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Groundhog Day

**Elite power, democratic disconnects and
the failure of financial reform in the UK**

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Groundhog Day: Elite Power, Democratic Disconnects and the Failure of Financial Reform in the UK¹

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ABSTRACT³ *This paper starts from a paradox: the post 2008 financial crisis is the most profound financial and regulatory crisis in the UK since before the First World War and yet it has (so far) produced negligible reforms like the Vickers proposals for ring fencing. In terms of fundamental principles and priorities, the UK is trapped in a Groundhog Day kind of time loop with elite politicians still biased in favour of finance. Our explanation is two-fold. First, finance wins because the crisis has strengthened the power of conservative financial, bureaucratic and political elites within our governing structures. Second, a series of democratic disconnects have disempowered the critics of finance in the technocracy and civil society who have been unable to turn popular hostility into effective reform of finance. The disconnects are such that, after the decline of the mass parties, it is difficult to convert the radical technocratic agenda or civil society activism into effective policy reform. Reform is postponed until some means is found of linking programmatic action with civil society discontent.*

KEYWORDS: Financial crisis; regulation; City of London; technocracy, civil society protest

¹ The paper reports continuing research on the financial crisis at the Centre for Research on Socio-Cultural Change (CRESC), University of Manchester. It summarises and updates the book length argument of Engelen *et al.*, *After the Great Complacency*, (Oxford University Press, 2011).

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“...Financial services must and will have a vital role to play in London and Britain's economic future. That is why I am determined that the City of London remains one of the world's most successful financial centres.

It's clear that, before the global financial crash, bank regulation wasn't tough enough here in Britain and around the world.....But we must be careful not to throw the baby out with the bath water. Yes, we need radical reforms to the banking system to protect customers and taxpayers and support the wider economy. But we must also get the balance right and ensure reforms are pursued internationally to protect the hundreds of thousands of British jobs dependent on financial services.

And we must stand up for Britain's interests in the European Union, because we cannot defend jobs at home by retreating to the sidelines abroad.....And while I support an international tax on financial transactions, doing it only in Europe and not including major financial centres such as New York risks real damage to the City.....our Prime Minister and Chancellor should push for a ‘Robin Hood Tax’ with the widest international agreement”.

(Ed Balls, Evening Standard, 31 October 2011),

We are living through a great financial crisis which began in 2007-8 with US sub-prime, derivatives and the failure of Lehman; and it continues in 2011-12 with the euro zone crisis about the long chains of debt that connect South European governments and North European banks. It is by any standard a great national crisis in the UK because from 2008 onwards the crisis has required extreme policy intervention and completely undermined public confidence in banking and finance. The Bank of England admits the crisis of 2007-8 prompted ‘the largest UK government intervention in financial markets since the outbreak of the First World War’ (Bank of England 2008: 31). It reshaped the ownership of the banking system, making the state once again a significant player as owner, guarantor and regulator. It redefined the relationship between key public institutions, notably between the Bank of England and the core executive; and resulted in a peculiar kind of central bank-led economy because tight fiscal policy and expenditure cuts were balanced by ultra-loose monetary policy of zero interest rates and quantitative easing to keep the markets going. Crisis events and the policy response also destroyed public confidence in banks. The time series provided by the British Public Attitudes

surveys tells the tale. In 1983, 90 per cent of the national poll agreed that banks in Britain were well run; the confidence expressed was higher than for any other institution surveyed. Even in 1994, the figure was 63 per cent. By 2009, it had dropped to 19 per cent: 'this is probably the biggest change in public attitudes ever recorded by the British Social Attitudes series.' (Curtice and Park 2011: 141).

The longer-term outcome in terms of policy interventions and attitudes is massively uncertain in 2011 because the on-going Eurozone crisis is about long international chains of credit and debt, which are (so far) beyond management by national politicians on the European mainland who are also (so far) preventing the ECB from acting as lender of last resort. The present position is one of impasse which will shortly end in explosion. Chain failure will create unforeseeable and uncontrollable collateral financial damage in the North European banking systems of countries like France which cannot easily recapitalise their banking systems. Chain maintenance will meet understandable political resistances in Southern Europe to deflation and structural reform which is unlikely to produce growth. In all this, British politicians are bystanders. They can immediately profit by blaming the euro crisis for our deficient economic performance but will shortly have to deal with unpleasant consequences. The crisis has displaced the old line of division in British politics between those who opposed British adoption of the Euro in any circumstances, and those who saw its adoption as inevitable. The dominant line of division in the political system for the coming decade may be the alignment around attitudes to the unravelling of the European unification project on mainland Europe.

We should always heed Sam Goldwyn's advice and never make predictions, especially about the future. But, if we narrow the focus into a national level and survey the recent past, it is really striking that a big crisis has (so far) produced modest reforms and limited changes in elite mindsets. Three years of on-going crisis, since 2008 have publicly discredited banking and finance, and raised suspicions about the conventional wisdom of the political classes. But by autumn 2011, the balance of domestic forces was such that the impetus to reform was exhausted. In terms of outcomes, this became obvious in September when all political parties warmly welcomed the very modest ring fencing proposals of the Independent Banking Commission and the Treasury was emboldened to the point where it could sell off Northern Rock to Richard Branson. If we refer back from reform proposals to elite mindscapes and structures, the absence of radical ambition and alternative policies is nicely epitomised by the October 2011 quote from Ed Balls which opens this article. Balls as shadow chancellor does not perform opposition but instead insists that finance will be safe in Labour's hands. Just over a month after he had welcomed the IBC reforms as "tough and rigorous", Balls was insisting in London's evening newspaper that Labour would always defend London as an international financial centre and Labour supported the financial transaction tax on terms which ensured it would never happen.

Ed Balls position is symptomatic of a larger failure. Since losing the election in May 2010, the Labour front bench has failed completely to articulate a set of radical sectoral policies for banking and finance and then make the connection between banking reform and alternative industrial and macroeconomic policy. We should, of course, not expect too much of Labour under Ed Miliband because, as his father Ralph Miliband argued in *Parliamentary Socialism* (1961), Labour has seldom been disruptively radical. But that acquiescence in the status quo, from Ramsay Macdonald to Tony Blair, always needs to be situated in a larger context of conservative governing structures where elite power neutralises mass parties and of democratic alignments for change.

Radical reform is blocked because the crisis has strengthened elite power over governing structures and highlighted the importance of democratic disconnects. First, the crisis has discredited banking and finance but it has not disempowered financial elites because crisis has strengthened the power of conservative financial, bureaucratic and political elites within our governing structures. Second, a series of democratic disconnects have disempowered the critics of finance in the technocracy and civil society who have been unable to turn popular hostility into effective reform of finance. The disconnects are such that, after the decline of the mass parties, it is now structurally difficult to convert the radical technocratic agenda or civil society activism into effective policy reform. Our story is of a stifled revolution and the reassertion of power by traditional elites. In the following sections, we trace the management of the crisis and show how it produced a stifled revolution but we begin in the next section by justifying our premise about Groundhog Day.

Before we turn to this exposition, we would emphasise that this working paper updates the distinctive argument of our book *'After the Great Complacency'* which was written in the second half of 2010 and published in September 2011. Our book argued that the financial crisis was a deep-seated political and democratic problem which should not be framed as an accident. If we accept the crisis as an accident, then we evict politics or, more exactly, paint out the role and interconnection of financial, regulatory and political elites who have undermined the formal parliamentary process and the substantive right of the masses to reasonable security. Since our book was written, by autumn 2011 events have moved on. The euro zone crisis has given a new role to technocrats in Southern Europe who claim expertise and promise to do what is necessary to reassure the markets. In our view, the replacement of elected politicians with technocrats is not a solution but another instalment of the problem which can only be solved by democratic political mobilisation against entrenched elite power. This working paper focuses on the UK case and explains why democratic mobilisation against our controlling elites is both necessary and practically very difficult.

2. Groundhog Day

Big crisis/small reform may be a useful starting point but it does not give us any measure of the effectiveness of elite political power, which will usually operate through some kind of parallelogram of forces which implies variable resistances by democratic forces. In this context, the effectiveness of elite power is best indicated by the Groundhog Day effect. If elites are in control, they can compel the masses to relive each new day so that it plays out exactly as before; just as in the Groundhog Day film, Bill Murray is trapped in a time loop so that every new morning he wakes at 6.00am on 2nd February with Sonny and Cher playing on the clock radio. This time loop is not immediately obvious in complex capitalist societies because of the flux of events and performance changes with each new conjuncture. So that, for example, the period after 2008 in the UK is obviously different because of the absence of 2-3% economic growth and the failure of job creation which was previously normal: we are surely by these economic metrics (of growth and unemployment) living in new and different times. But, more analytically, if we consider the operating principles and priorities of effective elite power, we would argue that very little has changed since 2008: in terms of political priorities and principles, this is Groundhog Day. The carry over elements are the primacy of shareholder value, elite control of re-regulation, limited reform, and the reliance on uncontrolled credit creation.

This is a huge achievement for our elites because the crisis challenged and destroyed the discursive world taken for granted which elites had constructed for us in the era of the long boom for about fifteen years after 1992. Globally, this period was represented by Anglo American policy elites as a better world of the “great moderation” when it was believed that markets had developed mechanisms which solved the great uncertainties of capitalist economics and had inaugurated a long smooth wave of economic progress. As we argue in our book (Engelen *et al.*, 2011), in retrospect this was a period of the “great complacency” about uncontrolled credit creation, asset bubble and long chains of credit and debt whose profits were privatised before their losses were socialised at huge cost. Nationally, before 2007, our political elites represented the UK as a post-industrial economy in which a dynamic services sector, powered by a global financial centre subject to only light touch regulation, was showing the rest of Western Europe a new superior Anglo-American economic model. The crisis showed that this pre-2007 narrative about the national economy was, as one of the few earlier critics described it, a fantasy (Elliott and Atkinson 2007). With the fantasy exposed after 2009, even coalition government ministers had to talk about rebalancing the British economy towards manufacturing.

After 2008, the British economy moved into an L shaped recession and every elite assumption about the world and the national economy was discredited, but our national political and policy elites managed to retain control of everything that mattered to the exercise of their

power in financialized capitalism. Specifically, the primacy of shareholder value was never challenged; the changes to the regulatory system continued to be decided congenially by elite contest (not mass incursion); there was to be minimal public control over the markets through reform of banking and finance; while, uncontrolled credit creation continued, albeit now under the direction of the central bank. Our increasingly gloomy economic prospects on growth and unemployment should be read in this context of unchanged principles and priorities: by autumn 2011, our problem is that we are living in a threatening new world without a bold new deal.

First, the primacy of shareholder value was never challenged after 2008. Double-digit return on capital targets for PLC banking remained acceptable despite the growing evidence that this pursuit of returns encouraged risk taking in wholesale and mis-selling in retail (Engelen *et al.*, 2011, pp. 97-131). Just as important, the British government had *faute de mieux* nationalised failing banks and by 2009 owned or held controlling stakes in Northern Rock, Royal Bank of Scotland and Lloyds/HBOS. The management of the public holdings acquired in the crisis (especially RBS) has since been governed by entirely traditional shareholder value assumptions of the sort that guided the thinking of markets before the financial crisis. United Kingdom Financial Investments, the holding company, though lodged in the Treasury, was from the beginning sociologically and culturally close to the City: its key staff were drawn from investment houses and city consultancies; its philosophy as articulated by John Kingman, its first chief executive, was to distance itself from the Treasury by establishing an arms length relationship with the public sector; and its business philosophy was expressed in the traditional City language of the maximisation of the shareholder value, by working to dispose of its holdings at the maximum return. The crisis created the largest ever expansion of public holdings in the banking system; but this has been interpreted by UKFI, and indeed by the remainder of the governing elite, as merely a transitional phase back to private ownership (for fuller documentation Froud *et al.*, 2010). And this view was confirmed aggressively when Northern Rock was sold off in November 2011, crystallising a loss to the taxpayer which showed that state asset sales are often managed so as to create value for the next owner.

Second, the changes to the regulatory system have been largely the product of bureaucratic infighting, not the incursion of any kind of democratic forces. The Brown Government, indeed, proposed only minor institutional reforms, retaining as an independent regulatory agency the body most responsible for the fiasco, the Financial Services Authority. The coalition responded more positively to the turf war efforts by the Bank of England to reclaim the regulatory jurisdiction lost in the reforms of 1997; the new institutional structures presently being erected are firmly within the control of the Bank. This created a new problem because it made the Governor of the Bank of England into what Alastair Darling described as “some kind of Sun King around whom the court revolves”. The Financial Times reported on a Treasury Select Committee which was “enthusiastically welcomed by (the finance sector in) the Square Mile”

(FT 8 November 2011) and commented that it involved more governance and accountability by “people like us”.

Third, official reform proposals for banking and finance envisage minimal public control over the practices of the markets. The formation of the coalition government in 2010 led to the establishment of the Independent Commission on Banking. This was proposed, as a way of diverting an argument between supporters and opponents of radical structural reform inside the new coalition; and it finally succeeded as a way of allowing all parties to endorse and enact reform which had been negotiated with finance and did not impose any constraint that would seriously upset London finance. The Independent Commission on Banking’s line of travel was pre-programmed by its terms of reference which were to pursue the generic objectives of increased “stability” and “competition” in the banking sector. These generic objectives were framed by the imaginary of mainstream economics and the agenda of normalising the finance sector so that it would look more like other sectors and more like economic theory. The terms of reference were ambiguous, because they could have led to radical structural reform proposals for reducing retail oligopoly or breaking up the conglomerates; such proposals would have fitted the known views of two of the Commissioners (Vickers and Spottiswoode) who had previous form as pro-competition policy regulators and intellectuals. The interesting point is that their final report made no such radical proposals of this sort because other elites generally accepted the finance sector definition of limited reform.

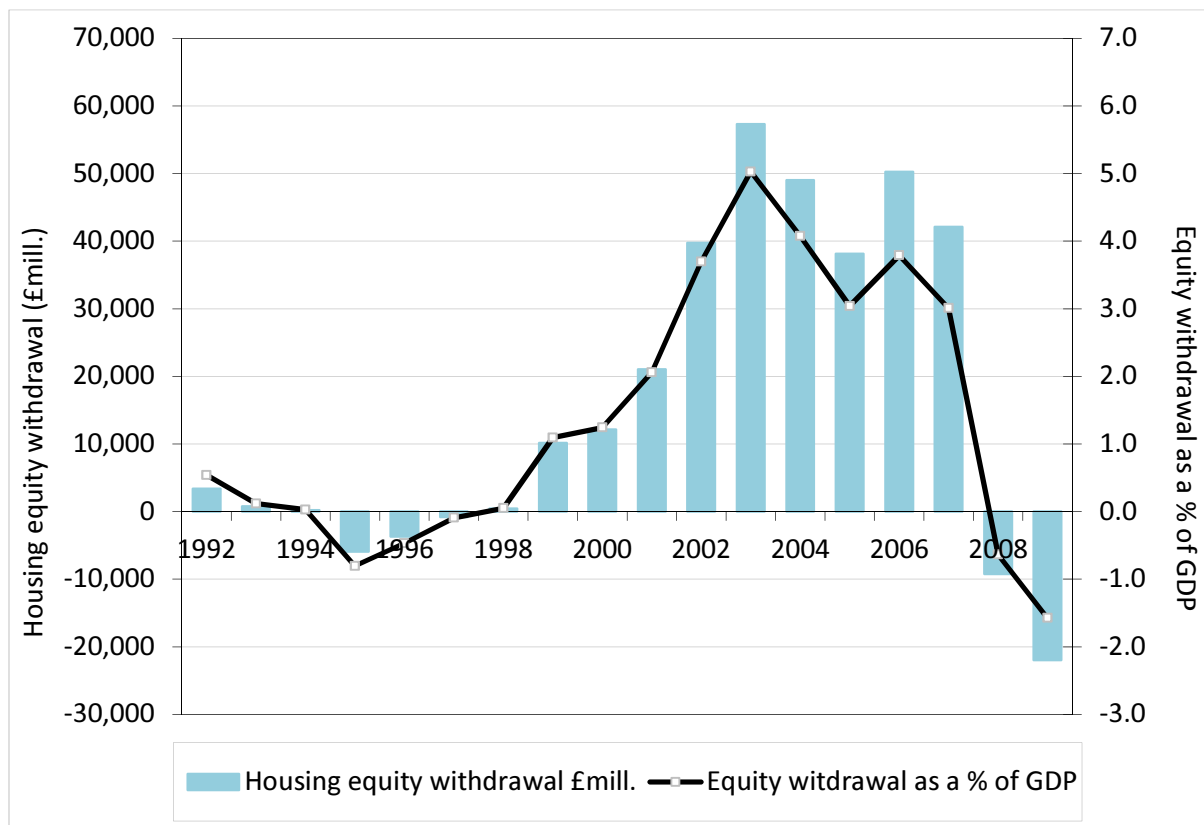
The Commission produced two reports (2011 and 2011a). The publication of the second (final) report in September 2011 was a moment when an elite consensus about banking reform in the UK crystallised. It is plain with the benefit of hindsight that the publication of the first (interim) report in April 2011 allowed the formation of this elite consensus around a set of limited reform proposals. The consultations invited in the wake of that interim report provided an opportunity for the banks to lobby hard against the most radical option, full separation between their investment and retail arms which would have involved the break-up of large financial conglomerates; and to lobby quietly against any large-scale branch divestment by the big four retail banking chains. On the critical question of the structural reform of ownership, the interim report used cautious language, but that language was sceptical about radical reform and breaking up the conglomerates. Casino finance could instead be quarantined if, within the one conglomerate firm, retail and SME business was ring fenced with its own capital and board. It said: ‘Some form of retail ring-fencing appears therefore preferable to full separation to the extent that: a) the rules around the subsidiary are firm enough to secure most or all of the benefits of the reform; and b) the costs of ring-fencing are substantially lower than those of a full split.’ (Independent Commission on Banking 2011: 89). That formula was repeated in the final report of September, which was equally judicious in its proposals for breaking up the retail chains where the Commission did no more than endorse modest

divestments, by Lloyds HBOS which had already been required by the EU competition authorities.

The IBC report represents the new elite consensus supported by all major political parties and the leaders of banking such as Bob Diamond, the CEO of Barclays who greeted ring fencing as a “welcome step” (Jenkins and Goff 2011). The consensus is not complete because some mainstream economists and technocrats, including Andrew Haldane at the Bank of England, believe the IBC reforms do not go far enough. The NIESR’s leading macro economist, for example, has publicly argued the case for “deeper and more fundamental reforms” (Armstrong, NIESR, October 2011). But the IBC final report marks the burial, for the moment, of any radical structural reform of the financial system. And the elite consensus on credit creation through quantitative easing was even more complete.

The fourth recurrence involved uncontrolled credit creation. After Big Bang, unregulated private sector credit creation was the driver of GDP growth. Under Thatcher and Blair, the nominal value of housing equity withdrawal was greater than GDP growth (Erturk et al., 2010, p. 33) and, according to the Bank of England, around half of that withdrawal ended up as consumption demand.

Exhibit 1: Value of UK housing equity withdrawal and equity withdrawal as a percentage of UK GDP



Source: Engelen et al., (2011) *After the Great Complacency: Financial Crisis and the Politics of Reform*

After 2008, the reliance on credit creation continued but the Bank of England, which was formally responsible for sound money and control of price inflation, but practically was now in charge of ultra-loose monetary policy via quantitative easing, now bizarrely led the process. Since March 2009, the Bank of England has maintained bank rate at 0.5% and backed that with some £200 billion of “quantitative easing” which involves injecting money by buying paper from the banks (Bank of England, 2011). With the economy flatlining, the prospect is for more quantitative easing at end 2011. The policy mix of loose monetary policy and tight fiscal policy is almost certainly technically wrong for dealing with a balance sheet recession but it is of course politically right for the financial markets because it provides them with cheap feedstock for trading.

The carried over principles and priorities ensure that we live through Groundhog Day and do so because our political, regulatory and financial elites all manifest a kind of redundancy of the imagination. The commitment to principles and priorities above suggests that our elites lack self-knowledge, demonstrated by their significant difficulties in social interaction and repetitive patterns of behaviour.

The Metropolitan State

If we consider the power effects analysed above, they represent a consolidation of elite power which ensures continuity and has (so far) neutralised the threat of crisis to established power. In this and the next section, we explain this striking outcome of immobility, in terms of the significant movements that produce it. Elite power in a stable polity is a bit like trench warfare in World War One because large forces are deployed offensively and defensively in the struggle over small amounts of ground and, after prolonged struggle, the lines are more or less, where they were before. In practice, control of position and alliance of forces operate in a combined way but it is analytically useful to separate them even if it does encourage a false dichotomy between structure and actors.

News of the death of the state has been greatly exaggerated. The crisis showed that the ‘hollowed out’ state is a myth, at least as far as the UK is concerned. The metropolitan governing institutions in London were central to crisis management which both put the governing institutions more firmly under elite control and gave the institutions a new authority over economic policy making. There are five signs of this conservative structural shift.

The core executive became stronger. The crisis once again made the core executive central to financial regulation – itself now the biggest single issue in the stabilisation of the economy (The following is more fully documented in Froud *et al.*, 2010 and Engelen *et al.*, 2011). Before the crisis, the management of the financial system was conducted in the domain of low regulatory politics. The critical actor was the Financial Services Authority, a regulatory body financed by a levy on the industry and with a culture that brought it close to City interests. The sight of

depositors queuing to withdraw their money from branches of Northern Rock on 14 September 1997 –the first public run on a bank in the UK since the Overend Gurney crisis of 1866 – transformed everything. The key actors at the top of the core executive –the Prime Minister and his Chancellor –became central to the management of the crisis. Moreover, they remained central to the attempted reconstruction in the wake of the catastrophe. Initially they tried to minimise this continuing involvement. Thus, in the months after the Northern Rock collapse millions were spent on consultants’ fees trying to find a buyer for the failed bank in an attempt to offload responsibility outside the core executive. The intensification of the crisis in the autumn of 2008 put an end to that. It proved necessary to accept that a large part of the banking system was now in public ownership, that this was a long-term commitment, and that some institutional means of managing it was needed. This is the moment when United Kingdom Financial Investments (UKFI) was created within the Treasury to manage the newly acquired holdings. By July 2009 UKFI owned 70% of the voting share capital of Royal Bank of Scotland, and 43% of the Lloyds Banking Group (UKFI 2009: 2).

The Treasury became more powerful. The fact that UKFI was lodged within the Treasury, and that its first CEO was John Kingman, the most successful civil servant of his generation, highlights a second feature revealed by the crisis: the ascendancy of that Department. Thain’s work (2004) shows how under the Brown Chancellorship the range and pervasiveness of Treasury influence spread through the core executive. Now the management of the crisis showed just how far the Treasury had moved centre stage – and how far crisis management reinforced it. A good indicator of the change is provided by comparing the management of the current crisis with the management of the last great systemic crisis in British banking usually labelled the ‘secondary banking crisis’ of the 1970s. In the 1970s crisis the Bank of England dominated crisis management and the Treasury was marginal; in the current crisis, the Treasury was the key manager (on the first, Moran 1986). The Chancellor, Alistair Darling, was the major figure in the crisis negotiations which led to the virtual takeover of stricken banks in October 2008; the Treasury was the dominant voice in deciding what strategy would be adopted in managing those banks; it was the dominant voice in the post crisis debates about the reform of the regulatory system; and, as we saw above, it was the dominant voice in setting up United Kingdom Financial Investments, the agency managing the state’s holdings.

The Bank of England reasserted its influence. The Treasury was not the only winner in the crisis. The regulatory system that failed so catastrophically in 2007-8 had been designed in 1997 in the wake of an earlier fiasco – the collapse of Barings Bank in 1995. In that collapse the Bank of England, which was responsible for banking supervision, had entirely failed to monitor and control Barings. The system created in 1997 therefore stripped the Bank of responsibility for banking supervision and replaced it with a Financial Services Authority with overarching responsibility for regulation across the financial system. But the 2007-8 crisis not only made the Bank once more central to regulation, it also created an extensive debate, and bureaucratic

infighting, about the shape of the new regulatory system. It was common ground among the regulatory elite after the crisis that one source of the fiasco had been the light touch regulation practised by the Financial Services Authority. For the Bank, this was an opportunity to reclaim the bureaucratic territory lost in 1997. The new regulatory system now being put in place accomplishes the bank's aims. The Financial Services Authority has been recast and absorbed into the Bank, which now controls the full range of banking supervisory institutions; and through monetary policy controls the active element in macro policy.

The metropolitan financial elite became more powerful. The period of deregulation before the crisis had seen the proliferation of competition in retail banking at the expense of the great metropolitan institutions. The crisis reversed that because one way or another failed bank operations (and/or their market shares) were often merged with or acquired by survivors. This is the 'Andersen effect' observed in accounting after the Enron scandal took out Arthur Andersen and the effects were similar when Barclays bought large parts of Lehman or HBOS was distress merged with Lloyds. The long-term structural consequence of the crisis was to increase concentration in the domestic banking system in the hands of a small number of London based institutions. In 2008, the four biggest institutions had a 64% share of the retail market, and that share had been falling; by 2010, it was 77% (ICB 2011a: 166). As we have argued elsewhere (Engelen *et al.*, 2011, pp. 173-8) and demonstrate in the next section, finance works through distributive coalitions on issues like regulation or taxation which threaten broad groups; but lobbying is greatly facilitated by having no more than 4-6 major players in retail or investment banking. As we shall see, the greater structural concentration underpinned important changes in forms of political mobilisation in the City. There are many calls for more competition in banking, most notably in a Treasury Select Committee Report of April 2010; but the executive so far has talked the talk about encouraging new entrants but not walked the walk by breaking up the retail chains.

The metropolitan governing elite asserted itself in the EU. For over a decade before 2008, the tide had run against the nation state in the European Union – a development crystallised by the introduction of the Euro. For much of the 1990s and the new millennium a key divide in British politics – a division that ran within, rather than between, the two major parties – concerned attitudes to increasing market integration and, in particular, British membership of the Eurozone. The on-going crisis tested the Euro to the point of possible destruction and removed from the agenda of British politics possible UK participation in the zone. By November 2011, there was a coalition against membership of the Eurozone uniting all the parties; even the most traditionally enthusiastic, the Liberal Democrats had quietly stopped talking about the issue. It has also changed the dynamic of monetary politics in the EU. Now, in shaping policy, it is national governments that are the dominant actors in seeking to manage the crisis. The British coalition government has incidentally become a much more important actor facing new risks of exclusion in two-tier Europe but also seeking to exploit new opportunities for

renegotiation and pursuit of British objectives on issues like finance or labour market deregulation.

In summary: the effect of the crisis on the governing structures was to centralise, to expand the domain of the core executive, and within the core executive greatly to strengthen a highly traditional nexus of power in the Westminster governing system – the Bank/Treasury nexus. What in many ways was a great regulatory failure by metropolitan established and run institutions turned into a considerable strengthening of the power of those institutions. It is hardly surprising that, as we have seen, this augmented positional power was then used to defend elite principles and priorities so that very little changed. But, to understand these developments, we must also understand the pivotal alliance of forces between the dominant financial elites and the metropolitan political classes.

4. Alliance of elite forces

The greatest financial crisis in living memory; a regulatory fiasco; destruction of public confidence in banks: all these have resulted in a strengthening of traditional power constellations. But the principles and priorities described above do not mechanically produce policy; they are mediated by political forces through which interests are mobilised and decisions made. And the power of political forces usually depends on alliances. In the UK case, the crucial alliance is a metropolitan one between the dominant elites from London finance and the Westminster politicians who are increasingly subservient because they are materially dependent on funding from the finance sector and practically detached from mass parties with provincial memberships.

Let us begin with the shared elite narrative about finance after the financial services revolution of the 1980s. The financial elite and its political allies from the 1980s told, and retold, a story about the central role of finance in creating jobs and employment in a post-industrial economy – in replacing the jobs and prosperity lost by the liquidation of the UK's industrial base. That account was largely ideology – a narrative, in other words, created to legitimise the interest of key elites (Froud *et al.*, 2010a). The evidence, which shows that, in the period of the economic boom that stretched in the UK from 1992 to the start of the crisis, financial services were neither a significant creator of new employment nor the major source of tax revenue (Johal, *et al.*, 2011), contradicts the narrative. What the financial services revolution did accomplish, however, was to create, and then concentrate in London, a financial elite which drew its wealth from the City's prominence as an international financial centre and then used that wealth to secure sympathy and increase influence with political parties.

Table 1: Taxes paid by the UK's finance and manufacturing sectors

	Share of total UK government receipts							
	Corporation tax		Employer's national insurance		Employee taxes and national insurance		Total	
	Finance %	Mfg %	Finance %	Mfg %	Finance %	Mfg %	Finance %	Mfg %
2002/03	1.9	1.1	1.3	4.1	3.3	10.7	6.4	16.0
2003/04	1.8	1.0	1.2	3.8	3.0	9.9	6.0	14.7
2004/05	1.9	1.0	1.3	3.6	3.3	9.2	6.6	13.8
2005/06	2.4	0.9	1.4	3.4	3.4	8.6	7.1	12.9
2006/07	2.4	0.9	1.5	3.3	3.6	8.0	7.4	12.2
2007/08	2.4	0.9	1.4	3.1	3.4	7.5	7.2	11.6
6-year average	2.2	1.0	1.3	3.5	3.3	8.9	6.8	13.4
Total taxes for 6 years £mill.	60,748	27,556	37,814	100,007	94,150	250,263	192,712	377,826

Note: Employer taxes summate corporate tax plus employer's national insurance and employee tax summates income tax and national insurance.

Source: Engelen et al., (2011) *After the Great Complacency: Financial Crisis and the Politics of Reform*

London's role in global finance largely depended on operations in wholesale markets, where small numbers of highly paid workers lifted huge values. Within London itself, wholesale finance concentrated affluence in a tiny number of areas of the capital city. A small number of working rich, senior bankers and financiers in and around the City of London, earned fabulous incomes. Their lucrative employment was highly concentrated in the local government area covered by the Corporation of the City of London – a correspondence that we examine in more detail below. The new working rich of senior bankers, hedge fund partners and such like were a small group commuting from a few suburbs of choice to places of work in the old City in the square mile behind St Paul's or to the main new City location in Canary Wharf, with alternative investment markets colonising a Mayfair village. When it came to finance, therefore, 'London' was shorthand for a highly concentrated geographical space with little connection to the rest of the metropolis. All this was reinforced by an allied feature of the sector after the financial services revolution. The City was a centre of *entrepôt* trade in money, an offshore financial

centre which just happened to be located on the muddy Thames rather than on a sandy Caribbean island. It is dominated by foreign institutions performing functions for international, especially EU markets. The UK banking sector originates more cross-border bank lending than any other country – 18% of the world total in June 2010 - and around half of European investment banking activity is conducted in London. Even the stock exchange is increasingly dominated by non-UK companies.

The interests embodied in financial markets at the moment of the crisis therefore did not represent a widely dispersed financial sector powering the UK economy; they were a socially and geographically narrowly confined elite. The location of those elites in London, its relation with key parts of the Westminster political elite, and the workings of its own system of government are all critical to explaining outcomes since the crisis. The observation that the financial markets, and the interests embodied in them, are powerful in shaping economic policy in the UK is hardly novel. But the striking development of recent decades has been the reconfiguration of the institutional mechanisms that convert this economic muscle into influence over policy, and this reconfiguration holds a key to making sense of what is going on. Two forces are at work: consolidation of forces through the reorganisation and professionalization of finance's lobbying capacities within the City; and alliance of forces through the changing relationship between London finance and democratic actors, especially the major political parties.

For much of the twentieth century the City was barely recognisable as a 'lobby'; its considerable influence over policy depended on social and cultural integration with governing elites, and on the Bank of England as an informal mediator between City interests and the core executive. The development of more open and transparent systems of interest representation, and the growing relative autonomy of the Bank from City interests, made this informal regime of representation increasingly anachronistic (Moran, 1986). The financial elite responded with professionalization and more formal organisation of its lobbying operations. Davis (2000, 2002) has documented the growth of professional financial PR and lobbying services in the City in recent years. The Corporation of the City of London – until near the end of the 20th century largely a body with narrow local government and social functions – has likewise reorganised into a systematic lobby for City interests. A key change occurred in 2002, when the constitution of the Corporation was reformed: it had hitherto escaped every reforming measure in local government since the original Municipal Corporation Act Of 1835. The City of London Ward Elections (2002) did something unique in British local government. The business vote in all other local government systems of the UK had finally been abolished in 1969. The Act of 2002 not only retained the business vote in the City, but also greatly expanded the business franchise, so that business votes now actually outnumber the residential vote in the City.

In other words, the financial elite is unique not only in British society but within the British business community: it controls its own system of local government. The Corporation has applied its considerable historical endowments to building up its advocacy and economic intelligence capacities: it was the Corporation, for example, which provided much of the research work for the Bischoff Report, a major restatement of the City's traditional 'narrative' after the financial crisis broke (Bischoff /Darling 2009: 54; Shaxson 2011 2011a; House of Lords 2002). The financial elite thus entered the crisis of 2007-8 with a lobbying operation which in its professionalism and command of resources was vastly superior to that commanded in earlier crises.

The second force identified earlier has in turn reinforced the strengthening of the alliance between the core executive and the elite of the City: the rise of a financial nexus between the leading parties and City interests. The colonisation of the major parties by the City plutocracy is particularly important, because it helps explain the failure of undoubted anger and dismay in civil society to convert into any coherent programme of radical reform. The link is symbolised by the family backgrounds of the present Prime Minister and Deputy Prime Minister, both offspring of the City working rich. But family background only dramatises key long-term changes in the financial relationship between the Party and City interests.

Pinto-Duschinsky's landmark study of party finance in the UK showed that in the golden age of the mass party, the Conservatives, contrary to many myths, raised most of their income through membership dues and fund raising activities at local level. For instance in the decade from 1967 only about 30 per cent of Conservative party income came from companies (Pinto-Duschinsky 1981: 234). The bulk came from the constituency parties – large in the age of the mass party, and highly effective middle class fund raising operations. This mass party, as it is well known, has now disappeared: there are presently about 200,000 individual members in Conservative constituencies, most of them elderly. The decay of mass membership has had an important financial consequence: the Party in the country is no longer a significant source of income. Moreover, increasing transparency about donations to parties – beginning with the 1967 Companies Act and culminating in the regulatory regime now run by the Electoral Commission – has made large corporations hesitant to contribute.

The Party thus has to rely heavily on rich individual backers. The result can be seen in the financial history of the Conservatives under David Cameron. In 2005, when Cameron became Leader, the financial services industries were the source of just under a quarter of total cash donations to the Party; by 2010 the figure had risen to just over 50 per cent (Bureau of Investigative Journalism, 2011). A large proportion of this money comes from the working rich created by the financial services revolution – high net worth individuals who have the means to make significant donations, and who as individuals do not feel constrained by the delicacies that hem in major corporations. A key threshold is a £50k annual donation, because this makes the donor a member of the 'Leader's Group', with an entitlement to meet 'David Cameron and

other senior figures from the Conservative Party at dinners, post-PMQ lunches, drinks receptions, election result events and important campaign launches' (Conservative Party 2011). In 2010, 57 individuals from the financial services sector made donations sufficient to join the Leader's Group. Fifty thousand pounds a year is hobby money for City plutocrats; it is no more than the first year's depreciation on a Ferrari like the 599 in basic Fiorano GTB specification.

The withering of the Party's non-metropolitan roots is thus closely connected to its increasing reliance on the working rich created by the financial services revolution. The colonisation of the Conservative Party by the City plutocracy is an important clue to what has happened to the management of the financial crisis since the advent of the coalition government. But the wider decay of the parties, as we shall now show, also explains why technocratic dissent and civil society protest has had such limited impact.

5. Democratic disconnects

The failure of banking and finance reform in the UK has in previous sections been explained in terms of the power of finance and the increased leverage of financial elites since 2008: First, the crisis has if anything strengthened the underlying structural power of finance in the UK economy: it has concentrated resources in a smaller number of institutions and helped create a renewed City narrative about the importance of London as a financial centre in a world where the Eurozone is in deep trouble. Second, the management of the crisis has reinforced the traditional nexus that historically linked the core executive and the City. Third, the decay of mass membership and the perpetual crisis of party funding has allowed financial interests to colonise the parties.

But the story can be told another way in terms of the weakness of the critics of finance who encompass a potentially significant coalition but have had very little success in influencing reform. The two stories are interconnected via the Labour Party which figures in both because its bias towards finance directly condemns us to live in Groundhog Day. But it would be wrong to rubbish the Labour Party without recognising the broader problem of democratic disconnects which has disempowered civil society and British technocratic critics of finance.

Progressive collectivist politics is not a kind of machine where cogs and levers fix the relation between input and output; but it does depend on a kind of alignment or connection between constituencies and institutions. The pursuit of security through mass employment and social welfare under the post-1945 settlement depended on establishing a connection between, (a) the social technologies proposed by liberal collectivist technocrats like Keynes and Beveridge, (b) mass parties like the Liberals or Labour capable of turning social techniques into manifesto demands and programmatic policies with parliamentary majorities at the same time as they, (c) articulated the civil society impulse for change partly through institutional overlap and

exchange of personnel. The existence and transmission of a progressive s reforming impulse was never straightforward; and British history includes many *cul de sacs* like the Liberal unemployment programme of 1929. But our point is that this transmission has now become more or less impossible because technocrats, civil society and the Labour party are compartmentalised and not communicating.

Technocrat means different things in various times and places. In traditional French usage, a technocrat was a pragmatic administrator or academic, like Raymond Barre, without elected office or party experience. In Italy or Greece now a technocrat is a structural reformer formed by disciplinary training in mainstream US economics and with a CV that shows proven loyalty to the EU project and network contacts in and around investment banking. The new Italian and Greek prime ministers, Mario Monti and Lucas Papademos are the perfect examples. Both have an American economics PhD and publication in mainstream economics; followed by a stint or two in management at a major euro institution like the EU or the ECB; plus network contacts in this case with Goldman Sachs via the derivatives deal that hid Greek debt or via the role of international adviser.

Britain fortunately retains a capacity to produce a very different kind of radical technocrat represented above all by Andrew Haldane, currently financial stability director at the Bank of England whom he joined after completing his masters degree in economics at Warwick. Haldane criticises shareholder value banking for pursuing high return on equity (ROE) through leverage and risk taking. In a kind of rejoinder to Vickers, Haldane's Wincot lecture of October 2011 proposes radical reforms and shows that some British technocrats know what to do. Haldane's reform agenda now includes capital ratios of up to 20%, removing tax privileges on debt, ending the shareholder monopoly of governance and targeting return on assets not return on equity. The problem is that these radical reforms are not within the field of the politically possible in banking (given the pro-finance stance of all mainstream parties). Haldane is defined as a dissident expert on safer banking with a reputation amongst the intelligentsia but without a dense network of political contacts and without any capacity for connecting with broader policy issues. As far as we can ascertain, he and his radical ideas were never mentioned publicly in the British general election campaign of 2010.

If Britain has a technocrat like Haldane who knows what to do, there is not much sign that his ideas have had much impact on the many critics of finance in civil society. The "fight the cuts" critics include some of the obvious victims from the crisis including large numbers of public sector workers, and the consumers of public services who are losers in the cuts enforced by the need to cope with the fiscal crisis of the state created by the cost of bailouts. But finance is also resisted by a wide range of more principled critics: the NGOs, churches and ad hoc lobby groups that were articulating criticisms of market practices even before the crisis; the ad hoc campaigns on particular issues such as tax management practices of corporations mounted by UK Uncut; the 'Occupy' protests of 2011 that were spread globally through social networking

media. The problem is that none of these forms of opposition connects with a radical technocratic reform agenda or with any set of programmatic political demands. It is significant here that the tented encampment outside St Pauls changed nothing in the City but did draw the Church of England into public debate about finance. Archbishop Rowan Williams responded very shrewdly by declaring for a financial transaction tax and observing that (FT, 1 Nov 2011) “the Church of England is still used by British society as a stage on which to conduct by proxy the arguments that society itself does not know how to handle”. The critics of finance have found a stage in public space but they are nowhere near the legislature.

Labour, the obvious ally of civil society critics, is a particular obstacle to mobilisation. Intellectually, it is disabled by its subscription during the years of office to the narrative that pictured the City as *the key* to British economic success. Institutionally, it is vulnerable to the appeal of any plutocrat who happens to be willing to provide it with significant funds. The revelation in the autumn of 2011 that Mr Miliband was combining party conference rhetoric attacking ‘predators’ while negotiating a one million pound donation from precisely such a plutocrat shows how the party’s financial problems hem it in (Pickard 2011). But the most important disabling feature is the withered state of Labour as a mass movement. The Party has no capacity to link with civil society critics because its own roots in civil society are almost non-existent. With an aged, small and declining membership, it has shrunk to a metropolitan cadre of professional politicians. It possesses neither the vocabulary, the incentive nor the social capacity to connect with civil society critics of the financial elite.

The effect of the disconnects described above is simply that democracy does not work. Civil society desperately needs alternative policies for finance; and, a radical technocrat like Haldane has a reform agenda that engages with the specifics of finance. But (as the opening Ed Balls quotation demonstrates) Labour is incapable of doing more than repeating its commitment to a competitive and successful finance centre in London which undermines the possibility of reform, including the financial transaction tax. It would be wrong to scapegoat the leadership of Miliband and Balls because they are part of a Europe wide problem where there is a larger problem about the *accidie* of the political classes as opposition parties (of centre-left and centre-right) fail to come up with radical reforms and national governments support their banks and financial sectors. The dilemma across most of Europe is that mass electorates can throw the scoundrels out of government office, as they have done most recently in Spain, but it makes no difference because the same principles and priorities are upheld by the incoming government; and if elected governments are not amenable, as in Italy, unelected technocrats and businessmen are put in charge.

But the position in Britain is clear. The problem is not simply the irresponsible and unaccountable power of financial elites but the impotence of its mass critics given the disconnects which prevent democracy working. The financial elite can be reassured that there is no danger of radical change until some way is found to reconnect either Labour, or an

alternative to Labour, to civil society critics and radical technocrats. We will then relive Groundhog Day through changing economic circumstances with the same old principles and priorities retained so that a more secure future will be postponed indefinitely.

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