U.S. Treasury's rhetoric of AIG bailout: a misguided justification

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The U.S. Treasury announced the sale of its final shares of AIG common stock on December 11, 2012 and a realized positive return of 5 billion to taxpayers on their "investment." The AIG experiment highlights a crucial function that the government served in the economy hidden behind the language of "financial investment": its ability to "smooth" the consequences of aggregate risk for individuals. This function becomes particularly pronounced when market valuation mechanism (e.g. stock prices) goes awry. As J. R. Common once said, "People act to enlarge valuations in periods of hope and to depress valuations in periods of fear." Only collective action could pre-empt such short-termism which was evident in the decision leading up to AIG's rescue. In fact, the role of government in the rescue of AIG is not essentially different than its overall social insurance function (e.g. unemployment insurance). This very role could have easily extended into foreclosure crisis through a loan modification mandate—a policy which would amount to investment in the *future* of the housing market. This paper intends to expose the logical inconsistencies and the ideological bias in the Treasury's conception of "government" and offer a more systematic articulation of the (welfare-enhancing) social insurance function that the government is very-well position to serve in dealing with the consequences of *aggregate risk*.