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The hollow case for bank bonus caps [1]

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Members of the European Parliament on the Economic Affairs Committee have agreed to introduce legislation to extend the bonus cap on bankers to fund managers as well. This is an indication of the envy, ignorance and economic illiteracy that drives much European policy.

The supposed purpose of the bonus cap on bankers is to make banks safer by reducing banks' ability to reward people for taking risks. It will have the opposite effect (as nearly all regulation does). Remember when Gordon Brown and the authorities in the United States were flooding the world with cash and a boom was raging? Then, certainly, the banks did reward people for simply doing deals because every deal succeeded. We are far from that situation now, and banks are no longer taking such risks. So why limit bonuses? Pure envy at the thought of bankers earning £1m bonuses.

Well, I know the feeling. But bonuses are how businesses in volatile sectors keep their salary costs under control. In bad years people earn less, in good years they earn more. If firms cannot manage those costs because of politically-imposed caps, and have to raise basic salaries instead in order to retain staff, the policy actually increases the risks that the banking sector takes.

But what about fund managers? They do not actually take the same risks as the banks at all. So why introduce a bonus cap on them? Again, it is just envy, not logic, that motivates the new move. The customers of fund managers are savvy, large-scale, well-heeled investors. Funds played absolutely no role in creating the financial crisis: they actually took much lower risks than the banks. Wealthy customers tend to want to conserve the fortunes they have built up over a lifetime, rather than gamble with them.

It is plain that MEPs do not understand the financial industry, which is largely based in London ? much to the irritation of those in Paris, Frankfurt and Amsterdam, who seem to think that if they hobble London, the business would transfer to them. It wouldn't, of course: it would probably go to New York, Hong Kong, Singapore, Shanghai or at best Zurich.

The British government should read Tim Ambler's new ASI paper on financial regulation [3] ? and follow his advice to resist this latest, spite-inspired regulation and instead get the EU and other regulators to endorse proper competition in banking and financial services.

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[3] http://www.adamsmith.org/research/reports/saving-the-city
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