Regulation Spawns 'Banks Too Big to Fail'

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By Richard Rahn

Last week, Jamie Dimon, CEO of the nation's largest bank, JPMorgan Chase, revealed that the bank had made a $2 billion-plus trading mistake.

The bank has more than $2 trillion in assets and made a profit of about $20 billion last year. So it lost one-tenth of 1 percent of its assets and an amount equal to about 10 percent of its income for last year. No big deal, despite all the hand-wringing of the political and media class.

Predictably, Sen. Carl Levin, Michigan Democrat and arguably the most irresponsible member of Congress, immediately issued a press release calling for more bank regulation.

One can understand that the bank's stockholders and board are unhappy with the mistake, because the bank's stock took the expected hit. Heads are rolling already. That is, the board is fulfilling its responsibilities without more rules from Congress.

Congress has the oversight responsibility for the U.S. government, in much the same way a corporate board has the oversight responsibility for a corporation. Sen. Levin has the responsibility (along with his colleagues) to make sure taxpayer dollars are spent wisely and not wasted or stolen.

Medicare, for example, spends more than $500 billion annually. Sen. Tom Coburn, Oklahoma Republican, who, unlike Levin, tries to be fiscally responsible, estimates that about 20 percent, or $100 billion, of Medicare spending is fraudulent.

Other estimates of Medicare fraud, including those of the U.S. government, range between $20 billion and $100 billion. The point is that Levin and many of his colleagues prefer to spend their time bashing private businesses rather than protecting the taxpayer,

which is their responsibility.

Whatever the real or imaginary problem is, Levin always has one answer: more regulation. There is never enough as far as he is concerned. How has that worked out? He and many others get all worked up about banks becoming "too big to fail," which is a doubtful proposition to begin with.

Yet they are in denial about the fact that their own actions have caused much of the banking consolidation and subsequent problems.

As can be seen in the accompanying table, before the advent of the Federal Reserve (the primary federal bank regulator) in 1913, the United States had more than 26,000 banks.

The Fed and the federal government began aggressive bank regulation during the Great Depression in the 1930s, and the regulations and economic policies of the time led to a loss of approximately 40 percent of the nation's banks.

Subsequently, Fed and bank regulatory policies were relatively benign until the 1970s, when the Fed went off the rails again and banks were saddled with anti-money-laundering and other regulations which, in part, caused a further drop in the number of banks.

The ever-growing bank regulations of recent years continue to result in a decline in the number of banks, as well as making it more difficult and costly for people to obtain bank accounts.

In fact, people who move frequently because of their jobs or other reasons, or Americans living abroad, increasingly find it impossible to open a bank account where they live, causing great hardship.

Years	**Numbers of commercial banks**
1912	26,472
1929	25,568
1939	15,210
1969	13,681
1999	8,580
2011	6,205
Sources: U.S. Census, St. Louis Federal Reserve	

Both large banks and small community banks — and even non-U.S. banks — must comply with most of the new regulations. A small community bank that engages in traditional banking by accepting deposits from local residents and then lending the money

to local businesses and consumers now must comply with the tens of thousands of pages of new banking regulations just like the largest banks, even though the bank wisely may have just a few dozen employees — an impossible task.

This fixed cost of regulation is far more burdensome to the smaller banks, helps drive banking consolidation and ultimately ends up with banks "that are too big to fail."

Levin and many of his colleagues seem incapable of understanding that much of the banking and financial regulation that they have imposed has been not only counterproductive but downright destructive and is in the process of driving trillions of dollars of foreign investment out of the United States — and the millions of jobs dependent on such investment.

They also seem to be willfully blind when one of their own, such as former Sen. Jon Corzine, runs his financial institution into the ground while apparently misusing more than $1 billion of his customers' assets, which, if true, is criminal in manner. Yet the Obama Justice Department has yet to indict Mr. Corzine.

Rational people understand that bank executives have huge incentives — their jobs, wealth and reputations to begin with — to avoid mistakes that can cause losses, let alone those that endanger the existence of their bank.

They don't need the government to tell them that. Nor do they need the government to tell them to treat their customers and depositors well, because they understand that if they don't, they will have neither.

In contrast, there is good evidence that government waste, fraud and mismanagement exceed the size of the deficit, but where are the calls by Sen. Levin for heads to roll at the top levels of the Obama administration and for corrective action?

Jamie Dimon immediately apologized for making mistakes at JPMorgan Chase and promised corrective action to make sure that it does not happen again. How long will we have to wait for apologies from President Obama and his Cabinet officers and the corrective action to protect taxpayers from the massive fraud and ongoing waste in federal spending?

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