

Marketplace



Tim Congdon

‘Adair Turner’s worry is that the UK’s financial sector takes up scarce resources and unfairly redistributes wealth. Lord Turner is talking rot’

Almost three years ago Lord Turner caused astonishment when, in an interview, he said that much of the financial services sector was “socially useless”. He was (and still is) chairman of the Financial Services Authority. The interview openly denigrated the work carried out by hundreds of thousands of well-paid and often highly-skilled people for whom Turner was the regulatory supremo. It would be hard to imagine a more brutal insult to their professional self-respect.

If one believed that much of the financial sector was “socially useless”, a logical further claim was that it was “too big”. Turner’s arguments were therefore widely adopted by left-wing critics of the banking industry and elaborated in a more general critique of the City of London. The City was alleged to be excessively large relative to the UK economy as a whole and, by implication, to be an unproductive parasite on genuinely productive manufacturing. This seemed to establish a case, now often articulated by government ministers, for “rebalancing the economy” away from financial services and towards manufacturing.

Despite the rumpus that followed his remarks, Turner has now returned to the charge in a new book: *Economics After the Crisis: Objectives and Means* (MIT Press, £17.95). The title is both ambitious and misleading, since the book is more concerned with topical issues that have arisen in the last few years of policy muddle and market upheaval than it is with economics as an intellectual discipline. At any rate, Turner is as hostile to finance in his latest work as he was in his 2009 interview. The second chapter is Turner’s most extended treatment so far of the “socially useless” thesis.

Economies are said to contain two kinds of activity, those which constitute “real value added” and those that are concerned with the distribution of income and wealth. Examples of the second—labelled “distributive rent extraction” by Turner—are a bookmaker (who redistributes between gamblers) and a divorce lawyer (who redistributes between husbands and wives). The nub of Turner’s critique is that finance is largely involved with redistribution rather than “real value added”. In his words, “The higher the share of complex financial services in our economy, the greater the danger that highly skilled people will be attracted to activities whose social impact is simply distributive”. He fears that, as a result, “a finan-

cial system could grow beyond its socially optimal size”.

In other words, Turner’s worry is that the UK has a financial sector that both takes up scarce resources and redistributes unduly between the millions of citizens that make up our nation. Implicitly, the UK’s financial industries—including of course the City—are engaged principally in domestic transactions, in transactions between British people and companies. But has Turner got his facts right? Abundant data are available on the geographical split of UK financial business and, in particular, on the relative size of the City’s foreign and domestic customers. This information demolishes Turner’s argument. It turns out that the City of London is dominated by international transactions.

Turner quotes extensively from a paper by Andrew Haldane, a senior Bank of England official, in a 2010 book *The Future of Finance*. According to Haldane, “In 2007 financial intermediation accounted for more than 8 per cent of [the UK’s] total gross value added [i.e. output], compared with 5 per cent in 1970.” It is this 3 per cent rise—this 3 per cent supposed over-expansion—that lies behind Turner’s conjecture that finance has grown beyond “its socially optimal size”.

If Turner or Haldane had checked what happened in this period to the UK’s exports of financial services due mostly to the City’s international business, they might have noticed that, as a share of national output, the UK’s exports of financial services rose from less than 0.5 per cent in 1970 to 4 per cent in 2008. The most important driver in the growth of UK finance has been a boom in exports. Indeed, anyone employed in the City of London cannot help but be aware of the extraordinarily cosmopolitan nature of their work. Only a small proportion of the City’s foreign exchange trading, securities underwriting and derivatives activity is in response to demands from UK companies. Instead the customers are predominantly multinational businesses from around the world, and that is why the fees, commissions, trading profits and so on are exports.

The expansion of UK finance in the last 40 years has not been because of an increase in “distributive rent extraction”. Turner and Haldane are talking rot. Moreover, if we were to rebalance our economy away from financial services, we would be rebalancing away from exports of financial services. The notion that manufactured exports are in some sense “better” for us is poppycock.