Thanks to Lobbying, Banks Obtain Unearned Wealth and Increase Systemic Risk

Daniel J. Mitchell
July 18, 2014

I periodically comment about government corruption, often in the context of trying to make the general point that shrinking the size and scope of the public sector is the most effective way of reducing sleaze in Washington.

Now let's get specific. I've already cited Obamacare, the tax code, and the Export-Import Bank as facilitators of corruption. Let's augment that list by looking at government intervention in the financial sector.

We'll start with some findings on the effectiveness of lobbying. In some new research, two professors at George Mason University's Mercatus Center found that being active in Washington is beneficial for top executives, but it doesn't help a company's bottom line.

Here's how the Washington Examiner summarized the study.

> "What is the return on investment in lobbying? Does a PAC contribution actually pay for itself? There are so many cases of a lobbyist winning an earmark, or a PAC contribution immediately preceding a subsidy, that it's hard not to see politics as a good investment. …But for every company that hits the jackpot after lobbying campaign, scores of others end up throwing away money on lobbyists — and scores of executives whose PAC contributions don't help the company a bit. Business professors Russell Sobel and Rachel Graefe-Anderson of the Mercatus Center at George Mason University collected the data and dug into the bigger question: Do lobbying expenditures and PAC contributions increase corporate profits, on average? Their answer: No… When Sobel and Graefe-Anderson crunched numbers, conducted regressions, and controlled for firm size, industry and other factors, they arrived at data "suggesting that any

> benefits gained from corporate political activity are largely captured by firm executives." In short, when a CEO and a lobbyist decide to get their company more involved in politics, the CEO and the lobbyist benefit, while not helping the company."

These findings at first struck me as counterintuitive. After all, there are plenty of companies, such as General Electric and Archer Daniels Midland, that seem to obtain lots of unearned profits thanks to their lobbying activities.

But don't forget that government – at best – is a zero-sum game. So for every company, industry, or sector that "wins," there will be lots of companies, industries, and sectors that suffer.

And speaking of industries that benefit, there was one exception to the Mercatus Center findings.

> "The only exception was the banking and financial sectors, where they found "positive and significant correlations between firm lobbying activity and three measures of firm financial performance," including return on investment and return on equity."

At this stage, let's be careful to specify that lobbying is not necessarily bad. If a handful of business owners want to join forces to fight against higher taxes or more regulation, I'm all in favor of that kind of lobbying. They're fighting to be left alone.

But a big chunk of the lobbying in Washington is not about being left alone. It's about seeking undeserved benefits by using the coercive power of government.

And this latter definition is a good description of what the financial industry has been doing in Washington. That's bad for taxpayers, but it's also bad for the financial sector and the overall economy. Here are some of the conclusions from a recent study published by the New York Federal Reserve Bank.

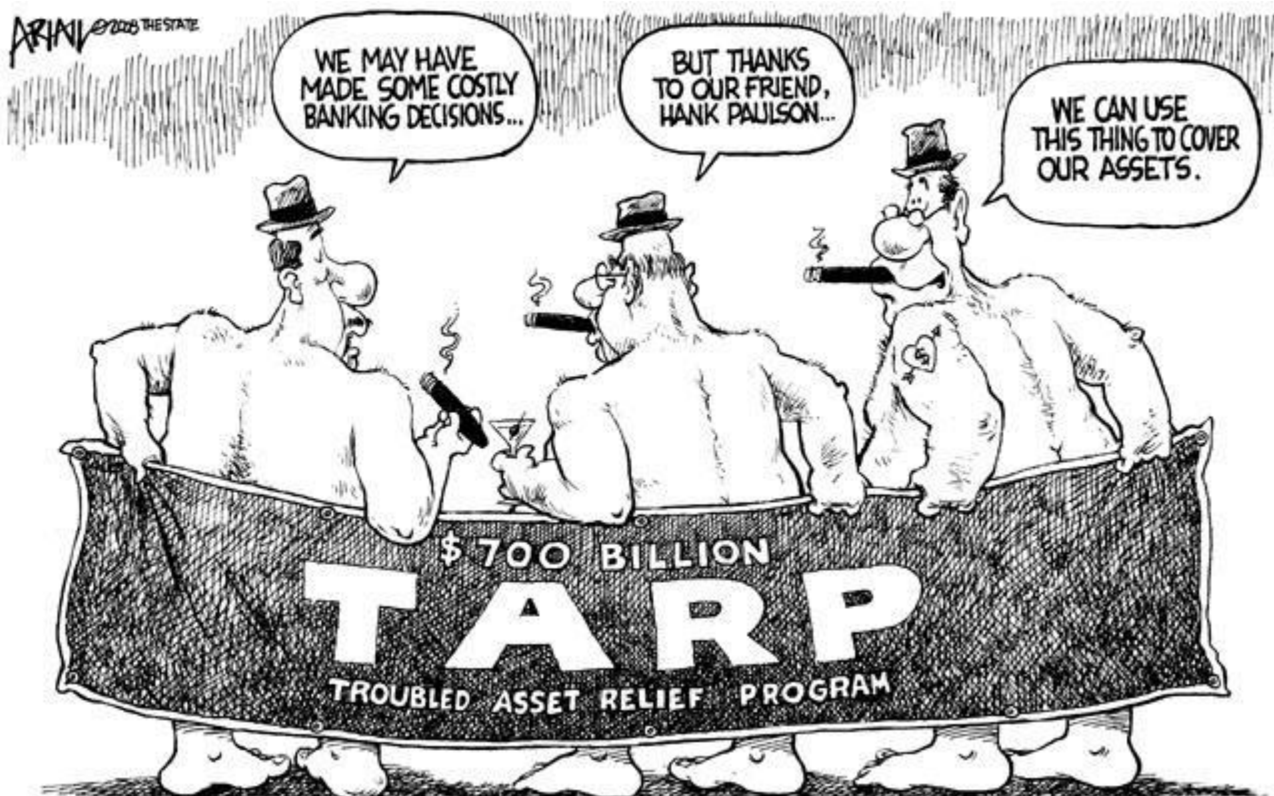
> "…there have been many concerns with banks deemed "too big to fail." These concerns derive from the belief that the too-big-to-fail status gives large banks a competitive edge and incentives to take on additional risk. If investors believe the largest banks are too big to fail, they will be willing to offer them funding at a discount. Together with expectations of rescues, this discount gives the too-big-to-fail banks incentives to engage in riskier activities. …The debate around too-big-to-fail banks has given rise to a large literature. … we study whether banks that rating agencies classify as likely to receive government support increase their risk-taking. …The results of our investigation show that a greater likelihood of government support leads to a rise in bank risk-taking. Following an increase in

> government support, we see a larger volume of bank lending becoming impaired. Further, and in line with this finding, our results show that stronger government support translates into an increase in net charge-offs. Additionally, we find that the effect of government support on impaired loans is stronger for riskier banks than safer ones, as measured by their issuer default ratings. …the level of impaired loans in a bank loan portfolio increases directly with the level of government support. …riskier banks are more likely to take advantage of potential sovereign support."

Isn't that wonderful. Our tax dollars have been used to increase systemic risk and undermine economic growth. Though none of us should be surprised.

Since this has been a depressing column, let's enjoy some morbid TARP humor.

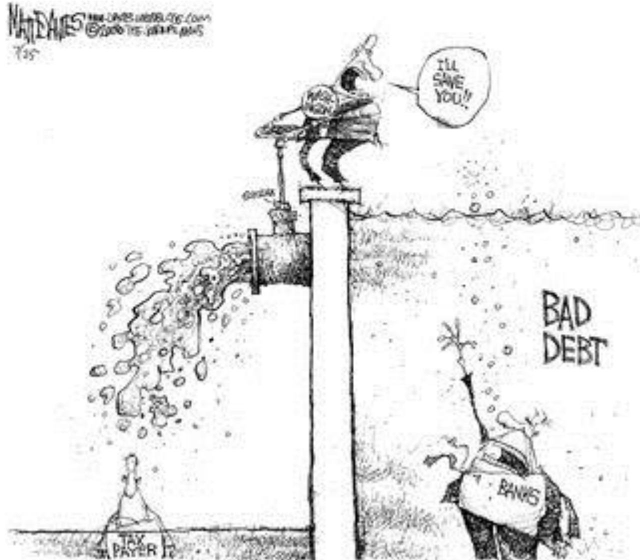
Here's a cartoon from Robert Ariail about the cronies who got rich from the Bush-Obama bailouts.



Good to see Hank Paulson getting ripped. At the end of the Bush Administration, I attempted to convince the White House that "FDIC resolution" was a much better way of recapitalizing the banking system. I was repeatedly told, though, that Paulson was in charge and there was no way of stopping him from bailing out his former cronies on Wall Street.

Oh well, at least I tried.

Here’s another cartoon about the real victims of TARP. Like the first cartoon, it’s an oldie but goodie and it’s a good illustration of how government is a zero-sum scam.



But let me re-emphasize a point I made above. Taxpayers aren’t the only ones to lose. The entire economy suffers from bailouts and subsidies. Such policies distort the allocation of capital and lead to slower long-run growth.

That may not be easy to measure, but it matters a lot.

Here’s a video explaining how such policies create moral hazard.

This is a good time to recycle the famous poster about supposed government solutions.

P.S. Not all financial institutions are corrupted by government. The nation’s 10th-largest bank, BB&T, did not want and did not need a bailout. But as the bank’s former CEO (and, I’m proud to say, current Cato Institute president) explained in his book, thugs from Washington threatened to use regulatory coercion if BB&T didn’t participate.

Daniel J. Mitchell is a top expert on tax reform and supply-side tax policy at the Cato Institute.