SEARCH

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Rep. Brad Miller

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Taxing 'Too Big to Fail' and Republican Hypocrisy

What's Your Reaction:

President Obama is proposing a tax on "too big to fail" banks to pay back the $120 billion in taxpayer money that we expect to lose from the Troubled Asset Recovery Program ("TARP") -- the bank bailout.

The proposed tax would also exact a payment for the "implicit guarantee" that the government will pay the debts of any big bank that becomes insolvent.

Republicans hate taxes, so they'll probably be against this one. But Republicans proposed exactly the same legislative measure a decade ago for Fannie Mae and Freddie Mac, and they did so for exactly the same reasons.

Republicans now claim that they warned us years ago that Fannie and Freddie were making loans to poor folks who couldn't pay them back. That wasn't what Republicans said at all.

Republican criticism of Fannie and Freddie was part of an internecine battle in the financial industry between Fannie and Freddie on one side, and their competitors, institutions like Bear Stearns, AIG and Merrill Lynch, on the other.

Fannie's and Freddie's critics in the financial industry -- and their Republican allies -- argued that Fannie and Freddie had an "implicit guarantee" from the federal government that amounted to an unfair subsidy.

The guarantee was that the federal government would never allow Fannie or Freddie to fail. Fannie and Freddie were shareholder-owned corporations operated for a profit, but they began as government agencies that bought mortgages from banks so banks could lend more money.

Fannie and Freddie held some of the mortgages, and packaged other mortgages and sold "mortgage-backed securities" to investors.

As a result, mortgage credit was plentiful and cheap, and the home ownership rate soared.

Mark Zandi, Sen. John McCain's (R-Ariz.) economic adviser in the 2008 campaign, told *USA Today* in 2002 that the creation of Fannie and Freddie was "the most successful policy initiative ever undertaken by the government."

Fannie and Freddie did very well by doing good. In 2001, Fannie was 13 and Freddie was 18 on *Fortune Magazine*'s list of the most profitable corporations.

But Fannie and Freddie no longer had the business of buying mortgages to themselves. Others in the financial industry were buying mortgages and selling mortgage-backed securities, also quite profitably.

The competition was bitter. Fannie's and Freddie's competitors argued that the "implicit guarantee" allowed Fannie and Freddie to borrow at lower interest rates. A Congressional Budget Office study estimated that the lower interest rates were a $6 to $7 billion federal subsidy, or about 40 percent of Fannie's and Freddie's profits.

So what was the origin of the guarantee, and the supposed taxpayer subsidy?

Fannie and Freddie were "privatized" during the Johnson Administration, critics argued, but they still had a smallish line of credit with the government; the President appointed members of the Boards of Directors of both Fannie and Freddie; and so forth.

But most of all, Fannie and Freddie were just too big to fail. The collapse of Fannie or Freddie would have catastrophic consequences for the economy. No administration, Democratic or Republican, would allow that.

Those criticisms of Fannie and Freddie have been vindicated by events, of course.

Is there any doubt that the same criticisms now apply to Fannie's and Freddie's critics? The "systemically significant" banks that received TARP funds all obviously enjoy the same "implicit guarantee" that Fannie and Freddie had. Community banks, banks that are small enough to fail, now complain about the unfair competitive advantage that the big banks get from the federal government's implicit guarantee.

The big banks are now fiercely fighting the very limitations that they urged for Fannie and Freddie a decade ago, including this, first suggested by the Congressional Budget Office and embraced by Stephen Moore, testifying before Congress in 2000 as an "Adjunct Fellow" at the Cato Institute: "a 'user fee' of 10 to 20 basis points on [Fannie's and Freddie's] debt to level the playing field between Fannie and competitors."

"The user fee is a partial payment for the implicit guarantee it receives from Uncle Sam," Moore said. "The rationale behind such a fee is that since taxpayers are bearing an implicit risk on Fannie Mae activities, it is reasonable that the federal government recoup fees to pay for that assumption of risk. The main advantage of such a fee is that it would help level the playing field between Fannie Mae and its fully private competitors."

What part of that rationale does not apply to President Obama's proposed tax on large, "systemically important" banks that have already been rescued once?

So if we just call President Obama's too-big-to-fail tax a "user fee" instead, will the idea have bipartisan support? Don't count on it.

Rep. Brad Miller (D-NC) is a member of the House Financial Services Committee and author of key elements of the Wall Street Reform Consumer Protection Act that recently passed in the House.

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