Let’s Talk Business: Analysing the Economic Impact of a Brexit

A Four-Part Brexit Blog, hosted by CCCU Politics/IR Jean Monnet Chair in European Foreign Affairs, Dr Amelia Hadfield.

Featuring: guest Jean Monnet Scholar Mechthild Herzog.

(https://canterburypolitics.files.wordpress.com/2015/07/british-eu-flag-2.jpg)Britain has entered the battlefield to save, slay or restructure its membership of the European Union. Key players from all national sectors have taken up their positions on all fronts. But clarifying the motivations of British stakeholders and sectors in terms of their support for, or opposition to European integration requires a little more insight. We need to fully understand the challenges faced, and the opportunities on offer from the EU side, and the way in which British industry perceives and responds. British feelings regarding Europe seem mired in semantic differences rather than cultural commonalities. Britain is with, not of Europe. Europe ‘is my continent, not my country’, suggested John Redwood. This produces a sense of resignation in some, who like Stanley Baldwin, argued that ‘whether we like it or not, we are considerably bound to Europe’. For others, the connection at least affords a singular opportunity for British leadership. ‘We have many times led Europe in the fight for freedom’, said Anthony Eden, ‘it would be an ignoble end to our long history if we tamely accepted to perish by degrees.’

This however, is a fight of a different type. It’s fight to determine the vision, and the viability of the Union, and the location of Britain within the EU. These are exciting, confusing, challenging times. And we need some level-headed analysis to chart our way forward. I’m therefore delighted that the Jean Monnet Chair activities, based here in the Politics/IR team of Canterbury Christ Church University, is able to provide open access to fast-moving, contemporary events of real importance, in a way that promotes the work of emerging European scholars. This four-part blog series offers an overview of the particular fears and hopes, and resultant positioning of different business sectors in the struggle to clarify the consequences for a British exit, or ‘Brexit’. In this first post, we examine those areas that are expected to be most gravely affected by a Brexit: the finance sector.

Amelia Hadfield

Part 1: If Britain Leaves the EU, We Leave Britain: The Finance Sector

(https://canterburypoli /2015/05/mechthild-herzog.jpg)
Guest blogger Mechthild Herzog

Most prognoses for a potential Brexit are not particularly promising. The *Open Europe* report[1] from March 2015 predicted that all sectors would experience an initial disruption if the UK decided to leave the EU. More than a third of Britain’s EU-bound goods – which account for half of the Kingdom’s total exports – could become subject to levies of at least 4%, which could entail rising prices for EU consumers, and a worse position for British enterprises in terms of international competition. Worst affected are likely to be automotive, foodstuffs/agriculture, the chemical industry (with an eye-watering 11% drop), , as well as the financial sector with projected losses in added value of up to 5%.[2] As Open Europe suggests, the choice is a double-edged one: while a successful Brexit that allows Britain to stave off economic contractions and engage with a more international spread of trade may boost the UK’s economy by as much as 1.6% over the next 15 years, an unsuccessful one may see its relations with key European trading partners wither at the root, causing the economy to shrink by up to 2.2% over the same period,.

The insecurity between these margins is expected to negatively affect the British economy. In a study featuring in Reuters in February, the Dutch bank ING forecasted a cut in growth of around half a percentage point per year until the referendum is held.[3] This insecurity has prompted a number of enterprises to take a clear stand on the ‘Brexit or not’ debate, and has already produced more pulic jockeying than the debate on whether or not to join the Euro in the early 2000s, to which the current struggle is sometimes compared[4]. On 23 June, an open letter bythe British Chamber of Commerce’s Director General John Longworth to Prime Minister David Cameron appealed not for exit, but for efforts to reform the UK’s position in the EU. In a crucial point, the letter mentioned distancing Britain from the ‘ever closer union’ dynamic intrinsic to the process of European integration, as well the guaranteed sovereignty of Britain.

If Cameron were successfully able to negotiate these terms, then “the tens of thousands of the businesses the BCC represents will be four-square behind you”[5]. The Confederation of British Industry (CBI), Britain’s employers’ organisation, supports further EU membership even more strongly. The CBI remained neutral when Tony Blair’s government debated the pros and cons of joining the Eurozone, with CBI members split on either side of the argument. Now, however, the CBI is emphatic in its position that a Brexit would put jobs at risk, cost the UK influence, and ultimately lead to isolation. The preferred model would be a UK firmly within in a reformed EU. However, CBI President Mike Rake indirectly implied that even if the government’s attempts to re-negotiate Britain’s position in the EU failed, the CBI would still back retaining EU membership – simply because of a realistic alternative.

The rating agency Moody’s has also joined the chorus of negative forecasts regarding a possible Brexit. Stating that the UK would face a downgrade of its current AA1 rating if counted separate from the EU., [6] as well as worsening its trade position, and crippling its medium-term growth, Moody’s envisages no separate trade structure which the UK as a non-EU member might conclude with the EU that could in any way realistically mitigate the overall loss of trade capital generated from continued membership. Standard and Poor another leading rating agency, has already taken action, downgrading in mid-June its outlook on the UK’s credit rating from AAA to ‘negative’[7].

In terms of employment, “a vast amount of uncertainty and instability” was predicted by the large recruitment firm Manpower[8],on the basis of a survey of 2100 employers. From their perspective, a Brexit would see firms less willing to invest in new jobs, tightening employment opportunities, and making it difficult to recruit qualified European workers, on which many sectors so heavily rely. EU labour forces would naturally be tempted to remain within the bigger EU labour market, to which the UK would no longer be a gateway, while key UK talent may also kick-start a British brain-drain, in search of larger, more integrated European opportunities. The same would apply for key enterprises, which might choose to rather relocate to the EU, a key leitmotif in the heads of those currently debating about opening new offices in the UK. The number of firms currently preparing contingency plans that cost-benefit the transfer of their UK-based business to other EU countries grows daily.

The Finance Sector

Is this a recent flurry? Not really. A variety of firms have seen the omens for a while now. In December 2013, Goldman Sachs for example was one of the first global financial players to look at a Brexit-induced relocation.[9] Since then, Goldman Sachs, which ranks among the world’s most powerful investment banks, has repeatedly warned that threats to the UK’s EU membership are threats to the UK’s business overall, and continues to argue strongly in favour of staying in the EU. [10] The following year, reports stated that HSBC, the Bank of America Merrill Lynch, JPMorgan, Citigroup and Morgan Stanley were all considering a move to Ireland, Paris or Frankfurt, and had already begun their own contingency plans.[11]

In May this year, Deutsche Bank joined the ranks of the disconcerted, stating publicly, on the basis of in-depth research from its in-house working group, that it would consider moving parts of its London-based operation from the UK in the case of a Brexit.[12] More is to follow. The Royal Bank of Scotland fears an adverse effect on its business, while Ernst & Young, one of the ‘big four’ international audit companies, demonstrated the destructive influence that the debate on a potential EU exit has already had on the finance sector. In its ‘UK Attractiveness Report’, the company stated that a third of the foreign investors it had surveyed would either cut, or freeze planned investments up to 2017, in connection with the anticipated referendum. The British Banking Association has further warned that “a prolonged period of uncertainty over the UK’s membership of the EU and its access to the single market could undermine international banks”.[13] In June, Dan Glaser, chief executive of Marsh & McLennan Companies, specialising in professional business services, emerged as the clearest voice yet: “I absolutely think it would be a big mistake economically, politically and strategically for the UK to leave the EU”.[14] Glaser is not alone. A recent survey by property advisors CBRE[15] indicates that 60% of the top 250 global firms based in London think similarly, with only 5% perceiving a possible Brexit positively.

The choice seems clear enough. In a report commissioned by the City of London Corporation,[16] if the UK remains in the EU, London’s financial sector could grow by more than a third, with a 10% increase in employment over the next decade, predicts If it leaves the EU, as argued by *Open Europe*, not only will the UK’s financial sector experience high disruption in the immediate future, but chances are sli that the UK can negotiate as a non-EU member terms with the EU that would bring it even close to its current position. Over 250 banks are currently headquartered in London – precisely *because* the UK is part of the EU. Absent EU membership, the City of London will not of course be cut off, but it will be significantly attenuated in terms of being able to remain on par with financial hubs like Frankfurt, Paris or even Dublin, all of whom have been targeted as potential new office locations for skittish banks and financial actors, large and small.

Yet this is only one side of the story. There are equally ardent oppositional voices, including several from the financial sector. For instance on 22 June, a group chaired by the former executive chairman of PA Consulting Group, Jon Moynihan, went public with a study called ‘Change or Go’.[17] The title says it all: the group request that Prime Minister Cameron either successfully re-negotiate Britain’s position in the EU, or lead the UK out of it. Arguing that the financial sector would suffer from the imposition of further European regulations, which the study describes as as “extremely expensive and damaging”, continued EU membership could only be countenanced if the UK were given a general national veto, full control over social and employment laws, and migration policy, an exemption from the ‘ever closer union’ commitment, and an escape route from burdening regulations on businesses. The study concludes simply by asserting that “…the UK – as the world’s fifth largest economy – has nothing to fear from [a Brexit] vote and, indeed, much to gain.”

In terms of the exodus of big banks, and big business, the picture is equally divided. Neither Frankfurt nor Paris for instance could immediately usurp the central and indeed historic role of London as a financial centre. “None of the major European cities could cater for that kind of demand at the click of fingers or even with six months notice”[18], argued Mat Oakley, head of commercial research at the global real estate consultancy Savills, in November 2014. The tricky issue of lack of sufficient office space means that banks would have to pre-let or buy a site before knowing the result of the vote on EU membership, in order to be able to move the own headquarters in time.

Whether such drastic moves might become necessary depends however not simply on a ‘yes’ or ‘no’ as result of the referendum, but on the nature of negotiations that prelude the referendum, and the structural consequences of their implementation in the event of a yes, and the overall impact in the event of a no. We should bear in mind the innate forms of integration that are facilitated by the UK remaining within the European Economic Area (EEA). As an EEA member, the UK could for instance retain so-called ‘passporting rights’, allowing businesses to operate in the entire EU even if situated in a non-EU EEA state. [19] As Frank Gill, credit analyst at Standard & Poor, argued recently, “the extent of this impact [of a Brexit] will crucially depend on what alternative free trade arrangements the UK government could agree with its European partners in the event of an exit.” Gill referred to a paragraph of a recent Standard & Poor report, which concludes that “Without these [passporting] rights, we see a risk that enough major global banks could choose to route their business through other financial centers in the EEA that retain those rights.”

As Nobel laureate Nils Bohr observed, ‘prediction is very difficult, especially if it’s about the future’. Sketching out possible scenarios that work on either side of the argument is a frustrating business. While the pro-EU group of financial actors is currently larger and louder, with clearer and more substantive points than the pro-Brexit group, their voice might not necessarily prompt the British public to vote in a way that favours their case. On the one hand, as the Liberal-Democrat MEP Sharon Bowles argued in April 2014: “Bankers are so hated by the public at large that saying the bankers want us to stay in Europe might lead the public to say, ‘Well then, I’m coming out.’”[20] On the other, the financial sector might well be the one most gravely affected by a potential Brexit – with enough impact to tip the balance. The next issue to examine in this respect? The ability of the UK to operate an independent global player rather than a slave to Brussels’ regulations: stay tuned for next week’s blog on the insurance and manufacturing sectors. In the meantime, let’s ruminate first on the salience of Jim Callaghan’s 1966 observation:

If Britain becomes a member of the Community, it will be healthier for Britain, advantageous for Europe, and a gain for the whole world. I do not know of many economic or political problems in the world which will be easier to solve if Britain is outside rather than inside the Community.

[1] http://openeurope.org.uk/blog/how-would-key-export-sectors-fare-under-brexit/ (http://openeurope.org.uk/blog/how-would-key-export-sectors-fare-under-brexit/).

[2] Cf. the study "Brexit – potential economic consequences if the UK exits the EU" by the Bertelsmann Stiftung: https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/Policy-Brief-Brexit-en_NW_05_2015.pdf (https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/Policy-Brief-Brexit-en_NW_05_2015.pdf).

[3] Cf. http://uk.reuters.com/article/2015/02/09/uk-britain-eu-economy-idUKKBN0LD0EI20150209 (http://uk.reuters.com/article/2015/02/09/uk-britain-eu-economy-idUKKBN0LD0EI20150209).

[4] Amongst others, Danny McCoy, boss of Ibec (Ireland's largest business lobby group) argued in May 2015 that Britain's vote against the Eurozone membership was equally preceded by black predictions, mainly that London would no longer be a financial capital – which never materialised; the City of London's financial market has instead been strengthened in the period after.

[5] http://www.britishchambers.org.uk/press-office/press-releases/bcc-businesses-will-back-pm-if-he-secures-reform-deal-in-the-interests-of-uk-economy.html (http://www.britishchambers.org.uk/press-office/press-releases/bcc-businesses-will-back-pm-if-he-secures-reform-deal-in-the-interests-of-uk-economy.html).

[6] Cf. http://www.telegraph.co.uk/finance/economics/11659188/UK-credit-rating-at-threat-if-country-leaves-EU-Moodys-warns.html (http://www.telegraph.co.uk/finance/economics/11659188/UK-credit-rating-at-threat-if-country-leaves-EU-Moodys-warns.html).

[7] Cf. http://www.telegraph.co.uk/finance/economics/11671596/UKs-credit-rating-downgraded-to-negative-by-SandP-on-EU-referendum-risk.html (http://www.telegraph.co.uk/finance/economics/11671596/UKs-credit-rating-downgraded-to-negative-by-SandP-on-EU-referendum-risk.html).

[8] http://www.bbc.com/news/business-33058006#?utm_medium=twitter (http://www.bbc.com/news/business-33058006#?utm_medium=twitter).

[9] Cf. http://www.theguardian.com/business/2013/dec/04/goldman-sachs-warns-london-exit-britain-eu (http://www.theguardian.com/business/2013/dec/04/goldman-sachs-warns-london-exit-britain-eu). The vast majority of Goldman Sachs's employees (6.000 of 7.000 in late 2013) in Europe are based in the UK.

[10] Cf. http://www.bloomberg.com/news/articles/2014-04-08/london-banks-opposing-britain-exit-from-eu-see-u-k-loss (http://www.bloomberg.com/news/articles/2014-04-08/london-banks-opposing-britain-exit-from-eu-see-u-k-loss), and also http://www.bbc.com/news/business-30964500 (http://www.bbc.com/news/business-30964500).

[11] Cf. http://uk.businessinsider.com/banks-brexit-if-britain-leaves-europe-2014-8?op=1?r=US#ixzz3cb4WC02ka (http://uk.businessinsider.com/banks-brexit-if-britain-leaves-europe-2014-8?op=1?r=US#ixzz3cb4WC02ka) and http://www.euractiv.com/sections/uk-europe/uks-eu-referendum-path-brexit-314774?utm_source=EurActiv+Newsletter&utm_campaign=24b5bbde39-newsletter_daily_update&utm_medium=email&utm_term=0_bab5f0ea4e-24b5bbde39-245800877 (http://www.euractiv.com/sections/uk-europe/uks-eu-referendum-path-brexit-314774?utm_source=EurActiv+Newsletter&utm_campaign=24b5bbde39-newsletter_daily_update&utm_medium=email&utm_term=0_bab5f0ea4e-24b5bbde39-245800877).

[12] Cf. http://www.independent.co.uk/news/business/news/deutsche-bank-considers-uk-exit-plan-10259849.html?origin=internalSearch (http://www.independent.co.uk/news/business/news/deutsche-bank-considers-uk-exit-plan-10259849.html?origin=internalSearch). The Deutsche Bank has 9.000 employees in the UK.

[13] Cf. https://www.bba.org.uk/news/press-releases/bba-on-competitiveness-of-uk-and-eu-referendum/#.VXrIAufkJnc (https://www.bba.org.uk/news/press-releases/bba-on-competitiveness-of-uk-and-eu-referendum/#.VXrIAufkJnc).

[14] Cf. http://www.independent.co.uk/news/business/news/british-exit-from-eu-could-jeopardise-londons-position-as-major-financial-centre-says-leading-us-boss-10311824.html (http://www.independent.co.uk/news/business/news/british-exit-from-eu-could-jeopardise-londons-position-as-major-financial-centre-says-leading-us-boss-10311824.html). Marsh & McLennan Companies, though headquartered in New York, employs 7.000 people in the UK.

[15] Cf. http://www.cityam.com/217799/cbre-says-uk-exit-european-union-will-hurt-property-sector (http://www.cityam.com/217799/cbre-says-uk-exit-european-union-will-hurt-property-sector).

[16] Cf. http://www.digitallook.com/news/news-and-announcements–/city-of-london-will-grow-if-a-brexit-is-avoided–748075.html (http://www.digitallook.com/news/news-and-announcements--/city-of-london-will-grow-if-a-brexit-is-avoided--748075.html).

[17] Cf. http://www.telegraph.co.uk/news/worldnews/europe/11689895/Britain-needs-to-get-a-better-deal-from-Brussels-or-leave-the-EU-major-new-study-reveals.html (http://www.telegraph.co.uk/news/worldnews/europe/11689895/Britain-needs-to-get-a-better-deal-from-Brussels-or-leave-the-EU-major-new-study-reveals.html), and also http://www.dailymail.co.uk/news/article-3133929/Britain-leave-EU-refuses-change-business-chiefs-tell-Cameron-Group-demands-PM-comes-veto-EU-laws-control-employment-rules.html (http://www.dailymail.co.uk/news/article-3133929/Britain-leave-EU-refuses-change-business-chiefs-tell-Cameron-Group-demands-PM-comes-veto-EU-laws-control-employment-rules.html).

[18] http://www.reuters.com/article/2015/05/26/us-britain-eu-offices-idUSKBN0OB0FT20150526 (http://www.reuters.com/article/2015/05/26/us-britain-eu-offices-idUSKBN0OB0FT20150526).

[19] Cf. http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11693103/Brexit-could-push-global-banks-away-from-UK-warns-SandP.html (http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11693103/Brexit-could-push-global-banks-away-from-UK-warns-SandP.html).

[20] http://www.bloomberg.com/news/articles/2014-04-08/london-banks-opposing-britain-exit-from-eu-see-u-k-loss (http://www.bloomberg.com/news/articles/2014-04-08/london-banks-opposing-britain-exit-from-eu-see-u-k-loss).

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