Yes, of course Cyprus should go bust: or at least the banks [1]

Written by **Tim Worstall** [2] | Saturday 23 March 2013

When an institution, person or country is bust then the obvious thing to do is say, well, yup, you're bust. Then clean up the mess and start again. So it is with the situation Cyprus is in (or at least, that it's in as I write, on Friday afternoon). The place is bust and someone is just jolly well going to have to take the losses that cannot be paid back. Paul Krugman (this is the Good Krugman, the economist, not the NY Times pontificator. Even if the economist is speaking through the NYT) says that Iceland did well when it simply agreed, yes, we're bust, and then dealt with cleaning up the mess [3]:

> Like Cyprus now, Iceland had a huge banking sector, swollen by foreign deposits, that was simply too big to bail out. Iceland?s response was essentially to let its banks go bust, wiping out those foreign investors, while protecting domestic depositors ? and the results weren?t too bad. Indeed, Iceland, with a far lower unemployment rate than most of Europe, has weathered the crisis surprisingly well.

The Wall Street Journal points out that it doesn't actually have to go quite that far [4]:

> The European Central Bank on Thursday gave Cyprus until next Monday to reach a deal on restructuring its insolvent banks. Our suggestion: Let them go bust. Cyprus's two biggest banks, Laiki and the Bank of Cyprus, are deeply insolvent. While the EU, the IMF and Cyprus could spend the weekend trying to negotiate a deal to inject billions into the banks, the time would be better spent arranging for their bankruptcy. Here's how it could work: Shareholders, along with senior and subordinated debt holders, would be wiped out. Deposits up to €100,000 that are insured would be protected. Larger depositors would take a haircut in the range of 40%?somewhat more for Laiki depositors, somewhat less for account holders at Bank of Cyprus, reflecting the extent of the losses and the capital needs at the two banks.

Madsen made a similar point earlier in the week [5]:

> The bank levy punishes savers but leaves the bond-holders untouched, violating the principle that small savers should be protected, while the bond-holders who knew they were taking a punt should take a hit.

I was recommending something close to the WSJ solution last weekend elsewhere. And this leads me to two points I want to make.

The first is that all of us making these sorts of suggestions are the capitalist neoliberal running pig dogs (yes, Good Krugman qualifies for that). You know, the people who are supposedly only the apologists for the rich and powerful. And we're all singing from the same hymn sheet here: let the rich take the beating. We're all resolutely opposed to these bad debts being heaped on the taxpayers' shoulders for decades to come. Against small savers getting gouged. Entirely in favour of rich people losing their money. It's yet another example of what is the most underappreciated fact about this capitalist neoliberal running pig doggery: how incredibly, massively, pro-poor it all is. It is, after all, the only politico-economic system that has ever raised the average man and woman up above a subsistence level income. And I really cannot think of anything more pro-poor than that.

The second is still capitalist dog running: the defining point of the system isn't in fact the way that assets are owned, the competition red in tooth and claw. Rather, it's the way that it cleans up the inevitable failures. For in any structure of human affairs there will indeed be failures. And I take bankruptcy to be one of the most valuable and defining points of this whole capitalist/market system that we've got. When failure does happen, when debts are unpayable, then we all agree, yup, those can't be paid. Oh dear, all you investors, you lost. Better luck next time. It's the *quid pro quo* that if the investors get it right then they make out like bandits. And if they put their cash into banks which then lend all the money to the Greek Government to default upon (which is indeed what the Cypriot banks did) then they lose large chunks of it.

So, the Worstall solution to Cyprus is that we should indeed be pro-poor and capitalist. Those banks are bust. OK, so, the large depositors lose much of their money, the small depositors were protected under law and so should be protected (yes, the rule of law is indeed important) and that's about the best we can do. Because failure really is failure and it has to be treated as such.

blog comments powered by Disqus [7]

Source URL: http://www.adamsmith.org/blog/money-banking/yes-of-course-cyprus-should-go-bust-or-at-least-the-banks

Links:
[1] http://www.adamsmith.org/blog/money-banking/yes-of-course-cyprus-should-go-bust-or-at-least-the-banks
[2] http://www.adamsmith.org/taxonomy/term/5778
[3] http://www.nytimes.com/2013/03/22/opinion/krugman-treasure-island-trauma.html?_r=0
[4] http://online.wsj.com/article/SB10001424127887324103504578372411352205582.html?mod=googlenews_wsj
[5] http://www.adamsmith.org/blog/money-banking/making-a-complete-mess-of-cyprus
[6] http://disqus.com/?ref_noscript
[7] http://disqus.com