

Government bailouts



Government Bailouts BY jacqute302 Introduction As individuals, Americans may desire to come to the aide of those in need out of the goodness of their hearts, but they are not legally obligated to do so. Traditionally, under American law, no general duty to rescue those in financial trouble is imposed on us. There may be a morale duty to rescue those in trouble, but the law leaves that to the individual and their conscience. So why are so many citizens looking to the government for help with today's economic situation?

Only people can have a responsibility and the government is not a person. It gives the wrong impression of what government really is and sends people looking for assistance in the wrong direction. I believe that Americans are divided as to whether or not the Government has an economic responsibility to bail out those corporations in financial trouble. Government is an instrumentality; it is a means that we use to achieve our goals and objectives.

We need to make sure that we use Government effectively, for the right reasons and not become totally dependent upon it every time we get into trouble. Will the bail out plans truly get our economy back on its feet? The question we should ask today is not whether or not our government works, but whether it works well. Most Americans understand that the economy isn't doing well, but there's confusion about how it got to this point, even on Wall Street.

In 2007, the economy was extremely robust. Less than 12 months later, the United States is facing a plunging stock market, record unemployment and total credit collapse. How, specifically did this happen? Well, some blame the

problem on the housing market. With the interest rate lowered, Americans were in a rush to purchase new homes. Low interest rates created a rush to buy housing creating a rush to generate business. Some fell under the spell of mortgage brokers.

Despite knowing in their hearts that there is no such thing as free money, Americans accepted the assurance from mortgage brokers that there is such a thing as free money. The blame has also been placed on the Bush administration. When President Bush spoke about the failing economy, some say that the stock market plunged by four hundred points. Another reason for the failed economy could be blamed on banks extending loans to customers that could not afford them. This proved to be a very unstable business practice causing the collapse of the banking industry.

There are many speculated reasons for the failed economy, but our main concern should be, how to fix it and are bail outs the answer? In President Obama's victory speech he said " So let us summon a new spirit of patriotism; of service and responsibility where each of us resolves to pitch in and work harder and look after not only ourselves, but each other. Let us remember that if this financial crisis taught us anything, it's that we cannot have a thriving Wall Street while Main Street suffers - in this country, we rise or fall as one nation; as one people.

It seems as though President Obama was already thinking of protection from bail outs for the American people before he won the election. In financial firms, President Obama urged the Treasury and the Federal Reserve to include four conditions in the plan. He called for a payback plan for

taxpayers if the bailout succeeds; a bipartisan board to oversee the bailout; limits on any federal money going to compensate Wall Street executives; and aid to homeowners who are struggling to pay their mortgages.

What do these conditions mean, was he for or against bail out plans?

President Obama side-stepped those questions about whether he would vote against bailout legislation that did not include his conditions. Ultimately, President Bush's \$700 billion bail out plan was approved. Supporters said the bailout was needed to prevent economic collapse; opponents said it was hasty, ill conceived and risked too much taxpayer money to help Wall Street tycoons, while providing no guarantees of success.

The rescue plan allows the Treasury to buy troubled securities from financial firms in an effort to ease a deepening credit crisis that is choking off business and consumer loans, the lifeblood of the economy, and contributing to a string of bank failures. Some other opponents of the bailout even went as far as to call the plan a costly Band-Aid that did not address the core problems in the financial system. Up until two years ago, the average American had never heard of a bail out plan. Exactly what is a bail out?

One definition of a bail out is listed as follows: A bailout is an act of giving capital to a failing company in order to save it from bankruptcy, insolvency, or total liquidation and ruin. Bail out plans can come from many sources, but lately, the government has taken the responsibility of rescuing failed businesses and big corporations, but emergency-type government bailouts can be controversial. Debates raged in 2008 over if and how to bailout the

failing auto industry in the United States. Those against it saw this bailout as an unacceptable passing-of-the-buck to taxpayers.

Some arguments stated that mismanagement caused the companies to fail, and they now deserve to be dismantled organically by the free-market forces so that entrepreneurs may arise from the ashes; that the bailout signals lower business standards for giant companies by incentivizing risk, creating moral hazard through the assurance of safety nets that others will pay for that ought not be, but unfortunately are, considered in business equations; and that a bailout promotes centralized bureaucracy by allowing government powers to choose the terms of the bailout.

Furthermore, government bailouts are criticized as corporate welfare which encourages corporate irresponsibility. Corporate welfare is a term describing a government's bestowal of money grants, tax breaks, or other special favorable treatment on corporations or select corporations. The term compares corporate subsidies and welfare payments to the poor, and implies that corporations are much less needy of such treatment than the poor. I guess this type of payment can also compare to transfer payments which were discussed in our textbook, *The Economy Today*.

Transfer payments are income payments for which no goods or services are exchanged. Hence, BAIL OUT. What benefits do the taxpayers receive from government bailouts? Americans were promised a reward for rescuing the nation's banks. In return for all those bailouts, the banks essentially granted stock options to the government a potential jackpot for taxpayers once the crisis blew over. But now banks are anxious to get Washington out of their

hair. They are pushing to undo for taxpayers. History tells us that the Government has benefited tremendously from bail outs in the past.

For instance, in 1976, the federal government consolidated the still struggling Penn Central with five other railroad companies that were also failing to form Consolidated Rail, or Conrail. The government spent \$19.7 billion, including roughly \$7.7 billion for the initial investment, to keep Conrail operating. By 1981, Conrail began to earn a profit. The government sold Conrail in 1987 for \$3.1 billion. In addition to the sale price, the Treasury received a \$579 million dividend from Conrail. By 1983, seven years earlier than the scheduled deadline, Chrysler had paid back its loan with the aid of the guarantees from the U.

S. government. The corporation bought back the 14.4 million stock warrantsA security entitling the holder to buy a proportionate amount of stock at some specified future date at a specified price, usually one higher than current market. This "warrant" is then traded as a security, the price of which reflects the value of the underlying stock. Warrants are usually issued as a "sweetener" bundled with another class of security to enhance the marketability of the latter. Warrants are like call options, but with much longer time spans sometimes years. Washington Post) given to the government in exchange for the loan guarantee. Because Chrysler's finances had improved and its stock had bounced back it reported \$1.7 billion in profits for the second quarter of 1984 the government netted a profit of more than \$660 million from its bailout investment. That motive to rescue failing companies is honorable, but government has never been very good at such protection. The law of unintended consequences cannot be repealed,

<https://assignbuster.com/government-bailouts/>

and what government gives with one hand, it inadvertently takes away with the other.

CONCLUSION What have we learned about bail outs? Is history doomed to repeat itself. Is the US economy doomed to suffer an endless cycle of ups and downs that will forever require the hand of government intervention? Are government bailouts, as some have recently said, akin to socialism? There are no easy answers to these questions but after the lessons of the 1980s, the Feds have acquired some common wisdom about when banks fail, if not always why. Whenever there's a period of rapid growth here's a tendency for both lenders and investors to get too cocky and take on far more risk than they should.

Today, there are number of industries on the verge of collapse, including the airline and automotive industries. Should the government always step in? The good news here is that, in almost every case, these course corrections have proved temporary and most finance experts believe they have been both necessary and beneficial in times of financial crisis. America is a democracy and sooner or later the will of the voters will prevail, so we must stay optimistic that we shall learn from our experiences and correct our errors.