Why I support an Italian Tarp, but I opposed the U.S. one

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Some attentive readers have been surprised by the fact that I have come out in favor of an Italian version of Tarp, when I was one of the main opponents of the original U.S. Tarp. It is a very legitimate question, which deserves an answer longer than 140 characters.

In September 2008, I strongly voiced my opposition to the initial version of Tarp, which was designed to buy the toxic assets from the troubled banks. Together with some colleagues I launched a very successful petition against it and I proposed a debt for equity swap of the major banks, what is now known as "bail in". I did it because I knew that all the major U.S. banks had enough widely held bonds to absorb the loss without generating a panic among investors. I was also confident that the federal insurance of deposits was strong enough to prevent devastating bank runs.

Unfortunately, neither of these conditions is present in Italy today. Italian banks – in particularly smaller ones—placed their bonds in the hands of retail depositors. There are several allegations that this placement took place in violation of the existing norms. What it is certain is that it took place with complete disregard of the clients' well-being. Banks routinely let people of modest means invest all their savings in one bond of one bank. It does not to take an economic model to understand the human suffering that such bail in would cause, as recent suicides among affected Italian investors show. But for those who care only about models, Oliver Hart and I have shown (see here (http://faculty.chicagobooth.edu/workshops/financelunch/pdf/Zingalesbank_liquidit.pdf)) why the welfare effects produced by a banking crisis are greater if the loss is allocated to retail depositors, who have high liquidity needs.

In addition, in Europe deposits are not federally insured. Thanks to the German government, who reneged on a promise made four years ago, the banking union started without federal insurance. Since the Italian sovereign cannot credibly guarantee all Italian deposits, the risk of a generalized bank run in Italy following a bail in is very high.

Last but not least, there is a huge difference between a sovereign country like the United States and a country that is part of a monetary union, like Italy. U.S. retail depositors, who want to withdraw their deposits from a risky bank but keep them in U.S. dollars, can only move them to another U.S. bank. Thus, in a crisis the total amount of U.S. deposits would not shrink, it would only be reallocated. In Italy, customers can move their deposits to Germany. The results would be a net reduction of deposits in Italy, with devastating consequences on the Italian banking sector's ability to fund loans to the economy.

For all these reason I reluctantly came to the conclusion that the Italian state should intervene to save the banking sector and I tried to design (see here (http://www.italy24.ilsole24ore.com/art/business-and-economy/2016-06-28/analisi-131922.php?uuid=ADp6iZk)) a system that minimizes the risk for taxpayers and the bail out for bankers. I am very open to suggestions to make this system better, provided they do not violate these three goals: stabilize the banking system, minimize the cost for taxpayers, and punish all those responsible of misconduct.

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