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Wasting a Crisis? Democracy and Markets in Britain after 2007

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'A crisis is too good an opportunity to waste' (popular Japanese saying)

THE CURRENT crisis of financial markets and institutions calls into question the way economic life, and especially financial markets, have been governed in this country. In this article we examine what the crisis is doing to the way markets are governed, and how it could be done better to enhance democratic control of finance. The article ends with some practical suggestions for banking reforms which would not only broaden participation, but would open up debate about a democratic agenda for what finance could and should do in economy and society. It is from this point of view—from the present failure to have such a debate—that the current crisis is being politically wasted.

The first section of the article argues that the post-Thatcher settlement from 1979 to 2007 was marked by a particular relationship between markets and democratic government in Britain: it involved a mostly successful attempt to insulate markets from democratic politics. The next two sections explore a paradox: the immediate impact of the crisis was to disrupt that settlement and open a window of opportunity for increased democratic control over markets; but subsequent developments have combined to begin closing this window, so that official reform proposals are timid, as we demonstrate in an analysis of the 2009 White Paper on financial reform. Our article then explains the closure of the reform window, and notes that this closure reflects long established historical features of the government of markets and of the business community in Britain. This leads to an analysis of the tropes and memes that are the intellectual capital of present day financial and political elites. Their invocation of 'arm's length control' and 'shareholder value' is, we argue, not an enabling resource but a limiting repertoire. In the absence of rule of experts, regulatory commonsense at the Treasury ensures that dramatic policy shifts like bank nationalisation do not have radical effects. The official narrative of the crisis, and the workings of the key agency of crisis management, United Kingdom Financial Investments, reproduces 'business as usual' in the relationship between the markets and democratic politics.

Insulating markets from democracy

The great economic crisis in Britain of the 1970s produced profound changes in the political economy but their chief political function was to insulate markets from the influence of democratic government. There were four signs of this. First, there were major changes in ownership relationships, most obviously through ambitious and far reaching privatisation, especially of the utilities in the United Kingdom, which shifted whole industries out of the domain of the public into the realm of markets. Second, the language of the public sector was changed so that

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public service delivery was represented as a market-like exercise; this was then performed by use of private contractors through a variety of outsourcing mechanisms. Third, there was a wide programme of deregulation, the effect of which, likewise, was to shift control over economic life from public institutions to the private sector. Fourth, there was created a whole new generation of regulatory institutions that were designed to be non-majoritarian in character. Majone's work on the European regulatory state systematises the argument that the complexities of modern market regulation were beyond the capacities of the institutions of majoritarian democracy, and required instead a Madisonian system that insulated decision makers from majoritarian pressures.[1] As in the case of privatisation, the United Kingdom led the way in the creation of these new regulatory arrangements.

There were parallel changes in financial regulation and financial markets after the 'Big Bang' of 1986. The rise of central bank independence was an important instance of this shift to institutional insulation from democratic politics. The era saw the creation of newly powerful central banks (notably the European Central Bank) designed to pursue prescribed objectives sympathetic to financial markets (notably constrained inflation) independent of 'political' control. In the United Kingdom throughout the 1990s the system edged towards more central bank independence, culminating in the creation of the Monetary Policy Committee with its control over short-term interest rates in 1997. This institutional change itself reflected a discursive shift that became particularly pronounced under New Labour after 1997. It amounted to a kind of naturalisation of financial markets, in a world where public policy and institutions had to accommodate to the play of market forces. It committed to shaping economic management in the interests of fostering market sentiments, and, more concretely, to shaping both the monetary policy regime, and the regulatory regime established after 1997 under the Financial Services Authority, as light touch, based on broad regulatory principles rather than close control or adversarial relationships. These policy strategies were supposed to be a key to securing London's comparative advantage as a global financial centre.

The political regime governing markets established in the aftermath of the 1970s crisis in the United Kingdom was simultaneously particularly powerful, and particularly unstable, because it was rooted in longer established British conditions. It was particularly powerful because the economic crisis that afflicted all advanced capitalist economies after the end of the long boom took an especially virulent form in the United Kingdom: Britain combined weak economic performance, jarring stop-go policy shifts and a primitive corporatism. She suffered most in the crisis, and of the leading capitalist nations responded with most radicalism on issues like privatisation and outsourcing. Yet the effect of new policies, which insulated markets from democratic control, was in turn assisted by their congruence with long established patterns of business regulation in the United Kingdom. The historical conjuncture of the development of business institutions and democratic institutions in Britain meant that business already benefited from a particularly powerful ideology of regulation when democratic politics was first established. When formal democracy and a state with powerful interventionist capacities first developed during, and immediately after, the First World War, business was already well organised as a series of lobbies, and there was already in existence a well elaborated ideology of regulation. That ideology stressed the importance of self-regulation and, where self-regulation was not deemed possible, cooperative regulation, which involved avoiding any adversarial confrontation

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between regulator and enterprise. It was under this established, hegemonic regulatory rubric that the great economic and institutional changes of the last two decades of the twentieth century were implemented.

Yet if long established practices and institutions made the post-1979 regime of market government particularly powerful, they also made it particularly unstable. Part of the instability was inscribed in the very histories of market government. What was being attempted was the exclusion of democratic forces from market government, especially from the government of financial markets. However, since the government of those markets demonstrably had consequences, both for the macro economy and for individual citizens as savers, investors or consumers, democratic forces kept trying to break in. The most obvious points of intrusion happened in crisis and scandal. From the great secondary banking failures of the 1970s, to the Baring collapse of the mid-1990s, there was a history of crisis, scandal and regulatory failure, which drew the regulation of markets to the attention of democratic actors. The signs of this were the succession of laws, and the succession of new regulatory bodies, designed to control the markets. Legislation and the creation of regulatory institutions with legal powers plainly threatened the capacity of markets autonomously to control their own affairs. Autonomy in these conditions could only be preserved by a mixture of constitutional mystification and convoluted institutional design. The signs included the short-lived 'self-regulatory' regime administered after the passage of the 1986 Financial Services Act by the Securities and Investments Board, which involved a labyrinthine series of licensed self-regulatory bodies; and the complex tri-partite system of coordination between the Treasury, Bank of England and the Financial Services Authority, which was created in 1997, and which so spectacularly came to grief in 2007–2008. It was this powerful, but congenitally unstable, system of economic government, especially in financial markets, which entered crisis from 2007; the rest of our article is an examination of the impact of that crisis, and how it has been managed to limit reordering of market government in Britain.

The return of politics

The most distinctive feature of the regulation of markets after 1979 was the attempt to remove 'politics'—for which read 'the public politics of democracy'—from the process. The immediate effect of crisis was to repoliticise regulation, and in the process to create a moment of great danger for the established regulatory system. There opened a brief window of opportunity when radical reform appeared possible—a window, that as we show later, is now closing. The crisis had four immediate political effects: It 'repolitcised' the terms of regulatory debate; it widened the domain of state ownership; it fused parts of the elite of the core executive with parts of the financial elite; and it created popular narratives of scandal, incompetence and illegitimate reward.

It 'repoliticised' the terms of regulatory debate

Financial regulation under the system created by New Labour after 1997 belonged to a domain of low politics—of technical operations and bureaucratic manoeuvring between the responsible agencies. That was exemplified by the workings of the Standing Committee, which coordinated the Financial Services Authority, the Bank of England and the Treasury. Nominally chaired by principals from high politics, like the Chancellor, in practice until the crisis its meetings were only attended, and

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chaired, by the technicians of regulation: in the decade after 1997 it met only once with the principals present.[2] With the run on Northern Rock in September 2007, the sight of depositors queuing to withdraw deposits shifted both the terms of regulatory argument and the arenas where it took place. The issue suddenly was of the highest priority for the Prime Minister and Chancellor. Institutionally the sign of the change was the transformation of the role of the Standing Committee, which from the Northern Rock crisis onwards drew the principals into attendance.[3] The systemic crisis of October 2008 deepened the transformation, for it widened the range of regulatory issues now commanding the attention of elected politicians at the apex of the core executive, beyond questions about the stability of particular institutions and the arrangements for depositor protection to the macro-stability of the whole banking system. Moreover, the combination of the collapse of particular institutions like Northern Rock and the systemic crisis pulled in a wide range of other democratic actors: the most significant, because it succeeded in generating wide publicity about its activities, was the House of Commons Treasury Select Committee, which from 2008 published a series of reports on the unfolding crisis.

It widened the domain of state ownership

The great privatisation movement had been a key to depoliticisng the regulation of markets. Yet the crisis now not only transformed the terms of debate about regulation; it dramatically reversed one of the great achievements of the preceding three decades. The initial response of policy makers was to dither and resist public ownership: in the months immediately after the collapse of Northern Rock, millions were spent on consultants in a failed attempt to off load the stricken bank. However, in November 2008 the authorities were obliged to establish United Kingdom Financial Investments as a vehicle for managing public ownership of a huge tranche of the banking system. By July 2009, UKFI owned 70 per cent of the voting share capital of Royal Bank of Scotland, and 43 per cent of the Lloyds Banking Group.[4] Or as John Kingman, UKFI Chief Executive, put it in more homely terms in introducing UKFI's first Annual Report: 'Every UK household will have more than £3,000 invested in shares in RBS and Lloyds.'

It fused parts of the elite of the core executive with parts of the financial elite

One of key principles of the system for governing markets that evolved in the decades after 1979 was to establish a clear separation between the roles of democratically elected politicians and financial regulators. Creating the FSA; strengthening the independence of the Bank of England; operating the coordination of the tri-partite system as a domain dominated by regulatory technicians: all served that purpose. However, the crisis broke this system, and reordered the relations between the elite in the core executive and the financial elite. Fusion between the two elites began with the very act of crisis management. The story of crisis management, both in respect of Northern Rock and in respect of the management of the systemic crisis in 2008, was one involving intense, often difficult, face-to-face negotiations between the ministerial figures (notably the Chancellor and the Prime Minister) and leading bankers.[5] The (as it transpired, disastrous) takeover of HBOS by Lloyds happened in part because of an informal deal struck on a social occasion between the Prime Minister and the Lloyds chairman guaranteeing Lloyds exemption from competition regulation.[6]

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In the depths of the crisis in 2008 the banking industry had to turn to the democratic state for the resources and authority to prevent systemic collapse; but the complexities of crisis management also drove the democratic state into close cooperation with the financial elite. Apart from instances like the Lloyds-HBOS deal, the most public sign was the hurried recruitment of City grandees into the government via the House of Lords: the appointment of Paul Myners as 'City' Minister on 3 October 2008, and the appointment of Mervyn Davies, Chairman of Standard Chartered as Trade Minister in January 2009. The complexities of managing the aftermath of the crisis, we shall see shortly, also drove United Kingdom Financial Investments (UKFI) into the arms of the financial elite.

It created popular narratives of scandal, incompetence and illegitimate reward

Protecting financial markets from democratic control in the decades before 2007 depended heavily on naturalising their functions—that is, on depicting the markets as responding to forces born of quasi-scientific laws. The legitimation of doctrines like shareholder value, and of the huge gap between the rewards of the financial elite and the mass of employees, depended critically on the claim that markets were responding to impersonal economic forces, and that fund managers and wholesale bankers were performing useful functions such as allocating capital and marketising risk. Yet during the crisis, and in the Parliamentary post-mortems, a narrative developed that traced the crisis to pathological features of the banking industry: to a system that produced 'excessive' rewards, and stimulated excessive risk taking, by a banking elite driven by the search for huge bonuses. Opinion polls also showed that these perceptions were widely shared by the public at large.[7] This was a moment of great danger, for it precisely rejected the assumptions of naturalisation, tracing the crisis to a combination of institutional defects in markets, and cultures of human greed. That phase probably culminated in two events: the arraignment of several former heads of the stricken banks before the House of Commons Treasury Select Committee, which was accompanied by wide broadcasting of selected clips from their cross examination on mass television news, and headlines in the tabloid press such as 'Scumbag millionaires', in the *Sun* on 11 February 2009; and the extended campaign against Sir Fred Goodwin, which focused on the huge pension he had succeeded in negotiating as a price of departure in the crisis-ridden weekend in October 2008 that saw the rescue of RBS.

The immediate political effects of the crisis merit some scrutiny because they were complex and many sided, and in this complexity lie many clues in explaining why the potential reform opportunity has been wasted. On the one hand, the crisis produced a reform moment, one when the style of market government built up over the preceding decades was subjected to potentially seismic forces. All the leading groups involved—politicians, regulators, even bankers—disavowed the light touch, market friendly regulation which had characterised London for so long. The enforced extension of public ownership on a huge and rapid scale made it impossible to avoid new questions about the banking industry, such as how far it was to be treated as a closely regulated, part publicly owned, utility (rather than an instrument of global competition). The great moment of crisis came after Lehman Bros went under in the autumn of 2008, and a domino collapse of banks and markets was in prospect. At that point, the official response in the United Kingdom is striking for its decisiveness and creativity. New Labour,

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the Treasury and the Bank of England tore up their neo-liberal scripts and in a very un-British way began to deliver a new deal via banking nationalisation, Keynesian-style reflation, cuts in interest rates and quantitative easing—all of which represented a willingness to think the unthinkable, and do the undoable. These developments were accompanied by a wave of popular hostility to bankers—one that briefly made media stars of some parliamentary critics of the preceding regulatory regime, like John McFall (chair of the Treasury Select Committee) and Vince Cable, the Liberal Democrats front bench finance spokesman.

Yet the new politics of financial regulation did not just open the markets to the influence of democratic actors. What had seemed like the very peak of a democratic assault—the ferocious criticism of Goodwin—also turned out to provide a key form of defence against radical reform: in scapegoating Goodwin it allowed the development of a narrative separating 'bad' and 'good' bankers. It opened the very highest reaches of the core executive to members of the financial elite, in the form both of ministerial appointments and in the shaping of institutions like UKFI in the image of a part of the City elite. Above all, serial bank failure and high mass unemployment had only been avoided by huge public expenditures. The IMF[8] estimates that some £289 billion was spent by the United Kingdom government on buying banks and injecting capital, while the total cost of bailout including undrawn guarantees and contingent liabilities is more than £1,200 billion. All this raised the United Kingdom public sector deficit from 3 to 13 per cent and both major political parties agreed that this would in due course require large cuts in public expenditure and employment. The political elite had bailed out the financial elite without imposing any conditions and without any plan for what to do next. We can see some of the consequences, if we turn to the state of present official proposals for reform.

Reforming financial markets

The White Paper of July 2009[9] details the Treasury's present proposals for reforming the institutional architecture of financial regulation. The White Paper is not the only guide to, or source of, reform. We already have on the statute book the 2009 Banking Act, which is essentially designed to rewrite the rules for future bank rescues, while the Financial Services Authority, especially since the appointment of Adair Turner as Chair, has been attempting to rewrite its rule book and its mode of operation in the wake of the supervisory fiasco revealed by the crash. Not only is the White Paper thus only part of the picture; like any White Paper it is provisional. Given the palsied state of the Brown government, and the strong possibility of a Conservative victory in the 2010 general election, it is nearly certain that government will start all over again with different reform proposals, ones where the Bank of England plays a much larger role. Yet the White Paper is nevertheless of great importance. After nearly two years of banking crisis it represents the best summary we have of what the official mind thinks about financial regulation: it is a distillation into official conventional wisdom of the debates about the substance of change, and struggles for institutional turf, that have been conducted now for two years. And, as we shall see, while it was widely criticised as timid, that timidity is symptomatic because it grew out of a consensus fashioned among the regulatory elite.

Viewed in this light the White Paper is remarkable, less for its words than for its silences. Faced with the greatest banking crisis for a century, the authorities have produced proposals that are limited and cautious. Three aspects of this caution are particularly striking. The first is that the Treasury has decisively rejected any

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move to reshape the structure of the industry and, specifically, to break up large, complex banking conglomerates. It reasserts, in language that could have been used at any time in the last thirty years, what it calls the 'pivotal' (p. 18) role of the City and of finance in the economy. It rejects any Glass–Steagall-like measures separating investment and retailing banking (p. 75). That rejection, in turn, means that the White Paper disavows the suggestion of the Governor of the Bank of England that allowing the development of banks that are 'too big to fail' creates problems of supervisory control and moral hazard; the problem is to be dealt with only indirectly by rules on capital requirements, not by intervention in banking structure.[10]

Second, only the most marginal changes are proposed to the institutional architecture of regulation itself. The Treasury Select Committee investigation of *The Run on the Rock*, and the internal auditors' report on the FSA's supervision of Northern Rock, demonstrated two things: that the Authority had practised an almost bizarrely permissive form of light touch regulation; and that in the key early stages of crisis management the system designed to coordinate the roles of the FSA, the Bank and the Treasury had been a considerable hindrance to managing the crisis. Yet the White Paper not only proposes to maintain the FSA's dominant position as regulator; it envisages merely the most marginal changes in the coordinating institutions. The old Standing Committee will be replaced by a statutorily based Council for Financial Stability. Early discussions of the Council suggested that it would be an analogue of the Monetary Policy Committee of the Bank of England. It will indeed publish minutes in the manner of the MPC, but there is one critical difference: membership will be restricted to the three authorities, depriving it of a key element that distinguished the MPC, the outside members (p. 49). And while there will be an annual report to Parliament, the White Paper commits only to the vaguest move to more democratic control: it announces that the authorities will 'discuss mechanisms for increasing the democratic accountability of the (Council)' (p. 50).

The third and final cautious feature of the White Paper concerns the exit strategy it proposes for disposing of the public ownership of the banking system acquired in the crisis. The White Paper is insistent both that ownership is a transitional stage, and is not to be a prelude to any long-term reshaping of the banking system. The terms of exit are described in entirely orthodox tropes about maximising value for the taxpayer as a shareholder in the publicly owned institutions: to 'protect and create value for the taxpayer as shareholder' (p. 136).

The White Paper's caution can in part be traced to contingent factors. In the weeks before its appearance it became apparent (for instance, from the Governor's Mansion House speech) that there were significant differences within the regulatory elite about how to reconstruct the system.[11] The differences in turn can partly be ascribed to bureaucratic turf struggles, as the Bank sought to reclaim some of the regulatory jurisdiction which it had been obliged to surrender in the reforms of 1997. Moreover, as the views of columnists in publications of the financial and regulatory elite, like the *Financial Times*, show, there were considerable differences over just how radical the new system should be. The White Paper therefore is in part an attempt to navigate between competing views. It is also probably the case that some even more immediate forces were at work: a Chancellor of a naturally cautious temperament; a Prime Minister conscious that he was the author of the regulatory system that had so disastrously failed, and thus engaged in blame avoidance; and an exhausted government struggling to survive after fierce internal disputes about the Prime

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Minister's authority and right to continue in office.

Yet this is only part of the story, and the less important part. What makes the White Paper especially significant is that its approach to the regulatory system is not idiosyncratic; it reflects a consensus about the design of the regulatory system, and the meaning of the banking rescue, that has come to unite both regulatory and banking elites. The Conservative opposition, for example, is more radical about scrapping the FSA and rearranging regulatory responsibilities between agencies, but the Conservatives agree entirely about not changing industrial structure by breaking up the conglomerates. This cross-party consensus has cultural and institutional foundations that have been shored up in the years since the crisis began. Moreover, the effect of this consensus is to reassert key political features that marked the government of markets in the decades before the onset of crisis: in other words, the insulation of the regulatory system, and banking markets, from agents of democratic politics. If anything like the consensus reflected in the White Paper is enacted, it will be 'business as usual' not only in an economic sense, but also in a political sense. This outcome does not depend on the final shape of reform by an outgoing Labour or incoming Tory government because it is already being enacted, as we shall now see: by UKFI, which operates under the old rubric against a back drop of expert ineffectuality, and by the contributions of the regulatory elite to the debate about the reconstruction of the regulatory system.

Wasting the crisis: UKFI and arm's length management

The unstable 1979–2007 settlement insulated regulation from the forces of democratic politics by combining new and old elements: the FSA fused a new kind of formal, proceduralised rule of expert regulatory technicians with traditional light touch, cooperative regulation between enterprises and regulators. The crisis threatened the expertise represented by the FSA and the Bank of England, both of which, with appropriate symbolism, are headed not by bureaucrats, or politicians, or money makers, but by an elite consultant (Turner) and an ex-academic economist (King). The regulatory technicians responded ineffectually by asking for new and more (effective) knowledge, which they could not immediately deliver. Meanwhile, the Treasury mobilised the old tropes and elite City personnel to ensure that bank nationalisation was a policy reversal that delivered more of the same.

The paroxysm of crisis required an improvised policy response that, as we have noted, worked through high democratic politics and involved Chancellor and Prime Minister in nationalising Northern Rock and managing the systemic crisis of 2008. Afterwards, there was a return to normal politics. This was an opportunity for a few key figures at the Treasury—notably the civil servant John Kingman, who created (and managed for its critical early months) the new post-crisis agency of UKFI. The principle of non-interference by 'politics' in banking matters was at this point re-established by inserting old tropes and memes into UKFI's mission, and by recruiting senior City figures with non-exec experience of delivering shareholder value. From 1 November 2008, UKFI was the holding company responsible for managing the government-owned British banks and the government minority stakes in banks that had been acquired *faute de mieux* in the crisis. UKFI has become the single most important institution in the public sector concerned with managing the aftermath of the crisis. The organisation is marked by three particularly striking features: its view of its relationship with the state; what for want of a better word we can call its

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'sociology'; and its definition of its mission.

The position of UKFI is ambiguous because it is a creature of the Treasury but claims to operate at arm's length from government. UKFI was set up and headed by John Kingman, probably the most successful career civil servant of his generation (he was Second Permanent Secretary in the Treasury before the age of forty). UKFI occupies a small number of offices in the Treasury building, and its operational budget is negotiated with the Treasury.[12] Yet, from the very beginning, Kingman's message as chief executive has been that UKFI operates at 'arm's length' from government. That was the theme of an 'op. ed.' in the *Financial Times* placed by Kingman and UKFI's first chairman early in its life, and again in Kingman's own account to the Treasury Select Committee of the relationship between government and UKFI.[13] The new agency is thus inserted into an old pattern of institutional arrangements between agencies and the democratic state in Britain. As Flinders' recent study shows,[14] the doctrine of the 'arm's length' relationship has been a central feature of constitutional rhetoric in Britain and a key device insulating the workings of agencies with delegated functions from accountability pressures of the democratic state. Thus, from its foundation, UKFI has sought to reassert the established undemocratic pattern of financial government that was characteristic of the longer history of the City and of the post-1979 settlement.

The constitutional cliché about arm's length control was performed sociologically by the way UKFI was from the beginning closely integrated with elite networks and institutions in the City. The way in which the organisation was put together meant that established mechanisms of search, advertisement and selection were sidestepped. The first two chairmen of UKFI were both retired City grandees who had subsequently made reputations as City friendly non-executives of major public companies. Before he departed to chair RBS, the first chair of UKFI was Sir Philip Hampton, an ex-finance director of Lloyds Bank turned non-executive chair of Sainsburys. He was succeeded by Glen Moreno, an investment banker who became chief executive of Fidelity International and then retired to become non-executive chair of Pearson. Moreno's account of his recruitment illustrates well how, in the press of crisis, the Treasury turned instinctively to the tiny elite networks of the City with which it had connections:

> What happened was that I volunteered to serve as UKFI non-exec, for obvious reasons, because I think this is the worst financial crisis we will ever face and, if we blow it, we are going to lose a generation of prosperity, and I have had a lot of experience of prior banking crises and downturns. What happened was Philip Hampton went to RBS, and I was with my wife on a brief holiday in Malta and I got a phone call, saying, 'Will you do this?' and of course I said 'yes'.[15]

Moreno's seat has now been taken by Sir David Cooksey, appointed in August 2009 at the same time as John Kingman announced his imminent departure. The Oxford-graduate engineer, considered an outsider in banking circles, is nevertheless a well-known name in the City: his Advent Venture Partners, established back in 1981 and a strong investor in life sciences and technology, is one of the first private equity houses in Europe. The board serving under him, on the other hand, consists mainly of insiders: with the exception of the Treasury representative, the four remaining members have spent together 110 years of employment in blue chip banks and fund management corporations from both sides of the Atlantic, with CVs including Citigroup, Merrill Lynch, Barclays and Warburg.

The doctrine of the arm's length relationship and the close integration into City networks then fused with the tropes of shareholder value to close off the possi-

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bility of any radical answer to the question of what should be done with the holdings acquired in the crisis of 2007–2008, and how they should be managed in the meantime. The nationalisation of the banks was operable for Kingman and Moreno if nationalisation was conceived as an interim stage governed by one simple principle: the taxpayer is a shareholder in failed banks, which must be first managed and then sold off in a way that maximises shareholder value. As UKFI elaborated its role and mandate, it increasingly offered, not so much the nationalisation of the banks, but the privatisation of the Treasury as a new kind of fund manager. The Framework Document of March 2009, which sets out the rules of engagement for the UKFI organisation, is crystal clear:

> [T]he Company should . . . develop and execute an investment strategy for disposing of the investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder.[16]

UKFI thus acquires the identity of an engaged, responsible, large institutional investor whose relations with company management are governed by its investment objectives. There is to be no interference with day-by-day management decisions or second guessing of business strategy. Yet UKFI, as an engaged investor, does monitor pay for performance and will meet with senior management to check on progress with value creation. The way this works is well illustrated by the controversy in the summer of 2009 over the remuneration package of Stephen Hester, chief executive of Royal Bank of Scotland—a package that attracted widespread critical comment because it offered huge rewards. For UKFI, however, this was pay for performance because the long-term incentive of a £6.9 million payment was conditional upon a doubling of share price. More generally, to check on progress, UKFI organises a round of meetings with the management of the companies in which it holds investments: in the months between March and July 2009, for instance, it held over fifty investor meetings. UKFI is thus an active institutional investor, which has the banks by the scruff of the neck and is energetically shaking them to extract every last copper of value for the taxpayer as shareholder

Wasting the crisis: regulatory technology and the suppression of politics

All this was originated at the Treasury where the old low intellectual tropes and memes about 'arm's length' and 'shareholder value' survived the crisis. Internal opposition within the government apparatus was limited because much high intellectual capital had been destroyed in the domain of the regulatory technicians at the Bank of England and the FSA. Queen Elizabeth's reproachful question ('Why did nobody see it coming?') illustrated how the experts were blindsided because they had misrecognised the bubble through the categories of mainstream economics and finance, whose intellectualism had legitimated light touch regulation. After autumn 2008, their immediate problem was that it was technically impossible to reinvent expert knowledge and devise a new management technology within the space of a few weeks or months. Hence the experts produced a guilty discourse about the limits of knowledge. In this revised expert world view, politics is again suppressed or marginalised. The failures that led to the crisis are seen as essentially technical in character, deficiencies in the soft technology of regulation. They are held to arise from the failure of the regulatory system to match innovation and adaptation in markets. Thus, the problem is one of knowledge, which is to be solved by more

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intelligent understanding of markets, and more discriminating surveillance of their operations.

Here, for instance, is the summary of the root cause of the crisis offered by the White Paper. After reviewing a series of failures of appreciation by bankers and regulators, it concludes: 'In short, the central lesson of the financial crisis is that, around the world, these issues were not sufficiently well understood' (p. 4). It is plain that the White Paper's view of the crisis was in turn strongly influenced by Lord Turner's *Review* conducted in his role as a new, reforming chair of the Financial Services Authority.[17] As one might expect of a kind of intellectual with a background in elite management consultancy, he emphasises even more strongly the significance of regulatory technology. Here he is on the critical failures of understanding—citing Keynes and Minsky, he writes that the crisis 'raises important questions about the intellectual assumptions on which previous regulatory approaches have largely been built'(p. 39). From this analysis flows the most important of Turner's recommendations: more investment in properly skilled regulatory personnel by the FSA, and more intensive surveillance of markets and institutions by these personnel. The new approach must be 'more intrusive and more systematic' (p. 88).

What are the new 'intellectual assumptions' that could underpin this more intrusive approach? The FSA report and other official documents offered the big new idea of 'macro prudential regulation', but that begged the question as to how this new macro domain should be conceived and how appropriate control technologies could then be devised. The answers to these questions depend on a prior exercise in heresthetics, which structures the world intellectually so as to shape the terms of any solution. The most radical attempt has come from Andrew Haldane, the Bank of England's Executive Director for Financial Stability, who proposes a fundamental shift in the terms of argument and explanation of the banking crisis. He suggests that banking regulators should think of the world they have to regulate as a complex, fragile system of a kind familiar from ecology and epidemiology. Understanding the crisis, and designing a more effective system, involves learning from the study of (allegedly) analogous physical systems. 'Seizures in the electricity grid, degradation of ecosystems, the spread of epidemics and the disintegration of the financial system—each is essentially a different branch of the same network family tree.'[18] Or as he puts it in a separate paper: 'If there is a unifying theme, it is informational failure.'[19]

In Haldane's world, the kind of 'commonsense' failures and solutions in Turner's review (for instance, more intensive surveillance) are no longer central. Above all, in this exercise in heresthetics, dimensions of systems mapping and expert decision about vaccinating the super spreaders and such like displace dimensions of economic and political choice. Politics is once again emptied out of banking regulation. Yet Haldane's displacement of the political is only a more subtle version of the commonsense of the regulatory elite. Turner's *Review* puts it more crudely: 'Intellectual challenge to conventional wisdoms is therefore essential. But so too is freedom from political pressure' (p 86). And here is the Governor of the Bank explaining why no special conditions were attached to the special facilities scheme, perhaps the most expensive and ambitious state rescue of an industry in British economic history: '[T]his was a central banking operation which I think would have failed if it had been thought that there were hidden political agendas attached to it.'[20]

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Reigniting democratic control?

The argument so far is that crisis drove elected politicians to take radical measures but, in the aftermath, the undemocratic habits of market government were reasserted by unelected civil servants and financiers. Thus the most likely outcome is not radical reconstruction, but retrenchment via public expenditure and service cuts. Yet this is only a missed opportunity if there are alternative agendas and political actors who could deliver a more democratic form of government. In this section we explore these issues. Through a kind of thought experiment we show that it is not intellectually difficult to break with established undemocratic modes of thinking; but it is much more politically difficult to construct the coalition of forces that would press for a more democratic agenda, against resistance from within government and the distributive coalition around the City of London.

What might a more democratic approach look like? It would surely have to address two pathologies of the old system that came so spectacularly to grief after 2007. First, the national bias in favour of more finance, and more finance friendly policies, must be challenged. This requires some kind of public interest inquiry into finance's justificatory narrative about the social benefits of wholesale activity, and about the City's contribution to the United Kingdom's economic success. Before 2007, this narrative provided a kind of higher order rationale for light touch regulation, low taxation and limited disclosure—all of which supposedly improved the 'competitiveness' of the City of London. The Bischoff and Wigley reports on the future of 'international financial services' in 2009 updated this narrative with new empirics on taxes paid and jobs created; while Bischoff added a promise that finance can, through new products, meet every 'social need'.[21] However, the City narrative greatly overstates these benefits. Retail and wholesale together have never employed much more than a million workers in the United Kingdom and the costs of bailing out the banking system must now be offset against taxes paid. After considering finance's share of GDP, the Governor of the Bank of England has already concluded that the finance sector in the United Kingdom has become 'too big'. A public interest inquiry—not just the kind of partisan special pleading of Bischoff and Wigley—must scrutinise the bias of policy towards finance, and address the difficult question of how far finance needs to shrink.

Second, in terms of the political process, participation in decision making about financial regulation must be widened and scrutiny of public policy must be made more effective. Classic democratic remedies need to be applied to the enclosed, elite-dominated and unaccountable processes we have described in this article. The narrow circle of decision makers, executives, non-execs and advisors needs to be broadened in all the relevant agencies so that different values and calculations about finance are represented. Under Conservative and Labour governments since 1979, there has been a shameful narrowing of the voices heard. On inquiries and advisory boards on finance, from the Macmillan Committee in the 1930s to the Wilson Committee in the 1980s, there was representation for non-financial business, trade unions, academics and elected politicians. All these groups plus nongovernmental organisations (NGOs) could and should be represented in advising a holding company like UKFI; any Council for Financial Stability should include outside members appointed through a transparent process. Official agencies like UKFI should not be largely staffed with a cadre of ex-bankers as executives and non-execs. Beyond this, parliamentary scrutiny should be strengthened by making all finance policy makers accountable

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to a new specialised Select Committee on Banking and Finance. This would learn from what the Treasury Select Committee has achieved and what it cannot yet do; so the new banking committee would have proper staff resources and the exceptional power to make binding recommendations when, as with bankers pay in mid-2009, different agencies are passing the buck.

If the bias for finance is challenged, and if representation is broadened and accountability is increased, then it should be possible to have an open democratic debate about the shape and regulation of finance. The big issue here is what a politically governed finance could and should do as servant, not master, of economy and society; and also how corporate forms and business models in banking should be reformed so as to make finance fit for social purpose. Here we can indicate not policies, but some preliminary, relevant questions for debate. On wholesale finance after the crisis, what is the scope for mandating shorter, robust transaction chains in processes like securitisation—because long circuits are more fragile and increase intermediary deductions? On retail after the crisis, what scope is there for structuring consumer choice and redirecting financial education so as to encourage prudent borrowing and saving—because financial literacy programmes will never stop predatory marketing? On organisation, what kind of mixed ecology of financial service providers, including mutuals and bond-based banks, should we encourage—because shareholder value-driven public companies are ill suited to the activity of utility banking, and large, complex banks are riven by conflicts of interest? On all these issues, the advice of regulatory technicians and experts would be required, on the understanding that the choice is finally political.

It is not intellectually difficult to propose reforms that would increase participation and accountability or to suggest the issues for a new democratic agenda. It is more politically difficult to find the actors who would press these issues. The old political forces are weakened, but the new political forces have not moved onto finance-related issues, except via their connection with development. Class-based organisation is in decline. The front benches of Conservative and Labour parties are in thrall to the City (and its financial contributions) partly because their mass membership is dying. After three decades of retreat, unions, especially in the private sector, are weak: according to the WIRS survey,[22] two thirds of workplaces in the United Kingdom now have no unions. We have, however, seen the rise of the new civil society groups, which include not only middle-class voluntary associations like the National Trust, but harder edged pressure groups like Cafod and Oxfam. Yet their presence on issues of development, climate change or ethical drug pricing is strong while their expertise and lobbying on finance is weak.

The new landscapes of civil society create problems in political mobilisation in finance, but they also create opportunities. There are imaginative possibilities of putting together coalitions of old and new organisations, such as Unite plus Oxfam plus the Consumers Association, around the democratic issues in finance. Banking after the crisis could be the rallying point for a coalition of losers because taxpayers, customers and the retail workforce are all now losers from shareholder value-driven banking. Unite, which organises one third of the retail workforce, could join forces with NGOs on issues like the high street banks' pay incentives for retail advisers to 'sell to' consumers; and the high street banks are vulnerable as brands to direct action. A new kind of politics of leafleting and boycotts outside high street branches would not directly address the problems about wholesale banking, but it would threaten the flow of savings and loan

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feedstock from the retail branches of conglomerates. And meanwhile our political and financial elites should remember that the exclusion of democratic forces from the political processes of a plural society generally results in the re-emergence of democratic forces elsewhere in forms that are less amenable to management and negotiation.

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Notes

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