ITINERA INSTITUTE NOTA

2010/25 01 | 04 | 2010

Bank taxes are no substitute for financial reform

Marc De Vos

Directeur

Itinera Institute

David Cameron, the leader of the Conservative Party in the U.K., wants to tax banks to repay the taxpayer money spent bailing them out. In the U.S., Barack Obama likewise wants "to compensate the American people for the extraordinary assistance they provided to Wall Street." The Financial Crisis Responsibility Fee will therefore slap major U.S. banks with a crisis tax for years to come. Several other European countries are also keen on following his lead. Germany is even advocating an internationally coordinated effort for taxes to cover the cost of potential future bailouts. Some countries—like Belgium—were actually there first and already have new bank levies in place. Bank profits are thus going the same way as bank bonuses. Taxing bankers is becoming a popular contagion in our

The political forces behind this evolution are strong. Nihilist banking brought us the subprime crisis and forced governments into costly bailouts, only to be followed by even more financial risk-taking and profit-making while the rest of humanity suffered from a global recession. Banks have added insult to injury. Taxation can therefore be sold as retribution to a vengeful public. And the additional revenue is certainly welcome as deficits squeeze state coffers. Any bank money is a relief – however ephemeral – for governments that increasingly feel the strain of their own unsustainable deficit spending.

The policy justification for it, however, is weak. For starters, there is really no guarantee that the taxpayer will indeed see his money back—there is no system in place to ensure that this particular revenue will transit out of the state's coffers into the taxpayers' pockets. Moreover, it is essentially impossible to prevent banks from translating the additional taxation into higher rates or charges that will eventually leave the bill with, well, the taxpayer.

More fundamentally, additional bank taxes are really targeting symptoms, rather than the disease. Profits and bonuses are symptoms. The disease is that banks are able to make huge profits and generate big bonuses by risky business practices without having to take responsibility when their bets go wrong. The real problem is that a "too-big-to-fail" approach privatizes profits while socializing losses during a systemic crisis like the subprime debacle. The real answer is not to socialize the profits through taxation but to privatize the losses through regulation: End "too big to fail" and avoid systemic threats by imposing a new architecture upon financial markets and their players.

"The real problem is that a "too-big-to-fail" approach privatizes profits while socializing losses during a systemic crisis. The real answer is not to socialize the profits through taxation but to privatize the losses through regulation."

It is precisely because such financial reregulation has proved elusive in the wake of the subprime crisis that governments around the developed world are increasingly resorting to punitive taxation. Additional bank taxes are therefore a sign of political failure, spawned by the very same impotence that caused the subprime crisis itself: the institutional inability to coordinate the regulation of financial markets internationally. The parade of G-20 summits has brought a great deal of spin and much posturing about financial markets, but only minor regulatory changes so far. In the absence of strong international coordination, individual countries cannot run the risk of smothering their financial sector and debilitating their banks by unilateral reregulation. The resulting stalemate has delayed regulatory overhaul while the window of opportunity gradually closes. If anything, the surge in punitive bank taxation is likely to further undermine the potential for financial regulatory reform. As banks come to be seen as paying off their debt to society, the case for burdening them with a transformative regulatory framework will weaken. Taxation, therefore, is an antidote to regulation.

The new taxes also bring a degree of state dependency on the resulting revenue. As a result, the financial sector may well be entering a scenario similar to that of the tobacco industry: The state tolerates an unpopular business model for the sake of addictive additional revenue. Bank taxes bring a degree of tense complicity between governments and banks, especially in an oligopolistic universe in which the few remaining big financial groups are assured of political clout.

Unless the impetus for international financial reregulation is forcefully reignited in the upcoming months, crisis taxes on banks risk entrenching that what should be the prime target for regulatory removal: the implicit state guarantee under the mantra of "too big to fail." In perception, if not always in design, bank taxes will lose touch with their punitive origins, gradually becoming the premiums paid into a de facto state-insurance program for systemically important financial institutions. In fact, this is apparently already the assumption of the German proposal. This is not the path toward more financial stability and sustainable growth; it is the highway to continuous excessive risk-taking and bubble blowing. Taxing the bankers may well be a gratifying political exercise for the present, but it will be massively counterproductive for the future. It is not a second-best alternative: Thorough-going regulatory reform has no alternative. It is a must.

Marc De Vos
UGent & Itinera Institute
Author of "After the Meltdown: the future of capitalism and globalization in the Age of the Twin Crises", published by shoehornbooks.com in 2010

Published as an opinion piece in the Wall Street Journal Europe of March 30th, 2010.