Written by **Alex Newman** on March 18, 2014

Obama Tax Scheme Could Destabilize Banks, Spark Economic Crisis

A crucial component of the widely criticized new addition to the U.S. tax regime known as FATCA, passed by Democrats and signed by Obama in 2010 as part of a "jobs" bill, could result in massive capital flight from American banks and economic devastation if efforts to stop it are unsuccessful, experts and policymakers are warning. With the U.S. economy still teetering, some analysts are even suggesting that allegedly unlawful IRS mandates purporting to force American financial institutions to report foreign account holders to their governments could be the straw that breaks the proverbial camel's back.

The Obama administration has refused to perform (or at least release) any sort of cost-benefit analysis of its new tax reporting scheme, labeled "DATCA lite" by some analysts, as it paves the way for even greater FATCA-linked domestic data collection and sharing. Independent experts, though, are warning that the plan could result in potentially tens or even hundreds of billions worth of foreign deposits fleeing from U.S. institutions.

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The capital flight could become so severe, documents show, and experts and policymakers told *The New American*, that it might even trigger runs on certain banks, taxpayer-funded bailouts, another economic crisis, a major devaluation of the already-struggling U.S. dollar, and a destabilization of the American financial system. The cost to embattled American taxpayers, businesses, and consumers would be enormous.

As part of the controversial new taxation scheme known as the Foreign Account Tax Compliance Act, or FATCA for short, the Obama administration is busy negotiating pseudo-treaties with foreign governments purporting to mandate the automatic exchange of financial information. As part of those deals, which critics and lawmakers say are likely unlawful, the IRS and the U.S. Treasury are hoping to force American financial institutions to hand over data on foreign account holders. That information would then be shared with authorities in foreign jurisdictions.

"We see no principled basis on which to require that financial institutions based in other countries collect and provide us with information on U.S. taxpayers, if we take the position that our own institutions should be exempt from similar requirements," explained Treasury Acting Assistant Secretary for Tax Policy Emily McMahon in a 2012 speech. "To the contrary, we believe that it will be critical to the success of our efforts to implement FATCA that we are able to reciprocate."

Of course, spying on people and sharing their deeply private information without a warrant or even probable cause is unlawful in many countries around the world — in the United States, the Fourth

Amendment to the U.S. Constitution was supposed to protect Americans from such machinations. To get around those obstacles in the supposed hunt for an extra billion or so dollars of tax revenue every year, the Obama administration is signing up foreign governments for what are known as “inter-governmental agreements,” or IGAs.

Once the unconstitutional pseudo-treaties are signed — the U.S. Senate gets no opportunity to offer its consent on the deals, despite what the Constitution requires — foreign governments are expected to violate the privacy of account holders in their jurisdictions and become *de facto* agents of the IRS. Information on so-called “U.S. persons” is to be collected and sent to the Treasury. In return, the Obama administration plans to force U.S. banks to “reciprocate” — or put another way, violate the financial privacy of foreigners with accounts in the United States on behalf of foreign IGA signatory governments.

“DATCA remains the Achilles heel of both FATCA and the OECD ‘automatic exchange’ scheme,” former U.S. diplomat and Senate staffer James Jatras, an attorney who runs RepealFATCA.com and its efforts to stop the controversial plot, told *The New American*. “The real purpose, in my opinion, is eventually to achieve the power to receive all asset information domestically as well (once it’s established no probable cause is needed, or even a ‘suspicious activity report,’ what’s the difference), subordination of the global financial system to the IRS (and NSA) in a seamless surveillance web, and Executive usurpation of the Senate’s treaty authority.”

Some two dozen governments have already signed IGAs, and many more still might in light of the massive pressure being exerted by the Obama administration. More than a few lawmakers, though, have already cried foul over the scheme — and especially the domestic element. “The Treasury Department, without the consent and authority of Congress, will force U.S. financial institutions to provide the bank account information of private customers to foreign nations,” complained Sen. Rand Paul (R-Ky.), who has introduced legislation to stop FATCA’s wholesale trampling of rights and privacy.

For about a century, U.S. policy has specifically worked to encourage foreigners to invest and deposit funds in the United States. Recent FATCA-related schemes, however, represent something of a dangerous turning point, analysts say. Even under the administration’s “regulations” that have already been put in place — so called “DATCA lite,” a prelude to even broader schemes — the implications of the reporting requirements aimed at foreign account holders could be devastating to the U.S. financial system and the broader economy.

In fact, according to analysts, hundreds of millions of dollars in foreigners’ bank deposits had already fled just from Florida by mid-2012 in response to the scheming. That was before the controversial new reporting requirements were even in effect. Experts say that could be just the beginning, with the first reports on foreigners’ accounts under the new reporting scheme due to the IRS last week.

By early 2014, the Texas Bankers Association said some $500 million had flowed out of the state’s banking system as a result of the IRS rules. Meanwhile, the Obama administration is still seeking to dramatically expand the domestic reporting regime and transform it into what critics refer to as full-blown DATCA, as opposed to the current DATCA-lite. That would only intensify the coming damage.

Thus far, there has been very little in the way of officially estimating the economic damage. “To this day, the Treasury has refused to do a cost-benefit analysis,” explained George Cecala, a spokesperson for Rep. Bill Posey (R-Fla.), who has been a leader in Congress on trying to rein in the scheme. Pointing out that there is a huge amount of deposits from foreigners just in Florida-chartered institutions alone, Cecala cited experts and analysis suggesting that the potential impact could be massive for the Sunshine State and the nation as a whole.

In all, it is estimated that U.S. banks have almost $4 trillion in liabilities to private foreign residents. Meanwhile, non-resident aliens — foreigners who do not live in the United States — have close to half of a trillion dollars actually deposited in U.S. financial institutions, according to estimates cited in court documents that all sides appear to accept. Due to the controversial way the banking system is structured, every dollar in deposits generates roughly $9 in lending.

In other words, if just 10 percent of those deposits were to flee American banks and institutions due to the Obama administration's machinations — the conservative end of the estimates — the impact on the U.S. economy could be devastating. Based on surveys, some analysts and industry groups have suggested that as much as 20 percent of those deposits could be at risk of leaving the U.S. economy — perhaps even more.

"This is about trying to prevent a potential future financial crisis," Cecala from Rep. Posey's office continued in a phone interview with *The New American*. "This is not about protecting tax evaders; it's about preventing a future financial crisis. These regulations put at risk tens or hundreds of billions of dollars in deposits, and that needs to be studied first, beyond the scope of what it costs to do paperwork. This is a very serious problem."

One of the most significant concerns is the potential for destabilization of the financial sector, Cecala said. "As many as two or three dozen institutions in Florida could be exposed to liquidity issues," he explained, adding that other states could see similar problems. "So that means the possibility of more bailouts. Has the Treasury Department even conducted a cost-benefit analysis? We know they haven't. What is the impact on the economy? This jeopardizes tens or even hundreds of billions in deposits."

The capital flight would also have a direct impact on the U.S. economy, American businesses, families, and more as banks deal with the carnage. "We're risking a run on deposits, and losing that money to other countries," Cecala continued. "That money is used to make loans to American families and small businesses. If you're an American, you should favor that; it's good for our nation. That's what American policymakers should be focused on. We're concerned that there could be a drain on some of these financial institutions that could destabilize them. Who will be stuck holding the bill? It's small, local people."

Members of Congress on both sides of the aisle have been trying to stop the so-called "DATCA lite" scheme, so far without success. The House of Representatives even passed a bipartisan bill, which went nowhere in the Senate, that would have frozen the IRS' ability to keep spewing "significant" regulatory schemes.

The Obama-IRS DATCA-lite plan was so controversial that even Rep. Debbie Wasserman Schultz, the chair of the Democratic National Committee, joined with every other member of Florida's congressional delegation in asking the administration to withdraw the rule. Keep in mind, too, that the potential damage from the IRS mandate in question would be dwarfed by the full reciprocity authority being sought by the administration to encourage other governments to sign FATCA IGAs.

However, lawmakers are hardly the only ones expressing major concerns about the potential effects of the information-sharing regime. "We strongly oppose this proposal. This proposed regulation by the Obama Administration would have disastrous consequences for U.S. banks and their customers, especially those in Florida, Texas, California and New York," explained Alex Sanchez, CEO of the

Florida Bankers Association, in 2011 congressional testimony. All of those states have significant amounts of foreign deposits.

Sanchez also echoed the capital-flight estimates cited by others in the field. “This proposal could result in the flight of tens to hundreds of billions of dollars of capital leaving our country thereby hurting our economy,” he explained. The Florida association, along with bankers in Texas, is currently suing in federal court to stop the scheme, with the case now at the appellate level.

Even former officials have offered similar warnings. The regulation mandating automatic reporting on accounts of non-resident aliens “creates serious safety and soundness concerns to banks and further will have significant negative economic impacts on the communities served by those banks,” J. Thomas Cardwell, former commissioner of the Florida Office of Financial Regulation, said in testimony before Congress in late 2011 about the scheme. According to a survey performed by his office, 11 out of 16 banks just in South Florida would be vulnerable to collapse if foreign-owned deposits were to be withdrawn.

Indeed, in more than 75 percent of the state-chartered financial institutions in the region, over 90 percent of deposits were from foreigners. Florida admittedly has a lot of foreign deposits due to its strong ties with Latin America, but it is hardly unique. The state Office of Financial Regulation also showed how dramatically lending could decrease if just a small amount of that money were to be withdrawn in the face of the Obama administration’s current reporting regulations — not to mention the full reciprocity regime being sought.

After studying the issue, the Florida agency concluded that “there will be a negative impact on the safety and soundness of individual financial institutions.” It also found that “there will be a negative impact on state and local economies.” The findings for Florida, Cardwell explained in his testimony before the House Financial Services Committee, “can be extrapolated to other parts of the country.”

The IRS and the Obama administration, along with a lower-court federal judge that sided with them in an ongoing case about the mandate, contend that only criminals and those seeking to avoid taxes would be likely to withdraw their deposits from U.S. banks under the current and proposed information-exchange regime. However, anybody even remotely familiar with Latin America and other troubled regions of the world knows that is far from the case — the claim is preposterous, in fact.

Consider, for example, the wild currency printing and wealth confiscation so typical of Third World regimes. Governments and economies in Latin America are often unstable, too, leading people from the region to deposit significant sums into Florida banks, Cardwell told lawmakers.

“Beyond economic concerns, citizens in some countries rightly distrust their governments,” he explained. While the administration has offered assurances that it would be careful with the sensitive data and not share it with problematic regimes, few believe the claims. The socialist regime in Venezuela, for example, is among the governments that have a tax treaty with the U.S. government and would presumably receive information on Venezuelans with accounts in American banks. Mexico, too, along with some authorities in at least 80 nations.

“Dictators, demagogues, political partisans, corrupt state and local officials often act outside the law,” continued Cardwell. “Extortion, abduction, robbery and embezzlement are facts of life. Providing such governments with a list of assets is felt by their citizens to jeopardize not only their property but also their lives and those of their families and associates.” Such concerns were expressed recently after it emerged that the Obama administration was quietly negotiating a FATCA IGA with Vladimir Putin’s regime in Russia as well.

Even a decade ago, the potentially devastating effects of DATCA-like schemes were understood. In a 2004 analysis of a similar proposed IRS measure, Jay Cochran, III, a research fellow in Regulatory Studies at George Mason University's Mercatus Center, estimated that the scheme "has the potential to trigger a deposit outflow from U.S. depositories of more than $87 billion, as [non-resident alien] depositors withdraw funds from the U.S. to secure alternatives better aligned with their privacy, financial, and other preferences."

To put that number in context, at the time, it represented 209 percent "of the entire U.S. banking system's reserve base," he continued. To deal with the massive blow to their balance sheets, banks would have a number of options, but he suggests the "most likely response" would be for them to sell securities.

That would come with its own set of consequences, including, among many others, some $4 billion per year more saddled on U.S. taxpayers forced to pay for the federal government's increased borrowing costs. It would also hurt the markets for stocks and bonds. Since that study, the situation has deteriorated further, meaning that the consequences would almost certainly be far more severe now.

"Other things equal, a reduction in the U.S. deposit base is also likely to lead to increases in U.S. interest rates, a constriction in the supply of credit, or some combination of the two, with the net result being that credit will become more expensive for all U.S. borrowers, including the federal government," Cochran explained in the hard-hitting Mercatus report. The effects would also imply a lower value for the U.S. dollar, he added.

"The estimates in this study indicate that the rule is likely to generate a minimum deposit outflow from U.S. depositories of $88 billion," the Mercatus report continued. "The subsequent adjustments that will be set in motion by this rule are quite likely to lead to unwelcome changes in U.S. depositories' balance sheets, and/or in the cost of funds obtained through deposits. These unwelcome adjustments are also likely to affect the dollar adversely, and to retard foreign investment (both direct and indirect) in the U.S. from citizens of the listed as well as non-listed countries."

Put another way, in its supposed quest to extract about $1 billion annually from alleged tax evaders (by its own estimates), the Obama administration might very well be pouring fuel on the fire and further threatening the economic stability of the United States. "Tax collection über alles has become the rallying cry of domestic and international tax collectors," Director of Government Affairs Brian Garst with the Center for Freedom and Prosperity told *The New American*. "Due to the unquenchable greed of the global tax elite, the next financial crisis may be just around the corner."

As *The New American* has reported in an ongoing series about FATCA and its tentacles, the potential harm to the U.S. economy represents just one of many reasons why critics, including the Republican National Committee, say the scheme needs to be promptly repealed. Other major criticisms include privacy and constitutional concerns, as well as the ongoing effort to seize on FATCA to build a truly global taxation regime under the OECD and G-20.

For much more on FATCA, see the articles linked below.

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