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The Bank of Dave and our broken banking laws [1]

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Channel 4's follow-up to the "Bank of Dave [3]" made for highly enjoyable viewing. The programme was subtitled 'Fighting the Fat Cats', but it was bureaucrats rather than Fat Cats that caused the problems.

The show followed the experience of Dave Fishwick's Burnley Savings and Loans community bank. The bank offers 5% AER to savers and small loans to local businesses, with profits given to local charities. In many ways, the concept has much in common with the old Credit Unions, Mutuals and Co-ops as well as the German Sparkasse (which, as the programme showed, have had similar struggles with regulation). Without knowing the full details of the business, it seems that Fishwick had a very successful model and a very low rate of non-performing loans.

As the programme portrayed it, however, Fishwick was lucky to survive a heavy-handed assault by the FSA. The regulator appeared to object to the simple business model and tried to impose a greater level of complexity of the savings accounts. This is typical - regulators want all banking institutions to conform to a chosen model, which may well be inappropriate. How is a regulator to know what customers want and which is the best means for suppliers to provide that? Fortunately, Fishwick is a charismatic character and was able to motivate public support and win some influential backing, particularly the support of the excellent Steve Baker MP.

This serves to demonstrate exactly why there is so little competition in the UK retail banking sector and why there have been so many financial scandals (PPI, Libor). In banking, as in any other market, regulation creates barriers to entry to small businesses. Not every small bank is lucky enough to have a crusading Dave Fishwick, but they should not need to. The regulatory barriers to entry drive consolidation and prevent small businesses entering and outcompeting established players. It is this which allows uncompetitive practices and harms the consumer. Big businesses have a symbiotic relationship with regulators and there is frequently a revolving door between the two. This is why we have ended up with banks that are too big to fail [4], but yet we still have the cry of 'more regulation' [5].

We should remember that, with the possible exception of energy, banking is the most heavily regulated sector of the UK economy. Moreover, it is one of the few sectors where the prices are controlled by the state - the nominally independent Bank of England in this case. It is ironic that populist demagogues such as Vince Cable and Ed Balls jumped on the Fishwick bandwagon, as it is they who advocate heavier regulation of the banking sector.

Competition in banking, as in any area of the economy, can only come from deregulation. Lowering barriers to entry, allowing small banks to enter and allowing *caveat emptor* by both savers and lenders (together with the re-introduction of sound money and privatisation of the Bank of England) is the only way to fix the broken banking sector.

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[2] http://www.adamsmith.org/authors/whig
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