Breaking Up is Hard to Do: The Case Against “Too Big to Fail”

By “Coach Vance” Trefethen

***Resolved: The United States federal government should substantially reform its banking, finance, and/or monetary policy.***

Case Summary: The housing and financial crisis that triggered the Great Recession in 2008 highlighted the dilemma of banks that are “too big to fail.” On the one hand, banks (like any other institution) should bear the risk of loss and enjoy the benefits of profitability. On the other hand, when a bank becomes enormous in size, its failure not only destroys itself, but it could take down big, unrelated and innocent, sectors of the economy with it. One solution is for taxpayers to bail out banks that are too big to fail, but it’s the wrong answer. The right answer is to break up such banks into multiple smaller banks. If a bank is “too big to fail,” it ought to be “too big to exist.”

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Banks grow huge, and take reckless risks with depositors’ money. Then when things go wrong, they tell the federal government that they’re “too big to fail” because the entire economy is at risk, and they need bailouts from the taxpayers. There’s a simple solution, but it requires affirming that: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy.

OBSERVATION 1. DEFINITIONS

“Too Big to Fail”

Prof. Satish Thosar and Bradley Schwandt 2019. (Thosar - Professor, University of Redlands School of Business. Schwandt - Solution Consultant Associate at NetSuite) Has ‘Too Big To Fail’ Been Solved? A Longitudinal Analysis of Major U.S. Banks 1 Feb 2019 JOURNAL OF RISK & FINANCIAL MANAGEMENT <https://www.mdpi.com/1911-8074/12/1/24>

In testimony before the Financial Crisis Inquiry Commission in 2010, then Federal Reserve chair Ben Bernanke stated: “A too-big-to-fail firm is one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face severe adverse consequences. Governments provide support to too-big-to-fail firms in a crisis not out of favoritism or particular concern for the management, owners, or creditors of the firm, but because they recognize that the consequences for the broader economy of allowing a disorderly failure greatly outweigh the costs of avoiding the failure in some way.”

OBSERVATION 2. INHERENCY, the structure of the Status Quo.

“Too Big to Fail” is bad and getting worse. Banks are getting bigger, and breakups aren’t happening

Prof. Satish Thosar and Bradley Schwandt 2019. (Thosar - Professor, University of Redlands School of Business. Schwandt - Solution Consultant Associate at NetSuite) Has ‘Too Big To Fail’ Been Solved? A Longitudinal Analysis of Major U.S. Banks 1 Feb 2019 JOURNAL OF RISK & FINANCIAL MANAGEMENT <https://www.mdpi.com/1911-8074/12/1/24>

Thus, in terms of legislation passed and regulations implemented since the crisis, the breakup prescription has not been adopted in the U.S. or in any other country to our knowledge. In fact, U.S. banks have grown significantly compared to pre-crisis levels (see Figure 1). For instance, the average total assets for the four top-tier banks combined grew from $6.146 trillion (pre-crisis; 2005–2007) to $8.207 trillion (normalcy; 2014–2016) in real terms—an increase of 33.5 percent. Similarly, the four mid-tier (low-tier) banks increased collectively in size from $705 billion ($651 billion) to $1.404 trillion ($857 billion)—increases of 99.1 (31.6) percent, respectively. Viewed in isolation from a purely bank breakup advocacy perspective, the trend indicates that the TBTF problem is far from resolved and in fact is moving in the wrong direction. However, size has been taken into account in terms of the intensity of regulatory scrutiny and compliance requirements imposed on financial institutions. For instance, the financial stability provisions (Title I, Section 115) in the Dodd-Frank Act (2010) imposed the asset threshold for enhanced prudential standards at $50 billion, and for company run stress tests and mandatory risk committees at $10 billion. These thresholds would cover all twelve banks that we include in our analysis. However, the Economic Growth, Regulatory Relief and Consumer Protection Act (2018), in partially rolling back Dodd-Frank, has increased the asset threshold for enhanced prudential standards to $250 billion while allowing discretion to the Federal Reserve in determining whether a financial institution with assets equal to or above $100 billion should be subject to such standards. It also increased stress test and mandatory risk committee asset thresholds to $250 billion and $50 billion, respectively. This implies that going forward three of our low-tier banks (BB&T, SunTrust Banks, and Regions Financial) would not be subject to stress tests.

OBSERVATION 3. HARMS

HARM 1. Fraud

Banks with huge market power can get away with fraud

Prof. Joseph Stiglitz 2018 (Nobel prize winner in economics, professor of econ. At Columbia Univ.) “Ten Years Later” Sept 2018 <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Roosevelt%2010-Years-After-the-Financial-Crisis.pdf>

Such clear abuses of market power contribute to Americans’ sense that the political system and the institutions it controls are rigged. Captured institutions undermine faith in the political system, and a disregard for the rule of law does, as well. There was a proliferation of fraud in the credit rating agencies and investment banks before the crisis. Banks even refused to comply with contracts in which they had provided “money back guarantees” to investors and others who bore the risks of the mortgages that the mortgages were as described--that, for instance, they were for owner-occupied housing rather than rental properties (the default on the former is typically much lower than on the latter). And yet these contracts' provisions were seemingly well-designed to contain moral hazard. But if a legal system is broken, contracts aren’t worth the paper they’re written on. This type of trust is foundational to the functioning of our society.

HARM 2. Bailouts promote bank failure

A. Unnecessary risks: TBTF (Too Big to Fail) Banks know their losses will be covered by taxpayers

Prof. Satish Thosar and Bradley Schwandt 2019. (Thosar - Professor, University of Redlands School of Business. Schwandt - Solution Consultant Associate at NetSuite) Has ‘Too Big To Fail’ Been Solved? A Longitudinal Analysis of Major U.S. Banks 1 Feb 2019 JOURNAL OF RISK & FINANCIAL MANAGEMENT <https://www.mdpi.com/1911-8074/12/1/24>

A related issue is whether some banks enjoy a ﬁnancing subsidy by virtue of their perceived TBTF status. The logic is that providers of capital to TBTF banks are willing to offer more favorable terms because they anticipate being bailed out in the event of default. Apart from the unfairness aspect of being favored over small, this could also induce the TBTF banks to take on greater risks since the rewards are reaped by shareholders/managers while catastrophic losses are ofﬂoaded on to taxpayers—a classic moral hazard scenario.

B. Failure rewarded. “Too big to fail” banks get federal bailouts, rewarding failure

Prof. Joseph Stiglitz 2018 (Nobel prize winner in economics, professor of econ. At Columbia Univ.) “Ten Years Later” Sept 2018 <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Roosevelt%2010-Years-After-the-Financial-Crisis.pdf>

In short, our bail-outs run the risk of transferring large amounts of money, often in nontransparent ways, to those banks that did the worse job in risk management—hardly principles on which normal market economics is based. Among these are some of the too-big-to-fail banks. In effect, the government is tilting the playing field—towards the losers, worsening the tilt that is always there simply from the implicit guarantees associated with being too big to fail.

C. The Impact: Multi-trillion-dollar losses when failures get worse and everything crashes

Nicole Gelinas 2009 (a City Journal contributing editor and the Searle Freedom Trust Fellow at the Manhattan Institute, is a Chartered Financial Analyst) “Too Big to Fail” Must Die” Summer 2009 CITY JOURNAL <https://www.city-journal.org/html/%E2%80%9Ctoo-big-fail%E2%80%9D-must-die-13211.html>

If real reform doesn’t happen, get ready for a fearsome certainty: that markets will eventually correct our unsustainable financial system. They have tried to do so several times over the decades by punishing firms like Continental, Long-Term, and, most recently, Citigroup, as well as the lenders who financed them. The government thwarted these necessary corrections at every turn, bailing out the reckless and their enablers. But the price of maintaining our untenable system keeps growing, and eventually the government won’t be able to pay the bill. The multitrillion-dollar price tag attached to the government’s current endeavors already endangers the nation’s fiscal health. A decade from now, failing financial firms could take the credit of the U.S. government right down with them.

HARM 3. Economic catastrophe and taxpayer burden

“Too big to fail” banks caused the financial crash of 2008 and cost taxpayers trillions of dollars

Dennis Kelleher 2018 (president and CEO of Better Markets, a Washington-based independent, nonpartisan, nonprofit organization that promotes the public interest in financial reform, financial markets and the economy) 1 Aug 2018 “BankThink ‘Too big to fail’ is alive and kicking” <https://www.americanbanker.com/opinion/too-big-to-fail-is-alive-and-kicking>

“Too big to fail” financial firms, those that would crash the entire financial system and global economy if they failed, were at the core of causing and spreading the financial crash of 2008. That was the worst meltdown since the Great Crash of 1929 and caused the worst economy since the Great Depression of the 1930s. A second Great Depression was only avoided due to unprecedented and incredibly costly government and taxpayer bailouts for those “too big to fail” global financial giants like JP Morgan Chase, Citigroup, Bank of America, Goldman Sachs, Morgan Stanley and many others. While most people think of the $700 billion Troubled Asset Relief Program when they think of bailouts, that was only the tip of the bailout iceberg, which [totaled in the trillions](https://www.gpo.gov/fdsys/pkg/CHRG-112shrg64832/pdf/CHRG-112shrg64832.pdf).

OBSERVATION 4. The PLAN, implemented by Congress and the President

1. Congress passes HR7383, the “Too Big to Fail, Too Big to Exist” Act. It sets standards for the breakup of banks and financial institutions considered too big to fail when their size reaches 3% of Gross Domestic Product.

2. Funding and enforcement through the Board of Governors of the Federal Reserve System  
3. Plan takes effect one year after an affirmative ballot.   
4. Affirmative speeches may clarify

OBSERVATION 3. SOLVENCY. There’s bipartisan agreement that bank breakups solve “too big to fail”

A Republican Federal Reserve banker and a Democratic Congressman agree breakups would solve

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf> (ellipses in original)

“Never again should a financial institution be able to demand a federal bailout,” added U.S. Rep. Brad Sherman (D-Calif.), the chief House sponsor of the measure. Sherman’s bill originally came from former U.S. Rep. Brad Miller (D-N.C.). “They claim; ‘If we go down, the economy is going down with us,’ but by breaking up these institutions long before they face a crisis, we ensure a healthy financial system where medium-sized institutions can compete in the free market,” explained Rep. Sherman. Added Neel Kashkari, President of the Minneapolis Federal Reserve Bank, “Given the enormous costs that would be associated with another financial crisis ... we must consider ... breaking up large banks into smaller, less connected, less important entities.” Kashkari is a Republican, former Goldman Sachs executive, and one of the principal authors of the government’s bailout when he served in the Treasury Department in 2008 under the administration of U.S. President George W. Bush. The Sanders and Sherman legislation would give banking regulators 90 days to identify commercial banks, investment banks, hedge funds, insurance companies and other entities whose “failure would have a catastrophic effect on the stability of either the financial system or the United States economy without substantial government assistance.” The list mandated by the Sanders/Sherman legislation would include Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo. These eight institutions already have been deemed “systemically important banks” by the Financial Stability Board, the international body that monitors the global financial system. Under the legislation, the U.S. Treasury Department would be required to break up those and any other institutions deemed too big to fail by the Treasury Secretary. Any entity on the TBTF list would no longer be eligible for a taxpayer bailout from the Federal Reserve and could not use their customers’ bank deposits to speculate on derivatives or other risky financial activities. A break-up would introduce true market discipline. Former U.S. Rep. Brad Miller (D-N.C.), the original author of the break-up bill, explained, “Market participants cannot realistically assess the assets and liabilities of a megabank any more than a regulator can.” He argues for a break-up so that the market can properly value banks. “If market participants knew they could be paid only from the assets of the specific subsidiary with which they did business, they would consider that subsidiary’s assets and potential liabilities. That diligence is part of ‘market discipline,’ a drastic change from the unlimited liquidity for every line of business.” Finally, a break-up would promote marketplace competition, which is the engine of efficiency. Just as the consolidations following the repeal of Glass-Steagall and the forced mergers as part of the 2008 bailout have led to higher consumer fees and less efficient capital mediation, a break-up can reverse this trend.

2A Evidence:

OPENING QUOTES

Shrinking the big banks would promote “free enterprise”

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

I would prefer a completely hands-off policy when it comes to financial markets, but the political reality is that deposit insurance and regulation are not going away. Given that they are not, the worst possible outcome is that the marriage of politics and finance evolves into outright corporatism, as it did with Freddie Mac, Fan nie Mae, and the rest of the nation’s largest financial institutions. And that evolution is directly attributable to the influence that comes from banks’ being big enough to achieve real political power. To expand free enterprise, shrink the banks.

DEFINITIONS

Text of the bill

<https://www.congress.gov/bill/115th-congress/house-bill/7383/text?r=19&s=1>

Print out and bring with you to the round.

Details of how the bill works

Sen. Bernie Sanders 2018 (I-Vt.) 3 Oct 2018 Sanders, Sherman Introduce Legislation to Break Up Too Big to Fail Financial Institutions <https://www.sanders.senate.gov/newsroom/press-releases/sanders-sherman-introduce-legislation-to-break-up-too-big-to-fail-financial-institutions>

Under the bill, entities that exceed the 3 percent cap would be given two years to restructure until they are no longer too-big-to-fail. These “Too Big to Exist” institutions would no longer be eligible for a taxpayer bailout from the Federal Reserve and could not use customers’ bank deposits to speculate on derivatives or other risky financial activities. As a result, JPMorgan Chase and Bank of America would be forced to shrink to where the banks were in 1998. Wells Fargo would go down in size to where it was in 2005. And Citigroup would shrink to where it was during the second term of Bill Clinton’s administration.

INHERENCY

A/T “Regulations made banks safer now” – Not enough, banks are not safer now than before the crash

Natasha Sarin & Lawrence H. Summers 2016 (Sarin - PhD Candidate in Economics, Harvard. Summers - Professor and President Emeritus - Harvard University) “Have big banks gotten safer?” Fall 2016 <https://www.brookings.edu/bpea-articles/have-big-banks-gotten-safer/>

Since the financial crisis, there have been major changes in the regulation of large financial institutions directed at reducing their risk. Measures of regulatory capital have substantially increased; leverage ratios have been reduced; and stress testing has sought to further assure safety by raising levels of capital and reducing risk taking. Standard financial theories would predict that such changes would lead to substantial declines in financial market measures of risk. For major institutions in the United States and around the world and midsized institutions in the United States, we test this proposition using information on stock price volatility, option-based estimates of future volatility, beta, credit default swaps, earnings-price ratios, and preferred stock yields. To our surprise, we find that financial market information provides little support for the view that major institutions are significantly safer than they were before the crisis and some support for the notion that risks have actually increased. This does not make a case against the regulatory approaches that have been pursued, but does caution against complacency.

A/T “Regulations solve” - “Too Big To Fail” banks are too big to regulate

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

And finally, while regulators were supposed to prevent banks from committing frauds or veering off the guardrails of banking rules, the spectacular missteps of bankers that caused the financial crisis revealed regulatory inadequacy. The banks had become too big to regulate. The mega-banks are too big to fail, too big to jail, too big to manage, and too big to regulate.

Trump administration has rolled back or stopped enforcing regulations, so the likelihood of another “too big to fail” crash has greatly increased

Dennis Kelleher 2018 (president and CEO of Better Markets, a Washington-based independent, nonpartisan, nonprofit organization that promotes the public interest in financial reform, financial markets and the economy) 1 Aug 2018 “BankThink ‘Too big to fail’ is alive and kicking” <https://www.americanbanker.com/opinion/too-big-to-fail-is-alive-and-kicking>

However, since the Trump administration, the Dodd-Frank law and many of its implementing rules have been rolled back to varying degrees, jeopardizing Main Street taxpayers, consumers and investors, our financial system and the economy. For example, FSOC has been effectively shut down; OFR has been neutered; CFPB has abandoned consumers and now seeks to instead protect financial predators; banks are being allowed to reduce their capital and liquidity and engage in more proprietary trading; and plans are in the works to reduce the strength and value of stress tests and living wills. Maybe worst of all, enforcement across the board has been dramatically reduced, which rewards and incentivizes high risk if not illegal behavior. (The fact that not one Wall Street executive or supervisor was held accountable for the 2008 crash created an intolerable moral hazard and only exacerbates this corrosive culture.) As legislative, regulatory and judicial deregulation continues, the very pillars of financial stability, consumer protection and revived lending are being systemically weakened by the Trump administration. Contrary to the rhetoric, all these actions make the problem of too-big-to-fail firms worse and greatly increase the likelihood of another financial crash and more taxpayer bailouts.

Since the financial crisis 10 years ago, nothing has been done to stop the risk of “Too Big to Fail” banks

Prof. Joseph Stiglitz 2018 (Nobel prize winner in economics, professor of econ. At Columbia Univ.) “Ten Years Later” Sept 2018 <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Roosevelt%2010-Years-After-the-Financial-Crisis.pdf>

Further, nothing has really been done to counter the risk posed by too-big-to-fail banks. In fact, the problem with too-big-to-fail is worse because of mergers that occurred during the crisis—and which the government encouraged. And it is not just too-big-to-fail that imposes systemic risk. There are problems of too intertwined-to-fail (or too-connected-to-fail), and too-correlated-to-fail. None of these problems have been fixed. Some of the too-correlated-to-fail issues would have been addressed if the United States had reenacted Glass-Steagall, but that opportunity was missed.

A/T “Attitudes have changed, big banks won’t get bailouts anymore” – They will when panic sets in

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Beyond what real economy problems a mega-bank failure might reveal, the failure itself can ignite repercussions. Consider the bank’s bond holders. Mega-banks buttress their balance sheets with bond loans as well as loans from depositors. Some of those bonds in a failed bank might be held by a state pension fund. That could force the pension fund to reduce benefits if the fund is insufficiently robust. Then there are psychological impacts, such as panic. Given these real problems, regulators have and will feel compelled to bail out a mega-bank before permitting it to fail.

Banks are big and getting bigger, even since the crisis. 4 banks have 1/3 of all bank deposits in the U.S.

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Yet today, the largest banks are even bigger than they were then. JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, Morgan Stanley. These Wall Street banks are the largest in the nation. JPMorgan, Bank of America and Citi each hold around $2 trillion in assets each. For context, the net wealth of all Americans is $80 trillion. Exxon, the world’s largest oil company, has $350 billion in assets, a fraction of those held by each of the largest banks. There are more than 6,000 banks (most with multiple branches) in the United States in which customers can deposit funds with a guarantee from the federal government that they can withdraw their money even if the bank fails. These taxpayer-backed deposits amount to $11 trillion. More than a third of this $11 trillion resides in four banks: JPMorgan, Bank of America, Wells Fargo and Citi.

Examples of multi-billion dollar “Too Big To Fail” bailouts

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Whereas Washington officials had facilitated such deals with federal funding in the past, it withheld that help for Lehman. Instead, Lehman declared bankruptcy on September 15, 2008. That decision hardly ended the TBTF policy. In fact, the policy soon became even more entrenched. The Lehman bankruptcy sparked financial contagion. It revealed that many major banks suffered from the same intrinsic problem as Lehman – assets that were worth less than they had reported, and worth less than their liabilities. (Assets are what are owned; liabilities are what are owed.) The financial sector, in short, was insolvent. Federal officials reversed course after the Lehman bankruptcy and launched the biggest bailout in global history beginning in September 2008. They claimed a Hobson’s choice; while a bailout was deplorable, economic devastation would be worse. The government deployed $45 billion to Bank of America, $45 billion to Citigroup, and billions even to major nonbanking firms, including $180 billion to AIG, an insurance company.

A/T “Dodd-Frank ‘Living Will’ rule will solve” – Living Wills aren’t credible and won’t work

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

In 2014, the Federal Reserve and FDIC declared that the “living will” plans by 11 large banks submitted in 2013 were “not credible.” The 11 banks were Bank of America, Citigroup, JPMorgan, Goldman Sachs, Morgan Stanley, Bank of New York Mellon, State Street, and the United States units of Barclays, Credit Suisse, Deutsche Bank and UBS. FDIC Vice Chair Tom Hoenig explained that the mega-banks’ derivatives portfolios should be altered to make them part of the bankruptcy process. Currently, derivatives can be settled immediately with the declaration of bankruptcy even as other credit relations must wait for the court. About a third of the world’s $700 trillion in outstanding derivatives bets are held by just four American banks. The JPMorgan living will for 2015 is 200,000 pages long. Such a length is unfathomable. Further, the lion’s share of these plans are not public and can’t be exposed to the discipline of the market forces that would re-price bond and stock values, undermining the chance for markets to force reforms.

A/T “Dodd-Frank resolution authority solves” – “Too Big” banks have a loophole: international jurisdictions. They grow too big for Dodd-Frank!

Peter Boone and Simon Johnson 2010. (Boone is chair of Effective Intervention, a U.K.-based charity, and a principal at Salute Capital Management Ltd. Johnson is a professor at MIT’s Sloan School of Management, a senior fellow at the Peterson Institute for International Economics, and former chief economist at the International Monetary Fund ) 7 Nov 2010 “Way Too Big To Fail” NEW REPUBLIC <https://newrepublic.com/article/78563/way-too-big-fail>

When the [Dodd-Frank](http://www.opencongress.org/bill/111-h4173/show) financial-reform bill finally passed in July, it created an expanded resolution authority, just as Geithner, Paulson, and Dimon had recommended. But there was an escape clause—a rather beautiful one, if you appreciate this sort of elegance. The resolution authority does not cover global financial activities. In fact, it cannot, because no legislature, including the U.S. Congress, can pass a law that determines what will happen in another country’s legal system. This has major implications for the next time that the financial system melts down. And bankers are well aware that there will be a next time—Dimon himself told the Financial [Crisis Inquiry Commission](http://www.cbsnews.com/8301-503983_162-6093076-503983.html) that there is a crisis “every five to seven years,” which is a completely sensible assessment of how the world’s credit system functions. Before the next crisis comes, however, all a bank has to do to escape the resolution authority is to grow so large that it is vital to not just the U.S. economy, but the entire international financial system. If one of these mega-banks goes under, the government will have no choice but to step in and provide full creditor protection. The resolution authority will effectively be meaningless.

A/T “Dodd-Frank” – Turn: Dodd-Frank made “too big to fail” worse

Alex J. Pollock 2017 (Distinguished Senior Fellow in Finance, Insurance & Trade at the R Street Institute; former President and Chief Executive Officer of the Federal Home Loan Bank of Chicago) 18 Aug 2017 “How big a bank is too big to fail? “ <https://www.rstreet.org/2017/08/18/how-big-a-bank-is-too-big-to-fail/>

The Dodd-Frank Act is claimed by some to have ended too big to fail, but the relevant Dodd-Frank provisions are actually about how to bail out creditors, just as was the goal with Continental. Thus in the opposing view, it has simply reinforced too big to fail. I believe this latter view is correct, and the question of who is too big to fail is very much alive, controversial, relevant and unclear.

HARMS / SIGNIFICANCE

“Too big to fail” banks caused the 2008 financial disaster and lack of federal intervention was to blame

Nicole Gelinas 2010 (City Journal contributing editor and the Searle Freedom Trust Fellow at the Manhattan Institute, is a Chartered Financial Analyst) “Too Big Not to Fail” Winter 2010 NATIONAL AFFAIRS <https://www.nationalaffairs.com/publications/detail/too-big-not-to-fail>

Beginning in the 1980s, and continuing over the quarter-century that followed, Washington afforded the world of big finance a terrible ­luxury: freedom from the fear of failure. Managers and lenders at financial companies came to understand that the larger and more complex their firms got, the more immunity from market discipline they would enjoy — since they could depend on government guarantees when necessary to protect the broader economy from their mistakes. The government thus countenanced and subsidized an untenable financial system. And it inevitably got more of what it paid for: reckless risk building up to disaster.

“Too big to fail” banks are incentivized to take reckless risks because the government will bail them out

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

As new financial catastrophes became daily events through 2008 and 2009, the problem of too-big-to-fail banks made clear the moral hazard of size. Moral hazard generally refers to a circumstance in which insurance against loss can motivate an actor to take on more risk. Calculating they would be bailed out in the case of failure, managers of mega-banks could gamble recklessly; worse, they were invited to gamble by the prospect of a bailout; worse still, they were mandated to gamble recklessly so as to compete with the other too-big-to-fail bankers.

“Too big to fail” banks are “too big to manage,” and they lose money through stupid mistakes

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

As the large banks stumbled to recover, it also became clear they were too big to manage. The $2 trillion in assets that each of the largest banks held proved too much for their respective managements to control. Operational mistakes abounded. Bank of America reported a $4 billion accounting error. JPMorgan lost $6 billion from a single London trading outpost of a dozen employees.

Large banks use the political system to shift risk of failure over to the public (while keeping the profits themselves) and regulation won’t solve

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

In recent decades, the blend of politics and banking created a Washington-Wall Street financial complex in the mortgage market. This development, and its consequences, have been well documented. Michael Lewis’s 1989 book *Liar’s Poker* includes a portrayal of the political exertions of investment bankers to enable mortgage securitization to take off. “The Quiet Coup,” an article by Simon Johnson that appeared in the May 2009 issue of *The Atlantic*, chronicles the rapid accrual of profits and power by large financial institutions over the past 30 years; during this period, Wall Street firms were able to shape the basic beliefs of political figures and regulators, a phenomenon that Brookings Institution scholar Daniel Kaufmann has dubbed “cognitive capture.” Andrew Ross Sorkin’s *Too Big to Fail*, which describes the response of the Federal Reserve and Treasury to the financial crisis, leaves the distinct impression that senior bankers had much more access to and influence over Washington’s decision makers than did career bureaucrats. Notwithstanding the good intentions of policymakers, who no doubt plan to create a stronger regulatory apparatus going forward, large banks will inevitably have too much power for the apparatus to govern them. They will shield themselves from its attentions by making political concessions on lending practices. So long as big banking is conjoined to big government, that is, we risk a return to the regime of private profits and socialized risk.

Reckless risks and immunity to prosecution by “too big to fail” banks

Rob Garver 2014 (master’s degree in public policy from Georgetown University) 9 Jan 2014 “Why ‘Too Big to Fail’ Is a Bigger Problem Than Ever” <https://www.thefiscaltimes.com/Articles/2014/01/09/It-Time-Break-Big-Banks>

The bank’s share price rose again yesterday despite The Wall Street Journal’s [revelation](http://online.wsj.com/article/SB10001424052702303848104579308543399871248.html?mod=WSJ_hp_LEFTWhatsNewsCollection) of yet more potential illegal activity – JPM is one of several banks being investigated for deliberately mispricing volatile residential mortgage-backed securities during the financial crisis. The point here is not to pick on JPMorgan alone. The very largest banks in the U.S. are [posting](http://blogs.barrons.com/stockstowatchtoday/2014/01/08/citigroup-bank-of-america-jpmorgan-chase-pick-a-bank-any-bank/?mod=BOLBlog) almost uniformly spectacular financial results that have seemingly inured them to the regulatory and legal penalties they are made to pay. A hearing held Wednesday by the Senate Committee on Banking, Housing and Urban Development addressed one of the reasons why the banks are doing so well even as they face continued legal actions: They enjoy a massive subsidy rooted in the market’s belief that, should they ever get in trouble, the government will bail them out. That enables those banks to borrow more cheaply than their smaller competitors and leads shareholders to believe that they are protected from downside risk should the bank get in trouble.

SOLVENCY / ADVOCACY

Breaking up large banks is the only way to solve “too big to fail”

Peter Boone and Simon Johnson 2010. (Boone is chair of Effective Intervention, a U.K.-based charity, and a principal at Salute Capital Management Ltd. Johnson is a professor at MIT’s Sloan School of Management, a senior fellow at the Peterson Institute for International Economics, and former chief economist at the International Monetary Fund ) 7 Nov 2010 “Way Too Big To Fail” NEW REPUBLIC <https://newrepublic.com/article/78563/way-too-big-fail>

There was only one way for us to truly fix the “too big to fail” problem and that was to make the largest banks small enough and simple enough to fail. That way, if a bank made bad decisions, it would be forced to deal with the consequences without endangering everyone else.

“American Banker” (bank industry trade publication) describes widespread and bipartisan advocacy for breakups

Prof. Simon Johnson 2012 (*Professor of Entrepreneurship at the M.I.T. Sloan School of Management*) 10 May 2012 NEW YORK TIMES “Breaking Up Four Big Banks” <https://economix.blogs.nytimes.com/2012/05/10/breaking-up-four-big-banks/>

According to American Banker, we now have in the “break up the banks” corner (in order of appearance in that feature): Richard Fisher, president of the Federal Reserve Bank of Dallas; Sheila Bair, former chairwoman of the Federal Deposit Insurance Corporation; Thomas Hoenig, a board member of the Federal Deposit Insurance Corporation and former president of the Federal Reserve Bank of Kansas City; Jon Huntsman, former Republican presidential candidate and former governor of Utah; Senator Brown; Mervyn King, governor of the Bank of England; Senator Bernard Sanders, an independent of Vermont; and Camden Fine, president of the Independent Community Bankers of America.

Size of big banks allows them to abuse power. Other countries (e.g. Australia) have curtailed it, so we know it works

Prof. Joseph Stiglitz 2018 (Nobel prize winner in economics, professor of econ. At Columbia Univ.) “Ten Years Later” Sept 2018 <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Roosevelt%2010-Years-After-the-Financial-Crisis.pdf>

The fundamental reason that the big banks have so thoroughly avoided painful consequences for the problems they caused is their excessive market power, their abuse of that power, and their conversion of their economic power into political power. One of the big fights in Dodd-Frank was getting through the Durbin Amendment, which was to curtail the abuse of monopoly power associated with debit cards. In other countries, such as Australia, this power has been curtailed, proving that it’s possible to get rid of this monopoly power.

Bankruptcy won’t work, we have to reduce the size of the big banks

Prof. Simon Johnson 2015 (Professor of Entrepreneurship, MIT Sloan School of Management Senior Fellow, Peterson Institute for International Economics) 29 July 2015 “The Role of Bankruptcy Reform in Addressing Too Big To Fail” <https://www.piie.com/publications/testimony/johnson20150728.pdf>

As it is currently obvious that bankruptcy cannot work, the legislative intent is clear. The Fed and the FDIC must require significant remedial action, meaning that something about the size, structure, and strategy of the megabanks must change, and these changes must be sufficient to allow bankruptcy (without massive systemic damage) to become a real possibility.

Rep. Sherman: Need to break up large institutions before they demand federal bailouts

Rep. Brad Sherman 2018 (D-Calif.) 3 Oct 2018 “Sanders, Sherman Introduce Legislation to Break Up Too Big to Fail Financial Institutions” <https://www.sanders.senate.gov/newsroom/press-releases/sanders-sherman-introduce-legislation-to-break-up-too-big-to-fail-financial-institutions>

“Too big to fail should be too big to exist,” said Sherman, who has advocated this position since 2009. “Never again should a financial institution be able to demand a federal bailout. Today they can claim: ‘if we go down, the economy is going down with us.’ By breaking up these institutions long before they face a crisis, we ensure a healthy financial system where medium-sized institutions can compete in the free market.”

Breakups are the solution to preventing bailouts

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Those who find government bailouts to be unacceptable should be anxious to compel the breakup of $1 trillion banks. Consider this: Continental Illinois, which the government bailed out in 1984 because officials believed it was too big to fail, had just $40 billion in assets. Even adjusting for inflation that would only be $90 billion today, a fraction of the size of the $1 trillion mega-banks.

Breakup is the only answer: Capital standards won’t work, regulations won’t work, rogue traders can wreak havoc and political influence blocks effectiveness of existing tools

Bartlett Collins Naylor 2016 (financial policy advocate for Public Citizen’s Congress Watch division, formerly chief of investigations for the Senate Banking Committee; former director of Corporate Affairs fo the Teamsters union, former principal of Capital Strategies Consulting) “The Mega-Banks Are Too Big to Fail, Too Big to Jail, and Too Big to Manage” <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Clearly, the regulators can and should order a break-up. That they have not done so may be due to a belief that improved capital standards, discussed above, will be sufficient to prevent a mega-bank from insolvency. Strong capital standards could conceivably prevent a bank failure. Yet these depend on accounting oversight that can prove difficult. As discussed, regulators failed to recognize that Washington Mutual’s loans were grossly overvalued, since too many were “liar loans” void of documentation that the borrower could repay them. And the London Whale episode showed that rogue trading desks can lead to abrupt, catastrophic losses. Finally, the Wall Street banks exercise consequential political influence in Washington, stifling efforts by regulators to use existing tools. They contribute generously to congressional and presidential campaigns, they lobby prodigiously, and their senior executives populate pivotal regulatory posts, which is explored later in this discussion. All this argues that Congress must be more explicit. i. Pass legislation requiring break-up of TBTF banks. Short of waiting for regulators, what’s necessary then, is to break up the largest banks.

The failure of a huge bank cannot be solved without harming the entire economy. The best solution is to make them smaller

Prof. Simon Johnson 2015 (Professor of Entrepreneurship, MIT Sloan School of Management; Senior Fellow, Peterson Institute for International Economics) 29 July 2015 “The Role of Bankruptcy Reform in Addressing Too Big To Fail” <https://www.piie.com/publications/testimony/johnson20150728.pdf>

The FDIC can close small and medium sized banks in an orderly manner, protecting depositors while imposing losses on shareholders and even senior creditors. But it is a stretch to argue that such a resolution authority will definitely “work”—i.e., prevent spillover systemic damage and negative impact on the real economy—for any failing large bank with significant cross-border operations. The resolution authority granted under Dodd-Frank is purely domestic, i.e., it applies only within the United States. The US Congress cannot make laws that apply in other countries—a crossborder resolution authority would require either a treaty-level agreement between the various governments involved or some sort of synchronization for the relevant parts of commercial bankruptcy codes and procedures. There are no indications that such treaties will be negotiated—or that there are serious intergovernmental efforts underway to create any kind of cross-border resolution authority, for example, within the G-20. The best approach for the United States today would be to make all financial institutions small enough and simple enough so they can fail—i.e., go bankrupt—without adversely affecting the rest of the financial sector.

A/T “Bernanke says we don’t need smaller banks” – But then he says we need policies that will make banks smaller

Prof. James Kwak 2013 (Professor of Law at the University of Connecticut School of Law ) 16 May 2013 “If the Fed Knows Banks Are Too Big, Why Doesn’t It Make Them Smaller?” <https://truthout.org/articles/if-the-fed-knows-banks-are-too-big-why-doesnt-it-make-them-smaller/>

Last week, Governor of Governors [Ben Bernanke](http://online.wsj.com/article/SB10001424127887324059704578475320994411626.html) quoted from the same talking points (emphasis added):   
“Mr. Bernanke said the Fed could push banks to maintain a higher leverage ratio, hold certain types of debt favored by regulators, or other steps to give the largest firms a ‘strong incentive to reduce their size, complexity, interconnectedness.’ “The Fed chairman acknowledged growing concerns that some financial companies remain so big and complex the government would have to step in to prevent their collapse and said more needs to be done to eliminate that risk.”  
It’s important to note exactly what Stein, Tarullo, and Bernanke are all saying.   
- Here’s what they’re not saying: Too-big-to-fail banks enjoy implicit subsidies and impose externalities on the rest of us; therefore those subsidies and externalities should be priced; and then those banks can decide whether they want to absorb those costs or make themselves smaller.  
- Here’s what they are saying: Too-big-to-fail banks are too big and complex and pose a systemic risk to all of us; therefore they need to become smaller and less complex; and the Fed will tweak the regulations until they become smaller and less complex. What’s remarkable about this? These three men—probably the three most important on the Board of Governors when it comes to systemic risk regulation (as opposed to monetary policy, for example)—all say that they know that the megabanks are too big and complex. They all say that accurate pricing of subsidies and externalities is not an end in itself.\* They all say that the goal is smaller, less complex banks. But here’s what baffles me: If the goal is smaller, less complex banks, why not just mandate smaller, less complex banks?

A/T “Bernanke opposes bank breakups” – He favors a more complicated way to get to the same results, and it’s wrong

Prof. James Kwak 2013 (Professor of Law at the University of Connecticut School of Law ) 16 May 2013 “If the Fed Knows Banks Are Too Big, Why Doesn’t It Make Them Smaller?” <https://truthout.org/articles/if-the-fed-knows-banks-are-too-big-why-doesnt-it-make-them-smaller/>

Instead, there’s an obvious solution: rules that limit the size and scope of financial institutions. But Bernanke has ruled out “arbitrary” size caps in favor of his cute regulatory dial-tweaking. Again, Bernanke’s position might be defensible if he wasn’t already sure that today’s banks are too big and complex. Then it might make sense to tweak the incentives and see how the market reacts. But if he knows they are too big and complex, he should eliminate that risk in the simplest, most direct way possible. If he’s not sure how much smaller and simpler banks need to be, he can do it in steps: set one set of size and scope limits, see what he thinks about the outcome, and then set another set of limits if he’s still unhappy.

DISAD RESPONSES

A/T “Higher prices to consumers from smaller less efficient banks”

Bigger banks aren’t more efficient. Benefits to consumers of big banks are more than offset by their inefficient complexity

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

Turn now to the question of efficiency: Is bigger better for consumers? Bankers speak mystically about the “financial supermarket” and claim that there are tremendous economies of scope in financial services, meaning that a consumer benefits from being able to have a checking account and a stock portfolio at the same large firm. But in practice, whatever benefits might be derived from such a supermarket are probably more than offset by the diseconomies of managing such a complex entity.

Cost savings of large banks outweighed by their risks

Prof. Mark Thoma 2013 (Economics, Univ. of Oregon) 5 Feb 2013 “The Case For and Against Too-Big-to-Fail Banks” <https://economistsview.typepad.com/economistsview/2013/02/the-case-for-and-against-too-big-to-fail-banks.html>

Even if the scale economies are there, we may still want to restrict the size of banks. The benefit from larger scale must be balanced against the increased risk to the financial system and the increased risk of political/regulator capture that comes with size and power. If the costs of size outweigh the benefits, then size should be restricted below the minimum efficient scale (How much risk comes with size depends, in large part, upon your faith in resolution authority discussed above. I am not fully convinced it will work.)

“Economies of scale” for big banks can be obtained by small banks too

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

There are economies of scale, but small banks can take advantage of them, too. For instance, a small bank can join an ATM network or contract with a third party to develop Internet services. It does not have to build such systems from scratch, and we do not need big banks to make them possible.

A/T “Interfering with free markets”

Big banks themselves got that way through politics (government intervention). Big banks are bad for “free markets”

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

It’s politics, not economics, that made them behemoths

Big banks are bad for free markets. Far from being engines of free enterprise, they are conducive to what might be called “crony capitalism,” “corporatism,” or, in Jonah Goldberg’s provocative phrase, “liberal fascism.” There is a free-market case for breaking up large financial institutions: that our big banks are the product, not of economics, but of politics.

Government policy, not free markets, created the very large banks

Dr. Arnold Kling 2010 (PhD economics; former economist on the staff of the Board of Governors of the Federal Reserve System) 5 Apr 2010 “Break Up the Banks” https://www.cato.org/publications/commentary/break-banks <https://www.cato.org/publications/commentary/break-banks>

If we had a free market in banking, very large banks would constitute evidence that there are commensurate economies of scale in the industry. But the reality is that our present large financial institutions probably owe their scale more to government policy than to economic advantages associated with their vast size. Freddie Mac and Fannie Mae were created by the government, and they always benefited from the perception that Washington would not permit them to fail — a perception that proved accurate. Similarly, large banks were viewed as “too big to fail,” which gave them important advantages in credit markets and allowed them to grow bigger than they otherwise would have.

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