FORTUNE

OPINION

4 ways Wall Street can ante up for fiscal health

Wall Street chiefs say they want Washington to come up with a long-term fix for our debt problems. How far are they willing to go?

By Sheila Bair

Nov 19, 2012

Okay everyone, listen up. I'm going to say something nice about Wall Street CEOs. That is because they are putting their considerable political clout behind a cause that benefits the rest of us: getting our fiscal house in order with a long-term, credible debt reduction plan. Some, such as Goldman Sachs' Lloyd Blankfein, have gone so far as to support higher taxes on the rich.

But before I get too carried away in my praise for these financial Caesars, let me challenge them a bit on just how much they are willing to do for the cause. Fiscal responsibility cannot and should not be achieved mainly on the backs of entitlement programs and middle income taxpayers. If they are serious about fiscal responsibility, here are four possible ways they can ante up:

End Preferential Treatment of Capital Gains and Dividends: Special tax breaks for long-term capital gains and dividends overwhelmingly benefit the top 1%. The investor class pays a maximum marginal tax rate of 15% on their investment income, while us working stiffs pay marginal rates as high as 35%. These special breaks cost the government about $90 billion a year in lost revenue even though though there is no concrete evidence showing that they promote economic growth or create jobs (except perhaps for the Wall Street financial engineers who construct tax shelters to exploit them.)

Ending the Bush tax cuts for households making more than $250,000 a year, as the Obama administration has proposed, will not end this inequity. Two-earner couples who receive salaries for their labor will pay marginal rates of up to 39.6% (this on top of payroll taxes which do not apply to investment income). Your average hedge fund manager or private equity investor, on the other hand, will pay a top rate of 20%. Even the administration's millionaire's tax (which appears to be going nowhere) would let zillionaire Wall Street financial mavens pay lower rates than wage earning households who make much less.

The administration's proposals to "tax the rich" simply treat the symptoms of preferential rates for investment income; they do not provide the cure. The "rich people" who would be impacted the most are small business owners and higher paid professionals who draw wages. Wall Street's investor elites would still keep special breaks. The Simpson-Bowles Commission recommended eliminating investment income preferences and closing other loopholes which would generate revenue, and still allow everyone's top marginal rate -- worker and investor -- to be set at 28%. Broadening the base and lowering marginal rates was the approach Congress took in 1986, under President Reagan's leadership, when it rewrote and simplified the tax code. Unfortunately, investor income preferences crept back into the code during the Clinton and Bush years. Let's get rid of them once and for all in 2012.

End Subsidization of Excessive Bank Leverage: It is beyond dispute (at least among rational people) that prior to the 2008 financial crisis, large financial institutions funded themselves with too much borrowed money, instead of putting their own shareholder equity at stake. This contributed to their failure (and ensuing bailouts) when they couldn't make good on their highly leveraged bets. Yet, a key reason why banks like to use borrowed money to support their risk taking is that the tax code makes it cheap for them to do so. The interest on their debt is fully tax deductible, regardless of how much they lever up. The Treasury Department has been studying this problem, but has yet to set forth a proposal. Stanford University's Anat Admati and others have suggested simply denying the interest deduction to over-leveraged institutions. I'd end the deduction for any institution with a debt to equity ratio above, say, 12 to 1.

Impose a Financial Transaction Tax: Developed nations in Europe and elsewhere are moving forward with fees on financial transactions. Instead of resisting these efforts, the U.S. should lead the way. For decades, we imposed a fee on stock transactions with no adverse effects on our markets. Eleven European nations are planning to assess a fee of 10 cents on every $100 transacted. Iowa Senator Tom Harkin has proposed a more modest assessment of 3 cents. (So, for instance, a $10,000 securities purchase would be assessed a $3 tax.)

Main Street households with their occasional securities investments would pay a few dollars at most under these proposals, while high frequency traders who buy and sell by the millisecond would pay a lot. Such a tax would penalize those who destabilize our markets with rapid fire trading, while rewarding those who invest for the long term. It would also raise real revenue: a 3-cent fee would raise about $350 billion over 10 years; a 10-cent fee would raise about $1 trillion.

Increase Mortgage Guarantee Fees:

Taxpayers are still about $140 billion in the hole on the support we have provided mortgage giants Fannie Mae and Freddie Mac, and it looks like we will need to plow billions more into the Federal Housing Administration (FHA). Taxpayer assistance provided to these three mortgage guarantors is yet another indirect subsidy to the financial sector. The government is guaranteeing about 90% of the mortgages financial institutions originate these days, while charging them insufficient fees to cover the costs of government backed mortgages going sour. Let's ratchet up those fees to make sure we taxpayers get our money back and in the process, force banks to shoulder more mortgage risk on their own.

Wall Street could do a lot to rehabilitate it's reputation by supporting some of these proposals. This is a special legacy opportunity for the outgoing Treasury Secretary as well. Now is the time for Tim Geithner to use all his financial skills, and his influence with Wall Street, to craft the consensus agreement the country badly needs. Just as the Cold-Warrior Nixon could credibly negotiate with Chinese communists, so can this Treasury Secretary lead negotiations to raise needed revenue through tax policies which will give us a fairer, more stable financial system

Sheila Bair is a Fortune contributor, and a former chair of the FDIC, and former member of the Basel Committee. She is also the author of the New York Times bestseller Bull by the Horns, Fighting to Save Main Street from Wall Street and Wall Street from Itself.