

BANKER BASHING MAY LEAD TO AN EXODUS FROM THE CITY

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Bank-bashing has become a commonplace, even rather boring. It is therefore losing its appeal to Britain's fashion-conscious political class. Indeed, the bank-bashers' credibility is waning as one of their standard allegations is being refuted by the evidence. This allegation, made on numerous occasions in late 2008 and 2009, was that the financial crisis would have a huge cost to the taxpayer.

In fact, the government has spent no money on the banks. Loans have been extended by the Bank of England and the Treasury to some banks at penal rates of interest, and these loans have been almost entirely repaid. Guarantees were provided by the Treasury on certain bank liabilities, but the banks' creditors have not had to call the guarantees. Instead the banks have honoured their liabilities and paid the guarantee fees. Finally, the British state acquired equity stakes on favourable terms in the Royal Bank of Scotland and Lloyds Banking Group, while snaffling the shareholders' funds of Northern Rock and Bradford & Bingley. These investments – or should one say these 'stolen goods'? – will be sold over the next few years at a profit running into tens of billions of pounds.

The likelihood of an immense taxpayer profit may puzzle the bank-bashers. The large salaries paid in the British banking industry owe nothing to government subsidies. They are instead due to receipts of various kinds (interest margins on loans, commissions, underwriting fees, trading profits, management and advisory fees) on transactions with customers.

The bank-bashers asserted that large personal incomes depended on hidden official support. In fact, the large incomes were and are justified in the marketplace. They have been and remain attributable to high productivity in the financial industries. Official data show that, in 2007, average hourly pay in the City of London was £28.77, whereas in Great Britain as a whole it was £12.69. Moreover, the differential between City incomes and the national average has been widening since the mid-1980s, a 25-year period in which the notion of a state-subsidised financial system was obvious poppycock. The 25 years were actually characterised by enormous tax payments on profits and incomes earned in the City.

Why did productivity in international financial services grow so rapidly? Two forces were dominant. First, computerisation and advances in information technology enabled a multiplication in the volume of transactions that could be processed and recorded, and so dramatically reduced the 'cost per unit of output'. Admittedly, the concept of a 'unit of output' is often complex in the financial sector, inviting sceptics – including such figures as Lord Turner, the chairman of the Financial Services Authority – to describe much of the activity as 'socially useless'.

The truth is that, overwhelmingly, the output of the London-based financial industries is sold to foreign companies and individuals, and for us to worry about its social utility is peculiar. What matters is our ability to pay our way in the world, not Lord Turner's hunches and prejudices. In 2008 the UK's exports of financial services exceeded £60 billion and were over 4% of national output.

The second dominant influence is implied by these export figures. The post-war era has seen a relentless tendency towards the globalisation of trade and finance. In the 1950s a US company would finance its operations almost exclusively in dollars from securities sold in the USA or by loans from US-owned banks operating only in the USA. The same would apply for British companies, German companies and so on. But nowadays a US company can finance its operations by a yen- or euro-denominated loan or securities issue, arranged in London by a syndicate of European, Asian and Arab banks, possibly with some US participation. Financial markets have ceased to be national. Instead they are global.

The main centre for the value added created is London. Computerisation and globalisation, not implicit government subsidies, are responsible for the personal incomes in the UK's financial services industries. But will the high-productivity, high-income people in the financial sector want to stay in banker-bashing UK in the long run? Perhaps not.

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