The BLACK CoMMentator

An independent weekly internet magazine dedicated to the movement for economic justice, social justice and peace - Providing commentary, analysis and investigations on issues affecting African Americans and the African world.

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January 29, 2009 - Issue 309

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Investing with Bernie Madoff: How it Happened, What Happened, and What Might be Done - Continued

National Affairs

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The courses of action discussed here previously all have major shortcomings: they leave people very short of money to live on, they harm the innocent, they take way too long, they are uncertain. There is a different course of action, however, which would avoid most of these pitfalls. It would be speedy. It would be certain. It would give people their money back. It would put money back in the pockets of charities and pension plans. And it would greatly help restore confidence in investors, whose confidence has been badly shaken, and who, so long on their confidence remain shaken, are likely to stay away from investments in droves, which will "help" cripple efforts at economic recovery - all as recognized by Congressmen at the January 5th hearing. It is a course of action which has been undertaken for the wealthiest corporations and individuals in the country. It is a course of action that will compensate for the most gross failure ever of government regulation, a factor responsible for the Madoff disaster. It is also a course of action which the smart money says is politically unpalatable and will never happen, though done for others in monstrously huge amounts (of scores and hundreds of billions), because people are tired of it and here the people who lost money "are nothing but a bunch of wealthy Jews."

The course of action is what can be called a "staggered-percentage bailout," or in the alternative, could be a full bailout.

Here is how a staggered-percentage bailout would work. Recognizing that many of the people who lost half a million or a million dollars were using and need that money to survive, all people would receive the entire first one million of their losses from the government. For losses between two and five million dollars, people would receive 90% of their loss, or another $3.6 million for someone who lost $5 million (and who would thus obtain a total of $4.6 million). For losses between 5 to 20 million, a person would receive 80%, or another $12 million (or a total of $16.6 million) if the individual lost a full 20 million dollars. From 20 million to 100 million in losses, a person would receive 70% of the loss, or another 56 million dollars (or a total of 72.6 million) if a person lost a full 100 million. Over 100 million a person would receive 60%. (This staggered-percentage bailout is analogous to the income tax system in that it uses a staggered rate depending on wealth.)

The losses should be calculated on the basis of what a person honestly and reasonably thought he had in Madoff - which for most people would be represented by their last statement, dated November 30, 2008. For what they honestly thought they had in Madoff is the basis on which people always acted, and would be *expected* to act in a capitalist system. (People who thought they had $1.5 million in Madoff and took out $125,000 a year to live, for example, would not have taken out that amount if they knew that in reality they only had $600,000 or so in Madoff. Charities that thought they had $15 million in Madoff would not have been giving out $1.6 million a year had they known they had only $6 million in Madoff, a reality they would have known but for governmental negligence.)

Persons who invested through funds and banks would be treated the same as persons who invested directly with Madoff, while the funds and banks would receive nothing (since the money is going directly to their investors).

There would be no recovery from SIPC or from the trustee in bankruptcy. There would be no tax refunds. There would be no tax deductions. The bailout would replace all of this. The government could, however, be subrogated to the rights of the bailed out individuals against anyone subject to lawsuit - against negligent money mangers, and against FINRA, a private organization. The money mangers and FINRA could of course argue that the government is banned from recovering from them due to its own negligence.

This would be simple, quick, and clean. It would avoid the terror and uncertainty of claw backs, the incomplete recoveries from SIPC, the wiping out of charities and injury to pension funds, the years-long wait and pain caused to individuals by lawsuits. It might also cost the government little more than tax refunds and deductions. This is complicated to explain, at least for me, and we would need to know the actual numbers before estimates can be made with some certainty, but the general idea is this: Tax refunds and theft deductions will cost the government billions of dollars under current law with the estimate sometimes being $20 billion. The money received back in the near future via tax refunds will be invested, will earn income, and taxes will be paid on that income in the future by tax paying individuals. Those taxes will reduce the government's "loss." (At least taxes will be paid and the government's "loss" reduced if enough is received back in refunds so that people *can* invest it instead of using it all to live.)

A similar idea obtains with theft deductions now and in the future. The money saved will be invested, will earn income on which taxes will be paid, and the taxes will reduce the government's "loss." This at least is true to the extent that people will not have to use the money saved in order to live, instead of investing it. Otherwise, the money may not be saved, invested, and earn income on which tax will be paid until many years into the future, because the theft loss has to be fixed pretty precisely before the tax deduction can be taken, and that won't happen for a long time.

The situation with a bailout would be different in important ways, however. The government will "lose" the money paid as part of a bailout, but it will not "lose" money via tax refunds and via theft deductions taken now and in the future.

Moreover, the bailout monies given to taxpaying individuals will be invested and will start earning money immediately - bailout money equal to what their statements showed they had in Madoff would enable people to live off earnings from investments rather than off principal, just as they did when they thought they had the money in Madoff. Income taxes will therefore start being paid immediately by tax paying individuals on the invested money from the bailout. These income taxes will reduce the government's "loss" from the bailout.

When all the numbers are known, it could well be that (i) the "loss" from the money paid in a staggered-percentage bailout, minus the "loss"-reducing tax paid on future earnings from the sums paid via bailout, may not be much more than (and might even be less than), (ii) the "loss" to the government because of tax refunds and present and future deductions for theft, minus the loss-reducing tax paid on earnings from invested monies that accrue to taxpayers because of tax refunds and deductions. And none of this even counts the "loss"-reducing amounts the government might recover in litigation due to subrogation to the rights of people who are bailed out.

Well, as warned, it's complicated, and reasonably accurate estimates of the difference in the government's "losses" await the facts. But even aside from the fact that a bailout might not cost the government much more than it will "lose" from tax refunds and deductions, a bailout has numerous and important advantages discussed above, not the least of which is that it is simple, will eliminate all the complications and uncertainties presently arising with regard to SIPC, claims made to the Trustee, tax refunds and theft deductions, and litigation, and it will help to re-engender all-important confidence in investors - without whose investments our economy will sink beneath the waves - by showing that government will act to protect people when its own gross, willful, incompetent failure to do its duty, and to stop a major crime, caused them to be wiped out.

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