only* when the existing distribution of wealth is equitable or just. If we are all on a reasonably level playing field, "[t]here is no more justification for using the state apparatus to compel some citizens to pay for unwanted benefits that others desire than there is to force them to reimburse others for their private expenses."[244]

The real danger of moving to a super majority rule in the case of certain significant policy decisions is the likely preservation of the status quo. The greater the number of votes required to enact legislation, the more likely it is that no legislation will be passed at all. Such a requirement would limit opportunities for reform. Proposals for more than a simple majority vote may simply be a reflection of sour grapes on the part of the minority or simply a "convenient rationalization for every minority that, out of fear of possible deprivations of some majority, has demanded a political system providing it with an opportunity to veto such policies."[245] As Rawls points out, unless and until the existing distribution of income and wealth and the definition of property rights is "just," a unanimity rule is inappropriate.

Although adoption of a super majority rule for redistributive bailout choices would be unwise as a policy matter, the focus on bailouts as a form

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242. Interestingly, the Charter of the United Nations calls for just such a super majority vote in the case of "important questions." L. GOODRICH & E. HAMBRO, CHARTER OF THE UNITED NATIONS—COMMENTARY AND DOCUMENTS 188 (2d rev. ed. 1949) ("Decisions of the General Assembly on important questions shall be made by a two-thirds majority of the members present and voting."). In addition to specified categories of pre-ordained important questions, the United Nations Charter permits additional categories of important questions to be determined by majority vote. The United Nations Charter itself names several categories of important questions including "recommendations with respect to the maintenance of international peace and security, the election of non-permanent members of the Security Council[,] . . . the admission of new members to the United Nations, the suspension of the rights and privileges of membership, the expulsion of members[,] . . . and budgetary questions." *Id.* at 189. Paragraph 3 of article 18 provides that "[d]ecisions on other questions, including the determination of additional categories of questions to be decided by a two-thirds majority, shall be made by a majority of the members present and voting." *Id.* at 190.

243. J. RAWLS, *supra* note 215, at 283.

244. *Id.*

245. R. DAHL, *supra* note 191, at 30 (footnote omitted) (Dahl's description of Madisonian ideology).

of redistribution is useful. Congressional and administrative policymakers should be cognizant of the redistributive quality of bailouts and should be aware of the winners and losers involved. The decision-making process should involve careful consideration and deliberation, followed by majority vote.

III. Developing a Substantive and Procedural Bailout Policy

A. *Enacting "Public-Regarding" Bailout Legislation*

Several legal scholars distinguish between "public-regarding" or "public interest" and "private-regarding" or "interest group" legislation. Public bailout of a private enterprise might well be private-regarding to the extent that the benefits are bargained for by a small group of investors or employees and provide little or no residual benefit to the public at large. Put another way, a bailout simply may be a form of rent seeking by private enterprise. One primary aspiration of the civic virtue school that I share is increasing the prevalence of public-regarding legislation. Several proposals have been made toward this end in general. My purpose is to suggest ways that bailouts in particular can be made more public-regarding.

Some definition of terms will be necessary. Different scholars have used very different meanings for the terms public- and private-regarding. Professor Mashaw suggests that legislation that is public-regarding "can make a coherent and plausible claim to serve some public, rather than a merely private interest."[246] Private-regarding legislation, in contrast, "benefits some group in ways that cannot convincingly be explained in terms of a broad range of possible public purposes, or in terms of a well-functioning democratic process."[247]

Although Jonathan Macey explicitly borrows the term "public-regarding" from Mashaw,[248] his concept appears to be slightly different. According to Macey, legislation is public-regarding if it "serves some purpose other than obtaining for particular legislators the pecuniary advantage of the political support of some narrow interest group, even if this purpose is the transfer of wealth from one group to another."[249] Such a definition of public-regarding legislation appears more consistent with the pluralist view of clashing interests than with the public interest view. Particular rent-seeking interest groups may successfully lobby for and achieve wealth transfers in

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246. Mashaw, *supra* note 193, at 867.
247. *Id.* at 875.
248. Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model,* 86 Colum. L. Rev. 223, 228, 229 n.29 (1986).
249. *Id.* at 229 n.29.

their favor, and the result might still be considered public-regarding under this definition. As long as the legislator *himself or herself* does not receive pecuniary advantage, the legislation is public-regarding. Macey backs off this point a bit, arguing that the distinction between public-regarding and private-regarding should be considered as largely procedural. "If the statute in question is the result of a reified, deliberative congressional process in which conceptions of the public good were considered, then the statute is public-regarding. If, however, the statute simply represents legislative acquiescence to raw political power, it is not public regarding."[250] Using a process-oriented approach, he concedes that an ad hoc distribution of wealth to a well-organized interest group is unlikely to be public-regarding.[251] Judge Easterbrook uses similar terminology to quite different effect. He too distinguishes between interest group and public interest legislation.[252] In Easterbrook's view, however, public interest legislation is simply pie-enlarging or allocative as opposed to pie-slicing or redistributive legislation.[253]

Most of the legal literature distinguishing public and private interest legislation focuses on the proper scope of judicial review,[254] but this Article will focus instead on the legislative process itself.[255] Notions of what is public-regarding for judicial review purposes will need to be retooled to fit the needs of policymakers interested in the common good as they consider proposed legislation. The policy maker seeking to enact public-regarding

250. *Id.*

251. *Id.*

252. Easterbrook, *Statutes' Domain,* 50 U. CHI. L. REV. 533, 541 (1983). He discusses the distinction further in Easterbrook, *The Supreme Court 1983 Term. Forward: The Court and the Economic System,* 98 HARV. L. REV. 4, 18 (1984) [hereinafter Easterbrook, *Supreme Court Forward*].

253. Easterbrook, *Statutes' Domain, supra* note 252, at 541. Even self-interested pluralists might agree on pie-enlarging legislation from which everyone comes out a winner and the only issue will be dividing the spoils. One suspects, however, that very little legislation would be regarded as pie-enlarging as Easterbrook views it. The Easterbrook view of what is public-regarding is reminiscent of the notion of Pareto efficiency. For a further discussion of Pareto efficiency and allocation as distinguished from redistribution, see *supra* notes 213-23 and accompanying text.

254. Mashaw, for example, concludes that the "citizen has a constitutional right to demand that public law be public-regarding." Mashaw, *supra* note 193, at 876. He argues that courts reviewing cases on constitutional grounds should question whether legislation was enacted for a "coherent and plausible" public purpose. *Id.* at 870-71. Easterbrook, on the other hand, argues that courts should simply distinguish between public and private interest legislation and use different styles of review for each category. With regard to the latter, Easterbrook concludes that "[i]f statutes are bargains among special interests, they should be enforced like contracts." Easterbrook, *Supreme Court Forward, supra* note 252, at 18. With regard to public-regarding statutes, Judge Easterbrook suggests that application of the maxim "remedial statutes are to be liberally construed" is more appropriate. *Id.* at 14-15.

255. To be sure, the proper scope of judicial review is relevant here. Knowledge that legislation will later be subject to strengthened review may result in more public-regarding legislation. Cass Sunstein explicitly makes this point. *See supra* notes 192-93 and accompanying text. Mashaw makes the same point more implicitly. *See* Mashaw, *supra* note 193.

bailout legislation surely should be concerned about the process by which bailout decisions are made. Several process-oriented reforms are suggested in the sections that follow,[256] but one yearns for a more normative standard by which to measure legislation. Easterbrook's meaning of public-regarding legislation for purposes of judicial review is extremely narrow, effectively encompassing only allocative distributions. Mashaw's suggested requirement also offers insufficient guidance to the policy maker finding her way. The concept of public-regarding should have greater aspirational content in the ex ante stages of the process. From the policy maker's point of view, bailout decisions should not simply have a coherent and plausible claim but *in fact* should serve a public, rather than merely a private, interest.

The sections that follow develop substantive and procedural proposals that may increase the prospects of public-regarding bailout decisions. My development of these proposals draws on concepts from public interest, pluralist, and distributive justice schools of thought discussed previously. Identifying the public interest served by bailout or any other legislation will not be easy. In developing the proposals that follow, I was mindful of two important realities. First, even legislators who in good faith have only the public interest at heart will have honest differences of opinion as to which policies best serve that interest. Second, the pluralist view of legislation as evolving from the clash of interest groups is an accurate description of the political world in which we live. The challenge is to channel this pluralist reality into more public-regarding legislation that takes into account the larger community that has been silent or left out of the policy debate.

B. *Developing a Substantive Standard*

1. Preconditions to Bailout

Earlier sections of this Article developed the argument that we should begin as a policy matter with a presumption against bailout.[257] Bailouts are extraordinary events and should not be lightly undertaken. Four basic preconditions should be met as a first step toward overcoming the presumption.

First, any firm seeking bailout relief should be required to attempt an informal workout or a chapter 11 reorganization in bankruptcy or at least establish that such an effort would not be viable.[258] In other words, "private

256. *See infra* notes 289-323 and accompanying text.
257. *See supra* notes 175-90 and accompanying text.
258. *See supra* notes 162-74 and accompanying text. Banks may not be debtors in bankruptcy, 11 U.S.C. § 109(b)(2), and thus may not reorganize under chapter 11. Consequently, this precondition could not be applied in the bank setting. Nonetheless, some evidence of an attempt at private bailout should be required.

bailout" should be attempted before resorting to "public bailout." From a public policy perspective, one advantage of the reorganization in bankruptcy is that it distributes bailout costs among those more intimately connected with the enterprise and those who have the most to gain from the success of the enterprise. Such an approach appears most equitable in the interest of distributive justice. It should also satisfy pluralists in that the parties most interested in the transaction will privately negotiate a solution in their own economic interest. A similar precondition is required by the Justice Department Merger Guidelines for the "failing company" defense to antitrust violations.[259] Formal extension of this bankruptcy precondition to general bailout policy thus would not represent a dramatic departure in public policy.

Second, except in extreme circumstances, an enterprise seeking bailout assistance should be required to establish that the threat of collapse is due to circumstances beyond its control. Sometimes, the cause of failure will be economic or other extreme conditions outside the control of the enterprise seeking assistance. At other times, however, threatened failure may be due to fraud, mismanagement, or other internal reasons. Freely provided bailout under the latter circumstances may increase the moral hazard problem. Permitting firms responsible for their own demise to obtain bailout relief just as easily as those whose demise is outside of their control might encourage more careless and risky behavior. It should be clear as a matter of public policy that, except in extraordinary circumstances, bailout relief requests will be considered only from those whose threatened failure results from circumstances they could not have controlled. This second requirement might be referred to as the "no-fault" precondition.

The no-fault requirement is merely a precondition, not an argument in favor of bailout. Chrysler, for example, argued that a significant part of its financial trouble could be attributed to costs imposed by environmental and safety regulations imposed on the automobile manufacturing industry—circumstances beyond its control. As the smallest of the "Big Three" automobile manufacturers, Chrysler argued that it was most vulnerable to financial distress resulting from compliance with burdensome regulations. Even if all of Chrysler's problems could have been attributed to the burdens of environmental regulation, it is not clear that bailout relief should have been provided. Such regulation is promulgated to protect consumers and the environment. Firms that are unable to meet such burdens perhaps should collapse. Nevertheless, establishing that the threatened collapse is due to outside factors should be an important precondition to serious consideration of bailout relief.[260]

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259. *See supra* notes 37-42 and accompanying text.

260. In some cases, threatened collapse may be due to negligent actions of government

As a third precondition, the firm seeking relief should establish that private insurance was unavailable to distribute costs among those in the industry. Although others in the same industry are not as intimately connected with the enterprise as parties to a chapter 11 bankruptcy proceeding, they have a strong interest in survival of the industry.[261] Before broadly distributing bailout costs to the general public, efforts should be made to concentrate costs within a more appropriate group of beneficiaries.

Finally, before bailout relief can be considered, it should be reasonably clear that the enterprise in fact would collapse without the relief. Although the threatened collapse ordinarily should be clear and imminent, the fourth precondition does not *require* that the threatened collapse be imminent.[262] As a practical matter, this precondition has the benefit of sparing unnecessary expenditure of government resources. Moreover, it is necessitated by the operating definition of bailout itself—that bailout is a form of government assistance or intervention designed to prevent enterprise failure. Government assistance in the absence of reasonable evidence that the firm would fail without relief is not a bailout but a different form of government subsidy.

Each of the four preconditions to bailout should apply except under extraordinary circumstances. In extreme cases, the preconditions might be relaxed to some extent. When the potential "community catastrophe" from financial collapse is extreme, earlier bailout intervention may be necessary. When Congress provided special merger relief for failing banks, for example, the Supreme Court observed that

> Congress was also concerned about banks in danger of collapse—banks not so deeply in trouble as to call forth the traditional "failing company" defense, but nonetheless in danger of becoming before long financially unsound institutions. Congress seems to have felt that a bank failure is a much greater community catastrophe than the failure of an industrial or retail enterprise, and that a much smaller risk of failure than that required by the failing company doctrine should be sufficient to justify

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regulators in exercising their regulatory authority. Evidence of regulatory negligence may provide a greater government obligation to bailout. As noted earlier, individual damage claims will be limited under principles of sovereign immunity. *See supra* notes 141-45 and accompanying text. For example, evidence suggests that negligent actions of bank regulators contributed significantly to the savings and loan crisis. A substantial government regulatory presence gives rise to a greater public expectation of protection. If the government is negligent in its exercise of regulatory authority, it will be more difficult for Congress to refuse to intervene with some form of public assistance.

261. Thus, for example, the bank industry in the pre-Depression years protected itself through private clearing houses and co-insurance. For a description of early bank insurance, see Calomiris, *supra* note 149. More recently, the insurance industry got together privately to provide assistance to customers of the Executive Life Insurance Company of California. *See supra* note 9.

262. Of course, evidence that the firm would collapse absent relief will be more persuasive as bankruptcy is closer at hand.

the rather radical preventive step of an anticompetitive merger.[263]

Early intervention of this type may well preclude requirement of the fourth condition that collapse of the enterprise absent intervention be reasonably clear.

Similarly, the no-fault precondition may be relaxed under extreme circumstances. Ordinarily, an enterprise seeking bailout assistance should establish that the threatened failure is due to circumstances beyond its control. Nonetheless, there may be cases where, despite the fault of the enterprise, the public interest is so great as to require bailout in any event. Certain bank bailouts arguably fall into this category.[264] These should be rare and extraordinary cases.

2. Substantive Policy Assessment

a. Assessing the Impact of a Failure to Intervene

Even after the preconditions are met, the presumption against bailout should continue. A strong public interest should be established to overcome this presumption. Too often, however, the public interest is described in vague, ambiguous, and flowery terms. No doubt, this is what has led some pluralists to claim that there is no such thing as the "public interest."[265] Despite these protestations, the "public interest" may be just slightly more identifiable in the bailout setting.

One mechanism for deciding when to intervene is to consider the cost to the government of nonintervention. Failure of an enterprise or industry will result in lost tax revenues, as well as increased government costs for unemployment coverage, welfare, and other programs. In his report on guidelines for rescuing large failing firms, the Comptroller General suggested that "Congress should compare the costs, benefits, and consequences expected to occur if assistance is offered with expectations of what would occur if market forces and established legal procedures are allowed to operate."[266] Where the government cost of a decision not to intervene exceeds the cost of government assistance that would be necessary to rescue the troubled enterprise, bailout would appear the financially prudent[267] and—at least in the short-run—the wise thing to do.

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263. United States v. Third Nat'l Bank, 390 U.S. 171, 187 (1968) (footnote omitted). For further discussion of the special defenses to antitrust laws as a form of bailout, see *supra* notes 78-82 and accompanying text.

264. For further discussion, see *infra* notes 271-72 and accompanying text.

265. *See supra* notes 203-07 and accompanying text.

266. COMPTROLLER GENERAL REPORT, *supra* note 11, at 25.

267. In fact, FDIC discretion to provide certain types of assistance to depository institutions is limited by statute to the amount reasonably necessary to save the cost of liquidating a failing bank. *See supra* notes 120-21 and accompanying text.

On the other hand, Congress also must consider the long-run implications. Even if the anticipated costs of nonintervention are higher than anticipated bailout costs, concern for equity or legislative integrity may caution against the bailout. Assume, for example, that one of several major competing industries in a large metropolitan area was threatened with collapse without government assistance. Absent special circumstances, providing ad hoc assistance to one of the competing firms would interfere with operation of the competitive market and be inequitable to the firms that managed to struggle against similar economic odds more efficiently and successfully.[268] Special circumstances that might support a more sympathetic hearing are those where the threatened failure was caused by circumstances, such as a disaster, beyond the enterprise's control. Even here, however, regular disaster relief programs available to all eligible applicants would be preferable.

Another similar measure of the public interest is the economic impact that would result from allowing the enterprise to fail. Economists can assist in designing tests to measure the impact or ripple effects of market failures. One model that might be useful in this regard is the interindustry or input-output analysis developed by economist Wassily Leontief.[269] The input-output technique involves identifying economic sectors and placing them in a matrix. Read horizontally, the numbers in the matrix show the outputs shipped from one sector to other sectors. Read vertically, the matrix shows inputs received by one sector from other sectors.[270]

Interindustry analysis performs two useful functions. First, it describes the interrelationship between sectors of the economy. Input-output analysis explores the impact of an enterprise failure within one industry, on other industries, and on the overall economy. Within the same industry, failure of one firm may impose ripple effects on other firms. Banking regulators have long been concerned that, given interrelationships among some members of the banking community, the collapse of a large bank would cause ripple effects among many other banks and lead to a banking crisis.[271] Thus, the FDIC adopted a too-big-to-fail policy.[272]

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268. The "moral hazard" problem thus is implicated, even when nonintervention costs are higher than bailout costs.

269. W. LEONTIEF, INPUT-OUTPUT ECONOMICS (2d ed. 1986). Leontief won the Nobel Prize for his work on input-output analysis. For his 1973 Nobel Lecture, see *id.* at 321-37.

270. This process and an illustrative matrix appear *id.* at 5-9. Such analysis already is being used extensively in government studies. *See, e.g.*, BUREAU OF ECON. ANALYSIS, U.S. DEP'T OF COMMERCE, THE INPUT-OUTPUT STRUCTURE OF THE U.S. ECONOMY: 1967 (1974).

271. Interindustry analysis would then show that collapse of the banking industry would have rather dramatic effects upon other industries and the economy generally.

272. The FDIC's authority to determine that a bank is too big to fail is thought to be derived from its power to declare that a depository institution is "essential to provide adequate depository services in its community." 12 U.S.C. § 1823(c)(4)(A). Congress recently revised this standard but continues to provide authority for emergency bank assistance. The too-big-to-fail policy has come under attack in recent years. *See, e.g.*, Lovett, *supra* note 157, at

Second, and more important in the bailout context, input-output analysis "is an analytical tool for measuring the impact of autonomous disturbances on an economy's output and income."[273] Once one develops an appropriate matrix, the ripple effects resulting from a firm or industry failure can probably be examined by deleting that firm or industry's input-output figures and rerunning the matrix.[274]

This discussion of input-output theory does not suggest that interindustry analysis is the only appropriate measure. One concern with major financial failures, from the public interest perspective, is the extent to which poverty levels would increase if government intervention is rejected. Input-output analysis may not be the best measure of such poverty levels. Nevertheless, it should be possible to develop some objective measures to determine the impact of a failure to provide government assistance.[275]

b. Public Goods Analysis

Economists often use the concept of "public goods" to distinguish those goods that should be publically, as opposed to privately, provided. The economic notion of public good may be useful in distinguishing those cases

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1367; Note, Garrett, *The Modified Payoff of Failed Banks: A Settlement Practice to Inject Market Discipline into the Commercial Banking System,* 73 VA. L. REV. 1349, 1375-78 (1987). For a more supportive view of the too-big-to-fail policy, see Wilmarth, *supra* note 229.

273. H. RICHARDSON, INPUT-OUTPUT AND REGIONAL ECONOMICS 14 (1972).

274. As described by Leontief himself, sophisticated use of interindustry analysis

> has had to await the modern high-speed computing machine as well as the present propensity of government and private agencies to accumulate mountains of data. It is now advancing from the phase of academic investigation and experimental trial to a broadening application in grand-scale problems of national economic policy.

W. LEONTIEF, *supra* note 269, at 4. Application of input-output analysis, or any other comparable economic models, will require collection of extensive data. The Department of Commerce and other agencies have collected and are collecting such data and have developed input-output tables. This data may need to be reworked to be most useful in the bailout setting. Nevertheless, most of the difficult collection work may already have been done.

275. Another public interest argument for overcoming the presumption against bailout might be protection of consumers. Elimination of a price-cutting firm from the marketplace may increase consumer prices dramatically. In draft, one article argues that

> [p]rice cutting is a risky business and it may be socially desirable to provide some insurance for this strategy from which consumers are bound to benefit. . . . While we do not argue that the government should frequently bail out failing firms, competitive bailouts deserve reassessment. In the end, one might conclude that it is administratively too difficult for government actors to identify the worthy recipients of an "efficiency" bailout. But the fact that down stream consumers are often willing to buy or subsidize failing upstream suppliers is at least sufficient evidence to shift the burden to those who would dismiss such interventions out of hand.

Ayres & Braithwaite, *supra* note 135.

in which bailout will serve the public interest.[276] If a bailout can be classified as a public good, a stronger case for overcoming the presumption against bailout is possible.

Two important characteristics generally are common to the economic notion of a public good. The first is nonexclusivity. Professor Mancur Olson describes a public good as any good that cannot feasibly be withheld from others in the group if one person consumes it;[277] if one person can consume the good, all are able to consume it and none can be excluded. The lighthouse is a common illustration of this nonexclusivity phenomenon in the economic literature. If a lighthouse is built in a harbor, it would be nearly impossible to exclude some boats from using it.[278]

The exclusivity element does not require that there be *no* method of exclusion but simply that exclusion not be feasible. As two other economists pointed out, "price-exclusion is seldom, if ever, literally impossible. Except in extreme cases, such as that of national defen[s]e, the problem in practice is to decide when exclusion is economic."[279] Since individuals cannot feasibly be excluded from using a public good, providing such goods in the private marketplace becomes inefficient. A price mechanism for selling such a good privately simply will not work because individual consumers will be tempted to free-ride upon the contributions of others. As one economist put it, "Those who enjoy the public good without paying for it never signal their desire for it. Consequently, not enough of the public good is provided. This is why public goods ought to be, in some way, publicly financed."[280]

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276. The notion of a public good is attributed to two short, but seminal, articles published by Professor Paul Samuelson in 1954 and 1955. Samuelson, *The Pure Theory of Public Expenditure,* 36 REV. ECON. & STATISTICS 387 (1954) [hereinafter Samuelson, *Pure Theory*]; Samuelson, *Diagrammatic Exposition of a Theory of Public Expenditure,* 37 REV. ECON. & STATISTICS 350 (1955). Professor Samuelson further developed the idea in *Aspects of Public Expenditure Theories,* 40 REV. ECON. & STATISTICS 332 (1958).

277. M. OLSON, *supra* note 188, at 14.

278. *See* R.H. COASE, *supra* note 26, at 187-213.

279. Head & Shoup, *Public Goods, Private Goods, and Ambiguous Goods,* 79 ECON. J. 567 (1969) (footnote omitted). Head and Shoup pose the question, "If a lighthouse beam can be scrambled so that only ships that purchase an unscrambler can receive the beam, how shall the service rendered by the lighthouse be classified?" *Id.* at 567.

280. A. FELDMAN, WELFARE ECONOMICS AND SOCIAL CHOICE THEORY 114 (1980). As Samuelson succinctly put it in his first article, "no decentralized pricing system can serve to determine optimally . . . levels of collective consumption. Other kinds of 'voting' or 'signalling' would have to be tried." Samuelson, *Pure Theory, supra* note 276, at 388. Professor Buchanan adds that the term public good,

> in its current technical and professionally used sense, tends to be reserved for those goods and services that are financed and provided through the governmental-political process, through the so-called public sector. . . . The subdiscipline of economic theory that is now sometimes called the modern theory of public goods is largely devoted to an analysis of why governmental provision of these goods and services may be required, and of how such provision should and does take

The second major characteristic of a public good is jointness of supply. A good whose production costs are fixed is considered to be jointly supplied. The lighthouse illustrates this characteristic as well. The cost of a lighthouse is fixed regardless of the number of consumers. Similarly, the cost of a national defense system is largely fixed independently of the number of consumers.

When the bailout of a firm or industry is considered a "public good," the free-rider problem will prevent the private sector from creating a workable price mechanism through which the good might be purchased. Therefore, if the good is to be provided at all, it will have to be provided publicly.[281] Bailouts, like most goods, cannot be classified as purely public or purely private. In fact, it is more useful to view all goods on a continuum with pure public goods at one extreme and pure private goods at the other. The closer on the continuum that a good comes to the public extreme, the larger the size of optimal group membership. At some point, the group becomes sufficiently large that the good should be provided through the governmental process.

A developing literature known as the "economic theory of clubs" attempts to fill in the missing points on this continuum by covering "the whole spectrum of ownership-consumption possibilities, ranging from the purely private or individualized activity on the one hand to purely public or collectivized activity on the other."[282] The closer a good comes to the private extreme, the smaller the size of the group. If it is possible to identify private interested parties who would suffer sufficiently from the failure that they would be willing to privately provide a bailout, the good should be privately purchased.

Bailouts falling close to the pure public extreme on the continuum should be provided, if at all, through the governmental process as general revenue bailouts. Even if one accepts the possibility of altruistic behavior,[283] it is

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place.

Buchanan, *Public Goods and Public Bads*, in FINANCING THE METROPOLIS: PUBLIC POLICY IN URBAN ECONOMICS 51, 53 (I. Crecine ed. 1970). Buchanan also points out in this article that public goods and public bads are reciprocal notions. The presence of pollution can be viewed as a public bad whereas the elimination of pollution might be regarded as a public good. *Id.*

281. In contrast to public interest conceptions, however, the moral component is missing from public goods analysis. The public good theorist does not ask whether government provision of the public good is morally correct or satisfies some notion of the common good. The semantic overlap here is unfortunate. "Public good" from the economists' viewpoint is quite different from something *for* the public good from the public interest perspective. Despite jointness of supply and nonexclusivity, a public good may not be important enough to be provided at all. In other words, it may not serve the public interest. To avoid this semantic overlap, all references to public good are to the economists' conception described in this section.

282. Buchanan, *An Economic Theory of Clubs*, 32 ECONOMICA 1, 1 (1965).

283. *See supra* notes 208-12 and accompanying text.

asking too much of altruism to suggest that uninterested parties will voluntarily agree to a private bailout. Most requests for public bailout arise because the good cannot be provided privately. Even if the bailout benefits a broad community, fear of free-riders prevents private groups from contributing. As one moves away from the pure public good end of the spectrum, bailouts in the middle ranges should be special fund bailouts and those at the lower end should have no government intervention at all.

What is the good provided through bailout legislation? The public good can be seen as preventing the public bad of economic collapse of a particular industry, firm, or municipality. Under the Samuelson approach to public goods, whether this good should be provided by government, depends upon the level of exclusivity and jointness of supply of the good. Saving a firm or industry involves fixed costs regardless of the number of people that benefit directly or indirectly. There may be uncertainty at the outset as to the final cost, but it will not fluctuate based on the number of consumers.[284] Thus, the jointness of supply element will be satisfied.

The degree of exclusivity involved in any particular bailout depends, in part, on the scope of the bailout. One is tempted to argue that bailout of an entire industry is likely to have a higher degree of nonexclusivity and is thus more likely to be a public good than bailout of an individual firm. But even in the case of failure or threatened failure of an entire industry, the degree of nonexclusivity may be so low that government intervention will not be considered. For example, if the kite-manufacturing industry were to disappear altogether, few would consider government intervention to assist the industry appropriate. On the other hand, if the entire airline industry were threatened with economic collapse, government intervention would be considered quite seriously. This is because the good of preventing collapse of the kite-manufacturing industry is not substantially a public good. Although the community might suffer the loss of pleasure from flying a kite or watching others do so, widespread suffering from collapse of the economy is unlikely to result from failure of this industry. Nor is it an industry that is fundamental to our economic or social fabric. The airline industry, on the other hand, plays a much more significant role in the economy, and the ability to travel quickly from place to place is an important component of our social and cultural fabric. The good provided through protection of the industry would be widely available to all, and few could be excluded. Even those who did not use the airlines benefit from the availability of the service to others.

Failures in other industries will present much closer questions. The textile and electronics industries are examples. If market failure arises largely from

284. For example, estimating the ultimate cost of the savings and loan bailout has been quite difficult. The difficulties stem largely from anticipating inflation, market conditions, and the like and not from variability of costs based on the number of beneficiaries. *See Hearings supra* note 2, at 10 (statement of Charles Bowsher, U.S. Comptroller General).

foreign competition, is bailout a public good? What should the response be to a failure of the private university system? It will be a useful exercise to develop a list and rank of those industries the strength of which is an indivisible public good. To determine whether the collapse of a particular industry would be a public bad calling for the corrective public good bailout, one must examine the degree of exclusivity. How integral is the industry to the overall economy? How many customers, employees, and other participants does the industry affect, directly or indirectly? Input-output analysis might also be useful in developing this list.[285]

Once those industries most critical to the overall economy and thus more likely candidates for bailout in the event of a business failure are identified, one must be mindful of the impact of such an assessment on industry behavior. Here again, moral hazard issues arise. Industries on the list may feel free to engage in more reckless behavior. Given this danger, the number of industries on the list should be very short. Second, industries in this category should be more heavily regulated and monitored. Some might argue that, much like the presumption against bailouts, this approach already exists informally. Many regard the banking industry as one that society cannot allow to collapse. It is among the more heavily regulated industries, yet the regulation was not rigorous enough to prevent the savings and loan crisis. An earlier bailout of sorts was provided through federal deposit insurance funded with premiums that were not based on risk. In a sense, the so-called current savings and loan bailout is simply the outcome of failed efforts to protect banks and customers through a combination of insurance and regulation. Savings and loan owners and managers arguably engaged in risky or reckless behavior knowing that deposit insurance protected most customers in any event.

The industry-wide effort involved in the savings and loan story is rather unique. Few industries are as central to the economy as the banking industry.[286] More generally, the issues involved in industry-wide failures differ from those involved in firm-specific failures. For one thing, the causes of industry-wide failure may be different from those resulting in specific firm failures. For example, much of the steam engine business failed years ago, presumably because new technology made the steam engine obsolete. It would be foolish for Congress to force attempts at reorganization or to rescue such an industry. On the other hand, assistance to assure an orderly retooling of industrial assets and employees may be appropriate.[287]

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285. *See supra* notes 269-71 and accompanying text.

286. However, thrift institutions make up only a small part of the banking industry. In addition, many customers are using other financial institutions to meet needs that were traditionally met only by banks.

287. The Japanese arguably have done a better job of shifting and retooling workers to gain a competitive edge as new technologies make old technologies obsolete. For a general

Where the threatened collapse results from causes other than obsolescence, industry-wide failure raises public bailout policy issues that differ largely as a matter of degree. Even in the case of industry-wide failure, the rebuttable presumption against bailout should remain. For certain industries, rebutting the presumption may be simpler than for others, however. Some industries simply are more important to overall economic health and stability than others.

c. Noneconomic Considerations

One should recognize the limits of public goods and other forms of economic analysis as public policy tools. A conclusion that a bailout meets the public good requirements of nonexclusivity and jointness of supply does not necessarily require that the good be provided publicly. To illustrate, suppose that a local community wished to build a monument. The monument has fixed costs regardless of the number of people who enjoy it, and it is not feasible to exclude individuals from this pleasure. Individuals may not voluntarily agree to fund the monument, however, for fear of free-riders. The monument will only be built if it is provided publicly, using tax revenues. The monument is a public good. This does not mean that the good should necessarily be provided. The local governing body will need to examine legislative priorities and determine whether or not, given those priorities, it can afford to provide the good. It is entirely possible that the good will not be provided at all. The same will be true in the public bailout context.

Even if the impact of collapse of an enterprise would be extreme and bailout relief appears appropriate on economic grounds, equitable considerations must be taken into account. For example, the too-big-to-fail policy in connection with bank bailouts protects investors and uninsured depositors in large banks but does not provide similar protection to investors in smaller banks and to depositors who happen to have accounts in smaller banks. Assuming that the bailout is necessary, should the government, in the interest of equity, go further and provide similar relief to small bank investors and uninsured depositors as well?

Other cases may involve lower levels of potential economic harm that would ordinarily not be sufficient to overcome the presumption against bailout. Nonetheless, there may be other compelling policy considerations. For example, the Newspaper Preservation Act provides bailout relief of a sort to failing newspapers.[288] Here the overriding policy concern was for an

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discussion of these issues, see M.E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS (1990). *See also* Reich, *Bailout: A Comparative Study in Law and Industrial Structure,* 2 YALE J. ON REG. 163 (1985).

288. For a discussion of the Newspaper Preservation Act as a form of bailout, see *supra* notes 82-83 and accompanying text.

independent free press that would strengthen and support the first amendment free speech rights so fundamental to our constitutional framework. As another illustration, even though failure of a particular enterprise would have a reasonably small economic impact, it might be appropriate to provide relief in the interest of community diversity. Thus, assistance to the sole minority-owned business in a community may be considered to be in the "public interest."

A word of caution is important here, however. If other policy considerations are the primary driving force behind a direct or indirect bailout, one should critically examine whether or not other alternatives might be a more appropriate way to effectuate the policy. If first amendment concerns are indeed paramount, careful consideration of alternatives to promote such freedoms should be undertaken *before* resorting to bailout.

The point here is that economic principles can provide only a threshold level of analysis in connection with bailouts. One cannot escape the ontological question: What is in the public interest? Although some substantive standards for reviewing requests for bailout relief can be identified, the policy choices remain difficult, and there is no obvious bright-line substantive test by which to measure the wisdom of any given bailout.

C. *Developing Procedural Standards*

Given the lack of a substantive bright-line test for deciding when bailout serves the public interest, the procedures used to make that decision become all the more important. While process-oriented reforms to improve the extent and quality of deliberation prior to enactment of legislation may be a good idea generally, the call for bailout often arises when time for deliberation is short. This setting, as well as the fact that bailout decisions require a reasonably unique form of economic analysis, implicate the need for special bailout procedures. The suggestions that follow are designed to increase the deliberativeness of the decision-making process while at the same time recognizing the need for speedy action in many bailout scenarios. They are also designed to increase the number of participants in the process so that the voice, or at least the interest, of more diffuse groups can be heard along with the voices of well-organized interests.

1. Need for a Central Monitoring Agency

Detailed economic information is critical in making any decision regarding bailouts. To wait to gather this information until a firm or industry is on the brink of collapse is unwise, however. In the bailout setting, firms or industries in *potential* distress should be monitored. On the eve of its bankruptcy, the Drexel Burnham Lambert Group withdrew substantial amounts of cash from its broker-dealer and government securities subsidiaries without notifying the Securities and Exchange Commission (SEC) or the New York Stock Exchange (NYSE). The SEC, working with other federal government regulators, was able to stave off disaster in the securities markets by "facilitat[ing] an orderly liquidation of the broker-dealer's positions and a speedy transfer of customer accounts to other financial institutions."[289] At the same time, SEC Chairman Breeden argued that "[t]he events surrounding the Drexel insolvency underscore the need for the SEC to have regular and unquestioned access to information regarding the financial position of a broker-dealer's holding company and its other affiliates."[290] In his testimony, Chairman Breeden urged passage of the Market Reform Act to provide for SEC access to such data.[291]

Financial problems needing government attention are not limited to those industries subject to securities regulation; early monitoring should be more generally available. Such monitoring could be done through a nonprogrammatic agency with authority to monitor the financial situation of industries in trouble and to make recommendations to Congress or the appropriate regulatory agency at a stage prior to crisis. Such an agency might be called upon to provide revenue estimates and other economic information. Unlike most agencies that are established to administer already existing legislation, such an agency would not have enforcement authority.

Perhaps one lesson of the savings and loan crisis is that it may be difficult for an agency responsible for industry regulation to admit its defeat at an early enough stage to take proper corrective action. Insolvent banks were permitted to operate long after evidence of their insolvency was apparent. Some have argued that moral hazards caused banking regulators to pursue this policy of forbearance rather than close insolvent banks.[292] Closing a significant number of banks would have severely strained the deposit insurance system. "When confronted with a correlated wave of insolvencies and the prospect of putting numerous institutions out of business, it often seems to be expedient to forego immediate action and hope that things may get better."[293] Regulators knew that if the bank failures became extreme enough Congress would provide a bailout. Some of this problem might be eliminated if the financial monitoring function was performed by a nonprogrammatic agency. Moreover, a nonprogrammatic agency would be less susceptible to "capture" by a regulated industry.

The possibility of more widespread financial monitoring raises a number of issues. First, the prospect may conjure up images of "big brother" and

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289. *The Issues Surrounding the Collapse of Drexel Burnham Lambert: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs,* 101st Cong., 2d Sess. 8 (1990) (statement of Richard C. Breeden, Chairman, Securities and Exchange Commission).

290. *Id.* at 9.

291. S. 207, H.R. 707, 102d Cong., 1st Sess. (1991).

292. *See, e.g.,* Scott, *supra* note 138, at 1900.

293. *Id.*

raise significant privacy issues. Individual firms in trouble may be willing to consent to such monitoring, given the prospect of later assistance should the situation reach crisis proportions, but entire industries may not be able to reach such a consensus. Protections and safeguards would be necessary to allay fears regarding leaks and misuse of information. For example, a firm might be entitled to opt out of the monitoring program but at a cost of being estopped from requesting assistance at a later date.

Second, it would be impractical to monitor all firms and industries. Some initial assessments will be necessary to determine those industries that should be subject to monitoring. Heavily regulated industries, such as banks, are already monitored, and the information learned as a result should be shared with the agency established to consider bailouts. In addition to the heavily regulated industries, other major industries with significant economic impact might be designated for automatic monitoring. Input-output analysis would assist in identifying likely candidates.[294] Finally, some industries would be monitored only after some triggering event suggesting economic problems in the industry.

In addition to collecting information and monitoring financial conditions in various industries, a separate division of the agency that I envision would be asked to provide sophisticated economic cost-benefit assessment and analysis of redistributive implications of proposed bailouts. In other words, the agency would assess not only the net benefits in a Kaldor-Hicks sense, but would also review the distribution of the costs and benefits to identify winners and losers.[295]

One existing prototype for this type of analysis is the Regulatory Impact Analysis (RIA) required for every major rule proposed by executive agencies.[296] In an effort to maximize aggregate net benefits of regulatory action,[297] executive agencies must submit this analysis to the Director of the Office of Management and Budget (OMB), who can require the agency to refrain from publishing the analysis or proposed regulations until the agency

294. See *supra* notes 284-85 and accompanying text for discussion on identifying those industries that are likely candidates for bailout in the event of extreme financial failure.

295. For an earlier discussion of redistributive theory, see *supra* notes 209-32 and accompanying text.

296. The RIA requirement was established by President Reagan in Exec. Order No. 12,291, 3 C.F.R. 127 (1982). A rule is considered major if it will result in

> (1) [a]n annual effect on the economy of $100 million or more; (2) [a] major increase in costs or prices for consumers, individual industries, Federal, State or local government agencies, or geographic regions; or (3) [s]ignificant adverse effects on competition, employment, investment productivity, innovation, or on the ability of United States based enterprises to compete with foreign-based enterprises in domestic or export markets.

Id. § 1(b). One of the earliest models of this type of regulatory cost-benefit analysis is the Environmental Impact Statement requirement enacted by the National Environmental Policy Act of 1970, 42 U.S.C. §§ 4321-43709(a) (1971).

297. Exec. Order No. 12,291, *supra* note 296, at § 2(b)-(e).

responds to and incorporates the Director's views in the rulemaking file.[298] A regulatory action that is Kaldor-Hicks efficient generally will pass muster under RIA review, but analysis of distributional effects is not technically required.[299] In providing guidance to executive agencies preparing regulatory impact analyses, OMB did address the issue of distributional effects, stating:

> There is no generally accepted way to monetize (and thus incorporate directly into the benefit-cost analysis) potential distributional effects. However, policymakers may wish to take these effects into account. Therefore, in situations where there are potentially important differences between those who stand to gain and those who stand to lose under alternative regulatory options, the RIA should identify these groups and indicate the nature of the different effects.[300]

Although my view is that greater emphasis should be placed on distributional effects, the regulatory impact analysis required of executive agencies by Executive Order 12,291 is a sophisticated approach to public policy that should be extended to independent agency actions and to legislative proposals. While recommending that such analysis should be applied to legislative bailout proposals, I am mindful of the limitations of cost-benefit analysis.

First, the obligation to perform such analysis can be burdensome and those responsible may do a perfunctory job. Second, cost-benefit analysis is far from a precise science and information can be manipulated to engineer a particular outcome.[301] Cost-benefit analysis was an important component of conservative deregulation efforts and has been correctly criticized for "compressing the issue of social regulation into an artificial set of restrictive guidelines."[302] Because benefits such as life, good health, and clean air were difficult to value, they were often trivialized or ignored. Cost factors that

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298. *Id.* § 3(f)(1). The Executive Order has come under attack for giving too much power to the OMB and enabling the President to control public policy without sufficient public debate. *See infra* notes 301, 312-15 and accompanying text.

299. The OMB concedes that "[a] strict regulatory decision framework designed to maximize net benefits does not take such distributional effects into account. Rather, it is based on the Kaldor-Hicks criterion." REGULATORY PROGRAM: APRIL 1, 1990-MARCH 31, 1991, *supra* note 223, at 39. For a critique of this aspect of Executive Order 12,291, see Grubb, Whittington, and Humphries, *The Ambiguities of Benefit-Cost Analysis: An Evaluation of Regulatory Impact Analysis Under Executive Order 12,291,* in ENVIRONMENTAL POLICY UNDER REAGAN'S EXECUTIVE ORDER: THE ROLE OF BENEFIT-COST ANALYSIS 124-25 (V. Smith ed. 1984); Sunstein, *Cost-Benefit Analysis and the Separation of Powers,* 23 ARIZ. L. REV. 1267, 1272-73 (1981).

300. REGULATORY PROGRAM: APRIL 1, 1990-MARCH 31, 1991, *supra* note 223, at 39. Despite this suggestion of sensitivity to distributional effects, Reagan-era regulatory policy has been criticized by many for its redistributive policies. *See, e.g.,* G. EADS & M. FIX, RELIEF OR REFORM? REAGAN'S REGULATORY DILEMMA (1984).

301. For an in-depth analysis of the strengths and weaknesses of cost-benefit regulatory analysis, see McGarity, *Regulatory Analysis and Regulatory Reform,* 65 TEX. L. REV. 1243 (1987).

302. S. TOLCHIN & M. TOLCHIN, DISMANTLING AMERICA: THE RUSH TO REGULATE 125 (1983).

were easier to quantify often won out in the balance.[303] The use of economics in public policy decisions arguably has a dehumanizing effect.

While I am mindful of these concerns, they are less troublesome as applied to bailouts. Although the line between economic and social regulation is a fine one, bailout is more clearly in the nature of economic regulation. Consequently, bailouts have serious economic and distributional implications, and whatever the merits of a broader legislative adoption of cost-benefit and distributional analysis, such analysis should be applied to bailout proposals.[304]

2. Structure and Location of a Monitoring Agency

A second issue crucial to the central monitoring and analysis function is the proper structure and location of the monitoring entity or agency. One possibility would be an agency within the Executive branch.[305] If the monitoring agency suggested here is established as a genuinely nonprogrammatic agency without regulatory authority, the risk of agency capture by particular industries should be low. On the other hand, industry awareness of the agency's policy recommendation authority may inspire lobbying efforts and some small risk of agency capture.[306] Although an executive agency is unlikely to be a captive of industry, it might be captive of a particular presidential administration if appointees served at the pleasure of the

303. *Id.* at 131-37.

304. Cost-benefit analysis may not be possible in emergency bailout situations. Early monitoring of the type suggested should minimize this problem and provide greater time in which to perform necessary economic analysis.

305. One existing example of such a largely nonprogrammatic executive agency is the Council of Economic Advisors (CEA). The CEA was initially established in the Executive Office by the Employment Act of 1946. Pub. L. No. 304, § 4, 60 Stat. 23 (codified at 15 U.S.C. § 1023). Its purposes are "to gather timely and authoritative information concerning economic developments and economic trends, both current and prospective, to analyze and interpret such information[,] . . . to appraise the various programs and activities of the Federal Government[,] . . . and to make recommendations to the President." 15 U.S.C. § 1023(c)(2)-(3). Each of these duties is to be performed in light of statutory policy to "promote full employment and production, increased real income, balanced growth, a balanced Federal budget, adequate productivity growth, proper attention to national priorities, achievement of an improved trade balance . . . and reasonable price stability." 15 U.S.C. § 1021 (as amended by the Full Employment and Balanced Growth Act of 1978, Pub. L. No. 95-523, 92 Stat. 1887). Another illustration is the Council on Environmental Quality (CEQ) established by the National Environmental Policy Act of 1969, Pub. L. No. 91-190, § 202, 83 Stat. 852 (1970) (codified at 42 U.S.C. § 4342). Both the CEA and the CEQ perform oversight functions in connection with existing legislative programs and, in this respect, go beyond what I envision as a crisis financial monitoring agency. Arguably, the jurisdiction of the CEA is already broad enough to permit such monitoring.

306. For example, the Council of Economic Advisors is empowered to "constitute such advisory committees and may consult with such representatives of industry, agriculture, labor, consumers, State and local governments, and other groups, as it deems advisable." 15 U.S.C. § 1023(e)(1) (1991). The CEQ has similar authority. 42 U.S.C. § 4345 (1991).

President. Information could be manipulated so as to tell the story the President would like to have told, frustrating the agency's fundamental purpose.[307]

If the goal behind such a monitoring agency is to increase deliberativeness and hence public-regarding legislation, it may be more sensible to locate the agency in the legislative branch.[308] One advantage to this approach would be to clearly limit the functions of the agency to gathering information and perhaps to making policy recommendations. Constitutional separation-of-power constraints would prevent the agency from getting involved in much more.[309] Such an entity would be at lower risk of agency capture. However, it would be subject to the vagaries of Congress. As noted previously, information and statistics can easily be manipulated. As power shifted from one party to another, a congressional monitoring agency may well be subject to changing political pressures.

A third, and preferred, alternative would be to set up an independent monitoring agency that would report to Congress.[310] An independent agency would not be subject to changing political pressures resulting from power

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307. In fact, OMB's strict control over regulatory impact analysis review under Executive Order 12,291 has come under severe attack for just this reason. *See, e.g.*, Note, *Executive Orders 12,291 and 12,498: Usurpation of Legislative Power or Blueprint for Legislative Reform?* 54 GEO. WASH. L. REV. 512 (1987) ("[T]he administration has empowered the Office of Management and Budget (OMB) to run a secretive and authoritarian regulatory program founded upon Executive Order 12,291."). The presidential order gives OMB the power to quash proposed regulations before they are exposed to public review or comment. *See also* TOLCHIN & TOLCHIN, *supra* note 302.

308. Several legislative proposals for regulatory reform along these lines have been proposed, apparently with little success. For a discussion of several proposals, see Note, *supra* note 307, at 516-21, 535-40. However, Congress did pass the Regulatory Flexibility Act, Pub. L. No. 96-354, § 3(a), 94 Stat. 1165 (1980) (codified at 5 U.S.C. §§ 601-611), requiring analysis of the impact of regulation upon small business.

One example of a congressional agency is the Congressional Budget Office (CBO), established by the Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, 88 Stat. 297. The CBO was established with "a specific mandate to assist House and Senate Budget Committees, [and] . . . serves as a principal source of information on the budget and on taxing and spending legislation." HOUSE COMM. ON THE BUDGET, 97TH CONG., 2D SESS., THE CONGRESSIONAL BUDGET PROCESS: A GENERAL EXPLANATION 7 (Comm. Print 1982). Another illustration is the Congressional Research Service (CRS), established to provide information and analysis on policy issues upon request from congressional members and staff. The CRS was originally established as the Legislative Reference Service. Its name was changed and it functions greatly expanded by the Legislative Reorganization Act of 1970, Pub. L. No. 91-510, § 321, 84 Stat. 1140. Another possible congressional home for the proposed monitoring function would be the Joint Economic Committee.

309. Under the appointments clause of article II, section 2, clause 2 of the Constitution, Congress has the power to appoint officers to perform internal legislative functions but cannot appoint officers to perform external enforcement or other functions. The landmark case on point is Buckley v. Valeo, 424 U.S. 1 (1976).

310. To some extent, the General Accounting Office (GAO) has already evolved into such a role for Congress. For a good discussion of the evolution of the GAO from an auditing agency to an agency actively involved in program review and policy studies for Congress, see F. MOSHER, A TALE OF TWO AGENCIES: A COMPARATIVE ANALYSIS OF THE GENERAL ACCOUNTING OFFICE AND THE OFFICE OF MANAGEMENT AND BUDGET 136-63 (1984).

shifts in Congress. Moreover, since the task of assessing distributional effects of bailout proposals is complex; an independent agency may be the better place for sophisticated economists and other professionals to work unhindered by the day-to-day concerns of congressional politics. Under this scheme, Congress would retain ultimate policy control over legislative bailouts; the independent agency would simply provide financial monitoring and work with Congress to provide assessment of economic and distributional effects.

Whatever its location within the government, Congress should establish a central agency responsible for monitoring threatened enterprise failure and assessing bailout requests. The assessment function of this agency should be minimal. If information is collected, policy options considered, and corrective measures implemented before problems reach crisis stage, there will be no need to consider bailout.

3. Congressional Committee Structure

One specific deliberative reform that would improve the quality of the bailout debate involves a change in internal congressional structure. While it is sensible for bailout legislation to be considered by the House or Senate committee that has jurisdiction over the particular industry at risk, there should also be a special enterprise failure committee that considers the general redistributional and other economic effects of the bailout provided by the agency described above. Given the massive public expenditures involved, such legislation merits specialized treatment in the House and Senate committee structure. At a minimum, the specialized committees should have available to them a staff of experts on such redistributional and economic implications. Jurisdiction of the enterprise failure committee need not be limited to consideration of bailouts. It could be expanded to include all measures designed to deal with economic failures, including bankruptcy and other related matters.

4. Deliberative Reforms

a. Exposing Hidden Bailouts

When a bailout is achieved through indirect or covert means,[311] opportunity for public awareness and debate is necessarily limited. At a minimum, covert bailouts should be exposed to the light of public scrutiny. Agencies that provide special breaks to particular firms or industries in order to

311. *See supra* notes 67-89 and accompanying text for numerous illustrations of hidden bailouts.

prevent economic hardship from threatening their viability should be required to report this information to Congress or otherwise provide an opportunity for public dialogue. Agencies should be clear about the extent to which enterprise failure concerns were involved in mixed-motive bailouts.

When hidden bailouts are granted, the record may not be explicit about the intended beneficiary of the special relief. Sometimes the relief will be drafted broadly in order to obscure the identity of the intended beneficiary. These are dangerous tendencies for several reasons. First, when subsidies are hidden and buried in larger pieces of complex legislation, opportunity for debate is limited. Those who might be opposed to a bailout may not even see the special provision as part of the larger bailout phenomenon. Second, when legislators draft provisions so as to mask the identity of the beneficiary, the special relief may be made broader than necessary to provide the assistance intended, costing the taxpayers more than they would otherwise spend. Third, the cost to the government of covert bailouts may be hidden and thus not adequately considered.[312] In addition, the costs of certain types of covert bailouts will be difficult to estimate. These tendencies suggest that covert forms of bailout should be used only rarely, if ever.

Covert bailouts are particularly inappropriate in the case of firm-specific failures. Providing special relief from tax or other regulatory requirements to specific firms raises serious issues of horizontal equity. Providing a benefit to one entire industry and not to another can raise serious questions of horizontal equity as well. This is particularly so with special tax breaks. Providing a special tax break to one sector of the economy and not to others is discriminatory.

When the covert bailout takes the form of relief from burdensome regulation, some of the equity concerns are eliminated. For example, if the entire automobile manufacturing industry was threatened with economic failure, the government might respond by delaying the effective date of a change in emissions standards that would be particularly costly to implement. Since these regulations only applied to the auto industry, relief to the entire industry in this form would not raise issues of discrimination. However, many regulations, such as emissions standards and safety regulations, are promulgated to protect the environment and the public; some may be too

312. Stanley Surrey, Assistant Treasury Secretary for Tax Policy from 1967 through 1969, first pointed out that certain tax deductions and special breaks were actually government expenditures that should be reflected in the budget and considered by appropriate congressional budget committees. *See, e.g.*, S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973). A tax expenditure budget is now routinely prepared by the Treasury Department. The covert bailout provided through special tax breaks reflects a subset of the broader tax expenditure issue. The tax expenditure budget includes many items that would not be considered bailouts, however. Thus, covert bailouts risk being hidden within the tax expenditure budget. Moreover, other forms of covert bailouts, such as relief from regulation or trade restrictions, may not be included in the budget at all.

important to compromise, even temporarily. Thus, if assistance to the industry is necessary, it should take a more direct form.

b. Greater Oversight of Major Regulatory Bailouts

Many regulatory bailouts are provided overtly under explicit legislative authority. Congress has given banking regulators discretionary authority to bail out banks with no oversight, reporting requirements, or procedural safeguards.[313] Prior to recent statutory changes, the essentiality finding necessary to free the FDIC of cost restrictions could be made by the FDIC Board alone without any hearings or public dialogue. New provisions require a joint recommendation of the FDIC Board and the Federal Reserve Board with ultimate decision-making authority resting with the Treasury secretary and the President,[314] but there is still no opportunity for hearings or public dialogue. Serious tensions surely accompany issues of agency discretion and congressional oversight. On the one hand, agencies are thought to be better able to deal with complex policy problems given their high levels of expertise.[315] Another argument in favor of delegating substantial authority to agencies is the depolitization of the policy review process.[316] On the other hand, agencies insulated from legislative and judicial oversight arguably are prone to capture by special interests and just as inclined to politics as other government branches.[317] Providing significant discretion to agencies insulated from congressional and public review is antidemocratic and displays a serious mistrust of the democratic process.[318] A strong case can be made that Congress should reassert its control and revive the nondelegation approach.[319] This is not to suggest that Congress needs to concern itself with

313. *See supra* notes 118-26 and accompanying text.

314. *See supra* notes 125-26 and accompanying text.

315. Bruce Ackerman and William Hassler describe this approach as the "New Deal" ideal. The New Deal response to complex policy issues was to delegate to agencies. The three elements to this New Deal answer identified by Ackerman and Hassler are: (1) the "affirmation of expertise," (2) "agency insulation from central political control," and (3) agency insulation from judicial review. B. ACKERMAN & W. HASSLER, CLEAN COAL/DIRTY AIR 4-6 (1981). *But see* Aranson, Gellhorn & Robinson, *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1, 23-24 (1982) (critizing this explanation for delegation on the grounds that agency heads do not necessarily have greater expertise and that the Constitution assigns determination of normative standards to Congress).

316. For a description and critique of this argument, see Aronson, Gellhorn & Robinson, *supra* note 315, at 24-26.

317. B. ACKERMAN & W. HASSLER, *supra* note 315, at 7; Aranson, Gellhorn & Robinson, *supra* note 315, at 26.

318. Recent changes transferring ultimate bank bailout authority to the Executive branch are arguably more democratic because the President (unlike the FDIC Board) is popularly elected.

319. One of the most thoughtful and developed proposals for renewing the nondelegation doctrine appears in Aranson, Gellhorn & Robinson, *supra* note 315. For another thorough analysis of delegation issues, see Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667 (1975).

every detail of designing and implementing public policy.[320] Congress should be more involved, however, in making fundamental policy choices. Major bailouts represent fundamental policy decisions in which Congress should play a greater role.

In the bailout setting, I am mindful of the need for quick response to emergency situations. Irvine Sprague, past Chairman and member of the FDIC Board forcefully argues that banking regulators are the experts best suited to deal with complex bank failures. The FDIC, he argues, needs authority to act quickly under emergency circumstances, and greater congressional involvement in the process would hinder effective responses to bank failure.[321] Even in emergency situations, however, there should be a formal requirement for the FDIC, the Federal Reserve, and the Treasury Department to report their actions and the reasons for those actions to the appropriate congressional committees.

In other situations, advance reporting should be required. Congress should be given a limited opportunity to state its objections. One possible model for such a rule is the Bank Holding Company Act[322] under which the FDIC can approve emergency mergers to be consummated immediately. Other mergers require a waiting period during which the Attorney General and the other banking agencies are notified and presumably have an opportunity to state their objections and negotiate a different solution.[323]

IV. Structuring and Funding the Bailout

Given the presumption against bailouts and the high standard required to overcome it, bailouts should be reasonably infrequent. However, once other private assistance methods have failed and Congress or other government officials decide to intervene, the bailout arrangement itself must be structured. It should already be clear that many alternative methods for achieving a bailout are available. As argued earlier, covert forms of bailout pose special dangers and should be avoided.[324] Once the decision is made to provide a more *overt* bailout, numerous options still are available. Given the different types of bailouts and the possible variations in terms within

320. In fact, Ackerman and Hassler use the congressional mandate to EPA requiring scrubbing technology in the coal industry to illustrate the dangers of a congressional "agency-forcing" statute that limits the terms of an important policy debate. B. Ackerman & W. Hassler, *supra* note 315.

321. I. Sprague, *supra* note 123, at 264 ("Changing the law to bring the administration or Congress into the picture would destroy its utility.").

322. 12 U.S.C. § 1828.

323. *Id.* § 1828(c)(6).

324. For a description of hidden bailouts, see *supra* notes 66-68 and accompanying text. For a discussion of the dangers of hidden bailouts, see *supra* notes 311-13 and accompanying text.

each of the types, difficult policy decisions remain at this next step in the process. This Part will first consider the choice of the proper bailout technique and, second, the proper method of funding and distributing bailout costs in those cases where the decision is made to provide a public bailout.

A. *Structuring the Bailout*

1. Government Involvement in Management

The most extreme form of overt bailout and government intervention in management is creation of a public enterprise or nationalization. While such extreme government intervention has been common elsewhere in the world,[325] nationalization has not been used with great frequency in the United States. Nevertheless, numerous examples of "public enterprise" can be found in the United States.[326] The collapse of the Penn Central railroad and subsequent railroad reorganization forming Conrail can be viewed as a bailout through nationalization or creation of a public enterprise. An earlier illustration is the Tennessee Valley Authority established during the Depression. In the bailout setting, government agencies may take over supervision and management to such an extent that the operation can be viewed, at least temporarily, as a public enterprise. For example, in the rescue of Continental Bank of Illinois, the FDIC took an eighty percent ownership interest in the bank and chose its new managers.[327] In the recent bailout of the savings and loan industry, the Office of Thrift Supervision is so extensively involved in the operation and closing of certain banks that the banks can be said to be public enterprises as well. In addition, throughout the period that federal loan guarantees on Chrysler debt remained outstanding, the corporation

325. In some countries, certain industries were nationalized as a matter of government policy even in the absence of economic crisis. For a general discussion of nationalization in Scandinavian countries, see G. HECKSCHER, THE WELFARE STATE AND BEYOND: SUCCESS AND PROBLEMS IN SCANDINAVIA (1984). In others, nationalization has been used as a form of bailout response to economic crisis. For example, in response to the threatened collapse of British Leyland, the government of Great Britain purchased a majority interest in the company and appointed a semi-independent government agency to manage the company. For a case study of the British Leyland bailout, see Reich, *supra* note 287, at 170-74.

326. One commentator describes four different types of public enterprise: (1) the government department funded through appropriations, (2) "the public corporation owned entirely by the state" and financed "through borrowing or revenues from sale of products or services," (3) the mixed-ownership corporation the stock of which is held both by government and privately, and (4) an operating contract through which the government arranges with a private firm to manage an enterprise. B. MITNICK, THE POLITICAL ECONOMY OF REGULATION: CREATING, DESIGNING AND REMOVING REGULATORY FORMS 400-01 (1980).

327. A full description of the FDIC's ownership interest and the government-appointed managers can be found in the News Release, *supra* note 125. Irvine Sprague describes the Continental bailout as, in effect, a nationalization of the bank. I. SPRAGUE, *supra* note 123, at 182.

was required to submit periodic reports on its activities and meet conditions set by the Chrysler Corporation Loan Guarantee Board. Failure to meet conditions set by the Board could have resulted in a declaration that the debt was due and payable in full. As a result, the government was involved in substantial oversight of Chrysler operations. Moreover, in order to protect its interest, the government received an equity interest in Chrysler in the form of warrants to acquire Chrysler stock.

While extreme forms of nationalization should be used only rarely, government involvement in management appears wise. When a private firm or industry seeks public bailout assistance and a policy decision is made to grant such assistance, the government has a strong interest in the success of the bailout. This is certainly true in the case of general revenue bailouts, where the taxpaying public in effect becomes an investor in the private enterprise. In a public bailout, the government in effect plays the role of bankruptcy trustee and should be entitled to have the same substantial input in overseeing management decisions that is provided in the private bailout setting.

2. Structuring the Loan or Loan Guaranty

Many instances of past bailout activity took the form of direct federal loans or guaranteed loans to particular firms or municipalities threatened with failure.[328] Concerned with the ad hoc response of Congress in each of these instances, the Comptroller General's Office urged the President and Congress to develop policies for federal assistance to failing firms and municipalities.[329] Early in his report, the Comptroller argued that one of the overriding considerations in any assistance package should be protection of the government's financial interest. To this end "reliance on the principles and practices followed by commercial lenders is not only possible but crucial."[330] The parallels between private lenders and the government as lender are not precise, however. As in the insurance model discussed previously, the government is only asked to step in where private lenders would not. Later in his report, the Comptroller concedes that

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328. For example, the Emergency Loan Guarantee Act, Pub. L. No. 92-70, 85 Stat. 178 (1971), was enacted to provide emergency loan guarantees to the Lockheed Aircraft Corporation. In addition, Congress provided for short-term direct loans to New York City through the New York City Seasonal Financing Act of 1975, Pub. L. No. 94-143, 89 Stat. 797, and later loan guarantees through the New York City Loan Guarantee Act of 1978, Pub. L. No. 95-339, 92 Stat. 460. Finally, loan guarantees were provided to the Chrysler Corporation in the Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. No. 96-185, 93 Stat. 1324. An earlier instance of direct lending is the Federal Home Loan Bank Board, established by the Federal Home Loan Bank Act of 1932, Pub. L. No. 72-304, 47 Stat. 725, to provide loans to assist savings associations after the Great Depression.

329. *See* COMPTROLLER GENERAL REPORT, *supra* note 11.

330. *Id.* at 7.

> [i]n deciding to provide aid, the government does not compare alternative investments to see if superior combinations of expected return and risk are available. Instead, the government assists a firm or municipality with full knowledge that it is unable to compete effectively for funds in commercial credit markets. Although government objectives differ from those of commercial lenders, it can frequently use principles and practices that commercial lenders follow.[331]

The commercial principles to be applied here are not those used in day-to-day lending practices. The borrower seeking government assistance generally finds itself in financial crisis. Thus, the commercial principles to be applied are those that would be used in a commercial workout for a borrower in financial trouble. Applying commercial workout lending notions in the government assistance context involves four basic elements. First, concessions may be required from the borrower in order to reduce the amount of assistance needed. This may include concessions from creditors, stockholders, bondholders, management, labor, suppliers, customers, state and local governments, and foreign beneficiaries.[332] Second, the lender should be empowered to exercise some management control over major contracts and financial and operating plans.[333] Third, adequate collateral should be required.[334] Finally, the lender should receive adequate risk compensation. A commercial lender will charge higher rates of interest depending upon the level of risk involved with the loan. Where the government assistance is in the form of loan guarantees, as opposed to direct loans, this option is not available. Thus, in loan guarantee settings, the government's risk compensation should be in the form of guarantee fees or equity participation in the firm requiring assistance.[335]

3. Federal Insurance Programs

As noted earlier, federal insurance programs themselves reflect bailouts of a sort.[336] Just as the government as lender or loan guarantor can rely to a large extent on the principles and practices of commercial lenders, the government as insurer can use many of the principles and practices of commercial insurers. Some of these were discussed previously.[337] Most important, the private insurance industry has developed numerous mechanisms to minimize the moral hazards to which insureds may fall prey. Among

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331. *Id.* at 29.
332. *Id.* at 40-44.
333. *Id.* at 45-46.
334. *Id.* at 46-48.
335. *Id.* at 48-50.
336. *See supra* notes 90-100 and accompanying text.
337. *See supra* notes 330-35 and accompanying text.

the most significant of these mechanisms is risk-based assessment of premiums. Higher premiums imposed on high-risk activity will create disincentives to engage in such activity and thus reduce moral hazard problems. Recent statutory changes directing the FDIC to establish a risk-based assessment system for insured depository institutions certainly reflect a step in the right direction.[338] In addition, those insured through federal programs should be required to meet rigid safety standards to be eligible for coverage.

B. *Funding and Distributing Bailout Cost*

Not all bailouts will ultimately involve cost to the government. Numerous past instances of federal loans and loan guarantees ultimately cost little or nothing because the loans were repaid and fees collected to cover administrative expenses. Other types of bailouts involve significant cost to the government. As developed earlier, bailouts can be broken into at least five different cost categories: (1) profitable bailouts, (2) no- or low-cost bailouts, (3) special fund bailouts, (4) general revenue bailouts, and (5) combination bailouts.[339] Ideally, of course, bailouts should be structured so that they fall into one of the first two categories. This often will not be possible. Where costs are involved, they may take the form of direct outlays or perhaps revenue foregone. Cost also may be remote and difficult to calculate. For example, delay in implementation of stricter emissions standards may result in environmental and health costs that are difficult to measure. Presumably these indirect costs would be taken into account in the deliberative process and cost-benefit analysis discussed earlier.

Costs that take the form of direct outlays can be covered by special funds, general revenues, or a combination of sources. Where possible, costs for a bailout should be imposed more precisely on the group that benefits from the bailout. Thus, special fund bailouts generally should be preferred to general revenue bailouts. We have already seen one illustration of the special fund approach in the case of bailouts in the form of insurance funds. Most government insurance programs are funded through fees imposed upon those protected by or benefitting from the program.[340]

Public goods theory and the theory of clubs provide support for this approach to the distribution of bailout costs. Clearly, the costs of providing a pure public good, such as the national defense, should be covered by general revenue from all taxpayers. As one moves away from the pure public good end of the continuum, one increasingly finds goods from which some segment of the population is excluded. Nevertheless, the group of beneficiaries of the good may have difficulty forming voluntary associations

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338. *See supra* note 97.

339. *See supra* notes 43-49 and accompanying text.

340. For a more detailed discussion of federal insurance programs, see *supra* notes 90-100 and accompanying text.

or clubs to provide the good privately. Reorganization in bankruptcy is an illustration of a mechanism designed to bring together a group of potential beneficiaries to negotiate an acceptable arrangement for the payment of creditors and rehabilitation of the firm. Survival of the firm may be viewed as a public good, at least with respect to those creditors with an ongoing relationship to the firm. Although some government involvement may be necessary to manage the bailout, the cost should be borne, to the extent that it can be identified, by the beneficiaries.[341]

One practical problem with such an approach is that by designating an identifiable group to bear the costs one has set up an interest group that will lobby heavily against bearing the charge. The larger group that is not bearing the charge will perhaps be too diffuse to organize on the other side.[342] Some early benefit-driven tax proposals avoided such problems by having taxpayers reveal their preferences for public goods and setting tax shares accordingly. One early version of such a linkage of tax cost to benefit is attributable to Swedish economists Wicksell and Lindahl, who wrote at the turn of the century. Under the Wicksell-Lindahl scheme, each person will have a particular desired output for public goods based upon her budget and the marginal utility she expects from such goods. A Public Goods Board deciding upon the output and funding of such goods will seek to "adjust the tax shares until every person agrees on the desired output of the public good."[343] Each person's share of the cost will vary depending upon her demand schedule as revealed to the Public Goods Board. One major problem with such a scheme is that devious individuals will be tempted to lie about their utility from the public good, thus free-riding on the contributions of other, more truthful participants.[344] This problem of demand-revelation led others to consider alternate tax schemes that might tie tax cost to benefits without incentives to lie about true demand for public goods. Under one demand-revealing scheme, an individual's tax share is the entire cost of providing the public good less the aggregate utility

341. This idea of imposing costs according to benefits has been gaining force to some extent in tax policy. In one recent ill-fated attempt at such an approach, Congress enacted a provision imposing the costs of catastrophic health care for elderly taxpayers upon the elderly with incomes above a specified level. Federal Hospital Insurance Catastrophic Coverage Reserve Fund, Pub. L. No. 100-360, § 112(a), 102 Stat. 698 (1988) (amending Act of Aug. 14, 1935, ch. 531, § 1817), *repealed by* Pub. L. No. 101-234, § 102(a), 103 Stat. 1980 (1989). In fact, much of the cost burden for the ill-fated catastrophic health insurance was imposed upon wealthy elderly and thus arguably represented a redistribution among elderly taxpayers. For a discussion of these implications, see Frolik & Barnes, *An Aging Population: A Challenge to the Law,* 42 HASTINGS L.J. 683, 710 (1991).

342. The catastrophic health care bill was repealed shortly after its enactment for probably just this reason. For an account of the repeal, see Frolik & Barnes, *supra* note 341.

343. A. FELDMAN, *supra* note 280, at 117.

344. "The critical problem with the Wicksell-Lindahl tax scheme is this problem of demand-revelation. People will not want to reveal their true feelings to the Public Good Board. This is why we must look elsewhere for an ideal public finance scheme." *Id.* at 119.

accruing to others.[345] One major problem with such a demand-revealing approach is the unavailability of accurate information. For any taxpayer to provide a true revelation of her preferences for public goods, detailed and accurate information must be available. The direct or indirect benefit to any given taxpayer of a bailout of a major industry or firm will be difficult to measure and assess, even with reasonably accurate information.

One should hesitate before taking this benefit theory too far, however. A taxing regime that identified the beneficiaries of particular programs and imposed costs accordingly would be even more complex than the existing tax regime, if such a thing is possible. For the moment, I am suggesting only that the benefit approach to distributing cost burdens be thoroughly explored in the bailout setting. To the extent that one can identify a discrete class of bailout beneficiaries, a strong case can be made for spreading costs among that group through some form of special fund bailout.[346] I do not advocate using this approach for social programs. Many social programs are designed to provide benefits to those most in need. It is counterproductive to impose the cost of the programs on their beneficiaries. The cost for food stamp programs should not be borne by those receiving food stamps.

CONCLUSION

One thing should be clear from this Article. There is no consistent public policy regarding enterprise failure. An examination of the history of domestic bailouts shows that Congress and government regulators respond to threatened private industry failure, if at all, in ad hoc fashion. Once the first bailout was accomplished, subsequent bailouts became easier to justify. As a start toward a public bailout policy, the presumption against it should be firmly established. In the case of threatened industry-wide failure, the presumption may be more easily overcome upon a showing that survival of the industry is crucial to the overall economy. Before such a conclusion can be reached, careful economic study will be necessary. Input-output analysis could be a very useful tool in this study.[347] In addition, early financial monitoring on a uniform basis should be available so that crises might be prevented before they occur.[348]

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345. This scheme is attributed to Edward Clark and Theodore Groves and is described in *id.* at 122-29. For further elaboration, see E. CLARK, DEMAND REVELATION AND THE PROVISION OF PUBLIC GOODS (1980).

346. Representative Joseph Kennedy (D-Mass.) attempted something like this approach in his proposed bill to fund the savings and loan bailout through a surtax upon taxpayers with incomes over a certain level. H.R. 5499, 101st Cong., 2d Sess. (1990).

347. *See supra* notes 269-71 and accompanying text.

348. *See supra* notes 289-94 and accompanying text.

With regard to firm-specific bailouts, the standard required to overcome the presumption should be more stringent. Before public bailout is considered, a failing individual firm should be required to attempt chapter 11 reorganization in bankruptcy. In the Chrysler case, Congress rejected the chapter 11 alternative, fearing that the "very word 'bankruptcy' could cause a psychological impact of incalculable proportions."[349] Perhaps some public education and revision of the bankruptcy laws is necessary to eliminate the tarnish to a firm's reputation from such a proceeding and to make reorganization in bankruptcy a more respectable option for the private enterprise. Such an approach has the advantage of imposing bailout costs on those most directly affected by firm failure. Resolution of the controversy over the proper role of bankruptcy law in favor of the value-based account will be useful in achieving these results.[350]

In general, direct forms of bailout should be preferred over covert ones. In all cases, when the target of the bailout is a specific firm, that firm should be identified so that the true beneficiary is not hidden. Bailouts should be subject to greater public scrutiny and review. When bailouts are achieved through regulatory action, Congress should be systematically notified of each such action. Deliberative reforms suggested by the public interest approach also may be acceptable to the public choice adherent who is willing to provide a greater voice to groups now left out of the political marketplace. It is comforting that the implications of each of these perspectives for bailout policy are not as different as one might suspect. Particularly in the case of covert regulatory bailouts, care must be exercised to assure adequate deliberation and opportunity to be heard.

My theoretical excursion included a brief analysis of public interest, public choice, and distributive justice principles as applied to a major modern public policy problem. Each of these perspectives can provide insight into the proper legislative response to bailout requests. Most important, the prevailing focus of recent literature on public interest and public choice approaches to legislative policy is unfortunate in that it fails to take equity and distributive justice issues into account.

The recent contrast of the decision to bail out the Bank of New England but not the Freedom Bank of Harlem underscores the distributive issues that are involved in bailout decisions. Public interest analysis of bailouts should include a consideration of distributive justice. Bailout decision makers should be required to study the distributional consequences of bailout action in a systematic way. To whom are the benefits flowing and from whom will the costs be extracted? Many of these questions are not limited to bailouts. Whenever firms engage in what economists refer to as rent-seeking

349. *See supra* note 171.
350. *See supra* notes 167-70 and accompanying text.

activity, rents extracted from others are transferred to the rent seeker. Many of the observations and suggestions made throughout this Article might be used to achieve more general legislative reforms. One might even argue that economically healthy rent-seeking enterprises that are simply lining their pockets with economic surplus raise more serious public policy issues than the private enterprise seeking assistance for survival. However difficult they are to solve, these larger issues should continue to be addressed. In the meantime, a consistent and systematic approach to the problem of enterprise failure is needed. Substantial work remains to be done if this goal is to be accomplished. This Article provides a preliminary sketch of the issues surrounding the bailout phenomenon and a first step toward developing a national bailout policy.