**<u>Positive Money response to ‘Financial Services Regulation: Measuring Success’</u>**

Positive Money welcomes the opportunity to respond to the HM Treasury’s call for proposals on Financial Services Regulation: Measuring Success.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

If you would like to discuss any aspects of this response please contact Simon Youel, Head of Policy & Advocacy at Positive Money: simon.youel@positivemoney.org.uk

<u>Q: What are the key metrics that the FCA and the PRA should publish in relation to their new secondary growth and competitiveness objectives?</u>

Metrics should not just be focused on how financial regulation impacts headline GDP figures, but should reflect a broader range of measures relating to sustainable economic development and shared prosperity across all regions of the UK.

Facilitating both the growth of the UK economy and the financial sector appears to be a contradictory objective for regulators to pursue, as, above a certain threshold, there is a wealth of empirical evidence illustrating a negative relationship between financial sector growth and the growth of the wider economy.[1] Not only do we fear that the objective’s emphasis on the financial sector will see the rest of the economy lose in this trade-off, but individual metrics may also struggle to provide useful measurements of the actual impact financial regulation has on growth and competitiveness.

The government may therefore wish to require regulators to **publish metrics that explore the impact non-productive financial sector activity has on the economy and its competitiveness**. A large volume of academic literature has charted a relationship between an excess of non-productive lending, such as mortgages, and weaker economic performance.[2]

Moreover the standard metrics for measuring economic growth, such as GDP, have significant limitations as targets for policymakers. As an obvious example, focusing solely on national GDP figures may mean that any financial sector-led growth is concentrated in London and the South East, which may be detrimental to the government’s Levelling Up

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[1] See for example: Cecchetti, S. G. and Kharroubi, E. (2012) 'Reassessing the Impact of Finance on Growth.' BIS Working Paper No. 381. *Bank for International Settlements*; Arcand, J. L., Berkes, E. and Panizza, U. (2015) ‘Too Much Finance?’ *Journal of Economic Growth*, 20, 105–148; Rousseau, P. and Wachtel, P. (2017) ‘Episodes of Financial Deepening: Credit Booms or Growth Generators?’ *Financial Systems and Economic Growth*, 52, 52-75; Epstein, G. and Montecino, J. (2018) ‘The UK's finance curse? Costs and processes.’ Report. Sheffield Political Economy Research Institute (SPERI), University of Sheffield; Sturn, S., Zwickl, K. (2016) A reassessment of intermediation and size effects of financial systems. *Empirical Economics* 50, 1467–1480 (2016)

[2] See for example: Housing Price Booms and Crowding-Out Effects in Bank Lending | The Review of Financial Studies | Oxford Academic, The Great Mortgaging: Housing Finance, Crises, and Business Cycles | NBER, House Prices, money, credit and the macroeconomy, Credit Allocation and Macroeconomic Fluctuations, 14025-GEM - From Boom to Bust in the Credit Cycle: The Role of Mortgage Credit

agenda. But GDP itself also tells little about how any gains from economic growth and competitiveness are shared among the public in terms of better living standards.

**We would recommend that the FCA and PRA publish metrics on how the financial sector is serving the investment needs of the real economy (i.e non-financial economic activity),** as a basis for understanding the role of financial regulation in supporting economic objectives. One such metric could be related to so-called 'Macmillan Gaps' - shortfalls in access to finance by UK companies, especially SMEs.[3] As Andy Haldane remarked while chief economist of the Bank of England, "there are reasons to think the Macmillan gaps may have widened" since the Macmillan Committee concluded decisively in 1931 that the financing needs of SMEs were not being met.[4] It was estimated in 2013 that UK SMEs face an annual funding gap of more than £20bn.[5]

[3] Seizing the Opportunities from Digital Finance - Speech by Andy Haldane - Bank of England
[4] Thirty years of hurt, never stopped me dreaming - speech by Andy Haldane | Bank of England
[5] Improving access to finance for small and medium-sized enterprises - National Audit Office (NAO) report