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The City finally sees the light on Brexit

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Wow. As U-turns go, this one takes some beating. TheCityUK, the main lobbying arm for the financial and associated business services sectors, appears to have suddenly embraced Brexit. In common with all the other big City groups and all the big banks, it was strongly in favour of remaining in the EU, seemingly at almost any cost. It argued loudly that the status quo, and especially the rules governing access to EU markets, was worth the cost in terms of counter-productive regulations, such as banking bonus caps or inappropriate, absurd Solvency II insurance rules.

No longer: its latest missive appears to have been penned with the zeal of the convert. The press release is entitled “TheCityUK hails opportunity for trade and investment policy reset”. While it obviously remains worried about the threat of protectionism from the EU, its new report emphasises the upsides of developing new markets.

Around 33pc of the UK’s exports of financial services go to the EU, which also accounts for roughly 40pc of Britain’s trade surplus in financial services. There is no doubt, therefore, that Europe is a crucial market for UK financial services firms. But it’s not that simple. The EU actually matters more to other sectors of the economy (44pc of all our exports of goods and services now go to the EU, a fast-declining share). Even more importantly, as TheCityUK points out in its new report, “over the next 10-15 years, 90pc of global economic growth is expected to be generated outside Europe and these markets – developed and emerging – must be a priority focus for the country post-Brexit”. In other words, we need to fight to retain as much access as possible to the EU, but our long-run future lies in trading a lot more with other economies, including emerging and already developed countries.

A recent Financial Services Briefing by Shanker A Singham and Victoria Hewson, published by the Legatum Institute, put this very well. It points out that international and wholesale banking business related to the EU is between 20pc-25pc of the total. That’s a big number, helped by the availability of passporting, but still means that a huge amount of business is conducted by the City without any passporting mechanism. We shouldn’t obsess about the minority of activity that goes to the EU while neglecting the majority that doesn’t.

Common sense? Of course, but such sentiments were hugely controversial a mere few months ago. A key pro-Brexit argument is the need to diversify away from the EU, partly because of fears that the region might eventually implode but also simply because, as the slowest-growing of the world’s major economic blocs, it is in accelerating relative decline.

In an extraordinary U-turn, TheCityUK has finally accepted the second of these arguments (about relative economic growth), as well as the need to quit the customs union. It now says that it “is a strong believer in the potential opportunities that the UK’s departure from the European Union will offer. One of the most significant of these is the chance, for the first time in decades, to frame UK trade and investment policy afresh. It is a once-in-a-generation opportunity… UK trade policy may have suffered a straitjacket effect from being integrated into the EU CCP (Common Commercial Policy)”.

The CCP goes to the heart of the customs union and ensures that tariffs and other barriers to trade are determined by the EU, rather than nation states.

So what exactly has happened? Why are City lobbyists finally seeing sense? The only possible answer is that the big institutions now realise that Brexit is happening and that it will mean leaving the single market and the customs union. British governments have traditionally listened to the City's concerns – understandably so, given its importance to the UK economy.

But an industry whose credibility has never really recovered from the financial crisis has ended up with almost zero influence in recent months. Financial services are not protected in any meaningful way under World Trade Organisation rules, unlike automotive products, and the City is thus more exposed to the threat of EU protectionism than any other sector. It is important for banks, fund managers and insurers to help the Government craft the best possible strategy to minimise the downside and maximise the upside from Brexit.

But it is very hard for the Government to engage with an industry that started off by funding the Remain camp; then went berserk after the result, using its army of economists to predict immediate armageddon; and then chose to produce wildly exaggerated claims about the numbers of jobs that would be lost. Even more damaging was the almost gleeful, vindictive tone of some of the recession and job cut threats. No wonder the Brexiteers all walked away in disgust.

The problem is that this silly strategy was neither in the banks' nor the economy's nor the Government's interest. Far better for the City's lobbyists to make peace with Brexit, and to try to make the best of the new political reality.

The City should work with the Government to pursue a four-pronged strategy. First, diversify as fast as possible. Second, use equivalence recognition and third-country frameworks as the basis for a three-year transitional solution. Third, negotiate a comprehensive free-trade agreement with the EU. Fourth, implement pro-growth tax and regulatory policies for the City.

I'm an optimist: with the right strategy, the City could end up more prosperous and larger in 10 years' time than without Brexit.