

## [Throwing fuel on the banking bonfire](#) [1]

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I'm very skeptical of UK government plans to 'ring fence' or separate out the retail arms of the banks from their investment arms.

In the first place, if banks are broken up by politicians and regulators, you can be sure it will be a mess. They will be broken up in ways that simply don't work, and UK bank business will leach abroad.

Second, retail bankers need investment returns, and investment bankers need savers' cash. If you try to split them, they will do their darnedest to keep that symbiosis going. The only split that might work would be if the investment and retail banks were completely separate institutions, separately owned and capitalised.

Third, if you did split out the retail banks, it becomes 100% certain that if one of them failed, they would be bailed out by the taxpayer ? which is part of the whole ring fencing deal. And 100% certain that such bailouts would be needed.

Of course, the argument is that retail banking is all safe, traditional, Captain Mainwairing stuff, so retail-only banks would never need a bailout anyway. Hence the calls to split them. However, given the certainty that the government would bail them out to protect retail customers, the new retail-only banks would have every incentive to behave riskily, generating big returns for their savers and offering borrowers fantastic mortgage deals.

You may think that the regulators would stop such risky behaviour in a sector that is supposed to be low-risk. Forget it. If there is one certainty to come out of the 2007/8 crisis, it is that regulators are useless. There was plenty of regulation in place, but it wasn't enforced, or it proved counterproductive.

The only thing that will make banking safer is competition. There is no proper competition in banking today because banks have to be huge in order to afford the costs of all that useless regulation. To boost competition, and to overcome the too-big-to-fail problem, the answer is not to break up the banks but to make the banks' reserve requirements more onerous, the larger they are. The sector would then naturally become less concentrated, and competition would do the regulators' job. It might even split, sensibly, of its own volition. Job done.

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