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Banks own the US government

There are smart ways to raise money and regulate the market, but Wall Street is working to kill any meaningful financial reform

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Last month, when the US Congress failed to pass a bankruptcy reform measure that would have allowed home mortgages to be modified in bankruptcy, senator Dick Durbin succinctly commented: "The banks own the place." That seems pretty clear.

After all, it was the banks' greed that fed the housing bubble with loony loans that were guaranteed to go bad. Of course the finance guys also made a fortune guaranteeing the loans that were guaranteed to go bad (ie AIG), and when everything went bust, the taxpayers got handed the bill. The cost of the bailout will certainly be in the hundreds of billions, if not more than $1tn when it is all over.

More importantly, we are looking at the most severe economic downturn since the Great Depression. The cumulative lost output over the years 2008-2012 will almost certainly exceed $5tn. That comes to more than $60,000 for an average family of four. This is the price that we are paying for the bankers' greed, coupled with incredible incompetence and/or corruption from our regulators.

Under these circumstances, it would be reasonable to think that the bankers would be keeping a low profile for a while. That's not the way it works in Washington. The banks are aggressively pushing their case in Congress and Obama administration. Not only are we not going to see bankruptcy reform, but any financial reform package that gets through Congress will probably contain enough loopholes that it will be almost useless.

In this political environment, the poor might get empathy, but Wall Street gets money, and lots of it. Even when the issue is global warming Wall Street has its hand out. The fees on trading carbon permits could run into the hundreds of billions of dollars in coming decades. A simple carbon tax would have been far more efficient, but efficiency is not the most important value when it comes to making Wall Street richer.

This is why it was so encouraging to see congressman Peter DeFazio's proposal to tax trades in oil options and futures. DeFazio proposed a tax of 0.02% on trades in oil futures and options as a way to make up a shortfall in the federal government's highway trust fund. This tax could raise billions of dollars each year in revenue and make speculation in the oil market a more dangerous affair.

The logic is very simple. For someone using these markets to hedge, the tax will be inconsequential. For example, a farmer that hedges a $400,000 wheat crop will pay $80 when selling a future. Similarly, airlines that hedge by buying oil futures will barely notice the higher cost. In fact, because trading costs have fallen so much in recent decades, a tax at this level would just be raising costs back to their levels of two decades ago, a point at which there was already a very vibrant futures and options market.

However, even a modest tax will make life much more difficult for speculators. Many of them expect to make quick short-term gains, often buying and selling the same day. For these traders, an increase in transactions costs of 0.02% would be a burden.

Of course, a modest tax will not drive the speculators out of the market altogether, it is just likely to reduce the volume of speculation. For this reason, even a modest tax can still raise an enormous amount of money in a market where tens of trillions of dollars of derivatives changes hands each year.

This tax can best be thought of as a tax on gambling. Gambling is heavily taxed in every state that allows it. DeFazio's bill is effectively a tax on gambling in the oil markets. It will not stop it, but it would discourage it, and in the process raise a huge amount of money that could go to productive purposes.

The bill faces an enormous uphill struggle in Congress. As Durbin said, the banks own the place, and they are not going to just step aside and let Congress impose a tax on such a lucrative business. But, it is important that people know about the DeFazio bill. First, DeFazio deserves a place on the honour roll for standing up to Wall Street.

Also, it is important for the public to know that there is a relatively low-cost way to make up the shortfall in the highway trust fund. When Congress raises some other tax and/or cuts a useful programme, people should know that there was a better alternative. It just didn't happen because, as we know, the banks own the place.