

**York University**

Differential Taxation:  
The Case of American Banking

Prepared by: Mladen Ostojić

Supervisor: Jonathan Nitzan

Second Reader: Bruce Smardon

Date Submitted: 14 November 2014 (revised 27 April 2015)

Course: M.A. Major Research Paper (GS POLS 6999)

**Table of Contents**

**Abstract ..... 1**

**Introduction ..... 2**

**1. American Corporate Profits and Taxation: An Overview ..... 4**

**Figure 1 ..... 5**

**2. The Differential Taxation of American Banking ..... 9**

**Figure 2 ..... 10**

**3. Banking Taxation and the American Government ..... 18**

**Figure 3 ..... 19**

**Conclusion ..... 25**

**Bibliography ..... 26**

## Abstract

This paper maps an empirical history of corporate profit and taxation in the United States, with a special focus on the differential profit and taxation of banks relative to other corporations. An examination of these trends reveals a striking anomaly within the American banking sector: from the early 1980s until the financial crisis of 2007–2008, its after-tax profits sharply outpaced those of the corporate average *despite* its effective tax rates having simultaneously *increased* relative to those of the corporate average. This curious combination of improved differential performance and an increased differential tax burden may have been due to banking deregulation – strong enough to boost *pre-tax* profits so much that they more than offset the effects of increased taxation and also raised *after-tax* profits along the way. In addition, these trends reveal a convergence of interests between American banking and government, with the former earning higher profits and the latter earning higher tax revenues. Whether implicitly or explicitly created, this tax arrangement relied on unsustainably deregulated banking profits and ultimately collapsed during the financial crisis of 2007–2008.

## Introduction

The American banking system has fallen under considerable scrutiny in recent years, having allegedly triggered the financial crisis of 2007–2008 and the subsequent Great Recession. This newfound uncertainty marked a drastic departure from what had previously been considered an almost invincible establishment – in the years leading up to this recent financial crisis, American banks constituted a formidable group of institutions that simply seemed too big to fail. The abrupt malfunction of this powerhouse surprised many and engendered a deep reassessment of American financial stability. Responses to this reversal have been abundant and produced countless critiques to rationalize the failure of what had once been a seemingly infallible system. Much of the resultant analysis has focused on particular instances of banking deregulation, attempting to discover specific legislation that might make this case of banking failure unique. While this approach has not been without merit and has certainly delivered worthwhile findings, its search for a deregulatory sine qua non may have overlooked other important considerations, and one seemingly unremarkable yet potentially crucial part of this ongoing story is taxation.

While taxation remains of central importance and normally receives its due attention, many decades of capitalist development have made this pivotal topic much more complicated. With increasingly complex business formations like banking creating deeply integrated markets, traditional administrative boundaries have blurred in the face of unprecedented capital mobility. And with market mechanisms thought to operate best in the absence of government intervention, tools of statecraft like taxation are increasingly thought of as extra-economic externalities. Although such attitudes may hold merit, the ability of taxation to redistribute wealth and income cannot be viewed as exogenous and must be treated as an integral part of capital accumulation. Indeed, the success or failure of entire business ventures can come down to questions of taxation, thus making these considerations of paramount importance to virtually any capitalist enterprise. Accordingly, no matter how complex taxation or the myriad theories explaining it have become, it remains of utmost concern to even the most advanced of modern capitalist business interests and must therefore be properly understood as *a regulatory tool in its own right*. Without a doubt, the American banking system, despite all its modern complexities, is no exception to this rule, and along with more popular analyses based on financialization and subprime mortgage bubbles, there must be room for taxation in understanding this most recent of crises.

With these considerations in mind, how might one actually explore the recent experiences of American banking in terms of taxation? Because American banking is a corporate activity, banks in the United States are taxed primarily on their profits. And like most other corporations, American banks also tend to measure performance in terms of these same profits. In this sense, corporate taxation presents an obstacle to the objectives of banking as a money-making venture. This otherwise unremarkable corporate reality becomes much more significant when considering that not all corporations face the same tax burden. Because effective corporate tax rates can vary, thereby subtracting different percentages of profit from even the most similar of corporations, *differential* taxation must also be understood as a moderator of *relative* corporate performance. In the simplest terms, a given corporation faced with a higher relative tax burden should retain less of its profits after tax than a comparable corporation faced with a lower relative tax burden, and such differences can thereby influence relative corporate performance. Bearing this in mind, assessing the impact of differential taxation on the performance of banking is simple in principle, as the investigation comes down to quantitative measurements of profits and effective tax rates.

And when comparing the evolution of these two variables across different corporate sectors, American banking reveals some very stark disparities.

Contrary to these expectations, banking profits have actually run *against* the grain of differential taxation: the sector performed best right when its relative tax burden was heaviest – in the decades preceding the financial crisis of 2007–2008. While American banks had enjoyed effective tax rates significantly lower than those of the corporate average since at least the 1940s, this differential tax advantage went into decline starting in the 1980s. Other things being equal, one would expect that a rising relative tax burden would serve to hamper corporate performance. But instead, American banks since the 1980s actually *outperformed* other corporate sectors, revealing an even stronger opposing force that more than offset the loss of their tax advantage and thus allowed them to outpace their competitors' profits not only before tax but also *after* tax. While a quantitative study of profits and taxation cannot identify the reasons behind this oddity, it is rather telling that such a tax-defiant burst of corporate performance should have taken place in a sector reputed for excessive deregulation – and especially so if that burst is assumed to have caused a financial crisis.

If this recent crisis has indeed exposed a want of banking regulation, then the origins of any relevant deregulation may well be embodied in banks' performance beginning in the 1980s. Corporate taxation, understood as a regulatory tool that moderates the pace of corporate profits, seems to have been more than offset in recent decades by the deregulation of the banking sector, and any deregulation that might have allowed American banks to enjoy improved performance beginning in the 1980s effectively outstripped the tighter regulation posed by increased tax rates. Therefore, if dissonant regulatory forces have pulled banking performance in opposite directions, *deregulation* seems to have triumphed by causing increased banking profits after tax. Meanwhile, with these banking profits outpacing their corporate competitors amidst an increased tax burden, government authorities also reaped benefits through increased contributions to their tax revenues. This mutually beneficial outcome reveals a bond between American banks and fiscal authorities, one held together by a curious deregulatory arrangement that allowed for higher banking profits despite increased taxation.

Although this quantitative study can only hope to speculate about the arrangement itself, offering relatively little legal background and nothing in the way of theory to explain its findings, profit and tax data are still more than enough to suggest its existence and weigh its implications. This paper will be presented in three sections. First, it will consider the connection between corporate profits and effective tax rates to assess the effect of taxation on corporate performance. Second, the paper will consider profit and taxation trends particular to the banking sector, demonstrating that the decades-long differential tax advantage enjoyed by American banks yielded to an increase in both profits after tax and effective tax rates beginning in the 1980s. Third and last, it will assess the contributions of corporate tax revenues to government receipts, showing a sharp increase in the importance of banking taxation since the 1980s. Taken together, this paper will thus assert the importance of taxation in the recent history of American banking, exposing a deregulatory convergence of interests that benefited both banking and the government until the financial crisis of 2007–2008.

# 1. American Corporate Profits and Taxation: An Overview

Before we examine any data particular to the banking sector, it would be helpful to first examine more general trends by considering the broader American corporate landscape. Indeed, if banking is to be understood as a corporate activity that has deviated from corporate norms, then the investigation should begin with a clear assessment of corporate normalcy. To this end, **Figure 1** traces the American history of corporate profits before tax, corporate profits after tax, and effective tax rates from 1929 to 2011 (more recent data were unavailable upon compilation). Both profit series presented are expressed as percentage shares of gross domestic product (GDP) and pertain specifically to domestic profits while excluding the Federal Reserve banking system, given that its nominally corporate proceeds are effectively governmental. The effective tax rates derived from these profits depend on the difference between profits before and after taxation. Mathematically, this difference is identical to the taxes paid by corporations, and dividing it by corporate profits before tax yields our effective tax rates in percentage terms:

$$\text{effective tax rate} = ((\text{profits before tax} - \text{profits after tax}) / \text{profits before tax}) \times 100$$

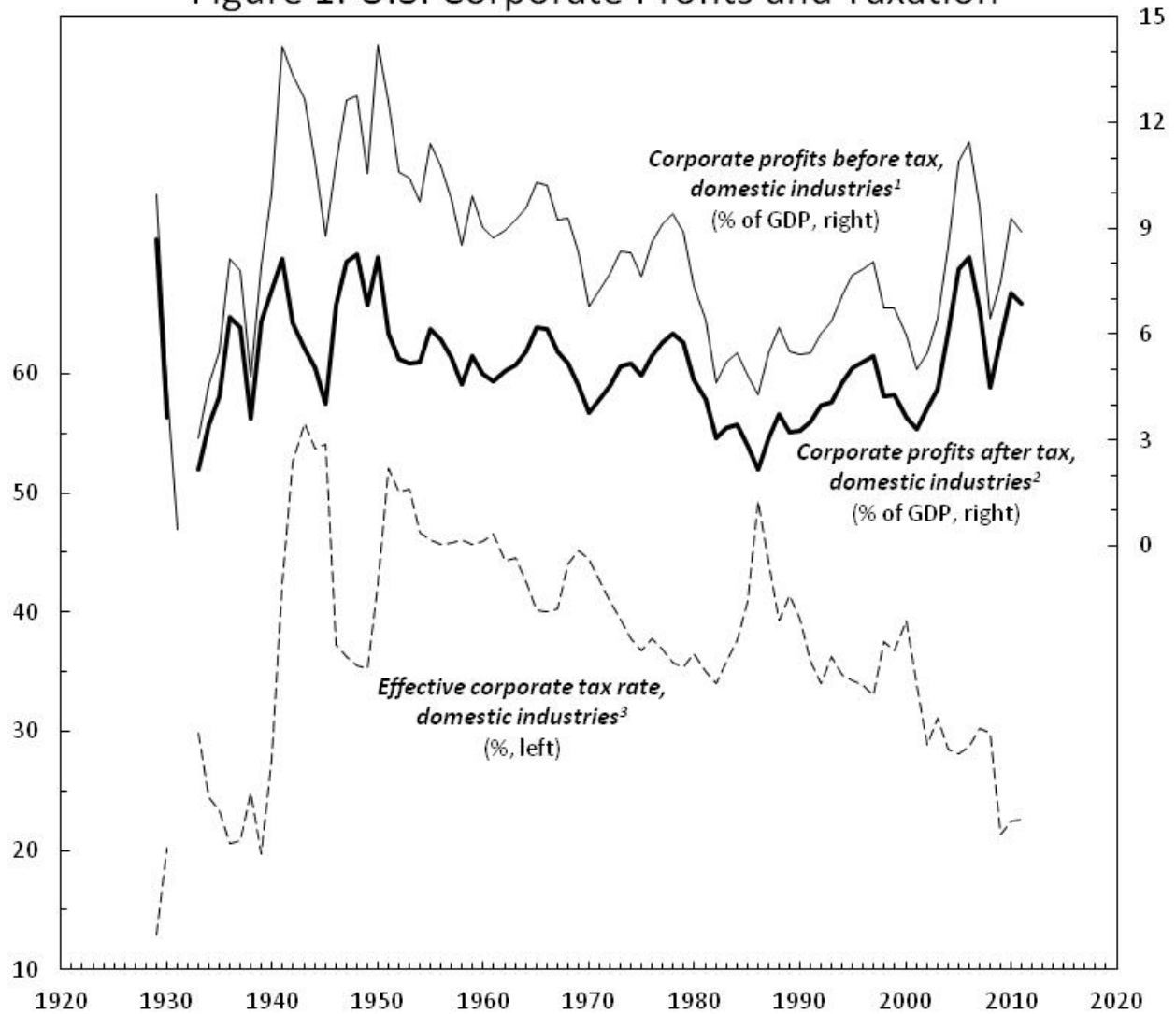
Or, more simply:

$$\text{effective tax rate} = (\text{tax payments} / \text{profits before tax}) \times 100$$

It is important to note that the corporate bottom line is primarily concerned with profits *after* tax, and this investigation therefore gives them much more attention than profits *before* tax. Even so, the latter variable is also correlated with effective tax rates and thus has significant bearing on the discussion.

As we can see, the long-term trends facing the corporate scene clearly exhibit patterns, painting a general landscape against which the specifics of banking can be properly juxtaposed. Indeed, while corporate profits and effective tax rates are inversely proportional in the short run, this has hardly prevented differing patterns from emerging over longer stretches of time. In fact, their interaction has varied enough over time to reveal three distinct corporate American periods. The first of these emerged at the beginning of the Great Depression in 1929 and continued through the 1930s and the Second World War until its peacetime resolution in the early 1950s. Unfolding at a time of political economic instability, this period exhibits relatively volatile data that reveal a collapse and recovery of corporate profits amidst rapidly rising effective tax rates. The second of these delineable periods starts in the early 1950s and lasts until the early 1980s, roughly overlapping with the postwar economic boom known as the Golden Age of Capitalism, which is considered to have ended around the early 1970s. The data during this second period are marked by relative stability and gradual but sizeable reductions in both corporate profits and effective tax rates for about 30 years. In the third period, lasting from the early 1980s until 2011, the data reveal more recent trends that emerged along with the rise of neoliberal governance, marked by rising corporate profits amidst initially surging and later declining effective tax rates. And most important, this third period coincided with the banking anomalies we seek to unravel. Together, these three periods provide an effective backdrop for studying the specifics of banking, and each deserves individual attention.

Figure 1: U.S. Corporate Profits and Taxation



SOURCE: U.S. Bureau of Economic Analysis, National Income and Product Accounts (NIPA) Tables; U.S. Bureau of Economic Analysis, Million Dollar NIPA Tables

1. "Domestic industries" from NIPA tables 6.17A–6.17D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D divided by "Gross domestic product" from Million Dollar NIPA table 1.1.5  
NOTE: 1931–1932 omitted due to values less than 0%
2. "Domestic industries" from NIPA tables 6.19A–6.19D divided by "Gross domestic product" from Million Dollar NIPA table 1.1.5  
NOTE: 1932 omitted due to a value less than 0%
3. "Domestic industries" from NIPA tables 6.18A–6.18D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D divided by "Domestic industries" from NIPA tables 6.17A–6.17D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D  
NOTE: 1931 omitted due to a value greater than 100%, 1932 omitted due to a value less than 0%

## 1.1 Corporate America in the Earlier Twentieth Century

The first period, marked by corporate instability and lasting from 1929 to the early 1950s, features the most volatile data accompanied by the most turbulent of political economic climates, thus demanding a closer look despite predating our most important findings. As seen in Figure 1, corporate profits after tax started at their highest and effective tax rates at their lowest in 1929, the former at 8.7% of GDP and the latter at 12.9%. But only one year into the Great Depression, a sharp fall in profits and a comparably abrupt rise in effective tax rates already become visible. Over the next two years, corporate America recorded losses that obscured tax calculations, leaving Figure 1 (along with Figures 2 and 3) punctured by statistical gaps in 1931 and 1932. From the reestablishment of standard corporate performance in 1933 until the end of the decade, a partial recovery of pre-Depression profit levels coincided with declining effective tax rates. The volatility exhibited by these profit and tax data reveals corporate trends quite congruent with the political economic instability characteristic of the Great Depression. With respect to profits, the initial crash of 1929 and the later troubles plaguing corporations have been well documented and are reflected by the profit collapse and instability seen at the time. With respect to taxation, the simultaneously sharp increase of effective corporate tax rates is also historically consistent, given that American authorities during the Great Depression attempted various economic stimuli, such as the tax-and-spend expansionary fiscal policies of the New Deal. Among other things, these initiatives raised taxes throughout much of the economy and included higher tax burdens for American corporations (Lazarowitz 351).

Corporate profits completed their recovery by the early years of the Second World War, reaching wartime maxima in 1941 that were comparable to the highs recorded in 1929. However, this latest phase of profit recovery was achieved amidst skyrocketing wartime effective tax rates, which almost tripled from the war's beginning to reach their global maximum<sup>1</sup> of 55.8% in 1943. Due to these tax hikes, profits *after* tax did not reach their pre-Depression high even though profits *before* tax far surpassed their 1929 level for most of the Second World War and beyond. In fact, as seen in Figure 1, corporate profits before tax would never reach higher shares of GDP than they did in the 1940s and early 1950s. But with effective tax rates also peaking at the time, this historic performance seems to have been taxed to the hilt for war and reconstruction efforts. And although both corporate profit measures shrank rapidly during the remainder of the war, peace would renew growth and postwar profits would prove to be just as high as during the war. Over the next few years, profit levels remained fairly volatile and eventually lost ground again, but this latest slump marked an end to instability for decades to come and profits after tax steadied at slightly above 5% of GDP during the early to mid-1950s. And as one might expect, effective tax rates also lost much of their former volatility and significantly stabilized thereafter, but not before swelling again to reach an almost wartime magnitude of 52.1% in 1951. Overall, this first period spanned decades of instability and culminated in heavy corporate restructuring, one in which corporate profits after tax rebounded only after decades of unprecedented tax hikes that more than *quadrupled* effective tax rates from 1929 to 1951.

---

<sup>1</sup> “Global maximum” (or minimum) denotes the absolute highest (or lowest) value in an entire data series. Similarly, “local maximum” (or minimum) denotes the highest (or lowest) value within a certain section of a data series.



## **1.2 Corporate America in the Postwar Decades**

The second period lasted from the early 1950s to 1982 and is much simpler to detail, being least volatile in terms of both data and political economic climate. For these three decades, both corporate profits and effective tax rates exhibited far less short-term volatility than before, thus following much more ordered trajectories. From a postwar high in 1951, effective tax rates recorded a long and relatively steady decline until 1982, gradually falling to slightly below 34%, a low not seen since the late 1940s. Meanwhile, corporate profits faced a similarly long decline, their after-tax measure falling from a final postwar high in 1950 to just 3.1% of GDP by 1982. Similarly to taxation levels, such low profit levels had not been seen since the Great Depression, although profits would continue to decline for a few more years and only break their fall in 1986. Important to note here is that corporate profits after tax and effective tax rates declined together, because this indicates waning corporate performance despite an improving tax climate. Indeed, more than 30 years of substantial corporate tax reductions coincided with falling performance, meaning that something else must have rendered this tax stimulus impotent; in the next section, we will see that banking performance similarly defied its own tax trends.

And while these reductions in profits and effective tax rates did not go uninterrupted, they nevertheless constituted some of the most stable tendencies observed in Figure 1. However, the relative stability of these data did not always coincide with a very stable political economy, and considerable political economic tensions developed during the period's later years. In 1971, the Bretton Woods system of monetary management ended after more than a quarter-century of multinational cooperation meant to arrange capitalist reconstruction after the Second World War. As the Americans abandoned the system's requisite gold standard, the U.S. dollar became a pure fiat currency and thereby led to floating exchange rates between its former members. As a result, the postwar mandates of state sovereignty and monetary stability yielded to capital mobility (Nitzan and Bichler 351). Meanwhile, from around the early 1970s and throughout the decade, the dual threat of stagnation and inflation ("stagflation") further eroded postwar prosperity, ending the Golden Age of Capitalism and foreshadowing later corporate turbulence.

## **1.3 Corporate America since the 1980s**

This brings us to the third and final period in Figure 1; lasting from 1982 to 2011, its data are somewhat more volatile than those of the second but not nearly as much as those of the first. This higher volatility is consistent with the increased political economic instability of the period. Although long unhindered by extreme crises on the scale of global depression and world war, America's political economy had experienced mounting pressure since the 1970s and now faced new challenges like neoliberal reforms and the end of the Cold War. And from 1982 to 1986, effective tax rates reversed their lengthy decline and ballooned to nearly 50%. In just four years, this sudden corporate tax increase almost entirely undid over three decades' worth of reductions, its speed and magnitude outdone only by those of the much more turbulent 1940s. Meanwhile, corporate profits decreased even further and reached an after-tax measure of only 2.2% of GDP, a low not seen since the greatest depths of the Great Depression. These 1982–1986 extremes, combining the heaviest corporate tax hikes and the lowest corporate profit levels in decades, mark a major turning point from which corporate trends would settle on relatively ordered paths. And since 1986, corporate profits expanded in stark contrast to those of previous decades,

affecting a sharp reversal of fortune away from their prolonged postwar contraction. Meanwhile, effective tax rates exhibited another lengthy decline that further boosted after-tax performance; by 1997, profits after tax had almost completely reversed the past three decades of reductions, and effective tax rates had reached levels as low as those of the Great Depression.

Later, the long-term tendencies exhibited by this final period were briefly interrupted by waning corporate profit levels and rising effective tax rates around the late 1990s. However, from 2000 to 2006, corporate profits again expanded to reach an after-tax level of 8.2% of GDP, a high only exceeded in 1929 and only matched in the 1940s and 1950s. Around the same time, effective tax rates resumed their decline, falling to a local minimum of just over 28% in 2005, approaching values recorded in the 1930s and marking their first return to Depression-era levels. Hence, the twenty-first century seems to have started quite favourably for corporate America, with profits higher and tax rates lower than they had been in decades. But this did not last long, as these benchmarks were reached just before the onset of the financial crisis of 2007–2008. During the years following this crisis, after-tax profits first declined to 4.5% of GDP by 2008 and then recovered to 6.9% by 2011, the last year for which we have data. But while profits suffered, the corporate tax burden continued to fall and reached an effective tax rate of just 22.6% in 2011, so low that the only significantly lower value in Figure 1 occurred back in 1929.

Looking back, the relatively favourable corporate profit and tax conditions seen prior to the Great Depression would be largely recreated 80 years later. By the early twenty-first century, profits after tax were much higher and effective tax rates much lower than in previous decades, thereby recording at least temporary values in the neighbourhood of their record 1929 levels. Therefore, corporate America has benefited greatly during this third and final period in Figure 1, and this recent position brings our overview of corporate American profit and taxation to an end. But given our investigation's ultimate focus on banking, this period gains additional importance, as it is here that the sector's own profit and tax trends deviated most from the corporate whole. And having now covered the major profit and tax trends facing the corporate American totality, we may proceed to compare them with the specifics of banking.

## 2. The Differential Taxation of American Banking

Having surveyed the aggregate development of corporate American profits and taxation, we may proceed to consider the banking sector in particular. With the corporate totality mapped, the banking trends we seek to investigate can now be situated within the broader corporate realm, enabling a proper comparison with other sectors subject to the same type of taxation. To this end, it is not enough simply to compare banking-sector profits to their effective tax rates in isolation: both of these factors must be contrasted with their corporate averages. Other things being equal, banking profits after tax should outpace the corporate average given lower effective tax rates and conversely lose ground to the corporate average when facing higher effective tax rates. However, the data instead reveal some striking deviations from these expectations – starting in the 1980s, banks outperformed other corporations precisely as they *lost* a heavy differential tax advantage. The loss of this historically preferential tax position thus coincided with a lasting transformation in banking performance and went uninterrupted until the recent financial crisis of 2007–2008. Such an anomaly certainly warrants closer inspection and further deliberation will demonstrate it as congruent with heavy deregulation of the banking sector.

**Figure 2** presents the effective corporate tax rates seen in Figure 1 and juxtaposes them against a sector-specific measure of effective *banking* tax rates from 1929 to 2009. In addition, banking profits after tax are expressed differentially as a percentage of corporate profits after tax. These data track both the differential taxation and differential performance of the banking sector, with the difference between banking and corporate tax rates measuring the extent of the former and banking’s share of corporate profits gauging the pace of the latter. The banking tax rates under consideration here are calculated from corporate-profit data specific to the banking sector and use the same source and method previously employed in deriving overall corporate tax rates. However, the source database updates some sectoral data more slowly than corporate aggregates, and the banking data presented here (and later in Figure 3) therefore extend only to 2009. Also, because the corporate bottom line is mainly about profits *after* tax, profits *before* tax are omitted, and the investigation thus focuses on the former as a measure of banking performance. However, one should recall that profits before tax also factor into the relationship with effective tax rates, explaining how profits after tax can deviate from their inverse relationship with the latter:

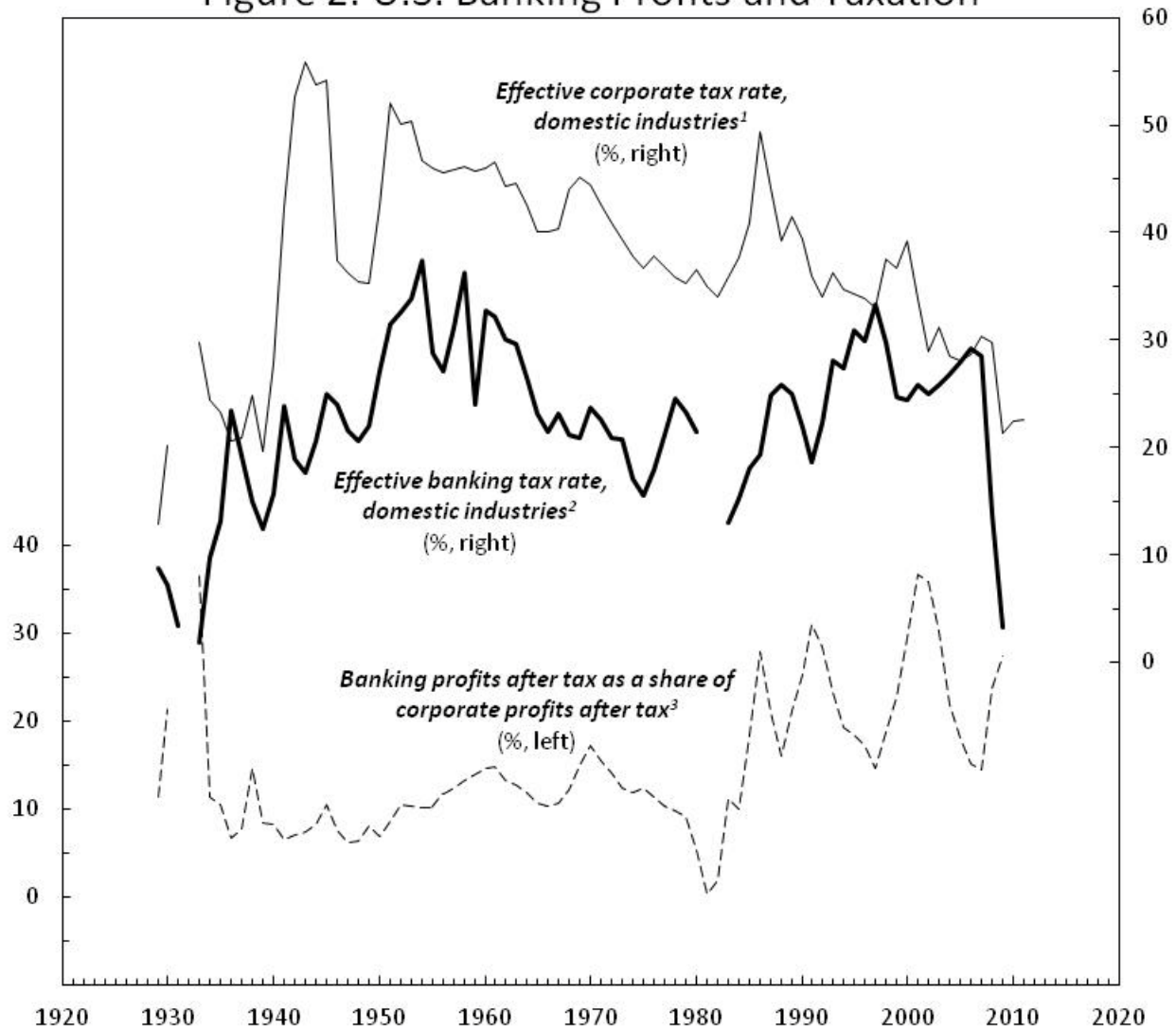
$$\text{effective tax rate} = ((\text{profits before tax} - \text{profits after tax}) / \text{profits before tax}) \times 100$$

Or, more simply:

$$\text{effective tax rate} = (\text{tax payments} / \text{profits before tax}) \times 100$$

It should also be noted that the source database categorizes banking differently at different times, and exactly what represents “banking” in different periods can be a difficult question to answer, but an informed synthesis of these categories yields a fair approximation (Key). Taken together, the data in Figure 2 provide a graphical comparison between banking and the corporate totality, allowing us to search for links between the sector’s differential performance and taxation.

Figure 2: U.S. Banking Profits and Taxation



SOURCE: U.S. Bureau of Economic Analysis, National Income and Product Accounts (NIPA) Tables; U.S. Bureau of Economic Analysis, Million Dollar NIPA Tables

1. "Domestic industries" from NIPA tables 6.18A–6.18D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D divided by "Domestic industries" from NIPA tables 6.17A–6.17D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D  
NOTE: 1931 omitted due to a value greater than 100%, 1932 omitted due to a value less than 0%
2. "Banking" plus "Credit agencies (other than banks) and holding and other investment companies" from NIPA table 6.18A minus "Federal Reserve banks" from Million Dollar NIPA table 6.16A divided by "Banking" plus "Credit agencies (other than banks) and holding and other investment companies" from NIPA table 6.17A minus "Federal Reserve banks" from Million Dollar NIPA table 6.16A for 1929–1947; "Commercial and mutual banks" plus "Credit agencies other than banks" from NIPA table 6.18B divided by the identically named series' sum from NIPA table 6.17B for 1948–1987; "Commercial and mutual depository institutions" plus "Nondepository institutions" from NIPA table 6.18C divided by the identically named series' sum from NIPA table 6.17C for 1988–2000; "Credit intermediation and related activities" plus "Management of companies and enterprises" from NIPA table 6.18D divided by the identically named series' sum from NIPA table 6.17D for 2001–2009  
NOTE: 1932 and 1982 omitted due to values less than 0%, 1981 omitted for graphical convenience

(Continued on next page)

[Continued from previous page]

3. "Banking" plus "Credit agencies (other than banks) and holding and other investment companies" divided by "Domestic industries" from NIPA table 6.19A for 1929–1947; "Commercial and mutual banks" plus "Credit agencies other than banks" divided by "Domestic industries" from NIPA table 6.19B for 1948–1987; "Commercial and mutual depository institutions" plus "Nondepository institutions" divided by "Domestic industries" from NIPA table 6.19C for 1988–2000; "Credit intermediation and related activities" plus "Management of companies and enterprises" divided by "Domestic industries" from NIPA table 6.19D for 2001–2009  
NOTE: 1931–1932 omitted due to values less than 0%

The banking data presented exhibit trends that are divisible into three distinct periods, and these roughly overlap with those of the corporate averages in the previous section. In brief, during the first period, spanning the instability of the Great Depression and Second World War, banking tax rates trended upwards in a volatile fashion comparable to the corporate average, remaining below the latter by accordingly erratic amounts over most of the period. Meanwhile, banking profits also proved to be volatile and lost some ground to those of the corporate totality. During the second period, comprising the relative stability characteristic of the postwar decades, banking and corporate tax rates once again moved in concert over the course of about 30 years, the former maintaining much lower levels and both entering gradual decline after the 1950s. Amidst this tax advantage, banking profits at first outperformed those of the corporate average, but began to lose out during the 1970s and eventually faced collapse by the early 1980s. Finally, the third, neoliberal-era period, brought about rising banking and falling corporate tax rates, completely ending the banking sector's longstanding tax advantage by the 1990s. Surprisingly, this did not prevent banks from recovering and eventually exceeding their former performance, and banking profits outpaced those of the corporate average while assuming higher volatility. Although it is this latest instance of tax-defiant profitability that chiefly commands our attention, other trends within these data also merit discussion.

## 2.1 American Banking in the Earlier Twentieth Century

During the first period, which covers the Great Depression and the Second World War, effective banking tax rates were already somewhat lower than those of the corporate average. Except for 1936 and the indeterminate period of irregular effective tax rates in the early 1930s,<sup>2</sup> banks faced a persistently lower tax burden than that imposed on the average corporation. Although this tax advantage was relatively small and highly erratic during the Great Depression, it grew during the Second World War and stabilized at much greater values for decades to come. Indeed, wartime banking tax rates were significantly lower than those of the corporate average, most often with differentials in excess of 30% that reached a global maximum of 38.2% in 1943. And although the banking sector would never again maintain a tax advantage of this magnitude, almost uninterrupted double-digit differentials took hold thereafter and continued until the 1980s. This drastic wartime increase in tax disparity resulted from effective corporate tax rates growing much faster than those of banks during the early 1940s. If this increase was used to fund the war, then banks did not have to pull their weight in tax payments as much as the average corporation, although banking tax rates kept rising during and especially after the war until the 1950s.

---

<sup>2</sup> Both corporate and banking effective tax rates were irregular at this time, making their comparison meaningless.

In terms of performance, the volatility of corporate profits during this same first period makes it difficult to determine how well banking fared relative to its corporate competition, although profits after tax as a share of the corporate total did fall somewhat by the period's end. During the Great Depression, even as corporate performance hit rock bottom in 1931 and 1932, the banking sector actually did not record any losses either before or after taxation. However, banking profits after tax slightly exceeded those before tax in 1932 (note the gap in Figure 2), and this temporary inversion reveals a net government subsidy to the banking sector. Therefore, while profits after tax remained positive even through the deepest years of the Great Depression, this may have had more to do with government intervention than the sector's resilience. Indeed, it is common knowledge that American banking struggled greatly during the Great Depression, and "[b]etween 1929 and 1932, ... more than 5,000 banks suspended operations" (Hunt 402). Furthermore, this banking failure is often understood as a leading cause behind the entire crisis, and government intervention in this fundamentally important sector went far beyond subsidies. Of particular interest is the Glass-Steagall Act of 1933, which forced banks to choose between either depository or investment banking in an attempt to discourage risk and decrease instability (Blackburn 64). This and other reforms might help explain why banking profits relative to those of the corporate average became much less volatile after 1934. Government intervention aside, the wartime growth of the sector's tax advantage also strengthened its differential performance, as banking profits after tax increased from 6.4% of the corporate total in 1941 to 10.5% in 1945. These rapid gains were lost over the next few years and eventually recovered by the early 1950s, stabilizing at a little over 10% amidst the highest banking tax rates experienced in all of Figure 2 and leaving the political economic instability of the earlier twentieth century behind.

## **2.2 American Banking in the Postwar Decades**

During the second period of postwar stability, effective banking tax rates remained below the corporate average, thereby maintaining a relatively stable tax advantage up until the 1980s,<sup>3</sup> with a mean difference of 16.7% from 1946 to 1980. Much larger and more stable than before, the differential tax advantage enjoyed by banks only really took hold during this second period, and its later dissolution would radically transform the sector. During the first few years of peace, banking tax rates experienced a decline that was much smaller than that of the corporate average. Since the banking sector had avoided the wartime tax hikes experienced by the corporate totality, it makes sense that the former should also have enjoyed a smaller peacetime tax break. However, banks did not escape the next significant tax hike that struck corporate America around 1950, and banking tax rates faced similar increases to reach their global maximum of 37.4% in 1954. Up from levels of around 20% in the 1940s, this marks the highest banking tax rate in Figure 2, but it also preceded the longest period of decline. Again in concert with the corporate totality, banking tax rates fell for almost three decades, though with somewhat more speed and volatility, thereby restoring their postwar levels by the mid-1960s. Being particularly unstable in the 1950s, banking tax rates here exhibited especially high volatility against fairly stable corporate tax rates, their fluctuations comparable to those of the previous two decades.

---

<sup>3</sup> Preliminary analysis surveyed the effective tax rates of dozens of other corporate sectors, and banks stood out with the most significant differential tax advantage by far. Only oil and gas extraction and mining were at all comparable.

Given that the postwar stabilization of corporate tax rates did not extend to banks, something other than political economic turmoil may have sustained banking tax-rate volatility, especially since banking tax rates were more volatile here than almost anywhere else in Figure 2. Perhaps some restrictions imposed on banks during the Great Depression had since been relaxed, but the authorities soon advanced additional measures aimed at tightening banking regulation, measures that may have contributed to the later stabilization of banking taxation. Among them, the Bank Holding Company Act of 1956 restricted bank holding companies<sup>4</sup> from engaging in non-banking activities and “interstate expansion” in an effort to limit their power (Hall 343–4). While such attempts at banking regulation did not always fully deliver their intended effects, even a limited impact on the stability of banking taxation is still worth noting here. And indeed, the postwar instability of banking tax rates diminished noticeably in the 1960s and early 1970s, ending several years of erratic decline to settle on values of a little over 20%. But not long after, banking tax rates came to experience renewed instability throughout and well beyond the 1970s. And although this departure from the short-lived tax stability of the 1960s seems unremarkable, it coincided with a gradual contraction of banking profits and foreshadowed their later collapse in the early 1980s.

Regarding postwar performance, banks showed improvement over most of the period, recording steady gains over the corporate average amidst few interruptions for over 20 years, their profits after tax as a share of the corporate total rising from 6.1% in 1947 to 17.1% in 1970. Excepting a notable decline from 1961 to 1966, banks therefore benefited under their extensive differential tax advantage during much of its postwar heyday. But this success did not endure, and despite no interruption of the previously lucrative differential tax advantage of decades past, banking-sector profits began losing ground to those of the corporate totality from 1970 on. Following three decades of increasing tax advantage, banking profits after tax declined relative to the corporate average and abruptly plummeted to reach unprecedented lows in 1980 and 1981: in just eleven years, these profits plummeted to less than 1% of the corporate whole. Therefore, the same differential tax scheme coincided with two opposite sets of results for banking profits – steady differential gains from 1947 to 1970, and mounting differential losses from 1970 to 1981. If the former development can be seen as a prolonged bout of tax-assisted banking performance, then the latter went against the grain by lowering banking profits after tax to unprecedented lows. Moreover, if the sector’s former success can be explained through its differential tax advantage, then some other factor(s) must have sufficiently disrupted the arrangement in the latter case to reverse banking profits after tax beginning in 1970. The reasons behind this reversal are unclear; perhaps the U.S. dollar becoming a pure fiat currency amidst floating exchange rates in 1971 somehow disrupted American banking enough to more than offset its favourable tax advantage, or perhaps the stagflation of the 1970s had proven particularly hard on banks. Speculation aside, it is clear that the longstanding benefits of this differential taxation were rendered impotent enough to contribute to the eventual collapse of banking profits in the early 1980s.

To be specific, in both 1981 and 1982, banking profits *before* tax (not shown in Figure 2) barely exceeded \$1 billion – a rather drastic decrease from well over \$17 billion in 1979. In fact, such a heavy drop in the banking sector’s profitability is unparalleled anywhere else in Figure 2, not even by the sharp downturn seen during the worst years of the Great Depression. In 1982, profits after tax again exceeded profits before tax and forced another omission in Figure 2, marking the second of two instances during which net government subsidies sustained the sector.

---

<sup>4</sup> A bank holding company is distinct from a bank. Bank holding companies are firms that control a bank or banks, and are not necessarily involved in banking themselves.

But the first instance, occurring at the height of the Great Depression exactly 50 years earlier, involved political economic circumstances that were a great deal more severe. Unlike the 1930s, the banking malady of the early 1980s occurred amidst a far less adverse political economy, facing stagflation but not depression or aggregate corporate losses. Yet despite a milder climate, banking profits after tax in the early 1980s actually fared much worse.

Therefore, this collapse requires a more specific explanation than that of systemic crisis, which may be found in the so-called Volcker Shock and the associated savings and loan crisis. Prior to this crisis, the American political economy suffered high inflation throughout the 1970s, with prices rising at troubling rates and government authorities unable to stop them. After 1979, the Federal Reserve intervened through an aggressive use of contractionary monetary policy, tightening the money supply so as to discourage borrowing and lower inflation (Greider 46–7). But the apparent success of this anti-inflationary monetary activism also caused a recession marked by higher interest rates that hit moneylending institutions like banks especially hard. Therefore, this recession might explain not only the 1980s' fall of aggregate corporate profits, but also why banking profits in particular declined to such unprecedented depths. In any case, this collapse of banking profits did not last long, and the banking sector would quickly recover amidst a radically different tax dynamic.

### **2.3 American Banking since the 1980s**

During the third and final period shown in Figure 2, the banking sector recovered rapidly from its collapse in the early 1980s and transformed into a considerable corporate powerhouse, its profits after tax outpacing the corporate average despite *losing* their historical tax advantage. That the loss of such a large tax advantage coincided with such extensive differential gains constitutes a central point of this investigation and accordingly demands thorough examination, but not before the individual tax and profit trends involved are duly detailed. Regarding taxation, the banking sector's tax advantage initially reappeared following the early 1980s' profit collapse, but it began to diminish gradually as banking tax rates rose and corporate tax rates fell. In 1983, banking tax rates once again became graphically presentable and registered a value of 13% – 23% lower than the corporate average and therefore still at a significant advantage. Thereafter, banking tax rates experienced rapid and uninterrupted increases until 1988 to reach 25.8%, maintaining differentials of over 20% amidst comparable corporate tax increases through 1986. However, because corporate tax rates after 1986 settled on a long-term trend of heavy decline, the tax advantage enjoyed by banks in previous decades quickly began to subside. And by 1997, banking tax rates had finished another rapid growth spurt to reach a local maximum of 33.4%, *exceeding* those of the falling corporate average and completely losing their tax advantage.

For years after 1997, banks were taxed at rates similar to those of the corporate average, and although the banking sector's tax burden did actually remain somewhat lower in most years, the differentials were much smaller and less continuous than they had been in previous decades. Moreover, banking tax rates from 1999 to 2007 were at about their most stable in all of Figure 2. But this tax stability did not last, being rudely interrupted by the financial crisis of 2007–2008, and banking tax rates from 2007 to 2009 thereby plummeted from 28.6% to reach a mere 3.3% – both their fastest decline and lowest value in Figure 2 (except the anomalies of 1932 and 1982). What is more, this decline sufficiently outpaced that of the corporate average to produce a new differential tax advantage comparable to the one seen during the postwar decades. To be exact, banking tax rates undercut corporate tax rates by approximately 16% in 2008 and 18% in 2009,



differentials that had not been since the 1980s. But with data that cover only two years of crisis, it remains too early to tell if banking's newfound tax advantage will achieve any lasting power, and the future of banking taxation can only be learned as new data become available. Regardless, this latest crisis has at least temporarily disrupted the tax trends that took hold in preceding years, which is perhaps indicative of yet another transformation in the banking sector. And in the end, our main interest is in how such changes in banking taxation related to the sector's performance, engendering a closer inspection of banking profits between the early 1980s and the crisis.

And indeed, banking performance did also change significantly during this time period, with profits recovering from their early 1980s' collapse to outperform the competition thereafter. In the process, the sector grew to account for a much higher share of corporate profits after tax, and this newfound profitability also exhibited far higher volatility. Before exploring further data, the magnitudes involved in this tax-defiant period of banking expansion deserve some emphasis, as the resultant profits were both much larger and more volatile than anywhere else in Figure 2 (except for the extremes seen during the early Great Depression). To quantify these magnitudes, from 1982 to 1983, banking profits after tax recovered to reach 11.1% of the corporate total, thereby quickly rebounding to levels comparable with those seen after the 1950s in a single year. Following this initial recovery, these profits experienced another upsurge from 1984 to 1986, rapidly increasing to 27.9% of the corporate total, a high not seen since 1933. In comparison, even the unprecedented eleven-year decrease in banking profits from 1970 to 1981 was outdone by the banking profit increase observed during this five-year period from 1981 to 1986. Hence, the banking sector not only recovered and outperformed its competition, but did so in a hurry. And because this upsurge of profits after tax occurred despite the sector losing its tax advantage, its underlying causes appear that much more striking.

After 1986, banking profits slowed their rapid growth and settled on more modest gains, but these gains were also accompanied by some of the broadest profit fluctuations in Figure 2. Amidst this volatility, banking profits after tax as a share of the corporate total oscillated sharply, bouncing between percentages in the mid-teens and the mid-30s while slowly trending upward, eventually peaking at their global maximum of 36.7% in 2001. And despite this great volatility, the lows found opposite this record high hardly seem debilitating compared to earlier periods, with even the lowest of profit shares surpassing the vast majority of previous values in Figure 2. Nevertheless, this unprecedented volatility attests to the altered character of the banking sector, with its otherwise favourable performance coming at the price of profit instability. Furthermore, although these fluctuating profits exhibit a noticeably inverse relationship with banking tax rates, the latter were relatively stable at the time and thus not the predominant influence on the former. Instead, with banking profits *before* tax (not shown in Figure 2) exhibiting comparable volatility, this after-tax instability was more a matter of profitability than taxation. In the long run, as well, the fact remains that the drastic improvements seen in banking performance from the early 1980s somehow coincided with the loss of the sector's longstanding differential tax advantage – precisely because profits *before* tax swelled to such an extent that profits *after* tax also increased. This wanton banking profitability betrays some underlying transformation of the banking sector, a transformation that is further suggested by the increased volatility of banking profits after tax. The institutional underpinnings of this change remain unclear, but are consistent with the account of a heavily deregulated corporate sector assuming dangerous amounts of risk in order to realize extraordinary but unstable profits that eventually led to financial crisis.

## 2.4 American Banking and the Financial Crisis of 2007–2008

As it turned out, this otherwise favourable deregulatory arrangement was interrupted by the financial crisis of 2007–2008 and its impact on the banking sector. As previously mentioned, this crisis effectively created differential tax rates comparable to those of the postwar decades, once again bestowing banks with a significant tax advantage over the corporate whole. Again, the duration of this latest bout of differential taxation cannot be known without more recent data, although separate calculations for the years 2010 and 2011 suggest a period of at least four years. In any event, banking performance in recent years definitely benefited from this latest advantage, and despite the financial crisis of 2007–2008 having allegedly involved an ailing banking sector, banking profits after tax from 2007 to 2009 actually *grew* to reach 27.4% of the corporate total. Indeed, these gains were quite unlike those seen in the decades leading up to the financial crisis, with profits *before* tax (not shown in Figure 2) expanding much more slowly than those after tax; therefore, the latter were bolstered largely by the sector's newfound differential tax advantage, making this latest burst of banking performance as much about taxation as pre-tax profitability. These gains also contradict the notion that banks suffered during the crisis and Great Recession, especially since the sector in the aggregate, and not just isolated banks, gained. At the same time, it is true that many banks fell victim and there were certainly losers amidst these aggregate gains. The frequency of bank failure before and after the financial crisis demonstrates these losses well – while only 25 bank failures occurred from 2001 to 2007, another 25 took place in 2008 alone, followed by 140 in 2009 and 157 in 2010 (Federal Deposit Insurance Corporation). Nevertheless, the banking sector as a whole still retained its after-tax profit levels despite the financial crisis, and this performance was largely due to its renewed differential tax advantage.

In summary, American banking underwent major changes over the past several decades, as evidenced by the profit and taxation tendencies it exhibited since 1929. Of particular interest, an extensive and enduring differential tax advantage emerged following the Second World War, its long tenure and later disappearance revealing a notably divergent set of profit trends. Uninterrupted for three decades, it coincided with steady differential profit gains until 1970 before comparably steady differential losses spiraled into eventual collapse by the early 1980s. But this slump would not last long, with the banking sector quickly recovering to outperform other corporations and encompass much larger shares of corporate profit amidst higher volatility, even as its longstanding differential tax advantage shrank and all but disappeared by the 1990s. Also of interest, the recent financial crisis actually served to boost banking profits even further, and did so amidst a new differential tax advantage comparable to that of the postwar decades. Indeed, the relationship between this sector's performance and taxation seems to follow patterns, but these patterns have changed drastically over time and in a manner that appears inconsistent. If the banking sector's differential after-tax profit gains made sense amidst preferential taxation, then the same can hardly be said when banks lost out under the exact same set of circumstances, and even less so when they re-emerged stronger than ever despite losing this same tax advantage. Although this investigation cannot offer any conclusive explanations with sufficient certainty, such an anomaly suggests that circumstances were *not* the same and other forces were at work; that said, the conventional wisdom on the financial crisis of 2007–2008 often cites deregulation, which may hold answers that can provide some insight.

According to this conventional wisdom, the financial crisis of 2007–2008 was rooted in the excessive deregulation of American banking, which began many years before the crisis itself. Perhaps the most famous instance of such deregulation is the Gramm-Leach-Bliley Act of 1999, landmark legislation that relaxed various restrictions on bank mergers by repealing large parts of both the Glass-Steagall and Bank Holding Company Acts (Barth, Brumbaugh, and Wilcox 191). Subsequently, banks could much more easily participate in markets like securities and insurance, although this participation came with a higher risk that many believe led to the crisis. However, our data suggest that the most tax-defiant of banking profit trends took hold in the early 1980s, and if the growth and volatility of these profits are any reflection of the sector’s deregulation, then analysis of any related deregulation should begin much earlier than 1999. Looking back, while recovery from the Volcker Shock and its associated savings and loan crisis might explain the banking sector’s initial bout of profit growth and instability experienced in the early 1980s, much deregulation may have followed to increase its profitability while it lost its tax advantage. And while this investigation does not directly examine the intent behind any such deregulation, its apparent application since the early 1980s is congruent with the aggressive neoliberal rhetoric of the Reagan administration and the subsequent popularity of deregulatory policies. That said, any comprehensive talk of deregulation should incorporate the government authorities behind it, especially if the simultaneous growth in profits and taxation also boosted tax revenues. Indeed, this arrangement was a two-way street in which banks not only earned profits but also paid taxes, and we must therefore also examine the other party to the arrangement: the government.

### 3. Banking Taxation and the American Government

As we have seen so far, the historical development of banking taxation strongly suggests that the sector's performance over recent decades was affected by heavy deregulation. However, both (de)regulation and taxation are ultimately legislative matters stemming from state authority, rendering our investigation incomplete without a deeper assessment of government involvement. Indeed, our analysis of banking has covered the business side of this deregulatory arrangement, but the effects of this arrangement on the government authorities behind it have yet to be seen. While the quantitative approach of this paper cannot offer much insight on any actual legislation, the monetary impact of such laws on the government can be readily observed in public accounts. Because tax revenues from corporate profits are an important component of government receipts, the government has a stake in and budgetary dependence on corporate profitability. Furthermore, deregulation that might influence corporate profitability can thus have an impact on tax revenues, making the government a potential beneficiary of policies otherwise aimed at the private sector.

Thus, if this drastic expansion of banking profits since the 1980s was due to deregulation, then the authorities behind any such legislation cannot be considered impartial. On the contrary, with banks experiencing sharp increases to not only their profits but also their effective tax rates, tax revenues from the sector must also have increased – much to the benefit of public coffers. And as we will see, both banking profits after tax and government tax revenues did increase, resulting in a mutually beneficial affair in which both banks and the government reaped rewards. Through taxation, American authorities thereby shared in the spoils of banking deregulation, turning the sector into a fiscal cash cow and entrenching government interest in its profitability. But with the financial crisis of 2007–2008 threatening the vitality of deregulated banking profits, this relationship between banking and the government grew less favourable for both parties.

**Figure 3** compares tax payments from the banking sector to those from all corporations, and both series are expressed as percentage shares of government current receipts.<sup>5</sup> In addition, these same government receipts are also included as percentage shares of gross domestic product (GDP). All three series begin in 1929, with corporate tax payments and government receipts both ending in 2011 and banking tax payments only extending to 2009. Using data on tax payments, we are able to assess the relative importance of banking and corporate taxation to public finance, thus determining the extent of government reliance on banking and corporate profits. Similarly, using data on government receipts, we are able to assess the relative scale of public finance itself, thus determining the size of government relative to its constituent political economy. At a glance, while government receipts recorded a relatively steady growth path throughout most of Figure 3, both banking and corporate tax payments formed more varied trends divisible into three periods that roughly overlap with those observed in Figures 1 and 2. This similarity is to be expected, since tax payments are the product of effective tax rates and profits before tax:

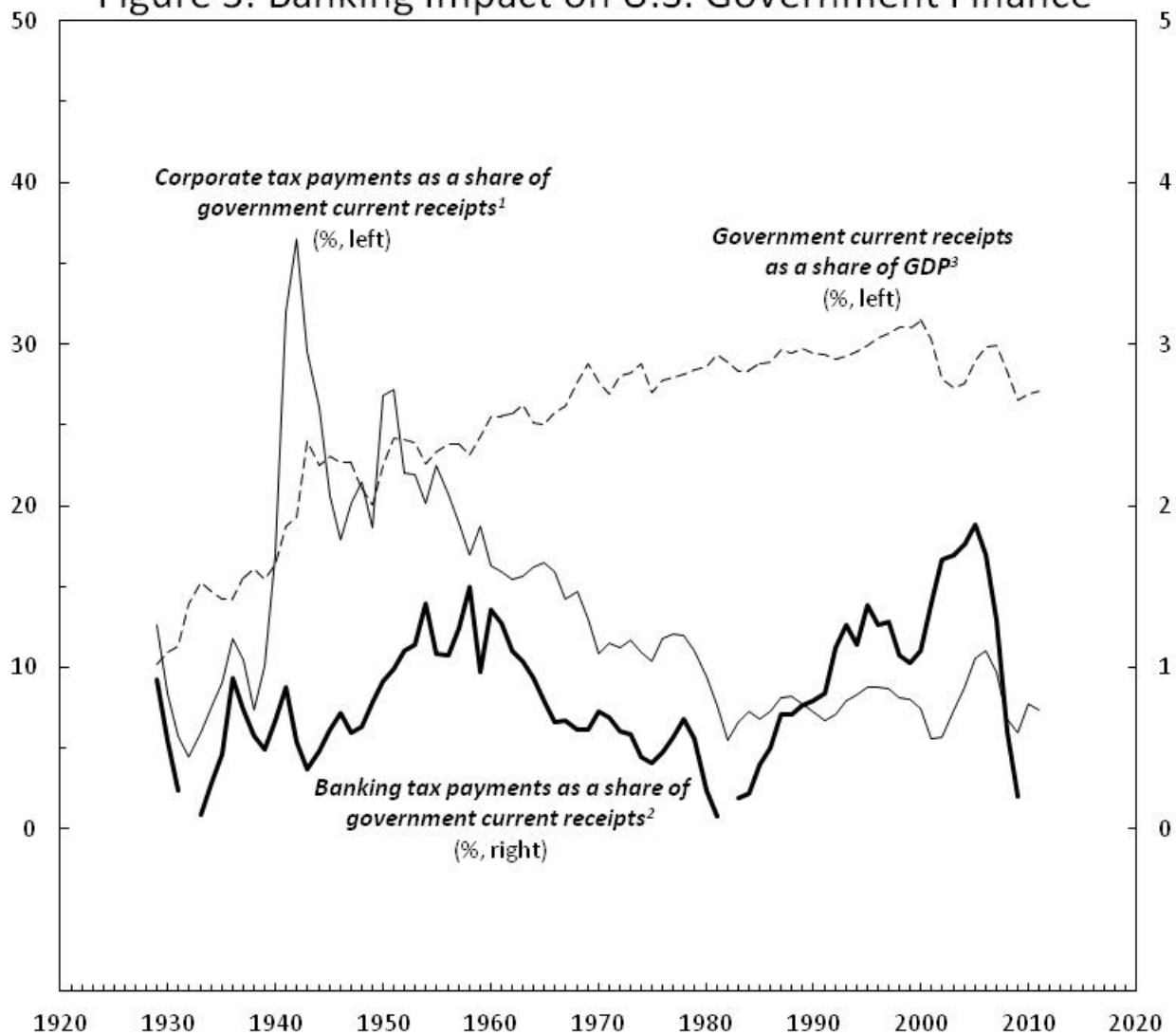
$$\text{tax payments} = \text{effective tax rate} \times \text{profits before tax}$$

Given this connection between tax payments and the variables considered in our previous graphs, it makes sense that the patterns of the former overlapped with those of the latter. To be specific, instances of higher profits and tax rates have coincided with higher tax payments and vice versa, making the trends in Figure 3 correspond with the three periods in Figures 1 and 2 rather neatly.

---

<sup>5</sup> These receipts are not limited to those of the federal government.

Figure 3: Banking Impact on U.S. Government Finance



SOURCE: U.S. Bureau of Economic Analysis, National Income and Product Accounts (NIPA) Tables; U.S. Bureau of Economic Analysis, Million Dollar NIPA Tables

1. "Domestic industries" from NIPA tables 6.18A–6.18D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A–6.16D divided by "Current receipts" from Million Dollar NIPA table 3.1
2. "Banking" plus "Credit agencies (other than banks) and holding and other investment companies" from NIPA table 6.18A minus "Federal Reserve banks" from Million Dollar NIPA table 6.16A divided by "Current receipts" from Million Dollar NIPA table 3.1 for 1929–1947; "Commercial and mutual banks" plus "Credit agencies other than banks" from NIPA table 6.18B divided by "Current receipts" from Million Dollar NIPA table 3.1 for 1948–1987; "Commercial and mutual depository institutions" plus "Nondepository institutions" from NIPA table 6.18C divided by "Current receipts" from Million Dollar NIPA table 3.1 for 1988–2000; "Credit intermediation and related activities" plus "Management of companies and enterprises" from NIPA table 6.18D divided by "Current receipts" from Million Dollar NIPA table 3.1 for 2001–2009
- NOTE: 1932 and 1982 omitted due to values less than 0%
3. "Current receipts" from Million Dollar NIPA table 3.1 divided by "Gross domestic product" from Million Dollar NIPA table 1.1.5

The first period, lasting from 1929 to the early 1950s, spanned both the Great Depression and the Second World War to end in a large expansion of tax payments from the corporate whole alongside a smaller but no less considerable expansion of tax payments from the banking sector. The second period, spanning the three postwar decades from the early 1950s to the early 1980s, brought persistent and deep declines to tax payments from the corporate whole and banks alike, declines that would ultimately return both sources of government funding to their prewar lows. During the third and final period, starting in the early 1980s and lasting until the end of our data, a striking divergence appears between total corporate tax payments and those specific to banks, with the former remaining relatively stable and the latter expanding to record highs. As a result, tax payments from banks would end up comprising a much greater share of government receipts, thus growing far more important for public finance. But during the financial crisis of 2007–2008, the share of government receipts coming from banking sector profits was sharply reduced, abruptly undermining the mutually beneficial arrangement between banking and the government. And while this arrangement demands the most attention, the data contain other important trends, and each of the three periods delineated deserve individual attention.

### 3.1 American Banking and Government in the Earlier Twentieth Century

During the first period, from the Great Depression to shortly after the Second World War, corporate tax payments faced higher growth and volatility than anywhere else in Figure 3, increasing much more rapidly than those of banks to reach a record share of government receipts. During the Great Depression, corporate tax payments fluctuated without any long-term growth, their share of government receipts at first falling to reach its global minimum of 4.5% in 1932, only to recover to about 10% by the late 1930s. But with the outbreak of the Second World War, corporate tax payments more than *tripled* their share of government receipts in only a few years, reaching their global maximum of 36.5% in 1942. The effect of this increase deserves emphasis, as government authorities earned *over a third* of their wartime funds through corporate taxation, thus turning corporations into a primary source of money with which to finance the war effort. This rapid expansion of wartime corporate tax payments is consistent with the fact that both corporate profits before tax and effective tax rates also ballooned during the war (see Figure 1). And although these tax contributions quickly waned from record highs during and after the war, the postwar importance of corporate tax payments continued to far exceed its prewar levels, hovering around 20% of government receipts well into the 1950s. Thus, the Second World War effectively transformed corporate America into a much more important source for public finance, and this importance outlasted the war by several years. Further entrenching the transformation, the government also grew during this first period, with tax receipts expanding their share of GDP from a little over 10% in 1929 to well beyond 20% by the early years of the war. Taken together, these trends indicate that the American political economy became endowed with a substantially larger government that came to rely on substantially larger corporate tax payments.

In comparison, banking tax payments as a share of government receipts experienced larger decreases during the Great Depression and smaller increases after the Second World War. Although banking tax payments followed a prewar trend similar to that of the corporate total, they also plunged from 0.9% of government receipts in 1929 to record *negative* values in 1932 (note the gap in Figure 3 and recall the sector's net subsidization). During the rest of the decade, these shares quickly recovered and went on to swing between values of around 0.5% and 1%. But the main deviation from the corporate whole came after the onset of the Second World War,

with banking tax payments as a share of government receipts being relatively stable in the 1940s and only increasing to exceed prewar levels in the 1950s. Compared to that of all corporations, the share of government receipts coming from banking tax payments grew much more slowly, reaching a local maximum of 1.5% in 1958. But while it came later than the corporate increase, this postwar expansion of banking tax payments still had a long-lasting impact on public finance, with government authorities rarely receiving less than 1% of their funds from the banking sector throughout the 1950s. Therefore, while wartime tax contributions from banks remained stagnant, their postwar importance grew, though much less than that of the corporate total during the war. This disparity in growth between corporate tax payments and those specific to the banking sector was largely due to the concurrent disparity found in their effective tax rates. As seen in Figure 2, the tax burden of the average corporation in the early 1940s increased a great deal more than that of the average bank in the 1950s. Given how poorly banks fared during the Great Depression and the government efforts to sustain them as a vital component of the American political economy, it makes sense that the authorities forwent some tax revenue from the struggling banking sector. By sparing banks wartime corporate tax hikes and following up with milder peacetime tax hikes, the banking sector may have been given lower taxes in order to ensure its stability. Regardless, public coffers after the war came to draw far more from banks than they did in previous decades, and these growing contributions continued to increase throughout most of the 1950s.

### **3.2 American Banking and Government in the Postwar Decades**

During the second period, roughly spanning the decades of postwar capitalist prosperity, both corporate and banking tax payments exhibited a persistent decline until the early 1980s, their shares of government receipts shrinking substantially over the course of about 30 years. These persistently decreasing tax payments are consistent with the fact that both corporate and banking effective tax rates were also in decline throughout the period. Corporate tax payments, which declined after hitting the notable postwar peak of 27.2% of government receipts in 1951, were reduced to a mere 5.5% by 1982 – an almost *fivefold* reduction. To put this into perspective, the decline meant that more than 20% of government receipts no longer came from corporations, lowering the latter’s contributions to levels not seen since the depths of the Great Depression and thereby greatly reducing the importance of corporate tax payments for public finance. Moreover, with government receipts simultaneously rising from slightly over 20% to almost 30% of GDP, any other source(s) of funding that offset these lost corporate taxes became even more important. In particular, this decreasing government dependence on corporate taxes was primarily offset by a simultaneously *increasing* government dependence on employment taxes;<sup>6</sup> by the late 1960s, employment taxes had replaced corporate taxes as the second largest source of federal receipts, after only individual income taxes, which have “always been the largest source” (Barthold 4). While this long transition away from corporate taxation did not extend beyond the early 1980s, the lows reached in the process persisted, such that corporate tax payments rarely exceeded 10% of government receipts for the remainder of Figure 3. With their tax payments heavily reduced, corporations thereby returned to their prewar role as a relatively minor source for public finance, a far cry from their importance during and shortly after the Second World War.

In the meantime, banking taxation experienced a comparable but more extensive decline, with banking tax payments as a share of government receipts decreasing from their record highs

---

<sup>6</sup> Employment taxes are taxes used to fund social insurance programs (primarily payroll taxes).

in the 1950s to reach record lows by the early 1980s. From their postwar peak of 1.5% in 1958, banking tax payments persistently decreased to once again record negative values in 1982. Thus, just as it had 50 years prior, the banking sector earned more profits after tax than before tax, making conventional calculation impractical and puncturing Figure 3 with another statistical gap. Although this collapse of banking tax payments proved deeper than that of the corporate totality, it also involved much less money and was accordingly less significant to public finance. Even so, that banks had previously accounted for more than 1% of government receipts is far from trivial, as it meant that a single corporate sector had supplied a sizeable portion of government revenues. But irrespective of its importance, the decline of banking tax payments during this second period appears to have been part and parcel of the broader decline of corporate tax payments. Therefore, the banking sector here behaved as a relatively inanimate part of a much larger corporate whole, making it accordingly unremarkable when viewed from the perspective of government accounts. But after their collapse in 1982, banking tax payments no longer mirrored the corporate whole, quickly recovering and settling on a path quite unlike any we had seen before.

### **3.3 American Banking and Government since the 1980s**

This brings us to the third and final period in Figure 3; unfolding after the early 1980s, this critical period reveals banking tax payments that diverged from those of the corporate whole, rapidly outpacing them as a share of government receipts until the financial crisis of 2007–2008. Corporate tax payments, as a result of the combination of rising profits and falling tax rates, became increasingly volatile since the early 1980s but fluctuated without long-term growth, oscillating between roughly 5% and 10% of government receipts. While far from insignificant, these contributions were comparable to those seen during the depths of the Great Depression, making corporate taxation far less important for the government than in the previous period. Moreover, government receipts in these recent decades had themselves doubled since the 1930s, having gradually expanded to reach their global maximum of 31.5% of GDP by 2000. Therefore, even though government receipts expanded to account for almost one-third of American GDP, their dependence on corporate taxation was comparable to when they were only half this size. However, this trend was not uniform across sectors, and the banking sector diverged sharply from the corporate whole.

Banking tax payments, under even faster profit growth and *increasing* effective tax rates, developed quite differently from the relative stagnation seen in recent corporate tax payments, and they comprised a rising share of government receipts until the financial crisis of 2007–2008. After their collapse in 1982, a quick recovery preceded over 20 years of rapid growth that went almost uninterrupted except for a short and moderate reversal in the late 1990s. Along the way, banking tax payments matched their late 1950s' share of government receipts by the mid-1990s and later reached their global maximum of 1.9% by 2005. This figure may seem unimpressive, but it means that almost one-fiftieth of the government was financed by a single corporate sector – a sector that relied on net subsidies to sustain its profits less than 30 years prior. Furthermore, banking tax payments in the early 2000s represented a full quarter of all corporate tax payments, turning this once-impoverished sector into a central source of corporate tax revenues. However, these highs did not survive the financial crisis of 2007–2008 and quickly subsided in its wake, with banking tax payments as a share of government receipts plummeting to just 0.2% by 2009 – their fastest decline in Figure 3. Mainly due to the concurrent collapse of their effective tax rates, banks thereby lost their former position as leading corporate tax contributors in only a few years,



their contributions reduced to levels comparable to those seen in the early 1930s and early 1980s. And although this latest of financial crises did not lead to a net subsidization of banking profits, its effects were sufficient to at least temporarily reverse the mutually beneficial tax arrangement that emerged between banking and the government after the early 1980s.

### **3.4 A Convergence of Interests between Banking and the Government**

The rise and fall of this apparent tax arrangement is a central theme of our investigation, and its effects on the government were greater than any other banking developments in Figure 3. Indeed, if deregulation led to increases in both banking profits and banking tax payments alike, then it worked to the advantage of not only banking but also government interests. What is more, if this same deregulation later proved responsible for triggering the financial crisis of 2007–2008, then it has also ensured the eventual collapse of the same arrangement it originally created, thereby suddenly straining the finances of both banking and the government in the process. Given the U.S. authorities' increased dependence on the taxation of deregulated banking profits, this financial crisis and the resultant Great Recession also turned out to be much costlier affairs. Not only were the policies employed to mitigate these downturns some of the costliest in history, but they also had to be financed with much lower tax revenues from the banking sector.

Unsurprisingly, the first thrust of these policies sought to bail out the financial sector, resulting in the outgoing Bush administration's Emergency Economic Stabilization Act of 2008 and its initial budgetary mandate to "purchase or insure up to \$700 billion of troubled assets" (Schatten). Meanwhile, intervening through an aggressive use of expansionary monetary policy, the Federal Reserve began to implement the irregular measures known as quantitative easing, acquiring troubled assets with newly created money and paying interest on excess bank reserves<sup>7</sup> that within only months ballooned from a few billion to almost *\$800 billion* at the end of 2008 (Federal Reserve Bank of St. Louis). Soon after this preliminary bailout of the financial sector, the Obama administration passed the American Recovery and Reinvestment Act of 2009, creating a much more widespread stimulus package that initially committed another \$787 billion. This act created both the largest stimulus package in history and the largest budgetary deficit since the Second World War, thereby establishing the need for heavy deficit spending ever since (Albo, Gindin, and Panitch 13).

Opposite these expenses, a single corporate sector's tax payments may seem unimportant, but this financial crisis meant that about 1% of government receipts no longer came from banks. Put into perspective, annual government receipts since the crisis have averaged some \$4 trillion, putting the amount of lost taxation in the order of tens of billions of dollars in 2008 and 2009, money that could otherwise have been used to finance the aforementioned stimuli. What is more, regardless of how responsible banks were for the financial crisis and its cost to the government, their proper function remains key to recovering from any lingering economic troubles. However, despite all of the government's efforts, the banking sector itself has yet to recover fully. For one, the Federal Reserve has yet to abandon the aggressive monetary injections of quantitative easing, and excess bank reserves have continued to expand since 2008 to surpass *\$2 trillion* by mid-2013 (Federal Reserve Bank of St. Louis). With banks parking trillions that could instead be lent out, they have rendered monetary policy relatively impotent as a means for any long-term stimulus, keeping the financial system in a sluggish state and thereby holding back recovery.

---

<sup>7</sup> Excess bank reserves are bank reserves in excess of reserve requirements (i.e. deposits banks must hold in reserve).

Moreover, the likelihood that banks will regain confidence in conventional investments is further diminished by new regulations introduced since the initial financial crisis of 2007–2008. Primarily through the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, new regulations have increased transparency requirements and restricted speculative investing, effectively outlawing many of the activities that banks previously engaged in to achieve their pre-crisis profits (United States Senate Committee on Banking, Housing, and Urban Affairs). Long-term stability aside, such reforms could not have been immediately helpful to ailing banks, and the rate of bank failure in the United States continues to surpass that of the pre-crisis years, with 51 failed banks in 2012 and 24 in 2013 (Federal Deposit Insurance Corporation). Therefore, the financial crisis of 2007–2008 proved as unfavourable to the government as it was to banks, dismantling the deregulatory arrangement between banking profits and government tax receipts and leaving both parties in a recession.

## Conclusion

Having traced the historical development of American banking, there remains little doubt about the centrality of its taxation in the decades leading up to the financial crisis of 2007–2008, as it led to a deregulatory convergence of interests between banking and the government. Banks, having outperformed corporate profits after tax despite losing their tax advantage in the 1980s, certainly appear to have benefited from heavy deregulation in recent decades. This deregulation, strong enough to skyrocket differential performance despite a waning differential tax advantage, transformed the banking sector into a formidable corporate powerhouse. And at the same time, the government also reaped rewards by receiving more of its funds from banks. This situation – significant increases to both banking profits and their tax contributions to government receipts – thus comprised a deregulatory tax arrangement that served both banking and the government. Furthermore, given that this arrangement only collapsed during the financial crisis of 2007–2008, a crisis purportedly caused by the same deregulation that had originally created the arrangement, it seems to have ended in much the way it began. And given that economic troubles still linger, the future of the relationship between American banking and government seems highly uncertain – as does the individual fate of both sets of institutions.

But while the existence and importance of this tax arrangement may have been affirmed, little is clear beyond the converged interests between banking and the government. In this sense, our investigation seems to raise as many questions as it answers and calls for additional research, some of which has already been conducted but remains inconclusive for want of additional data. For example, what might banking sectors in other countries have experienced in recent decades, and how would the American trends considered change with the inclusion of foreign profit data? In addition, this largely quantitative investigation has not explored many of the potentially useful legal and theoretical aspects relevant to its subject matter. An examination including such aspects might ask why banks were taxed at such lower effective rates than other corporations for so long, and how exactly they outperformed the latter upon the loss of this tax advantage. Furthermore, what else can be learned about the tax arrangement that followed besides its pecuniary benefits? Answers to such questions might provide a better understanding of how banking taxation became so important to the instability that marked the recent history of American finance. To this end, the findings presented by this investigation have established some of the necessary groundwork, offering an empirical starting point for further research.

## Bibliography

- Albo, Gregory, Sam Gindin and Leo Panitch.  
*In and Out of Crisis: The Global Financial Meltdown and Left Alternatives*.  
Oakland: PM Press, 2010. Print.
- Barth, James R., Dan Brumbaugh Jr., and James A. Wilcox.  
“Policy Watch: The Repeal of Glass-Steagall and the Advent of Broad Banking.”  
*The Journal of Economic Perspectives* 14.2 (2000): 191–204.  
*JSTOR*. Web. 27 Aug. 2013.
- Barthold, Thomas A. The Joint Committee on Taxation.  
*Testimony of the Staff of the Joint Committee on Taxation Before the Joint Select  
Committee on Deficit Reduction*.  
Washington, D.C.: The Joint Committee on Taxation, 2011. Web. 5 May 2014.
- Blackburn, Robin. “The Subprime Crisis.” *New Left Review* 50 (2008): 63–106. Print.
- Federal Deposit Insurance Corporation. “Failed Bank List.”  
*Federal Deposit Insurance Corporation*. 19 Aug. 2014. Web. 30 Aug. 2014.
- Federal Reserve Bank of St. Louis. “Excess Reserves of Depository Institutions.”  
*Federal Reserve Economic Data*. 7 Aug. 2014. Web. 31 Aug. 2014.
- Greider, William. *Secrets of the Temple: How the Federal Reserve Runs the Country*.  
New York: Simon and Schuster, 1987. Print.
- Hall, George R. “Bank Holding Company Regulation.”  
*Southern Economic Journal* 31.4 (1965): 342–55. *JSTOR*. Web. 6 Nov. 2013.
- Hunt, E.K. *History of Economic Thought: A Critical Perspective*. 2nd ed.  
Armonk, N.Y.: M.E. Sharpe, 2002. Print.
- Key, Greg. “RE: Regarding banking in your NIPA tables.”  
Message to the author. 5 Apr. 2011. E-mail.
- Lazarowitz, Arlene. “Hiram W. Johnson: The Old Progressive and New Deal Taxation.”  
*California History* 69.4 (1990/1991): 342–53. *JSTOR*. Web. 18 Aug. 2014.
- Mishkin, Frederic S. and Apostolos Serletis.  
*The Economics of Money, Banking, and Financial Markets*. 2nd Canadian ed.  
Toronto: Pearson Education Canada, 2005. Print.
- Nitzan, Jonathan and Shimshan Bichler. *Capital as Power: A Study of Order and Creorder*.  
New York: Routledge, 2009. Print.

Parkin, Michael and Robin Bade.

*Economics: Canada in the Global Environment*. 5th ed.  
Toronto: Pearson Education Canada, 2003. Print.

Schatten, Eric. Congressional Budget Office.

*The Troubled Asset Relief Program: Report on Transactions Through December 31, 2008*. Washington, D.C.: Congressional Budget Office, 2009. Web. 8 Jul. 2014.

U.S. Bureau of Economic Analysis. "National Economic Accounts."

*U.S. Bureau of Economic Analysis*. Various publication dates. Web. 2 Aug. 2012.

United States Senate Committee on Banking, Housing, and Urban Affairs.

*Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act*.  
Washington, D.C.: United States Senate Committee on Banking, Housing, and Urban Affairs, 2010. Web. 16 Jul. 2014.