Policy Matters

Political Studies Association | BJPIR

The British Journal of Politics and International Relations
2016, Vol. 18(1) 255–269

DOI: 10.1177/1369148115612793
bpi.sagepub.com
SAGE

The Finance Curse: Britain and the World Economy

John Christensen[1], Nick Shaxson[1] and Duncan Wigan[2]

Research Highlights and Abstract

- Outlines harms caused to countries hosting an oversized financial sector
- Argues Britain is subject to a Finance Curse, which carries many similarities with the Resource Curse, afflicting mineral-exporting countries
- Provides a narrative and framework to analyse the political economy of finance and financialisation

The Global Financial Crisis placed the utility of financial services in question. The crash, great recession, wealth transfers from public to private, austerity and growing inequality cast doubt on the idea that finance is a boon to the host economy. This article systematizes these doubts to highlight the perils of an oversized financial sector. States failing to harness natural resources for development led to the concept of the Resource Curse. In many countries, resource dependence generated slower growth, crowding out, reduced economic diversity, lost entrepreneurialism, unemployment, economic instability, inequality, conflict, rent-seeking and corruption. The Finance Curse produces similar effects, often for similar reasons. Beyond a point, a growing financial sector can do more harm than good. Unlike the Resource Curse, these harms transcend borders. The concept of a Finance Curse starkly illuminates the condition of Britain's political economy and the character of its relations with the rest of the world.

Keywords
Finance Curse, financialisation, international political economy, UK economy

Introduction

The argument for the utility of finance is well-rehearsed. Liquid and deep financial markets reallocate capital from savers to borrowers, ensuring that funding is directed to those best able to use it. The notion that finance is essential to economic development has a long lineage (Schumpeter, 1934). Financial systems act as efficient information processors, centralising the dispersed knowledge of market participants to generate prices reflecting

[1]Tax Justice Network, Chesham, UK
[2]Copenhagen Business School, Frederiksberg, Denmark

Corresponding author:
Duncan Wigan, Copenhagen Business School, Porecelæanshavn 24, Frederiksberg DK-2000, Denmark.
Email: dw.dbp@cbs.dk

economic fundamentals. More finance completes markets ensuring an efficient competitive equilibrium (Arrow and Debreu, 1954). Finance cannot cause harm since market movements mirror but do not drive changes in the real economy (Friedman and Schwartz, 1963). Speculation is ultimately stabilising (Friedman, 1953). Hosting a large financial sector represents the high road to economic success. The sector provides quality jobs and sizeable fiscal dividends to host states. Finance-dependent countries perform well in international rankings of income per capita. Given this, governments should focus on growing the financial sector.

This position held considerable sway until the Global Financial Crisis (GFC) when doubts emerged about finance-driven growth models. In the United Kingdom (UK), Adair Turner, former Chair of the Financial Services Authority, nominated some activities conducted in London's financial sector 'socially useless' (Turner, 2009). Subsequent analysis from the Bank of England, the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) argued that beyond a point the growth of finance and credit does more harm than good (Arcand et al., 2012; Barajas et al., 2013). The BIS study concluded,

> The growth of a country's financial system is a drag on productivity growth [and] reduces real growth […] financial booms are not, in general, growth-enhancing, likely because the financial sector competes with the rest of the economy for resources. (Cecchetti and Kharroubi, 2015)

We build on this analysis, arguing that claims for the contribution of an oversized financial system are overblown, and often outweighed by a range of negative effects, in a 'Finance Curse'. Countries heavily dependent on natural resources are prone to a Resource Curse with low growth, crowding out of alternative sectors, poor job creation, extenuated inequality, diminished political freedoms, economic instability and heightened conflict, rent-seeking and corruption (Karl, 1997; Sachs and Warner, 1995; Thomas and Treviño, 2013). Large inflows of windfall money drive up prices and raise nominal exchange rates making local tradable goods and services uncompetitive in world markets. Skilled workers gravitate towards the better-remunerated sector, leaving alternative sectors and government bereft of skilled staff. Commodity price cycles induce violent swings in state revenues. Resource abundance provides easy rents, so policy makers lose interest in addressing long-term challenges and creating conditions for diversified growth. Revenue from other sectors is unnecessary to sustain power configurations, which severs links between government and citizens (Shaxson, 2008). In this winner-takes-all scenario, politics becomes a 'fight for a share of the cake' and overt conflict and repression becomes more likely.

Countries overly dependent on an outsized financial sector display similar characteristics. Britain, whose financial sector is the world's third largest, and the largest by a composite measure of size and interconnectedness, is a case in point (IMF, 2010). 'Financialisation' has crowded out manufacturing and non-financial services, leeched government of skilled staff, entrenched regional disparities, fostered large-scale financial rent-seeking, heightened economic dependence, increased inequality, helped disenfranchise the majority and exposed the economy to violent crises. Britain is subject to 'country capture' with the economy constrained by finance, and the polity and media under its influence. The Finance Curse provides a new analytical platform through which to capture this conjuncture.

Our thesis rests essentially on a cost–benefit analysis, which we provide below. While the gross benefits can mostly be measured, many of the costs—such as political capture, or criminalization—cannot. We argue that the net cost–benefit balance is negative for Britain and that oversized finance is a curse. We challenge others to rebut this, and are confident they cannot without airbrushing out the costs. Consequently, we have the basis for a strong new narrative to challenge dominant finance in Britain. The narrative is a call to arms. Our analysis is probabilistic, not deterministic. We encourage British academics to pursue further empirical work into the concept, identifying its symptoms, the various causal dynamics that may be at work and the relationships between them. Christensen has a long professional background in finance, and Shaxson has extensive past experience in analysing the Resource Curse (Shaxson, 2008); both are active in the Tax Justice Network (TJN). So the article represents a collaboration between expert activism, academia and professional services. The potential pay-off of this collaboration is to catalyse an authoritative alternative narrative, with accelerated and enlarged impact. The thesis may help British political scientists understand the nature of the British political economy: it points to the sources and exercise of political power in the United Kingdom; the form of the British state; the knowledge and mode of reasoning of its personnel; the strategies it pursues; and its relationships with key commercial and financial actors. The Finance Curse carries clear lessons for public policy and regulation in the United Kingdom, and beyond.

Below, 'The Finance Curse and its hypotheses' section outlines the principal hypotheses constituting the Finance Curse, and shows its similarity to the Resource Curse. The 'Evidence and the "City is Indispensable" narrative' section questions a 'City is indispensable' narrative, scaling down claims about finance's economic contribution. The third section, 'The economic harms', highlights the harms arising from overdependence on finance, against which the scaled-down claims can be balanced. The 'Politics, Policy and the Finance Curse' section considers the political dynamics and implications of the Finance Curse, further worsening the cost–benefit balance. 'The Finance Curse and the World Economy' section suggests that pernicious effects transcend borders; elements of the Curse are transmitted overseas, and the international system powerfully impacts Britain via finance. In conclusion, we reflect on the implications of the Finance Curse for policy and research.

The Finance Curse and its hypotheses

Arguments in defence of a 'competitive' and growing London-centred financial sector have been deployed to legitimise and promote its expansion. A simple but powerful cost–benefit analysis is offered, but with costs excised. These arguments suggest that the financial sector is key to Britain's economic prosperity and the City of London in particular is economically indispensable. These arguments are so intuitively appealing that many consider it self-evident that expanding the financial sector benefits the national economy. These arguments circumscribe public and elite debate, and counter-arguments levelled against finance are piecemeal, each seemingly unable to penetrate this deep consensus. If this consensus were persuasive, the Finance Curse thesis would be null and void.

The Finance Curse challenges this 'City is indispensable' narrative and rebuts its core claims. Table 1 outlines the core hypotheses of the Finance Curse, showing how it relates to the now well-established thesis of a Resource Curse. Both curses share similar components, in cause and effect, though with notable differences. We offer the table for critical scrutiny, testing and development.

The similarities between the two curses are perhaps more surprising: the latter tends to strike developing countries hardest; but the 'Finance Curse' tends to strike developed

Table 1. Finance Curse and Resource Curse: similarities and differences.

	Resource Curse	Finance Curse
Dutch Disease, crowding out, brain drain	Widely recognised. Forex inflows bid up real exchange rate, make other tradable sectors internationally less competitive. High-wage resource sector sucks skilled labour from other sectors, public and private.	Similar dynamics. Financial services exports cause appreciation of currency, capital inflows bid up local prices of non-tradables: real exchange rate appreciates, damaging alternative tradable sectors like manufacturing. High-wage finance sector sucks skilled labour from other sectors, public and private.
Economic instability	Follows commodity cycles. Drivers mostly external.	Cycles track financial booms and crises. Drivers often internal.
Higher private debt, public debt	When commodity prices are high, bankers lend freely; when prices fall, debt rises further as arrears build. A ratchet effect.	Also a debt ratchet effect, but boom-bust cycles, underlying drivers are different. Private debts driven by intra-financial lending, housing: these become public debts after crises.
Long-term growth damage	Growth below 'potential'; for some, a 'curse' is evident.	Research indicates that financial overabundance harms long-term growth. UK enjoys no long-term growth premium over OECD peers despite City of London.
Corruption, rent-seeking	Fundamental part of Resource Curse. 'Easy rents' from oil. Politics becomes winner-takes-all game of who gets what: favoured clients benefit.	Myriad rent-seeking activities in City of London. Finance abhors chaotic local corruption, but official tolerance for foreign 'corrupt' and dirty money creates rent-seeking opportunities. Products often designed to undermine, arbitrage or circumvent state regulation.
Damage to entrepreneurialism	'Easy rents' from resources distract, detract from tasks of building alternative sectors, made tougher by crowding out.	'Easy rents' from finance distract, detract from tasks of building alternative sectors, made tougher by crowding out.
Inequality	Inequality fuelled by high, resource-based incomes at the top and corruption which privileges wealthiest. Crowding out and damage to other sectors impacts the bottom.	Links between financial services growth and inequality widely acknowledged. Key difference with Resource Curse: much of financial wealth at the top is extracted from those lower down the income scale, for example, via 'socialisation of losses'. Political capture worsens inequality via policy capture, financialisation, preferential tax treatment to city firms and so on.
Conflict	Battles for 'share of the cake' foster conflict: political and even military.	International/offshore finance abhors instability: military conflict is a no-no, though economic warfare, for example, through tax wars (beggar-thy-neighbour processes) and regulatory degradation abounds.

Table 1. (Continued)

	Resource Curse	Finance Curse
Political capture, country capture,	Political capture an inevitable byproduct of resource dependence.	Political capture required for 'stability' of privileges of finance, to keep local democracy out. Deep capture: lobbying, media capture, societal capture.
Political repression	Local society can be 'surplus to requirements' as resource revenues flow in; revenues can pay for brute force to suppress dissent.	Repression mostly limited to protests about finance, and privileges of wealthy. Repression is most visible in small havens. Political, cultural, societal repression. Usually subtle: brute force is very rare.
Relocation risk	The oil is in the ground, and will not flee: low relocation risk. Yet, resource sector interests often whip up fears of relocation to gain privileges.	Relocation risk exists but usually far less than feared: finance is rooted in cluster effects. Much of the sector is domestic. Yet finance sector interests win privileges by whipping up often unjustified fears via 'Don't tax or regulate us too much or we'll flee to lower-tax, laxer-regulated places'. 'Race to bottom': deregulation, tax-cutting, is contagious.
International contagion, inwards and outwards.	Outwards contagion not significant. Most oil producers are not big enough to destabilise world oil markets. Inwards contagion from global booms and busts.	International interconnectedness increases financial sector opacity, instability and crises impacts. International contagion works in both directions. 'Competitiveness' fears transmit deregulation/tax-cutting inwards.

OECD = Organisation for Economic Co-operation and Development.

countries. We must qualify and delimit the scope of our claims, and we invite further research to clarify how the various features of the Finance Curse and its drivers interact across multiple environments, and under what conditions it is likely to exist in strong or weak form. Each cause and effect is stronger or weaker, depending on the level of resource/finance dependence. Causes and impacts interact cumulatively, so the table does not seek to disentangle them. Further research might explore complex and cumulative causation and path dependency. It would also be useful to investigate for each cause and effect, the extent to which it is impacted by different aspects of financial sector size/dominance: whether this involves the balance between 'casino' and 'utility', the mix between patient and short-term capital, the extent to which finance is internationally focused or domestic, or whether it is credit (or credit growth) as a share of the economy—or perhaps some other yardstick—that is most relevant.

Evidence and the 'City is Indispensable' narrative

Oft-cited lobbyists such as TheCityUK systematically overstate the economic contribution of Britain's financial sector to taxes, employment, financial surpluses, output and productivity. This section ('Scaling down the gross contributions' and 'Private gains as social losses') scales down such claims. 'The economic harms' section takes these scaled-down claims and sets them against a range of harms that flow from oversized finance.

At first glance, it seems, finance makes you rich. Of the 10 countries topping the World Bank's 2013 gross national income (GNI) per capita rankings, all depend heavily on natural resources or finance. (GNI here is a more appropriate measure than GDP, since GNI excludes artificial profit-shifting by multinational corporations: for countries with large financial sectors relative to the economy, this profit-shifting, which has little bearing on genuine economic activity, can significantly skew the picture.) Under its Atlas method, seven (Monaco, Liechtenstein, Bermuda, Switzerland, Isle of Man, Luxembourg and Macao) are finance-dependent and three (Norway, Qatar and Australia) are resource-dependent. Under the Purchasing Power Parity (PPP) method, Kuwait, United Arab Emirates, Singapore and Hong Kong replace Australia, Liechtenstein, Isle of Man and Monaco (World Bank, 2014).

Finance also provides income for the state. TheCityUK, a lobbying organisation promoting the interests of UK-based financial and related professional services industry, estimated that 'UK financial services contributed £65bn in tax revenue in 2012/13, accounting for 12% of total UK tax receipts'.This is 'enough to cover three-quarters of the projected public sector deficit for 2014/15' (World Bank, 2014: 5). The jobs contribution is presented as equally impressive with over 2 million employed in finance and related professional services. Of these, 1.3 million are employed outside London. These employees, it says, are highly productive, generating £174bn for the United Kingdom, or 12.6% of the total, and a 2013 trade surplus of £55bn, 'larger than the combined surplus of all other net exporting industries in the UK' (World Bank, 2014: 4). London's financial sector, on this evidence, is 'the goose that lays the golden eggs'.

Scaling down the gross contributions

This formidable story is at the heart of the 'City-is-indispensible' narrative, but it is problematic. First, GNI and GDP rankings reflect a strong selection bias: finance gravitates to already well-governed and wealthy jurisdictions. Additionally, high mean GNI per capita may not translate into broad-based welfare gains: it may be that in Britain, finance-derived wealth merely gravitates to the top and stays there. The United Nation's Human Development Index (HDI) ranks countries according to a combination of education, life expectancy and income per capita levels. The United Nations Development Programme (UNDP) until 2012 published a statistic called 'Gross National Income (GNI) per capita rank minus HDI rank'. This gives a very rough indication whether high incomes are transformed into tangible benefits at ground level. The data strongly suggest that both finance-dependent and resource-dependent countries (Kuwait, Oman and Qatar) tend to be poor at translating national income into genuine economic well-being (Shaxson and Christensen, 2013: 18). Additionally, a large share of higher paying jobs in finance-dependent countries, especially smaller ones, accrue to skilled but transient expatriates, raising the question of how much genuine long-term wealth creation is occurring.

A core problem, partly explaining the UNDP data, concerns 'gross versus net' contributions: these estimates airbrush out all the harms we outline in Table 1 and in 'The economic harms' section below. Incorporating these means not only a sharply reduced contribution, but potentially an oversized financial sector that may be a net long-term cost.

We also distinguish between mobile and immobile finance. TheCityUK (2014) reports that 40% of the total tax contribution comes from internationally mobile firms

(p. 11). On this evidence, any threat of exit would impact only 40% of the sector: 60% cannot move. A key policy question raised here is whether it is a good idea to pursue 'competitive' finance sector growth. From this 'competitive' perspective, the immobile part is largely irrelevant. What is more, TheCityUK's 40% is likely to be an over-estimate: the purpose is to persuade politicians to accept their demands, 'otherwise 40 percent of the City will disappear'. So this figure is an upper limit and the true figure is likely to be significantly lower. Much of London's attraction is due to language, widespread use of UK common law, geographical position amid key time zones, historical specialisation, local skills, path dependence, access to large nearby markets, infrastructure, interpersonal relations and networks and clustering effects. Much of it will never exit. As Mainelli puts it in Cooper (2011), 'clustering forces may well be strongest in one of the most weightless of industries—financial services' (p. 4). From the perspective of policy towards nurturing a 'competitive' financial sector, claims for finance's gross contribution should be scaled down according to the mobile-immobile distinction before costs are subtracted.

Furthermore, PricewaterhouseCoopers' (PWC) 'Total Tax Contribution' informs TheCityUK estimates and is contentious. It includes taxes that corporations pay and those paid by others such as customers, suppliers and workers (McIntyre, 2006). Pay-As-You-Earn receipts from the banking sector were £17.6bn in 2013–2014, compared with corporate tax receipts from the sector of £1.6bn (HM Revenue & Customs (HMRC), 2014: 6). Competing measures of the tax contribution are lower. Engelen et al. (2011) estimate the gross contribution of £193bn between 2002–2003 and 2007–2008, or £32bn per year (pp. 147–148). The 40% scale-down factor would cut the average total tax contribution over these 5 years to £12.8bn. Applying the scale-down factor to the TheCityUK (2014: 17) estimate of the financial sector corporate tax contribution of £5.4bn yields a scaled-down figure of £2.16bn. Likewise, scaling down TheCityUK employment figure provides gross national employment of 800,000, not over 2 million. Buchanan et al. (2009: 13) estimate direct employment in the sector at 1 million. Half of direct employment in the financial sector is in banking (432,000) and 80% of this in the more locally rooted 'utility' sector. The study concludes, '[F]inance remains a relatively small source of employment, which has created almost no new jobs over the past fifteen years'. There are further reasons to be sceptical. For example, financial surpluses measured in GDP do not necessarily come into Britain at all: Britain's extensive offshore archipelago only extenuates this phantom feature of financial surpluses.

Private gains as social losses

Reported financial-sector profits are another chimera. Return on equity in the British financial sector increased from less than 10% between 1920 and 1970, to 20% in ensuing decades and 30% in the run up to the crisis (Allesandri and Haldane, 2009: 3–4), but this does not necessarily correlate with net contribution, or the above-cited £174bn economic contribution. As Haldane and Madouros (2011) of the Bank of England explain,

> [T]he value of financial intermediation services is significantly overstated in the national accounts […] High pre-crisis returns to banking […] reflected simply increased risk-taking across the sector. This was […] a traverse up the high-wire of risk and return. In what sense is increased risk-taking by banks a value-added service for the economy at large? […] Bearing risk is not, by itself, a productive activity.

Profits to finance were thus substantially extracted from the future, via subsequent bailouts and below-potential economic growth. Where the system is overgrown, highly internationalised and crowded, and especially where an implicit or explicit public backstop is available, competition amplifies risk-taking and crisis depth. Accelerated credit creation renders a financial sector vulnerable to Ponzi dynamics. Democratic governments, hoping to take the cream 'before the next election' and to see losses realised later down the line, play along. Payback for the pre-GFC returns to finance materialised as losses when crisis struck.

The economic harms

Against these scaled-down gross contributions of the financial sector, we must now incorporate a range of additional harms creating a net cost–benefit balance. Post-GFC, UK Treasury support to banks peaked at £1.1tn. These exposures have since shrunk but this support remains a net cost to the United Kingdom (National Audit Office (NAO), 2014). Furthermore, Andrew Haldane (2010) estimated worldwide output losses from the GFC equivalent to between $60tn and $200tn and £1.8tn–£7.4tn for the United Kingdom (p. 2). A more recent study (Ball, 2014) comparing current estimates of potential output from the Organisation for Economic Co-operation and Development (OECD) and the IMF with that for 2007 found an average loss across advanced economies of 8.4%. Britain suffers a potential output loss of 12.5% and a decline in the growth rate from 2.7% to 1.9%. This bloated downside is a function of financial sector size.

The costs of the crisis alone dwarf even the gross contributions of finance, going back years. Financial crisis in turn produces a ratchet effect where ground lost in busts is not regained in booms, as in resource-rich countries. 'Hysteresis' is apparent, where capital and firm formation slow and workers who lose jobs suffer 'scarring', making reemployment less likely. A former Bank of England senior official commented,

> Why do we allow our banks to speculate for such a small and doubtful contribution to GDP? Before the financial collapse the bank lobby pointed to its contribution to tax revenues. If the published loans and support supplied by the taxpayer through the Bank of England and the Treasury are summed, the banks are in the red over the last decade. (Potter, 2012)

In the wake of the GFC, we now see new financial sector gains arising—at the cost of incubating future crisis. Not only does finance enjoy a failure subsidy, borne by the majority, it enjoys an ongoing operational subsidy. Investor beliefs that 'too-big-to-fail' banks will be rescued by government translate directly into lower funding costs. This subsidy was estimated at £100bn in 2009 and £220bn in 2010 (Haldane, 2011; Noss and Sowerbutts, 2012). Just four banks, Barclays, the Hong Kong Shanghai Banking Corporation (HSBC), the Royal Bank of Scotland (RBS) and Lloyds, enjoyed an implicit subsidy estimated at £37.7bn in 2012 (New Economics Foundation (NEF), 2013). Surprisingly, 'The problem posed by some banks being too big to fail is greater today than in 2008 […] the magnitude of the subsidy has generally grown since the crisis' (Admati and Hellwig, 2013: 12).

Additionally, Britain suffers acutely from the Dutch Disease. Trade surpluses in financial services tend to make the real exchange rate appreciate, creating a higher cost environment that crowds out other tradable sectors. This curbs economic diversity—and diversity provides resilience, capability accumulation and synergies arising from interconnectivity

(Hausmann et al., 2011). Sterling's marked decline after the GFC 'should' have generated an export boom, yet, despite political commitments to a more 'balanced economy' (as is routine in resource-rich countries), a lack of industrial diversity, partly caused by financial dominance, forestalled export-led recovery driven by alternative sectors. 'The UK has a revealed comparative advantage in every service sector, but in only three out of 15 goods sectors: pharmaceuticals, aerospace and chemical and related industries. This is fewer than any other G7 country' (Institute for Public Policy Research (IPPR), 2014: 3). From 1970–2008, output in UK financial and business services grew by some 350% in real terms, while real output in manufacturing grew by only around 25%, mostly before the late 1990s (Gardiner et al., 2012: 25). A related factor is brain drain, as highly remunerated finance attracts the brightest and best, leaching from and crowding out other private sectors. This further damages economic diversity and dynamism. 'Finance literally bids rocket scientists away from the satellite industry. The result is that erstwhile scientists, people who in another age dreamt of curing cancer or flying to Mars, today dream of becoming hedge fund managers' (Cecchetti and Kharroubi, 2012: 1). Finance also sucks talent from the public sector, with impacts on state regulatory capacity and policy.

Moreover, an economic sector predicated heavily on easy rent-seeking saps innovation and resilience. 'Parasitic' rent-seeking is a classic cause and symptom of the Resource Curse, and must be recognised as a core element of the Finance Curse, though mostly for different reasons. 'The primary locus of modern rent-seeking is the overblown financial sector, where burgeoning trade in existing assets has overwhelmed the creation of new wealth, attracting scarce talent from elsewhere and creating instability' (Kay, 2012). The prevalence of rent-seeking is widely explored but we should add a further element, less well understood: Britain's status as a tax haven and the British Offshore Archipelago (Shaxson, 2011), which, as discussed below, feeds enormous (often illicit and abusive) easy financial rents into and through London.

Several other harms we describe may not yet have fully emerged. Notably, 'growth' in Britain has been predicated on a constant expansion of credit supply. Arcand et al. (2012) report that 'GDP growth reaches a maximum when credit to the private sector is at 76 percent of GDP'. Beyond 90%, growth begins to suffer. This becomes statistically significant above 113%. Cecchetti and Kharroubi (2012) suggest that the optimal point is reached when private sector debt passes 100% of GDP. Most advanced countries were far beyond these levels when the GFC struck: credit to the private sector in the United States stood at 195% in 2008, and for Ireland, the Netherlands and the United Kingdom, the figures stood at 220%, 193% and 211% respectively (World Bank, 2013). Recent data suggest private sector debt has since expanded. Total UK private sector debt in the second quarter of 2011 stood at over 400% of GDP, with household debt at 98% of GDP and financial sector debt at 219%. British household and financial sector debt was higher than any other G7 member state (Thompson, 2013: 476–478).

The nature of credit has been transformed too, with damaging long-term effects. Until the 1980s, bank loans to businesses comprised most loans. Now mortgage loans and loans to financial companies account for over 70% of UK bank loans (Knott et al., 2014: 5). This shift marks the specificity of the UK 'growth' model and weighs further on prospects for long-term recovery; 'Financial sector debt was central to UK growth before the crisis and is now an ongoing burden on the UK economy. Exposed bank balance sheets and weak lending make recovery from recession through other sectors extremely difficult' (Thompson, 2013: 490). The British government's protracted and so far unsuccessful struggle to persuade banks to target successive quantitative easing programmes towards business lending can be seen as evidence of short-termism and crowding out. Bowman et al. (2013) suggest the 'failure of banks either to pass on lower interest rates or to expand lending raises large questions about whether quantitative easing is above all a form of bank welfare' (p. 478). Policy to boost business benefits the financial sector instead.

The Finance Curse also deepens regional imbalances. Since 2010, 79% of private sector job growth occurred in London. Aberdeen and Edinburgh are the only non-southern cities in the top ten UK cities for innovation; for employment, all top-ranked cities are in the south (Centre for Cities, 2014). Annual employment growth in the north averaged 0.6% from 1992 to 2007 compared with London's 1.3%; gross value added grew by 2.9% in the north and 5.6% in London (Gardiner et al., 2012: 16). The north and south have suffered deindustrialisation, just as areas outside the orbit of financial flows from natural resources have withered in many resource-dependent countries (Shaxson, 2008). London is portrayed as the economic 'engine' of Britain, but, in part, this is possible because the City has 'financialised' business sectors in the regions, extracting profits at the regions' expense (Leaver, 2013).

Sectoral and spatial imbalance is accompanied with rising income and wealth inequality, which themselves harm long-run growth. Increases in income in the United Kingdom have been concentrated in the top five percentiles. Within this group, financial sector workers account for 60% of the gains, while accounting for only 5% of the total workforce and 12% of the top decile. Loss of income share is spread evenly across the remaining 90% of workers, hurting manufacturing and public sector workers particularly. Bell and Van Reenen (2010) conclude, '[A]bout 60% of the increase in extreme wage inequality is due to the financial sector' (p. 16). Given the relative dependence of regions outside London and the south-east on public sector and manufacturing employment, wage inequality is closely linked to sectoral and spatial imbalances.

Politics, policy and the Finance Curse

That the financial sector achieved regulatory and even cultural capture in the run up to the GFC, and afterwards, is widely recognised. Private interests wrote public policy (Persaud, 2003; Wigan, 2010). The resulting disjuncture between privately and socially optimal leverage meant excessive risk-taking and dangerous concentrations in counterparty exposures (Baker, 2010). Revolving doors between public agencies and private entities, an intellectual consensus around the efficient markets hypothesis, a largely unchallenging media and vast resources dedicated to influencing regulatory outcomes ensure regulatory capture (Johnson and Kwak, 2010; Seabrooke and Tsingou, 2014). The outcomes have persisted beyond the GFC with the UK parliamentary enquiry into the London Interbank Offered Rate (LIBOR) scandal described by Member of Parliament (MP) John Mann as a 'total whitewash' and the 'Vicker's' bank reforms panned as 'feckless' and 'paying lip service' to reform (Treanor and Sparrow, 2012; Kotlikoff, 2012).

The political party system is heavily funded by the financial sector, and the media dominated by its representatives and preferred opinions. The Bureau of Investigative Journalism found that 51.4% of donations to the Conservative party over 2010–2011 came from the financial sector (Mathiason, 2011). Analysis of the United Kingdom's most popular news programme demonstrates that 'in reporting the banking crisis, the parameters of debate on the *Today* programme are set by a narrow group of City sources, regulators, IMF spokespersons and front bench politicians' (Berry, 2012: 14). In a 2-week period surrounding the bank bailouts during which the option of full-scale bank nationalisation was effectively erased from the agenda, more than 70% of discussants were City sources (Berry, 2012: 15). Anecdotes abound. For example, Peter Oborne, the *Telegraph*'s chief political commentator, resigned in February 2015, saying that its coverage of the HSBC Swiss tax evasion scandal amounted to a 'fraud on its readers', as it censored critical coverage of the bank to protect advertising revenues. While *The Guardian* investigated the same scandal, HSBC put its advertising 'on pause'.

The Finance Curse and the world economy

The Finance Curse differs from the Resource Curse in two main respects. First, political capture by a dominant resource sector is a byproduct of the Curse, whereas in finance-dependent countries, political capture is deemed necessary to reassure flighty mobile capital of a welcoming, stable atmosphere. Second, the Resource Curse essentially strikes the local economy, with relatively few outward international repercussions; but the Finance Curse flows in both directions: outwards from Britain, and inwards from the world.

The outward harms come in three main forms. First, the City of London originates and exports financial instability, and played a central role in the GFC. For example, the collapse of the US insurance giant AIG was triggered by a 377-person unit located in London to take advantage of London's 'competitively lax' regulation. Joining other US politicians in attacking London as a serial originator of financial crises in the wake of $2bn trading losses at the UK unit of JPMorgan Chase, Gary Gensler, chairman of the US Commodity Futures Trading Commission, complained, 'So often it comes right back here, crashing to our shores […] if the American taxpayer bails out JPMorgan, they'd be bailing out that London entity as well' (Braithwaite, et al., 2012). London and the UK's offshore satellites also serve as key nodes transmitting financial shocks internationally. IMF research on the transmission of funding strains from Greece in 2010, for instance, shows British offshore networks playing a central role in transmitting contagion (Moghadam and Viñals, 2010: 19).

Second, Britain exports deregulatory 'competitive contagion'. Relaxing rules in one jurisdiction prompt others to adopt equal or deeper measures to stay in the race. From the perspective of financial stability, inequality and the rule of law, this is a race to the bottom. For example, a lobbying document published in January 2007 by US Senator Charles E. Schumer and New York City Mayor Michael Bloomberg, entitled *Sustaining New York's and the US' Global Financial Services Leadership*, urged massive financial liberalisation and deregulation (shortly before the GFC.) It cited 'light touch' London a stunning 135 times in the context of 'competition' to attract financial service activity (Bloomberg and Schumer, 2007). Bill Black, a US criminologist, described the HSBC tax evasion and political scandal in 2015 as 'the inevitable result of the City of London "winning" the regulatory "race to the bottom" and becoming the financial cesspool of the world' (Black, 2015).

The third class of negative effects rippling outwards concerns offshore tax havens. Britain has important 'offshore' characteristics itself, including its 'non-domicile' tax rule, the permissive corporate tax regime since 2010 and a lax company incorporation regime. But Britain also runs a global offshore network of tax havens, dubbed the 'UK's Offshore Archipelago' (Haberly and Wójcik, 2014) with varying degrees of connection to and control by Britain. This 'Spider's web' has London at the centre, surrounded by 3 Crown

Dependencies (Jersey, Guernsey and the Isle of Man) and seven of Britain's 14 Overseas Territories (including Caymans, Bermuda and the British Virgin Islands). These territories are substantially controlled by Britain, and might be considered arms of the City of London: Jersey Finance, the lobbying arm of the Jersey tax haven, has stated that for major financial service players, 'Jersey represents an extension of the City of London' (Jersey Finance, 2012). Outside these orbits lie many Commonwealth and other tax havens with close links to London, many with the UK's Privy Council as their final court of appeal. These havens harbour and hide looted assets, facilitate and foster tax abuses, abet financial crime and promote further competitive contagion. Tax haven effects could be construed as a British 'Finance Curse export'.

The Finance Curse strikes inwards at Britain's domestic economy too: most dramatically through the discourse of 'international competitiveness' which has helped the financial sector achieve political capture. Policy options are dismissed because they might make the financial sector 'uncompetitive'. This potent, ubiquitous argument contains a double fallacy. First, it is rather meaningless to talk about the 'competitiveness' of a national economy (Krugman, 1994; Wolf, 2004). The Finance Curse thesis exposes the second, related fallacy: what is good for the City may not be good for Britain—especially where wealth is extracted from the economy rather than adding to it. Yet, these two core fallacies are seldom challenged, and false consciousness prevails under the banner of 'competitiveness'. Popularising the Finance Curse thesis could undermine this brittle consensus, unshackling politicians from their fear of implementing policies that voters want.

A second 'inward' international effect is the Dutch Disease, as discussed above: the crowding out and repression of other tradable sectors by finance, a persistent feature of the British economic landscape (Ingham, 1984).

A third 'inward' international effect concerns the British 'Offshore Archipelago', which serves as a feeder mechanism attracting capital, and profiting from the business of handling capital, from around the world. So the Cayman Islands, for instance, is an important incorporation centre for affiliates of US hedge funds and private equity firms: the Cayman feeder enables the City of London players to get a piece of the US action. Likewise, the two biggest sources of foreign investment (on paper) into China for some years have been the British Virgin Islands and Hong Kong, each closely linked to London. This Offshore Archipelago, a residue of the British Empire, is predicated substantially on financial secrecy and tax-free treatment, and collectively serves (as the formal Empire did) as a vast rent-extracting opportunity for the City.

Conclusion

The Finance Curse hypothesis overturns an entrenched orthodoxy that what is good for the City must be good for Britain. Claims about the financial sector's gross contribution are overblown, and an oversized financial sector imposes a wide range of costs on the economy, polity and society, to result in a net negative for the country. The accelerated rise of finance in recent decades has damaged Britain's alternative economic sectors, as productive activity cedes ground to financial rent extraction. Many of the harms, in cause and effect, are similar to those of a widely studied 'Resource Curse' afflicting mineral-rich countries. Under the Resource Curse, rents come from the earth—but under the Finance Curse, rents are extracted from the economy and society more broadly. In the face of long-term stagnation, historically low productivity levels, an elusive search for growth, huge public and private debt overhangs and ever greater natural and social precarity, the time is ripe to consider new paths. A starting point is a new grand narrative, the Finance Curse, to confront and help reverse the political dominance of finance, and to support alternative economic sectors. The language of financial 'competitiveness' must be dethroned.

Policy prescriptions arising from the analysis abound. Overarchingly, the financial services sector should be downsized. Macroeconomic policy should be conducted in the interests of a broader set of objectives and constituency. In turn, industrial policy should explicitly target diversification and the spatial diffusion of economic activity. Downsized finance itself will provide the basis for such a transformation with, for instance, finance losing its virtual monopoly on UK talent. Competitive contagion should be tackled with firm domestic commitments to high regulatory standards and multilateral action to ensure these standards are followed elsewhere. Before this can be achieved, we urge UK researchers to test and develop our probabilistic analysis, and more closely investigate the elements of the Curse that are most volitional, and how causes and impacts interact.

Acknowledgements

The authors would like to thank the editorial team and anonymous reviewers for their crucial advice and insights.

Funding

This work is supported by European Commission Research Director General, Horizon 2020 Framework Programme, 2015–2018—'European Legitimacy in Governing through Hard Times (#649456-ENLIGHTEN).

References

Admati A and Hellwig M (2013) *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It*. Princeton, NJ: Princeton University Press.

Arcand J-L, Berkes E and Panizza U (2012) *Too much finance?* IMF Working Paper No. 12/161. Washington, DC: International Monetary Fund (IMF).

Arrow K and Debreu G (1954) Existence of an equilibrium for a competitive economy. *Econometrica* 22(3): 265–290.

Baker A (2010) Restraining regulatory capture: Anglo-America, crisis politics and trajectories of change in global financial governance. *International Affairs* 86(3): 647–663.

Ball LM (2014) *Long-term damage from the great recession in OECD countries*. NBER Working Paper 20185. Cambridge, MA: National Bureau of Economic Research (NBER).

Barajas A, Beck T, Dabla-Norris E, et al. (2013) *Too cold, too hot, or just right? Assessing financial sector development across the globe*. IMF Working Paper WP/13/81. Washington, DC: International Monetary Fund (IMF).

Bell B and Van Reenen J (2010) *Banker's Pay and Extreme Wage in the UK*. London: Centre for Economic Performance.

Berry M (2012) The today programme and the banking crisis. *Journalism* 14(2): 253–270.

Black W (2015) HSBC CEO: My pay was so outrageous I had to use tax havens to hide it from my peers. *New Economic Perspectives*, 23 January. Available at: http://neweconomicperspectives.org/2015/02/hsbc-ceo-my-pay-was-so-outrageous-i-had-to-use-tax-havens-to-hide-it-from-my-peers.html (accessed 9 November 2015).

Bloomberg M and Schumer C (2007) *Sustaining New York's and the US' Global Financial Services Leadership*. The City of New York Office of the Mayor and U.S. Senate. Available at: http://www.nyc.gov/html/om/pdf/ny_report_final.pdf (accessed 9 November 2015).

Bowman A, Erturk I, Froud J, et al. (2013) Central bank-led capitalism. *Seattle University Law Review* 36: 455–487.

Braithwaite T, Nasiripour S, Masters B (2012) US watchdog hits at 'risky' London. *Financial Times*, 19 June.

Buchanan J, Froud J, Johal S, et al. (2009) *Undisclosed and unsustainable: Problems with the UK business model*. Working Paper 75. Manchester: Centre for Research on Socio-Cultural Change (CRESC).

Cecchetti SG and Kharroubi E (2012) *Reassessing the impact of finance on growth*. BIS Working Paper No. 381. Basel: Bank for International Settlements (BIS).

Cecchetti SG and Kharroubi E (2015) *Why does financial sector growth crowd out real economic growth?* BIS Working Paper No. 490. Basel: Bank for International Settlements (BIS).

Centre for Cities (2014) *Cities Outlook 2014*. London: Centre for Cities.

Cooper M (2011) *The Great Game; Clustering in Wholesale Financial Services*. Long Finance and Qatar Financial Centre Authority. Available at: http://www.longfinance.net/lf-research.html?id=791 (accessed 9 November 2015).

Engelen E, Erturk I, Froud J, et al. (2011) *After the Great Complacence: Financial Crisis and the Politics of Reform*. Oxford: Oxford University Press.

Friedman M (1953) *Essays in Positive Economics*. Chicago, IL: University of Chicago Press.

Friedman M and Schwartz A (1963) *A Monetary History of the United States, 1867–1960*. Princeton, NJ: Princeton University Press.

Gardiner B, Martin R and Tyler P (2012) *Spatially unbalanced growth in the British Economy*. Working Paper CGER No. 1. Cambridge: Centre for Geographical Economic Research, University of Cambridge.

Haberly D and Wójcik D (2014) Regional blocks and imperial legacies: Mapping the global offshore FDI network. *Economic Geography* 91(3): 251–280.

Haldane A (2010) The $100bn question. *Speech at the Institute of Regulation & Risk*, Hong Kong, 30 March, BIS Review 40/2010. Basel: Bank for International Settlements (BIS).

Haldane A (2011) Tackling the credit cycle and too-big-to-fail. *Presentation at the Institute of International and European Affairs*, 20 January. Available at: http://www.iiea.com/events/andrew-haldane-on-fixing-finance (accessed 9 November 2015).

Haldane AG and Madouros V (2011) What is the contribution of the financial sector? *Vox*, 22 November. Available at: http://www.voxeu.org/article/what-contribution-financial-sector (accessed 9 November 2015).

Hausmann R, Hildago C, Bustos S, et al. (2011) *The Atlas of Economic Complexity: Mapping Paths to Prosperity*. Cambridge, MA: MIT Media Lab, Centre for International Development, Harvard University.

HM Revenue & Customs (HMRC) (2014) *Pay-As-You-Earn and Corporate Tax Receipts from the Banking Sector*. London: HMRC.

Ingham G (1984) *Capitalism Divided? The City and Industry in British Social Development*. Basingstoke: Macmillan Education.

Institute for Public Policy Research (IPPR) (2014) *Gathering Strength: Backing Clusters to Boost Britain's Exports*. London: IPPR.

International Monetary Fund (IMF) (2010) *Integrating Stability Assessments under the Financial Sector Assessment Program into Article IV Surveillance* (Monetary and Capital Markets, Legal, and Strategy, Policy, and Review Departments). Washington, DC: IMF.

Jersey Finance (2012) *Jersey: For Banking—Jersey's Finance Industry Delivers Innovative Banking Services in a Stable Jurisdiction*. Saint Heliers, New Zealand: Jersey Finance.

Johnson S and Kwak J (2010) *13 Bankers: The Wall Street Take Over and the Next Financial Meltdown*. New York: Pantheon Books.

Karl T (1997) *The Paradox of Plenty: Oil Booms and Petro States*. Berkley, CA: University of California Press.

Kay J (2012) The monumental folly of rent-seeking. *The Financial Times*, 20 November. Available at: http://www.ft.com/cms/s/0/3c72c7f0-3278-11e2-916a-00144feabdc0.html#axzz3TVm97K1S (accessed 9 November 2015).

Knott S, Richardson P, Rismanchi K, et al. (2014) *Understanding the fair value of banks' loans*. Financial Stability Paper No. 31. London: Bank of England.

Kotlikoff L (2012) Vickers is not enough to stop another Libor scandal, *The Financial Times*, 9 July.

Krugman P (1994) Competitiveness: A dangerous obsession. *Foreign Affairs* 73(2): 28–44.

Leaver A (2013) The metropolitinisation of gains, the nationalisation of losses. *Open Democracy*, 25 September. Available at: https://www.opendemocracy.net/ourkingdom/adam-leaver/metropolitanisation-of-gains-nationalisation-of-losses (accessed 9 November 2015).

McIntyre B (2006) Transparently dishonest. *American Prospect*, 30 August. Available at: http://prospect.org/article/transparently-dishonest (accessed 9 November 2015).

Mathiason N (2011) Hedge funds, financiers and private equity make up 27% of Tory funding. *Bureau of Investigative Journalism*, 20 September. Available at: http://www.thebureauinvestigates.com/2011/09/30/hedge-funds-financiers-and-private-equity-tycoons-make-up-27-of-tory-funding/ (accessed 9 November 2015).

Moghadam R and Viñals J (2010) *Understanding Financial Interconnectedness* (Strategy, Policy, and Review Department and the Monetary and Capital Markets Department). Washington, DC: International Monetary Fund.

National Audit Office (NAO) (2014) *HM Treasury Annual Report and Accounts 2013–14*. London: NAO.

New Economics Foundation (NEF) (2013) £37.7bn taxpayer reward for the big four banks—But what do we get in return? *NEF*, 17 December. Available at: http://www.neweconomics.org/press/entry/37-7bn-taxpayer-reward-for-the-big-four-banks-but-what-do-we-get-in-return (accessed 9 November 2015).

Noss J and Sowerbutts R (2012) *The implicit subsidy of banks*. Financial Stability Paper No. 15. London: Bank of England.

Persaud A (2003) The political economy of Basel II. *European Business Law Review* 14(3): 219–225.

Potter D (2012) Let's welcome the enmity of the bankers. *Open Democracy*, 5 October. Available at: https://www.opendemocracy.net/ourkingdom/david-potter/lets-welcome-enmity-of-bankers (accessed 9 November 2015).

Sachs J and Warner A (1995) *Natural resource abundance and economic growth*. Working Paper 5398. Cambridge, MA: National Bureau of Economic Research.

Schumpeter J (1934) *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*. Cambridge, MA: Harvard University Press.

Seabrooke L and Tsingou E (2014) Distinctions, affiliations, and professional knowledge in financial reform expert groups. *Journal of European Public Policy* 21(3): 389–407.

Shaxson N (2008) *Poisoned Wells: The Dirty Politics of African Oil*. Basingstoke: Palgrave Macmillan.

Shaxson N (2011) *Treasure Islands: Tax Havens and the Men Who Stole the World*. London: Vintage Books.

Shaxson N and Christensen J (2013) The Finance Curse: How oversized financial sectors attack democracy and corrupt economies. *Tax Justice Network*. Available at: http://www.taxjustice.net/topics/finance-sector/finance-curse/ (accessed 9 November 2015).

TheCityUK (2014) *Driving Economic Growth Creating Sustainable Jobs: How Financial and Related Professional Services Serve the UK*. London: TheCityUK.

Thomas A and Treviño J (2013) *Resource dependence and fiscal effort in Sub-Saharan Africa*. IMF Working Paper 13/188. Washington, DC: International Monetary Fund.

Thompson H (2013) UK debt in comparative perspective: The pernicious legacy of financial sector debt. *British Journal of Politics and International Relations* 15: 476–492.

Treanor J and Sparrow A (2012) Libor scandal: Banking inquiry branded 'total whitewash' before it starts. *The Guardian*, 13 July.

Turner A (2009) How to tame global finance. *Prospect Magazine*, September. Available at: http://www.prospectmagazine.co.uk/features/how-to-tame-global-finance (accessed 9 November 2015).

Wigan D (2010) Credit risk transfer and crunches: Global finance victorious or vanquished? *New Political Economy* 15(1): 109–125.

Wolf M (2004) *Why Globalization Works: The Case for the Global Market Economy*. New Haven, CT: Yale University Press.

World Bank (2013) *Domestic Credit to Private Sector (% of GDP)* (World Bank database). Available at: http://data.worldbank.org/ (accessed 9 November 2015).

World Bank (2014) *GNI Per Capita Ranking, Atlas Method and PPP Based* (World Bank database). Available at: http://data.worldbank.org/ (accessed 9 November 2015).