QUASI-MERIT GOODS:
THE CONCEPT AND A CASE STUDY OF PRIVATE BANK DEPOSITS

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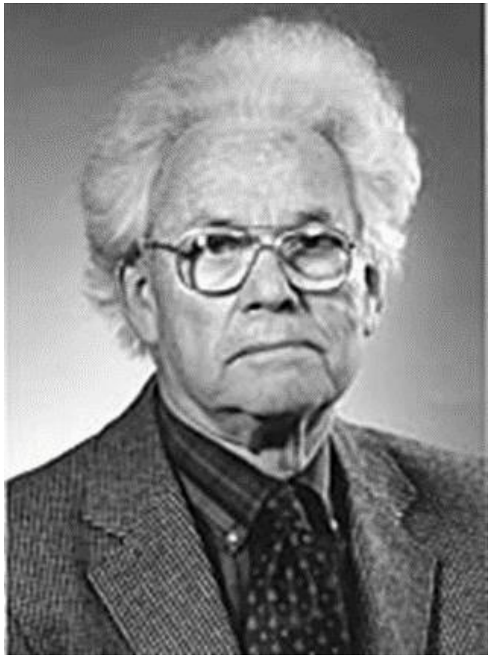
Motivation and objective

- Motivation
  - Merit goods concept and the theory of public finance (Musgrave, 1957; 1959; 1987; 1996; Tanzi, 2011; Ver Eecke, 2007)
  - Paternalism and nudging (Thaler, 1980; Thaler, Sunstein, 2003); social wants (Baumol, 1993)
  - Public choice (Buchanan, 1960; 1985)
  - Collective action theory (Olson, 1965)
- Objective: To examine a special case of the concept

  merit goods
- Outline:
  - Merit wants and merit goods
  - Case study: Private bank deposits
  - Genuine merit or false merit?



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Merit wants and merit goods

Concept and definition

- Merit wants:
  - “Those needs where government interference intends to increase the consumption connected with these needs“
  - “Its satisfaction is provided for through the public budget, over and above what is provided for through the market and paid for by private buyers“
  - “Wants with regard to which consumer choice is abandoned“
- A merit good:
  - “A good which would be under-consumed (and under-produced) in the free market economy”
  - “… A commodity which is judged that an individual or society should have on the basis of some concept of need, rather than ability and willingness to pay”
- De-merit goods

Merit goods: main features

- Positive externalities: public benefits exceed private ones
- Unlike public goods, a merit good is rivalrous, excludable and diminishable
- Merit good:
  - produced privately
  - consumed privately
  - provided privately, unless the government takes over
  - "by its very nature, involves interference with consumer preferences"
- Vague criteria for selection
  - All specifics left to public choice by each nation
  - Few case studies in the literature

Meritorious intervention

- Theoretical controversy around the concept of meritorious intervention
  - Violation of consumer sovereignty and overrule individual preferences
  - “The state cannot seek its own ends or objectives”; “there are no group wants”
  - “Who knows better?”
  - Distributional effects
- Hard paternalism Vs. soft paternalism (‘nudging’)

Case study: Private bank deposits

Theoretical justification for government intervention into private deposit-taking

- Liquidity risk management by banks Vs. depositor protection
- Arguments in favor of meritorious intervention
  - Bank stability is a social want
  - Positive externalities
  - Irrationality argument
  - Ignorance argument
  - Weakness of will argument
  - Unavailability of private solutions

'anthropological' reasons

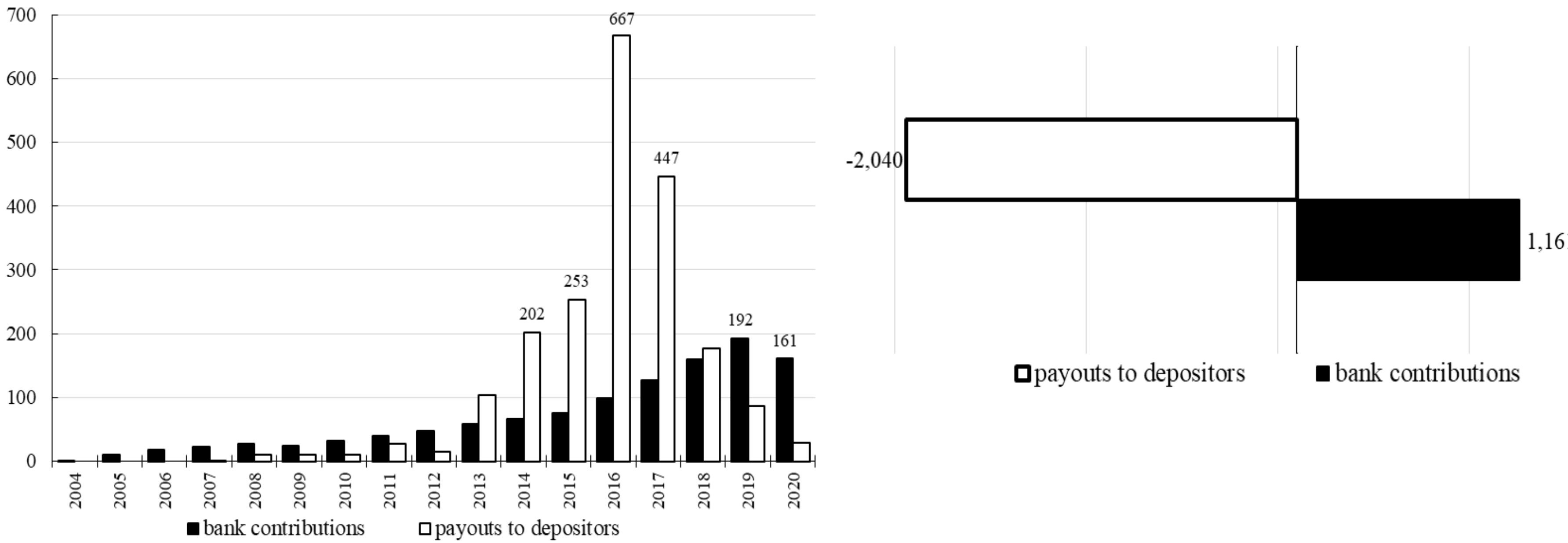
Political economy of deposit guarantee

- Theory provided an ex post apology for an already existing institution
- FDIC was originally a political device caused by the trauma of the Great Depression
- Policy practice: explicit or implicit DIS exists in 144 countries (IADI data)
- Internal pressures
  - Populism
  - Panic
  - In order to maintain a cartel and delay a restructuring of the industry (White, 1995)
- External pressures
  - International obligation
  - Peer pressure, including that from IFIs
- Fashion
- Deposit insurance is inappropriate for developing or transition economies

The effects of deposit protection by the government

- Inflow of household savings into the formal banking system
- Bank (in-)stability
  - "Deposit insurance reduces liquidity risk but can increase insolvency risk by encouraging reckless behavior" (Calomiris, Jaremski, 2018)
  - Banks keep failing
  - Weak banks given second chance; criminal ones get a unique chance
  - The quality of financial intermediation (moral hazard; relative prices distorted; risk mispriced; erosion of discipline)
- Explicit costs
  - Payments to affected depositors (recovery, shortfall of funds at DIS, NPV)
  - Bank bailouts and nationalizations beyond DIS
  - Unfair distribution of costs (socialization of losses and privatization of profits; subsidization of unsound agents by sound ones)

Russian bank contributions to deposit insurance fund and the payouts to depositors, RUB bn



(a) Yearly

(b) Cumulative, 2004-2020

Source: Deposit Insurance Agency

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Genuine merit or false merit?

Is intervention into deposit-taking unavoidable?

Questionable reasons supporting paternalism:

- Unawareness; ignorance
- Irrationality; myopy
  - Withdrawing money from an ailing bank is rational, not irrational
  - Profiteering is opportunistic and rational
  - Deposit guarantee distorts natural rationality
- Weakness of will
- Unavailability of private solutions: Yes, but …

Private interest & the political economy of deposit guarantee

- Liquidity risk management by banks, under the guise of depositor protection
- Interest Group 1: Owners and top managers of uncompetitive banks
  - Subsidy (cheaper funds)
  - Liquidity management
  - Access to household savings
  - Leverage on the monetary authorities and bank regulators
- Interest Group 2: Mass-affluent depositors
- Interest Group 3: Politicians
- Political process
  - Pressure by interest groups (Olson, 1965)
  - Manipulation
  - Incomplete or inaccurate information
  - Misconception

Quasi-merit goods: Definition and concept

- Private bank deposit might be a false merit good rather than a genuine one
- I introduce the concept of quasi-merit good (= a pseudo merit good): a private commodity attributed merit by public choice, but maybe groundlessly
  - The commodity has remained privately produced, delivered and consumed
  - Protection is sought on the assumption that a commodity satisfies a public want, while in reality it serves identifiable private interests
- The difference with de-merit goods
- Relative position of quasi-merit goods:

The cases of quasi-merit goods

- Private bank deposits
- COVID-19 vaccines (?)
- ……….

Conclusions

- Research implication
  - The theory of public finance leaves room for special cases when a private commodity seeks protection not quite rightfully
- Policy implications
  - The balance between private and public gains and losses is to be assessed more accurately
  - How to resist pressure groups?
- Direction for future research
  - Refine the concept
  - Other case studies of quasi-merit goods.

Thank you!

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