



Turner could cost the City of London 50,000 jobs and set it back 10 years

Those brought up in the colonial diaspora became connoisseurs in the more inventive excuses given by the servants as to the origins of minor domestic mishaps. My favourite was a cleaner who, trying to explain away the breaking of a rather expensive vase that had been dropped to the ground said not entirely helpfully 'No one was holding the vase when it fell...that's why it fell...'

One is reminded of this when reading the Turner proposals for reregulating the banks. You might think that a regulator that had directly supervised the failures of Northern Rock, Bradford and Bingley, HBOS and the Royal Bank of Scotland would admit that it had failed and possibly even apologise. But you would think in vain. The FSA's take on this is: 1) The problems were global and were created by weak regulation elsewhere; and 2) That capitalism failed.

In other words 'Not me, guv'.

The Turner report's analysis of regulatory failure deserves a gamma minus at best. It fails to explain why the most regulated financial institutions – the clearing banks - were the ones that got into most trouble, while the least heavily regulated – the hedge funds – did comparatively well.

Some of the analysis of market failure reads like an undergraduate student attempting to recycle Marx. The report argues that the problems that emerged 'was based on a sometimes implicit but at times quite overt philosophy' which believed that: markets are self correcting, the primary responsibility for controlling risks lay with managers and that competition was the best provider of consumer protection. In other words, capitalism is some kind of philosophy, not a normal form of human behaviour.

Looking forward, it is clear that for those banks that are too big to fail, they have to be given an explicit government guarantee. For this guarantee not to be called upon, they will have to be tightly regulated so that they take only very limited risks. Those risks that have to be taken should be taken by institutions that do not have a guarantee. In other words, some type of Glass Stegall needs to be reintroduced, ideally by restricting the scope of the guarantees and the lending by institutions that are guaranteed to other non-guaranteed institutions through the appropriate capital adequacy requirements. Clearing banks will supply particular types of finance in a relatively boring fashion. Other non guaranteed institutions 'investment banks' will take higher risks but they will be allowed to fail. Systematic issues mainly need to be addressed by a monetary policy that takes account of asset values. Some procyclical banking regulations might work but given the difficulty that Gordon Brown had when chancellor in trying to define the cycle (remember how many times it was redefined in a vain attempt to show that he was still meeting the golden rule on a cyclically adjusted basis?) this looks to be pretty difficult to make work in practice.

The problem with the Turner report is that by failing to distinguish between those banks that are too big to fail and other financial institutions, it is proposing tight regulation for all financial institutions. This would lead to an exodus from London to other more flexible regulatory regimes. A rough back of the envelope calculation is that it would cost the City perhaps 50,000 jobs and set it back 10 years. The Turner report's attempts to prevent this rely on the proposals for the UK being copied elsewhere. But the recent experience of international agreements is that whatever governments may say at global conferences, when they get back home they follow their own self interest. And a wide range of financial authorities, from the Irish through the Swiss to the Middle East, would jump at the opportunity of having the City of London decamp to their own financial service centres.

Fortunately I suspect that the Turner proposals will largely be rejected. But even the uncertainty created by Turner's rhetoric will have a cost. And given the tax take from the City, this cost will be shared by the rest of us.

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