Suppressing job and wealth creation: Dodd-Frank doesn't address the cause of the financial crisis

by Eric Grover

Washington Times

September 24, 2015

The Dodd-Frank Act doesn't address the principal causes of the financial crisis and Great Recession but it does suppress economic growth. If a Democrat wins the White House in 2016 it won't be repealed. If however a Republican wins, repeal may be possible, which would take Washington regulatory mandarins' boots off banks' and the economy's throats.

Certain conditions must be changed. The president must be committed to repeal. Joe and Sally Sixpack need to come to understand Dodd-Frank doesn't address the cause of the financial crisis and puts a damper on economic growth. Greg Baer, the new president of the Clearing House Association, says banks need to restore their credibility with the public, but doesn't go far enough. The demonized banking industry must make the case it is morally noble. That may jar some ears, but surely enabling retirees to earn a return on their savings and funding business expansion creating jobs and wealth, improving Americans' quality of and opportunities in life is morally noble.

Republican presidential candidates have criticized Dodd-Frank. Sen. Ted Cruz promised outright repeal. During the August Fox Republican presidential debate Sen. Marco Rubio declared Dodd-Frank was "eviscerating small businesses and small banks," and called for its repeal and replacement.

To achieve good policy Nobel-laureate Milton Friedman counseled it's vital to establish a political climate of opinion making it "politically profitable for the wrong people to do the right thing" and warned if it wasn't, "the right people will not do the right thing either."

AEI's Peter Wallison in "Hidden in Plain Sight: What Really Caused the World's Worst Financial Crisis and Why It Could Happen Again" makes a cogent case that government-housing-finance policy was the principal cause of the financial crisis, the critical factor without which it wouldn't have occurred. The Fed's easy credit contributed, as did dumb regulation by the SEC requiring financial institutions to mark mortgage-backed securities to market when the market had frozen. Unfortunately however, the false narrative that Wall-Street buccaneers and insufficient regulation was the problem still reigns on Main Street.

America remains mired in an economic malaise. The 62.6 percent labor-force-participation rate is the lowest since 1977. Median income in 2013 was the lowest since 1995. The 63.4 percent home-ownership rate is the lowest since 1967. Yet voters know more about the New England Patriots' deflated footballs than Dodd-Frank suppressing job and wealth creation. Investors' Business Daily opined Dodd-Frank cost "millions of lost jobs, trillions of lost income and a crippled small-business sector." Former Senate Banking Committee Chairman Phil Gramm noted if growth had just averaged previous post-WW2 recoveries there'd be 14.4 million more jobs and per capita income would be $6042 higher.

Dodd-Frank massively increased regulatory uncertainty and the costs of starting and running a bank, impairing credit and payment markets critical for economic growth. There were 1271 fewer commercial banks in March, 2015 than January, 2010. At the end of 2014 there were 304 fewer savings banks and 1281 fewer credit unions than at 2010's outset. From January, 2010 through 2014 only six new commercial and one new savings banks were chartered. During the previous 25 years two and half thousand new banks were chartered.

Dodd-Frank undermines the rule of law. On its fifth anniversary DavisPolk reported 22,296 pages of Dodd-Frank-related rules have been published, 13,115 of which are final. The CFTC, SEC, FDIC, Fed, OCC and CFPB have issued 631 Dodd-Frank-related regulatory releases. Dodd-Frank is the administrative state on steroids. In "Is Administrative Law Unlawful?," Columbia law professor Philip Hamburger makes a powerful argument it is.

Compliance costs are enormous. Citi estimated it spent $180 million in the second half of 2014 on the Fed's stress tests alone. The greater cost however is management focused on serving their Washington overlords rather than on competing, innovating and delighting customers and shareholders.

Dodd-Frank’s vise on financial services is tightening. Its politburo, the Financial Stability Oversight Council, designated GE Capital, insurance carriers AIG, Prudential and MetLife and nine “financial market utilities” as systemically important and therefore subject to its prudential oversight. But even if large U.S. banks lost 100 percent of their exposure to MetLife, it wouldn’t exceed 2 percent of their capital. Mr. Wallison notes MetLife showed DOJ fines on giant banks were four times greater than the largest loss any would suffer from its meltdown, but they didn’t skip a beat.

With the possible exception of fossil fuels no industry does as much moral good as banking while being so vilified. On the other end of the continuum, the sacrosanct solar-and-wind-energy industry makes consumers poorer and businesses less competitive by boosting the cost of electricity. Yet the banking industry has been reluctant to make a righteous case against being treated as a public utility, on its behalf and of Americans suffering stagnant wages or unemployed or out of the labor force.

When tens of millions of average Americans understand banks do good and Dodd-Frank is a millstone around their necks and thus around the neck of the beleaguered economy, its repeal will be inevitable.

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