Regional Imbalances in the UK Economy Inquiry:

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Summary

This submission engages mostly with the first part of the inquiry, concerning the nature and consequences of the UK's regional imbalances. Our main task is to offer a new prism through which to view the issues. We also make some focused and some general recommendations, including suggestions for improving measurement.

In particular, this article uses a short piece of forensic research, complemented by a growing body of research from the International Monetary Fund (IMF,) the Bank for International Settlements (BIS), and others, to challenge a widespread view that London is necessarily the 'engine' of the British economy, creating jobs and wealth and showering taxes and subsidies on other parts of the country, in a grand one-way flow.

For example, a 2017 article in the *Financial Times,* entitled "Why London deserves a thank you note from the rest of Britain," argued:

> London "is definitively the cash cow that allows [politicians] to promise the high quality public services all parts of the country crave

> . . .
>
> Official estimates show that "In 2015-16, average Londoners paid £3,070 more in tax than they received in public spending . . . if London was a nation state, it would have a budget surplus of 7 per cent of gross domestic product, better than Norway. . . . the idea that London sucks the life out of other parts of Britain is absurd."

Supporting this view, the Office for National Statistics (ONS) presents regional data for Gross Value Added (GVA,) showing London's per-capita productivity at 179 percent of the UK average, while West Wales & the Valleys are at just 63 percent. While other studies suggest that the true picture is less stark after adjusting for workforce, housing, industry mix and other factors, this has not dented the conventional view[1].

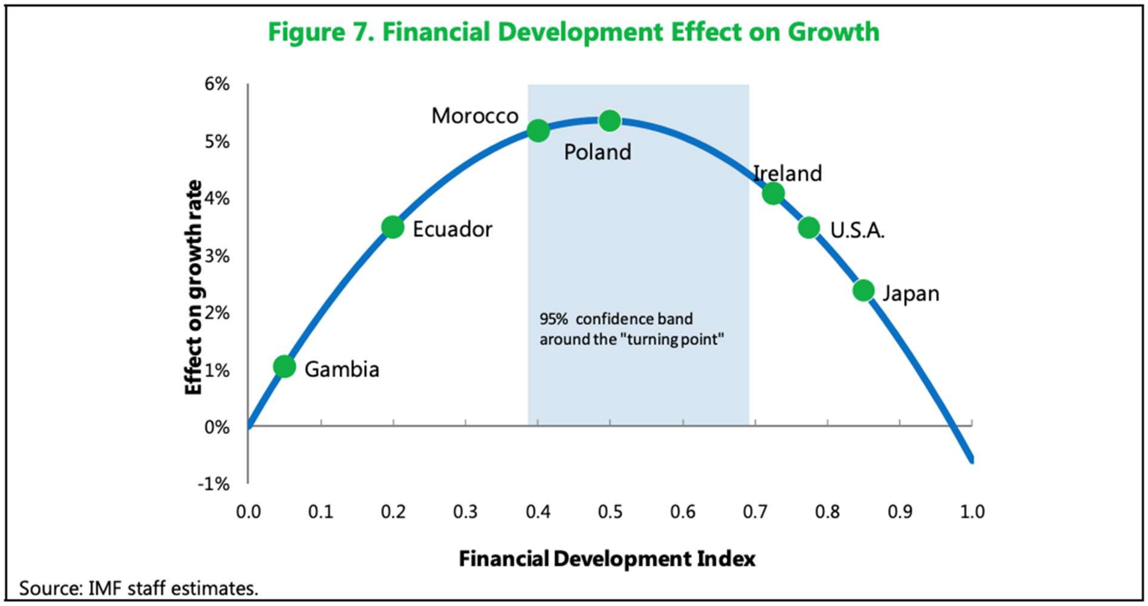
Our view paints a more nuanced picture, which shows how a group of actors concentrated heavily in London and the South-East of England are as likely to have wealth *extracting* effects from other parts of Britain, as they are to have wealth *creating* effects that allow redistribution to the regions. This worsens London's gravitational pull on resources and talent from other parts of the country. The actors involved are disproportionately employed in the financial sector. As one analysis put it, "The vigour of finance derives precisely from its ability to capture resources from the rest of the economy.[2]"

As documented below, this has important regional implications given that in the case of those activities that have wealth-*extracting* effects, the regions away from London (along with poorer parts of London) are more likely to be the parts of Britain extracted *from*, while wealthier parts of London and its hinterlands are more likely to be where the national or global headquarters are located, receiving the proceeds. So the very obvious one-way flow of wealth as evidenced by London's tax and budgetary and jobs contribution, is only the most visible part of a more complex, less visible, two-way flow, with powerful and troubling regional implications. We argue that these sorts of activities are far more pervasive than is commonly understood.

1. Introduction: The 'Too much finance' literature

A growing body of econometric research since the global financial crisis has established clearly that countries can have 'too much finance.' That is, deepening and broadening access to financial services is beneficial, up to an optimal point, after which further financial development starts to reduce economic growth.

This has powerful national <u>and</u> regional implications for Britain. This stylised graph from the IMF shows the basic relationship, an inverted 'U' shape which is repeated in several studies.[3]



Source: Sahay et al., IMF, 2015

While this IMF report did not identify the UK on the curve, other reports, using different measures of financial sector size, have shed light. To summarise one:

> "The too much finance literature uncovers an inverted U-shaped relationship between credit to the private sector and GDP growth (Arcand et al, 2015, Cecchetti and Kharroubi, 2012, 2015). This literature puts the threshold turning point where credit starts to impact negatively on growth at around 90-100 per cent GDP. In the UK, average credit to the private sector during 1995-2015, was 160 per cent of GDP."
>
> *(Baker, Epstein, Montecino, 2018: p8)*

In other words, the various research articles suggest that Britain's credit to the private sector – one measure of financial sector size – passed its optimal point long ago. The same report by Baker, Epstein and Montecino estimates a £4.5 trillion cumulative impact on the UK economy from 1995-2015, as a result of the British financial sector having expanded beyond its optimal size and its useful roles. While this figure is based on international comparative data and clearly needs further investigation in Britain's case, the three components of the damage that the researchers identified are relatively uncontroversial, and have been studied elsewhere:

1) **The costs of the financial crisis**, estimated at £1.8 trillion. (Andrew Haldane of the Bank of England estimated in 2010 that the crisis cost Britain £1.8-7.4 trillion in long-term losses.[4])
2) **Misallocation costs**: that is, efficiency losses due to the financial sector crowding out and harming other sectors: £2.7 trillion.
3) **Excess profits and rents**: £680 billion (this was not added to the final £4.5 trillion total, since an unknown portion of these costs fall on the shoulders of residents of non-UK countries).

The largest component was 'misallocation costs', though all three components are relevant for understanding regional imbalances, in terms of a geographical analysis of where the winners and losers are, as we explain further below. These misallocation costs seem to loom relatively larger for the UK than for the US: a similar investigation (Epstein & Montecino, 2016) identified a smaller overall harmful impact on the US relative to the size of its economy, and a lower share of misallocation costs.

2. Those misallocation costs

The econometric 'Too Much Finance' literature has (so far) only limited explanatory power. A newer analysis, broadening the frame of analysis, is the *Finance Curse*, which affects jurisdictions like Britain dominated by an oversized financial sector.[5] This is analogous to the Resource Curse afflicting some countries (like Venezuela, Angola or Iraq) over-dependent on a sector producing natural resources like oil, which may end up *poorer* and with worse development outcomes than would have been the case without the resource. This "Paradox of Poverty from Plenty" has been well studied since the mid 1990s and is known to have multiple causes: a brain drain of skilled, talented people out of government, out of industry and out of civil society into the high-pay dominant sector; rising (and growth-sapping) inequality between the dominant sector and the rest; a Dutch Disease impact arising from financial inflows linked to the dominant sector raising price levels in the domestic economy, making other tradable sectors less competitive with imports; recurrent crises led by commodity price roller-coasters; or a rise in rent-seeking and corruption and a related loss of entrepreneurialism at the expense of genuinely productive, wealth-creating activities, as easy money (from an oilfield, say,) flows in.

Baker, Epstein and Montecino in explaining their 'misallocation costs' identify a similar set of pathologies facing Britain, with its oversized financial centre (discussed on pp12-14 of their report). They add two further effects. First, *Harmful financial agency* – conscious decisions by predominantly financial actors to allocate resources in ways that may inflict collateral economic damage. Second, *structural gravitational forces* that go beyond the brain drain and involve what Haldane (2012) called a "vacuum cleaner effect[6]" also pulling assets and investments away from their most productive uses, into more profitable but less productive activities elsewhere, with the winnings tending to accumulate in SE England and the City of London hinterland (and to a much lesser extent in regional hubs or university towns,) while the losses arise more uniformly across the country. The sections below outline some ways in which this has happened.

The 'Too Much Finance' literature and the newer Finance Curse analysis overlap with a broader and older academic literature on "financialisation", which is generally taken to refer to two things: first, the financial sector expanding faster than the underlying economy, and second, application of financial techniques, practices and debt into non-financial parts of the economy, with the primary goal of maximising shareholder value for owners. This trend frequently involves a shift from wealth-creating activities towards more predatory wealth-extracting activities such as rent-extracting monopolisation, too-big-to-fail banking, the use of tax havens to escape from laws and taxes, or the widespread purchase of well-functioning businesses (by a private equity firm, say) for the purpose of financially engineering them for greater profit at the expense of the acquired firm's many stakeholders. In all these activities, a wealth-extracting shell sits around a useful wealth-creating core, generating distortions and 'misallocation costs' that harm overall prosperity but also have major regional implications.

The example below illustrates a particular wealth extraction technique, and shows how this can have damaging regional effects. It then links this to broader trends.

2.1 Police Training Centre in Scotland

In July 2002 HRH Prince Charles opened the Strathclyde Police Training and Recruitment Centre in East Kilbride in Scotland. Now renamed the Police Scotland College at Jackton (pictured), the project was part of the Private Finance Initiative.

Latest official data record the project as having a capital value of £17 million (though news reports said the project cost was £27.5 million.) However, the same official data show a stream of payments to the company delivering the project of £111 million over the 26-year financing life of the project.[7] This fourfold to sixfold disparity between project capital cost and total repayments is only partly explained by standard discounted financing costs: it would have cost the government roughly £35-50 million had it financed the capital value of this project by issuing a bond paying five percent interest, and used the proceeds to pay private contractors directly.

Such discrepancies are common for PFI, which is widely reported to be delivering poor value for money: "one hospital for the price of two," as one expert has put it, with "grotesquely high returns on equity".[8] It is also well known that excessive financing costs go a long way towards explaining the high costs of PFI projects. However, a more forensic exploration of the corporate structure and financial flows involved provides useful new regional perspectives.

The equity holder for this particular PFI project was officially recorded in the government's 2016 database as "Strathclyde Limited Partnership,"[9] whose corporate structure – and this is a *simplified* version of the full ownership structure — went as follows (it is not necessary to do more than a skim-read in order to get a sense of it).

Strathclyde Limited Partnership: structure of ownership and control (2016/7,) including financial charges against each*, **, ***

Hunt companies, Inc. (El Paso, Texas)

Ultimate parent of *Owners??*

Hunt Amber Development US, LLC **Hunt Amber Holdings US, LLC (Delaware)**

Owns 35 x £1 shares (35%) *Owns 65 x £1 shares (65%)*

Hunt Amber London 1 Limited

Owns 1 x £1 share (100%)

Hunt Amber London 2 Limited

Estera Trust (Jersey) Limited
Ambre Holdings SARL (Lux)
Michael John Gregory
Orangetone Limited
Thomas Brendan O'Shaughnessy.

Majority shareholder *Minority shareholders of*

Amber Infrastructure Group Holdings Limited

Owns 56.9m shares @£0.0625p each

Amber Infrastructure Holdings Two Limited (2 *Charges)*

Owns 3.56m shares @£1 each (100%)

Amber Infrastructure Holdings Limited *(1 charge)*

Owns 3.56m shares @£1 each (100%) *Owner***?**

Amber Infrastructure Group Limited *(3 charges)*

Owns 1 x £1 share (100%) Empty filing history

International Public Partnerships GP Ltd
(27 charges)

International Public Partnerships LP

General Partner of *Limited Partner of*

IPP Holdings 1 Limited

Owns 10,005 x £1 shares (100%) *owns 1 x £1 share*

IPP Bond Limited **IPP Investments UK Limited**

(1 securities pledge agreement)

General Partner of *Limited Partner of*

IPP Investments Limited Partnership

Owns 1000 x £1000 shares (100%) of

Bootle Derby Holdings Limited

(1 charge)

Owns 2 x £1 share (100%) of

IPP PFI Holdings Limited

(8 charges)

Owns 2 x£1 share (100%) of

Fieldsecond Limited

(2 charges)

Owns 2 x £1 share (100%) *owns 2 x £1 share (100%)*

Strathclyde Limited **IPP Properties (Strathclyde) Limited**

(8 charges) *1 charge*

General Partner of *Limited Partner of*

Strathclyde Limited Partnership

Project Equity holder (100%)

POLICE TRAINING CENTRE

Source: Nicholas Shaxson, Finance Curse (book,) footnote 4 p333, supplemented by subsequent research at Companies House.
** Most data was collected from 2017: ownership structure may have changed:*
*** If an entity has no charges against its name, charges are not known or absent.*
** * * The accounts for several of these companies also list various entities as the ultimate controlling parties for the different companies: International Public Partnership Limited (Guernsey) as the ultimate controlling party for some entities in this structure; but also at different points in the structure the ultimate controlling parties were listed as: IPP Holdings 1 limited (UK); Amber Infrastructure Group Holdings Limited (UK,) and Hunt Companies, Inc.*

Nothing remotely illegal is being alleged here. Yet it raises an important question: what is the purpose of this astonishingly complex corporate tower sitting atop a police training centre in Scotland?

The shortest answer is that this is a classic example of the financialisation of apparently mundane parts of Britain's economy. As explained below, this is not an outlier: it is increasingly the way business is done.

Such structures serve several purposes. Some may involve genuine wealth creation, such as the generation of economies of scale, the provision of investment finance, and the efficient pooling of resources. However, alongside these gains, many other, more extractive activities are evident.

Overall, the general purpose of such complexity is for the owners higher up in the corporate tower to obtain maximum possible rewards from a particular arrangement, while shifting maximum risks onto others' shoulders. This occurs in several ways (these are general bullet points, which don't necessarily relate to the specific Strathclyde structure):

- Investing minimal amounts of their own money as share capital at risk. For example, most of the ownership links in the above example involve nominal shareholdings, with issued share capital often of just £1 or £2.

- Using limited liability laws to minimise their own exposure to risk and liabilities, beyond their share capital applied. (To be fair, there are sometimes other channels beyond share capital by which liabilities can sometimes be transmitted up the chain.)

- Complementing this, complex vertical structures help maximise the amount of external financing ("Other People's Money," or OPM) available to complement or replace the use of share capital.[10] The complexity helps in this respect, providing investors and lenders with a range of preferences for risk and reward at various points up and down the corporate structure, investing at a holding company level, or lower down at the level of an individual investment, or higher up in the parent company. This ability to offer a wide variety of investment opportunities, each with a different mix of risk and reward and focus, enables the group to attract maximum "assets under management". For instance Amber Infrastructure Group Holdings Ltd. in the above example said on p2 of its financial accounts for the year ending 2016 that its revenues substantially reflected "fund and asset management fees as well as significant advisory and development fees."

- In a related point, this structure creates myriad opportunities to use debt. For example, financing often comes through secured loans — either from outside parties, or from related parties — instead of through share capital. Debt, in turn, can be deployed for several purposes, beyond OPM.

- Loans can be used to enable companies to escape tax, for example through high-interest bearing shareholder loans to or from related parties. For example, one affiliate lends to another, charging the highest allowable annual interest rate (for example, the now-bankrupt Caffé Nero saw an intragroup loan in 1997 carrying interest rates that varied between 19 and 25 percent annually.) These interest payments are treated as costs, receiving 100 percent tax deductibility in the UK, while the affiliate receiving those payments is typically set up in a tax haven, where it may pay little or no tax. Overall, the group tax bill – and public revenues – fall[11]. Note that no productivity improvement results: merely a transfer of wealth **from taxpayers** to shareholders and fund managers.

- These loans can be used for risk-shifting purposes. The shareholder loans between related parties are often not repaid but rolled over and added to the original loan total. If there is bankruptcy, those who provided the loans tend to stand at the front of the queue for recovering assets, in contrast to **shareholders** and **suppliers** or **workers** who stand at or near the back. Again, this is what happened with Caffe Nero's bankruptcy, for instance, which was part of an opaque "maze of companies" linked to the tax havens of the Isle of Man and Luxembourg, and which *"has not paid any corporation tax in the UK for the last decade despite total sales of around £2bn through its 637 shops **across the country.**"*

- Banks, which provide external financing to such structures, also stand at or near the head of the queue in bankruptcies, and are thus eligible for higher levels of recoveries from bankruptcies than are those providing share capital, or **local suppliers**, **or local employees or local pensioners**, or taxpayers.

- The logic of powerful and constant demands for loan repayments sets up a 'pressure' at the bottom of the structure to maximise returns upwards through the corporate structure. When such structures are involved in home care – to take one example – this can create terrible and harmful pressures on **local carers** and **local patients** and on **local councils**.[12]

- Holding company structures can be used to acquire competitors in a sector, increase market power, and thereby extract monopoly rents from a range of stakeholders: from **local employees**, from **taxpayers**, from **local councils**, **local consumers**, **local suppliers**, and more.

Our **emphasis** has been added to the above to aid an analysis of the distributional impacts of financialisation between winners and **losers**.

The winners from this corporate structure are the owners of (or are otherwise linked to) the entities or arrangements named above. All of these named entities apart from the entities in El Paso, Texas, and the police training centre itself, are based at 3 More London Riverside, by Tower

Bridge in London). What is more, the accounting firms and the banks for all the different accounts and charges examined (there were far too many to investigate), were also all registered in or near central London, or in the United States, Canada, or in various tax havens. To summarise: these are the winners from this structure.

The losers, the generic victims of these extractive activities, are the ones highlighted in bold: local carers, local patients, local councils, local employees, local consumers, local suppliers, UK taxpayers more generally.

Clearly this is a pipeline which, while delivering a valuable service (in the Strathclyde case, a police training centre), contains a rather invisible superstructure perched atop it which extracts wealth, representing the excessive part of those £111 million repayments earmarked over 26 years.

In other words, that financial superstructure extracts wealth from Britain's regions, such as East Kilbride and Scottish police budgets in this case, and delivers it to central London, its hinterlands, overseas and offshore.

2.2 The wider UK regional and national economy.

Complex corporate structures like this are commonplace, not just with PFI projects, but across the UK economy. Several PFI companies have been explored, every one of which involved a comparable corporate structure, at least in form if not in detail, all with similar regional implications[13]. What is more, investigations of a rash of recent corporate bankruptcies have revealed the same, damaging extractive infrastructure perched atop the genuine business: including British Steel, Carillion, Maplins, Toys R Us, HMV, and others.

This is not an aberration of British capitalism: these complex corporate structures reflect techniques and arrangements that increasingly lie at the heart of the British economy, each with the same rough implications for regional imbalances. (As an aside, one could make a similar analysis where, instead of focusing on geographical flows, one could focus on winners and losers along gender lines, or along racial lines, or other lines, where financial techniques are delivering wealth away from more disadvantaged groups to more privileged groups – though that is outside the scope of this report.)

The genus of complex corporate towers highlighted here constitute just one of a range of types of 'misallocation,' extractive or otherwise, all of which are antithetical to genuine productivity, both at an overall UK national level but most especially at a regional level. In the words of accounting professor Adam Leaver at Sheffield University Management School, such activities:

> *"sedate the creative impulses of socially useful entrepreneurialism. If money-making becomes too easy, capital will flow to those areas at the expense of others. It is now too easy for firms and individuals to strip cash out of bloated assets and shift the proceeds to tax havens and this now distorts the overall allocation of capital within the national economy."*[14]

A few generic examples of other, different kinds of mechanisms will suffice to illustrate the point:

- **The global financial crisis.** The large wealth-extraction pipeline was to a large degree a temporal one, which became a geographical one. Ahead of the crisis, financial players mostly in London and its hinterlands and offshore enjoyed large profits from taking large risks, in the tacit knowledge that "I'll be gone, you'll be gone" if and when the risks materialised in crisis. In the end it was British taxpayers, writ large, who picked up the costs, not just in terms of bank bailout costs but also in terms of wider economic damage. Ensuing national and local government spending cuts have had disproportionately large impact on the regions. The whole process has been obfuscated by a *"morally-laden (and quite widely accepted) discourse about the unfair subsidies received by the regions and advocacy by some influential Londoners to keep more of 'their' income," while the reality has been described as the "metropolitanisation of gains, the nationalisation of losses."*[15]

- **Monopolisation.** In short, large financial and multinational firms are able to leverage their market power to extract supersized profits from their stakeholders - whether they be suppliers, investors, employees, pensioners, pension funds, taxpayers, consumers or other interest groups. For instance:

    - As discussed above, too-big-to-fail banks exert market power not just over clients and counterparties but also over taxpayers, as their systemic risk profile almost guarantee that taxpayers will bail them out when the next crisis hits.

- The Big Four accounting firms offer advisory services, tax minimisation services, and others, alongside their accountancy services, enabling them to milk a range of profitable conflicts of interest, at the expense of those audited, of those who are the victims of bad audits, of their clients, and of governments, who may receive bad tax and other advice that is tilted towards their clients' interests. This has been extensively researched.[16]

- Social media groups. Facebook, for instance, uses its enormous market power to entrap its users into a devil's bargain, where if users want to connect with friends on this unique platform that benefits from network effects, they have no choice but to accept potentially dangerous terms that may allow their data to be used for socially harmful purposes, spreading political damage, as the Cambridge Analytica scandal showed. Facebook's UK headquarters is in Rathbone Square in central London, while most of those subjected to its mass surveillance techniques are spread across the country.

- Large supermarket firms, which can exert enormous market power over their suppliers, and sometimes over their customers, who often have few other alternatives.

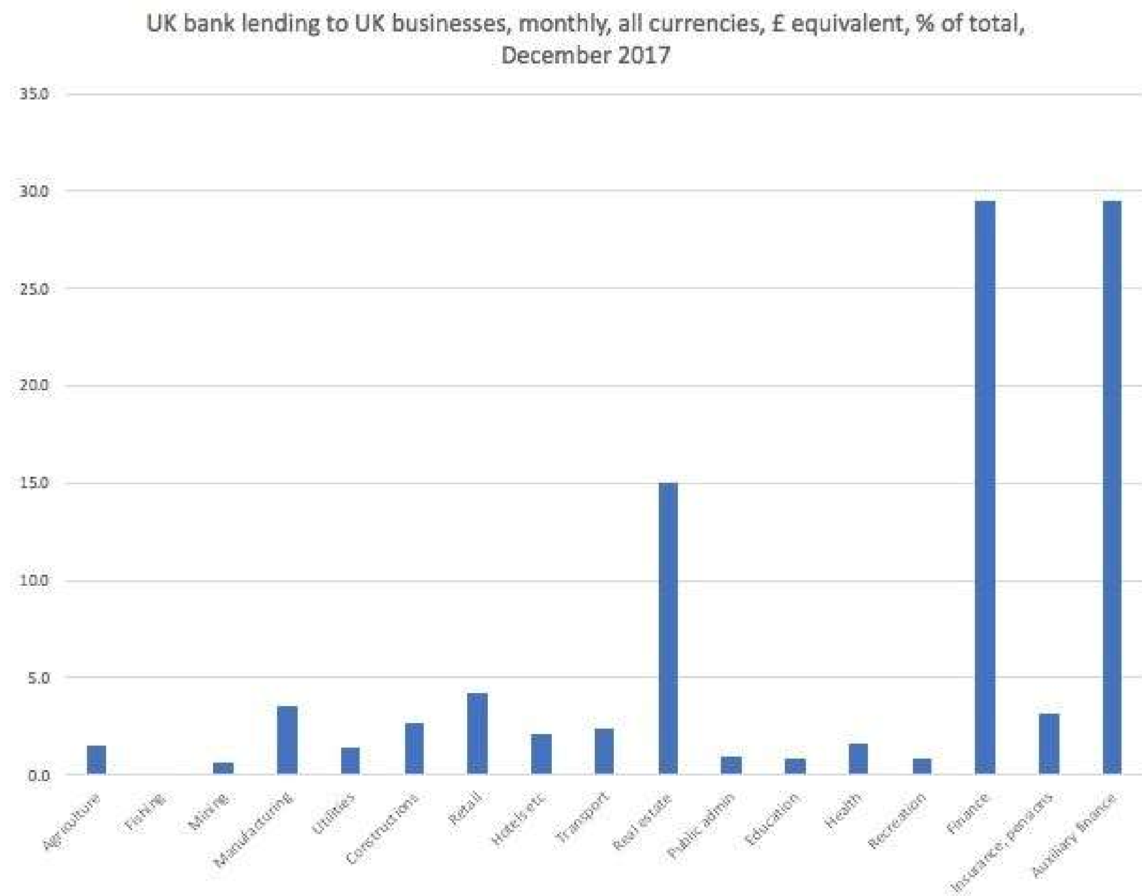
• **Transfer pricing.** Multinational firms may use transfer pricing techniques to manipulate the prices of transactions between affiliates, to shift profits into tax havens, and shift losses into high-tax countries, thereby cutting their tax bills in countries including the UK.

Various other financial extractive mechanisms exist.

These geographical patterns involving the metropolitanisation of gains and the regionalisation of losses are not only the result of *deliberately* extractive activities, but are part of a wider picture of centralisation and the 'gravitational pull' of investment and resources and political attention towards London that penalises the regions – as Section 2.2 below briefly illustrates. These patterns create an unproductive net shift of wealth away from the regions, along with associated overall inefficiencies at both a national and especially a regional level.

2. 2 Bank lending in the UK

The following rather startline graph, assembled from Bank of England data in 2018, illustrates the 'gravitational pull' of finance, as it has become increasingly dedicated to serving itself, rather than to other parts of the British economy.



(Source: Bank of England Statistics, Table C1.2, Industrial analysis of monetary financial institutions' lending to UK residents, amounts outstanding of lending in all currencies, compiled at www.financecurse.net, Sept 14, 2018.

In simplified tabular (and updated) form, the following selection of data highlights the 'misallocation' issue starkly:

Outstanding lending by UK resident financial institutions to UK residents, all currencies, Jun 2019		
As of March 2019	*£billion*	*% of total excl. individuals*
Agriculture, forestry	19	1.5
Manufacturing	50	3.9
Construction	32	2.5
Wholesale, retail	51	4.0
Real estate, professional services	195	15.2
Financial intermediation (excl. insurance, pension funds)	397	30.1
Insurance and pensions	41	3.2
Activities auxiliary to financial intermediation	355	27.6
Total all activities*	**1,285**	**100****
Memo: total lending to finance, real estate, insurance, pensions, auxiliary finance	*988*	*76.9*

**excludes lending to individuals and individual trusts*
*** totals do not add up to 100 because only a selection of sectors is included*

In other words, outstanding lending to finance, real estate, insurance, pensions and auxiliary finance constituted 76.9 percent of all lending by UK financial institutions to residents, while only 3.9 percent of lending was allocated to manufacturing. This is another demonstration of 'misallocation'. This reduces the success and resources of other sectors of the economy, making it harder for them to compete in international markets and to survive in domestic markets (Baker, Epstein and Montecino, 2018.)

Again, the regional implications are serious, since manufacturing activities (for example) are spread across the country, while finance and associated activities are heavily concentrated in central London.

A London-centric financial sector, its practices and cultures thus contribute to what the Bank of England's Andy Haldane has called the UK's long, low productivity tail, with relatively little loan financing going to a large number of struggling Small and Medium Enterprises (SMEs), while a small number of large, productive companies are able to secure financing. This stands in comparison to Germany, where SME lending is more available, and typically from localised funding sources lending to local borrowers.

It would be a most useful research exercise to identify how much of the lending by UK financial institutions is being directed towards the kinds of extractive activities identified in the examples above – for example, the transfer pricing-related loans mentioned above – and how much is being directed towards genuine wealth-creating activities. What is more, it would be useful for the Bank of England to compile statistics of UK financial institutions' lending to the regions, broken down by sector.

3. CONCLUSION: Policy changes, and measurement issues

A simplistic approach to addressing Britain's regional economic imbalances, on the above analysis, would identify parts of the financial sector as extractive, then seek to shrink such parts, in the name of regional rebalancing. It may indeed be possible to consider how and which parts of the financial sector may usefully be made smaller, and regional and national cost-benefit analyses conducted of various strategies for doing this.

However, a more nuanced approach would recognise that many of the more extractive sectors, and more broadly those forces that represent the 'gravitational pull' of investment and resources and effort and talent away from the regions (and from poorer parts of London) towards the parts of London and its hinterlands that represent the 'winners', are frequently inseparable from one another. Useful and productive lending and investment, for instance, are entangled with leverage techniques and securitisation, which contributed to the global financial crisis and may do so again.

Measuring these effects will be difficult, requiring innovative new ways for identifying financial extractive mechanisms, or other gravitational effects. For instance, might one estimate the scale of wealth extraction via excess market power and put this in a regional context?

In some cases, however, whatever the measurement difficulties, policy measures can help to "sort the wheat from the chaff" even when the two are hopelessly entangled. For example:

- One way to reduce the unnecessary and productivity-draining complexity of these corporate towers, would be to curb (or entirely abolish) tax relief on all interest payments, and /or to reduce the allowable interest rates that can be charged on intragroup lending. As Section 2.1 suggests, these measures could have positive impacts in regional terms.
- Stop the systematic abuse of limited liability for private equity and

similar investments, making the acquiring firm liable for that company's debts, and making it easier for creditors to access the assets of fund sponsors and general partners.[17]

- Enact much stronger competition policies, to curb monopolisation, which is in itself a centralising economic force, and which delivers great wealth to the winners in central London and its hinterlands, and offshore, to the detriment especially to the UK's regions. There are currently relatively limited analytical resources available in the UK to help policy makers see beyond the conventional wisdom on monopolisation: it may be useful to consult or examine the output of US-focused groups such as the Open Markets Institute, who can provide pointers towards powerful new approaches that might be taken.
- Break up the Big Four accounting firms, along the lines of their highly profitable conflicts of interest. The regional dimensions of this could be profound, since the current set-up sees the victims of such conflicts spread rather evenly across Britain's regions, with the winners in London, its hinterlands and offshore.
- A more activist state could nurture, create, legislate for and oversee an SME lending sector more along German lines, whose core purpose is to identify long term prospects, including new market entrants, and invest in and cultivate these enterprises. A mandate to reduce regional disparities could be included in such a package, with autonomous regional offices with local knowledge, and a remit to lend and finance

activity within tightly bounded geographical domains. This would prioritise ‘relationship banking’ based on local knowledge and expertise, rather than through risk models presided over by head office designed to maximise “*shareholder value*” (a term that, incidentally, needs unpacking: in its crudest form the term implies maximising wealth extraction on behalf of owners, and its pursuit has had profound regional implications[18].) This could be complemented with properly funded regional development banks, alongside a cultivate private regional credit lending regime. At the same time, one could (for example) create rules so that every financial institution above a certain size needs to allocate a percentage of its lending to a strongly firewalled SME sector, and to comply closely with its tight regulatory requirements.

These are a few examples of what might done: many other policy measures are conceivable. The main purpose of this submission has not been so much to make policy recommendations, as to provide a more appropriate frame for understanding and recognising some of the flows and processes that are damaging Britain’s regional economies, and to advance a recognition that a policy of seeking to “uplift the regions while treating London as the engine of the economy” will face insurmountable headwinds.

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END

[1] See 'Local productivity: The real differences across UK cities and regions,' Christina Beatty and Stephen Fothergill, Sheffield Hallam University project report, 2019. The report, after making a series of adjustments including the fact that the financial sector is concentrated in London, estimates that London's adjusted productivity is just 111 percent of the national average.

[2] 7 ways the 'Finance Curse' harms the UK – how can we lift it? Andrew Baker and John Christensen, Open Democracy, Nov 1, 2018. This article summarises, among other things, Baker's co-authored work *The UK's Finance Curse? Costs and Processes*, Andrew Baker (University of Sheffield), Gerald Epstein (University of Massachusetts Amherst) and Juan Montecino (Columbia University,) Sheffield Political Economy Research Institute (SPERI,) Oct 5, 2018, and Nicholas Shaxson's book *The Finance Curse* (Penguin Random House, 2018.)

[3] For a collection and summary of the main research papers in the "Too Much Finance" field, see https://financecurse.net/research/academic-papers-too-much-finance/

[4] See *The $100 billion question,* Andrew G Haldane, Comments given at the Institute of Regulation & Risk, Hong Kong, 30 March 2010.

[5] The first academic article published on this is *The Finance Curse: Britain and the World Economy*, John Christensen, Nick Shaxson, and Duncan Wigan, British Journal of Politics and International Relations, Jan 5, 2016.DOI: 10.1177/1369148115612793. This was followed by Baker, Epstein and Montecino (2018), which estimated that the UK may have suffered a cumulative £4.5 trillion economic damage from 1995-2015 as a result of its financial sector being above its optimal size. This was complemented by Nicholas Shaxson's more journalistic book, *The Finance Curse,* (Penguin Random House, 2018) exploring political, social and economic aspects of the phenomenon.

[6] Haldane, A. (2012). *A leaf being turned*. A speech given by Andrew G. Haldane, Executive Director, Financial Stability and member of the Financial Policy Committee, Bank of England to Occupy Economics, "Socially useful banking" at Friend's House, Euston, London on, 29.

[7] See Private Finance Initiative and Private Finance 2 projects: 2018 summary data / Current Projects as at March 31, 2018. Row 531, Col. P.

[8] On the quote, see "Stop Protecting PFI Contracts," Allyson Pollock and David Price, The Guardian, 4 Nov 2010. The National Audit Office backs this up, reporting that rewards have been "sizeable compared to the original amount of equity." See Equity investment in privately financed projects, NAO, Feb 10, 2012, p5.

[9] In the more recent official data, the equity holder for the project had had a different name, "Amber Infrastructure Group Holdings Limited." The 2016 example is used because Strathclyde Limited involves a more complex (and thus illustrative) chain of ownership and control, and was previously investigated for the Finance Curse book, including sending relevant details to the parties involved for comment.

[10] Other People's Money, or OPM as some in the markets call it, is the title of John Kay's seminal book on finance and financialisation. The key OPM technique is to maximise assets under management, from which to charge maximum fees, while putting as little of one's own money at risk as possible. As one analysis put it, the controllers of such structures are like "a croupier presiding over a roulette table surrounded by gambling addicts. Whatever the outcome for the players, the croupier makes a steady return. Indeed, if he wants to increase the take, he simply spins the wheel more frequently." See *British Steel shows the poor incentives embedded in private equity*, Jonathan Ford, Financial Times, May 28 2019.

[11] See, for instance, *Here's how Caffe Nero made £2bn in sales but didn't pay a penny in corporation tax*, Prem Sikka, leftfootforward.org, March 12, 2018.

[12] For an examination of exactly these pressures in the home care industry, see the private equity chapter in Nicholas Shaxson's book *The Finance Curse.*

[13] Several examples are given in The *Finance Curse* book, in various places.

[14] See *Disgorging the social settlement: What the Paradise Papers tell us about firms*, Adam Leaver, SPERI blog, Nov 10, 2017.

[15] See *The metropolitanisation of gains, the nationalisation of losses,* Adam Leaver, Open Democracy, Sept 25, 2013. It's been widely reported that spending cuts have impacted lower-income councils worse than others: for a powerful account of this, see The Strange Death of Municipal England, Tom Crewe, London Review of Books, Dec 15, 2016.

[16] See, for instance, work by Atul Shah on the Big Four accounting firms; and Richard Brooks' 2018 book *Beancounters,* which examines the conflicts of interest and market power and their effects in great detail.

[17] Exactly this has recently been proposed by Elizabeth Warren, a candidate for the Democratic party's presidential nominee, in her "Stop Wall Street Looting Act." See *Elizabeth Warren is right to worry about private equity looting*, Jonathan Ford, Financial Times, July 28, 2019.

[18] The "Shareholder Value" ideology has been widely critiqued. See, for instance, "The Myth of Maximizing Shareholder Value," interview with Bill Lazonick, Institute for New Economic Thinking (INET,) available freely on Youtube, Jan 23, 2014.