the ruling coalition and politically well-connected businessmen, which in turn 'raised concerns about the transparency of government policymaking and implementation'." Yoshihara, on the other hand, views crony capitalist as "rent-seeking 'private-sector businessmen who benefit enormously from close relations' with government leaders by obtaining 'not only protection from foreign competition, but also concessions, licences, monopoly rights, and government subsidies (usually in the form of soft loans)', resulting in 'all sort of irregularities' in the economy" (Yoshihara, 1988: 3-4, 71).

It should be highlighted that a "rent", like a bailout, is in itself neither good nor evil since rent(s) *may* be efficient or inefficient depending on how they are obtained, and deployed and for what purpose – affecting the outcome. As such, financial assistance given to firms, that would otherwise have been liquidated, given market forces, constitutes a rent. Put differently, bailouts can be seen as rents that accrue to those parties that receive financial assistance or "protection" against market discipline. This rent *could* be socially undesirable since it may signal allocative inefficiency, by allocating too many resources to aiding firms that are not economically viable when other more deserving corporations are crowded out because of such choices.

In the following section, I will look at the debate between those favouring government intervention and the "no bailout" advocates.

5. Arguments For and Against Corporate Bailouts

The interconnectedness and interwoven relationship of banks and corporations have created a symbiosis that can be extreme in its effects – exceptional and impressive growth if the environment proves favorable, or severe contraction of output and growth when the reverse happens; there is a positive synergy in the former case and negative synergy in the

latter. A systemic crisis is especially paralysing since it involves the deterioration of both the financial as well as the corporate sector. Such a crisis could prove catastrophic, imposing high costs in terms of foregone economic output (as shown in Section 3.0), slowing of investment expenditure, credit crunch and others that could very well lead to permanent repercussions on the future economic prospects of a country; thereby prompting some form of government action.

"Too Big to Fail" (TBTF) Argument and Counterargument

Those arguing from a "free market" perspective perceive bailouts of "large" corporations by governments as impeding the functioning of markets or market signals in allocating scarce resources. The costs of bailouts also entail the crowding out of public and private funds (if banks are required to roll over and write off bad debts) to more deserving corporations that should remain in the market.[56] Hence, governments are seen as obstructing the "natural selection" of firms and preventing "survival of the fittest" from taking place. This is in line with the "social Darwinian view" that corporations that are weak or uneconomic should be weeded out, so that presumably successful and solvent companies can take their place, for investors' funds, employment, etc. to flow into these companies (Ohanga, 1999). Firms that are economically distressed, and therefore financially distressed as well, should be liquidated.

Those favouring bailouts are aware that their argument contradicts the orthodox "free market" rationale that presumes the demise of "weak" and "nonviable" corporations as a natural process leading to efficiency in the marketplace.[57] Nonetheless, care has to be taken since the poor growth prospects of nonviable corporations are not attributed only to

a permanent decline in industry (see endnote 60). Under certain circumstances, modifications can be made to increase these prospects.

Even if the corporation is not viable because of a permanent decline in demand, orderly exit – as opposed to quick exit – of the corporation can help contain the spread of the problem. Furthermore, Enoch *et al.* (1999) point out that classification determined solely on financial and operational criteria would not provide a workable resolution for banks [and corporations] that are weak, but deemed essential, or of systemic importance to the economy. Enoch *et al.* (1999) explain, for instance, that it may not be feasible to close a very large bank [or corporation] in an orderly fashion, or one that dominates a region of the country, underpins the payments system [a corporation that has high borrowings from banks may cause banks to become insolvent by default, thereby aggravating or, exacerbating the banking crises], or has a special niche in the credit market.[58]

Bailing out corporations that are TBTF (i.e., of systemic importance) may seem unavoidable because doing otherwise would lead to severe negative externalities, domino or ripple effects, adversely affecting the real economy, i.e., production, investment and unemployment.[59] According to Wijnbergen (1997: 55), loss-making corporations that are kept *temporarily afloat* will allow workers to, at least, be productively engaged. If these workers can produce enough value added to pay the excess of their own wages over what they would cost the government in unemployment pay [inclusive of the administrative costs of unemployment insurance (if any)], the government could come out ahead from a fiscal point of view.

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As highlighted by Ohanga (1999), there are some circumstances where insolvent [and nonviable] companies may need to be rescued in order to rescue (at least in the short term) viable *businesses* especially with group structures.[60] As such, allowing corporations to "exit" under such circumstances may not be "ideal" for "creative destruction".[61]

However, referring to the argument that bailouts are needed to minimize output loss, one could argue that bailouts in themselves also entail high fiscal costs normally borne by the public through higher taxes, lower expenditure on public goods and social safety nets. According to a study conducted by Honohan and Klingebiel (2000), unlimited deposit guarantees, open-ended liquidity support, repeated recapitalizations, debtor bailouts and regulatory forbearance add significantly and sizably to costs.[62]

Furthermore, they concluded that extensions of liquidity support actually appeared to have prolonged the crisis, as crisis recovery took longer and output loss was bigger. In addition, they highlighted that "the assumption by government of large and unforeseen bailout costs can destabilize the fiscal accounts, triggering high inflation and currency collapse – costly in themselves – as well as adding to the deadweight cost of taxation" (Honohan and Klingebiel, 2000: 3).

On a different note, with respect to the argument that bailouts are essential to check unemployment, the act of bailing out corporations may not be the only way to minimize the unemployment problem in a systemic crisis. The government can opt for direct (re)nationalization. However, for this measure to work, there should be a change of management. As long as managerial, administrative, productive inadequacies, skills and competencies, and negative political associations are maintained, these inefficiencies will continue to hamper revitalization of the corporation. Nevertheless, such a measure has its

own risks and costs, since eventually, the government will have to re-privatize these corporations if it chooses to retain them in the economy.[63]

Besides re-nationalization, other studies suggest that acquisitions (or takeovers)[64] by "vulture investors" can fulfill the role of taking over financially-ailing (cash-strapped) corporations while maintaining some employment (of course, with a certain degree of structural reengineering, which necessarily involves some form of down-sizing).[65] Hotchkiss and Mooridian (1997) showed that improvements in performance relative to pre-default levels are greater when a vulture joins the board, becomes CEO or Chairman, or gains control of the firm. Evidence further suggests that vulture investors serve to discipline managers of companies in financial distress, thereby minimizing the moral hazard problem.

However, as highlighted by Hotchkiss and Mooradian (forthcoming), this prospect is sometimes not as attractive as theoretically presented since potential bidders in the same industry are also likely to be financially distressed and thus constrained in their ability to raise funds to acquire the bankrupt firm.[66] Not only *may* the price bid for a bankrupt firm be low (as in the case of fire sale of assets, but in Shleifer and Vishny's model, the winning bidder *may* not be the firm that values the assets most. (See also Krugman, 1998c.)

According to Gertner and Picker (1992), asymmetric information may also impede acquisitions of distressed firms. Potential bidders, in particular those from outside the target's industry, *may* be uninformed, not only with respect to the firm value, but also with respect to the best use of the target's assets. In general, however, even bidders with operations in the same industry, face a "lemons problem". Given a "lemons" market (as

opposed to a "peach" market), we would expect to find only bad firms for sale. Hence, this option may be more difficult to execute in reality.

Stein (1988) argues that takeover *pressure* can be counterproductive if it "induces" managers to sacrifice long-term interest in order to boost current profits to pacify stockholders. If stockholders are imperfectly informed, *temporarily* low earnings may cause the stock to become undervalued, increasing the probability of a takeover at an unfavorable (or "unfair") price. This may reposition the manager's focus away from enhancing long-term viability to current profitability (giving rise to the term "myopic" – or short-sighted – managers).[67] Danger arises when corporations that operate in ventures that require long gestation periods (and understandably higher uncertainty) and/or pursue "social" objectives, are perceived to be less efficient and profitable (due to certain circumstances), even though they *may* very well be profitable in the longer term[68] (under certain circumstances) or provide a "subsidization" service (e.g., infrastructure or transportation industry) that improves consumer welfare, are subject to "ill-informed" and "unfair" takeovers. (See also Haan and Riyanto, 2000.)

Many have argued that bailouts of "large" firms promote "moral hazard"[69], potentially prolonging the recovery process and increasing the likelihood of crisis recurrence. The management of these corporations will have little incentive to restructure and enhance efficiency, confident in their knowledge that being TBTF will guarantee subsequent bailouts of future failures. By bailing out firms today, the government has created an environment conducive to subsequent bailouts, that add to the costs of bailouts in the first period, that is, loss of potential output in the future.

Nonetheless, as pointed out by Frankel (1998), even though the moral hazard concern is valid, there is a danger of exaggerating it. He notes that actions in one area can generate (partly) offsetting reactions in another. That is not, in itself, a reason not to take action. He acknowledges research demonstrating that drivers react to seat belts and airbags by driving faster and less safely than they used to. But that is not a reason to dispense with airbags. If it were, to discourage dangerous driving, we should put a spike in the steering wheel (as quoted from Michael Mussa of the International Monetary Fund).

Chang (2000), on the other hand, argues that if the owner or management realizes that financial injection is conditional upon change of ownership and top management if the firm continues to do badly, then they cannot afford to be lax in managing the corporation or supervising hired managers.[70] As such, bailing out "large" firms per se does not promote moral hazard. Government bailouts only encourage moral hazard when the bailouts are not accompanied by punishment for mismanagement and/or tough terms for financial and operational restructuring. Therefore, bailouts may not promote moral hazard if proper incentive systems and disciplining mechanisms are in place.

Economic Sovereignty Argument and Counterargument

Proponents consider bailouts to be essential for maintaining national sovereignty in the economic sphere. If domestic corporations, especially in developing countries (encompassing more infant industries with potential dynamic comparative advantage compared to developed countries), are allowed to be insolvent and bankrupted, then foreign enterprises may come to dominate and monopolise the national economy.[71]

Some would argue that if the "rescued"[72] corporation is not economically viable because the corporation is not equipped to compete effectively due to operational and managerial inadequacies (which are prevalent throughout the industry), then these firms may eventually be taken over by foreign firms or simply die out if they become too costly to maintain. This represents a case where the management is willing, but *unable* to deliver positive outcomes in the short term.[73]

These operational and managerial inadequacies may be the result of the corporations being granted "excessive" protection and privileges (or rents) – high tariffs, subsidies, concessions, monopoly rights, contracts without going through competitive bidding, etc., while not subjected to disciplining mechanisms or performance standards – thereby weakening the cost and quality competitive drive.[74] As such, maintaining corporations that are ill equiped to compete and generate profits, simply because of the fear of losing ownership to foreigners, is unfounded. If (foreign) private investors are interested in acquiring these firms, this represents a source of private funds and expertise that may prove beneficial to the economy. However, some may argue that the government or domestic owners can still retain control of the corporation by gaining the services of foreign professionals, experts and consultants where necessary, taking into account their "exorbitant fees" and repatriation of income.

Some argue that bailouts are important in the Malaysian context because allowing corporations under the redistribution program to falter would mean that all previous initiatives would have been in vain. As highlighted by Nesadurai (1998), the patronage-based economic system has led to strong links between the state and part of the corporate elite. Adjustment strategies are likely to be influenced by leaders wishing to protect their

corporate allies and supporters. The Malay political elite regards the ethnic redistributive policies as vital.[75] It can be argued that such an entrenched ethnic-based patronage and distributive program has resulted in the government being *unable* and *unwilling* to break with the status quo.

Even though the objective of the Malaysian ethnic redistribution policies to reduce inter-ethnic socio-economic disparities may be noble, its benefits have not been widespread, concentrated in the hands of elite businessmen with close government ties.[76] Hence, it is doubtful there is a strong case for bailouts based on national interest.[77] As such, bailouts can be abused to only mainly benefit an elite few, with widespread costs and concentrated benefits.

Concluding Remarks

Each argument and counter-argument has its own merits. In deciding whether bailouts are indeed welfare decreasing, we must compare the relevant benefits and costs of undertaking such tasks which often involve massive public funds and affect national interest and welfare. Focusing only on the costs or problems associated with bailouts, without reference to the potential benefits accruing from bailouts, will give an incomplete analysis (reflecting negatively against bailouts) and assessment of the "best" or "optimum" path to take.

If ever a "corporate rescue" is conducted, it must be tightly managed to avoid undesirable political pressures and bias. Bailouts can lead to desirable outcomes if conducted or implemented with tough, but reasonable conditions. If appropriate negative and positive incentives are in place, these economic agents will react positively towards these incentives, thereby minimizing the moral hazard problem.

Bailouts of corporations will lead to adverse consequences if there are no conditionalities attached to change current financial, operational or managerial practices to improve corporate performance or to minimize or dilute the position and power of managers and owners if failure to obtain "satisfactory" results persists. Here, the government must be able to create a credible threat.

Therefore, balancing the costs against the benefits of a bailout *may* signal the desirability of bailing out corporations, after considering the net loss to society due to negative externalities or spillover effects. Besides the "economic" aspect, one also needs to consider the equity aspect when assessing policy measures.

It should be noted that bailouts perceived to be conducted in a non-transparent and politicised manner, could reduce investor confidence, thereby obstructing medium- and long-term foreign direct investment inflows, adversely affecting economic potential in the medium and long term. Obviously, this calls for transparency of corporations being assisted and strong arguments, supported with evidence, for assisting these corporations.

There are numerous views of the appropriate role that the government should play when dealing with systemic crises. This will be the area of focus in the next section. Detailed legal aspects of winding-up procedures, bankruptcy proceedings and "break-up basis" liquidation are beyond the scope of the paper.

6. Appropriate Government Role and Policy For Corporate Restructuring

Due to the nature of the East Asian financial crisis (with both financial and corporate[78] sectors in distress)[79], banks had to be recapitalized and restructured program while corporations had to undergo restructuring[80]. It is important to keep in mind the goal of corporate restructuring, i.e., the timely and orderly[81] transformation and reduction of debt