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DIRECTION FOR
THE DEMOCRATIC LEFT

NEVER AGAIN

No turning back to boom & bust banking:
a new banking settlement for the 21st century

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THE DEMOCRATIC LEFT

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Introduction

In September 2007 systemic funding problems at Northern Rock triggered the first run on a British bank for more than a century. A year later America's banking system was brought to the brink of meltdown as American investment giant Lehman Brothers collapsed. If in the following days more banks were allowed to fall like dominoes, populations all over the world would have been financially wiped out, civil unrest and total chaos would inevitably have ensued. The crisis continued into October when the near implosion of the Royal Bank of Scotland left the UK just hours from banking shut-down.[1] Britain and the world economy was left tilting on the edge of collapse; this is how serious it got.

Capitalism has been brought back from the abyss; coordinated action from across the Group of 20 nations harnessed the power of the state to shore up banks' balance sheets, pump credit into the markets and underwrite bank assets. This totals over $14 trillion of taxpayer money or almost a quarter of global GDP.[2] Ironically it was the very same institutions that brought about the near collapse of the economy that benefited most from this state action.

In the UK the financial burden to the taxpayer is not yet known. A National Audit Office report shows that purchases of shares by the public sector together with offers of guarantees, insurance and loans made to banks equate to £850 billion.[3]

The Treasury estimated in April 2009 that there may *be a loss to the taxpayer of between £20 billion and £50 billion*. Total losses will depend on losses from the Asset Protection Scheme and the price at which the government sells its holdings in RBS and Lloyds.

For reasons of justice, equity and efficiency, it is important that ordinary taxpayers are fully reimbursed for the money they have invested into the bail out. The public stake in RBS and Lloyds also raise important questions about how best to ensure these institutions can return to profitability without engaging in the speculative and risky behaviour that caused the crash.

This paper is due to be published online on the same day as the Royal Bank of Scotland announces their profits and remuneration packages for this financial year. The bonus pool is rumoured to be £1.3 billion[4] but whatever the figure it is likely to be hugely unpalatable to the taxpayer.[5] While the banning of bonuses and large reductions in remuneration for staff in these institutions could certainly be justified on egalitarian grounds, it would have significant consequences for these banks. Two policies which we briefly outlined below could ensure that these egregious payouts be tamed and taxpayers could get a better deal:

- *Remuneration caps* – A cap across the whole of the UK banking sector would help prevent the movement of staff away from RBS to higher paying rivals that are less constrained by government pressure and public outrage. It would reduce the staff pay bill, saving the taxpayer money and help shore up the balance sheet.
- *Extending the banker's windfall tax* to other institutions such as hedge funds, which have benefited from public money; this would further prevent staff from seeking higher remuneration in other sectors.

Yet this goes far beyond RBS or Lloyds. We believe that the taxpayer is an invisible investor in every banking business, whether it is openly nationalised, such as RBS, or purely private, such as Goldman Sachs or HSBC. This means that taxpayer interests must be represented in their regulatory framework.

This paper is written at the same time the economic benefits of an overly dominant financial system are being questioned. Nobel Prize winning economist Paul Krugman suggests 'the rapid growth in finance since 1980 has largely been a matter of rent-seeking, rather than true productivity'.[6] Martin Wolf of the *Financial Times* also described the value added by financial services as 'modest'.[7] A recent New Economics Foundation Report suggests that

> While collecting salaries of between £500,000 and £10 million, leading City bankers to destroy

1. *Guardian*, 6 September 2009, www.guardian.co.uk/business/2009/sep/06/banks-fsa-rbs-financial-crisis

2. *Andrew G Haldane: Banking on the State*, www.bis.org/review/r091111e.pdf

3. *Maintaining Financial Stability Across the United Kingdom's Banking System*, National Audit Office, 4 December 2009, www.nao.org.uk/publications/0910/uk_banking_system.aspx

4. *E Financial Careers*, 11 February 2010, http://news.efinancialcareers.co.uk/newsandviews_item/newsItemId-23738

5. Online campaign calls for caps on RBS bonuses, www.nobonus4rbs.co.uk/

6. Paul Krugman, The New York Times blog, 9 December 2009, http://krugman.blogs.nytimes.com/2009/12/09/darling-i-love-you/

7. The FT blog, 9 February 2009, http://blogs.ft.com/lex-wolf-blog/2009/02/09/populism-over-bankers-pay/

£7 of social value for every pound in value they generate.[8]

The economic arguments for taming the dominance of the finance sector are overwhelming. The social and moral arguments are incontrovertible.[9] Our recent polling also shows that the public are concerned by the return to large bonuses and there is public support for tougher regulation, including support for all of the policies proposed in this document.[10]

We believe the ideas set out below will appeal to a broad political spectrum and should be of interest to all citizens. There is a new common sense to be fashioned: that nobody should be beyond democratic accountability, and when they are, things go badly wrong. As the immediate crisis calms, at least for a while, we believe this to be a good time to push for policy ideas before lessons are forgotten.

We demand six policy proposals; if introduced in the right way they would significantly transfer risk from the state and taxpayers back on to the financial institutions. These policies would give greater taxpayer value, help tackle egregiously high pay and re-balance the economy away from the over-dominance of the financial services.

8. The New Economics Foundation, *A Bit Rich*, 2009, www.neweconomics.org/publications/bit-rich

9. *Why More Equal Societies Do Better*, Equality Trust, www.equalitytrust.org.uk/why/evidence

10. For full poll results see Appendix, p.15

Policy 1:

Making the banker's bonus windfall tax permanent

What is it?

In the 2009 pre-budget report UK banks had a 50% levy imposed on all bonuses above £25,000 paid before 5 April 2010, which was forecast to accumulate around £500 million in tax revenues.[11] This applies to banks, building societies and UK branches and subsidiaries of overseas lenders.

Public support

Our polling shows 59% total support for this policy with only 23% opposing.[12]

How does it work?

The tax payable is to be calculated by adding together all bonuses above £25,000 and then levying a charge on the aggregated sum of those big bonuses. Although this was enacted as a one-off windfall tax, the tax could be replicated annually.

Why desirable?

When announcing the windfall tax, the Chancellor Alistair Darling announced that the aim was to force a 'permanent culture shift' in the City through a one-off punitive super-tax. The BBC's Robert Peston described this measure as a 'semi-voluntary windfall tax'.[13] Banks could reduce the tax burden of the bonus tax by deferring bonuses or reducing them. Recent announcements suggest that, on the whole, banks have not attempted to avoid the tax but merely absorbed the tax as an extra cost. According to one estimate the 50% British tax on bonuses will in practice lead to a reduction of between 5% and 12% in bonuses paid to all bankers, wherever they happen to be living.[14] In reality the 'permanent culture shift' Darling hoped to introduce through this measure has not occurred thus far, as large bonuses continue to be paid and higher than expected yields from the windfall tax of £2 billion are forecast.[15] The 'one-off' nature of the windfall has meant that most institutions have taken this short term hit and carried on functioning as usual. This tax may be more difficult and costly to ignore if it was made permanent. If banks continued to pay excessive bonuses then the tax yield would remain high, accruing a large amount for the Treasury. Alternatively, a permanent bonus tax could lead to bonus payments being reduced as a way to avoid tax; this has the benefit of discouraging the payment of bonuses. A tax focus on bonus pools would discourage the payment of bonuses, reducing risk and short-termism.

Likely outcomes

A permanent tax would be expected to yield less than a one-off windfall but it could still be expected to raise around the £500 million initially projected this year by the Chancellor.

Where has it been tried?

This windfall tax has been replicated in France. The yield from the tax has been earmarked to top up the guarantee fund for banking deposits.[16] Furthermore, the French government has warned banks that if they do not obey the strict guidelines on pay they will be excluded from competing for exclusive government contracts.

11. *Guardian*,10 December 2009, www.guardian.co.uk/business/2009/dec/10/brown-and-sarkozy-tax-bankers

12. See www.compassonline.org.uk

13. *BBC News Online*, 9 December 2009, www.bbc.co.uk/blogs/thereporters/robertpeston/2009/12/how_the_bonus_tax_will_work.html

14. *BBC News Online*, 4 January 2010, www.bbc.co.uk/blogs/thereporters/robertpeston/2010/01/bumper_bonuses_mean_bumper_tax.html

15. *Guardian*, 8 January 2010, www.guardian.co.uk/business/2010/jan/08/bonus-time-city-banks

16. *Financial Times*, 10 December 2009, www.ft.com/cms/s/0/05b1bb70-e570-11de-81b4-00144feab49a.html

Policy 2:

Extending the banker's bonus windfall tax to other financial institutions

What is it?

The 50% levy on all bonuses above £25,000 in the banking sector would be extended to hedge funds and private equity houses.

Public support

Our polling shows 60% total support for this policy with only 20% opposing.[17]

How does it work?

The tax payable is to be calculated by adding together all bonuses above £25,000 and then levying a charge on the aggregated sum of those big bonuses.

Why desirable?

Although hedge funds will claim they are separate from banks and should be free to do as they please, the reality is that many hedge funds are officially owned by or closely associated with the large investment banks, often created by being spun out directly from their trading teams. The lack of transparency, excessive pay and high-risk speculation demands that they too require close attention.

The government policy of quantitative easing included acting as the buyer of last resort for bonds. Many hedge funds directly benefited by having a buyer for their assets, which otherwise would have had no sellable value. Others have benefited by speculating on the consequences of the policy of quantitative easing. Although potentially fuelling further bubbles in the sector, which could burst in the future, hedge fund manager Crispin Odey says 'everyone should enjoy it' for now![18]

Some 80% of the European hedge fund industry is based in the UK,[19] along with 60% of private equity – the industry manages £250 billion in wealth.[20] At a time of economic austerity hedge funds have paid individuals up to £1,600,000,000 (£1.6 billion) as bonuses for good performance in 2009.[21] Due to the bankers' windfall tax it is rumoured that many bankers will move into the hedge fund industry, seeking a higher level of remuneration.[22]

Hedge funds and private equity houses are at the sharp end of financial speculation. They are less constrained than investment banks which have diluted ownership and, relatively speaking, a stricter regulatory framework. Although most hedge fund bonuses are predicted to fall this year, portfolio managers, quants, programmers and traders are all expecting large rises in bonuses for performing well in a difficult market. Hedge funds are largely expected to recover if favourable economic conditions continue in 2010.[23]

Hedge funds are systematically risky organisations for a number of reasons:

1. *High leverage*, e.g. Long Term Capital Management's failure in 1998. LTCM was leveraged by factor of 30. It had $4 billion worth of investor money yet had $125 billion in assets.
2. *Secrecy* – lack of transparency and regulation means there can be no guarantees that hedge fund activities will not jeopardise financial stability – that there may well be undisclosed structural risks to the economy. According to the European Central Bank, 'the increasingly

17. See www.compassonline.org.uk

18. *Reuters Blog*, 22 September 2009, http://blogs.reuters.com/hedgehub/2009/09/22/enjoy-the-bubble-says-odey/

19. *Daily Telegraph*, 13 November 2009, www.telegraph.co.uk/finance/newsbysector/banksandfinance/privateequity/6564572/Hedge-funds-stunned-by-EU-clampdown-on-bonuses.html

20. *Guardian*, 20 August 2009, www.guardian.co.uk/business/2009/aug/20/hedge-fund-regulation-battle

21. *This is Money*, 22 December 2009, www.thisismoney.co.uk/markets/article.html?in_article_id=496373&in_page_id=3

22. *Reuters*, 16 December 2009, www.reuters.com/article/idUSLNE5BF03O20091216

23. Head Fudge Digest, *Hedge Fund Compensation Report 2010*, www.jobsearchdigest.com/hedge_fund_jobs/career_advice/hedge_fund_compensation_2010

similar positioning of individual hedge funds within broad hedge fund investment strategies is another major risk for financial stability, which warrants close monitoring despite the essential lack of any possible remedies'.

3. *Short-selling* can be used as a hedging or investment strategy. If used as an investment strategy losses can be limitless. It is widely believed that some hedge funds betting on the collapse of banking shares exacerbated the global crisis.[24]
4. They generally have a higher appetite for *risk*. They are effectively stripped bare investment banks without most of the operational parts. Most people join hedge funds so they can invest without many of the restrictions and controls a bank has and enjoy more of the profit for themselves.
5. *Volatility* – many hedge funds thrive on instability in the markets, whereas the national interest lies in having stability.
6. There are a huge number of funds that rely exclusively on *computerised trading* – programs that look at a huge amount of historical and current data in order to make automated trading decisions. There are fears in some quarters that this could trigger a meltdown in the future if everybody sells in a falling market.

In the USA, UK and comparable countries, the average base salary in 2008 was $140,000, with a bonus of $172,000. It is the senior roles that benefit most from bonuses. COOs on average receive the largest bonuses.'[25]

In 2008 UK hedge fund analysts earned bonuses of approximately $50,000 more than their US counterparts – around $225,000. This doubles if senior analysts' average bonuses are examined.[26]

Although hedge funds would probably not be bailed out by the government in the event of collapse (unless the collapse was a threat to wider economic security) they have benefited from the bailout through *government backed guarantees and quantitative easing*. They also now have a competitive advantage over banks that have had the windfall tax imposed upon them.

Likely outcomes

The state bailout has been good to the hedge fund industry. Heidrick & Struggles' analysis concluded that in 2009 hedge funds made their best returns for a decade – averaging 15–20%.[27] Although remuneration trends in 2009 were mixed, large bonuses continued to be paid and more junior staff still received bonuses over 100% of their base salary.[28]

A lack of public statistics around remuneration make projections almost impossible. 10,000 people are employed directly with hedge funds in the UK[29] so we can assume conservatively that the tax could raise in excess of £700 million from hedge funds alone.[30]

24. *Guardian*, 20 August 2009, www.guardian.co.uk/business/2009/aug/20/hedge-fund-regulation-battle

25. Head Fudge Digest, *Hedge Fund Compensation Report 2010*, www.jobsearchdigest.com/hedge_fund_jobs/career_advice/hedge_fund_compensation_2010

26. FT Alphaville Blog, *The Hedge Fund Salary Calculator*, http://ftalphaville.ft.com/blog/2007/04/24/4066/the-hedge-fund-salary-calculator/

27. *Hedge Fund Industry* Trends: 2009 and beyond, Heidrick & Struggles, www.heidrick.com/NR/rdonlyres/F1921334-8638-49D0-9D47-4FA3C90705E3/0/HS_HF_TrendsQ4_09.pdf

28. *Hedge Week*, 16 December 2009, www.hedgeweek.com/2009/12/16/27718/2009-sees-mixed-hedge-fund-compensation-trends

29. *Alternative Investment Management Association*, 26 January 2009, www.aima.org/en/media_centre/press-releases.cfm/id/180A446A-76C4-4B92-B1703ECCC77DBEC7

30. If we assume that 60% of the 10,000 directly employed in UK based hedge funds are 'revenue generators' and conservatively (excluding CEOs) their annual bonus is $225,000. This gives a combined bonus pool of around $2,250,000,000. This would be taxed at 50%. The resulting $1,125,000,000 is the equivalent to £720,469,789.35 (XE.COM 12 February10)

Policy 3:

Remuneration caps

What is it?

This would be a short term ceiling on total remuneration given as both cash and share options.

Public support

Our polling shows 76% total support for this policy with only 14% opposing.[31]

How does it work?

UK banks building societies and UK branches and subsidiaries of overseas lenders would have a remuneration cap imposed. A low compensation ratio would be set at around 15%.[32]

Why desirable?

As a way of tackling flagrant high pay, shoring up bank balance sheets and providing a level playing field across the banking sector.

During the boom years investment banks set aside between 45% and 65% of their net revenue to pay staff before calculating profits or paying out dividends to shareholders.[33] The latest round of payouts have had a compensation ratio of nearer 30–40% as banks try to convince politicians and the public that they can self-regulate. High staff costs lead to diminishing profits and dividends as well as lower capital reserves. It also puts huge pressure on less profitable institutions – for example the 2009 compensation ratio for UBS is 81.2%, which is unaffordable in the long term.[34]

As mentioned above, the link between excessive pay and the economic crisis is now widely acknowledged. Remuneration caps could therefore give greater economic stability to the banking system.

Taxpayer anger over the high levels of remuneration at banking institutions in which the public has a stake remains high. Yet at the same time the taxpayer has an interest in seeing RBS returning to profitability. Stephen Hester, Chief Executive at RBS, claims that recruitment at RBS is difficult because of the public scrutiny of pay and bonuses and that RBS is a 'prisoner to the market' when it comes to staff pay.[35] The remuneration cap would free RBS from this dilemma, giving greater value to the taxpayer. It would also help reduce excessive risk taking as a result of the pursuit of short term rewards across the UK banking sector.

Likely outcomes/projections

If imposed this could have saved around £520 million from RBS bonus payments this year alone.[36]

Where has it been tried?

Barack Obama has imposed individual salary caps of around £345,000 per year for those working in institutions that have received government support. There are concerns that this will cause a 'flight of talent' from those banks that have accepted bail-out money.[37] In September 2009 the leaders of the UK, Germany and France co-signed a letter encouraging the G-20 to explore the possibility of introducing bonus caps.[38]

31. See www.compassonline.org.uk

32 The compensation ratio is the percentage of an institutions net revenue allocated to staff pay

33. *F.T.com*, www.ft.com/cms/s/0/a7cdcc3e-183b-11df-9256-00144feab49a.html

34. *eFinancial Careers*, 11 February 2010, http://news.efinancialcareers.co.uk/newsandviews_item/newsItemId-23738

35. *Daily Telegraph*, 12 January 2010, www.telegraph.co.uk/finance/newsbysector/banksandfinance/6973415/RBS-chief-executive-Hester-says-bank-is-a-prisoner-of-the-market-over-large-bonuses.html

36. The RBS bonus pot is forecast to be £1.3 billion at a compensation ratio of 25%. The figure is calculated by assuming a compensation ratio cap of 15%.

37. *Guardian*, 4 February 2009, www.guardian.co.uk/business/2009/feb/04/obama-bank-salary-cap

38. *Wall Street Journal*, 9 September 2009, http://online.wsj.com/article/SB125197829721482899.html

Policy 4:

Financial transactions tax

What is it?

A financial transaction tax is a tax placed on a specific type of financial transaction for a specific purpose. A domestic version could be introduced through the CHAPS system. There is also a broader international variant or 'Tobin tax'.

Public support

Our polling shows 51% total support for this policy with only 23% opposing.[39]

How does it work?

Last year the Trade Union Congress (TUC) put forward a proposal of a 0.05% transaction tax on instant sterling transfers between UK financial institutions. The Clearing House Automated Payments System (CHAPS) transaction is as 'a simple extension of good old British stamp duty' that wouldn't require international agreement.[40] The CHAPS system is used by large banks to make same day, irrevocable payments. These transactions – which reached £74 trillion in 2008 – are dominated by the trading activity of large financial institutions. The total value of CHAPS annual transfers is 50 times greater than the UK's GDP (£1.5 trillion) and more than 15 times bigger than all cash transactions such as debit cards, cheques and ATMs.

Why desirable?

Japan's vice-minister for finance recently said: 'We're seeing speculative funds flowing carelessly around the world – one day in stocks and real estate, other times in oil and grains – and this is destroying the lives of ordinary people.'[41] Although this tax will have the effect of dampening speculation it could raise vast amounts of money, which could be used for investment in socially useful ventures.

The TUC envisaged this as an alternative to premature and damaging cuts to the public sector in order to rebalance the nation's accounts. If spent on deficit reduction alone this kind of annual income would halve the deficit by 2013/14. Moreover, the introduction of the tax would fend off overtures of a rise in regressive taxes such as VAT to 20%, which would leave the most vulnerable in society picking up the bill for mistakes of the very well off.

The difference between the CHAPS tax and the more recent proposal by the 'Robin Hood' Tax Campaign for a 0.05% tax on banking transactions is that the latter targets a broader range of banking activities. The Robin Hood campaign demands the tax placed on all non-public transactions such as those in shares, bonds, derivatives and foreign currency.[42]

Likely outcomes/projections

CHAPS tax – levied at the TUC's suggested level of 0.05% – would have raised £37 billion in 2008, and adjusting for changes in the behaviour of financial institutions, they estimate a tax take of £30–40 billion a year.

Robin Hood tax – experts have estimated an international transaction tax system could eventually raise as much as £250 billion annually.[43]

Has this been tried?

In the UK a 0.5% stamp duty on share transactions raises more than £3 billion each year. In Belgium a FTT on the transfer of shares, bonds and other securities, at a rate of 0.5–1.7%, raised €147 million in 2005.[44]

39. See www.compassonline.org.uk

40. *Guardian*, 11 November 2009, www.guardian.co.uk/commentisfree/2009/nov/11/fiscal-deficit-chaps-tax

41. *Guardian*, 18 February 2010, www.guardian.co.uk/business/2010/feb/18/uk-banker-exodus-exaggerated

42. *Robin Hood Campaign*, http://robinhoodtax.org.uk/

43. *Trade Union Congress*, 10 February 2010, www.tuc.org.uk/economy/tuc-17542-f0.cfm

44. *Robin Hood Campaign*, http://robinhoodtax.org.uk/

Policy 5:

Separation of retail and investment banks

What is it?
The separation of banks that engage in 'retail banking' activities from those that engage in 'investment banking'.

Public support
Our polling shows 68% total support for this policy with only 12% opposing.[45]

How does it work?
Any bank that is engaged in retail or 'utility' banking (those that execute transactions directly with consumers including savings and checking accounts, mortgages, personal loans, debit cards and credit cards) cannot engage in investment or 'casino' banking (owning hedge funds, aiding in the sale of certain securities, facilitating mergers and other corporate reorganisations, acting as brokers to individual and institutional clients, and trading for their own accounts).

In today's world, where markets and banks are global and where 'innovations' in financial products such as complex derivatives mean transactions are much harder to unravel, where and how you build the dividing wall will take time to get right.

However, the ultimate goal would be to create two separate types of institutions that would have different relationships with the public, the government and the regulators. One set of institutions would be protected from failure in order to secure depositors but would be limited in the risk it can take as a result. The other set of firms would be allowed to take risks with their own money but would still need to be regulated to ensure their actions do not put the economy at risk. However, it would be made clear that they would not receive protection from the taxpayer.

Why desirable?
A handful of extremely large and politically powerful banking organisations that take deposits from ordinary folk also trade financial products such as stocks speculatively in the global market place.

The problem inherent in this system is that the socially necessary 'utility' function of a bank has attached to it a risky 'casino' where the house tries to make profits for itself using money entrusted to it for safe-keeping, an activity known as proprietary trading. If the casino part fails through bad judgement, rogue trading or unforeseen circumstance, it is the ordinary depositor who loses. Alternatively the government can choose to underwrite these deposits which put the taxpayer at risk.

Furthermore, the knowledge that the bank will be bailed out encourages riskier choices. Imagine you are playing poker and you know you get to keep any winnings but if you lose, you'll probably get most of your money back: that would have great implications for how you bet.

The division between trading focused and customer focused banks would:

- remove the moral hazard problem so depositor funds were protected by government guarantee schemes while the proprietary trading firms would be allowed to fail just like any other business
- send a signal in terms of what kind of banks and what kind of economy we want to encourage. Banks should be encouraged to profit by serving their customers well and collectively providing liquidity and capital to the economy. The most dangerous forms of proprietary trading and derivatives transactions should be more heavily regulated

45 See www.compassonline.org.uk

and restrictions imposed where there is suspicion of systemic threats to the broader economy. Hence, as a society we can encourage businesses to profit where they provide real social or economic value and discourage those that don't.

Likely outcomes

Specific outcomes are difficult to predict because of the uncertainty of the exact scale and nature of such a policy. The potential for truly radical change that could diminish the power of the large banks will undoubtedly be met with severe opposition from that sector despite having broad support, including from President Obama, Mervyn King, Nigel Lawson, Vince Cable and so on.

The moral hazard would be removed because proprietary trading units would be detached from the bank and stand alone and none would be bailed out if they lost their bets and folded. The size of speculative trades would also decrease as ordinary deposits could not be used. Banks then could refocus their business models to ensure value for their customers and to perform better in their core functions such as lending to businesses and individuals. There would be an opportunity to create more specialised, smaller banks some of which could be community based.

Where has it been tried?

The Glass-Steagall Act of 1933 was introduced after the last banking crises in the USA because banks had indeed used depositor money to fuel a stock market bubble that burst triggering the Great Depression.

In the UK an informal Glass-Steagall existed, until market deregulation in search of greater profits and faster growth under a backdrop of Thatcherite neo-liberalism that markets knew best and heavy lobbying meant this virtual 'wall' between depositors and speculation was removed in 1986. Market deregulation did indeed spur growth and profits in London and, not wanting to miss out on the bounty, the USA repealed Glass-Steagall in 1999.

The removal of the act spurred considerable takeover activity where large firms gobbled up smaller ones resulting in a few massive, between five and ten, banks being at the centre of the global financial system. As ex-conservative chancellor Nigel Lawson says, 'There is a great concern of the huge danger you get into when you have institutions which are considered to be too big to fail.'

While the system was in place, banks did fail but they did not create systemic risk that would send shockwaves through the system. The collapse of banks such as Barings (investment bank) due to one rogue trader resulted in the shareholders being wiped out but did not bring down the economy.

The Volker plan now being introduced in the USA has restrictions on proprietary trading, which would prevent banks from owning hedge funds or private equity firms engaged in risky economic activity. The final legislative outcome of this plan is not yet known but it is underpinned by the same thinking.[46]

46. *BBC News Online*, 31 January 2010, http://news.bbc.co.uk/1/hi/business/8486091.stm

Policy 6:

High Pay Commission

What is it?

An open, balanced and thorough examination into pay and income at the top in order find long term and tested solutions into how better to reduce excessive risk and excessive rewards.

Public support

Polling shows 65% total support for this policy.[47]

How does it work?

A balanced commission led by a director, under the instruction of the chair and a small number of commissioners, backed up by an expert panel of advisers. The commissioners would be broadly representative, and include one representative from the financial and business community; one from organised labour; a relevant academic or economist; and a journalist, charity or civil society representative. The expert panel will be brought together to provide guidance, ideas and research input in to the project.

They would operate by:

- gathering and analysing existing data
- commissioning any new research
- calling witnesses and holding hearings
- testing the analysis with interested parties
- testing recommendations with interested parties.

A High Pay Commission would be given the job of examining why and how best to reduce excessive risk and excessive reward in the medium to long term.

It would explore and gather evidence into the most egregious examples of excessive pay, examining how and why the rewards have become so inflated and the effects of excessive pay in the financial sector and wider economy.

The Commission would explore examples of ownership, governance models and regulations that have been better able to reduce excessive pay and risk. It would conclude by suggesting a set of tested recommendations for tackling excessive pay.

Why desirable?

The link between excessive pay and the economic crisis is now widely acknowledged. According to the Treasury Select Committee – Ninth Report: Banking Crisis: reforming corporate governance and pay in the City: 'the bonus culture in the City of London, particularly amongst those involved in trading activities in investment banks, contributed to excessive risk-taking and short-termism and thereby played a contributory role in the banking crisis'.[48]

Evidence suggests that extremely high pay, like extremely low pay, creates market failures. Top earners in some sectors, like banking, are overpaid, and talented individuals are drawn to banking, and drawn away from other socially useful sectors. Many of the quantitative analysts recruited by banks have advanced degrees in maths and physics; their skills could be put to better use for generating scientific innovation rather than for generating an increase in profits for banks.

Martin Wolf writes in the *Financial Times*, 'It is a gross misallocation of resources to pull the most talented people into a business whose true value added is modest and many of whose activities are zero sum. For the UK it has surely been a catastrophe.'[49]

Therefore the issue of pay needs to be comprehensively addressed. A full and lasting solution into tackling high pay including desirable governance structures, payment structures (base and performance bonuses), regulation, individual

47. According to a ComRes/ Independent on Sunday poll carried out on 19–20 August 2009, available at www.comres.co.uk/page1901054041.aspx

48. Treasury Select Committee, *Ninth Report: Banking Crisis: reforming corporate governance and pay in the City*, www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/51905.htm

49. *Financial Times*, 9 February 2009, http://blogs.ft.com/lex-wolf-blog/2009/02/09/populism-over-bankers-pay/

and corporate taxation must all be explored and joined up to enact a tight policy framework for regulating excessive pay.

Likely outcomes

It would be difficult to pre-empt the outcome of any Commission. Ultimately the Commission would recommend a comprehensive set of joined up regulations to tackle excessive pay.

Where has it been tried?

The Australian Productivity Commission established a more narrow investigation into the regulatory framework around remuneration of directors and executives of companies in 2009.[50] It concluded with various recommendations, including to create independent remuneration committees and to enhance pay disclosure.

Conclusion

As we have seen, greed-fuelled risk taking, inadequate scrutiny and regulation, governance structures with no regard for taxpayers' interests and compensation practices that have no relationship with social and economic value added pose a massive problem for our economy.

Whether we like it or not, the financial sector has massive implications for the whole of the country but it has become complicated, self-serving and unstable. The policy proposals we have made attempt to tackle these problems.

Any new tax or regulation raises technical questions about its implementation, particularly in the area of avoidance and evasion, so its introduction would require detailed work. Yet this is no legitimate reason not to employ these policies. Furthermore, it is equally imperative to close existing loopholes and practices of tax avoidance alongside introducing new legislation.

Although we recognise these regulations are best enforced multilaterally (and many already are), it should not stop the UK government taking unilateral action. The disproportionate influence of the financial sector over the UK economy leaves it particularly vulnerable to future crises and we should not allow ourselves to be at the mercy of international consensus.

We know that some automatic opposition to these policies will include fear-mongering that talented individuals will leave Britain in droves and growth will be hit. However, some of the outdated assumptions underlying these claims need to be examined. Recently, the *Guardian* has found 'Fears of mass UK banking exodus prove unfounded'.[51]

Others will claim that some tinkering with the system, such as banks planning how they wind-up and toughening up existing rules on capital adequacy and liquidity, will solve all our problems. They won't. We have shown there are some fundamental problems that need to be solved if we are to avoid repeats of this crisis.

This must be a watershed movement in which we reverse the trend of the past 30 years where private financial risk has been publicly shared and the gains increasingly privatised. The measures outlined here are economically and politically feasible.

A banking crisis like this must never happen again, but to make sure we must act now.

50. Australian Government Productivity Commission, *Executive Remuneration in Australia; inquiry report*, www.pc.gov.au/projects/inquiry/executive-remuneration/report

51. *Guardian*, 18 February 2010, www.guardian.co.uk/business/2010/feb/18/uk-banker-exodus-exaggerated

Model Letter to the Chancellor of the Exchequer

Rt. Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Dear Chancellor of the Exchequer,

I write to highlight my concerns regarding the future regulation of the financial sector. For reasons of justice, equity and fairness for all we need a new banking settlement and to learn the lessons of the financial crash.

I believe that the taxpayer is an invisible investor in every banking business, whether it is openly nationalised, such as RBS, or purely private, such as Goldman Sachs or HSBC. This means that taxpayer interests must be represented in their regulatory framework.

The economic arguments for taming the dominance of the finance sector are overwhelming. The social and moral arguments are incontrovertible. Recent polling commissioned by Compass shows that 75% of the public are worried that banks have not changed and are still not being properly regulated which could be bad for the economy, I too share these concerns.

I would therefore like you to implement six policy proposals; a mixture of short and long term, which if introduced in the right way would significantly transfer risk from the state and taxpayers back on to financial institutions. These policies would help deliver greater taxpayer value, help tackle egregiously high pay and re-balance the economy away from the over-dominance of the financial services.

These are:

- Remuneration Caps – Supported by 76% of those polled. A cap across the whole of the UK banking sector would help prevent the movement of staff away from RBS to higher paying rivals that are less constrained by government pressure and public outrage. It would reduce the staff pay bill, saving the taxpayer money and help shore up the balance sheet.
- Extending the Banker's Windfall Tax to other institutions such as hedge funds (supported by 60% of those polled), who have benefited from public money; this would further prevent staff from leaving RBS and seeking higher remuneration in other sectors.
- The separation of retail and investment banks, supported by 68% of those polled.
- Repeating the one-off windfall tax on bankers' bonuses annually, supported by 59% of those polled.
- A financial transactions tax, supported by 51% of those polled.
- A High Pay Commission, supported by 65% of those polled.

A banking crisis like this must never happen again, but to make sure we must act now. A new banking settlement is not only popular, but it is the right thing to do.

Kind regards

YouGov/Compass survey results   Sample size: 1281 GB Adults   Fieldwork: 18–19 February

		Voting intention %			Gender %		Age %			Social Grade		Region				
	Total	**Con**	**Labour**	**Lib Dem**	**Male**	**Female**	**18–34**	**35–54**	**55+**	**ABC1**	**C2DE**	**London**	**Rest of South**	**Midlands & Wales**	**North**	**Scotland**
Weighted sample	1281				615	666	393	449	440	631	650	164	416	274	315	111
Unweighted Sample	1281	453	277	155	673	608	296	439	546	686	595	216	398	245	317	105
	In response to the recent financial crisis, the UK Government supported banks to help kick-start the economy. As the industry recovers, banks have posted large profits and paid their staff bonuses. On balance what do you think about this?															
On balance I'm pleased, as it shows that banks are recovering which could be good for the economy	18	23	19	16	19	16	22	16	15	19	16	23	15	17	18	19
On balance I'm worried, as it shows that banks have not changed and still not being properly regulated which could be bad for the economy	75	74	76	81	77	74	68	75	82	76	75	70	79	75	74	74
Don't know	7	3	6	3	4	10	10	9	3	5	9	7	6	8	8	7
	The Government this year introduced a one-off windfall tax on bankers' bonuses. Some people however are calling upon the Government to take further action aimed at changing the culture of the financial sector and ensuring greater economic stability. Others argue that too much regulation would drive the financial sector elsewhere, with the loss of jobs in Britain. Broadly speaking, to what extent would you support or oppose each of the following?															
	Repeat the one-off windfall tax of 50% on bankers' bonuses annually															
Stongly support	29	27	34	32	34	24	22	27	38	29	29	27	29	31	28	31
Tend to support	28	33	32	26	28	29	29	30	27	32	25	29	29	26	30	26
Total support	59	60	67	57	63	53	51	56	65	61	54	57	58	57	59	57

		Voting intention %			Gender %		Age %			Social Grade		Region				
	Total	**Con**	**Labour**	**Lib Dem**	**Male**	**Female**	**18–34**	**35–54**	**55+**	**ABC1**	**C2DE**	**London**	**Rest of South**	**Midlands & Wales**	**North**	**Scotland**
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Tend to oppose	15	15	15	19	19	12	18	14	15	17	14	16	15	13	15	23
Stongly oppose	8	11	7	7	8	9	7	10	9	10	8	11	7	13	5	8
Total oppose	23	26	22	27	27	22	25	24	24	26	22	27	22	26	20	31
Don't know	18	14	11	16	11	26	25	20	12	12	24	16	20	17	21	12
	Apply the one-off windfall tax of 50% on bankers' bonuses to staff in other financial institutions such as hedge funds and private equity houses															
Stongly support	30	28	35	34	36	24	22	28	39	33	27	29	28	29	32	35
Tend to support	30	30	34	32	32	29	29	32	30	34	27	32	31	30	30	27
Total support	60	58	69	66	68	54	51	61	69	67	54	61	59	59	62	62
Tend to oppose	13	16	13	12	15	11	17	10	12	14	12	17	13	10	10	18
Stongly oppose	7	10	4	7	6	7	4	8	7	6	7	6	5	10	4	8
Total oppose	20	26	17	19	21	18	21	18	19	19	19	24	19	20	14	26
Don't know	20	16	14	15	12	28	28	22	13	14	27	15	22	20	24	12
	Introduce a law to cap bankers' bonuses (set as a percentage of profits)															
Stongly support	43	43	48	41	46	41	34	44	51	43	43	35	41	44	49	46
Tend to support	33	33	34	40	29	37	34	31	36	36	31	37	37	30	28	39
Total support	76	76	83	82	75	78	68	74	86	79	74	72	78	74	77	84

	Total	Voting intention %			Gender %		Age %			Social Grade		Region				
	Total	**Con**	**Labour**	**Lib Dem**	**Male**	**Female**	**18–34**	**35–54**	**55+**	**ABC1**	**C2DE**	**London**	**Rest of South**	**Midlands & Wales**	**North**	**Scotland**
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Tend to oppose	9	10	9	10	12	6	12	10	5	10	8	10	9	10	7	8
Stongly oppose	5	7	4	6	5	4	4	6	4	6	3	7	3	6	4	2
Total oppose	14	17	12	16	17	10	16	15	9	16	11	17	13	16	11	10
Don't know	10	7	5	3	8	12	15	10	5	5	15	11	10	10	11	5
	Introduce a financial transactions tax to raise revenue and reduce financial speculation															
Stongly support	18	17	23	19	24	13	14	17	24	18	18	21	19	20	15	17
Tend to support	33	31	40	37	35	30	29	32	36	36	29	35	30	30	34	41
Total support	51	48	62	56	60	42	43	49	59	54	48	56	49	50	48	58
Tend to oppose	16	18	16	22	17	16	21	13	15	16	16	17	15	17	15	18
Stongly oppose	7	12	4	5	8	6	6	8	7	9	6	8	6	9	7	6
Total oppose	23	30	19	27	25	22	27	21	22	25	22	25	21	26	22	25
Don't know	26	22	19	18	15	36	30	30	19	22	31	19	30	25	30	18
	Introduce a law to separate retail banking (consumer deposits and loans) from investment banking (speculating and raising funds on international currency and stock markets)															
Stongly support	30	32	31	29	36	25	24	29	37	30	30	34	31	27	29	36
Tend to support	38	45	39	46	38	39	40	37	40	45	32	39	40	41	37	31
Total support	68	77	70	75	74	64	63	66	77	75	63	72	71	68	66	67

		Voting intention %			Gender %		Age %			Social Grade		Region				
	Total	**Con**	**Labour**	**Lib Dem**	**Male**	**Female**	**18–34**	**35–54**	**55+**	**ABC1**	**C2DE**	**London**	**Rest of South**	**Midlands & Wales**	**North**	**Scotland**
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Tend to oppose	9	5	14	8	10	7	12	8	7	9	9	10	6	8	9	15
Stongly oppose	3	5	2	3	3	3	3	4	2	3	3	3	3	4	2	3
Total oppose	12	10	16	11	13	10	14	12	9	12	11	13	9	12	12	18
Don't know	20	13	14	15	13	27	23	22	15	13	26	15	20	20	23	15
	Allow banks to pay whatever they choose in bonuses in order to attract the best staff															
Stongly support	4	5	2	4	6	2	6	4	2	6	2	9	3	4	3	4
Tend to support	16	21	18	16	21	12	20	17	12	19	13	20	17	16	15	8
Total support	20	25	20	20	26	14	26	20	14	25	15	29	20	20	18	11
Tend to oppose	28	29	23	37	30	26	29	25	30	30	26	31	30	22	29	30
Stongly oppose	42	39	52	34	38	45	30	42	51	39	44	28	40	51	40	50
Total oppose	70	69	76	71	68	71	60	68	81	69	70	59	70	73	69	79
Don't know	10	6	5	9	6	15	14	12	6	6	15	12	10	7	14	9
	Stop any new regulations on the financial sector as it is a valuable part of the economy															
Stongly support	5	5	4	4	6	4	7	4	5	5	6	9	4	7	5	5
Tend to support	15	19	18	15	18	13	17	12	17	18	13	21	15	16	14	13
Total support	20	24	22	19	24	18	24	17	22	23	18	30	18	22	19	18

		Voting intention %			Gender %		Age %			Social Grade		Region				
	Total	**Con**	**Labour**	**Lib Dem**	**Male**	**Female**	**18–34**	**35–54**	**55+**	**ABC1**	**C2DE**	**London**	**Rest of South**	**Midlands & Wales**	**North**	**Scotland**
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Unweighted Sample	1281	453	277	155	673	608	296	439	546	686	595	216	398	245	317	105
Tend to oppose	34	36	32	40	34	34	34	36	33	36	32	33	40	30	31	32
Stongly oppose	25	23	32	28	30	20	17	27	29	27	23	21	21	28	26	30
Total oppose	59	59	64	68	64	54	51	62	62	63	55	55	61	58	57	62
Don't know	21	17	14	13	13	29	26	21	16	15	27	16	21	20	24	20

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DIRECTION FOR THE DEMOCRATIC LEFT

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