## The failings of regulated independence [1]

Written by Alister McFarquhar [2] | Friday 14 December 2007



The Prime Minister still likes to crow over making the Bank of England independent when he was chancellor. He is keen to take credit for every success, but when the fan gets clogged his McCavity alter ego is assumed. In any case, recent occurrences have shown the Bank's independence to be purely cosmetic: they are culpable when inflation targets are missed, but when they try to avoid moral hazard by not bailing out Northern Rock, the Treasury takes over.

What the Northern Rock debacle has illustrated is the weakness of Brown's tripartite system of financial regulation (divide and rule) where the boundaries are blurred and the Treasury maintains close control. This kind of regulation is a feature of the government's approach to everything from the NHS to quangos? and it doesn't work. Everyone who is anyone in the City knew Northern Rock was in trouble months before it collapsed through the most normal of banking failures: borrowing short and lending long. Why did the situation get so out of hand?

Another failing was highlighted by the Bank of England's decision not to inject liquidity into the markets over the summer, as the European Central Bank and the US Federal Reserve chose to. As James Harding put it [3] in *The Times:* 

Was this because it was not sufficiently in touch with the financial markets? Was it because the Financial Services Authority knew what was needed but, under Gordon Brown?s model of tripartite regulation, did not have the authority to make it happen? Was it because the Bank is mandated to meet inflation targets but, unlike the Fed, does not have an equal responsibility for nurturing growth?

All in all, the former chancellor may deserve more blame than credit for his handling of the country's financial stability. And there may be harder times ahead. As Sir Samuel Brittan wrote [3] last week, stagflation may, once again, be on the horizon.

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