Differential Taxation: The Case of American Banking

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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 also bloated the American banking sector with unsustainable profitability, and ultimately fell apart 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, *de*regulation 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 comprise two sections, one focused on banking and the other on the government. The first of these sections will consider the historical profit and taxation of the banking sector, thus demonstrating that the decades-long differential tax advantage enjoyed by American banks has yielded to the curious increase in both profits after tax and effective tax rates after the 1980s. The second section will assess the contribution of corporate tax revenues to government receipts, showing a sharp increase in the importance of banking taxation since the 1980s. Taken together, this approach will 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. The Differential Taxation of American Banking

To properly assess the historical development of banking profits and effective tax rates, we must situate these variables within their broader corporate realm and make a comparison with other corporate sectors that are subject to the same type of taxation. 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 have instead revealed some striking deviations from these expectations – after the 1980s, banks would outperform other corporations precisely as they *lost* their differential tax advantage. The loss of this historically preferential tax position thus coincided with a lasting transformation in banking performance that 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 1 traces the American history of effective corporate tax rates from 1929 to 2013, and juxtaposes them against that of effective *banking* tax rates from 1929 to 2011[1]. In addition, banking profits after tax are expressed differentially as a percentage of corporate profits after tax. Our differential profit data are based on raw figures and pertain specifically to domestic profits, while our effective tax rates are derived from these profits and depend on the difference between profits before and after taxation. Mathematically, this difference is equivalent to taxes paid and dividing it by profits before tax yields our effective tax rates in percentage terms:

[1] Because the source database publishes its sector-specific data more slowly than that of its corporate aggregates, the banking data presented here (and later in Figure 2) lag behind the corporate data by two years.

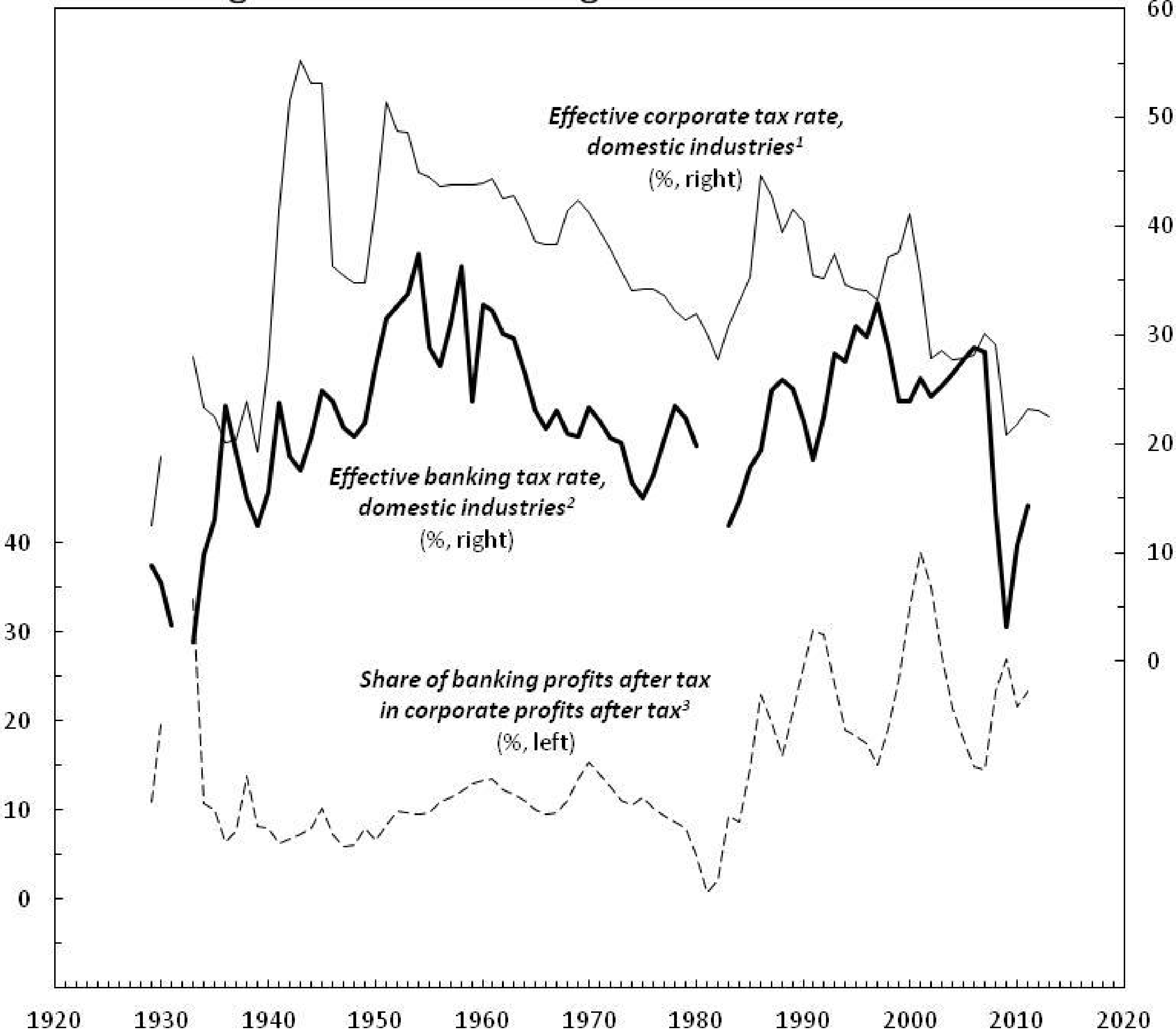
*effective tax rate = ((profits before tax - profits after tax) / profits before tax) * 100*

Or, more simply:

*effective tax rate = (tax payments / profits before tax) * 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 informed synthesis of these categories yields a fair approximation (Mr. G Key 2011, 5 April). Altogether, Figure 1 provides a graphical comparison between banking and the corporate totality, allowing us to search for links between the sector's differential performance and taxation.

Figure 1: 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 tables 6.17A-6.17D minus "Federal Reserve banks" from Million Dollar NIPA tables 6.16A-6.16D

   NOTE: 1931 omitted for graphical convenience, 1932 omitted due to a value lower 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 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 2001-2011

   NOTE: 1932 and 1982 omitted due to values lower than 0%, 1981 omitted for graphical convenience

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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 6.17B for 1948-1987; "Commercial and mutual depository institutions" plus "Nondepository institutions" divided by "Domestic industries" from NIPA table 6.17C for 1988-2000; "Credit intermediation and related activities" plus "Management of companies and enterprises" divided by "Domestic industries" from NIPA table 6.17D for 2001-2011
NOTE: 1931 omitted due to a value greater than 100%, 1932 omitted due to a value lower than 0%

Bearing in mind that our primary interest is in banking developments since the 1980s, Figure 1 reveals two relevant periods, the first lasting from the early 1950s until the early 1980s, and the second taking place since the 1980s. At a glance, the first of these periods overlaps with the decades of post-World War II economic prosperity known as the Golden Age of Capitalism. Comprising relatively stable data, this first period exhibits gradual but significant reductions to both corporate and banking effective tax rates for roughly 30 years. During these reductions, effective banking tax rates maintained much lower levels than effective corporate tax rates, granting banks a heavy differential tax advantage over other corporations. Amidst this advantage, banking profits after tax initially outperformed those of the corporate average but later began to lose out during the 1970s and eventually faced collapse by the early 1980s. The second period, taking shape after this profit collapse, roughly coincided with the rise of neoliberal governance and witnessed a sharp reversal of earlier trends that drastically transformed American banking. With effective corporate tax rates falling and effective banking tax rates now *rising*, this period thus completely ended the banking sector's longstanding tax advantage by the 1990s. However, this did not prevent banks from recovering and eventually exceeding their former performance, and their profits *outpaced* those of the corporate average while taking on increased volatility. Ultimately, this tax-defiant banking profitability ended during the financial crisis of 2007-2008, and a new differential tax advantage would take hold thereafter to sustain banking performance. To better understand these trends, let us detail both delineated periods in turn.

1.1 American Banking in the Postwar Decades

During the decades following the Second World War, effective banking tax rates were significantly lower than effective corporate tax rates. This disparity took shape during the war, with effective corporate tax rates in the 1940s almost tripling to their highest levels in Figure 1 while effective *banking* tax rates remained relatively unchanged. In the wake of this separation, the banking sector recorded a mean differential tax advantage of 14.8% from 1946 to 1980[2]. Although it is unclear exactly how or why such a heavy tax differential might have come about, it seems reasonable to suspect some sort of intervention on the part of the American government. And indeed, banking regulations had changed significantly as recently as the Great Depression, during which "more than 5,000 banks suspended operations" in three years (Hunt 2002, p. 402). Perhaps the most famous example, the 1933 Glass-Steagall Act forced banks to choose between either depository or investment banking in an attempt to discourage risk and decrease instability (Blackburn 2008, p. 64). Therefore, the tax advantage later enjoyed by American banks might have been another attempt at postwar stabilization of the sector. Such attempts did not end there, and the 1956 Bank Holding Company Act restricted bank holding companies[3] from engaging in non-banking activities and interstate expansion so as to limit their power (Hall 2002, pp. 343-4). That said, the prevalence of such regulation attests to the government's influence over the sector, and this banking tax advantage may also have been sponsored by the state.

Regardless, the impact of this taxation on banking performance also deserves attention, and before their early 1980s' collapse, banking profits after tax expanded for much of the period. Recording steady gains over the corporate average with only few interruptions for over 20 years,

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[2] Preliminary analysis surveyed the effective tax rates of dozens of other corporate sectors, and banks stood out for having the most extensive differential tax advantage. Only oil and gas extraction and mining were at all comparable.

[3] 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.

these profits as a share of the corporate total rose from 1947 to 1970 and began to fall thereafter. Despite sustaining their tax advantage, banking profits after tax thus entered decline after 1970, eventually leading to an abrupt collapse and unprecedented lows in 1980 and 1981. 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 extraordinary lows. And if we are to understand the sector's former success in terms of its differential tax advantage, then interference by some other factor(s) must have disrupted the arrangement in the latter case, enough to reverse banking profits after tax in 1970. The reasons behind this reversal are unclear, but it *is* clear that the longstanding benefits of this differential taxation were rendered impotent, enough to affect the eventual collapse of banking profits in the early 1980s.

To emphasize, even banking profits *before* tax (not shown in Figure 1) barely exceeded $1 billion in 1981 and 1982 – a rather drastic decrease from almost $17 billion in 1979. In fact, such a heavy drop in the banking sector's profitability is unparalleled anywhere else in Figure 1, including during the sharp downturn seen in the worst years of the Great Depression. Moreover, in 1982, profits after tax actually exceeded profits before tax and forced an omission in Figure 1, marking the second of two instances during which net government subsidies sustained the sector. However, the first such instance, occurring at the very height of the Great Depression in 1932, involved political economic circumstances that were a great deal more severe. Unlike the 1930s, the banking malady of the early 1980s took place 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 to restrain borrowing and slow inflation (Greider 1987, pp. 46-7). But the apparent success of this anti-inflationary monetary activism also caused a recession that was marked by higher interest rates and hit moneylending institutions like banks especially hard, offering an explanation as to why banking profits fell to such unparalleled 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.

1.2 American Banking since the 1980s

Following the early 1980s, the banking sector experienced yet another reversal of fortune, recovering from its previous collapse and re-emerging as a considerable corporate powerhouse, its profits after tax outpacing those of the corporate average despite *losing* its tax advantage. Although the banking sector's tax advantage initially reappeared after the collapse of its profits, it deteriorated amidst rising banking and falling corporate effective tax rates. And by the 1990s, American banks eventually faced a tax burden comparable to that of the corporate average, thereby losing their longstanding differential tax advantage for many years to come. However, rather than to lose ground to their corporate competition amidst the loss of such a tax advantage, banks not only managed to recover but sharply outperformed other corporations. In the process, the sector expanded to account for the highest shares of corporate profits after tax in Figure 1.

This shift reveals a transformation of the banking sector that raised its profits *before* tax so much that banking profits *after* tax also increased despite their simultaneously increasing tax burden. But these newfound banking profits also came at the expense of higher banking profit volatility, which further attests to the altered character of the banking sector since the 1980s. In particular, this volatility supports 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.

As it turned out, this otherwise favourable deregulatory arrangement was interrupted by the financial crisis of 2007-2008 and its impact on American banking. But as mentioned before, this crisis also led to the creation of differential tax rates comparable to those of postwar decades, and these actually sustained banking profits after tax since the onset of the crisis. What is more, banking profits after tax from 2007 to 2009 have actually *grown* as a share of the corporate total, even further contradicting the notion that banks suffered during the crisis and Great Recession, especially since the sector as a whole, rather than only select banks, gained. But at the same time, it is true that many banks fell victim to the crisis, and there were certainly losers amidst these aggregate gains. The rate of bank failure before and after the crisis demonstrates these losses – while only 25 bank failures occurred from 2001 to 2007, another 25 took place in 2008 alone, followed by 140 in 2009 and another 177 in 2010 (Federal Deposit Insurance Corporation 2014). Nevertheless, the banking sector as a whole retained its after-tax profit levels despite the crisis, and this performance was largely due to its renewed differential tax advantage.

In summary, the American banking sector has undergone major changes over the past several decades, as evidenced by the profit and taxation tendencies it has exhibited since 1929. Of particular interest, a heavy differential tax advantage emerged after the Second World War, its long tenure and later disappearance revealing a decidedly divergent set of profit trends. Uninterrupted for three decades, it first resulted in steady differential profit gains until 1970 before comparably steady differential losses spiraled into eventual collapse by the early 1980s. But this slump did not last for long, with the banking sector quickly recovering to outperform other corporations and encompass much larger shares of corporate profit amidst higher volatility, even though its longstanding differential tax advantage practically disappeared by the 1990s. Also striking, the recent financial crisis actually served to augment 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. Presumably, this is because circumstances were *not* the same and other forces were at work. Again, while this investigation cannot offer any conclusive explanations with sufficient certainty, the conventional wisdom surrounding the financial crisis of 2007-2008 often refers to cases of banking deregulation.

As is often thought, banks were heavily deregulated over many years prior to the crisis. Perhaps the most famous case of such deregulation is the Gramm-Leach-Bliley Act of 1999, landmark legislation that relaxed restrictions on bank mergers by repealing large parts of both the Glass-Steagall and Bank Holding Company Acts (Barth, Brumbaugh & Wilcox 2000, p. 191). As a result, banks could much more liberally participate in markets like securities and insurance, although this participation came with higher risks often thought to have culminated in the crisis.

However, our data show that the most tax-defiant banking profit trends took place in the 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 the aforementioned 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 more deregulation may have followed to increase the sector's profitability while it lost its tax advantage. And although this investigation does not directly examine any such deregulation, its apparent existence 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.

2. 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, and our investigation remains incomplete without a deeper look at 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.

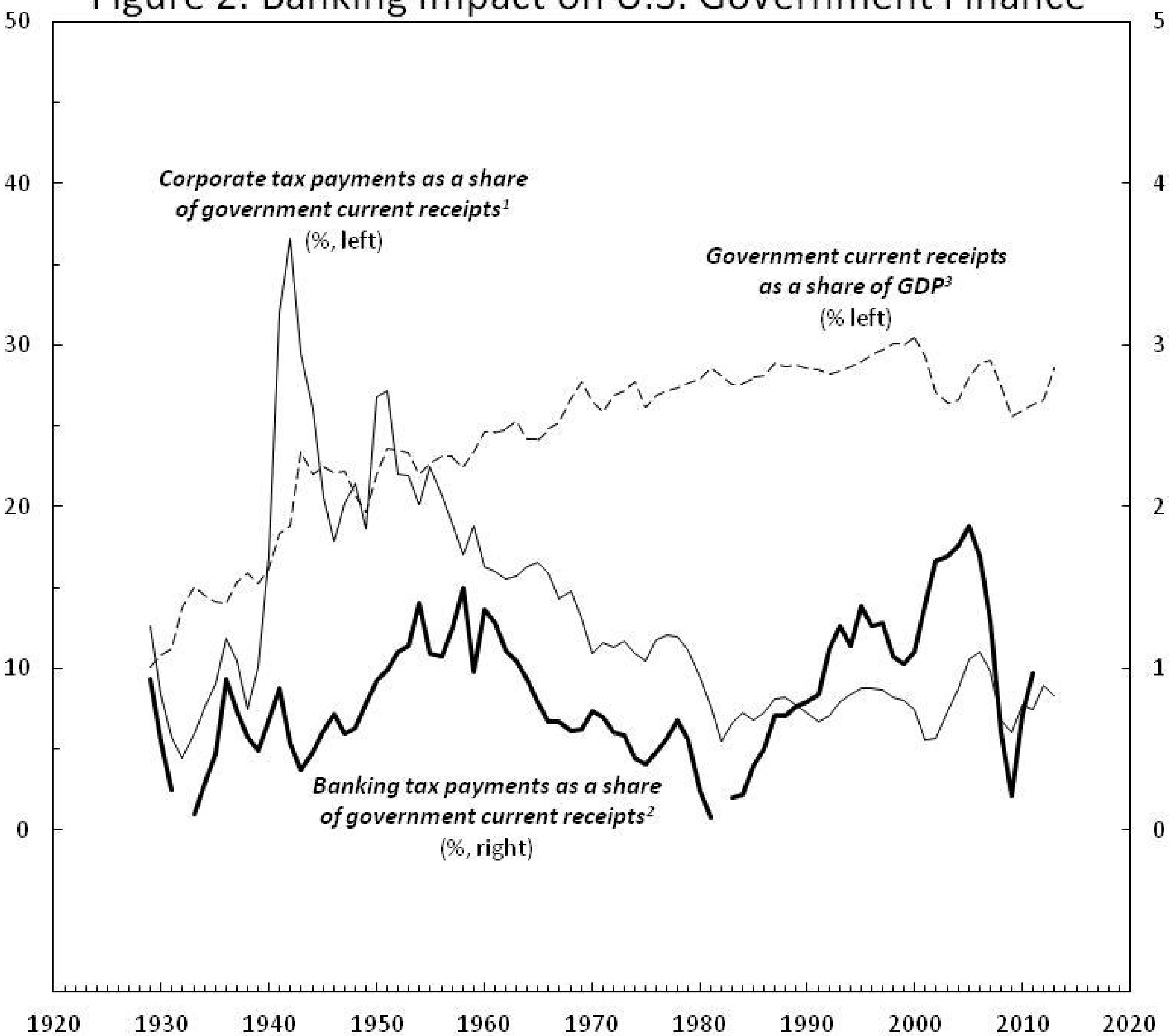
Therefore, if the expansion of banking profits since the 1980s was due to deregulation, then the authorities behind any such legislation cannot be considered impartial. On the contrary, with banks experiencing sharp increases to not only their profits but also their effective tax rates, tax revenues from the sector must also have increased – much to the benefit of the US Treasury. 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 2 compares tax payments from the banking sector to those from all corporations, expressing both as percentage shares of government current receipts. In addition to tax payments, these same government receipts are also included and expressed as percentage shares of 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. Through our data on tax payments, we can assess the relative importance of banking and corporate taxation to government finance, thus determining the extent of government reliance on banking and corporate profits. Similarly, through our data on government receipts, we can assess the relative scale of government finance, 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 2, both banking and corporate tax payments formed more varied trends divisible into two periods, periods that roughly overlap with those seen in Figure 1. This similarity can only be expected, since tax payments are the product of effective tax rates and profits before tax:

*tax payments = effective tax rate * profits before tax*

Given this connection between tax payments and the variables considered in our previous graph, it makes sense that the patterns of the former should overlap with those of the latter. Specifically, instances of higher profits and tax rates have coincided with higher tax payments and vice versa, making the trends in Figure 2 correspond with the two periods in Figures 1 rather neatly.

Figure 2: 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 recepits" 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 recepits" 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 recepits" 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 recepits" 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 recepits" from Million Dollar NIPA table 3.1 for 2001-2011

   NOTE: 1932 and 1982 omitted due to values lower than 0%
3. "Current receipts" from Million Dollar NIPA table 3.1 divided by "Gross domestic product" from NIPA table 1.1.

The first period, spanning the 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 second, beginning in the early 1980s and lasting until the end of our data in Figure 2, 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 ended up comprising a much greater share of government receipts, turning them into a major source of public revenue. 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 the government and banking. And while this arrangement demands the most attention, the data contain other important trends, and both of the periods delineated deserve individual attention.

2.1 American Banking and Government in the Postwar Decades

During the postwar decades, both corporate and banking tax payments exhibited decline until the early 1980s, their shares of government receipts persistently falling for about 30 years. Corporate tax payments, after tripling to over one-third of government receipts in the 1940s, declined sharply but recorded relatively high levels well into the 1950s. But from 1951 to 1982, they experienced an almost *fivefold* reduction to settle on a little over 5% of government receipts. This decrease meant that over 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 greatly reducing the importance of corporate tax payments for government finance. Furthermore, as government receipts simultaneously expanded 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;[4] by the late 1960s, employment taxes had replaced corporate taxes as the second largest source of federal receipts, the only larger source being individual income taxes (Joint Committee on Taxation 2011, p. 4). And while this long shift 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 2. With their tax payments heavily reduced, corporations thus returned to their prewar role as a relatively minor source of government funds, a far cry from their importance during and following the Second World War.

In the meantime, banking taxation experienced a comparable but also amplified decline, with banking tax payments as a share of government receipts decreasing from their record highs in the 1950s to reach record lows by the early 1980s. From a noteworthy postwar peak in 1958, banking tax payments declined to reach negative values in 1982. Just as they had 50 years prior, banks earned more profits after tax than before tax (recall their net subsidies in 1932 and 1982), making conventional calculation impractical and puncturing Figure 2 with another statistical gap. Although this collapse of banking tax payments proved deeper than that of the corporate totality, it involved far less money and was accordingly less significant to government 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 provided a significant 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,

[4] Employment taxes here refer to taxes used to fund social insurance programs (primarily payroll taxes).

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.

2.2 American Banking and Government since the 1980s

Since the early 1980s, banking tax payments 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, facing the combination of rising profits and falling effective tax rates, became increasing volatile in the early 1980s but fluctuated without growing over the long term, oscillating between roughly 5% and 10% of government receipts. While far from insignificant, these contributions proved to be no larger than those recorded during the Great Depression, keeping corporate taxation far less important for government finance than in the postwar period. Moreover, government receipts in these recent decades have themselves doubled since the 1930s, with continuous expansion approaching one-third of GDP by the turn of the century. Therefore, although the American government has grown to siphon more of its country's money than ever, its dependence on corporate taxation is no larger than when it received half this much. That said, these recently stagnant corporate tax payment trends were not uniform across different sectors, and the banking sector diverged sharply from this corporate totality.

Banking tax payments, under even faster profit growth and *increasing* effective tax rates, developed quite differently from the relative stagnation of recent corporate tax payments and comprised an increasing 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 caused banking tax payments to match their late 1950s' shares of government receipts by the mid-1990s and eventually reach 1.9% in 2005, their highest value in Figure 2. This may seem unimpressive, but represents almost one-fiftieth of the government being financed by a single corporate sector – a corporate sector that required net subsidies to sustain less than thirty years prior. 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 2. Mainly due to the concurrent collapse of their effective tax rates, banks would thereby lose their position as leading corporate tax contributors in only a few years. And while this latest of financial crises did not lead to a net subsidization of the banking sector, 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.

2.3 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 2. Indeed, if deregulation led to increases in both banking profits and banking tax payments alike, then this deregulation benefited not only corporate but also governmental interests. Furthermore, 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 very arrangement it originally created and thus suddenly strained the finances of both banking and the government in the process. That said, given the US government's 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 had to be financed without the benefit of abundant tax revenues from banks.

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 commitment to "purchase or insure up to $700 billion of troubled assets" (Congressional Budget Office 2009, para. 1). Meanwhile, using 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[5] that within only months ballooned from a few billion to almost *$800 billion* at the end of 2008 (Federal Reserve Bank of St. Louis 2014). Soon after this initial 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 & Panitch 2010, p. 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 from 2008 and 2011, 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 the recovery from the ongoing Great Recession. 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

[5] Excess bank reserves are bank reserves in excess of reserve requirements (i.e. deposits banks must hold in reserve).

(Federal Reserve Bank of St. Louis 2014). With trillions parked that could instead be lent out, banks 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.

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 engaged in to achieve their pre-crisis profitability (United States Senate Committee on Banking, Housing, and Urban Affairs 2010). Long-term stability aside, such reforms could not have been immediately helpful to ailing banks. And indeed, the frequency of American bank failure continues to surpass its pre-crisis years, recording 51 failed banks in 2012 and 24 in 2013 (Federal Deposit Insurance Corporation 2014). Therefore, the financial crisis of 2007-2008 was damaging to both banking and the government, 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 a tax advantage after 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 same way it began. And given the ongoing Great Recession, 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 converging 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 inquire why banks were taxed at lower effective rates than other corporations for so long, and how exactly they managed to outperform the latter upon losing this tax advantage. Further, 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 acute turmoil marking the recent history of the American political economy. To this end, the findings presented here have established some of the necessary groundwork, offering an empirical starting point for further research.

Biography

[omitted for the refereeing process]

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