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Banking on Recovery: Towards an accountable, stable financial sector

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The impact on Britain's economy of the 2007/8 financial crisis was grave. Not only did it affect the financial sector but its implications for the whole economy continue to leave their mark. The government was quick to respond with fresh regulation and changes to the law. However, the 'cure' is likely to be worse than the disease.

That's the view of a number of senior economists and politicians (*) writing in Politeia's next volume, Banking on Recovery: Towards an accountable, stable financial sector. They discuss where the official response has been flawed, badly timed and damaging and say that many problems remain. In particular:

- **Banks are still 'too big to fail'**. The mechanisms for greater accountability lack teeth.
- **The timing of policy for higher capital ratios prolonged the downturn**, although right in principle.
- **Targeting bankers' bonuses can damage banking**, lead to excessive 'risk reduction' and credit rationing.
- **Power has been concentrated in the hands of the Bank of England. It could make for too little scrutiny, accountability and transparency**. Bank decisions transferring wealth from savers to borrowers would, under fiscal policy, need parliamentary approval.
- **The EU Commission and HMG have picked the wrong 'targets'**. The crisis was in the banks, but the French and German Governments, EC officials and MEPs wanted to hurt the hedge funds.
- **EU Regulation has increased tenfold in the last decade**, with greater say often going to countries with a far smaller stake in or knowledge of the industry than the UK.

Looking ahead, the authors propose a clear course based on the following principles to guide successful policy for the future:

- '**Too Big to Fail' must be tackled -** restored to the priority agenda or alternative solutions found.
- **Shareholder interests should be aligned with managers**. New ways of promoting risk-sharing between the state and private shareholder should be sought.
- **Lessons should be learned from banks which weathered the storm** -e.g. a strong deposit base, restrained use of structured products, resistance to shareholder calls to increase leverage.
- **The authorities should use economic models which take proper account of monetary indicators**, and not just the official interest rate.
- **If Britain votes to leave the EU:**

- The UK authorities should become more proactive to promote the new agenda for the financial sector, rather than awaiting the outcome of Article 50 discussions.
- Lessons should be learned from the US - their securities regulation obliges firms and individuals to have a US presence or qualifications to do business there. London's dominance of European finance should allow it to seek an 'a la carte' menu.

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