Insight

New Bank Taxes Under Financial Reform Will Raise Borrowing Costs, Hurt Growth

DOUGLAS HOLTZ-EAKIN | JUNE 18, 2010

The beleaguered American taxpayer deserves a break. The housing-led financial crisis begat trillions of dollars of red ink.

Now the financial regulation reform bill, which is supposed to fix the things that caused the crisis, promises — you guessed it — more red ink.

The Congressional Budget Office puts the price tag at $19 billion. But with Democrat conferees busy stuffing the bill full of items from their personal wish-lists, who knows how big and expensive the legislation might get?

It’s not that raising revenue isn’t on the radar screen. The administration continues to push its so-called Financial Crisis Responsibility Fee — the “bank tax.”

It stems from the benighted Troubled Asset Relief Program, which empowered the federal government to recoup the costs of the financial bailouts, if those costs are not returned by way of recovering asset values within five years.

Why A Bank Tax?

But there is no good policy reason to enact this bank tax — and certainly not now. The law permits Congress to wait as late as 2013, and waiting makes sense.

A crippling bank tax will either come out of bank capital or be passed along as higher borrowing costs — limiting the supply of loans, raise their costs, or both.

This is not what our struggling real economy needs. While modest growth in final sales is a hopeful sign, employers continue to demonstrate no appetite to hire.

It is widely agreed that such circumstances amount to the wrong time to raise taxes. It is even less desirable — even self-defeating — to impose a levy that would constrict the flow of credit to the business sector.

Recoupment of TARP costs will be appropriate (and legally required) once the economic recovery has solidified.

Even then, however, good policy dictates that any proposal distinguish between recouping the money and forward-looking objectives of financial regulation policy.

Too Much Regulation

The former goal is simply about getting the cash back from those who lost it, notably AIG, GM, GMAC, and Chrysler. A tax structured in this way bears little resemblance to the current proposal; indeed it is not a “bank” tax at all.

The second argument is that a bank tax is needed to incentivize reduced leverage and to provide the means to resolve failing institutions in the future.

These goals are sound.

But the conferees are moving on a multitude of related fronts to achieve similar objectives — higher capital requirements for all banks, heavy regulation of systemically important institutions, the legal authority and procedural framework to seize and wind down banks of any size, and “living wills” to expedite the resolution of failing large banks.

There is no need for the poorly targeted and punitive bank tax that will hit hard the financial services companies that are still struggling to get their feet back under them and have already repaid their loans.

Amazingly enough, the House-passed version of financial reform did contain something to protect the taxpayer, and it has been retained in the base text for the conference agreement.

Specifically, the FDIC was “authorized to conduct risk-based assessments on financial companies in such amount and manner and subject to terms and conditions that the Corporation determines . .. are necessary to pay any shortfall in the Troubled Asset Relief Program.”

This approach is promising. If used correctly, it would permit the FDIC to cover the costs of the regulatory reform.

Further, as time passes and the scale of losses become clearer, these same charges could repay the costs of the TARP from the institutions where the taxpayer is most exposed: the known losses from Fannie Mae, Freddie Mac, AIG, GMAC, Chrysler and others.

These behemoths are the justifiable source for financing the reform bill they necessitated. And they certainly owe the American taxpayer repayment of the billions they were loaned.

The TARP is one of the most controversial policies in recent memory. Financial regulation reform is one of the most important initiatives the country faces.

The conferees have the opportunity to insulate the taxpayer from the costs of both, and to do so in an equitable manner that doesn’t jeopardize the still-fragile economic recovery. They should do so.

This article was orginillay posted by Investor’s Business Daily on June 18, 2010