A new book, Guardians of Prosperity: Why America Needs Big Banks by Richard Bove

The Economist reviews:

IF ANY good has come out of the financial crisis that reached its peak in late 2008 it has been a plethora of useful books. These have ranged from “Too Big to Fail”, Andrew Ross Sorkin’s fly-on-the-wall account of the efforts by the Federal Reserve and America’s Treasury Department to save the banking system, to the more recent analytical work of Anat Admati and Martin Hellwig in “The Bankers’ New Clothes”. A common theme of many of these books has been that big banks are dangerous, regulations are worryingly lax and bankers are self-serving maniacs who need to be curbed.

Amid all this admittedly gratifying banker-bashing there have been remarkably few words written in defence of big banks. This is partly addressed by “Guardians of Prosperity”, by Richard Bove, a respected banking analyst with decades of experience.

Mr Bove sets out to challenge the very notion that America’s biggest banks are too big to fail. With some justification, he places blame for the crisis not on individual bankers but on macroeconomic imbalances in the world economy. Prime among these were America’s trade deficit and China’s surplus that sent oceans of money sloshing through the world’s financial system and spurred the creation of toxic mortgages in America. Also culpable in Mr Bove’s eyes were regulators, who should have stopped banks making risky loans, and politicians, who encouraged lending to people who could not afford to repay their mortgages. The cure of tougher regulation and higher capital standards, he argues, “has made things worse” by driving up the cost of financial services and making it harder for small businesses to borrow.

This book provides a timely challenge to much of the wisdom that is now accepted on the causes of the financial crisis and on the cures to prevent the next one. Yet it is ultimately an unsatisfying series of assertions rather than a reasoned argument. Capital, the author argues, plays no role in making banks safer. Yet he cites as evidence little more than a string of examples of banks that appeared to be well-capitalised before they failed, without acknowledging that capital can curb risk-taking and absorb losses. He argues that big banks are unequivocally good despite ample evidence that they pose a greater danger to the rest of the financial system than smaller ones, and are thus more likely to be bailed out by taxpayers. Trimming them, he frets, may lead to “a point when America can no longer be called a superpower” and would be “handing the baton to China”.

Regulators and their charges would benefit from a critical and thoughtful rebuttal of the current unanimity on the need for tougher regulation and more capital in the banking system. Unfortunately this is not it.