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**Should the Government Compensate the Clients of TAT?**

**By Sam Vaknin, Ph.D.**

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This, of course, is a political decision. There is no "right" thing to do. Even the IMF imperatives are not sacred. Sometimes, inflationary goals should be sacrifice to avoid the total collapse of the banking system and, with it, the economy as a whole.

Unfortunately, a lot of experience has been accumulated elsewhere in the world. No country was exempt, all suffered collapsing or near-collapsing banking systems. India had to nationalize the fourteen biggest banks - and, later on, tens of private, smaller ones - in 1969.

This was done to avert a major financial catastrophe. No one can enumerate all the banking crises in England. As late as 1991 it had a 10 billion USD collapse (the BCCI bank).

In 1973-4, during the "secondary banking crisis", the government had to launch operation "Lifeboat" to save 60 banks. They failed because the Bank of England deregulated the credit markets and freed it to competition.

As we review this scorched earth of ruined banks, six patterns emerge concerning the compensation offered by the state to the adversely affected clients.

The USA established a Federal Deposit Insurance Corporation (FDIC) as early as 1933.

Every depositor in every American bank is insured and the participation of the banks in the FDIC is obligatory. The FDIC covers deposits of up to 100,000 USD per person per bank.

The savings and loans associations (SLAs) were insured in a separate agency, the FSLIC.

When a wave of bankruptcies engulfed the SLAs in 1985-7, the FSLIC went bust and was unable to meet the demands of the panicky depositors.

The USA reorganized the whole system but it also decided to compensate the depositors and savers in the SLAs. To do that, it initially injected - using budget contingency funds - 10.8 billion USD. Then, a special agency was set up (the RTC).

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This agency established RefCorp, a corporation whose sole purpose was to issue bonds to the public and sell them in the various stock exchanges throughout the USA. The proceeds of the of the sale were used to beef up the failing SLAs and to make their balance sheets much healthier.

It is important to note that nothing explicit was promised to the depositors. The government made vague and late statements about its willingness to support the ailing institutions. This was enough to calm the panic and to re-establish trust between the depositors and the SLAs.

RefCorp bonds were not backed by a federal guarantee. Still, the fact that RefCorp was a federal entity, associated with the administration was enough to give it a federal credit rating.

People believed in the sincerity of the commitment of the government and in the long term repayment prospects of the bonds. They bought 300 billion worth and the money was immediately injected to heal the bankrupt institutions. Using long term debt - which was not even part of its obligations - the government was able to stabilize the financial system and to fully compensate depositors for their money.

A similar approach was adopted by Israel to cope with its 1983 banking crisis. The whole banking system collapsed as a result of a failure of a pyramid scheme involving the banks' shares. The government was faced with civil unrest and decided to compensate those who bought the shares in the stock exchange.

At first, the banks were nationalized and trading in their shares in the stock exchange was suspended to prevent panic selling. The government, having become the owner of the banks, declared a share buyback scheme. Owners of bank shares were permitted to sell them to the government in three specific dates over a period of 9 years (originally, the share buyback scheme was for a period of 6 years with two exit dates but it was prolonged). The price at which the government agreed to buy the shares back from the public was the price on the last day that the shares were traded prior to the collapse (5/10/83) and it was linked to the exchange rate of the Shekel-USD. The government used funds allocated within the national budget to buy the shares back. This means that it used taxpayers money to financially save a select group of shareholders. But there was no public outcry: so many people were involved in these pyramid schemes for so long that all the citizens stood to benefit from this generous handout. When the last shares were bought in 1992 the total damage became evident: no less than 6 billion USD (minus what the government could get when it were to sell the banks that it owned).

1994 was arguably the worst year for banks in South America since 1982. Banks collapsed all over that region.

It started with Venezuela in January 1994. One of the major banks there, Banco Latino, failed, dragging with it 7 others. The Government decided to fully compensate all the depositors and savers in these banks. It has created a special fund to which revenues from the sale of oil were transferred. Obviously, this money was taken away from the budget and was compensated for by extra taxation. The whole economy was horribly

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effected: inflation shot up uncontrollably, a credit crunch ensued and business bankruptcies proliferated. Venezuela entered one of the worst economic periods in its history with rampant unemployment and a virtual state of economic depression. It cost the country 12 billion USD to extract its banking system from the throes of imminent evaporation - an amount equal to 22% of its annual GDP.

And this was nothing compared to the Brazilian predicament. Brazil is divided to geographically huge states, each with its own development bank. These banks are really commercial banks. They have hundreds of branches spread across the states, they take deposits and make loans to business firms and to individuals. But their main debtors are the administrations of the states. When Banespa, the Sao Paolo state development bank collapsed, it was owed 19 billion USD by the state government, not to mention other bad loans. This bank had 1,500 branches and millions of depositors. It would have been political suicide to just let it die away. In December 1994, the Central Bank took over the day to day management of the bank and installed its own people in it. The bank was later completely nationalized. Moreover, the other state development banks began to wobble, together with a sizeable chunk of the private banking sector - 27 banks in total. This was really ominous and the government came up with a creative solution: instead of saving the banks - it saved the big clients of the banks. Sao Paolo received 66 billion USD in federal credits which assisted it in re-financing and in re-scheduling its debts, especially its debts towards Banespa. The bank was saved, the state was saved, the federal budget was 66 billions poorer - and this was only the beginning. In certain cases, the loan (asset) portfolios were so bad and unrecoverable that the government had to inject money to the bank itself - because there were no more clients to inject money to. Banco do Brazil received 7.8 billion USD on condition that it writes off loans from its books. Another 13.6 billion USD were given to private banks. The government also cajoled banks into merging or into finding foreign partners. The depositors were completely compensated but only a few of the 27 saved banks are of any interest to foreign investors. After all, a bank without assets is hardly a bank at all.

The most vicious of all banking affairs in this part of the world occurred in Paraguay a year later. The Treasure of the Central Bank, no less, was found using the Central Bank funds to run a lucrative money lending operation. He lent 3 million of the bank's funds before he was caught. Needless to sat that he pocketed the interest payments. In April 1995, the Governor of the Central Bank there decided that things were getting too hot for him and he fled the country altogether. The public was in panic. No one knew what happened to the reserves of the commercial banks which were deposited with the Central Banks. Banks with no reserves are very shaky and dangerous institutions. So, depositors and savers queued in front of the banks to draw their money. It was a matter of a very short time before the banks became insolvent and closed down their operations, albeit "temporarily". Four banks and 16 savings houses collapsed that year and four more banks - the next. The bank supervision discovered mountains and oceans of black money on which the banks paid high rates of interest. The legal "white" money - a much smaller amount altogether - bore a lower rate of interest.

The government adopted a politically brave decision: it would compensate only those depositors which deposited money on which they paid taxes ("legal money"). Even so, the damage was great (in Paraguayan terms): 450 million USD. Those depositors who received excess interest payments on their undeclared funds - lost both their funds and

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the interest accruing thereon. Moreover, the government forced the owners of the banks to increase the equity capital. The system was saved, though the basic malaise was not cured and the banking system is still obscure, secretive, nepotistic and highly dangerous.

A course very similar to that chosen by Macedonia was adopted by the government of Japan.

In 1990, the Tokyo Stock Exchange began its long 50% decline. People lost trillions of USD.

As a result, they had no money to continue to pay the outlandish prices which were demanded by sellers of real estate property. So, real estate prices went down by as much as 80% in the Tokyo area - and by a bit less elsewhere in Japan. Real estate property served as the main security on huge portfolios of loans which were provided by banks through Junsen, financing corporations set up especially to provide mortgage collateralised loans.

The logical - and inevitable - result was the collapse of seven important Junsen, followed by a chain reaction of banks ceasing to function.

The Japanese government set up a special agency, the HLAC, which "cleaned" the books of the banks by taking over the non-performing loans. This move was very similar to what the Macedonian government did with the Ägencija za Sanacija na Bankiti" - clean off the balance sheets of the banks, make them healthier and then supervise them heavily. No one knows how much the government of Japan has doled out to save the banks (actually, the depositors money). Rumours have it that about 1.8 billion were invested in the rescue operation of 1 junsen, the Nichiei Junsen.

Different countries bring different cultures and different solutions to the same problems.

Yet, there is one thing common to all: depositors are usually almost fully compensated using state money on and off budget. Some countries spread the payments over longer periods of time - other do not even dare raise the possibility and they take over the liabilities (and the assets) of the failing banking system. Some sell bonds to raise the money - other us taxpayers money. But they all succumb to the ultimate political imperative: survival.

Sam Vaknin is the author of "Malignant Self Love - Narcissism Revisited" and "After the Rain - How the West Lost the East". He is a columnist in "Central Europe Review", United Press International (UPI) and ebookweb.org and the editor of mental health and Central East Europe categories in The Open Directory, Suite101 and searcheurope.com. Until recently, he served as the Economic Advisor to the Government of Macedonia.

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The ninth amendment: It's cool!!

By Darrin F. Coe, MA

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Recently, Colorado passed a law banning participation in “toughperson” fighting competitions. This is wrong and unamerican. I believe the right to engage in consensual violence falls under the ninth amendment right to privacy. What makes the United States great is choice. Our government was founded on choice. The right to chose the words I speak; the right to chose the way I worship; the right to assemble peaceable and to question my government; and the right to chose to arm or not to arm myself are all part and parcel of the greatness of America.
The ninth amendment says, “the enumeration, in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people.” The right to privacy falls under these unenumerated rights. The right to privacy is the right to not have the government dictate personal behavior. Thus, as long as it does not harm other people, deprive others of property, or engaged in by those who can give consent, our government does not have the right to regulate it.
I do not believe the federal government has the constitutional power to regulate who marries who; I do not believe the government has the right to regulate the wearing of seatbelts by adults; I do not believe the government has the right to regulate the wearing of motorcycle helmets; nor do I believe the government has the right to regulate competitive violence.
The constitution affords the federal government the right to regulate commerce between the states; establish revenues and taxes; pay the debts of the country; and provide for the common defense and general welfare of the United States. Any rights not specifically enumerated as belonging to the federal government belongs to the state governments.
I encourage every citizen to know the content of their state and federal constitutions. It is incumbent upon the citizens to know and protect their rights. It seems to me that the federal and state governments will take away rights if we allow them to do so; sometimes in the interests of “welfare” and sometimes in the interests of “money”.
Take the time to care enough about our government and your rights as individuals; to get involved and be informed. The more you give the more they’ll take and those in government have great love for the uninformed.

Darrin F. Coe holds a master's degree in professional psychology and is the author of "Bring The Noise: Warrior Poetry" and the horror serial "feeding ground". contact at http://dcoe1.tripod.com

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