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Company Bailouts Aren't Always the Best Medicine for the Economy

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Covid-19 will cause some companies to fail and will push entire sectors to the brink. The question is how much the federal government—and, by extension, the American taxpayer—should do to rescue companies felled by the economic effects of the virus. It's treacherous territory. Bailouts of financial institutions damaged by the 2008 crisis provoked populist anger on the left and the right. Donald Trump owes his presidency in part to the public's revulsion over taxpayer funds going to Wall Street while ordinary citizens suffered.

Now it's the Trump administration that has to decide which companies and sectors merit help, how much, and in what form. On March 10 the president pitched Republican senators on economic relief for the travel and hospitality industries, Lindsey Graham of South Carolina, who attended the meeting, told Bloomberg News. Graham said Senators John Hoeven of North Dakota and James Lankford of Oklahoma suggested a federal bailout for the shale drilling industry. "I don't know at this point if that will be in any final package," Senator John Thune of South Dakota said.

The silhouettes of pumpjacks are seen above oil wells in the Bakken Formation near Dickinson, North Dakota, U.S., on Wednesday, March 7, 2018. When oil sold for $100 a barrel, many oil towns dotting the nation's shale basins grew faster than its infrastructure and services could handle. Since 2015, as oil prices floundered, Williston has added new roads, including a truck route around the city, two new fire stations, expanded the landfill, opened a new waste water treatment plant and started work on an airport relocation and expansion project.

The argument in favor of bailouts is that the Covid-19 pandemic is an out-of-the-blue disaster that no company could reasonably have been expected to prepare for, and if companies fail, there will be serious harm to their employees, customers, suppliers, lenders, and the overall economy.

The argument against bailouts is that companies can and do continue to operate even if they require protection from creditors in federal bankruptcy court. True, shareholders may lose everything without a bailout, and creditors will take a haircut, but that's how capitalism works. "Capitalism without bankruptcy is like religion without hell," says Jeffrey Miron, an economist at Harvard and the libertarian Cato Institute, quoting an economists' bromide.

The key question in assessing whether to bail out a firm is whether its failure would cause harm to the overall economy. Timothy Geithner, who was President Obama's Treasury secretary, argued that saving financial institutions in the 2008 crisis was crucial because they were too big

to fail and too interconnected. If one defaulted, it could trigger a cascade of defaults that would shut down lending and destroy the economy.

In other industries, though, the failure of one company can help competitors. If one airline shuts down, its rivals pick up its customers, and with one less rival, their prices can rise to more profitable levels. So letting weaker companies go under could save an industry.

Another question is who wins from a bailout. After the financial crisis, some Democrats argued that the government should have done more to help homeowners pay their mortgages, rather than helping banks that recorded losses when they foreclosed on the loans. Similar arguments may be made this time around. Dean Baker, senior economist at the liberal Center for Economic and Policy Research, says the quid pro quo for any bailout should be a hard cap of $1 million in annual compensation for the company's chief executive officer and other officers. ("I'm confident that they can find good help for under a million bucks," he says.)

Whoever wins from a rescue, though, someone else is going to lose by comparison. That's why most economists urge caution. "One should be very hesitant about bailouts," says Harvard's Miron. "Once you do it, it gets harder not to do it again the next time."