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RESEARCH SUMMARY

How Much Would It Cost to Guarantee Debt for All Publicly Traded US Corporations?

When banks and other large corporations experience distress, the government may decide to assist them through debt guarantees and similar measures to protect them from default and the need to go through bankruptcy proceedings. What are the costs of such government debt guarantees? Stephen Matteo Miller sets out to answer that and related questions in "How Much Would It Cost to Guarantee Debt for All Publicly Traded US Corporations?"

What the Numbers Show over the Past 50 Years

This study estimates what it would cost ex ante to guarantee the debt for all available corporations with publicly traded shares in the United States from Q4 1971 to Q4 2022. It finds the following:

- During economy-wide periods of distress, such as a financial crisis or pandemic, the estimated ex ante aggregate cost of guaranteeing debt tends to spike.
- To the extent that the ex ante aggregate costs of guaranteeing debt reflect moral hazard, observed spikes suggest moral hazard may be a temporary but recurring problem.
- Higher-cost guarantees periodically arise with a handful of large banks and financial corporations, as well as with nonfinancial corporations.
- Leverage, defined as the market value of equity relative to the quasi-market value of assets (i.e., book assets minus book equity plus market equity), and asset volatility can each contribute to higher ex ante estimated debt guarantees, but the highest estimated debt guarantees arise from high leverage, rather than high asset volatility.
- The ex ante cost of guaranteeing debt was highest during the financial crisis of 2007–2009.
- The second-highest ex ante cost of guaranteeing debt occurred at the outset of the COVID-19 pandemic, when the estimated guarantees arose more with nonfinancial corporations.
- The period with the third-highest ex ante cost of guaranteeing debt occurred briefly in late 1998, after the Russian debt default, to which a few banks were exposed.

Why Policymakers Might Want to Keep Certain Corporations Around

A common criticism of debt guarantees is that, ex ante, they simply represent a transfer of dollars from taxpayers to shareholders—and that they therefore lead to privatized gains and socialized losses for corporations. Yet, as Miller indicates, there may be more to the story than that.

For example, policymakers may use debt guarantees to keep a corporation fully operational instead of allowing it to go through bankruptcy proceedings. This may prevent substantial increases in unemployment. However, it also has a downside in that policymakers may sustain inefficient corporations. Empirically, during periods of distress, the corporations with the largest 5 percent of guarantees tend to employ three times or more people on average than those with smaller guarantees.

In addition, preventing large corporations from failing may allow the government to continue relying on such corporations in response to national emergencies if they provide essential goods and services during such events. Such emergencies include financial crises, pandemics, and wars.

How to Limit Taxpayer-Assisted Bailouts of Large Corporations

That said, one market-oriented way to address bailouts would be to impose leverage restrictions on large corporations in industries that are more likely to receive a bailout, including airlines, auto manufacturers, banks, and the defense contractors. For example, policymakers could restrict the equity-to-asset ratio from falling below 15 or 20 percent for corporations that are likely to benefit from debt guarantees. Doing so may not eliminate bailouts but could reduce their size, likelihood, and frequency.