

Press Release



Holtz-Eakin Testimony On GAO Report Regarding “Too Big To Fail” Subsidy

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American Action Forum President Douglas Holtz-Eakin will testify this afternoon before the Senate Banking Committee regarding the Government Accountability Office (GAO) report on expectations of government support for bank holding companies. Following are key highlights from his testimony. You can read the full testimony [here](#).

- Any expectations of government support for bank holding companies is at root a problem created by policymakers’ discretionary actions.
- Attempts to measure any “implicit too-big-to-fail (TBTF) subsidy” is an elusive quest due to the many confounding factors.
- What is too big to fail? It is not a market failure, like an externality; it “is a rational market response to expectations set by government policy.” The proximate beneficiaries of any perceived bailout expectations (the banks) benefit passively – the ultimate source of any implicit subsidy exists at the nexus of the banks’ creditors and expectations imputed from policymaker choices.
- Financial interdependencies may be the transmission mechanism for shocks to spread throughout a system, but policymakers make the ultimate decision to intervene, creating the ex ante expectation in the first place. Thus policymakers attempting to eliminate any implicit TBTF subsidy will need to look to themselves – or more specifically they will need to consider the rules and regulations which open the door to future intervention, or even lead creditors to believe intervention is forthcoming.
- One prevailing line of thinking points to the fact that large financial institutions can borrow more cheaply relative to smaller ones, and thus this differential is evidence of TBTF. But there are many factors that affect the funding costs of various institutions. This large-small differential in fact exists across most industries, with the banking industry somewhere near the middle.
- If a TBTF subsidy does exist, it stands to reason that it exists on a continuum, rather than simply as a binary condition between those firms that are TBTF and those that are absolutely not.
- But the larger point is that any policy chosen now or in the near future as a TBTF corrective may be (in the best case scenario) appropriately targeted for some fixed state of the world, but cannot easily adjust to changing

conditions. In the extreme, would such a policy corrective (such as a tax) become a refund if and when the TBTF subsidy reverses?

- One particularly promising avenue in this regard is to replace Title II of the Dodd-Frank Act with a bankruptcy process for banks. This would place decisions in the hands of a court, and not either an agency or the Congress. In the process it would limit discretion and clarify the outlook for creditors.