

Thomas D. Stoddard  
The Blackstone Group

I would like to preface my remarks by pointing out that The Blackstone Group's corporate advisory business has counseled a number of companies receiving public assistance, including TARP recipients in the banking, insurance, and automotive industries. Since the crisis weekend of September 13–14, 2008, I have been part of the Blackstone team advising AIG on its restructuring and global divestiture program.

Three areas deserve more attention in the discussion of interventions and unwinding: market effectiveness, competitive effects, and public policy coherence.

### **Measuring effectiveness**

Regulators need an appropriate framework for measuring the effectiveness of public interventions in private companies. Too much of the discourse on this subject has centered on investment return analysis. More attention should be paid to a proper assessment of the net impact of the interventions on overall social welfare, as measured in terms of the net economic costs and benefits to society. The problem with the investment return approach is twofold.

First, because there was no market source of capital to fund some of these private company interventions (e.g., AIG on September 16, 2008), the imputed "subsidy" was arguably the entire amount of the assistance rendered. Put another way, the private cost of capital for these firms was infinite, since no one would invest on any terms. So comparing the investments made by governments with private market securities does not capture the whole story.

Second, the exclusive focus on investment returns has enabled the large Wall Street banks to take the position that they have repaid their debts to society by returning the government's capital with a positive return (IRR) to the government. This misses the external costs to society of unbridled risk-taking and widespread financial failure. The public has borne this cost, restored these institutions, and is now rightly frustrated that bankers propose to enjoy the fruits of the public intervention through high profits and equally high bonuses. (Public monetary policy favoring low interest rates in the aftermath of the crisis also may have the effect of exaggerating this profitability.) The financial sector needs to be held accountable for its overall impact on the economy, which requires a broader analysis of the costs and benefits of public intervention.

Measuring the effectiveness of public interventions is a difficult econometric task of course, but important. It probably requires both a top-down and bottom-up analysis, looking at the impact on GDP and employment on the one hand, and interconnections between institutions on the other.

### **Impact on competition**

European authorities seem to be much more concerned than U.S. regulators about potentially disruptive competitive effects of public interventions. The European Commission has acted on the concept of “too big to fail” by breaking up institutions and imposing penalties to compensate for receipt of public assistance. In the United States, the focus has been almost exclusively on addressing systemic risk and short-term job losses, regardless of second-order competitive impact.

### **Importance of public policy**

Public interventions and exits must be executed within a coherent public policy regime rather than on a deal-by-deal basis. Perhaps too many bankers and not enough economists have been on the front lines of company-specific interventions. For example, efforts to shrink or split up AIG and Citibank have seemingly contradicted the simultaneous encouragement for the combination of Merrill Lynch and Bank of America. This apparent incoherence is explainable in light of the need to make decisions quickly in a crisis, particularly when existing statutes do not provide all the right tools for regulators to intervene effectively.

Nevertheless, regulators and legislators need to determine what the future regulatory environment looks like as soon as practical so that they and private companies can build a bridge from here to there. For example, it is clear that financial institutions that benefit from the public safety net should be required to hold a larger capital buffer. During the crisis, however, they were permitted to operate with relaxed requirements. Since private companies are making decisions now in planning for the future, they need to know what target levels they will need to satisfy. Similarly, they need to know what the standards or limitations on size will be relative to the concept of “too big to fail.” It may be that institutions in that category are simply too big and need to be regulated more aggressively or forced to shrink in size or scope.