Funding the Future

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The UK suffers from a finance curse. Far from being our economic jewel, the City of London has drained trillions from the economy. That’s lost jobs, lost investment, and a weaker democracy. In this video, I explain why finance is making Britain poorer — and what must change.

https://www.youtube.com/watch?v=Ssa_4TqpxVg?si=NTrBk_srV1rxdK6C

This is the audio version:

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This is the transcript:

The UK has a finance curse.

What do I mean by that? My point is that the financial services industry in the UK is so large that it's actually harming our prosperity.

Far from the City of London, being the jewel in the crown of the UK economy, it's actually dragging us down. That is what a finance curse means.

And to put a figure on this, the cost could have been at least £4.5 trillion over a period of 20 years, and that estimate was made a while ago, so it's probably gone up significantly by now.

So, let me explain this. What do I mean by a curse?

A curse is quite literally the opposite of a blessing, and in economic terms, what this means is that far from finance now being a productive activity in the UK economy, it's extractive. In other words, it's withdrawing value from the economy, and we are worse off as a result of it.

Finance is serving the interests of a few at cost to the many. And far from creating wealth, it's reducing the overall value of wealth in our society.

Now, the scale of the loss that I'm talking about here is based upon the estimates prepared by Andrew Baker, my Sheffield University colleague, and others in 2018.

I stress, the estimates are now out of date. They're based on the period 1995 to 2015. But if anything, the figures will be higher because nothing has really changed in the meantime. And their estimate was that the loss in growth potential in the UK over that period of 20 years was £4.5 trillion.

Again, because of the inflation, that number would now be well over £6 trillion without any further adjustment.

But the point was it was equivalent to 2.5 years of average GDP, or national income, over that 20-year period, which means that one year in eight of our productive capacity was lost because we were doing too much finance. Now that's a staggering drag on our national well-being.

So this is really important, and as Andrew Baker and his colleagues pointed out, the cost would be even bigger if we looked at the wider distributional elements with regard to the consequences of the finance curse. They suggested then that because of the false allocation of resources in society, and the inequality that resulted, the cost could have been £5.2 trillion rather than £4.5 trillion.

So this data suggests that the negative cost of too much finance might be dramatic in the UK, but they also contextualise that by comparing the UK with the USA, where, although there is a very large, if not larger, finance sector, the costs are one-third in terms of the imposition of that finance sector on the economy as a whole, because it is less distorting overall than the UK finance sector is inside a relatively smaller economy.

Let's just have a look at that £2.7 trillion, which is part of the total loss.

This is the cost of the misallocation of resources that is included in the £4.5 trillion cost that I've already mentioned. That cost as a result of the misallocation of resources arises because the city drags money away from all other activity in the UK.

It drags money away from the investment in productive industry.

It drags highly talented people away from doing jobs, which will be of greater benefits than the one that they do inside the City of London.

And the consequence is a cost of £2.7 trillion over 20 years, or one and a half years of lost GDP over that period.

The rest of the costs that they calculated was £1.8 trillion as a consequence of the 2008 financial crisis. Of course, we've had another financial crisis since then as a consequence of COVID, and so those costs could already be higher. But put the two figures together, £ 2.7 trillion of cost as a consequence of the misallocation of resources towards the City of London when they could be better used elsewhere, and the cost of the crash, which had everything to do with the City of London in 2008 and we come to a total cost of £4.5 trillion, and that cost is ongoing.

The consequence of this is that the data suggests that the UK economy may have performed much better if the financial sector was smaller and if finance was more focused on supporting other areas of the economy rather than trying to act as a source of wealth generation, or extraction, in its own right.

So what we're seeing is this form of misallocation. The City is favouring speculation over investment.

It's dragging people who could be doing something useful - physicists, mathematicians, people who could be training in high-level skills in other activities, or simply teaching, and we know we have a shortage of those skills in teaching - into the City of London, where they're adding no value at all.

But worse in some ways, at least with regard to the economy, the City is creating price distortions. We've seen the excessive cost of housing and how that has risen over the period that was reviewed by Andrew Baker and his colleagues.

We've seen that this has put a squeeze on the real economy.

We know that people who are renting in London are now paying 40% of their gross incomes in rent on occasions.

We know the enormous financial burdens that are being created on people who manage to get mortgages when they are relatively younger in life, but we know that people can't get mortgages relatively young in life anymore, precisely because of the cost of inflated housing assets.

And all of that is because of the excesses of the finance industry.

Don't blame a lack of houses for this. There are enough houses for people to live in in the UK. The fact is that the ownership of those houses is too concentrated in the hands of people who are not actually living in them because of the actions of finance.

Put these activities, dragging the economy towards speculation, dragging people out of real work and creating price distortion, and you end up with crippled productivity within the economy as a whole. If our Labour Party government wants to discover the answers to falling productivity in this country, this is it.

We are effectively suffering what is called a Dutch disease. The name was created when the Netherlands first found oil. There was so much oil coming out of the North Sea into the Netherlands at the time that the value of the Dutch currency at the time was so inflated that it was impossible for any other business activity in the Netherlands to possibly trade effectively because they simply couldn't export. They were crowded out by oil. And that's the case with finance in the UK.

Finance has so misplaced our expectations over a wide range of areas - including pension allocations, by the way - that other activities are now literally unaffordable. Housing is unaffordable because finance has made pensions via buy-to-let properties the dream of too many. Young people are suffering as a result, and regional imbalance is fueled by the fact that the Southeast of England is so wealthy compared to everywhere else. We are seeing the crowding out in our economy in the same way as the Dutch did because of oil in their economy when they first got their hands on it.

But let's be clear about this. The benefits of this concentrated wealth are in the hands of too few people. The vast majority of people in the UK, and our series on wealth shows this, are getting none of the benefit. Over 90% of people in the UK aren't terribly wealthy, but some are really exceptionally wealthy.

And wages have also stagnated outside finance. In real terms, many people have not seen increases in their wages in the UK for decades, but finance has. Inequality has as a consequence, become structural, and there's been a great danger to the country as a whole as a consequence.

Policy has been captured by the interest of the City of London. Time and time again, we see this; we see the Financial Times and the other heavyweight newspapers demanding action on tax, on government spending, on the supposed excesses of a government that is trying to actually simply deal with the problems inside our society, and that they do not wish to be addressed. And the danger is that they're heard. Rachel Reeves is very clearly in their pocket, and so is the Bank of England.

The consequence is also deregulation and light-touch supervision. And again, we're seeing that happening once more at present, under the guidance of the Bank of England, who are driving us towards light-touch regulation once more, and that has always ended in tears.

There is, in addition, a political dependence on money from finance. We're seeing that in the UK. The power of donations is clearly distorting the policy of our current Labour government. It was done the same in the USA. And democracy, as a consequence, is being severely weakened

As a case study, the 2008 financial crisis is perfect. The collapse was driven by financial excesses. Too much lending for mortgages. Too much lending to businesses based on property valuations. An excessive enthusiasm for the fact that the bubble could keep on going, and then it didn't. There was a crash, and the bailout was at cost to the public. We had over a decade of austerity as a consequence, and then we got the COVID crisis, and everything has carried on since then. The aftermath has effectively been continual social harm. The finance curse has human consequences.

But let's put those consequences in the context of what we hear all around us.

We keep on hearing a myth that the City is Britain's economic jewel in the crown. Rachel Reeves says it. She actually believes this. But the reality is that the evidence shows that the economy is being dragged down by the City of London.

And there's a myth that finance creates wealth. But the reality is, very often the money that has gone into the City is used to extract value for a few and destroy value for many.

This is a crisis. It's a crisis to which we are all vulnerable. And the UK is particularly vulnerable because of our deep reliance on the City, on our light-touch regulation culture, our dependence upon a private housing market which is larger than in most other states, and the weakness of our industrial strategy, which has never tried to find an answer beyond the City of London ever since Margaret Thatcher pinned all her hopes on it in the 1980s.

The consequences are clear.

We have low wages. Insecure work. Poor public services. A housing crisis - particularly with regard to social housing or housing for those on low incomes. And now we are seeing political disillusionment. People are alienated from government itself because they cannot see the reason for believing in government when government only believes in the City of London.

So what can be done? We need to recognise the problem. We need to change the narrative. We need to talk about the finance curse. We need to talk about how we can solve it. We need to shrink finance to its useful core. I'm not saying finance has no purpose, that would be absurd, of course, we need finance, but we don't need it to wag the dog. We need it to be the tail on the back end of the dog, and that's it.

So we've got to get this relationship right. We've got to regulate finance properly. And we've got to tax fairly, including wealth. We've got to invest in the real economy. And we've got to invest in the care economy.

Markets won't do this.

The state must lead reform.

Democratic accountability, in all of this, is essential because without it, we will not take people on this journey. And the journey is one to the point where finance serves society and does not rule it.

This is a progressive agenda.

It requires tax justice to close loopholes and end secrecy because they are part of the basis of the distortion that the finance curse has created.

We need public banking.

And we need public investment institutions who are accountable to the people who save with them. We need to look again at the mutuality of savings activity.

We need an industrial policy that is balanced for real growth and sustainable growth, but does not focus on finance.

And we most definitely need strengthened regulation.

The finance curse has cost us dearly. Growth has been suppressed. Inequality has been entrenched. Democracy has been weakened, but, and this is my key point, change is possible, but it's urgent. We have to end the finance curse; unless we do, we haven't got a viable future for most people in this country.

The City has to be put back in its box.

Comments