London’s financial industry: the city of blinding lights

In recent times the financial services industry and its failures have provoked great economic harm in the world as a whole and particularly in a number of countries. Nevertheless, some countries have adopted policies protecting the financial services industry, what can be at odds with penalizing their pre-crisis way of behaving.

Considerable research has been conducted on a number of issues regarding the financial industry, some of them using the approach of the geographical location of industries: the causes and effects of the transformation of this industry’s landscape, the foundations of the global pre-eminence of some financial centres…

This paper provides a new perspective to the question of “too big to fail” enlarging this concept to include the financial industry as a whole, through the analysis of the archetypical case of the City of London. The hypothesis of the paper is that the financial industry could be oversized in London, but being this city’s economy so dependent to this industry, no relevant attempt to downsize it will occur spontaneously.

JEL classification
G10, G29, R10

Key words
Financial centres, financial cluster, crisis, too big to fail

1. Introduction: the current Financial Crisis

In the past, financial crisis have led to severe market dysfunctions, and deeper and more protracted economic recessions (Reinhart and Rogoff, 2009). Hence, the prevention of future financial crisis should be a main objective for society as a whole, but specifically for the industry itself and the political bodies. The aim of this paper is to present one of the reasons of the financial meltdown of 2007-2013, and to analyse the impact of the size of the financial industry in the slow pace of adoption of measures to reduce the odds of future financial crashes.

During the early years of the XXI century, developed economies experienced continued growth fuelled by citizens' consumption; historically low interest rates made borrowing much more affordable, and many citizens, blinded by cheap finance, got involved in unreasonable real estate investment or excessive consumption[1]. The effect of cheap imports from China, allowing an increase in consumption compatible with historically low inflation throughout developed economies played also a key role in these developments. In some countries an unusual sense of prosperity[2] led to the creation of a huge bubble in the housing market, enhanced by the use of new financial instruments distributed throughout the globe to investors that most times did not understand the risks involved in their investments. Financial institutions developed ways (securitization, structured finance) of passing risk from the company that generated those cheap loans to other financial institutions (SIVs[3], investment funds, insurance companies, international banking corporations) that would invest in them.

In the spring of 2005 the excesses of the previous years in the US housing market (loans of billions[4] of dollars had been granted to people without income, job or assets) started to be visible to insiders within the financial industry (Mc Donald, 2009) and to some reputed economists (Krugman, 2005a and 2005b), even though most analysts and mainstream economists did not pay attention to these predictions or to the erratic moves of the ABX (Asset-backed Securities Index) index occurred in 2006.

---

[1] James (2007) characterized English-speaking developed nations across the globe as suffering from *affluenza*, a mental disorder defined by placing a high value on money, possessions, appearances and fame (and making them top priorities in people's lives). He also alerted about other developed nations' societies becoming increasingly afflicted by this phenomenon.

[2] This was compatible with many discontents in developed and emerging nations (Stiglitz, 2002).

[3] Structured Investment Vehicles.

[4] Billions is used in this paper as 10^{12}.

In 2007 and 2008, despite the attempts of central banks to provide liquidity and substitute the frozen interbank market[5], the crisis was mounting and finally hit severely the financial industry, effectively paralyzing the economy. After panic had spread through the markets, governments were forced to bail out the financial industry in many developed economies, mainly the US and the UK. Some of the first attempts to control the damage, as the Paulson initiative (Draft Proposal for Bailout Plan, 21st September 2008), were merely gifts to the financial industry.

Rage against the "*financial culprits*" prevented some of the softest measures towards the financial industry, but could not help the injection of billions of euros in order to keep the whole system on foot. In April 2009, at the London meeting of the G-20 countries, their governments agreed to "*do everything necessary to ensure recovery, to repair our financial systems and to maintain the global flow of capital.*" By then, the interest rates in all developed economies were at the zero lower bound, and contagion to the real economy had occurred (through a combination of sharp reduction of credit, loss of confidence, and losses in financial investments).

The combination of the desperate need for a large public intervention in the financial markets to keep them alive, and the deep economic crisis engendered by the financial turmoil (with the subsequent fall in public revenues and surge on governmental expenditure as the automatic stabilizers were ignited), provoked extremely large public deficits all over the world, affecting specially some developed economies with previous economic weaknesses (among others: real estate bubbles; loss of competitiveness; excessive dependence on foreign credit). It is worth noting that, as interest rates were at the zero percent level, there was no place left for conventional monetary policy, and only stimulus packages could reignite the economy, that went paralyzed in an extremely short period of time. Hence, governments designed large expenditure plans for 2009 and 2010, in order to replace a private sector that was not willing to invest or spend.

[5] In August 2007, the European Central Bank had to intervene injecting 95,000 million euros to the European banking industry, anxious for new sources of finances, as the interbank market had dried up. Banks were uncertain about which competitors held in their balances assets contaminated by subprime mortgages. This behaviour was triggered by the suspension of redemption for three of the BNP Paribas funds, heavily affected by the crisis in subprime mortgages.

Another round of problems arose when Greece acknowledged in October 2009 that their public debt was much larger than previously admitted; around the same time, Dubai's government released a statement exposing that they would not back debt issued by some government sponsored entities (though somehow they stepped back in this decision). The mismanagement of the Greek crisis by both Greek and European authorities provoked serious concerns about the *grexit*, or the possibility of Greece leaving the euro, and started a domino effect involving other peripheral European countries with enormous difficulties for finding finance. Ironically, the financial institutions whose fails and very poor performance had fuelled the financial crisis (Credit Rating Agencies and some Banks), started to lecture Governments on their excessive deficits; deficits incurred, to a very large extent, because of the financial crisis itself.

Since then, many actions have been designed and implemented, from harsh austerity plans[6] to a new framework for controlling systemically relevant institutions, or to the design of a European banking union with a single backstop for this industry. Nevertheless, actions to control the financial industry itself have been shy and have lacked ambition.

2. One of the reasons for the financial collapse: the financial industry itself

A large literature from both scholars and international institutions accepts the view that the financial system had become too complex and leveraged before the crisis[7] (De Larosière, 2009; Financial Stability Forum, 2008; French *et al.*, 2010; National Commission, 2011; Sánchez Ferrero and Yanes Luciani, 2008; Trichet, 2008), pointing to some of its weaknesses: misaligned incentives, lack of transparency, poor management of associated risks and excessive dependence on credit ratings agencies. This is why the G-20 group stated that "*we will not allow a return to banking as usual*" (G20, 2009).

Two of the most thorough works analysing the reasons of the financial crisis, the De Larosière report (2009) and the US National Commission report (2011) agree on a number of reasons that cooperated to provoke the financial collapse:

[6] Which arguably have worsened the prospects of economic recovery.
[7] Even though some authors may disagree with the "originate-to-distribute" explanation of the causes provoking the financial crisis (Gorton, 2010).

- Widespread failures in financial regulation and supervision proved devastating to the stability of financial markets

- Dramatic failures of corporate governance and risk management at many systemically important financial institutions was a key cause of the crisis

- A combination of excessive borrowing, risky investments and lack of transparency put the financial system on collision course.

- Governments were ill prepared for the financial crisis, maybe because of a common misperception of the adequate role of government and excessively "corporate-friendly" policies towards the industry

- There was a systemic breakdown in accountability and ethics

- Collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion

- Over-the-counter derivatives contributed significantly to the crisis

- The failures of credit rating agencies were essential cogs in the wheel of financial destruction.

Some other failures may be added, as the short-term thinking in the industry; the failures of the international financial architecture (inherited for a design 70 years old); and the widespread ill designed compensation schemes that provided wrong incentives. The uncontrolled growth of financial products and institutions were also key factors of the crisis, as the relatively long period of economic growth and moderate inflation in OECD countries quite likely favoured that many households took too much borrowing and excessive risks when investing.

Hence, one of the reasons for the financial crisis was the continuous growth of some segments of the financial market, and the changes it experienced in terms of larger institutions

that become much more interconnected and traded more complex products. In fact, the financial sector grew much faster than the real economy it is supposed to serve.

As Rajan (2006) wrote, because of the emergence of these intermediaries and assets "*economies may be more exposed to financial-sector-induced turmoil than in the past*". Regrettably, Rajan's view was considered "*misguided*", and at odds with the tradition set by Greenspan (Johnson and Kwak, 2010). Other authors were just ignored: Cetorelli found that the growing role of the financial industry has been accompanied by financial markets becoming more interlinked, thus making every one of them vulnerable to problems experienced in the other markets (Cetorelli et al., 2007). Another source of risk creation was the rise of large multinational banks and the consolidation of national markets among a few large players, as there is evidence of a negative and significant relationship between banking market concentration and systemic crisis (Beck et al., 2006). In any case, mainstream opinion was the opposite (Johnson and Kwak, 2010); for instance, the president of Barclays claimed in 2007 that "*markets are increasingly safer, more reliable, and less volatile*" (Barron and Gómez, 2007).

From the late nineties to the beginning of the crisis, there was a large development of securitization and of the shadow banking industry[8]; the growth of the financial industry was thought to be indispensable to the continued rapid growth in the world's real economy. Financial derivatives and other complex financial instruments were seen as "*especial contributors to the development of a far more flexible, efficient, and resilient financial system than existed just a quarter-century ago*" (Greenspan, 2002) and the "*possibility of a chain reaction, a cascading sequence of defaults that will culminate in financial implosion*" due to the large leverage they implied was regarded as "*remote*", and under control with the checking proceeds in place.

The global issuance of some financial products, as the infamous collateralized debt obligations (CDO), grew exponentially previously to the crisis, and with some exceptions, they have not dramatically diminished their size. In 2013, the global derivatives market still dwarfs the real economy: the notional outstanding amounts in December 2012 to

[8] The shadow banking industry refers to financial intermediaries playing a role similar to banks (intermediating between savers and borrowers) but not enjoying the tight regulations of traditional banks (those that can accept deposits from their clients). Investment banks, money market funds, hedge funds and other institutions composed this lightly regulated group of financial companies.

approximately 9 times the global GDP of this year, 663 and 71 billion dollars respectively (BIS, 2013; IMF, 2013). Growth in these financial products has been exponential: in mid-1998, the global derivatives market had a notional amount of only 72 billion US $ (and the global GDP was 30.2 billion US $ that year). Within this market, some products had even a more accelerated growth: the notional value of Credit Default Swaps multiplied by ten in just three years, to the extreme of overtaking the global GDP in 2007. The success of these products was seen as a better distribution of risks throughout the economy (Santomero and Babbel, 2001), towards those willing to bear them, who, following Greenspan (2002) were presumably more able to bear them. Hence, it was the "*appetite for risk*" of investors that led this process; even though, given that a large share of the market was highly rated (IMF, 2008) or most positions were supposedly hedged, it would better be stated that investors did not recognize risks, or were even cheated about them[9].

Additionally, the surge of the financial industry created *alpha* cities throughout the globe (Friedmann, 1986; Thrift, 1994) in which most of this industry is concentrated and whose societies depend heavily in the success of the financial industry. In the following section, some context about financial centres will be given.

The growth of this industry was to a large extent disconnected from the real economy's needs, as most operations occurred solely between financial institutions in some segments of the financial markets. To be more precise, a large fraction of this growth in the financial industry corresponded to what the chair of the British Financial Services Authority referred to as "*socially useless*" financial services that led to an industry beyond its "*optimal size*" (Turner, 2009). Harder analyses identify some of the financial institutions' activities as "*wolf-pack behaviour of speculators*" (The Guardian, 2010).

Interestingly, some authors may identify "*powerful interests with a stake in the statu quo*" which "*impede*" and "*resist*" financial reform directed to address the weaknesses of the

[9] In the Memorandum of Understanding between the *troika* and the Spanish Government, in July 2012, measures to ensure adequate consumer protection were part of the package of compulsory actions. These actions would be aimed to limit the sale by banks of subordinate debt instruments to non-qualified retail clients, and to substantially improve the process for the sale of any instruments not covered by the deposit guarantee fund to retail clients. Very likely cases like that of an illiterate old lady from Galicia who had bought complex financial products to her local bank were in the mind of the proposers. In this case, she even signed with her fingertip as a proof of conformity (and the bank considered her to have enough understanding of the financial system so as to get in the deal).

financial system and the causes of the current financial crisis, and would even "*fight against their loss of power and resources*" (French *et al*, 2010). Nevertheless, these authors do not include among these opponents to reform the governments of countries and regions where the financial industry is a key driver of the local economy, providing services to other regions and countries, and generating both public and private income (Oxford Economics, 2011). Hence, even though in some financial centres "*the securities industry is critically important*" to the local "*economies and budgets*" (Dinapoli and Bleiwas, 2011), with "*ripple effect through the rest of the local economy*", no opposition against downsizing this sector seems to be expected from the local governments concerned, those very governments that can laud, for instance, "*how the City of London has risen by [the financial industry's] efforts, ingenuity and creativity to become a new world leader*" (Brown, 2007).

Furthermore, analyses show that the financial industry has enjoyed above normal profitability in the last decades (European Commission, 2011; Lepetit, 2010), which may result from "*the existence of an (implicit or explicit) safety net*" (European Commission, 2011), and that these economic rents can explain 30% to 50% of the wage differentials in this sector (Philippon and Reshef, 2009). Similarly to the previous point, the existence of these rents is not linked to the sector's overgrowth.

Only well informed advocates of the relevance of the financial industry would acknowledge that the financial sector used "*to point its "industrial policy significance" — its contribution in terms of jobs, GDP generation and taxes paid- when faced with policy challenges and criticisms*". If sophisticated enough, they would also "*consider "indirect" jobs, value added, and taxes for industries in the region around a financial centre, created via "multiplier" effects*" (Europe Economics, 2011). These advocates' claim that "*international financial centres produce a whole host of socially useful functions*" is flawed if they do not compare these positive contributions to our society and economy, with the also real negative impact of the financial industry's actions. Actions that, we should recall, may leave "*in a state of shocked disbelief*" those who more hearteningly trust "*the self-interest of lending institutions to protect shareholder's equity*[10]" (Greenspan, 2008). Not to be mentioned that the overgrown financial system is essential for allowing "*the mega-rich to use complex offshore structures*" to own property and other assets, "*gaining tax advantages and anonymity*

[10] Presumably, it should also be in the best interest of these financial institutions to protect their clients' interest, even though this contradicts the findings of the National Commission (2011).

not available to average people", through a "*well-paid industry of accountants, middlemen and other operatives*" controlled by the largest global banks and that provides "*shelter in many cases to money laundering or other misconduct*" (ICIJ, 2013).

Hence, given this general oblivion about the understandable interest that some governments may have to keep safe a relevant industry in their region, it is not surprising that the financial debacle has been thought "*not to be severe enough to be followed by a fundamental reform of the financial system*" (Cassis, 2011).

3. Financial centres

In this section we will shortly analyze financial centres, which can be defined as "*the grouping together, in a given urban space, of a certain number of financial services*" or as "*the place where financial intermediates coordinate transactions and arrange the settlement of payments*" (Cassis, 2006 p. 5). According to why the financial centres are born, Kindleberger (1974) had a seminal work analysing the historical evolution of financial centres. There, Kindleberger proposed some determinant elements for their success (economies of scale; central location; a single currency; the administrative capital; a certain culture… among others). Some years after this early work, Friedmann (1986) suggested that corporate headquarters would be concentrated in a select group of cities, which would become the "*command and control centres*" of the world economy. Choi et al. (1986) proposed a classification of financial centres through the presence of banks headquartered in other main financial centres. Sassen (1991 and 1994) argued that business service firms providing knowledge-based service to their global clients would have to locate their offices in the main world cities. Reed (1981 and 1989) constructed a hierarchy of international financial centres, with London as the supranational centre par excellence. The World Economic Forum, consultancy firms, and think tanks as the Z/Yen group produce frequently rankings of the global financial centres.

O'Brien (1992) discussed the evolution of the financial services industry and the likely future of financial centres in Europe, claiming that with virtual financial markets, geography had died as a reason to locate financial services: "*geographical location no longer matters in finance or matters much less than hitherto*" (O'Brien, 1992, p.1). Nevertheless, the impact of changes in information technologies has been simultaneous to an increasing agglomeration of

financial services in certain hubs, following Friedmann's theory. Thrift (1994) argued that precisely the volume and speed of informational flows were determinant for the rising of "centres of comprehension" of this information: international financial centres. Bindemann (1999, p. 96) stated that "*despite the globalisation of financial services, geography still matters*". Agnes (2000, p.363) pointed out "*an important geographic paradox: although swaps are based on globalization and "end of geography" processes, local embeddedness remains an important constraint*". Hau (2001) found that "*location matters*" also in terms of traders profitability (although traders' performance seemed to be more related to location in a given linguistic area or to location proximity than to location in a financial centre).

4. The London financial centre

As London is still ranked as the first financial centre in the world, and by far the most important in Europe (Z/Yen, 2013), our attention will turn to this city and its financial industry.

The development of the financial sector in London dates back several centuries, at least to the second third of the eighteen century[11] (Cassis, 2006), gaining world pre-eminence in the early nineteen century.

It is noteworthy that London still has this relevant role in the global financial system, and that this success was not fully expected only two decades ago, in the early nineties. Even after the *Big bang* of 1986, the *market sentiment* about the future role of the City of London was, at best, uncertain. Thus, Frost and Spence (1991) found a balanced number of advantages and disadvantages for London to maintain its prime role in the financial services industry; Stafford (1992, p. 45) wrote that in the late eighties "*the atmosphere in the City was one of defensiveness and disappointment*"; in the same line, Coakley (1992, p. 70) argued that "*it is not inconceivable that by the middle of the nineties London will be struggling to compete with Paris and Frankfurt for financial hegemony in Europe*"; Raikes and Newton (1994) recognised "*the need to avoid complacency and to ensure that the services that they provide are fully competitive*"; Thrift (1994) wrote that the future of the City "*is often depicted as tentative and insecure*" (p. 327).); and O'Brien (1994, p. 504) foresaw that in the European landscape no financial centre would be "*that dominant*", although he considered that Britain would "*probably retain its predominance, as it is well ahead*".

[11] Even though some of its institutions were established well before then.

By the end of the 90s the case of the growing London financial cluster despite other financial centres' failure could be perceived. Although rival financial centres were expected to challenge the City, *"the net effect for London is that [financial] business will continue to consolidate"* (Edwards, 1998, p. 10). In fact, the increased integration of European financial and capital markets had encouraged non-UK financial institutions to move some activities to the City or to expand their previous position in London (Group of ten, 2001), strengthening the City's financial cluster.

The reasons for the success of London in the financial centres' market-place lie on economies of scope and scale, arising from the agglomeration of firms in different industries with strong links (Kuah, 2003). Thus, the concentration of financial services firms generates a strong demand for qualified labour, technology and other suppliers (Oxford Economics, 2011), confirming the "*new international division of labour*" proposed by Fröbel *et al.* (1980). Furthermore, Kuah found that financial firms located in the London cluster tended to grow faster than firms with a different British location. Thus, Michie (1998) suggests that London's success lies in the ability to attract talented individuals from everywhere in the world, while simultaneously maintaining a solid fabric of within UK relationships. "*London is particularly well placed to exploit the opportunities that overseas talent brings"*, as the city attracts a much higher proportion of overseas students than other large cities in Europe, and a comparable number to that of New York (Oxford Economics, 2011).

Similarly, Thrift (1994) considered that a key factor was the City's role as a centre of knowledge, expertise and contacts, extending its influence from global financial press to the "*cultural authority*" for global financial services; for instance, four London Universities are ranked among the top 25 European Business Schools (FT, 2012). Krugman (1987, p. 172) assessed that "*London acts as a world financial centre partly because of the external economies associated with its already established position (which in turn rests on historical accident)*[12]*"*. And finally, Plender (1986, p.42) highlighted the virtuous cycle of strengthening a financial centre as well as well: *"the success became self-feeding. International bankers wanted to be in London because other international bankers were there*", although he claimed that London's success as a global financial hub owed much to the fact "*that the United States*

[12] By "historical accident" Krugman means that some of the historical events that fostered London as a financial centre in the first term (the rising of the British Empire, the long period without wars in British soil, the accumulation of financial expertise both national and international, the relative decay of Amsterdam as a financial centre) were not inevitable and could have not occurred.

chose, until recently, not to take advantage of its own economic strength to promote American financial institutions in the international sphere", a statement that seems to underestimate British own strength in the financial market.

Taylor et al. (2003) examined the benefits and costs that financial firms receive for locating in London (mainly in the City, but also in Canary Wharf and the West End). As in their previous works (Cook et al., 2003) they found that location is thought to transmit a trustable signal of the firm's history and performance. Financial services companies gain prestige if located in the City. To some extent, reliable financial institutions "should" have a foothold in London. Furthermore, proximity enhances knowledge transfer and the building of a soft relations network, what is considered a key factor for success in this industry. The accumulation of different industries enables multi-disciplinary teams to assemble quickly if needed and fosters face-to-face interaction. These authors also emphasised the large and skilled labour market which attracts specialists from all over the world to work in the London financial services industry. Simultaneously, they found that transport deficiencies, together with unmanageable regulation and the high cost of premises, are the main disadvantages for a financial firm in a London location. It is noteworthy that both weak transport provision and high rental levels were already pointed out as two of London's weaknesses by Frost and Spence (1991).

Beaverstock et al. (2001) found that although relevant agents had an overwhelming view on the financial markets of both London and Frankfurt, the City remained highly favoured as a place to do business over its German counterpart. This result is consistent with the conclusions of Bindemann's research (1999) and with the fall of Frankfurt's attractiveness as a financial centre during the period 1970-2000 showed by Choi et al. (2002).

5. Economic impact of the financial industry in London

In 2005 the financial industry offered 300,000 direct jobs in the City, and 400,000 more jobs were connected to London's role as a main global financial centre, adding to roughly 18% of the total jobs in London (Haluska et al., 2005). Nowadays, despite what could be thought to be the impact of the financial crisis, London offers more than 350,000 jobs in the financial industry (Oxford Economics, 2011). This increase in financial jobs in London is

coherent with the evolution of the *square mile*[13] itself: "*the level of financial employment has fluctuated since 2008 decreasing from 146,000 in 2008 to 137,000 in 2009 before increasing to 152,000 in 2010 and to 155,000 in 2011"* (City of London, 2012).

The previous estimate of indirect jobs is slightly lower to similar estimates corresponding to New York, where every job created in the securities industry is expected to create "*almost two additional jobs in other industries in the City*" (Dinapoli and Bleiwas, 2011). Differences in the main subsectors within the financial industry presented in both centres may help to explain the disparity.

If we move our focus to value added, "*financial intermediation and insurance*" accounts directly for more than 21% of London's GDP in 2010 (ONS, 2013). In fact, in the city of London represents 46.9% of the total gross value added produced by the British financial industry (while representing just 21% of the national GDP). As commented before, the industry has experienced a pace of growth faster than that of the real economy. In fact, "*London's financial and business services sector has grown by just under 6 per cent annually over the decade before the global financial crisis"* (Oxford Economics, 2011). Besides, London's path through recession has differed from other British regions: London's nominal output has risen faster, and its employment and unemployment rates have fared better. Meanwhile, the share of London's GDP corresponding to the finance and insurance sector has increased from 17.4% in 2005 to 21.1% in 2013 (ONS, 2013).

Regrettably, no regional input-output tables are produced for London, so we cannot estimate multipliers for the financial industry in the City of London. If the British input-output tables are analysed, some branches of finance (as insurance and pension funds) have large output multipliers, and even larger employment-cost multipliers ranking among the industries producing larger indirect effects in others. Output I multipliers for 2005 were between 1.53 and 2.15 (ONS, 2011), meaning that the effect of 1 additional unit of demand on financial services would produce between 1.53 and 2.15 units of total output, including all sectors. Some industries, as *computing,* or *telecommunications, business services, consultancy, courier, advertising and legal services* greatly benefit from the financial industry, according to the British Input-Output Tables.

[13] Traditional name for the City of London, one of the districts composing London and where financial institutions were located traditionally. The financial sector has sprawled to other areas of London.

Although the financial industry in Scotland is not directly comparable to that of London, it represents a large industry in both Glasgow and Edinburgh. Scottish multipliers for financial industry ranged between 1.59 and 1.82 previous to the crisis, when the financial sector accounted to roughly 7% of the Scottish GDP (Larreina, 2008). Noting the much higher percentage of the local economy this industry represents in London, we can reasonably expect higher multipliers for the financial industry in the City of London.

There are a number of other factors that show the relevance of the financial industry in London: the City is likely to be responsible for over half of the UK's exports for *activities auxiliary to financial intermediation* and for *legal activities*, and over 40% of UK exports for *accounting and other monetary intermediation*, becoming a critical component of the British balance of payments. In fact, it has become the dominant UK location for high value added and export-orientated service industries like *security broking and fund management* (74% of the British activity in this industry is based here according to Oxford Economics, 2011).

Besides, financial activity has a wider impact in the life of the City, as financial services firms occupy 57% of core space in the City of London, while an additional 27% is occupied by related businesses and professional services (Lizieri and Kutsch, 2006); the City of London's occupational market, according to these authors, had bound its future "*tightly and irrevocably*" to the evolution of the global financial market. This is very relevant if considered that London "*is key to the UK economic recovery*" (Oxford Economics, 2011).

No doubt then that British authorities are more than sceptical about downsizing in any way their financial industry, to the extreme of vetoing a new European Union treaty as it was not the "*right course*" for the United Kingdom, because refusing a European banking union was their "*national interest*" (Cameron, 2011). This effectively "*isolated*" their country from their European partners "*in great part because of fears that the City would be strangled by regulations emanating from Brussels*" (Lyall and Werdigier, 2011). Very likely, the financial industry in London is *too big to fail,* and even *too big too be downsized,* and supporting it has become a must for British governments.

Even more extreme has been the protest of some British Crown dependencies, like the Channel Islands, which "*threatened to leave the UK*" if legal reforms affected their financial system, based in attracting "*multinational business and wealthy individuals*" (The Guardian,

2012) that try "to optimize their tax payments", what could also be explained as "to escape their tax authorities".

Given this context, it may seem naïf to evaluate the "*negative employment effect*" as "*limited*" when assessing the economic impact of the proposals on a financial transaction tax because of "*the extremely low employment intensity of such activities […] mainly located in the investment banking arm of the sector*" (European Commission, 2011), while this effect can be huge in certain locations, as London, what could lead to obstacles to its implementation, and distortions of the European internal market if the tax is not introduced in a coordinated and harmonized way in all Member States. In fact, if London "*concentrates 17% of all global trading in equities*", London-based fund managers "*manage portfolios worth 11% of the global total*", and "*London's fortunes are closely aligned to the flow of world investment*" (Oxford Economics, 2011) it is hardly noticeable that the City of London commissions a report on the impact of the European financial transaction tax and finds that its adoption "*would cripple activity in the bond market*" (London Economics, 2013).

The interest of safeguarding such a high value-adding industry[14] can be understood: in a report about London's financial industry in 2005, it was estimated that almost one quarter of "City-type" activity in Europe would be lost if London's financial cluster did not exist. In fact, in their opinion "*the disappearance of London [financial cluster], even were some of its activities to be spread around the rest of Europe, would be little short of disastrous [for financial services]… nearly 13% of the current market would be lost to competitors in the other continents… an [additional] estimated 10% of business would not take place, driven out of existence by the higher costs that would ensue*" (Halushka et al., 2005). Considering this reduction in financial activity as an important shock to the European economy, it would be even far more dramatic for London. Although at the time this was seen as a potential problem, given the excesses of the industry it is clear that it would have been much better downsizing the sector at least by 10%. Probably, this industry had too many workers and too much economic role (Larreina, 2008); as Krugman (2009) put it, "*an overgrown financial sector that did more harm than good*". Coming back to Turner (2009), "*financial services form a vital industry and source of high-skilled employment*", playing a vital role in the UK economy and in others, "*but not everything that a financial system does is socially useful; and*

[14] As noted before, this high added-value relies in not considering the negative externalities the financial system may produce.

sometimes bits of it can get too big and it would be better for society if they got smaller". Some more focus needs to be put into the size of this sector, as it is far from unquestionable that its current size is adequate.

6. Conclusion

In the aftermath of the financial crisis' outburst, the G-20 group promised that "*we will not allow a return to banking as usual"* (G20, 2009). Despite this, maybe the financial debacle has not been *"severe enough"* (Cassis, 2011) to provoke a fundamental reform of the financial system.

In this sense, it is interesting to recall that the share of London's GDP corresponding to the finance and insurance sector has increased from 17,4% in 2005 to 21,1% in 2013, meaning that "*London's fortunes are closely aligned to the flow of world investment"* (Oxford Economics, 2011).

This may shed some light on the reasons for some British actions, thought to be in their "*national interest"* (Cameron, 2011), very likely because the financial industry in London has become *too big to fail,* and even *too big too be downsized.*

Some more focus needs to be put into the size of this sector, as it is far from unquestionable that its current size is adequate, as it is even bigger than before the crisis and seemingly disconnected from the evolution of the real economy it is supposed to serve.

7. References

AGNES, P. (2000): "The "End of Geography" in Financial Services? Local Embeddedness and Territorialization in the Interest Rate Swaps Industry**",** *Economic Geography*, Vol. 76, Nº 4, pp. 347-366.

AKERLOF, G.A. and R.J. SHILLER (2009): *Animal Spirits,* Princeton University Press, Princeton.

BARRON, I. and M.V. GÓMEZ (2007): "*Entrevista con Robert Diamond, presidente de Barclays",* El País, 25th February 2007.

BEAVERSTOCK, J.V., M. HOYLER, K. PAIN AND P. J. TAYLOR (2001): *Comparing London and Frankfurt as world cities: A relational study of contemporary urban change*, Anglo-German Foundation for the Study of Industrial Society, London.

BEBCHUK, L. A., J. M. FRIED, and D. I. WALKER (2005): "Executive compensation in America: optimal contracting or extraction of rents?*",* *The Berkeley Law & Economics Working Papers vol. 2001- issue 2.*

BECK, T., A. DEMIRGÜÇ-KUNT and R. LEVINE (2006): "Bank concentration, competition and crises: First results", *Journal of Banking and Finance,* 30, pp 1581-1603

BINDEMANN, K. (1999): *The future of European financial centres,* Routledge, London.

BIS (2013): *Annual Report 2012/13,* Bank for International Settlements, Basel.

BROWN, G. (2007): *Mansion House Speech, 20th June 2007*, HM Treasury, London
CASSIS, Y. (2006): *Capitals of capital,* Cambridge University Press, New York.
CASSIS, Y. (2011): *The shaping of Modern Finance*, Oxford University Press, New York.
CETORELLI N, HIRTLE B, MORGAN D, PERISTIANI S, and J. SANTOS (2007): "Trends in Financial Market Concentration and their Implications for Market Stability", *FRBNY Economic Policy Review,* March 2007, pp. 33- 51.
CHOI, S-R., A. E. TSCHOEGL and C.M. YU (1986): "Banks and the World's Major Financial Centres 1970-1980", *Weltwirtschaftliches Archiv*, vol. 123, nº 4, pp. 48-64.
CHOI, S-R., D. PARK and A. E. TSCHOEGL (2002): *Banks and the World's Major Financial Centres, 2000*, Working Paper 02-36, Wharton Financial Institutions Center, Philadelphia, Pennsylvania.
CITY OF LONDON (2012): *Employment trends*, Department of the Built Environment, City of London Corporation, London.
CUOMO, A.M. (2009): *"No rhyme or reason: The 1eads I Win, Tails You Lose Bank Bonus Culture"*, New York State Attorney General's Office, New York.
DE LAROSIÈRE (2009) : *The De Larosière Report on Financial Supervision,* European Commission, Bruxelles.
DINAPOLI, T.P. and K. BLEIWAS (2011): *The Securities Industry in New York*, Office of the State Comptroller, State of New York, New York.
ELLIOT, L. *et al.* (2008): *A Green New Deal,* The New Economics Foundation, London.
EUROPE ECONOMICS (2011): *The Value of Europe's International Financial Centres to the EU Economy*, City of London Economic Development, London.
EUROPEAN COMMISSION (2009): *Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies,* European Commission, Brussels.
EUROPEAN COMMISSION (2011): *Commission staff working paper – Impact assessment accompanying the document Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC,* European Commission, Brussels.
FAMA, E. (2010): "Interview with Eugene Fama by John Cassidy*", The New Yorker*, 13th January 2010.
FINANCIAL STABILITY FORUM (2008): *Joint letter of the FSF and the IMF to G20 Ministers and Governors*, FSF, Basel.
FRENCH, K.R., M.N. BAILY, J.B. CAMPBELL, J.H. COCHRANE, D.W. DIAMOND, D. DUFFIE, A.K. KASHYAP, F.S. MISHKIN, R.G. RAJAN, D.S. SCHARFESTEIN, R.J. SHILLER, H.S. SHIN, M.J. SLAUGHTER, J.C. STEIN, R.M. STULZ (2010): *The Squam lake report – fixing the financial system,* Pricenton University Press, Princeton.
FRIEDMANN, J. (1986): "The world city hypothesis", *Development and Change*, 17, pp. 69–84.
FROST, M. E. and N.E. SPENCE (1991): "Employment Changes in Central London in the 1980s. Understanding Recent Forces for Change and Future Development Constraints", *The Geographical Journal*, Vol. 157, nº 2, pp. 125-135.
FT (2012): *Three years' rank of European Business Schools*, Financial Times, London.
G-20 (2009): *Leaders' statement – 2nd April 2009*, Group of Twenty's summit, London.
GORTON, G.B. (2010): *Slapped by the invisible hand. The panic of 2007,* Oxford University Press, New York.
GREENSPAN, A. (2000): *Structural changes in the economy and financial markets in the United States,* America's Community Bankers Conference, New York.

GREENSPAN, A. (2002): *World finance and risk management*, Speech at Lancaster House (London) on Sept. 25th 2002; available at http://www.federalreserve.gov/boarddocs/speeches/2002/200209253
GREENSPAN, A. (2007): *The age of turbulance. Adventures in a new world.* The Penguin Press, New York.
GREENSPAN, A. (2008): *Testimony before the Committee on Government Oversight and Reform*, House of Representatives, Washington. Available at http://oversight.house.gov/.
HALUSHKA, A., A. McCRONE, D. McWILLIAMS, M. PRAGNELL, D. WALLEY and L. WARD (2005): *The City's importance to the EU economy 2005*, Centre for Economic and Business Research and
Corporation of London, London.
HAU, H. (2001): "Location matters: an examination of trading profits", *Journal of Finance*, vol. LVI, nº 5, pp. 1959-1983.
HM TREASURY (2010): *A new approach to financial regulation: judgement, focus and stability*, HM Treasury, London,
ICIJ (2013): *Secrecy For Sale: Inside The Global Offshore Money Maze*, International Consortium of Investigative Journalists, Washington DC.
IMF- INTERNATIONAL MONETARY FUND (2008): *Global Financial Stability Report - Containing Systemic Risks and Restoring Financial Soundness*, April 2008, IMF, Washington.
IMF- INTERNATIONAL MONETARY FUND (2013): *World Economic Outlook*, April 2013, IMF, Washington.
JACKSON, T. (2009): *Prosperity without growth. Economics for a finite planet*, Earthscan, London
JAMES, O. (2007): *Affluenza*, Ed. Vermillion, London.
JOHNSON, S. and J. KWAK (2010): *13 Bankers. The Wall Street takeover and the next financial meltdown*, Ed. Pantheon, New York.
KINDLEBERGER, C.P. (1974): *The formation of financial centres: a study in comparative economic history*, Princeton Studies in International Finance nº 36, Princeton University Press, Princeton, New Jersey.
KRUGMAN, P. (2005a): "Running Out of Bubbles", open editorial in *The New York Times*, 25th May 2005.
KRUGMAN, P. (2005b): "That Hissing Sound", open editorial in *The New York Times*, 8th August 2005.
KRUGMAN, P. (2009): "The Market Mystique", open editorial in *The New York Times*, 26th March 2009.
KRUGMAN, P. (2010): "The Real Story", open editorial in *The New York Times*, 2nd September 2010.
LARREINA, M. (2008): "Financial centres in peripheral regions: the effect of the financial services industry on regional economy. The case of the Scottish Financial cluster", *CRIEFF Discussion Papers nº 0805*, University of St. Andrews, St. Andrews (Scotland).
LEPETIT, J.F. (2010): *Report on Systemic Risk*, Ministère de l'Économie et des Finances, Paris.
LIZIERI, C. and N. KUTSCH (2006): *Who owns the City 2006*, University of Reading, Reading.

LONDON ECONOMICS (2013): *The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt*, City of London Economic Development, London.
LYALL, S. and J. WERDIGIER (2011*): In Rejecting Treaty, Cameron Is Isolated*, New York Times 9th December 2011.
MINSKY, H. (1992): *The Financial Instability Hypothesis*, Working Paper nº 74, Jerome Levy Economics Institute of Bard College.
MC DONALD, L. (2009): *A colossal failure of common sense*, Ebury Press, Reading.
NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011): *The Financial Crisis Inquiry Report*, U.S. Government Printing Office, Washington DC.
O'BRIEN, R. (1994): "General Report on the Colloquium", in D.E. Fair and R. Raymond (eds), *The Competitiveness of Financial Institutions and Centres in Europe*, Kluwer, Dordrecht, pp. 497–505.
ONS, OFFICE FOR NATIONAL STATISTICS, (several years): *Regional Gross Value Added*, ONS, Newport.
OXFORD ECONOMICS (2011): *London's Competitive Place in the UK and Global Economies*, Oxford Economics, Oxford.
PHILIPPON, T. and A. RESHEF (2009): "Wages and human capital in the US Financial Industry: 1909-2006", *CEPR Discussion Paper nº 7282*.
REINHART, C.M. and K. ROGOFF (2009): *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, Princeton (NJ, USA).
RAJAN, R.G. (2006): "Has Finance Made the World Riskier?", *European Financial Management*, vol. 12, pp. 499–533.
RANNSÓKNARNEFND ALTHINGIS (2010): *Report of the Special Investigation Commission*, Icelandic Parliament, Reykjavik.
REED, H.C. (1981) *The Preeminence of International Financial Centers*, Praeger, New York.
REED, H.C. (1989): "Financial center hegemony, interest rates and the global political economy", in S.Y. Park and M. Essayyad (eds), *International Banking and Financial Centers*, Kluwer, London.
SÁNCHEZ FERRERO, F and J. A. YANES LUCIANI (2008): "De los modelos de banca y la función de riesgos*", Estabilidad Financiera*, nº 14, pp. 139-154.
SANTOMERO, A. And D. BABBEL (2001): *Financial Markets, Instruments and Institutions*, McGraw-Hill, Singapore.
SASSEN, S. (1994) *Cities in a World Economy*, Pine Forge Press, Thousand Oaks, California.
SIGFÚSSON, S. (2010): *Rising from the ruins*, Icelandic Ministry of Finance, Reykjiavik.
STAFFORD, L. (1992): "*London's financial markets: perspectives and prospects*", in L. Budd and S. Whimster (eds), *Global finance and urban living*, Routledge, London, pp. 31–51.
STERN, N. (2006): *The economics of climate change. The Stern Review*, HM Treasury, London.
STIGLITZ, J. (2002): *Globalization and its discontents*, Penguin, London.
STIGLITZ, J., A. SEN y J.P. FITOUSSI (2009): *Report by the Commission on the Measurement of Economic Performance and Social Progress*, Presidénce de la République Française, Paris.
THE GUARDIAN (2010): "Minister: EU launches "wolf pact" to tackle "wolf pack"", *The Guardian*, 10th May 2010.
THRIFT N, 1994, "*On the social and cultural determinants of International Financial Centres: The Case of the City of London*", in S. Corbridge, R. Martin and N. Thrift (eds), *Money, Power and Space*, Blackwell, Oxford, pp. 327–355

TRICHET, J.C. (2008): *Enhancing the EU arrangements for financial stability,* speech at the European Parliament on the 23rd January 2008, Brussels.
TURNER, A. (2009): *Mansion House Speech*, Financial Services Authority, London.
Z/YEN (2013): *Global Financial Centres Index,* Z/Yen Group, London.