

## [Britain's financial crisis was 100% home grown](#) [1]

Written by [Blog Editor](#) [2] | Thursday 15 October 2009



One year on from the part-nationalizations of Lloyds-HBOS and RBS, a new ASI report by John Redwood MP has pinned the blame for the financial crisis squarely on the government and the Bank of England.

In [Credit Crunch: The Anatomy of a Crisis](#) [3], published this week, Redwood attacks the notion that the UK economy was well run, and that its problems were imported from the US. He blames bad monetary policy from the Bank of England, bad regulation from the Financial Services Authority, and bad fiscal policy and crisis management by the British government for the severity of the crash. Britain's crisis may have had much in common with America's, Redwood says, but it was very much home grown.

### **Britain's fake boom**

The report traces the roots of the banking crisis to the "false boom" of 2001-2007. A boom fuelled by ultra low interest rates, lax credit controls, and an explosion of lending, rather than real, sustainable growth. These economic conditions encouraged banks, like Northern Rock, to pursue an aggressive growth strategy based on selling securitized mortgages and borrowing short-term from the money markets to finance new lending. As well as driving a house price bubble, this approach sowed the seeds of later disaster.

### **Blame the Bank of England**

The Monetary Policy Committee of the Bank of England must take a major share of the blame for the crash. Redwood explains that having first kept interest rates too low for too long, it then raised them too far and too fast in 2007. They starved the money markets of cash and triggered the first phase of the financial crisis, as Bradford & Bingley, Alliance & Leicester and HBOS had to be bailed out, and Northern Rock, ultimately, nationalized. Incredibly, Redwood points out, in the year that followed the run on Northern Rock, the Bank of England acted as though nothing serious had happened, keeping interest rates relatively high when they should have been cutting them.

### **The government got it wrong**

The report argues that the worst policy mistake of the crisis was the government's. In autumn 2008, just as world markets were showing serious signs of strain, they suddenly decided to insist that the banks hold more cash and capital than they had required during the boom years. As Redwood points out:

"That was the worst possible moment to make such a request, and the worst possible thing to do when markets needed reassurance from the authorities that the banks would survive. As soon as the regulators' demands became public, confidence in the major financial institutions was undermined, and RBS and Lloyds-HBOS were forced into semi-nationalization, at huge taxpayer risk."

### **Reforming Britain's banks**

The result of this disastrous intervention, Redwood says, is that Britain has been left with a banking sector with too few competitors and too many weak balance sheets. He argues that the prime task facing the next government will be to remodel the state owned banks, splitting them up into smaller institutions to encourage domestic competition, and return them to the private sector as soon as possible. The report also suggests that banking regulation should be returned to the Bank of England, who would in future focus on the 'big picture' and set counter-cyclical cash and capital reserve requirements for the banks.

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