

# Europe's bail-out must be taxpayer friendly

**Tito Boeri**

**T**he leaders of the eurozone finally agreed on a plan. It is an ambitious rescue plan for the banking system, as it should be, to stop the self-fulfilling prophecies that brought us to the brink of another Great Depression. But the plan should now also be made acceptable to European citizens.

In the next couple of weeks we shall see how effective these extreme measures are in reducing the spread between the euro interbank offered rate (Euribor) and the European Central Bank refinancing rate. If they only partly succeed in reassuring markets, there will be sizeable outlays to the banking sector. The insurance for the interbank market is potentially very costly – before the crisis the overnight volumes in many euro countries were of the order of 1-2 per cent of gross domestic product – while the bank recapitalisation plans commit so far up to 20 per cent of eurozone GDP. This share is bound to increase further as

national plans are unveiled and countries are forced to raise capital to match the core tier one levels of UK banks (too bad that there was no cross-country co-ordination in this respect).

Is public opinion in the European Union ready to accept such potentially massive transfers of resources from the taxpayer to the banking sector? It is true it is mainly gross debt that will increase. By selling assets later on, net public debts may in fact go down when the crisis is over. It is also true that in saving the banking system we ultimately save economies and millions of jobs. Nonetheless, there is a risk that plans committing large resources to bank rescues will find strong opposition in national parliaments.

Paradoxically, the opponents to “bank socialism” will come mainly from the ranks of the former supporters of the socialisation of the means of production. So far the crisis has contributed to reducing wealth inequalities in Europe. This is due to the relatively low participation of households in financial markets and the relatively low take-up of pension schemes.

Another reason these measures will be hard for public opinion to swallow is that the eurozone package postponed much-advertised measures to “punish the bankers”. There is a clear sequencing: first, rescue financial systems in order to restore confidence in the markets; next, work on avoiding all this happening again. This was the right thing to do. However, are European citizens ready to accept measures rescuing banks, giving public money to bankers while deferring the punishment for those who were earning up to \$50m (£37m, £28m) – Richard Fuld’s compensation in 2007 – and for banks that were experiencing before the crisis rates of return on equity of 20 per cent or more and making profits amounting in some cases (eg Unicredit and Banca Intesa) to almost 0.5 per cent of GDP?

Economists have, in the past few weeks, been successful in inducing governments to come to terms with the financial crisis. Economists should now be equally effective in devising ways to involve European citizens in the benefits. Here are three options:

First, there is an alternative way to punish banks and bankers that can be operated immediately: increasing competition. After experiencing a serious liquidity crisis, banks will compete more to attract savings from households. Removing barriers to competition in the retail sector is important to drive down profit margins and improve services for citizens. The way out of the crisis will also involve a fair amount of bank restructuring. National protections against mergers and acquisitions could severely hamper this and hence should be removed as soon as possible.

Second, governments have not been at all active in Europe in providing support to low-income families with mortgages. It is true the problems are not as acute as in the US, but the increase in Euribor rates (to which monthly mortgage rates are often indexed) is significantly increasing the number of poor families facing difficulties in meeting their payments. Temporary relief schemes for these families should be devised, narrowly targeted to minimise costs and moral hazard problems.

Third, there is also scope for implementing tax reductions for low-wage earners. These would act on both demand and supply. They increase demand as they target the households with the highest propensity to consume and increase supply because they induce more people to work without increasing companies’ labour costs. As these measures could reduce the informal sector, they would also have a limited impact on the budget.

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**Is public opinion ready to accept giving public money to bankers while deferring the punishment of former high earners?**

