EIR Editor Testifies on Glass-Steagall Before the Maryland Legislature

Testimony of Paul Gallagher, EIR *Economics Co-Editor, March 3, 2017, before the Ways and Means Committee of the Maryland House of Delegates, on a resolution to move the U.S. Congress to restore the Glass-Steagall Act, Maryland House Resolution HJ4.*

Committee Chair and Delegates,

Thank you very much for holding today's hearing on the resolution to the U.S. Congress to restore the Glass-Steagall Act separating commercial bank units from all other types of financial institutions, and limiting FDIC insurance to those units.

Glass-Steagall restoration legislation in the U.S. House of Representatives, H.R.790, the Return to Prudent Banking Act of 2017, was introduced Feb. 1 by Republican Walter Jones of North Carolina, and Democrats Marcy Kaptur and Tim Ryan of Ohio and Tulsi Gabbard of Hawaii. It has grown to 32 [now 37] co-sponsors, and needs support. Twelve state legislatures are now considering resolutions supporting this legislation.

If Glass-Steagall is not restored now, the next large bank—or non-bank—financial failure will again topple the banking system and trigger both new bailouts and confiscation of bondholders and depositors in the form of bail-in. U.S.-based large bank holding companies have $2 trillion in exposure to European megabanks, which are full of non-performing loans and have not had a single profitable year since the 2008 crash, despite hundreds of billions in bailouts and trillions in bond purchases by the European Central Bank.

And if Glass-Steagall separation is not restored now, the largest U.S. bank holding companies—which dominate the banking system to the extent of 60-70% of deposits and assets—will continue to limit lending, in practice, to the large corporate bond issuers and borrowers, shutting out technologically progressive SMEs from credit.

JPMorgan Chase had $837 billion in loans/leases outstanding at Dec. 31, 2015, just 65.1% of its deposits of $1.279 trillion. Citigroup had $605 billion in loans/leases at the same date, just 66.8% of its deposits. But the entire U.S. commercial banking system has loans/leases outstanding equal to 79.2% of deposits according to the Federal Reserve's flow-of-funds report. Since the six largest banks hold more than half of all deposits, the comparative ratio for the nation's 6,000 community banks and regionals clearly must be in the range of 90%-plus loans/leases to deposits. The biggest banks' loan ratios are very low indeed; they both hurt the economy and demonstrate the great degree to which households' and businesses' deposits are being used for securities and derivatives speculation.

But since the 2008 crash, the biggest 12 banks have largely absorbed the deposits and assets of some 2,000 small banks that have disappeared—one quarter of all the commercial banks which existed in the United States a decade ago.

The largest bank holding companies changed dramatically from 1995—the point at which Glass-Steagall enforcement had effectively ceased—through the 2007-08 crash. This was studied and effectively described already in a 2011 study by the New York Federal Reserve entitled, "Peeling the Onion: The Structure of Large Bank Holding Companies." These giants became impossibly complex, morphing from 100-200 subsidiaries typically in 1995 to 3,000 or more units per megabank in 2011. They became giants dominating the assets and deposits of the entire U.S. banking system for the first time in U.S. history. They shifted their huge and growing deposit bases from lending toward supporting securities trading units, derivatives trades, etc.

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Derivatives markets exploded ten times in size in ten years 1997-2007.

Already in 1998-99, the failure of a single hedge fund called Long Term Capital Management was admitted to have nearly caused a global bank panic, because 55 U.S. and European banks, through leveraged loans, were into LTCM's immensely risky derivatives trading. By 2008, Lehman Brothers and other investment banks, insurance companies, and hedge funds were in the same blowout event condition.

Today, a media report March 2 identified $321 billion in fines which the world's biggest banks have had to pay since the 2008 crash, for illegal and/or immoral activities which they continue to commit up to the present. The dominant character of these violations of banking law and practice is the use of the very large deposit bases of these banks to support speculative units, securitization of investments, and derivatives bets. The currently very public Wells Fargo mis-selling scandal is emblematic of this.

To Restore Commercial Lending

If the Glass-Steagall Act *is* restored by Congress now, financial failures will take down only individual financial institutions, as when important investment banks like Drexel Burnham Lambert and Solomon Brothers failed under Glass-Steagall enforcement without affecting the rest of the banking system. U.S. branches of the biggest European universal banks, which absorbed great volumes of taxpayer bailout loans and recapitalizations, will have to recharter themselves completely independently if they are to operate in the United States at all. But in fact, Glass-Steagall restoration in the United States is likely to be followed more or less immediately in Europe, where many nations have already had Glass-Steagall bank separation legislation introduced.

And if Glass-Steagall *is* restored by Congress now, even as large holding companies are divesting securities units, their commercial banking units will necessarily be in the business of lending to businesses and households, aside from holdings of Federal and municipal bonds. The common Wall Street argument against Glass-Steagall—that it will reduce bank lending or damage the capital market—is the opposite of the truth. As FDIC vice-chair Thomas Hoenig has frequently argued in recent years, the United States capital markets were the deepest and most reliable in the world in the decades when commercial banking and securities trading were separated and the Federal safety net protected only the former.

If a national bank for great infrastructure projects is established, it will need a system of private commercial banks lending on good terms to its contractors. Glass-Steagall will again make lending the business of those banks.

EIR believes that restoring Glass-Steagall is the initiating action of four laws Congress should take. It should lead to a national Hamiltonian credit institutions for trillions in infrastructure investments; to an accelerated return to manned space exploration and to rapid development of fusion power and plasma technologies.

Thank you again for debating this crucial subject.