WHY OUR FINANCIAL SERVICES NEED A CLEAN BREXIT

ONLY LEAVING THE SINGLE MARKET CAN DELIVER GREATER OPPORTUNITY FOR UK FINANCIAL SERVICES

GLOBAL BRITAIN

Why our financial services need a clean Brexit

Only leaving the Single Market can deliver greater opportunity for UK financial services

by Ewen Stewart and Brian Monteith

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FOREWORD

By Dr Gerard Lyons

SINCE the outcome of the Referendum on June 23rd, the debate has moved on. Now the focus covers a number of areas. Of particular importance is the nature of the UK's future relationship with the European Union, and how can the UK negotiate its exit from the EU and at the same time be best placed to succeed globally.

Naturally, this has many aspects to it, both domestically and internationally. It has also triggered a welcome debate about how the UK should leave the EU and position itself after, so that it both rewards its domestic population and remains internationally attractive, open for business and global in its outlook.

It is in the context of this debate that Leave Means Leave has commissioned a number of papers on some key areas of this important debate. It should be congratulated for doing so. This report is a welcome addition to the debate, focusing on one of the UK's key areas: The City and the financial industry. The report takes a strong view and provides a robust defence of its position. There are many takeaways, one of which is the ability of The City to remain a global leader with the UK outside the European Union.

I would encourage people who want the UK and The City to be a true global leader to be open to listening to the different points of view on all sides in this debate and to read widely the various viewpoints on offer. We need to take the best arguments and adopt the most progressive approach in order to move forward.

Regardless of how people voted, the need now is to ensure the best outcome for all, helping to position the UK to succeed in a changing and growing global economy. Currently, in some quarters, there is too much pessimism. Certainly no one should doubt the near-term challenges ahead, particularly in leaving the EU, but as this paper outlines, there are also many opportunities too, not least for The City and financial services across the UK. It is a welcome addition to the debate.

Dr Gerard Lyons
Independent economist and co-founder of Economists for Brexit

EXECUTIVE SUMMARY

- The financial services sector is one of the most important drivers of the UK economy, employing 1.1 million people directly and a further 1 million in related professions. The sector records consistent trade surpluses (£66bn in 2015) and accounts for 11% of tax raised in the UK. The large majority of employment and GVA is, however, in domestic financial services that, while negatively impacted by EU regulation, is not affected by UK membership of the Single Market, or issues such as passporting.
- We demonstrate that domestic financial service industries have much to gain from leaving the EU and Single Market, increasing returns for the consumer and revenues to HM Revenue.
- The current EU regulatory approach is burdensome, highly expensive and does little to engender stability. Its primary focus is on firefighting to defend the Euro. It provides a one-size-fits-all regime with little scope for adapting to national circumstances.
- On BREXIT the UK will again have the legal power to regulate financial services more effectively, whereas currently supreme regulatory authority resides at EU level through a number of agencies. These include the European Banking Authority, European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority.
- While developing more appropriate regulation will take time, the potential savings are very significant and could equate to 2-3% of sector costs or between £8-12bn per annum. The City should focus more on this potential now.
- While we estimate around 250,000-300,000 people are directly employed in what we call 'Square Mile' activities, the majority of financial services employment is domestic. This is the subset with the most potential to gain from UK withdrawal from the Single Market.
- The City and Business overwhelmingly argued in favour of the UK joining the Euro believing not to do so would cause economic stagnation, the migration of City jobs to Frankfurt and political marginalisation. In each case the opposite happened. Today the City employs 50% more people than it did in 1999, the year of the Euro's foundation – and London's dominance of the sector, in an EU context, has never been greater.
- In particular Euro advocates underestimated the UK's deep financial services culture, critical mass, skilled labour availability, rule of law, economic stability and a myriad of skills in associated trades that builds a successful and growing eco-system – with our World leading status as a Soft Power behind it.
- These advantages continue to grow and it is a fallacy to believe being outside the Single Market, will cause an exodus from London. On the contrary we believe London's relative dominant position in financial services will accelerate as we deregulate away unnecessary rules.
- Likewise the threat to financial services *across the UK* comes not from being outside the Single Market but from seeking to stay in it. With two thirds of some 2 million financial

and related professional service jobs located outside Greater London the opportunities from escaping burdensome regulation and EU imposed taxes can help our major cities and city regions grow.

- The importance going forwards of the EU in financial services is greatly exaggerated. Consider the trade surplus in financial services. 59% of this is currently with the rest of the world outside of the EU. Meanwhile, in terms of exports, change is also evident. These are growing much more quickly to the rest of the world. Since 2008 exports in services to the US grew by 48%. Over the same period they increased with the EU by just 28%. Furthermore, The City is positioning itself in some of the likely growth markets of the future, whether it be the offshore Chinese currency, Islamic finance or the growth of insurance services in the rest of the world. These are all outside the EU. This exposes the myth that the Single Market is critical to trade: the UK has no special trade deal with the US where it has succeeded – but where it is 'in the Single Market' growth has lagged.

- Critically there is no real Single Market in financial services. There is no Banking Union, no single stock market, a patchwork of pension regulations and highly different cultural attitudes to banking, pensions and insurance across the continent. The one area where there is conformity is in product regulation, via MiFID directives and that has been inefficient and productivity and return sapping.

- The benefit of passports to the City is overstated. If there is no deal on financial services, many firms in the EU 27 will have to move departments to London as the UK has the deepest, most liquid capital market in Europe, and hence the lowest cost of capital. This might explain why Deutsche Bank's investment bank HQ is in London.

- MiFID2 regulation allows for the principle of equivalence in certain sectors where similarly tightly regulated markets have clearance. UK firms should already be fully compliant with EU law and City firms are already establishing brass plates and subsidiaries where they need them at relatively modest cost.

- The claim that 75,000 jobs and £10bn of tax receipts are at risk lacks credibility. That would assume almost all intra EU trade from London collapsed. The Bank of England has confirmed that the challenge to London continues to be from New York rather than the Eurozone.

- We therefore conclude the risk to the UK financial sector is from remaining in the Single Market. That is the worst conceivable option, by having all its domestic regulation with no say in its framing. EU form on this is very poor – be it bonus caps, financial transaction tax proposals or capital adequacy rules.

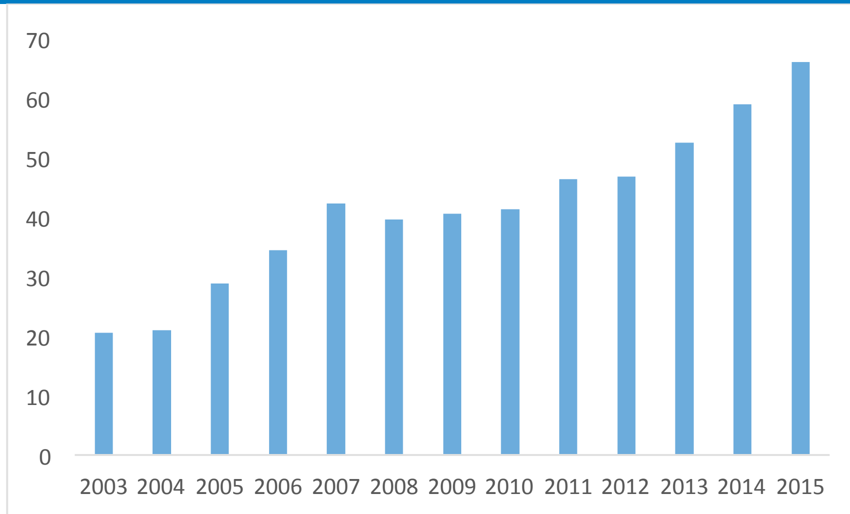
- It is clear the EU's interests have diverged from the UK. The EU is pre-occupied with saving the failed Single Currency and providing financial regulation to further that end. The UK is the world's leading financial sector, with global capital flows that risk severe damage from heavy EU regulation.

- Leaving the Single Market will lighten regulation, enable more appropriate capital requirements and grow City and UK jobs, as happened when we did not join the Euro. That in turn will increase tax revenues, benefiting society as a whole.

1. IMPORTANCE OF THE CITY TO THE UK ECONOMY

Financial and related professional services is one of the UK's key industries accounting for 11.8% GDP in 2015. The industry employs 1.1m people directly, equivalent to 3.6% of the UK workforce and just over 2m if associated industries like accountancy, law and management consultancy are included. The industry is the most significant positive contributor to the UK balance of payments with consistent and growing surpluses, currently running at £66bn, as can be seen from the chart below.

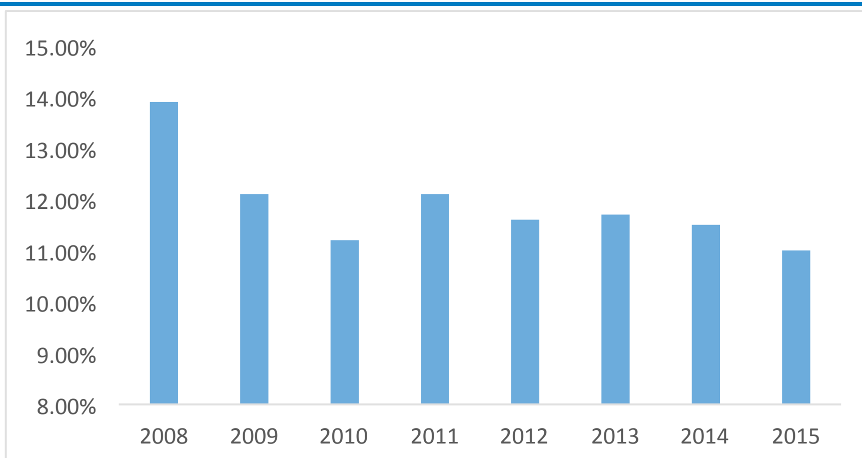
UK surplus in financial services £bn



Source ONS

Moreover the financial services industry provided 11% of the total tax receipts, to the UK Exchequer, in 2015, as is demonstrated in the chart below. While this has been in decline, as a proportion of total tax receipts since a high in 2008 (and is a gross figure before the very significant cost of financial support to the sector via rescues to RBS, HBOS, Northern Rock and others during the credit crisis) this remains a key UK industry in terms of global leadership, financial contribution to the Treasury and employment.

Financial services sector contribution to total tax receipts %



Source PWC and City of London Corporation

A highly diverse industry

UK financial services industry is highly diverse with much of the industry being involved in the 'bread and butter' of domestic banking and insurance as is demonstrated by the table below which splits financial services into employment by industry sub-sectors.

While definitions between export led investment banking, insurance and high-end financial services are inevitably arbitrary we would estimate that around 250-300,000 people are directly employed in what we euphemistically call 'Square Mile' type activities with the remainder being primarily servicing the domestic market.

Employment by financial services sub-sector (k)

	2011	**2014**
banking	451	417
insurance	318	309
fund management	32	42
securities	63	48
other financial services	205	245
	1069	*1061*
legal services	339	314
accountancy	285	319
management consultancy	362	483
	986	*1116*
Total	**2055**	**2177**

Source ONS

2. THE BREXIT OPPORTUNITY TO DEREGULATE DOMESTIC FINANCIAL SERVICES

Domestic banking, insurance and financial services will be impacted by BREXIT and this largely domestic segment, serving the UK consumer and small and medium sized UK business, makes up the bulk of the industry in terms of total GVA and employment. This segment is clearly unaffected by the debate over Single Market access and 'passporting' however we judge can benefit significantly from regulatory authority moving from Brussels to London.

Currently ultimate regulatory authority rests with the EU through a number of agencies including the European Banking Authority, European Securities and Markets Authority and the European Insurance and Occupational Pensions while wider EU legislation also impacts on the sectors productivity, be it through employment, health and safety or consumer regulations for example.

On BREXIT the UK will again have the legal power to adopt a regulatory regime more appropriate for the UK financial services industry. While it will take time to repeal inefficient or duplicated legislation, longer term, this should benefit domestic banks, insurers and pension funds and importantly the consumer and small business as the EU approach has become notoriously expensive and bureaucratic to administer with little tangible benefit in terms of superior corporate governance.

Poor regulation has a direct impact on returns for the industry and consumers. Examples where a more appropriate and efficient structure could be devised include banking and insurance capital adequacy and solvency rules that currently constrain both sectors (designed to prop up the structural problems in Euro banking system and the overly restrictive for UK banking), legislation on employee remuneration, potential transaction taxes and intrusive compliance and verification procedures.

This one-size-fits-all governance negatively impacts UK banking and insurance productivity and it should, in time, be possible for the UK Treasury and Bank of England to devise more appropriate legislation for the UK rather than the necessities of the wider Eurozone.

The impact of inefficient bureaucracy in the EU system is directly felt by consumers in the UK, impacting negatively on returns and fee structures. While developing more appropriate regulation will take time, the potential savings are very significant and could equate to 2-3% of sector costs or between £8-12bn per annum. The City should focus more on this potential now.

It is important to remember the vast majority of financial services sales and employment is domestic and as we have explained will benefit from more appropriate domestic regulation. Therefore, when looking at the impact of withdrawal from the Single Market, the proportion of jobs potentially impacted by trade with the EU, or changed passporting rules, while critical to those effected, are relatively small in totality.

3. THE EURO AND THE CITY
– a lesson that not being part of something is irrelevant to growth and trade

The Euro came into being in 1999. With a few honourable exceptions the City and business overwhelmingly believed we had 'to be part of the Eurozone to prosper.' The CBI and senior City opinion was clear to be outside the Euro would mean economic stagnation, the migration of large parts of the City to Frankfurt and political marginalisation.

In almost every respect the opposite happened to these doom laden predictions with UK growth and prosperity materially outperforming the EU average as the EU stagnated. The UK financial sector prospered and its lead over other EU centres accelerated and the UK's global political leadership remained undimmed as the Eurozone problems caused EU introversion.

GDP growth, since 2009, is outlined below. Eurozone GDP growth materially lagging other developed countries moreover average unemployment is more than 2x greater that the UK.

Cumulative GDP 2009-2016 (2009 = 100)
Eurozone countries in red

China	187
India	164
US	113
Sweden	112
Ireland	110
Switzerland	110
Norway	110
UK	109
G10	108
Germany	108
Belgium	106
France	105
Austria	105
Japan	104
Netherlands	102
Euro Area	102
Denmark	101
Spain	99
Portugal	96
Finland	96
Italy	94
Greece	74

Source ONS

What is more predictions that not joining the Euro would lead to a flight of finance away from London and the UK, instead moving to the Eurozone in general and Frankfurt in particular, proved totally unfounded. Indeed the opposite happened, with London's lead accelerating to the point where it has near total dominance of most high end financial service based products. The City employs approximately 50% more people now than in 1999.

In our judgement not joining the Euro, from a finance sector perspective, was much more significant than leaving the EU. There is absolutely no reason to believe these siren warnings will be any more accurate this time than they have been over the last 20 odd years.

4. WHY DOES THE UK IN GENERAL AND LONDON IN PARTICULAR DOMINATE FINANCIAL SERVICES?

We have written extensively (see *Why the EU's Single Market is Failing Britain, September 2016)* about the structural failures of the Euro that have led directly to the Eurozone being the weakest performing economic region, in terms of GDP growth, now for a generation. This has led to endemic levels of unemployment and substantial migration away from large parts of Southern and Eastern Europe.

The failure of the Eurozone in general and a credible policy response has led directly to a decline in the EU's global importance, its influence and soft and hard power. Therefore when special interest groups talk about the need to be within the Single Market their comments should to be considered within the context of economic failure. The EU Single Market has now been the world's slowest growing region for a generation or more. It is not the success some would have one believe.

It also needs to be remembered that the very people who are currently calling for the UK to remain in the Single Market are those who argued the UK should join the Euro. These groups including major investment banks, like Goldman Sachs, or JP Morgan coupled with the CBI and other major city organisations, who all argued that if the UK did not join the Euro much of the UK's financial centre would migrate to Paris and Frankfurt.

Their analysis was completely wrong. But why were they so wrong?

Firstly, they completely over-estimated the success of the Euro. While the Euro may have superficially been able to cope with a stable GDP environment it proved totally inflexible in more troubled times, directly leading to mass unemployment in Greece, Spain, Portugal and Ireland amongst others as the safety value of de-valuation was removed. This has led to internal firefighting, and an inappropriate and inflexible one-size-fits-all regulatory regime, neither of which suited the differing problems of the various member states, causing introspection and policy paralysis that has stifled growth.

Further, the Euro failed to challenge the US Dollar as the world's global currency with USD supremacy increasing not declining. The Euro is nowhere near being a global reserve currency which some hoped it would achieve.

Secondly, supporters of the EU assumed you had to be part of something to trade with it. This is absurd and a complete fallacy. One does not need to be part of the US to trade with the US or part of China to benefit from its 1.1bn people any more than one needs to be part of the Single Market to trade cars or anything else for that matter. So long as a country complies with local legislation you can trade, outside extreme cases of countries under sanction.

Hence US, China, Brazil, Japan and Australia have no problem at all trading successfully with the EU despite having no formal trade deal with it. If this were not the case then it would be impossible to buy a Japanese-built Mazda or an American-built Jeep in the UK. In the trading of currency a clear historical example of this is when Sterling ceased to be the global reserve currency around 1924. USD currency trading did not move to New York. On the contrary London's domination of the market increased.

The ECB may be in Frankfurt but London's market share of EU financial services has increased unabated. Ironically the second and third financial service sectors in Europe are not in the EU. They are in Zurich and Geneva despite the fact that Switzerland is not a member of the EU. Being part of an entity, be it the Euro or EU, is irrelevant to market share.

Thirdly, the critical factors for success in any industry are business culture, critical mass, skilled labour availability, rule of law and economic stability and stable but moderate regulation. London meets all these criteria. No other EU centre comes close and will not do after BREXIT. The UK is one

of the world's most global economies and beautiful as Paris, Rome and Frankfurt may be, they are not global centres, but national ones without the breadth of assets to challenge London's position.

So long as the UK continues to adopt a global, stable regulatory and favourable taxation regime the threat to London's globally dominant position will not come from Frankfurt or Paris, in the Single Market, or not.

Fourthly, the UK is one of the world's leading soft power nations, consistently ranked within the top 3 in the world. This matters as it gives a unique nexus of the benefit of the English language together with media, cultural and artistic assets, and world beating elite education at secondary and tertiary level, a stable political environment, the rule of law and relative freedom from corruption and a critical mass of ideas, people and innovation. Moreover the UK possesses London, the world's global capital. These are advantages that are often forgotten or not even appreciated at home, but are valued by others wishing to do business with us.

Indeed we believe the risk to London's position comes from remaining within the EU Single Market, as we shall demonstrate later, but in a nutshell, where its key priority of ever greater one-size-fits-all regulation where the key priority is to preserve the failing Euro[1] and not provide prudential financial services regulation. If this indeed is the case, the threat to London's competitive position comes from New York, Singapore or Hong Kong. This is why, for the City top prosper, the UK must adopt clean BREXIT, leaving the Single Market and its Customs Union, for if the UK stays it is the worst of all worlds.

It will mean EU control on financial regulation with no say on its framing. This is a very dangerous place for the City to be in indeed. We have already witnessed the dangers of the EU approach through control of banking capital ratios, insurance solvency, a proposed transaction tax and wage caps. The EU and UK interests have diverged. The former are focused on propping up the Euro with ever greater centralisation[2] while the UK outside the Euro and with control of its own financial services regulation will be in a very strong position to chase and enjoy further growth.

Deeper regulation, financial taxation and constant changing of the rules are the primary risk to the City's prosperity. Indeed BREXIT is very likely to breathe even more life into UK financial services as the UK Government can adopt policies to help this critical industry flourish. The big opportunity is to be the most sensibly regulated, lowly taxed financial centre in the world. City lobby groups should be addressing this wonderful prospect and telling the government what unnecessary rules they want to get rid of, not looking backwards at yesteryear in an attempt to protect their vested interests.

Leaving the Single Market can lead to more growth and jobs for the City, as happened when we did not join the Eurozone.
The EU, fixated with the Euro's problems has no such incentive.

The UK's tapestry of assets is globally unique and preferential 'Single Market access' is very far down the pecking order in importance. Despite huffing and puffing from certain investment banks and

[1] *The Euro Currency cul-de-sac*, Bob Lyddon, Global Britain, October 2016
[2] *The Deutsche Bank liability*, Bob Lyddon, Global Britain, October 2016

trade lobbies leaving the Single Market will make no difference to London's pre-eminence in financial services.

To summarise, UK financial services prosper because of a deep and unique interconnection of language, critical mass, openness, rule of law, a host of cultural and educational assets and focussed on London, the world's global capital. The Single Market does not feature. After more than thirty years of waiting in vain on a Single Market in financial services the EU's economic bloc that is designed to protect farmers and manufacturers does not offer any binding attractions.

5. THE CITY'S RELATIVE POSITION IN AN EU AND GLOBAL CONTEXT

A league table of the relative merits of financial centres clearly is subjective but the Z/Yen Global Financial Services Index is generally considered to be the definitive survey of centre strength. London and New York dominate with London currently having the edge over New York. Of the next two European centres to make the top 10 – both are outside the EU, in Switzerland. Frankfurt is ranked 10th. The full table is outlined below.

World's top financial service centres

1st London
2nd New York
3rd Hong Kong
4th Singapore
5th Zurich
6th Tokyo
7th Geneva
8th Boston
9th Seoul
10th Frankfurt

Source Z/Yen Global Financial Services Index

Considering the UK accounts for around 12.5% of the EU population the UK's market shares of key financial service products are extraordinary as can be seen from the chart below. The breadth of expertise is unrivalled with all the associated eco system of services from legal, to physical office, to client reach, to IT, to printing and distribution.

As the Deputy Governor of the Bank of England, Sir Jon Cuncliffe, has confirmed this cannot be recreated easily. The power of economic concentration takes decades to gain and no rival EU centre has anything approaching that. In the same way the UK may make some splendid sparkling wines but it is highly unlikely ever to match the dominance of Champagne.

London's share of EU financial services industry % 2014

Hedge Funds	85
FX trading	78
Interest rate OTC trading	74
Marine Insurance	65
Fund Management	50
Private equity Funds raised	49
Equity Market capitalisation	30
Bank Lending	26
EU Financial Services GDP	23
Insurance Premiums	22
Bank Assets	21

Source CityUK

6. THE BREXIT OPPORTUNITY FOR THE WHOLE UK IN FINANCIAL SERVICES

The opportunity that lies with leaving the European Union is not limited to the City but extends to the whole of the UK, for the sector is of major importance to other cities and regions. Over two million people work in financial and related professional services across the UK, with two-thirds of located outside Greater London.[3] The sector has grown nationally by 76% over the past decade in comparison to 43% for the UK economy as a whole.

Nor is it commonly recognised that 60% of the GVA produced by the UK's financial and professional services is generated by companies outside London. Employment is spread across the UK; in Scotland some 156,700 people work in the sector, with a further 54,300 in Wales and 31,100 in Northern Ireland. In England more than 233,000 are employed in the North West; 273,000 in the South East and over 100,000 in each of Yorkshire and the Humber, the South West, East of England and the West Midlands.

Leeds city region, for instance, is the UK's second largest banking centre with 22,000 employees in that sector alone[4]. Scotland accounts for 24% of all UK employment in life insurance and 13% in banking, with various firms managing more than £800bn in funds[5]. In Northern Ireland, Belfast employs 17,000 in the financial services sector and the Belfast South parliamentary division is ranked 15th out of 650 Westminster constituencies for concentration of financial services workers.

Across the UK, the financial services sector has accounted for nearly a third of all foreign direct investment into the UK since 2007 and in 2014 accounted for half – £14.0bn out of £27.8bn. Given that there is no EU Single Market in financial services this investment cannot be claimed as

[3] UK Financial Centres of Excellence, UK Trade and Investment, HM Government.
[4] p3, The Big Facts, Leeds City Region Enterprise Partnership
[5] 'Facts' and 'Sector Info', Financial services in Scotland, Scottish Financial Enterprise, www.sfe.org.uk

dependent on EU membership, indeed announcements continue to be made about European financial businesses locating or relocating operations to the UK following the vote for Brexit. The largest Dutch bank, ING Groep NV recently announced[6] it is to move over fifty trading jobs from Amsterdam and Brussels to the UK.

It would also a mistake to see the City as being in competition with the rest of the UK for often firms are attracted to locating in London and then spread their operations across the country. The largest private sector employer in Dorset is JP Morgan, Citigroup is a major employer in Belfast and BNY Mellon has made a significant contribution to jobs in Manchester. What impacts on the City therefore impacts in those companies' UK operations.

The financial services in cities or city regions such as Edinburgh, Leeds, Aberdeen, Bristol, Glasgow and Norwich all help to give the UK the fourth-largest banking sector, the third-largest insurance industry, the second-largest fund management sector and the second-largest largest services industry *in the world*[7].

It follows that the opportunities and risks that are open to companies based in the City are also open to those located across the UK, and that the arguments that favour City companies benefitting from lighter regulation better suited to the UK's own circumstances will benefit all financial industries irrespective of their location.

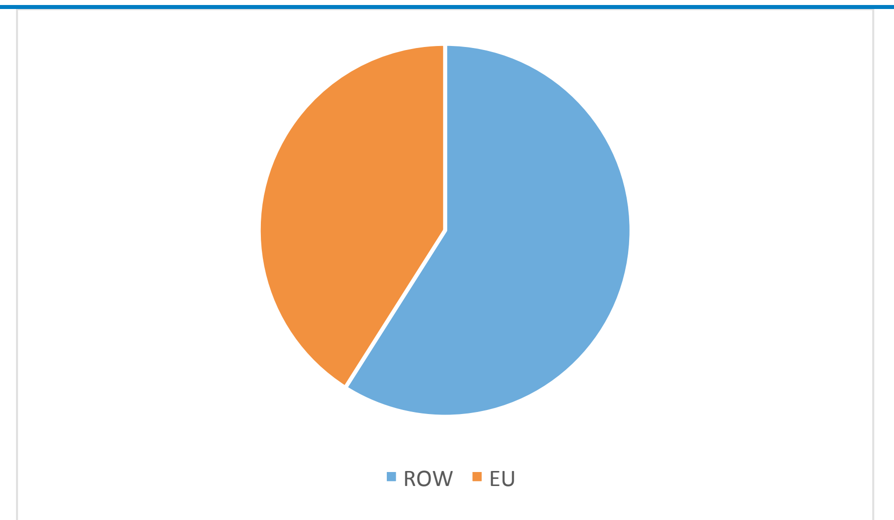
Likewise, it is often forgotten in media reports about EU threats to the City – through new transaction taxes, overbearing governance rules and policies designed to prop-up the ailing Euro – that the rest of the UK would suffer also from such impositions. Indeed, without the benefits of the City's critical mass the costs of EU regulation and taxes could be expected to be more onerous for financial services outside London. It is therefore vital the opportunities of a Brexit are seen as a benefit for the whole of the UK and not just one sector located in a square mile of London.

7. HOW IMPORTANT IS THE EU TO THE UK IN FINANCIAL SERVICES?

The chart below shows the EU is an important export destination to the financial services sector but is not the major one as 59% of the UK surplus in financial services exports is outwith the EU. This is a slightly higher percentage than the balance of total UK trade with the EU and rest of the World.

[6] Wall Street Journal, 13 October 2016, http://www.wsj.com/articles/ing-to-move-trading-jobs-to-london-despite-brexit-1476357609
[7] While in Europe alone, the UK is the leading centre for investment and private banking, hedge funds, private equity, exchange-traded derivatives and sovereign wealth funds.

UK surplus in financial services 2015 %



Source ONS

Splitting the surplus by key nation, in 2015 we find the relative importance outlined in the table below. The US is over 2.5x more significant in terms of the UK's financial service surplus than any individual EU country which again is noteworthy given the UK operates with the US without any trade deal but solely under WTO governance.

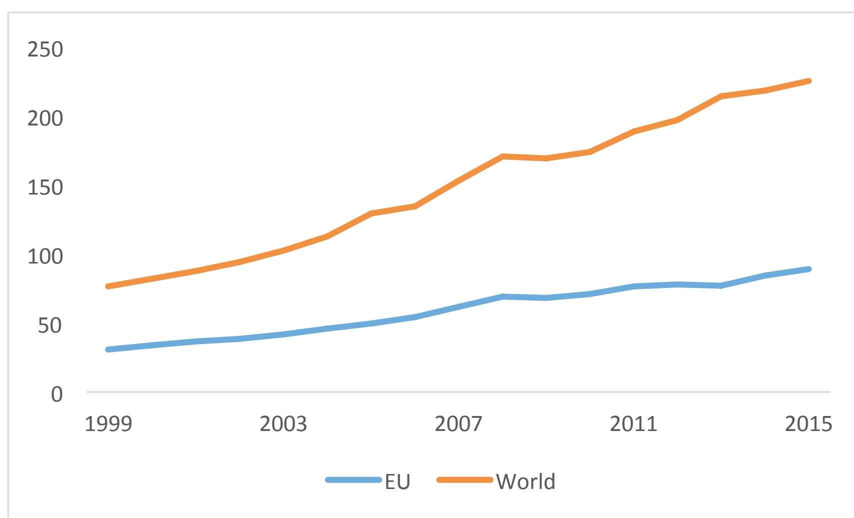
UK trade surplus in financial services £bn 2015

US	13250
Rest of World	13519
Japan	2746
Switzerland	1493
Australia/ Canada	1062
Other EU	9178
France	5102
Germany	3721
Netherlands	3205
Ireland	1552

Source ONS

Looking at services generally since 1999, growth has been more pronounced with the rest of the world compared with the EU, as is demonstrated in the chart below

Trade in Services to EU and World since 1999 £bn



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Source ONS Pink Book

Comparing the growth in UK trade in all services with the EU and US is also revealing as is shown in the table below. Since 2008, UK service sector trade to the US has increased by 48%. Over the same period trade in services with the EU increased by just 28%.

Trade in services since 2008 EU and US

	EU	US
2008	69.2	35.9
2009	68.4	32.9
2010	70.9	38.6
2011	76.7	38.7
2012	78.1	42.6
2013	76.9	51.6
2014	84.4	47.1
2015	88.9	53
Growth since 2008	28%	48%

Source ONS Pink Book

This is somewhat counter-intuitive and strongly at odds with the message given out by some major investment banks and trade bodies who constantly argue that 'access to the Single Market is critical' highlighting passporting in particular as being key. If such 'access was so critical why has growth in services been so much stronger where there is apparently no similar access?

Is it not odd that service trade increased by 48% to the US where the UK has no trade deal and no passporting rights and only 28% where there is a 'Single Market' and passporting rights?

The truth is trade flows to where the opportunity is. The importance of passporting rights and Single Market access are overplayed. While we will show that the UK almost certainly will gain similar reciprocity to the current passporting rights through Markets in Financial instruments Directive 2 (MiFID2) 'equivalence' – it is clear from the UK's relative service sector trade growth that being part of the Single Market cannot be a key determinant of trade growth at all.

7. PASSPORTING IS OVERSTATED AND THE CITY MAY BENEFIT WITHOUT IT

As we demonstrated in our paper *Why the EU Single Market is failing Britain*[8] one of the reasons why the UK has such a large trade deficit with the EU is that the Single Market does not play to our strengths in services. The EU has had the time and opportunity to rectify this since the Single Market's formation in 1992. It has failed to do so.

The truth is there is no real Single Market in financial services. There is no Banking Union, no single stock market, a patchwork of pension regulations and hugely differing cultural attitudes to investment and banking. Thus, to talk of the Single Market in financial services is a fallacy. Only in product quality is there any form of conformity via MiFID2 but even here it is weakly enforced in much of the EU (although not in the UK).

A manifestation of the lack of a Single Market in financial services is passporting. This lack of a Single Market is one of the reasons the UK trades more effectively in services globally relative to the EU. However most companies who do trade intra EU already have subsidiaries in Luxembourg, or Dublin, in particular who distribute product, usually 'manufactured' in the UK to Eurozone economies. It would be a gross violation of WTO rules to deny the setting up of new, or closing of existing subsidiaries, and would be legally challengeable. We believe it will thus be relatively easy to circumvent passporting rules.

Moreover, one of the WTO principles is that a member cannot, outside sanction (i.e. North Korea, Syria etc.), discriminate arbitrarily. UK companies would need to be treated the same as a Swiss, US or Australian financial services company. Thus, to deny UK business the opportunity to set up subsidiaries would also have to be denied to the US, China and others.

While we doubt the value of passports, outside some administrative easing, under MiFID2 the principle of equivalence is accepted where countries like US, and Singapore and others will become legally equivalent counter-parties, thus circumventing the need for 'passports,' and making them redundant. As the UK is currently a member of the EU, UK firms are currently fully compliant with all EU law thus qualify as equivalent and it would be extraordinary if the equivalence status that can be given to firms in the US and Singapore was not offered to UK firms. Further, with a £110bn current account surplus, that the EU enjoys with the UK, it is clear any demonstrable arbitrary attempt to deny UK access would result in much greater pain on German, French and Spanish industry than it would in the UK.

The issue of passporting need to be kept in context; while they may matter for the business models of certain firms even for these firms it should not mean moving part of their business from London;

[8] *Why the Single Market is failing Britain*, Ewen Stewart & Brian Monteith, Global Britain, September 2016

moreover there are many other factors (such as equivalence) and for The City there are many different business models.

The irony is, however, that the loss of passports may actually increase EU involvement in London. London is by far the largest centre in Europe with the deepest capital pools and hence lowest cost of capital. Many EU corporates would move part of their Treasury departments to access this more liquid cheaper pool of equity and debt capital. It may well be rather than business migrating away it exacerbates the flow to London as EU companies seek to benefit from London's overwhelming advantage.

What is already happening in reality is the services firms that operate with the EU 27 are already finding ways around the passporting and Single Market issues by brass plating operations at relatively low cost. As always, markets move faster than politicians and smart money is adept at finding ways to trade.

8. WHAT THE PRO EU LOBBY SAYS AND WHY IT IS WRONG

The recent CityUK report suggested that should the UK leave the Single Market 75,000 jobs would be at risk, as would £10bn of tax revenues. This was, however, contradicted, in his report of the impact of clean BREXIT, when the Deputy Governor of the Bank of England, Sir Jon Cuncliffe argued New York not Paris, Frankfurt or Dublin would benefit, saying to the EU financial affairs subcommittee,

> *'I can't see [what the City offers] being replicated in the foreseeable future in one place in the European Union.'*
>
> *It takes an awful lot of time, human capital, it's based around the interaction of financial services. The idea this ecosystem is transplanted somewhere else into Europe in the foreseeable future … I think to me is highly unlikely,"*

If the major investment banks are so concerned about leaving the Single Market and passporting, the obvious place to go is within the Single Market to avoid so called loss of access, not New York, as appears the concern of the Bank of England. We conclude so-called access to the Single Market and passporting to be materially over-estimated in terms of importance.

Of course New York is a competitive threat. It was yesterday and will be tomorrow but it is clear that access to the Single Market and passporting cannot be a significant concern if the belief is that trade will migrate to New York and not Frankfurt.

Moreover the CityUK report arguing a £10bn hit in tax revenues and 75,000 jobs is simply unrealistic. Is it really suggesting around 25% of all City jobs will be lost by leaving the Single Market? That would imply a virtually totally collapse of cross border trade which is stretching credibility.

Moreover, the CityUK report does not address the opportunity presented by leaving the Single Market from the UK's ability to regulate more effectively as earlier described. That is the real prize. As we have argued a mere 2-3% cut in City costs via better regulation saves £8-12bn per annum improving returns and creating *new* jobs.

Infrastructure for Financial Services

The reality is that potential EU competing centres do not have the high quality office space, trading floors, schools, housing nor medical facilities to accommodate the 75,000 jobs, nor the local pool of skilled workers in financial services.

In particular, the senior employees in financial services firms are well paid and demanding in the quality of life they require; their spouses, partners and families want to live in the best global city, being London. They don't want to move to Frankfurt or Luxembourg. Nor will their firms' more junior employees tolerate the senior workers staying in London and moving other people and functions elsewhere in the EU; this will damage morale and increase risk through lesser controls in situ.

This factor is critical and overlooked. When coupled with the much more restrictive labour laws on hiring and firing, financial services firms will conclude there is downside – not upside – to trying to move operations to other EU centres. The proof of this argument is that the 2nd and 3rd financial centres in Europe, after London, are in Switzerland, outside the EU – not France or Germany.

On the contrary, we believe that with there no longer being a regulatory gravity focused on Euro survival, leaving the failing Single Market will accelerate City growth through better regulation and the ability to seek trade deals where the growth is; US, China, India for example. The CityUK pressure group report is therefore deeply pessimistic and flawed. There will be a net increase in financial services employment and tax revenues only by leaving the Single Market. Why does it wish to remain in an area of relative decline where the UK has no say on regulation framing? That would be a very dangerous proposition indeed.

10. CONCLUSION

The UK's dominance in financial services has grown markedly despite the formation of the Euro. No other EU centre has the critical mass, capacity or soft power to compete. Europe's second and third markets, after London, are in Geneva and Zurich. Frankfurt is a distant 10th in terms of global financial markets.

The failure of the Euro, which has directly led to low growth and unemployment levels across the Eurozone over twice that of the UK, has led to a loss of EU power, introspection and regulatory firefighting that is inappropriate for the UK. The interests of the UK and Eurozone have diverged.

Suggestions that 75,000 jobs and £10bn of tax revenues are at risk are beyond credibility. This would require around 25% of City jobs to disappear, which effectively assumes all EU City business is lost in a financial services environment where there is no Single Market.

The real risk to the City is remaining in the Single Market. That is the "take EU regulation with no say" option that would be worse than the current unsatisfactory position. What is a risk to The City is also a risk to financial services throughout the UK – and likewise the opportunities for the City in being outside the EU Single Market and its Customs Union would be of benefit the financial service sector across the whole of the UK

Outside the Single Market gradually, but surely, the UK can devise a more intelligent prudential approach to regulation that benefits the industry, consumer and HM Revenue. Only by leaving the EU will our financial services be able to seize the opportunities of being more dynamic, creative and responsive so that London's financial dominance can continue and UK financial services can flourish.

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About the authors…

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Global Britain

Global Britain was founded twenty years ago to provide the positive business case for the UK to leave the European Union and published a wealth of research briefs and papers to that end. Now that the argument for an outward-facing, sovereign, democratic UK has been won Global Britain is committed to ensuring that our politicians do not betray the 17.4 million Britons that voted for change through the publication of papers that showing how Brexit can be delivered.

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