London Calling Brexit: The City of London and the 'baptist-bootlegger' coalition


Think of London and Brexit and most will think of what it means for 'the City', the heart of the UK's financial services industry. In this, the second in our London Calling Brexit series, Scott James (King's College London) and Lucia Quaglia (University of Bologna) examine why London's financial institutions have failed to wield the influence over Brexit that many might have expected.

The so-called 'Chequers' deal on Brexit, enshrined in the Government's White Paper in July 2018, came as a shock to many within the UK financial industry. While it pledged to secure a final Brexit agreement that retained privileged market access and compliance with a common rulebook for goods, no such commitment was made for services. In fact, the Chequers compromise was quite explicit that existing market access for financial services, based on passporting rights, will not continue and that the prospect of future regulatory divergence is a real one.

The dissatisfaction of the main City authorities, which tend to represent the views of the largest London-based banks, is not difficult to explain. What is more puzzling is why the City has been so ineffectual at shaping the UK government's Brexit policy, and has been forced to repeatedly row back on its lobbying position? The City is often viewed as an all-powerful force in UK politics. It's easy to see why. Financial services make up 6.5% of the UK economy and just over 11% when associated professional services are included. London is the source of more than half of this, generating an equivalently large percentage of UK taxes. The problems, and especially the costs, unleashed by the 2007-08 financial crisis served as a reminder to how central and disruptive the City's place in the UK can be.

During the 2016 referendum campaign, several US investment banks with offices in the City campaigned hard for a Remain vote, while UK 'national champion' banks like HSBC pushed strongly in the aftermath of the vote for the UK to retain membership of the European Economic Area (EEA). Yet the City authorities were forced to revise their collectively-agreed position in response to Prime Minister May's Lancaster House speech in January 2017 which explicitly ruled out single market membership. Instead, they advocated a 'bespoke deal' for financial services based on 'mutual access' and 'mutual recognition' which would allow UK firms to passport into the EU in-all-but-name. The City pushed this position throughout 2017, seemingly to no avail, until eventually, the Chancellor Philip Hammond acknowledged in December 2017 that this was also the Government's preferred position. Yet this alignment in position proved short-lived. In the face of intransigent EU opposition to a special deal for finance, the bespoke arrangement was finally laid to rest in Chequers and replaced by a 'new regulatory arrangement' for financial services which retains autonomy for both UK and EU regulators. Roughly translated, this is most likely to entail a strengthened or 'enhanced' form of the EU's existing third country equivalence regime whereby UK-based firms will be able to access the EU single market, provided that UK regulators can demonstrate 'equivalence' with EU rules. In practice, and as the City has long been at pains to point out, this arrangement will impose new regulatory barriers on UK firms with EU subsidiaries and provides a less secure basis for trading in the EU. Hence, while the July White Paper set out a relatively soft Brexit landing for manufacturers, large parts of the City are still heading for a turbulent hard Brexit.


Image by DAVID HOLT, (CC BY-SA 2.0).

Intriguingly, backtracking by the City on its Brexit position reverses the normal dynamics of regulatory capture: rather than policymakers shifting their position in response to industry lobbying, it is the City authorities that have been forced to revise their position in the face of political opposition. Industry insiders that we have spoken to are acutely aware of the extent to which they have been forced to ‘sing the same tune’ as the Government on Brexit. How can we explain this apparent ‘reverse capture’ of the City? We argue that this is less of a puzzle once we begin to disaggregate what the ‘City’ actually is. Although widely used as shorthand for the UK financial industry, in reality the City of London represents a loosely-interconnected network of financial firms which together constitute what political geographers refer to as an agglomeration economy. In simpler terms, the City does not constitute a coherent political or institutional entity, and less still does it share a common set of preferences around, redistributive policy issues like Brexit. If we consider the wider ecosystem of actors that make up the City, the UK government’s position set out in Chequers makes more sense. This is because there are at least two important sets of actors pushing for a relatively hard Brexit deal that would leave the EU outside the EU single market, opposed to full alignment with the EU’s Single Rulebook on financial services, and supports the possibility of regulatory divergence in the future.

The first group are composed primarily of non-banking interests within the City. Roughly one-third of the UK financial sector is broadly relaxed about the prospect of Brexit. This figure comes from a variety of sources, including the recent YouGov survey of Financial Times and City AM readers, a third of whom professed their support for leaving the EU. From a political economy perspective, this is not difficult to explain: only around 20% of the City’s revenue is reliant on EU passporting rights and vast swathes of financial services are traded in Europe without them. For example, the investment fund industry assumes that it will be able to delegate the management of EU-domiciled funds back to London after Brexit. Similarly, it is possible for hedge funds and other alternative investment funds to use national placement regimes to continue doing business across the EU, as was commonplace a decade ago. Moreover, some prominent voices view Brexit as an opportunity to roll back some of the more unpopular post-crisis measures to have emerged in recent years, including the insurance regulation, Solvency II.

The second group are financial regulators. In the immediate aftermath of the 2016 referendum, senior regulators made it clear that they would not support any outcome that would leave them as ‘rule takers’ from Brussels. Indeed, the Bank of England was quick to torpedo HSBC’s early push for the UK to seek EEA membership. Their opposition to a soft Brexit is grounded in bureaucratic politics: any such arrangement would inevitably involve a serious diminution of regulatory power, status and discretion. Over time, the role of UK regulators in shaping the UK government’s thinking and strategy on financial services has become increasingly important. It is no coincidence, for example, that the July 2018 White Paper stresses that UK regulators must retain ‘autonomy’, not as a route to potential deregulation, but on the contrary, to ensure that they can continue to impose tougher regulatory (capital) requirements on UK-based banks. This language is a direct legacy of the prolonged battle that British officials fought with the European Commission in 2012-13 over the ability of national regulators to impose capital requirements above and beyond EU rules.

These two groups – non-banks and regulators – constitute a powerful 'baptist-bootlegger' coalition; that is, two actors that have seemingly opposing interests, but have shared preferences around a specific policy issue. Hence, the interests of non-banks and regulators diverge as many prominent voices within the former favour regulatory rollback post-Brexit, while the latter are determined to maintain their capacity for 'goldplating' EU and international rules. But they are nonetheless unified in their preference for a hard Brexit outcome that provides scope for future UK-EU regulatory divergence in financial services. These actors have not sought to coordinate their lobbying efforts, but together they have proven to be highly effective in shaping the UK government's Brexit strategy.

This article gives the views of the author, not the position of LSE Brexit or the London School of Economics. An earlier version of this article appears in New Political Economy.

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