GOP Platform Contains Serious Mistake on Banking

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One of these things is not like the other. In the generally good section of the GOP's Platform entitled Regulation: The Quiet Tyranny (p.27-28), there is this paragraph:

The Environmental Protection Agency has rewritten laws to advance the Democrats' climate change agenda. The Department of Health and Human Services has ignored the enacted text of the Affordable Care Act to do whatever it wants in healthcare. Both the Department of Labor and National Labor Relations Board have scrapped decades of labor law to implement the agenda of big labor. The Dodd-Frank law, the Democrats' legislative Godzilla, is crushing small and community banks and other lenders. The Federal Communications Commission is imperiling the freedom of the internet. We support reinstating the Glass-Steagall Act of 1933 which prohibits commercial banks from engaging in high-risk investment.

EPA: check. DHSS: check. DoL/NLRB: double check. Dodd-Frank: check. FCC: check. Glass-Steagall reinstatement: wait, what?

It is the considered wisdom of every expert on financial regulation in the conservative movement that Glass-Steagall's repeal had nothing whatsoever to do with the financial crisis. My colleague John Berlau has written extensively on it here and elsewhere. Peter Wallison of the American Enterprise Institute sums up the issue well:

Adopted early in the New Deal, the Glass-Steagall Act separated investment and commercial banking. It prohibited commercial banks from underwriting or dealing in securities, and from affiliating with firms that engaged principally in that business. The GLBA repealed only the second of these provisions, allowing banks and securities firms to be affiliated under the same holding company. Thus J.P. Morgan Chase was able to acquire Bear Stearns, and Bank of America could acquire Merrill Lynch. Nevertheless, banks themselves were and still are prohibited from underwriting or dealing in securities. [N.B. contra the Platform's insinuation]

Allowing banks and securities firms to affiliate under the same holding company has had no effect on the current financial crisis. None of the investment banks that have gotten into trouble

— Bear, Lehman, Merrill, Goldman or Morgan Stanley — were affiliated with commercial banks. And none of the banks that have major securities affiliates — Citibank, Bank of America, and J.P. Morgan Chase, to name a few — are among the banks that have thus far encountered serious financial problems. Indeed, the ability of these banks to diversify into nonbanking activities has been a source of their strength.

That last sentence is important. As the Cato Institute's Mark Calabria rightly notes, "The proponents of Glass-Steagall also ignore one of the basic rules of finance: diversification generally reduces risk." To re-impose Glass-Steagall now would be to inject risk into the financial system, not reduce it. This is a serious mistake.

Moreover, as this careful study by Norbert Michel of The Heritage Foundation shows, there is no evidence that banks before Glass-Steagall were any more vulnerable than banks after its introduction. His conclusion backs up everyone else's work: "Evidence does suggest, however, that banks engaged in both commercial and investment banking were stronger than those firms engaged in only one type of financial intermediation."

The real solution to the problem supposedly identified in the GOP Platform is not more regulation but a genuine conservative policy: competition. The House's Financial Services Committee has made great steps towards that goal by compiling the Financial Choice Act. Championing these ideas would be much more satisfactory – and less risky for the American consumer – than trying to outflank Hillary Clinton by agreeing with Elizabeth Warren.