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Agenda: Spanish banking lessons are lost in translation

It was the small regional cajas that got Spain into trouble. Britain's reformed banks will look much the same

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Forced mergers reduced Spain's cajas from about 50 to 10

There is still an easy way to get a round of applause from the BBC's Question Time audience. A simple mention of the word "bankers" in a spiteful tone is all it takes.

Last week it was a tactic deployed by the Scottish actor Alan Cumming — perhaps best known for playing a Bond villain. Having been repeatedly slapped down by the former Scottish secretary Michael Forsyth on various points, Cumming attempted to fight back by pinning the entire eurozone crisis on "bankers". The studio audience in Inverness duly performed its role: vigorous hand-clapping ensued.

There's no doubt about it — banker bashing is still a popular national sport. To play the game properly, however, one needs to know which banks and bankers deserve bashing most.

Spain's banking sector is this weekend at the epicentre of the euro crisis. Its banks need anything up to €100 billion (£81 billion) of new capital to plug the gaping holes in their balance sheets. Until Madrid last night agreed to ask for an international bailout, it was unclear where that cash would come from — and that uncertainty had raised the eurozone crisis to new levels.

Yet the lesson to be drawn from the crisis is the opposite of what many may think. Spain's banking problems are nothing to do with the global spread of its two giant lenders, Santander and BBVA. Nor is it anything to do with investment banking. The Spanish crisis is actually a tale of what happens when power-hungry politicians get their hands on financial institutions.

Spain's problem lies with its regional savings banks — the cajas — that lent money hand over fist to the property developers that fuelled Spain's boom. Almost all of these banks were controlled or influenced by one of Spain's local governments. The party in power would own voting shares in its local caja and sit on the board. Nobody in Madrid was paying much attention to how that relationship between local banks and local politics played out.

The cajas weren't too big to fail, they were too small to bother with — and too numerous. Until the Bank of Spain started smashing them together in a series of forced mergers there were about 50 of them. Now there are 10.

Investigators probing the caja loan books claim they have already uncovered some alarming stuff. Here's a typical scenario. A local developer that gave donations to local politicians would win public sector construction contracts from those same politicians. They would then fund the projects with loans from the pet bank in question, on extremely generous terms. Or so the story goes.

Rumours abound of much bigger scandals lurking in the caja loan books.

It sounds at least as bad as what happened in Ireland or Iceland, not least because of the scale, and provides interesting food for thought. The Spanish cajas are exactly the sort of banks Sir Mervyn King and Vince Cable pine after. They were small, local and focused entirely on retail and commercial banking, ploughing their cash into local businesses — and they have jeopardised the entire future of the European Union.

This week George Osborne will unveil the final details of the reforms to British banks proposed by the Independent Commission on Banking. They will lead to deposittaking institutions being ring-fenced from the high jinks of investment banking, supposedly making savers' money more secure.

Structurally, these new ring-fenced banks will look quite a lot like Spanish cajas. Or Northern Rock, for that matter.

Most of the British banks that have failed in the past few years would operate entirely inside the ring-fence, if they still existed: Bradford & Bingley, Alliance & Leicester and HBOS were all pure retail banks. Under this new model, they would still fall back on the state in a worst-case scenario.

So what exactly was breaking up banks supposed to achieve? They are already much more robust than they were four years ago, holding vast amounts of capital and liquid reserves in case of emergency. It is the other measures in the new legislation that reduce the likelihood of future state involvement in the sector — more complex elements buried in the detail. The part about breaking up banks is just window dressing. Is it really worth the effort?