

[Ring-fencing is the wrong answer to the wrong question](#) [1]

Written by [Dr Eamonn Butler](#) [2] | Monday 4 February 2013



The government is proposing to 'electrify' the ring fence around retail banking activities by warning them that they risk being forcibly broken up by the Bank of England if they try to get round the fence.

Ring-fencing is the wrong answer to the wrong question. Thanks largely to the rhetoric of Business Secretary Vince Cable, many people, including too many politicians who should know better, imagine that the financial crash occurred because of the failures of 'casino banks' ? that is, the international investment banks. These, we have been told, crashed and brought down the retail banks that were attached to them. So to protect ordinary customers, we need to separate the two.

But as Miles Saltiel [showed in an Adam Smith Institute report in 2011](#) [3], it was not the investment banks that brought down the retail banks and threatened people's savings. The first banks to fail were the ex-building societies like Northern Rock that got out of their depth when they dropped their mutual status and started offering silly mortgage deals. Then it was the turn of the big banks who were buying mortgage assets ? supposedly 'safe' retail-based business ? that turned out to be rubbish.

Ultimately, it was politicians and regulators who caused the crash, by flooding the world with cheap credit and money for decades and then cutting back suddenly ? as, again, John Redwood [demonstrated in yet another Adam Smith Institute report](#) [4]. No wonder banks took risks that brought them down. And when the ex-building societies were offering 120% mortgages and other risky products, the regulators did nothing.

I certainly think that bank customers should know what the bank is doing with their money, so they can judge the risk they are prepared to take and balance safety against cost. But ring fencing does not cure any of the problems I have listed. What it might do is to deny the retail banks access to international capital, making retail banking more expensive for customers and continuing the problems faced by small businesses who cannot get loans. And since other countries have no plans to ring-fence their banks, Britain's financial sector will be setting itself at a self-imposed international disadvantage.

[blog comments powered by Disqus](#) [6]

Source URL: <http://www.adamsmith.org/blog/money-banking/ring-fencing-is-the-wrong-answer-to-the-wrong-question>

Links:

[1] <http://www.adamsmith.org/blog/money-banking/ring-fencing-is-the-wrong-answer-to-the-wrong-question>

[2] <http://www.adamsmith.org/authors/dr-eamonn-butler>

[3] http://www.adamsmith.org/files/Botched_Opportunity_ASI_2011.pdf

[4] <http://www.adamsmith.org/sites/default/files/images/stories/credit-crunch.pdf>

[5] http://disqus.com/?ref_noscript

[6] <http://disqus.com>