On Bail Outs and Bail Ins

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Are you tired of seeing the government rescuing wealthy bankers from their errors with your tax money? Are you tired of watching banks creating questionable securities, then making large profits by selling them to unsuspecting customers based on risk ratings that were bought and paid for by the banks who created the suspect securities? Meanwhile, when the bad securities crashed, the bankers took your tax money from the government to continue and expand their gambling racket. Are you tired of watching your friends and neighbors lose their houses and jobs while the politically well-connected bankers are compensated and rewarded for failure? In short, are you tired of seeing these Wall Street losers line up to take bailouts to save them from their own incompetence while the taxpayers take the loss? Well cheer up chumps, in addition to future recurring bail-outs, there will come a day when you will be "invited" to "participate" in a bail-in. Here's how the scam will work.

When you make a deposit at a bank, you receive in return a demand deposit in the form of either a savings account or checking account entry. Likewise, when you purchase a certificate of deposit, you receive a document, which is, like the savings and checking accounts, a receipt showing that the bank owes you the deposited amount upon presentation of a claim. In other words, the bank does not sequester the money you deposited; it simply issues you a future right to a certain amount of money in the future, namely, the amount you deposited in one of the account types. You are actually lending those assets to the bank, and the bank may do with it as it pleases. The bank is merely obligated to fulfill its promise return it to you upon demand, and likewise with all other depositors. The bank therefore keeps a small amount of cash on hand to disburse to its depositors from day to day; the rest is loaned out at a profit to the bank. (Yes it's true: banks make their profits by lending out something they do not actually own: your deposit).

But what if the bank engages in shady real-estate transactions, or lends money to people who refuse to pay back, or who cannot pay back; or if the bank over-extends itself through highly leveraged investments that decline in value? There may come a time when the bank's cash flow is insufficient to meet the daily demands by its depositors; in that case, it will have to obtain more capital to cover those losses and make good on its promises to the depositors. But what if it cannot raise the required capital? Remember, banks do not make money by risking their money; only by risking yours. The CEO of the bank is not going to pony up $300 million of his own money to cover the depositors: he will inform the government that a bailout is needed. If enough banks make the same mistakes, and the entire cartel becomes insolvent, then they get a very large bailout because they can claim that the entire financial system will collapse. So it becomes an extension of the old rubric, which goes: "If you owe the bank $100 and can't pay, you have a problem. If you owe the bank $1,000,000 and can't pay, the bank has a problem". To which we now add, "If the banks owe $1,000,000,000,000 and can't pay, then the taxpayers have a problem." Hence the need for the government to bail out the bankers; the funds to do so are created by the central bank (the Federal Reserve in the U. S.), and the repayment is made by future tax increases to pay off the new debt created by the central bank. A bail-out is when the bank is rescued by some external entity, usually the central bank acting on behalf of the government.

A bail-in is different. A bail-in is when bankers are rescued by internal entities, which is to say, the depositors. This is done by getting the government to allow the banks to refuse to honor claims by depositors, or prevent risk of capital loss to the bank by depositors demanding their own property back. The bankers are unable to understand the colossal nerve of depositors, demanding to exercise their rights, formerly issued by the bank, to retrieve their own property on demand. To the bankers, you are nothing more than an ingrate if you still insist that the bank uphold its end of the deal A bail-in is manifested by

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"capital controls", (not on the banks since they do not risk their capital), but on its depositors. It comes in the form of limitations upon depositors on how much can be withdrawn per day or week; a prohibition on the cashing of checks, limitations on how much currency can taken out of the country, limitations on over-all volume of transactions, etc. It matters not that a depositor needs money to pay for groceries or the mortgage: what matters is that the bank, by exercising a bail-in, gets to keep their money as long as it needs to, thus avoiding default, until it can coerce, bribe, or intimidate a government or other banks to give it a bail-out. Now banks do not have the legal power to invoke a bail-in unilaterally: it has thus far required a conspiracy with the government to transfer such a power to the bank; for which consideration, the politicians are of course rewarded with favorable loan terms or even forgiveness of existing loans. A bail-in generally does not permit the banks to pilfer the contents of "safe deposit" boxes, but it would be naive to exclude such a future possibility.

Lest you think this is all idle speculation, be advised that it already happened in Cyprus in 2013. When the Cypriot national banks got into trouble, it negotiated a bailout with the IMF and other European central banks, but the deal was contingent upon the government of Cyprus to allow a bail-in binding on depositors. So, in March of 2013, Cypriot depositors were saddled with the following restrictions on their own property [1, 2], some of which are still in effect:

a. withdrawals limited to 300 euros per day
b. cashing of checks prohibited
c. Persons exiting Cyprus could take no more than 1000 euros with them
d. Payments or transfers to foreign accounts limited to 5000 euros per month
e. A 9.9% tax levied on depositors with balances greater then 100,00 euros, and a 6.75% tax on deposits less than 100,000 euros

What happened when the government imposed these violations of rights upon its own citizens in order to save the incompetent and/or corrupt bankers? Did the people reach for the pitchforks and torches and descend upon the bankers and politicians? No; they patiently waited in long lines like sheep; they raised no protest at the violation of their rights; they did not question the merits of the government's actions against them. You may be sure that this quiet acquiescence did not go unnoticed by the bankers and their political cronies. When U. S. banks get in trouble again, as they are sure to do, it will create the perfect excuse for the government to restrict most cash transactions, allow the banks to prosper without risk, and track your every economic move electronically.

[1] BBC News Europe, "Cyprus eases some bank restrictions after bailout", 29 Mar 2013, http://www.bbc.co.uk/news/world-europe-21978286
[2] Edward Harrison, "Cyprus' Bank Deposit Bail-In", 16 Mar 2013, http://www.nakedcapitalism.com/2013/03/cyprus-bank-deposit-bail-in.html

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