Tracy Blackwell
and **David Pitt-Watson**

Reform finance and we should all benefit

It is said that you should never waste a good crisis. So as we come to the 10th anniversary of the collapse of Northern Rock, we might want to ask whether reforms have created a financial system that is better than the one that went over the edge in 2007 and 2008. If we did, we would struggle to find a coherent answer, perhaps because we have rarely asked the most basic question about the system: what is its purpose?

One of the principle purposes of a bank is to take our deposits and lend them out for useful investments. The process is known as "intermediation"; taking money from point A, where it is, to point B, where it is needed. That is what Northern Rock was supposed to be doing in 2007. Indeed that was its very purpose from 1850, when Northern Counties Permanent Building Society was founded as a mutual. It had a reputation for prudence and a clear focus on its home region. Yet somewhere along the way the safe, purposeful management of the organisation was lost, to disastrous effect.

'The industry that financed the railroads is as efficient as the one financing the internet'

We are unlikely to see Northern Rock again. But we can ask how well the finance industry performs its function of intermediation. One study in the US has looked at how much it has cost, over 130 years, to take $1 of savings and invest it in the real world. You might expect it would have fallen, after all we have invented phones, computers and the internet in the intervening years. But you would be wrong. Thomas Philippon, the academic who wrote the report, concluded that there had been no improvement in productivity as measured this way. The industry that financed the railroads was as efficient as the one financing the internet.

If we are to have a financial industry that meets our needs we should begin by defining its purpose. We need it to keep our money safe, to help us transact with one another, to share risk, and to intermediate between saver and investor.

Our paper on this topic, launched earlier this year, sets out some initial thinking for the industry as a whole. But we can also apply the same logic for each of the constituent parts of the finance industry, including banks, pension funds, stock exchanges and so on. It is not an easy question to answer, but it is surely the only safe foundation for designing the institutional checks and balances, and the regulatory framework, that would sustain a purposeful industry over the long term. In the 10 years since the banking crisis, no one has approached reform from this perspective. Few have seriously noted the worrying view of the former head of the Financial Services Authority, that much of what goes on in the industry may be "socially useless".

So we hope to facilitate a debate on exactly that topic. While we are only just at the beginning of this project, initial conversations have given some shape to the debate.

First, finance is a vital industry. Its functions are central to a modern economy.

Second, the initial findings of a study of productivity in the European finance industry, which we have commissioned, shows that while there are some interesting differences with the US study on this topic, there is little consistent improvement in productivity.

Third, regulation is not the (only) answer. Indeed, we should be very careful about over regulating. For example, in 1990 there were 3,000 pages of regulation covering pensions. Today there are 166,000. Yet you'd be hard pressed to find anyone who would argue that the pension system we have fulfils its purpose as a result.

Finally, the benefits of reform could be huge. Just by creating a well-designed and regulated pension system in the UK, we could add the equivalent of more than 2pc to GDP. This is a significant sum, roughly equivalent to the contribution that North Sea oil makes to our economy. Think of the benefit if the same were true for the rest of the finance industry.

This is a big prize. Let's not wait for a crisis before we try to win it.

Tracy Blackwell is the chief executive of the Pension Insurance Corporation and David Pitt-Watson is the author of "The Purpose of Finance", written on behalf of the Pension Insurance Corporation