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A changing world; is global still good? Speech by Dame Clara Furse

In a speech to the Institute of Chartered Accountants of Scotland on 11 February, Dame Clara examines the UK's position as host to a global financial centre through the lens of the Financial Policy Committee's two main objectives: its primary objective to maintain financial stability, and its secondary objective to support the Government's economic policy, including its objectives for growth and employment; productive investment, innovation, competition and the lead role of the City of London in international financial markets.

In the context of financial "de-globalisation" and sharply falling cross-border capital flows, Dame Clara believes that now is a good time to consider the benefits of global markets and financial centres. Historically, Dame Clara notes, the development of global financial centres went hand-in-hand with the integration of international capital markets, because a more complete market can allocate capital with much greater efficiency.

According to an IMF staff discussion note, financial development increases a country's resilience; mobilises savings, promotes information sharing, improves resource allocation and facilitates diversification and management of risk. It also promotes financial stability to the extent that deep and liquid financial systems with diverse instruments help dampen the impact of shocks.

But at the same time, financial deepening and connected markets can transmit shocks as well as dispersing and absorbing risk and driving growth. "Overall, however, with the right policy framework, choices and institutions, it seems clear that the benefits of financial globalisation are compelling," Dame Clara observes.

Next, Dame Clara considers why global centres are needed, when advances in technology have made it feasible for the financial system to become decentralised.

On reason why it is good to be global is that a specialised financial centre can yield "agglomeration benefits" – the economies of scale arising from having an industry cluster in a particular location - and which can also improve access to finance for households and businesses.

Another benefit of centralisation is that it allows the authorities to see more. “The more that activity clusters in a small number of centres, the more that regulators and policymakers can take a holistic, systemic view of threats to financial stability,” Dame Clara says.

In the UK context, there are also economic benefits in being a global financial centre. “While the primary objective of financial stability is paramount for the FPC, the UK clearly has an interest in maintaining its strong position as a provider of these services. Provided the financial sector remains resilient – and our new regulatory framework seeks to ensure that it does – this is central to the FPC’s secondary objective.”

Following on from this, Dame Clara considers the conditions for the success or failure of financial centres. Looking back over time, she observes that while financial centres have tended to cluster around centres of economic power, they can remain in place and prosper even after economic power has shifted elsewhere. “The UK has maintained its position right into this century, even though the days in which Britain was the dominant superpower are long gone.”

That said, the decline of a financial centre can be precipitated by an adverse event, such as war or a policy error that makes the continued provision of financial services impossible, uneconomic or simply destroys confidence in it. As such, one lesson to be drawn from history is that policy choices and institutions matter.

Looking forward, proximity to power may be less important for financial centres such as the UK, thanks to advances in communications technology. However, because moving is easier than it was in centuries past, the same factors that mean the UK can serve the world, allow for a wide range of alternative centres to become established, possibly leading to a decentralisation and fragmentation of the financial system. This would undermine the efficiency of global capital markets and harm global growth.

“To avoid this, authorities need to remain alert to shocks, including those arising from the geopolitical and wider macrofinancial environment, as well as the more ‘bread and butter’ risks that are visible on banks’ balance sheets. This is where the FPC can play an important role,” according to Dame Clara.

An environment where geography and sheer economic scale matter less, means that institutions may matter even more. “We need a clear, prudent, proportionate system of regulation, which is sensitive to the different risks and opportunities posed by different kinds of activity,” Dame Clara says.

Dame Clara concludes that: “International and global financial centres have historically played a crucial role in promoting both growth and stability. But policymakers cannot take their existence for granted. In a world where institutions and policy choices matter more than ever, a prudent and proportionate regulatory framework is essential to sustainable growth. That is what we on the FPC are seeking to achieve.

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