

Central banking, financial regulation and property rights

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Most constitutional formulations of human rights include the right to own property. The first part of Article 17 of the Universal Declaration of Human Rights 1948 states that “everyone” has the right to own property, while the second part elaborates this principle by saying: “No one shall be arbitrarily deprived of his property.” In practice, private property rights are less than absolute in all jurisdictions. Well known are the problems arising from 'externalities', where a divergence between private and social costs may justify restrictions over the exercise of property rights. Further, the tax system may sometimes discriminate against particular groups and hence make them worse off, so that the economic effect is the same as if they had lost part of their property. The results of new regulations can be similar in that they encroach on individuals' freedom to act according to their perceived self-interest and prevent them reaching a desired outcome.

The argument of this chapter is that the recent financial crisis has shown a particular kind of property right - that to the ownership of bank equity - to be highly vulnerable to changes in law and regulations. It will be suggested that government interventions in the banking industry in 2007 and 2008, particularly their recapitalisation packages in late 2008, had major adverse impacts on the value of banks' equity. Whether these impacts amounted to the arbitrary deprivation of property remains to be established, both in the courts and elsewhere. At any rate, the expectation must be that the new insecurity of property rights in this area will inhibit future investment in the banking industry. The chapter concentrates on the United Kingdom, where government policy towards the banking system has been punitive by international standards.¹

1. Illiquidity, insolvency and the central bank's role

Our initial focus is on problems arising from the breakdown in the international wholesale money markets in Summer 2007. These problems can be better understood if a distinction is drawn between banks' solvency and liquidity. The meaning of the term 'solvency' is somewhat different in banking from that in other industries. Generally, non-banking companies are insolvent when payments cannot be made from bank deposits as they fall due and continued trading would mislead creditors about the ultimate ability to pay. By contrast, banks can create liabilities against themselves by issuing new deposits and promising to convert these deposits into legal tender cash. Indeed, since banks can expand deposits (ie, money) 'out of thin air' by adding identical

¹ The clearest illustration of this statement is the pricing of the preference shares which a number of governments forced banks to issue in order to boost their capital. In many countries governments themselves were the only or main subscribers to these shares. In the United Kingdom, the government required banks to pay a 12% interest rate on the preference shares, compared to 5% to 8% in other nations. But in other respects also, such as its preparedness to pass legislation which would nationalise banks with limited or negligible compensation, the United Kingdom was out of line with most other industrial countries, including nations such as the United States and Canada which share its common law traditions. (But see footnote 20 on the passage of German legislation allowing the expropriation of banks.)

