SECTION VI

THE BAILOUT

Overview

Section V has laid out our proposals for the prudential regulation of systemic financial risk, for the conduct of monetary policy, and for the design of lending facilities to deal with liquidity crises. These proposals were aimed at reducing the likelihood of a systemic crisis. Financial crises, however, are to some extent unavoidable. It is therefore important for contingency plans to be prepared, and in that respect, we have much to learn from the current crisis. This is our focus in this section:

- Chapter 15, "The Financial Sector "Bailout" – Sowing the Seeds of the Next Crisis?", focuses on the financial side of the rescue package, namely the loan guarantees and recapitalization programs. It compares the US and the UK packages based on the pricing of the guarantees and the decision to make participation voluntary or compulsory. It concludes with an analysis of their relative merits.
- Chapter 16, "Mortgages and Households," assesses the longer-term aspects of the rescue packages, in particular the existing proposals to stabilize the housing market, and presents a new, coherent solution – the shared appreciation mortgages (which are part of the FHA plan) which offer an attractive way to implement the much-needed debt-for-equity swaps for mortgages.
- Finally, Chapter 17, "Where should the bailout stop?", addresses the issue of whether the bailout should extend beyond the financial industry, and focuses on the case of the car manufacturers in the United States. It uses the General Motors bailout discussion to illustrate a consistent set of principles that government interventions should be based on.