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What Has the Financial System Ever Done for Us?

Aeron Davis

The Rise of Big Finance: Despite the financial crisis of 2007-08, finance has been and generally still is, regarded as a big economic success story for Britain. First it provides many functions any good economy needs: the means to invest capital in the economy, facilitates ordinary banking, savings, loans, pensions, insurance and so on – all necessary features for any economy. But, ours is particularly large. In the UK, the sector employs around a million people now. Each year it contributes tens of billions in taxes to the Treasury.

More than that, the City of London, along with New York and Tokyo, is regarded as one of the three main centres of the global financial system. It also is one of the areas where we export rather more than we import. We don't have many export success stories – but finance is one – again contributing a 60-70 billion trade surplus. And this is one reason big business and the Treasury is terrified of Brexit. This narrative is why successive UK governments have continued to defend the sector.

Problems: Now, I could attack this picture of the UK financial sector on lots of grounds. The costs of the bailout of banks, plus quantitative easing, plus government bank guarantees, amount to more than a £trillion, and cancel out all that many years of that tax take – not to mention the knock on effects of the recession that followed. The financial sector facilitates tax evasion and avoidance on a huge scale – over £125 billion a year on some calculations. The extreme salaries and bonuses that are paid to those working in the financial sector. The ongoing fraud and scandals, which have amounted to over $235 billion dollars in fines for all banks since the crash since 2008.

A Giant Hoover for Money: But, what I'm going to focus on is how the sector has sucked the life out of the real economy. Instead of taking and investing money in the real economy, it's sucked it out and used it to invest in the global financial system. Over several decades, it has expanded exponentially. So, for example, back in 1980, total UK bank assets were roughly half of GDP and had been for half a century. By the time of the financial crisis they were five times GDP. The value of the UK stock market, bond markets, and so on, all multiplied many times. A large part of this expansion comes through the creation of money within the financial world and through complex financial instruments such as derivatives. And, a large part also comes through privatizations of state assets, investing our pension funds, personal mortgage and credit card debt. By the time of the financial crisis personal debt had grown to over £1trillion.

Investment in Abstract, Disconnected Financial Markets: We are told that this money is being invested in companies and the wider economy. But, the truth is, that connection has been broken long ago. Some 97% of 'money' in the economy is actually just circulating around the financial sector. Only 3% is lent to firms and individuals operating in the real economy. Quantitative Easing, the policy of the Bank of England – which amounts to nearly

£450 billion now – has not put that money in the real economy either, but just added to this abstract financial investment pot.

The LSE and Companies: The main example I know about is large UK companies of the kind quoted on the LSE – the FTSE 100. And, a whole range of studies have shown how, over the years, stock markets have been continually reshaped to serve the needs of financiers rather than the real economy. Deregulation and the tax system, have been shifted in various ways, to encourage this, and often at the expense of real companies and industries. The principles of organisation have always been: shareholder value above all else and free flowing, frictionless markets that encourage lots of transactions.

Back in the 1980s, taxes on shares, bonds and dividends were steadily reduced or eliminated altogether. So was VAT on financial services. Sadly, those tax losses were made up in the real economy. So, capital investment allowances for real machinery and plants were removed, and VAT on real world goods and services increased. Barriers to company takeovers were steadily whittled down. Again and again, governments, both Conservative and Labour, have bowed down to the lobbying of the financial sector, and done what was required to grow our financial sector as a 'world leading industry'.

Consequences: If you compare us to the leading G7 economies, or in many cases, the larger pool of OECD countries, the UK: has had the fastest decline in its industry over the last three decades, it has the lowest levels of investment in research and development, it is about the easiest place in the world to do takeovers – including double the rate in the US, lowest rises in productivity. The average length of time a company share is held by an investor has gone down from 8 years, in the 1960s, to 3 months now. Almost all top companies working out their payment metrics for CEOs, use something related to the rise in share price as the key measure. In a recent survey, three quarters of top managers said they would avoid investing in projects with potential long-term value creation if they were damaging to short-term earnings. I've interviewed many top CEOs who admit they are under constant pressure to do things which increase share price in the short-term or face a sell-off of their shares, a takeover or dismissal. So, they cut investment, sell off assets, do their own takeovers, lay-off workers, etc. all to do that rather than invest in the long-term.

Make Finance Less Profitable and Real Investment More: What's my answer. Well, apart from dragging financiers more under the spotlight, making rather more of them go to jail for their actions – hardly anyone ever does – my simple answer is make finance less profitable and make investing in real industry more profitable. Discourage all that anonymous short-term financial trading, tax avoidance and take-over activity through taxes and regulation and legal means. Encourage investment again in research and development, apprenticeships, regional development, etc. Make those useless aspects of finance less profitable, which means real investment will be more.