Voodoo too: The GOP addiction to financial deregulation

By Paul Krugman
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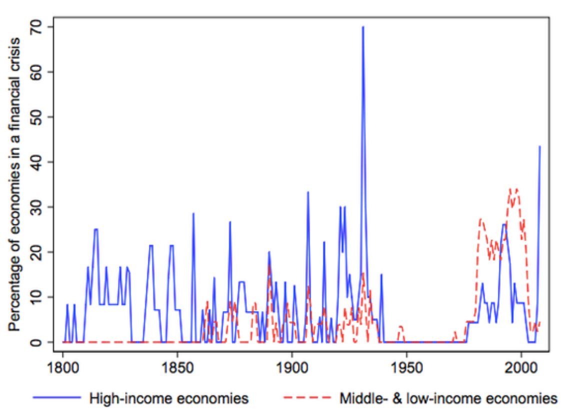
The big economic policy story for this week will be the attempt to ram through the Republican tax bill, which manages both to raise taxes on middle- and lower-income Americans even as it blows up the debt, all in the service of big tax cuts for corporations and the wealthy. To the extent that there's any intellectual justification for this money grab, it lies in the conservative insistence that cutting taxes at the top will magically produce huge economic growth.

That is, it's still voodoo economics after all these years, and nothing — not the boom after Clinton raised taxes, not the failure of the Bush economy, not the debacle in Kansas — will change the party's commitment to a false economic doctrine that serves its donors' interests.

Figure 1 The Frequency of Banking Crises



But just behind the tax story is the effort to gut the Consumer Financial Protection Bureau; and this too needs to be understood in the context of a broader GOP commitment to a demonstrably false but useful narrative.

Think about it: what would it take to persuade the right that financial deregulation is a bad idea, and some kinds of regulation are very good for the economy?

Modern financial regulation came about in the aftermath of the Great Depression, and — as you can see from the figure — the era of effective regulation was also an era of historically unprecedented financial stability. Did this stability come at the expense of economic growth? Hardly: the era of effective regulation was also the era of the great postwar boom in America, the thirty glorious years in Europe.

Nonetheless, by the 1970s a combination of free-market ideology and big money (with the latter helping to feed the former) produced a widespread belief among policymakers that those old regulations were pointless and harmful. Regulations were lifted, and, maybe even more important, malign neglect allowed unregulated shadow banking to expand rapidly. (The Trump Treasury department wants global regulators to stop using the term "shadow banking", which it says conveys the impression that there is something wrong with such institutions. Funny how causing the worst crisis since the 1930s can give you a bad reputation.)

Anyway, at this point the results of the great rise of deregulatory ideology are all too clear: banking crises returned with a vengeance, culminating (so far) in the 2008 crisis. And it's not as if 2008 came out of nowhere: we'd already had the S&L crisis of the 80s, the Long-Term Capital Management/Asian crisis of the 1990s, both of which were clear signals of the growing risks. Add in 2008, and you have a remarkable record of disaster.

Why has financial deregulation been, literally, such a bust? There are multiple, interacting reasons, all of which are well studied at this point. Banking is inherently vulnerable to self-fulfilling panic; if you guard against panic with explicit or implicit guarantees, you create moral hazard which must be contained via regulation. Beyond that, finance is an area where the risks of fraud, of scammers exploiting the limits of consumer understanding and rationality, are especially high. Very few people are in a position to assess the fine print of financial contracts, and the most deceptive, risky deals are sold to those least able to make that assessment.

Hence Dodd-Frank, which made a limited but serious attempt to rein in some of the new risks that had arisen from deregulation and shadow banking, and which created the CFPB to help protect consumers from financial scams perpetrated, in many cases, by big financial institutions. And these measures have been successful: leverage and financial risks are down, and the Bureau has surprised even those of us who supported it with just how effective it has been, just how much positive influence it has had on the honesty and transparency of financial dealings.

So naturally the GOP wants to tear it all down. On the right, all of the disasters brought on by deregulation were actually the fault of liberals, who somehow forced banks to make subprime loans to Those People, or maybe the Fed, which somehow forced lots of bad lending by failing to raise interest rates in the face of low inflation.

And Republicans insist that the prudential regulations introduced after the terrible crisis of 2008 are holding the economy back, despite zero evidence to that effect.

But evidence isn't the point. Like faith in the magical powers of tax cuts, faith in the wondrous things that happen if you let bankers do whatever they want has become a free-floating ideology on the right, untethered to any kind of reality check. And of course it's a very convenient faith from the point of view of financial industry types.

So really the attack on the CFPB and the tax cut are part of the same story. They're both about voodoo economics in the service of plutocracy.