

Banks not lending, but not willing to let credit unions lend either

By Steve Pociask, president, American Consumer Institute Center for Citizen Research - 04/27/12 08:35 AM ET

Small businesses account for 60-65% of jobs created during an economic rebound. However, hiring continues to be abysmal in large part due to the inability of small businesses get adequate access to capital for investing and expanding operations. In this upside-down real estate market, depressed home prices mean that small businesses cannot get home equity loans, forcing them to go to banks for capital. But the banks aren't lending. Last year, banks rejected 60% of small business loan applications, and they reduced small business loans by 20% during the last recession. On the other side, credit unions increased loans by 40% during the last recession, but their lending has been capped by an outdated law that suppresses small business access to capital and deters smaller credit unions from serving these businesses.

To fix this, Congress is considering the Credit Union Small Business Lending Bill, S.2231, which raises the current credit union lending cap from 12.25% to 27.5% of assets. For small businesses, increasing the lending cap means more capital; for workers, it means more jobs; and for the economy, it means more investment and increased economic output. The increased lending is predicted to generate \$13 billion in investments and 140,000 new jobs, as well as produce other significant indirect benefits to the overall economy.

On the other hand, keeping the cap in place maintains an economic barrier to entry that protects near-monopoly status for banks that collectively control 95% of small business lending. In other words, the arbitrary cap on credit union lending is a regulation that inhibits competition and protects competitors (the banks).

The cap puts credit unions at a competitive disadvantage. Not so, say the banks! The banks say that the nonprofit status of credit unions provides a tax advantage not available to for-profit lenders.

Nice try, but not true. The reality is that the credit unions' nonprofit status requires all profits go back to their customers (members), meaning that customers get lower interest on loans and higher interest on savings accounts. In other words, credit unions serve the public in a break-even manner, so they have no real profits to tax.

Similarly, banks could also operate in a break-even fashion and avoid all income taxes, but they choose not to. Instead, they freely choose to generate profits and distribute them with investors or stockholders as dividends. Alternatively, if for-profit banks chose to operate as

a Subchapter S corporation, instead of a Subchapter C corporation, their investors and stockholders could also avoid dividend taxes as well. Furthermore, if nonprofit status is truly an advantage, for-profit banks should consider converting, but that won't happen. Considering that banks control the vast majority of lending, cry of an "unlevel" playing field is just weak and disingenuous lobby-speak.

The only "unlevel" playing field is that credit unions are subject to a cap that prevents them from lending to small businesses. This is unfortunate since, compared with banks, credit union lending produces a third of the delinquency rate and bad debt. In other words, we could see more loans at lower market risk.

Public policy needs to encourage competition, remove market entry barriers, encourage investment— and do all of this without government funding. As I look across the political spectrum and hear the free-market, pro-competition and anti-regulation voices, it will be very interesting to see where politicians stand on this issue.

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