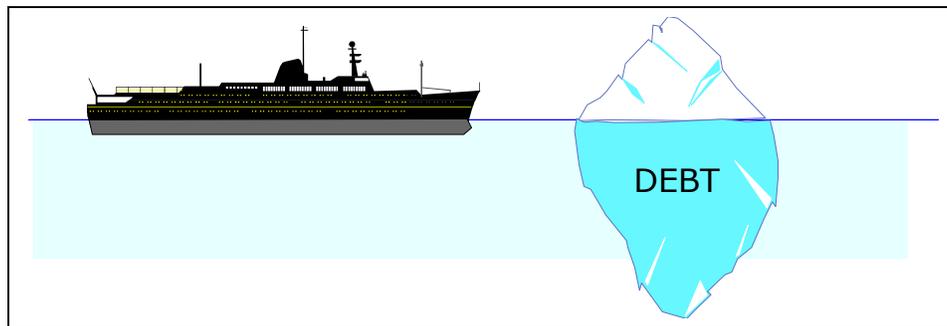




"TOO BIG TO FAIL"

5 When large banks or companies fail, some policymakers believe it is
10 time for government to step in with loans and special laws intended to
15 keep them going. This happened in Japan during the troubled period from
1995-1998, and still does happen in countries all over the world. These
institutions requiring assistance are termed "too-big-to-fail" (TBTF). An
organization is designated TBTF, if its failure would trigger many other
failures in the financial system of a country. Panic would ensue creating a
run on the banks as desperate depositors withdraw their money for fear of
losing it. If this happens, many other types of business will suffer as
consumers refuse to spend. In order to avoid this type of banking crisis,
government has created "deposit insurance" which protects depositors
from losses in the form of cash deliveries to the troubled banks. Such a
move will not only restore confidence in the financial system, but in the
government as well. If these policies fail, social and economic order could
deteriorate or perhaps even fail completely. However safe this system
may seem, it does present a big problem: one built within it.

Which companies in your country do you consider too big to fail?



Moral Hazard

20 Bailing out (helping out) banks can create another serious difficulty,
because it allows them to engage in risks with depositors' money they
might otherwise not be inclined to take. Thus, instruments such as
depositors' insurance create a "moral hazard" which means it brings about
the very situation it was meant to prevent. Once a person is insured,
25 (s)he has more of an incentive to take a risk knowing that someone else
will pay for the loss in case of failure. That is why insurance policies have
"deductibles". The insured person has to pay for some of the loss out of
his/her own pocket before the insurance company steps in to help. In this
way, the "injured" person pays something for his/her own misfortune,
mistake or negligence. But, in the case of depositors' insurance, there is
30 no deductible. Government will pick up the tab for the whole of the
insured amount letting those responsible for the failure off the hook.

**Can you give more examples of situations in which people take
greater risks with other people's money than with their own?**

35 What is government money, besides taxpayer's money anyway? So, as it turns out, citizens must first suffer the loss of their investments, and later pay for them out of their own pockets with more tax money. Without government intervention, in the form of insurance, new loans and regulations, companies would have to face the consequences of their own mismanagement and bad decisions alone. Although this could be a good lesson for them and send a strong message to other faltering organizations; few governments have the courage or political will to let this happen for fear of the consequences.



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50 Helping companies has also come under fire; because it is not even certain, in some cases, that they actually would have gone under (bankrupt) had government not stepped in. What is to stop an organization from claiming to be in distress just to get some extra sympathy and assistance?

55 **Which group is more responsible for the failure of a government supported industry, company executives or the government officials who are supposed to watch over them?**

Airbus and Boeing

60 Perhaps the most well-known case of TBTF is in the rivalry of the two aerospace giants, Airbus and Boeing. Airbus relies heavily on subsidies from its European based industries in France, Germany, Spain and the United Kingdom, while Boeing receives massive backing from the US government. Both these two industries blast the other for receiving subsidies as "unfair" or "illegal". Airbus says that Boeing is to blame for its own financial problems while Boeing says that since Airbus is competing as a government sponsored industry, it has an unfair advantage in the marketplace.

65
70 Neither the US or EU governments would hesitate to defend their financial backing of these two industries, for both are vital to national defense, necessary as a source of new home-based technology, have created spin-off industries, and provide countless jobs. Both governments hold to the TBTF doctrine which states financial collapse would result if their sponsored industry were to fail.

The Stock Market

75 Public officials may think it necessary to intervene in the stock market from time to time in emergencies such as stock market crashes or terrorist attacks. But while supporting the market, government is using particular financial houses thereby giving those brokers a tremendous

80 advantage over agents used by ordinary investors. Share prices of favored companies would be driven up while prices of those, not in favor, would, most likely, go down. In effect, government is betting against all citizens who do not invest along with it.

85 A situation may arise in which it is impossible to distinguish between national emergency and political favoritism. In fact, the public may not even know what decisions its leaders are making with their money, if transactions are conducted in secret. Political leaders will probably reward companies run by its supporters by purchasing shares of their stock with taxpayer money. Doubtless, money will go to companies backing certain political causes, too. Citizens will not want to give to causes with which they wholly disagree or perhaps even consider immoral. This includes 90 casinos, tobacco companies, weapons manufacturers; enterprises owned by religious groups, and alcoholic drinks makers or even meat packing companies, if citizens are vegetarians. Suppose a strong political supporter is about to go bankrupt due to mismanagement or bad decision 95 making, would leaders use public money to keep this individual in business longer? The entire process must be considered undemocratic and subject to suspicion.

Would you consent to let your government support industries you are against?

100 Public support of industry may not be wrong in itself (although some experts would disagree), but the potential for abuse is always present. Instead of helping the public, the TBTF doctrine does little in the way of lowering costs or achieving economic prosperity. By favoring selected industries, policy makers protect local companies from harmful 105 competition as well as good competition from outsiders: good competition that could mean more advanced or improved technology, better service and lower prices for the consumer.

