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If We Broke Up Standard Oil, We Can Break Up the Giant Banks

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If we broke up standard oil, we can break up the giant banks.

Says who?

Senator Ted Kaufman (interviewed recently by The American Prospect's Tim Fernholz):

You and Senator Sherrod Brown have proposed an amendment that would cap the size of the largest banks and, in effect, break them up. How do you sell this to people who are leery of what seems like a radical move?

First off, we've broken up things before. We broke up Standard Oil, we broke up AT&T, we broke up the accountants, too. A lot of the changes we're talking about, the mergers, are just new. When you look at the reasons these banks are so big — and you know how big they are — remember the reason JP Morgan Chase is so big is because they bought Washington Mutual when it was in trouble, and Wells Fargo bought Wachovia, and Bank of America bought Merrill Lynch [during the crisis]. It is pretty straightforward, now that these are back on their feet, that it makes sense to break them up.

Alan Greenspan:

U.S. regulators should consider breaking up large financial institutions considered "too big to fail," former Federal Reserve Chairman Alan Greenspan said.

Those banks have an implicit subsidy allowing them to borrow at lower cost because lenders believe the government will always step in to guarantee their obligations. That squeezes out competition and creates a danger to the financial system, Greenspan told the Council on Foreign Relations in New York.

"If they're too big to fail, they're too big," Greenspan said today. "In 1911 we broke up Standard Oil — so what happened? The individual parts became more valuable than the whole. Maybe that's what we need to do."

At one point, no bank was considered too big to fail, Greenspan said. That changed after the Treasury Department under then-Secretary Hank Paulson effectively nationalized Fannie Mae and Freddie Mac, and the Treasury and Fed bailed out Bear Stearns Cos. and American International Group Inc.

"It's going to be very difficult to repair their credibility on that because when push came to shove, they didn't stand up," Greenspan said.

Fed officials have suggested imposing a tax or requiring higher capital ratios on larger banks to ensure the firms' safety and reduce some of the competitive advantage from the implied subsidy. Greenspan said that won't work.

"I don't think merely raising the fees or capital on large institutions or taxing them is enough," Greenspan said. "I think they'll absorb that, they'll work with that, and it's totally inefficient and they'll still be using the savings"…

"If you don't neutralize that, you're going to get a moribund group of obsolescent institutions which will be a big drain on the savings of the society," he said.

"Failure is an integral part, a necessary part of a market system," he said. "If you start focusing on those who should be shrinking, it undermines growing standards of living and can even bring them down."

Former chief IMF economist Simon Johnson:

Writing in the New York Times today, Joe Nocera sums up, "If Mr. Obama hopes to create a regulatory environment that stands for another six decades, he is going to have to do what Roosevelt did once upon a time. He is going to have make some bankers mad."

Good point – but Nocera is thinking about the wrong Roosevelt (FDR). In order to get to the point where you can reform like FDR, you first have to break the political power of the big banks, and that requires substantially reducing their economic power – the moment calls more for Teddy Roosevelt-type trustbusting, and it appears that is exactly what we will not get.

Former Secretary of Labor Robert Reich:

Neither the draft bill, nor the Committee, nor anyone on the Hill having anything to do with financial regulation, is raising what I consider to be the two key reforms necessary for avoiding another financial meltdown — resurrecting the Glass-Steagall Act that once separated commercial from investment banking, and applying antitrust laws to the remaining five biggest Wall Street banks so none is "too big to fail."

One of the world's leading economic historians, Niall Ferguson:

What's needed is a serious application of antitrust law to the financial-services sector and a speedy end to institutions that are "too big to fail."

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[Geithner is proposing that] there should be a new "resolution authority" for the swift closing down of big banks that fail. But such an authority already exists and was used when Continental Illinois failed in 1984.

Indeed, even the FDIC mentions Continental Illinois in the same breadth as "too big to fail" banks.

And William K. Black – the senior regulator during the S&L crisis, and an Associate Professor of both Economics and Law at the University of Missouri – says that the Prompt Corrective Action Law (PCA), 12 U.S.C. § 1831o, not only authorizes the government to seize insolvent banks, it mandates it, and that the Bush and Obama administrations broke the law by refusing to close insolvent banks. And see this. Whether or not the financial giants can be broken up using the PCA, no one can doubt that the government could find a way to break them up if it wanted.

Break 'em up …

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