Lobster 58

The economic crisis

Robin Ramsay

The tune changes

The headline in *The Guardian* 29 July 2009 was 'Mandelson backs British ingenuity to engineer a new industrial age'. Lord Mandelson was quoted as saying:

> 'We, like other governments, had taken for granted that our wealth would continue to be generated from the size of the financial sector, and that this would be replicated in the coming decade – but it won't.'

From the former MP for Hartlepool, the belief that 'our wealth [had been] generated by the size of the financial sector', is an astonishing piece of self-delusion. Did Mandelson look round his run-down constituency and think the wealth was coming from financial services?[1]

In *The Telegraph* 27 August 2009 , 'Lord Turner puts in focus regulators' task', Philip Aldrick stated:

> 'financial services accounts for 7.1pc of GDP, our second biggest industry *after manufacturing* and proportionately one of the largest among leading nations. In the past 10 years, the financial services industry has grown by 1.2 percentage points of GDP. In the same time, manufacturing has shrunk from 19.4pc to 13.3pc of GDP.' (emphasis added)

1 As an exercise, ask yourself which economic changes *would* regenerate places like Hartlepool, say, (or Hull, where I live); then ask yourself if those changes are compatible with membership of (a) the World Trade Organisation and (b) the European Union. (Never mind whether or not they would be compatible with lower carbone missions *etc*.)

So financial services are only 7.1% of GDP. Even after three decades of policies indifferent, if not positively hostile, to manufacturing,[2] and a decade during which a 6% *decrease* in manufacturing GDP has been traded for a little over 1% increase in financial services, manufacturing remains almost twice the size of the financial sector.[3] Yet it has apparently taken the financial crisis to reveal this simple fact to NuLab. The City will not feed and heat and clothe and employ us all and we have to look elsewhere. So manufacturing is suddenly back on the agenda. At any rate back on the agenda of ministers' speechwriters.

The delusion about the size of the City is at the centre of the current problem. In so far as there was any theory behind NuLab's relationship with the City, it was the belief that the City was the UK's comparative advantage[4] in the world economy as we moved into a post-industrial 'knowledge economy'. Precisely what this new economy would look like, and how having a financial hub in London was going to benefit – say – the voters of Hartlepool was never explained.

Fear of the City

But London-as-world-financial-centre was tied in with another part of NuLab's economic thinking, the fear of what the City could do to a government it didn't approve of. Like the City's size and contribution to the economy, this was also grossly exaggerated. In the days of fixed currencies, yes, the moneylenders could organise 'a run' on the pound, and force the government to use reserves or, in the worst case, borrow from the IMF to maintain the value of sterling. But with floating

2 A case could be made that the John Major governments did better by manufacturing, thanks due in some part to Ken Clark as chancellor.

3 Admittedly all these figures are little better than educated guesses and can be inflated/deflated by changing definitions.

4 <http://en.wikipedia.org/wiki/Comparative_advantage> Robert Henderson writes about comparative advantage in his essay in this issue. See p. 81/2.

currencies, in a global financial economy, in the long run there is little they can do. If the global economy diminishes what governments can do, it also diminishes what cabals of financiers can do. Profit is the only motive in global finance. The data considered by currency traders round the world does not include political approval or disapproval. NuLab didn't understand this. Their initial posture towards the City was fear mixed with butt-kissing. As chancellor, Gordon Brown may have famously not worn the expected dinner suit for his address at the annual meeting of the City bigwigs, but as his central policy that night he gave them Aleister Crowley's notorious credo: *do what thou wilt shall be the whole of the law*. NuLab would continue to offer London to the world as a barely regulated financial playground.

And there was an apparent up side for the government: as the City grew, so did its contribution to the exchequer. There has been much talk in the last year of the City as the goose which lays the golden egg, terribly important as a source of taxes to the exchequer, too important to be tampered with. We were told recently that the combined taxes of the financial sector, i.e. the City plus all the rest, in 2007 was £67.8bn, 13.9% of the total.[5] Assume, for the moment, that the figure is genuine, (though, in a report paid for by the City, the chances are good that the figure is overstated). Let us say that half of this, 7%, is generated by the role of the City as a world financial hub. Let us say that NuLab introduced policies which the international banks did not like and and half of them unplugged their laptops, put their houses on the market and moved somewhere else. That would only be about 3% of the UK total tax take. Significant, but not cripplingly so.[6]

5 According to a report by PricewaterhouseCoopers for the City of London Corporation, the financial sector employs 1.04m people, including 450,000 at the 336 domestic and foreign banks operating in the UK and 320,000 in the City alone. The report is available at <www.cityoflondon.gov.uk/>

6 Thinking along similar but much more detailed and technical lines is a report at </www.cresc.ac.uk/publications/documents/AlternativereportonbankingV2.pdf>

But this government has no intention of tampering with the imaginary golden goose. It has done nothing of substance to reduce London's role in the next financial bubble and crash. And one there will be: not only because the government will allow banks to carry on as before, but because technology will create one. Computers and clever brains mean that economic trends are almost automatically 'bubbled' by the panoply of gambling activities made possible by computers, none of which this government (or the next; or any conceivable British government yet) is thinking of prohibiting.

The EU to the rescue?

They may yet not need to: the European Union may do it for them. The EU is discussing proposals for a European Systemic Risk Board and three supervisory bodies: a European Banking Authority, a European Insurance and Occupational Pensions Authority and a European Securities and Markets Authority, planned to come into being at the end of 2010.

Precisely what these will do, if they get created, is not clear. But the threat is alarming the City's boosters. In October the Commons Treasury Committee announced 'an urgent inquiry over fears that European Union plans for financial regulation and supervision could damage London's pre-eminent role as a world financial centre.' [7] And Ruth Lea, erstwhile director of free market propagandists the Centre for Policy Studies and the Institute of Directors, said at a conference in September:

> 'I am extremely worried about the City of London. Britain may be able to influence EU regulation, but we won't be calling the shots. *Britain should consider the nuclear option of leaving the EU*.' [8] (emphasis added)

We shall see. A lot of politics lies in front of the implementation

7 <www.accountancyage.com/accountancyage/news/2251690/eu-plans-damage-london>

8 <www.bloomberg.com/apps/news?pid=20601102&sid=aoK0x3qYrfCI> Lea has never been a fan of the EU.

of any effective proposals: the American financial system, which has a near complete grip on the thinking of the governments of the US and UK, is not going to sit still for anything meaningful in the way of regulation. Meanwhile Gordon Brown will continue to put forward great proposals for global action, such as the so-called Tobin tax, which he thinks will make him look good but have no chance of being implemented.