We need more competition to break the banking oligopoly [1]

Written by **Dr Eamonn Butler** [2] | Thursday 28 June 2012

I've defended bankers pretty robustly over the last few years. The popular view is that their greed and recklessness sunk the whole financial system, taking us with it. Oh yeah? Well, what about the greed and recklessness of the politicians and monetary authorities, who engineered a fake fifteen-year boom built on artificially cheap credit, paper money and government debt? Or the greed and recklessness of the public who saw house prices spiralling upwards and took out 125% mortgages so they could make as much money out of the bubble as possible? Or for that matter the ineptness of the financial regulators, who had a whole kitbag full of regulatory tools, but who didn't actually see that there was a problem that needed fixing.

It's not surprising that bank business-getters were paid huge amounts to take more risks and do more deals ? because in this fantasy boomland, every risk paid off and every deal worked. Until over-indebted governments and householders could no longer afford to keep the boom going, of course.

But nobody can defend bankers on their cynical manipulation of inter-bank 'Libor' rates. It might be an arcane sort of thing to 99.9% of the general public, but the rate at which banks lend to each other is a crucial signal about the state of financial markets. It is the rate that famously soared five years ago when banks discovered that they couldn't actually be sure that other banks were as deeply polluted by toxic debts as they were. They couldn't trust their colleagues to repay, any more than they could repay loans themselves.

As the Nobel Economist F A Hayek pointed out so well, prices are an essential signalling system. They reveal the state of supply and demand. They tell people where to invest their money to generate the greatest return and, in the process, create the greatest good for the whole population of customers, merchants and manufacturers. If prices are manipulated ? by a business with lots of market power or by politicians imposing wage and price controls or unleashing inflation ? they cannot perform their vital economic function. So investors and consumers starts to make mistakes and pretty soon the whole structure gets out of kilter. Like an over-moist piece of clay on the potter's wheel, it soon becomes distorted and then spins apart.

So when you have a bank that, using its market power, deliberately manipulates the price of interbank credit in order simply to make itself look good, that is indefensible. You need to clamp down, and fast. No doubt other banks have been up to exactly the same thing. This story will run and run. And it won't make the banking sector look any prettier.

The response from the politicians and the papers is dismally predictable. They will call for more controls over bank practices, new regulations to prevent similar manipulation from re-occurring, new teams of watchdogs to look over the shoulder of traders and see what they are up to.

All a complete waste of time and money, at a moment when the last thing our economy needs is more regulation and higher taxes to pay for it. There is only one way to make sure that such things do not re-occur, and that is to make sure that firms do not in fact have the market power to sustain it. We have far too little competition in banking in the UK, far too small a number of banks. Indeed, even fewer since

Gordon Brown, bizarrely, forced through the merger of Lloyds and HBOS. Banking is an oligopoly in which the players each have far too much scale and therefore far too much power over the financial markets ? including the power to manipulate them and indeed mess them up.

The right solution is not to call for yet more regulation ? the regulators' toolkits are already bursting at the seams with regulations that either don't work or are counter-productive ? but to increase bank competition. Regulation and compliance is fabulously expensive: banks have to be huge because only huge banks can carry its cost. We actually need simpler ? and less ? regulation to encourage new market entrants and give the existing oligarchs a dose of competitive market discipline. I think we would be astonished by the beneficial result.

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