Lobster 60

The crisis

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The doom loop

We are now into the 'doom loop' described last year by Bank of England officials Alessandri and Haldane in which the banks, having discovered that their respective host states do not have the courage to regulate them, say 'Thanks for the bailout' and carry on gambling as before.[1] Another great financial crash is thus very likely (and some will be making bets on that, of course). Will Hutton described the return to business as usual as 'breathtaking and depressing'.[2] Also absolutely predictable. After all, for the most part these are people who are solely interested in their own salaries and bonuses. Why would they desist? An insight into this world was provided by the account of a conference call between Ireland's finance minister Brian Lenihan and 'the bond vultures' which descended into farce and chaos as what the *Telegraph* called 'the investors' began heckling Lenihan, making 'monkey noises' and shouting 'short Ireland'.[3]

A paper published by the New Economics Foundation, *Where did our money go?*, made this interesting suggestion:

'the scale of the current cuts in public services is

1 See p. 114 of *Lobster* 59.

2 Will Hutton, 'The banks have refused to mend their ways. Beware the next crash', *The Observer*, 13 June 2010.

3 Harry Wilson, 'Ireland's finance minister Brian Lenihan ridiculed by City investors', *Daily Telegraph*, 1 October 2010.

> partly dictated by the Coalition government's covert provisioning against the need to bail out the banks again, in the not too distant future.'[4]

The core belief of the major political parties and the mass media in this country is that the financial services are very important and governments tinker with them at their peril. But few seem to be sure exactly how important; and even fewer think it worth trying to find out. In the edition of the BBC's Robert Peston's *Who Runs Britain?* (2008) published after the big financial crisis broke, he devotes almost two pages to telling us how critical the City is to British society and economy, without giving us any figures on its actual size in the economy.

It is not surprising that London-based political and media systems think the money men are very important: it is hard to live in London and not be affected by their presence in some way – if only in the absurd price of houses, driven from the top by the enormous sums a few thousand people in the City are willing to pay. For most people outside London, however, a bank is just somewhere that's got an ATM on the High Street (or is a Website) and handles your income and standing orders.

It is obviously true that the City is a significant part of the British economy; but, as I quoted in the previous *Lobster* (p. 114) the latest estimates put the financial services sector of the economy at only slightly more than half the size of the manufacturing sector.

> '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

4 <www.neweconomics.org/>

GDP.' [5]

The loss of 5% of GDP via shrinking manufacturing under NuLab explains much of the growth of the government deficit: less economic activity, fewer taxes collected, higher welfare payments; and so borrowing to make up the gap between government expenditure and income.[6]

The song changes

To my ear there has been a change in the way the City presents its significance. With the possibility of government and/or EU regulation in the air, the story seems increasingly about how much the City contributes to the government's tax base; and thus – this is the threat – how much income the state would lose if the banksters left the country. As the EU began moving slowly forwards with its proposed financial regulation package, the CEO of Goldman Sachs warned:

> 'Operations can be moved globally and capital can be accessed globally.'[7]

The *Telegraph* commented:

> 'His warnings raised fears that Goldman Sachs, which employs 5,500 staff in London and pays more than £2.5bn to the UK exchequer, could scale back its British operations.'

5 Philip Aldrick, 'Lord Turner puts in focus regulators' task', *The Daily Telegraph* 27 August 2009 and repeated in 'General Election 2010: a fact checker for the leaders' debate on the economy', *Telegraph* 7 October 2010.

6 It is curious that the insurance group RSA (the merger of *Sun Alliance* and *Royal Insurance* in 1996) wrote in a recent press release that 'The City contributes around 2.5% to the UK's GDP'. <www.rsagroup.com/rsa/pages/media/ukpressreleases?type=press&view=true&ref=533>. Even among the City's major players there is little agreement.

7 Harry Wilson and Jamie Dunkley, 'Banks could leave Europe over regulation, warns Goldman Sachs chief Lloyd Blankfein, *Daily Telegraph* 30 September 2010.

According to another *Telegraph* piece a quarter of London-based hedge funds have left for Switzerland, costing the Treasury £500 million in lost tax revenues.[8] (But a piece in the *Financial Times* in October reported that there has been only a very small exodus of bankers.[9])

But what if – say – half the mobile, international banksters did leave London? How much taxation does the City pay?

In December 2009 the City of London corporation issued its annual report on the City, by PricewaterhouseCoopers, *Total Tax Contribution of UK Financial Services*, which claimed that financial services (undefined) contributed £61.4bn in tax during 2008/09, this being 12.1% of the total UK tax take. One could quibble with the figure: it's an extrapolation from 38 firms; maybe it exaggerates a little in favour of the people who commissioned the report. But even if we just accept it as true, para 3.6 of the report states:

> 'The data provided for FS companies for 2009 shows that the retail and commercial banks..... represented 46.1% of the CT (corporation tax) payments, 61.9% of taxes borne and 59.5% of taxes collected. [9]

'Retail and commercial banks' are what you and I think of as banks, high street banks, and the figures tell us that they generated 46.1% of corporation tax paid by the financial services sector. And they are going nowhere. So let's say something more than half the tax paid by the City is paid by the foot-lose international bankers; and let's say half of them left for lower taxes and fewer controls elsewhere. That's (say) 25–30% of total tax paid by the financial sector; and 25–30% of 12.1%, the sector's total tax contribution in 2008/9, is about 3–4%. Let's say 5% to include the fact that these are

8 'Treasury 'will lose hundreds of millions of pounds' in tax as hedge funds move abroad', *Daily Telegraph*, 2 October 2010.

9 Megan Murphy, 'Banker exodus fails to hit City', *Financial Times*, 15 October 2010.

high income earners some of whom pay income tax.

3% of GDP was my guess in *Lobster* 58 was to the potential loss if half the international banksters left London. This I concluded was significant, but not cripplingly so. And even at 5% of the tax base this remains my view. Could the Revenue not find 5% if they were allowed to go after tax avoiders?

The pity is that no-one of any weight within British politics is willing to simply say to the banksters: 'If you don't like it here, piss off. And if you do we'll try and ensure that you never do any business in the UK or with the UK government.'

The costs of the City?

The endless stream of articles and press releases about the benefits to the UK of the City never mention the costs incurred, starting with the destruction of a large chunk of manufacturing by policies sought by the financial sector. I don't know how one would go about doing a cost-benefit analysis of the City in the British economy and when I googled 'the economic cost of the City of London', and 'cost-benefit analysis of the City of London', with and without the inverted commas, I got the replies, 'No results found'. Is it possible that no-one has ever done an analysis of the cost to the UK economy of being the host body of the City of London?

Greed

One of my correspondents, a financial journalist, points out that if you read the transcript of the class action suit currently being pursued against AIG (American International Group),[10] whose London operation was one of the cores of the present

10 <www.barrack.com/media_center/documents/AIG_Consolidated_Complaint.pdf>

crisis, you will find among the testimony that:

> 'CW (confidential witness) 1 stated that AIGFP (American International Group Financial Products) could have protected itself by hedging its credit default swaps, but did not do so because "their [AIGFP management's] bonuses were highly dependent on revenue out of that book of business" and if they had incurred the added cost of hedging "it wouldn't have been much of a business". This was confirmed by CW4, who stated that "if you had to hedge the business it would not be an economically viable line of business."
>
> According to CW1, the decision not to hedge the CDS [credit default swaps] portfolio was not due to "conservatism" – as defendant Forster stated – but because "they were being greedy". In short, AIGFP's top management, including defendants Cassano, Frost and Forster, put the Company at greater risk in order to increase their own compensation.'

If you read the piece by someone with the moniker WhistleblowerIRL and subsquent responses to it, [11] you will learn that part of the Irish economic disaster was fueled in part by Irish-based banks simply ignoring the rules governing the amount of capital they should retain. WhistleblowerIRL writes:

> 'I resigned from my position as the risk manager of a foreign bank operating in Dublin in 2007. We breached minimum liquidity requirement by BILLIONS of Euro on a regular basis.'

The American banksters as scapegoats for empire?

On The Baseline Scenario, the very good site hosted by former

11 Somewhat confusingly laid out at <www.guardian.co.uk/discussion/user-comments/WhistleblowerIRL>

IMF chief economist Simon Johnson, this comment from *rayllove* appeared about the financial crisis.[12]

> 'What has made our economy, and our culture, what it is, has more to do empire building than it does bankers and financiers. *The "banksters" are merely scapegoats*, a convenient distraction that is part of an excuse based on a premise of there only being "a few bad apples". This diverts scrutiny away from the true cause of the economic downturn. The actual cause of the mess though reveals just how jingoistic the US has become, and if revealed, *this vast effort to control and dictate the planet* would be met with much more resistance than it currently is, both domestically and abroad, especially abroad.'
>
> 'If a genuine effort were being made to analyze what caused the global downturn that would start with the fact that *cutting taxes during 2 wars was made affordable by foreign inflows*. The trade surpluses and other dollar holdings that are recycled back through the US, in of course mostly T-bills, is a clever way of minimizing competition from foreign investment. This "recycling" takes vast sums of dollars out of foreign hands and puts this capital in US hands at a very low cost. This allowed the US government to fund its obligations which in turn made the tax cuts doable and that allowed US investors increased capital formation. But it is the minimizing of foreign competition that is critical to consider, and, it is this "exorbitant privilege", as de Gaulle put it, that is most worthy of scrutiny.'
>
> 'Bernanke did of course testify before Congress and explain how foreign inflows combined with excessive leverage to provide the source of excessive liquidity. Naturally, Bernanke did not mention the dollar

12 <http://baselinescenario.com/2010/11/03/the-white-house-needs-elizabeth-warren-now-more-than-ever/#more-8184>

> hegemony but if the cause and effect clues are traced back it is somewhat obvious that most of the "financial innovations" would not have been possible without the massive foreign inflows due to their downward influence on interest-rates. *So the inflows definitely came before the "innovations", broadly speaking.* But of course this implicates the US Government as opposed to a "few bad apples". And ultimately, the causal trail leads back to dollar hegemony taken to an irresponsible and misunderstood extreme......'
>
> 'US economic policy and the vast effort dedicated to empire building, maintenance, and protection, have become so intertwined that they are one and the same. Yet, somehow we settle for the "it was just a few bad apples" diversion. Then it follows that when those who are the most culpable, (government officials, [military included here]), do not push to prosecute those who are mostly just sullied scapegoats, (bankers, financiers), we are left to wonder why? But we are simply being duped again, and those who can provide intellectual support for the diversion, they will be rewarded again. They will be our most respected writers and journalists, professors, public officials, economists, and etc. And so goes the duping.' (Emphases added.)

This is a useful reminder not to just concentrate on the bankers. Yes, you only get currency hegemony when you have military hegemony; the dollar follows the fleet. But are the bankers and financiers just 'sullied scapegoats'? Do you think that's how these masters of the universe see themselves?

UK subprime

The really important moves that are happening are hard to keep track of, as well as being intrinsically difficult for an outsider to understand. The re-regulation of the banksters – if there is to be some – is the critical issue. So we ought to be reading things like the response from the Council of Mortgage Lenders (CML) to the Financial Service Authority's consultation paper on new regulations.[13] But who has the time? It would take days to digest this properly but I noticed two things as I skimmed it in about ten minutes.

You and I might think that lending money on the basis of nothing more than what the applicant says he or she earns and owns – so-called self-certification; a.k.a. liars loans – is the quintessence of irresponsible lending. Not so the CLM.

> 'We recognise that self-certification is a higher risk product, that it has been abused in the past, and is not a mass market product. We warn against banning self-certification without a clear understanding of how borrowers with complex incomes and the self-employed would not be excluded from the market.

Dontcha just love it? Self-certification was abused (so not the fault of the 'product'); and let's not forget those poor self-employed people who have no means of demonstrating what they earn! (How did the self-employed ever manage before?)

Secondly, an analysis done for the the CLM and included in their response, concludes that if the proposed new tougher lending policies were introduced,

> '19% of current borrowers, or 2.2 million individuals would not be able to borrow at all and a further 30% (3.4 million) would see reduced borrowing.'

By the proposed new standards a fifth of the current mortgages should not have been given; so there's the size of the UK's subprime problem – and one of the reasons we are going to have low interest rates for a long time, with or

13 Response by the Council of Mortgage Lenders to 'Mortgage Market Review: Responsible Lending 15 November 2010 at www.cml.org.uk/cml/home

without (more likely with) inflation.