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Too big to maintain?

By George F. Will,

DALLAS

If in four weeks a president-elect Mitt Romney is seeking a Treasury secretary, he should look here, to Richard Fisher, president of the Federal Reserve Bank of Dallas. Candidate Romney can enhance his chance of having this choice to make by embracing a simple proposition from Fisher: Systemically important financial institutions (SIFIs), meaning too-big-to-fail (TBTF) banks, are "too dangerous to permit."

Romney almost did this in the first debate when he said the Dodd-Frank Act makes TBTF banks "effectively guaranteed by the federal government" and constitutes "the biggest kiss that's been given to — to New York banks I've ever seen." Fisher, who has a flair for rhetorical pungency, is more crisp:

There are 6,000 American banks, but "half of the entire banking industry's assets" are concentrated in five institutions whose combined assets amount to almost 60 percent of the gross domestic product. And "the top 10 banks now account for 61 percent of commercial banking assets, substantially more than the 26 percent of only 20 years ago." The problems posed by "supersized and hypercomplex banks" may, Fisher says, require anti-obesity policies equivalent to "irreversible lap-band or gastric bypass surgery." The land of TBTFs is "a perverse financial Lake Wobegon" where all crises are "exceptional," justifying "unique" solutions that are the same — meaning bailouts. This incurs "the wrath of ordinary citizens and smaller entities that resent this favorable treatment, and we plant the seeds of social unrest."

Fisher cites Andrew Haldane of the Bank of England who calculates this: The assumption that certain banks have implicit TBTF status gives them preferential access to investment capital. In 2009, these silent subsidies enjoyed by TBTFs worldwide approached $2.3 trillion in value. Haldane notes a parallel between financial systems and epidemiological networks: Normal epidemiology involves "focusing preventive action on 'super-spreaders' within the network to limit the potential for systemwide spread."

Endorsing the axiom (attributed to Napoleon) that one should "never ascribe to malice that which is adequately explained by incompetence," Fisher says that TBTF banks "are sprawling and complex — so vast that their own management teams may not fully understand their own risk exposures, providing fertile ground for unintended 'incompetence.' "

Fisher's rejoinder to those who impute "economies of scale" to such banks is that there also are "*dis*economies of scale." Fisher, among many others, believes the component parts of the biggest banks would be "worth more broken up than as a whole."

Furthermore, the economy suffers as indefensible preferences multiply. In an essay, "Choosing the Road to Prosperity: Why We Must End Too Big To Fail — Now," Harvey Rosenblum of the Dallas Fed's Research Department notes that "people disillusioned with capitalism aren't as eager to engage in productive activities." The desire to strive is inversely proportional to the suspicion that the game is rigged. Rosenblum adds:

"For all its bluster, Dodd-Frank leaves TBTF entrenched. . . . In fact, the financial crisis increased concentration because some TBTF institutions acquired the assets of other troubled TBTF institutions. The TBTF survivors of the financial crisis look a lot like they did in 2008. They maintain corporate cultures based on the short-term incentives of fees and bonuses derived from increased oligopoly power."

At bottom, the TBTF phenomenon raises questions not merely about the financial system but also about the nature of the American regime. These are Jacksonian questions, implicating issues Old Hickory raised in 1832 when vetoing the Second Bank of the United States: Should the government be complicit in protecting — and by doing so, enlarging — huge economic interests?

Capitalism — which is, as Milton Friedman tirelessly insisted, a profit *and loss* system — is subverted by TBTF, which socializes losses while leaving profits private. And which enhances the profits of those whose losses it socializes. TBTF is a double moral disaster: It creates moral hazard by encouraging risky behavior, and it delegitimizes capitalism by validating public cynicism about its risk-reward ratios.

It is inexplicable politics and regrettable policy that Romney has, so far, flinched from a forthright endorsement of breaking up the biggest banks. This stance would be credible because of his background and would be intelligible to voters because of its clarity. As the campaign reaches what should be a satisfying culmination, they would be astonished by, and grateful for, the infusion of a fresh thought into the deluge of painfully familiar boilerplate. Having tiptoed close to where Fisher stands, Romney still has time to remember Gen. Douglas MacArthur's axiom that, in war, all disasters can be explained by two words: "Too late."

georgewill@washpost.com