

Reject Taxpayer Bank Bailouts

by [Rep. Ron Paul, MD](#)

 [SAVE THIS](#)  [EMAIL THIS](#)  [PRINT THIS](#)  [MOST POPULAR](#)

Before the US House of Representatives, May 4, 2005

Mr. Speaker, H.R. 1185, the Federal Deposit Insurance Reform Act, expands the federal government's unconstitutional control over the financial services industry and raises taxes on all financial institutions. Furthermore, this legislation increases the possibility of future bank failures. Therefore, I must oppose this bill.

I primarily object to the provisions in H.R. 1185 which may increase the premiums assessed on participating financial institutions. These “premiums,” which are actually taxes, are the primary source of funds for the Deposit Insurance Fund. This fund is used to bail out banks that experience difficulties meeting commitments to their depositors. Thus, the deposit insurance system transfers liability for poor management decisions from those who made the decisions to their competitors. This system punishes those financial institutions that follow sound practices, as they are forced to absorb the losses of their competitors. This also compounds the moral hazard problem created whenever government socializes business losses.

In the event of a severe banking crisis, Congress likely will transfer funds from general revenues into the Deposit Insurance Fund, which would make all taxpayers liable for the mistakes of a few. Of course, such a bailout would require separate authorization from Congress, but can anyone imagine Congress saying no to banking lobbyists pleading for relief from the costs of bailing out their weaker competitors?

Government subsidies lead to government control, as regulations are imposed on the recipients of the subsidies in order to address the moral

hazard problem. This certainly is the case in banking, which is one of the most heavily regulated industries in America. However, as George Kaufman (John Smith Professor of Banking and Finance at Loyola University in Chicago and co-chair of the Shadow Financial Regulatory Committee) pointed out in a study for the CATO Institute, the FDIC's history of poor management exacerbated the banking crisis of the eighties and nineties. Professor Kaufman properly identifies a key reason for the FDIC's poor track record in protecting individual depositors: regulators have incentives to downplay or even cover-up problems in the financial system such as banking facilities. Banking failures are black marks on the regulators' records. In addition, regulators may be subject to political pressure to delay imposing sanctions on failing institutions, thus increasing the magnitude of the loss.

Immediately after a problem in the banking industry comes to light, the media and Congress inevitably blame it on regulators who were "asleep at the switch." Yet most politicians continue to believe that giving more power to the very regulators whose incompetence (or worse) either caused or contributed to the problem somehow will prevent future crises!

The presence of deposit insurance and government regulations removes incentives for individuals to act on their own to protect their deposits or even inquire as to the health of their financial institutions. After all, why should individuals be concerned when the federal government is ensuring banks following sound practices and has insured their deposits?

Finally, I would remind my colleagues that the federal deposit insurance program lacks constitutional authority. Congress' only mandate in the area of money, and banking is to maintain the value of the money. Unfortunately, Congress abdicated its responsibility over monetary policy with the passage of the Federal Reserve Act of 1913, which allows the federal government to erode the value of the currency at the will of the central bank. Congress' embrace of fiat money is directly responsible for the instability in the banking system that created the justification for deposit insurance.



Dr. Ron Paul is a Republican member of Congress from Texas.

Ron Paul Archives

[Back to LewRockwell.com Home Page](#)