Saving in the land of good cheer and better beer

Belgium was already mired in a web of political crises for nearly a year when the full force of the bursting American credit bubble struck its seemingly robust financial system. Not surprisingly, the shockwaves from across the ocean did nothing to resolve the political stalemate. On the contrary, they set in motion a process of government intervention in the financial sector that last week resulted in another major political crisis and the resignation of the government. This came about because of the near-collapse of one of the major banks, Fortis.

When the government, in its panicky efforts to "rescue" the bank, arranged for BNP Paribas to buy most of what remained of Fortis (after the Dutch government had unilaterally taken over the Dutch branches), it neglected to follow standard procedures. Angry shareholders went to court and against all political odds won their case for a review of the conditions of the sale. As it created delays for the settlement of the Fortis affair and even the risk that BNP Paribas would bow out of the deal, the verdict was a serious setback for the government. To make matters worse, it was rumored that members of the prime minister's staff had attempted to interfere with the court proceedings. Clumsy handling of the affair by the prime minister and an indignant letter from the president of the highest court sealed the fate of the conflict-ridden Leterme government, a five-parties coalition of center-to-left Christian-democrats, "progressive" liberals, and socialists. Then there were rumors about misconduct by members of the judicial branch, which prompted an official advisory body to launch an investigation of all the magistrates that had had anything to do with the Fortis case.

Consequently, headlines in the media are again all about the political and "institutional" crisis, just as they were before Bear Stearns, Lehman Brothers, Fannie and Freddie, Bernanke and Paulson became household names in the land of good cheer and even better beer.

However, that does not mean that the government is going to just let the market clean up the rubble left by the wizards of central banking and "creative finance". Fully aware of its responsibility never to appear to do nothing, the government has just issued a decree that will have serious effects for the savings of every household in the country. Compared to the massive bailouts and "guarantees" that the government has somehow found ways to finance (or not), the new regulation may seem insignificant. Nevertheless, it is a perfect example of how governments seek to manipulate and exploit people for its own benefit as well as, in this case, for the benefit of the major pillars of "its" banking system.

According to the new regulation, which will go in effect on April 1, 2009, banks offering regular savings accounts must apply either the European Central Bank's repo rate (currently 2.5 percent) or else a maximum basic rate of 3 percent. Most banks now offer a diversity of types of savings accounts with basic rates between 1.25 and 4.25 percent (in a few cases 5 percent).

In addition to this rigorous price control, the banks will be required to add a single "loyal customer" premium on top of their basic rate, but only for deposits that remain untouched for at least a year. This will replace the customary system, which has two different types of premium. At present, banks are *not* allowed *not* to offer at least one such premium. That is why some banks offer them at the symbolic rate of 0.01 percent, although most have a rate up to 1 percent. Some banks with low basic rates have premiums of up to 2 percent.

The new single premium may range from a minimum of one quarter of the bank's basic rate to a maximum of one half of that rate. Consequently, there will be a minimum rate of 3.75 percent and a maximum rate of 4.5 percent for depositors at commercial banks that have a basic rate of 3 percent. Of course, a depositor can earn the additional premium only on that part of his deposit that remains on the bank's books for the whole of the stipulated period; the rest will earn only the bank's basic rate.

The maximum will become redundant when the ECB raises its rate again above 3 percent, which nobody expects to happen anytime soon. However, the rates on savings deposits will still be capped even when the European central bank eventually raises its rate—as it will have to do when the extraordinary monetary inflation of the past years and, especially, the past few months works it way through the price system and becomes manifest as price inflation. Thus, if the ECB rate goes to, say, 8 percent then commercial banks can only offer a rate between 10 percent and 12 percent.

How long the measure will remain in force is, of course, anybody's guess. Like most governments, the Belgian political authorities are committed to the belief that the best way to build up confidence among the public is to continually surprise it with ad hoc interventions and changes of the rules.

The new policy is sold to the public as a measure to increase transparency. At present, there is indeed a bewildering array of basic rates and premiums on savings deposits. These vary considerably not only from one bank to another but also within banks. Many banks have several types of saving accounts with different—and, in some cases, significantly different—rates and conditions. This situation is a constant source of complaints from the public. It is also a reflection of the fact that the people who make up the public are not instances of a single abstraction (the "saver") but individuals with widely divergent needs, preferences, fears and hopes. As financial-service providers, banks compete for the custom of each of those people. They know that no set of considerations applies equally to all savers and would-be savers, and that it pays to specialize in serving parts of the market rather than to attempt to be all things to all men. Not all banks have the same business model. Hence, the "bewildering array" of rates and conditions is what one would expect in any relatively free market for financial services.

The real motive for the new policy is more likely the government's desire to prop up the banking cartel, at least the "big banks" that are its heart and soul. They are also intimately intertwined with the Belgian establishment and government at all levels.

The primary effect of the policy will be a severe reduction of competition among banks. The now widespread practice of "bank-shopping" by people in search of the best haven for their savings will be discouraged. This is to the advantage of the big banks, which have inherited a large customers base from earlier times, when there were only few banks and their cartel was at its strongest. They also have a large network of branches and agents, covering almost the whole of the territory. However, trust in the big banks has eroded because of scandals and problems at Fortis, Dexia, and to a lesser extent KBC, as well as other financial institutions with a privileged relationship to the authorities. An example is Ethias, an insurance company that originally serviced governments and its personnel at all levels. Smaller, more competitive local banks and Belgian subsidiaries of foreign banks (with the notable exception of one Icelandic bank) have so far avoided the worst ravages of the financial crisis. They have benefited from the crisis, as many people took their savings out of the big banks to deposit them elsewhere. These transfers were large enough to prompt the big banks to raise their rates to levels comparable to those paid by their competitors—and this increased their costs precipitously at a moment when there were grave doubts about their profitability or even solvency.

As the crisis unfolded, the big banks were bailed out or temporarily taken over by the government, which has also "guaranteed" deposits at all banks up to 100.000 euros. These measures too were to the particular advantage of the big banks, although they were ostensibly meant to "restore confidence in the banking system". Indeed, the big banks were hit particularly hard by the public's loss of confidence. They suffered from significant exposure to the American financial disaster (the bursting of the mortgage bubble and the shockwaves it caused throughout the credit industry) and the consequences of disastrous acquisitions (Fortis clearly overplayed its hand when it took over the Dutch ABN-Amro).

Capping the basic rates for savings deposits at 3 percent or at the ECB's repo rate (whichever is higher) is not to the advantage of the majority of the people, who are savers. Thus, one may expect a drop in the savings rate relative to what it otherwise would be. Keeping saving accounts will be discouraged, although the traditionally high savings rate may continue and so mask this effect, at least for a while. People who otherwise would have deposited their savings in the banks will be driven to costlier, riskier and more volatile investments in commercial paper. After all, gold has been completely de-monetized. Yet, while people have been indoctrinated with the belief that keeping gold is foolish "because it does not earn interest",[1] they also know that their banknotes are "fiat money" and will depreciate rapidly. Hence, they see no alternative to opening an interest-bearing account at a bank, buying bonds, or speculating on the stock and real estate markets. This will increase their exposure to the bursting of future bubbles and put them at larger risk of seeing all of their savings, their entire "nest eggs", evaporate in a short time. At a moment in history when everywhere in the

[1] It is of course true that gold stuck under a mattress does not earn interest—but neither do banknotes stuck under a mattress. An ounce of gold (about 31.1 gram), bought for $20 dollars in 1928 and kept under the proverbial mattress for eighty years buys you approximately 800 paper dollars in 2008, whereas 20 paper dollars kept as cash since 1928 buys you less than 1 gram of gold in 2008.

Western world Social Security and government-run pension schemes are under growing strain, such a development is unlikely to inspire confidence.

The new scheme will hurt the "small savers" in particular. Part of the attraction of the traditional saving accounts is that, up to a specified maximum interest (currently about 1,700 euros) the 15 percent tax on the interest earned is not withheld. From April 1 next year on, this advantage will continue only for savings accounts that comply with the new rules. Banks will be permitted to offer non-complying savings accounts for which the entire interest will be fully subject to the 15 percent tax rate (or whatever it happens to be). Thus, people might still be able to collect interest at a higher than the regulated rate, but only for large sums and only at banks that are willing to assume the higher costs.

However, there are other consequences to consider. On the one hand, people who aim to get the maximum amount of interest not subject to the withholding tax of 15 percent will have to deposit more money in the capped-rate savings accounts. They will have to keep it there for longer periods if they want a reasonable return. Although term deposits are not [yet] affected by the 3 percent rule, it is far from certain that small savers will find them an interesting alternative to the no-term traditional savings accounts: the 15% withholding tax is fully applicable to them. On the other hand, people whose capacity for saving does not reach the stipulated threshold will lose part of the "fiscal benefit". In fact, because many people have several savings accounts, which are not yet linked together for tax purposes, the loss will hit large segments of the middle-classes as well as the poor and the profligate.

As one would expect, the new policy is a fiscal measure designed for the benefit of the Treasury. What it will mean in terms of "transparency" remains to be seen. It is doubtful, however, that households will like the price they have to pay for such transparency (assuming it will ever materialize).

If and to the extent that capping the basic rate does not significantly affect the public's disposition to deposit its savings in the banking system, the banks will have an increased ability to lend money to all sorts of commercial and political enterprises. As the costs of attracting deposits are capped, the spread between interest paid on deposits and interest charged to borrowers will grow wider than it would be otherwise. Consequently, competition among banks will be much more intense in the area of extending credit than in the area of attracting deposits. This implies an increased risk of new waves of indiscriminate, reckless lending and more mayhem in financial and other markets.

Of course, we are talking about a relatively minor, "technical" regulation in a very small country. Nevertheless, an accumulation of such regulations may well result in a massive loss of freedom and economic security. Who cares? The government does not care. In the present intellectual climate, it appears to derive ever-more credit for its willingness to embrace Keynesian and monetarist fallacies in the face of any major crisis. The political opposition does not care: its ambition is to control the powers of government, not to diminish them. Nor do the guardians of the banking system care about the plight of the nameless people whose savings are the backbone of the credit industry. Why should they care? Whatever people intend to do with their money, they will have to go through the banking system and pay for its services. Finally, the majority of the public does not seem to care. It has been deluded into believing that social, economic and financial problems have one cause and one cause only: lack of regulation. It no longer even contemplates the idea that the principles of property, contract and liability law applied by truly independent judges suffice to discipline markets.

The banking system is the quintessential public-private partnership. It acts as a fiscal and police agent for the state, supplies it with credit, sells its debt, withholds taxes, and alerts the authorities to "suspicious" transactions. In return, the banks get privileges and protection as well as the assurance that the government will continue to discourage the use of cash in favor of electronic payments. Already now, they collect information and create a paper trail that allows the government to know almost everything there is to know about every person who ever deals with a bank. How could the fiscal-financial Panopticon that is modern society function without them? What would they be if they were nothing but ordinary businesses instead of pillars of the "mixed", now thoroughly mixed up economy?

Oh well! We still have our beer. Cheers!

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