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Cameron skewered

The lesson of a levy on banks

By Miles Saltiel

Summary

Great Britain bears a record peace-time burden of debt and uncounted additional “off-the-books” obligations. British politicians on the run from an angry electorate find it easier to scapegoat wicked bankers than to shoulder their responsibilities. Sadly, the Conservatives are showing themselves as bogus as the rest of the pack, most recently with feel-good posturing about a “bank levy”. This does nothing to correct banking’s real problems, let alone the dismal state of public finances. Such tomfoolery impairs action should Cameron be elected and undermines any claim of the shadow treasury team to be taken seriously.

A parable for our times

Richard Curtis makes jolly films, but it is best not to rely on his grip on reality. When he directed *The Boat That Rocked*, he suggested that in the sixties, radio pirates were suppressed by po-faced curmudgeons, by implication Tories. Not so. As those who were there remember, it was a combination of the music unions, the BBC and the government of that old twister, Harold Wilson.

Now Curtis has been at it again with more feel-good flummery. According to *The Times* of 23 March, he has been lobbying Steve Hilton and George Osborne on his “Robin Hood tax”.¹ This is the final incarnation of “Red” (Lord) Adair’s bonkers “Tobin tax”, given a token airing by Brown and Darling but shot down as an international scheme by saner counsel elsewhere.² But Cameron fell for it and on 20 March, he announced on Sky News that he was to incorporate it into Tory policy as a “bank levy”.³

What is this all about? The same *Times* article tells us that the Robin Hood Tax Facebook page has more followers than members of all political parties. So now Cameron and

his crew can claim that they have signed up, that they are cool dudes. This is what is to be passed off as leadership in engagement with the electorate and the formation of policy in economics.

Not of course that Cameron is alone: politicians in general, and Brown in particular, have devoted themselves to an Orwellian reconstruction of the past, so that the banking crisis is attributed entirely to greedy bankers to the exclusion of the political or regulatory regime. At a time when British parliamentarians are serial offenders on corruption, they are attempting to change the subject in a classic public relations “pivot”.

The paradox of a bank levy

Cameron devoted only a few dozen words to his thinking on 20 March and subsequent expansions have put little flesh on the bones. He spoke of a “levy to get taxpayer’s money back”. Value for taxpayers is always a good watchword, but “getting money back” is half-baked. First, history tells us that in bank crises, the big money doesn’t go to the banks but to governments themselves.⁴ Second, that same history tells us that the money which HMG subscribed for shares puts them in line for capital gains on realisation.⁵ Third, insurance schemes to protect depositors are already funded by premiums charged to the banks—a levy if you will.⁶ Fourth, any loans made to banks have been made against collateral, attract interest payments and are of course repayable—indeed the banks are aching to pay them back.

So what schemes are in the air at present? Germany is considering a plan to raise €9bn a year;⁷ Sweden is bringing in a tax to build up a fund equivalent to 2.5% of GDP over 15 years;⁸ the US is introducing a levy of 0.15% on uninsured portions of banks’ balance sheets, with more

in the works. But these schemes aren't intended to "get taxpayers' money back". Instead they purport to create a fund for future crises.

No-one will credit that. Every western government faces deficits unprecedented in post-war history. We look at the US and UK in greater detail below. To summarise, the former has just gone into the healthcare business in a big new way, their State pensions are unfunded, as are ours, and both have uncounted and/or "off-the-book" obligations which tower over the borrowings they own up to. Some countries may be able to ring-fence these levies, but in this country at least they will follow long-standing Treasury rules and go to general funds.

Worse still, the effect of such schemes is to hold up bank lending. This is because such levies cut into the profits of banks and prevent them restoring their reserves. This is at a time when politicians are screaming at the banks to do the reverse.

Fiscal framework

During the thirty-five years prior to 2008, American governments of both parties encouraged Federal mortgage insurers to add fifty percent "Off-the-books" to conventional money supply and bankers to extend loans to those formerly seen as bad risks. When they proved to be just that, precipitating the recent banking crisis, politicians unleashed a torrent of abuse upon the lenders for incentivising their people to carry out the policy of the government of the day. This is the foundation underpinning those now reforming American banking.

The United States has gross public debt of \$17tn plus unfunded pension and healthcare obligations (before those assumed on 23 March) of \$107tn: all together that adds up to 7.3x GDP.⁹ America confesses to borrowings of 94% of GDP. Britain has gross public debt of \$1tn, unfunded pension obligations to civil servants of more than £6.5tn, similar obligations to all UK residents of £4.3tn and "off-the-books" PFI obligations of \$85bn: all up more than 8.4x GDP, before uncounted "off-the-books" healthcare and welfare obligations.¹⁰ Britain admits to borrowings of 72% of GDP. The US and the UK bear respectively the second worst and worst fiscal position of nine major economies analysed at the end of 2009.¹¹ Discrepancies of this kind can be pooh-poohed as actuarial quibbles for years, even decades. But not for ever. These are the foundations

underpinning US and UK claims to responsibility with public money.

Closer to home, the current Prime Minister sets the tone. He started in office by stripping £67bn from the value of private pensions.¹² He made no bones of claiming credit for the "NICE" (non-inflationary constant expansion) decade, the abolition of economic cycles and ultimately "saving the world". He trashed the productivity of public services by throwing more money at them than they could absorb. He concludes by leaving the country with record peacetime levels of public debt, deficit and expenditure. This is the foundation underpinning Gordon Brown's economic judgement.

But he faces scant opposition. This is because British parliamentarians of all stripes are on the run. They have been caught out doctoring their expenses to accumulate capital and covering up favours exchanged with foreign governments. Former cabinet ministers have promoted their services as "cabs for hire" to influence policy. This is the foundation underpinning British parliamentarians' claims to probity.

So what are we left with? British politicians terrified of the truth and unwilling to engage in any serious or detailed manner with the public. Instead, they prefer the abbreviated syntax of tweeters.

The UK pickle—"double blind" errors

Let's recall how the UK got into its own particular pickle. The country enjoyed one hundred and forty years without a failure in banks taking deposits from consumers. This led to a fools' paradise: UK high-street banks consolidated to a classic oligopoly, whose members judged that they were too big to fail, for decades successfully resisting any proposals to insure bank deposits.

In the last decade, blind-faith confidence in impregnable high-street banks was joined by blind-eye regulation of provincial newcomers, whose incautious managements were permitted to cut corners with a view to reviving regional economies. An amiable objective; but a bridge too far.

When the crisis took hold, bank failures were so unfamiliar to the British public and authorities that all concerned panicked, luring the government into bank nationalisations.

These took place first when the bank most reliant on interbank lending caught a cold: thus the run on and hasty nationalisation of Northern Rock. Falling property values hurt banks with unsound loans, such as B&B and HBOS. The value of banks themselves also fell, hurting RBS with a top of the market acquisition; and Lloyds who allowed itself to be drawn into the ill-judged opportunism of rescuing HBOS.

Now we are stuck with arrangements which combine all of the worst of the former dispensation, with the added defect of government support. This is moral hazard gone mad: why should any banker resist making bad loans if he believes that government will bail him out?

Good ideas we don't hear enough about

All agree that the most important things are to have more honest accounting and stronger buffers against future problems.

First, honest accounting. Here, governments are in no position to preach. The extent of their “off-the-books” obligations dwarfs the figures rightly deemed criminal when stemming from Enron, Lehman or Madoff. Anyhow, reform of accounting (and the associated profession of rating) is dull: it doesn't get the focus groups hot and bothered. So not a lot on this from our politicians.

Second, buffers against future problems. This means agreeing and enforcing a tougher view about what is to be recognised as capital and tougher ratios on capital and liquidity. But the UK can't achieve this on its own, and the international community has decided to put this off—in part to encourage lending. No doubt this explains the silence of our politicians: they won't trust the public with the complexity of such issues

Other good ideas for the UK

So let's focus on what the UK itself can realistically achieve without international agreement—or what it should be campaigning for. Some ideas are a bit nerdy—too much so for a cohort of politicians so much on the run from the public as not to dare to go into detail. Others have the ring of “high-concept”, but fly in the face of the long-standing weakness for oligopoly among our high-street bankers, as well as the emerging corporatism of our partially nationalised banking sector.

Three nerdy ideas. We ought to restrict how much banks trade on their own account in capital markets. This is probably best accomplished by increasing the buffers—capital reserves—they have to hold against such activity. Next, we should make sure that failed banks can be run down in an orderly way—so-called “living wills”. Laws to this effect should go with a robust approach to freezing (and if need be seizing) the local assets of failed overseas banks. Finally, we should campaign to get derivative contracts onto regulated exchanges—good business for London.

As to “high-concept”, the Treasury should prepare for sale the public stake in Northern Rock, Lloyds and RBS. Before it does so, it should break them up, to demolish future expectations of “too big to fail”. This means going beyond the requirement of the EU that the former Williams & Glynn Bank be split out of RBS. The Treasury should take the opportunity to fillet out the former ABN-Amro investment bank as well as NatWest—possibly going so far as to break the latter up into its original constituents, Westminster plus National & Provincial. As to Lloyds, both its recent disastrous acquisition, HBOS, and the earlier success, TSB, qualify to be split out.

But we hear nothing of this, as it flies in the face of the comfortable oligopoly of UK banking, hallowed by time, and reinforced by their shiny new political masters

Dopey ideas which some politicians love

At a time when politicians are on the run, we need to listen to their ideas, particularly their ideas about money, with forensic scrutiny not the sentiments of social networking websites.

- The idea of segregating high-street and investment banking may make sense in the US (or it may not; opinions differ), but it doesn't here as our troubles came from ill-managed and/or ill-regulated high-street banks.
- Reforming UK regulation and disbanding the FSA is good tub-thumping stuff, but things went wrong all over the world. It's true the FSA failed the test of events, but putting up new signs over the door achieves nothing.
- Punitive regulation or taxation on hedge funds or private equity funds is several tube-stops beyond Barking. The Europeans have a bee in their bonnet

about this and Brown and Darling have been too supine to see it off in Brussels once and for all, instead delivering it as a hospital pass to the next government.

- The original idea of a “Tobin tax” on financial transactions was semi-coherent as “sand in the wheels”, but it is a sentimental solution to the problems of poverty. It would also be less effective as a remedy for recent problems than restoring banks’ own buffers as described above.
- “Jawboning” or tax penalties on bankers’ salaries still draws cheap applause. No-one wants to hear that bonuses keep banks’ costs down; that individuals rarely earn bonuses from year to year; that bankers earn less than equivalent lawyers or accountants; that the shot at a bonus compensates for zero job security; or that bonuses help banks rebuild capital and hang onto good people. The demonising of bankers has become such common currency that we must live with it till the next villains emerge.

Perhaps our politicians should reflect that the real problem is the lack of restraint on government spending and paper money, which allowed them to create boom and bust cycles. But they don’t.

Conclusion: let’s get real

Banks matter: they oil the wheel of commerce, take our savings and turn them into loans. They participate in capital markets which matter even more. Like every institution, they contain fools and knaves, plus many honest people working hard. They work in an environment which is affected more than anything else by regulation and policy. When these fail, we all get it in the neck.

Over the last eighteen months we have been reminded that only governments have enough juice to dig us out of the holes then arising, holes only they could have dug us into. And at what a price: not so much the money, horrifying as the bill is, as the Orwellian inventions. Just looking at the UK, our politicians and their apologists have perpetrated a campaign, far more successful than anyone might have credited, to falsify a decade. And of course, ritual harrumphing from the usual suspects—the bankers themselves, articles like this—pushes the Tories towards an ever more perfect union with the sweet-spot of the focus groups they follow so closely.

And then what? If Cameron is elected, he has skewered himself on Morton’s fork: either he changes his tune and reinforces the ill-repute in which politicians are held, or he governs as he campaigned, afraid of his own shadow. How successful do we think either will be?

We owe it to ourselves to resist such inauthenticity and to require that politicians pay the electorate, the economy and the banks the respect of steering clear of goofiness. In other words, to do what no politician in the UK at present has the guts to do—to take them seriously.

Endnotes

- 1 Times newspaper and website. London 23 March 2020. http://www.timesonline.co.uk/tol/comment/columnists/rachel_sylvester/article7071761.ece
- 2 Sky TV and website, 20 March 2010. <http://news.sky.com/skynews/Home/Politics/Tory-Leader-David-Cameron-Pledges-New-Tax-To-Pay-For-Bank-Bailouts-By-Taxpayers/Article/201003315577845?f=rss>
- 3 For our analysis see ASI September 2009 <http://www.adamsmith.org/publications/economy/regulatory-corporatism/>
- 4 Reinhart and Rogoff, *Aftermath of Financial Crises*, Harvard, 2008, http://www.economics.harvard.edu/files/faculty/51_Aftermath.pdf.p2
- 5 UK Statistical Bulletin. Public Sector Finances, February 2010. The cover chart shows that the “financial intervention” represented eight percent of current borrowings <http://www.statistics.gov.uk/pdfdir/psf0310.pdf>
- 6 Reinhart and Rogoff *Banking Crises: An Equal Opportunity Menace*, Harvard 2008, www.aeaweb.org/annual_mtg_papers/2009/retrieve.php?pdfid=245.p36 et seq;
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- 8 Deutsche Welle, 22 March 2010 <http://www.dw-world.de/dw/article/0,,5379883,00.html>
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- 9 United States Government, 24 March 2010. http://www.usgovernmentspending.com/downchart_gs.php?year=1900_2010&view=1&expand=&units=p&fy=fy11&chart=HO-fed&bar=0&stack=1&size=l&title=&state=US&color=c&local=c; Social Security and Medicare Trustees’ Reports, 2009, cited in National Centre for policy analysis. 11 June 2009 <http://www.ncpa.org/pub/ba662>
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- 11 HM Treasury, 2008, “Signed PFI Contracts List” plus author’s calculations
- 11 Public Debt And Demography – An International Comparison Using Generational Accounting, Christian Hagist, Stefan Moog, Bernd Raffelhüschen and Johannes Vatter, DICE Report 4/2009, IFO Institute for Economic Research, Munich
- 12 Internal papers of the Savings and Investment Division of the Inland Revenue, cited in the Times, 2 April 2007, <http://www.timesonline.co.uk/tol/news/politics/article1599843.ece>

Miles Saltiel is a Senior Fellow of the ASI and the founder of Fourth Phoenix, which provides valuations and other services to banks and industry.