

Funding the Future

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As [The Guardian](#) reports this morning:

A group of 58 leading economists and politicians, including the former business minister Vince Cable, has written to the chancellor to say that scaling back City regulation will put the UK at risk of another financial crash.

The open letter, which has also been signed by the former Greek finance minister Yanis Varoufakis and Columbia University professor Adam Tooze, was sent in reaction to the Queen's speech, which [outlined Rishi Sunak's plans to "cut red tape"](#) through a financial services and markets bill.

I was one of the 58. The letter is intended to make these points:

- * **We are worried because the government's approach drags us back again into past mistakes.** Having regulators focus on 'competitiveness' as an objective was, after all, found by the Treasury and parliament to have contributed to the 2008 financial crisis which cost the world economy some **\$10 trillion**.
- * **The choice to prioritise this during a cost of living crisis is also clearly totally out of touch.** The last thing people need is their employment and what small savings they have put at risk by provoking another financial crisis. Polling evidence by charity Finance Innovation Lab shows 70% of people think such a policy is 'out of touch & elitist', and 9/10 don't think it should be a priority.
- * **On a basic level it's clear the role of any financial regulator should be as a watchdog, not a cheerleader,** and the public understand there's something very dubious about changing that.
- * **The reality of promoting 'competitiveness' will be to once again set the financial sector against the real economy,** reducing real economic growth and instead encouraging short term gambling and risk taking, crowding out investment in small business and jobs.
- * **The government says they want to 'level up', but the only ones to benefit from this policy are big multinational finance companies based in the City of London that want to gamble in pursuit of short term profits.** It will suck money out of the rest of the economy, increasing inequality across the country, and dumping risks and consequences on the rest of us.
- * **It also means an inevitable reduction in standards, as companies 'race to**

the bottom'. This is one reason that a 'competitiveness' objective contributed to the last financial crisis, and it also means more corrupt and criminal money will end up in the UK

*** Instead of focussing on competitiveness, the government should be using this 'once-in-a-lifetime opportunity' (their words) to ensure that the future of financial regulation helps the financial sector play its part in tackling our real social challenges.** Why not strengthen regulatory mandates to ensure that the sector contributes to our fight against climate change, overcome deep-seated financial exclusion, or to promote stable and sustainable economic growth evenly across the whole country? Those are the kind of objectives for the future of finance we can all get behind.

In other words, the government has got it very wrong if they thinkg that deregulating the City is going to help right now.

The full letter was as follows:

The Chancellor of the Exchequer and The Economic Secretary

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Letter regarding the dangers of a competitiveness objective for financial regulators

Dear Rishi Sunak MP and John Glen MP,

We, the undersigned, are writing to express our concern about proposals for the UK's **Financial Services Future Regulatory Framework** (FRF) to give regulators statutory objectives to promote "competitiveness" after Brexit.

The Economic Secretary, John Glen MP, rightly called the FRF a "once-in-a-generation opportunity" to set the course for post-Brexit regulation. The FRF says the government intends "a greater focus on growth and competitiveness by introducing new, statutory secondary objectives for the PRA (Prudential Regulation Authority) and the FCA (Financial Conduct Authority)." Chancellor Sunak has said that UK finance should be "globally competitive over the long term."

We wholeheartedly support the government's aim to stimulate long-term UK economic growth, including through financial regulation. Yet we believe that competitiveness is an inappropriate objective for regulators, for the reasons below.

1. A recipe for excessive risk-taking

After the last global financial crisis (GFC, 2007/08), which cost the world economy some **\$10 trillion**, it was accepted that a focus on competitiveness by the then Financial Services Authority had helped cause the disaster.¹ Andrew Bailey, Bank of England Governor, said recently that we tried a competitiveness objective before, and "it didn't end well, for anyone."

The main purpose of a financial sector is to support the economy as an intermediary, facilitating transactions, savings and investment, managing risk, and so on. It can have secondary purposes, including as a source of export earnings. But these should not undermine the primary purpose.

2. Harm the real economy

While the financial sector supports the UK economy in many ways, it also can compete *against* parts of it. Four examples illustrate this tension.

1. High pay in finance creates a domestic brain drain drawing talented people (and resources) out of other economic sectors. The economist Andrew Haldane called it "a great sucking sound as both people and monies were drawn into banking," hitting R&D-intensive firms hardest and crowding out "the very businesses that today we are seeking to re-nurture."
2. Before the GFC, financial-sector actors profited by taking large risks, then taxpayers across the UK shouldered the burden when those risks crystallised into crisis.
3. Large net foreign inflows into UK finance can raise the real exchange rate, potentially making other sectors (e.g. manufacturing) less competitive against exports, in a "Dutch Disease".
4. Inflows of money and investment into the UK from Russian state-backed actors benefit UK finance, but the Ukraine crisis reminds us of the long term damage to national security.

UK finance is disproportionately located in parts of London. Promoting its international competitiveness will also intensify this competition against other parts of the UK economy, which are disproportionately located elsewhere in the UK. So a competitiveness objective will likely undermine the government's 'levelling up' agenda.

3. Reduced economic growth

The FRF talks of a "*growth and competitiveness* objective," but those two goals may be in conflict. The above examples of misallocation of resources do not only involve redistribution of resources from other parts of the economy to finance, but may well reduce overall economic growth too. Indeed, there is extensive evidence in econometric research, including that conducted by the Bank for International Settlements, that excessive growth of a financial sector beyond a certain point starts to retard economic growth.²

That literature reports that a country can have 'Too Much Finance' that comes at a cost to the rest of the economy, when credit to the private sector exceeds around 90-100 percent of GDP. While there is some contestation in the literature on this point,³ it is clear that some parts of the financial sector are potentially harmful. Since the GFC, credit to the private sector in the UK has ranged from 160-180