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Bipartisan Policy Center Looks at Breaking Up 'Too Big to Fail' Banks

By Robert Feinberg
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The Bipartisan Policy Center (BPC) held panel discussions recently in a program titled "The Big Bank Theory: Breaking Down the Break-Up Argument" to introduce a new report on proposals to break up the largest banks in order to reduce the risk they pose to the financial system.

A word about the BPC. It is a well-funded group founded by prominent former legislators that takes on important policies issues with a view to finding bipartisan ideas that will gain support from both parties. In practice, this appeal tends to extend to Democrats and centrist Republicans. When it comes to banking legislation, issues tend to divide more according to industry interests than to partisan divisions, and this group tends to align with the banking industry. For this writer, the ideas presented regarding "too big to fail" banks are a case in point.

During the past couple of years, proposals have been floated, primarily in the Senate, to require higher capital ratios for the biggest banks and to re-impose some version of the Glass-Steagall Act, both with the purpose of reducing the cost of the next financial crisis. Another idea from these same proponents is the take concrete steps to reduce the size of the banks by forcing them to divest themselves of both banking and nonbanking activities. Leading proponents of these measures are Sens. Sherrod Brown, D-Ohio; Elizabeth Warren, D-Mass.; and David Vitter, R-La.

It is fair to say that the BPC, in accordance with the views of the too big to fail banks, does not think that restricting the size and powers of the biggest banks is a good idea. The key conclusions of the report are 1) that the Dodd-Frank Act, through new powers conferred on regulators and higher capital standards, has already reduced expectations as to the cost of future financial crises; 2) that research raises questions about the impact on the economy if the largest banks were broken up; and 3) that breaking up the largest banks would be difficult to do and would entail significant transition costs.

All three of these objections are controversial, and the discussion served to air some of this controversy through the remarks of two skeptics, Arnold Kling, an adjunct scholar at the Cato Institute, and Marcus Stanley, policy director of the Americans for Financial Reform.

Kling set forth a series of tests that calls into question the first point — that regulators really are better-equipped to handle the next crisis without another round of costly bailouts.

Stanley questioned that the latest research supports the view that the activities of the megabanks

support the economy. No one can reasonably doubt that breaking up the largest banks would be difficult, in large part because of the opposition of groups like the BPC.

Also, panelists made the point that even if the banks were cut down to a size on the order of $200 billion, which is one of the standards being discussed, they would still be highly complex and interconnected.

Among other panelists, Douglas Elliot, of the Brookings Institution, was especially vociferous in protesting anything that would restrict the ability of the largest banks to serve their customers, and he insisted that the driving force behind their growth has been to enable them to meet the needs of the largest corporations as they have grown and expanded globally.

BPC's Financial Regulatory Reform Initiative Co-Chair Phillip Swagel, a professor of international economics at the University of Maryland who was one of the chief administrators of the Troubled Asset Relief Program, awkwardly defended the idea that the regulators will be able to perform better under Dodd-Frank than they did in 2008, but he made a startling observation. Swagel pointed out that in its latest rules the Federal Reserve has decided not to implement the "risk retention" rules of Dodd-Frank, so banks will return to "crazy lending."