

## The Chancellor of the Exchequer and The Economic Secretary

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16 May 2022

### Letter regarding the dangers of a competitiveness objective for financial regulators

Dear Rishi Sunak MP and John Glen MP,

We, the undersigned, are writing to express our concern about proposals for the UK's **Financial Services Future Regulatory Framework** (FRF) to give regulators statutory objectives to promote "competitiveness" after Brexit.

The Economic Secretary, John Glen MP, rightly called the FRF a "once-in-a-generation opportunity" to set the course for post-Brexit regulation. The FRF says the government intends "a greater focus on growth and competitiveness by introducing new, statutory secondary objectives for the PRA (Prudential Regulation Authority) and the FCA (Financial Conduct Authority)." Chancellor Sunak has said that UK finance should be "globally competitive over the long term."

We wholeheartedly support the government's aim to stimulate long-term UK economic growth, including through financial regulation. Yet we believe that competitiveness is an inappropriate objective for regulators, for the reasons below.

#### 1. A recipe for excessive risk-taking

After the last global financial crisis (GFC, 2007/08), which cost the world economy some **\$10 trillion**, it was accepted that a focus on competitiveness by the then Financial Services Authority had helped cause the disaster.<sup>1</sup> Andrew Bailey, Bank of England Governor, said recently that we tried a competitiveness objective before, and "it didn't end well, for anyone."

The main purpose of a financial sector is to support the economy as an intermediary, facilitating transactions, savings and investment, managing risk, and so on. It can have secondary purposes, including as a source of export earnings. But these should not undermine the primary purpose.

#### 2. Harm the real economy

While the financial sector supports the UK economy in many ways, it also can compete *against* parts of it. Four examples illustrate this tension.

1. High pay in finance creates a domestic brain drain drawing talented people (and resources) out of other economic sectors. The economist Andrew Haldane called it "a great sucking sound as both people and monies were drawn into banking," hitting R&D-intensive firms hardest and crowding out "the very businesses that today we are seeking to re-nurture."
2. Before the GFC, financial-sector actors profited by taking large risks, then taxpayers across the UK shouldered the burden when those risks crystallised into crisis.
3. Large net foreign inflows into UK finance can raise the real exchange rate, potentially making other sectors (e.g. manufacturing) less competitive against exports, in a "Dutch Disease".
4. Inflows of money and investment into the UK from Russian state-backed actors benefit UK finance, but the Ukraine crisis reminds us of the long term damage to national security.

UK finance is disproportionately located in parts of London. Promoting its international competitiveness will also intensify this competition against other parts of the UK economy, which are disproportionately located elsewhere in the UK. So a competitiveness objective will likely undermine the government's 'levelling up' agenda.

### **3. Reduced economic growth**

The FRF talks of a “*growth and competitiveness* objective,” but those two goals may be in conflict. The above examples of misallocation of resources do not only involve redistribution of resources from other parts of the economy to finance, but may well reduce overall economic growth too. Indeed, there is extensive evidence in econometric research, including that conducted by the Bank for International Settlements, that excessive growth of a financial sector beyond a certain point starts to retard economic growth.<sup>2</sup>

That literature reports that a country can have 'Too Much Finance' that comes at a cost to the rest of the economy, when credit to the private sector exceeds around 90-100 percent of GDP. While there is some contestation in the literature on this point,<sup>3</sup> it is clear that some parts of the financial sector are potentially harmful. Since the GFC, credit to the private sector in the UK has ranged from 160-180 percent of GDP, suggesting that the UK may be suffering from “Too Much Finance.” In which case, a competitiveness objective to promote finance would likely undermine a regulatory mandate to promote wider economic growth.

### **4. A poorly defined, confusing objective**

It is necessary to distinguish between the competitiveness of a private *company*, and the competitiveness of a whole *country*. It is meaningful to talk of a company being competitive, but economists know that it is hard to pin down how whole countries might compete in economic terms. For example, uncompetitive companies (like Northern Rock) can collapse and disappear, while uncompetitive countries may perform poorly, but they don't disappear. The processes are completely different.

In a famous 1994 article Competitiveness: A Dangerous Obsession, the US economist Paul Krugman warned that “a government wedded to the ideology of competitiveness is as unlikely to make good economic policy as a government committed to creationism is to make good science policy.”

It is worth asking which version of competitiveness the FRF envisages. Is it the private-company version, or the whole-country one?

The FRF does not adequately define “competitiveness,” although recent high-level official statements suggest that it involves two overlapping objectives: i) attracting mobile businesses (financial and non-financial) to domicile or do business in the UK; and ii) promoting the UK financial sector relative to other financial centres.<sup>4</sup> This suggests the government wants to promote the competitiveness of an economic *sector* like finance – thus a hybrid of the (meaningful) private-company version and the incoherent country version. Yet official documents do not spell this out, so regulators would have to navigate the contours of this strange hybrid, without charts.

### **5. A race to the bottom**

Even if regulators could address all these questions effectively, a general competitiveness objective poses a further challenge, because it does not differentiate between “good” competitiveness and “bad” competitiveness. The “good” version might include, for example, situations where financial firms cut fees and costs, or provide higher-quality products and services, or promote greater probity and legal clarity, or create a financial system that more powerfully tackles climate change.

Harmful competitiveness might involve (for example) watering down money-laundering rules, to attract Russian oligarchs' money. Or, one might try to attract global businesses that profit from "greenwashing"; or that engage in profitable risk-taking at taxpayers' expense. Recent pressure to weaken 'ring-fencing' safety rules for banks in the name of competitiveness, are an example. Moreover, the 'harmful' kind implies a 'beggar-thy-neighbour' race to the bottom competition with other nations, leaving everyone worse off.

## **6. Secondary objective**

The government has stated that having competitiveness as a "secondary" objective will provide a "clear hierarchy" allowing the good to overrule the bad when there is tension.<sup>5</sup> Yet we can promote the good and minimise the bad simply by allowing private competition in healthy markets to flourish, within strong public-interest guardrails. For all the above reasons, there is no place for "competitiveness" *anywhere* in the financial regulatory toolkit.

## **7. Finance doesn't need another helping hand, but a firm hand**

The UK financial sector is economically and politically dominant in the UK, and many powerful interests already support it, including UK Finance, TheCityUK, the City of London Corporation, and individual firms and associations. There is no need to add to this list of cheerleaders by hobbling regulators with a competitiveness objective. As Andrew Bailey said in 2019, regulation should serve the public interest, not entrench incumbents or pick winners.

The UK instead needs clear regulatory objectives that promote economy-wide productivity, growth and market integrity, and also protect consumers and taxpayers, advance the fight against climate change, and tackle dirty money to protect our collective security.

Yours sincerely,

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**Professor Michael Ash**, University of Massachusetts Amherst

**Professor Andrew Baker**, University of Sheffield

**Professor Mark Blyth**, Brown University

**Professor Massimo Bordignon**, Catholic University of Milano

**Dr Jo Briggs**, Northumbria University

**Sir Vince Cable**, Former Secretary of State for Business, Energy and Industrial Strategy

**Professor Sharon Collard**, University of Bristol

**Professor Christopher Cramer**, SOAS, University of London

**Professor Will Davies**, Goldsmiths, University of London

**Professor Jan Eeckhout**, Universitat Pompeu Fabra

**Dr Karen Elliott**, Newcastle University Business School

**Professor Gerald Epstein**, University of Massachusetts Amherst

**Ismail Erturk**, University of Manchester

**Miatta Fahnbulleh**, Chief Executive, New Economics Foundation

**Professor Amelia Fletcher CBE**, Norwich Business School

**Associate Professor Steven Hail**, Torrens University

**Professor Martin Hellwig**, Max Planck Institute, Bonn

**Dr Leslie Huckfield**, Glasgow Caledonian University

**Professor Michael Hudson**, University of Missouri

**Will Hutton**, London School of Economics

**Professor Michael Jacobs**, University of Sheffield

**Sir John Kay**, St John's College, Oxford

**Dr Andrea Lagna**, Loughborough University  
**Professor Paul Langley**, Durham University  
**Professor Adam Leaver**, University of Sheffield  
**Professor Andrew Leyshon**, University of Nottingham  
**Professor Francisco Louçã**, Lisbon University  
**Professor Arthur MacEwan**, University of Massachusetts Boston  
**Professor Stephen A. Marglin**, Harvard University  
**Mick McAteer**, Former FSA and FCA Board Member  
**Professor Jonathan Michie**, Kellogg College, Oxford  
**Dr Johnna Montgomerie**, King's College London  
**Professor Richard Murphy**, Sheffield University Management School  
**Dr Alberto Paloni**, University of Glasgow  
**Professor Ugo Panizza**, Graduate Institute Geneva  
**Professor Raj Patel**, University of Texas at Austin  
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**Ann Pettifor**, Progressive Economy Forum  
**Vicky Pryce**, King's College London  
**Professor Dani Rodrik**, Harvard University  
**Dr Joshua Ryan-Collins**, University College London  
**Professor Diego Sánchez-Ancochea**, Oxford University  
**Professor Malcolm Sawyer**, University of Leeds  
**Professor Francesco Scacciati**, University of Torino  
**Dr Andy Schmulow**, University of Wollongong  
**Professor Leonard Seabrooke**, Copenhagen Business School  
**Nicholas Shaxson**, Balanced Economy Project  
**Lord Prem Sikka**, University of Sheffield  
**Professor Pritam Singh**, Oxford Brookes Business School  
**Professor Joseph E. Stiglitz**, Columbia University  
**Dr Geoff Tily**, Trade Union Congress  
**Professor Adam Tooze**, Columbia University  
**Professor Jan Toporowski**, SOAS, University of London  
**Professor Dimitri Vayanos**, London School of Economics  
**Professor Yanis Varoufakis**, University of Athens  
**Professor Matthew Watson**, University of Warwick  
**Professor (mso) Duncan Wigan**, Copenhagen Business School  
**Professor Jonathan Williams**, Bangor University

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## Endnotes:

1. See e.g. [Pursuit of 'competitive' regulation makes unwelcome return in UK](#), Helen Thomas, Financial Times, Nov 12, 2021.
2. Cecchetti, S. G., & Kharroubi, E. (2012), *Reassessing the impact of finance on growth*. BIS Working Paper, no. 381; Cecchetti, S. G., & Kharroubi, E. (2018), *Why does credit growth crowd out real economic growth?*. NBER Working Paper 25079, Sept 2018; Arcand, J. L., Berkes, E., & Panizza, U., *Too Much Finance?* IMF Working Paper WP 12/161. (2012); Arcand, J. L., Berkes, E., & Panizza, U., *Too much finance?* Journal of Economic Growth, 20(2), 105-148 (2015).
3. For instance, Beck et al. (Journal of Financial Stability 10:50–64, 2014) criticise the “Too Much Finance” literature and find that finance benefits growth, whereas [Sturn & Zwickl \(2016\)](#) in turn find that Beck’s research “depend on outliers and are not robust against alternative specifications or estimation approaches. . . . Beck et al.’s criticism of the “Too Much Finance” literature is grounded on thin empirical evidence.” See also [Sturn & Epstein](#), 2021, looking at methodological problems in how the finance-growth nexus is typically studied. They conclude: “Too much finance is robustly found to harm growth.”
4. “Competitiveness” is not effectively defined in the FRF, or in the Treasury’s related 2021 document “[A New Chapter for Financial Services](#).” Elsewhere, however, Rishi Sunak in March 2021 [explained](#) it as a need for the UK to be “an attractive domicile for internationally active financial institutions, and that London retains its position as the leading international financial centre.” The Financial Services Act 2021 [says](#) that the FCA must have regard to “the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities.”
5. John Glen – 2022 Speech to [TheCityUK Annual Dinner](#), Feb 12, 2022. “We have taken a balanced approach and chosen to introduce this new objective as secondary. This provides clarity – you might say a clear hierarchy – when there may be a tension between regulators’ various objectives.”