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Brexit and the Limits of Financial Power in the UK

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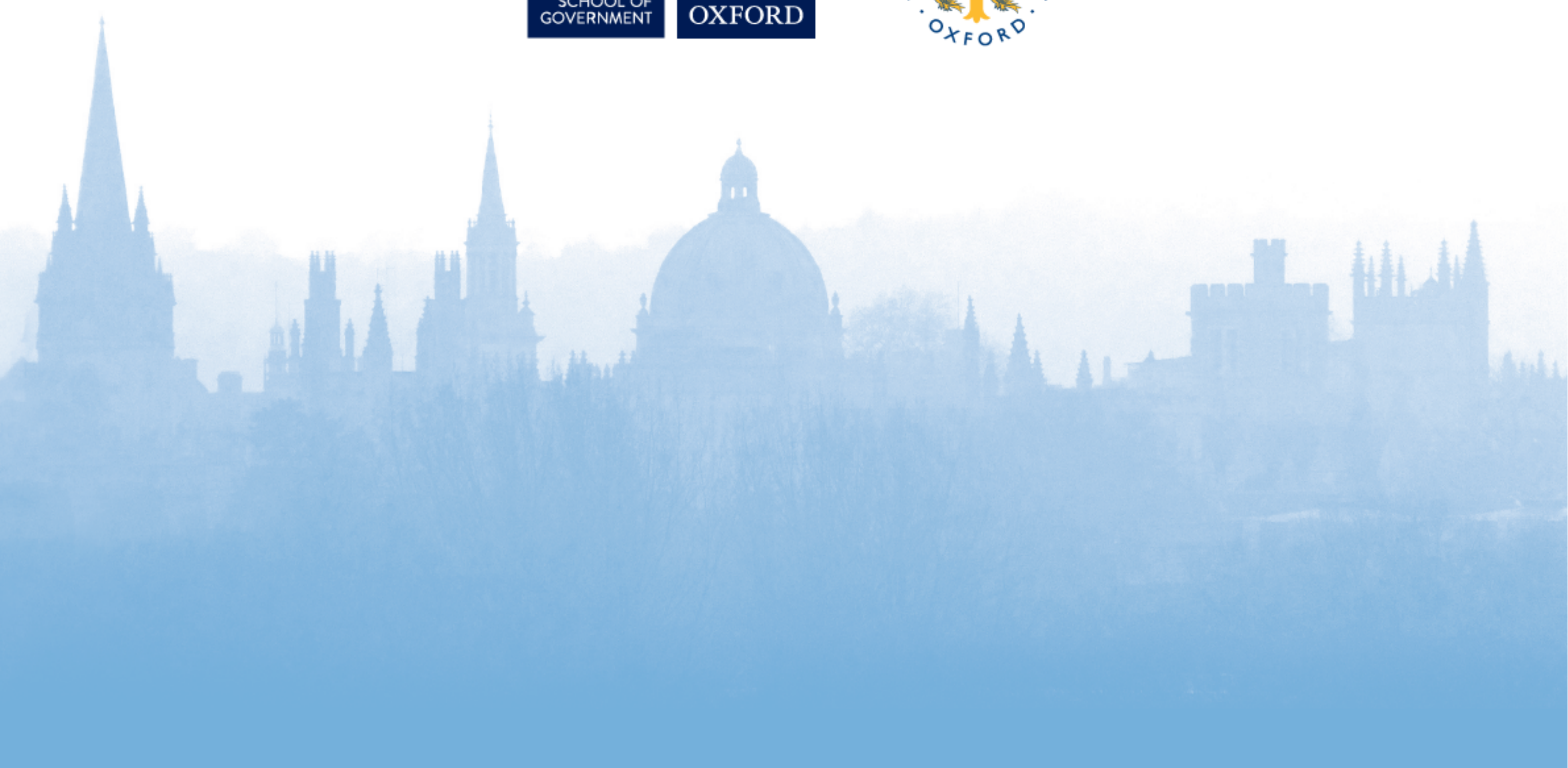

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Scott James[1] and Lucia Quaglia[2]

Abstract:

Brexit poses a profound challenge to the economic fortunes of the City of London. Recognising this, the UK financial sector campaigned for a Remain vote in the June 2016 EU referendum, and has subsequently lobbied for a 'soft' Brexit policy to guarantee continued access to the EU's single market. Despite this, the newly-formed government led by Theresa May has pursued a 'hard' Brexit policy which will see the UK withdraw from both the single market and customs union. This is puzzling because it is potentially highly damaging for the UK national business model, characterised by a large, internationalised and competitive financial sector that is dependent on exports to the EU. How can we explain the City's apparent failure to influence the UK's Brexit policy? We argue that while the UK financial sector continues to wield formidable 'latent' structural power, its capacity to translate this into instrumental forms of influence within government has been constrained by three factors. First, the high political salience of Brexit has reduced the effectiveness of City lobbying, which traditionally operates through closed networks of influence. Second, institutional reform within government has challenged the traditional City-Treasury-Bank of England 'nexus', thereby weakening the representation of the City's interests within government. Third, the City itself is deeply divided on this Brexit issue, constraining the industry's capacity to organise collectively to influence policy makers.

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1. Introduction

The decision of the United Kingdom (UK) to leave the European Union (EU) will have significant implications for the British economy and its national business model, characterised by a large, internationalised and competitive financial sector and the status of London as a leading international financial centre (Amable 2003; Hall and Soskice 2002; Schmidt 2002). The City[3] - a term used here as shorthand for the financial industry based in the UK - greatly benefitted from financial integration in the EU over recent decades. In fact, in 2016 up to 30% of financial services exports were directed towards the EU27 (the EU minus the UK) and the UK *de facto* acted as 'Europe's investment banker'. The impact of Brexit, which threatens the financial sector's access to lucrative EU markets, therefore poses a direct challenge to the interests of the City of London.

The literature on varieties of capitalism would predict that the UK should seek to defend its national business model by protecting and promoting the interests of one of its largest and most competitive sectors, namely finance (Fioretos, 2010; Macartney 2010). Similarly, the literature on business power would predict that the City should exert significant influence in the UK policy process, given the substantial dependency of the state on finance and the intense lobbying activities of the industry (Culpepper and Reinke 2014; Culpepper 2015). Furthermore, a distinctive feature of the UK business model in the past was the close nature of business-government relations in finance and the ability of the financial industry to exert political leverage (Baker 1999; Bell and Hindmoor 2015; Hopkins and Shaw 2016).

Despite this, the City has been surprisingly ineffective at shaping the UK's Brexit policy. It is particularly puzzling that following the EU referendum, Prime Minister Theresa May announced her intention to negotiate a so-called 'hard' Brexit that will leave the UK outside the single market and the customs union. This raises two questions. How has the City sought to influence the Brexit policy of the UK government? Why has it not been more successful in doing so? The aim of this paper is twofold. First, we set out to provide an account of the preferences and influence of the UK financial services sector on the Brexit issue. Second, we explain the City of London's apparent lack of success in shaping the new government's 'hard' Brexit policy.

We argue that the City continues to wield formidable 'latent' structural power owing to its pre-eminence in the UK economy. Yet its ability to translate this into instrumental forms of influence on Brexit have been constrained by three factors. First, Brexit is an issue of high political salience. Yet the City is not well-equipped to fight political battles or shape public opinion as it traditionally exerts its influence through the 'quiet' politics of closed policy networks. Second, the traditional City-Treasury-Bank of England 'nexus' has been weakened by institutional reform within government, driven by the regulatory response to the financial crisis and by the organisation of the Brexit negotiations. Third, the financial industry itself is internally divided on the Brexit issue, limiting its ability to project a powerful collective voice or to strengthen its capacity to lobby policy makers. Contrary to what we would expect from the comparative political economy literature, these three factors have given the May Government significant autonomy from organised financial interests in defining the UK's Brexit policy.

[3] The financial services sector in the UK is also located outside London (primarily in Edinburgh, Manchester and Bristol) and around half of the UK banking sector is foreign owned.

This paper contributes to the literature on theories of business power by showing how the strategic assertion of structural power is dependent upon effective instrumental mechanisms of influence. By identifying three factors that have contributed to weakening the City's capacity to do so, we can potentially specify a number of important scope conditions for the translation of latent structural power into real policy influence. Its empirical contribution is to analyse and explain the preferences of the City of London, and its attempt to influence key decisions taken by the UK government, on Brexit.

The material is organised as follows. Section 2 reviews the literature on the power of the financial industry. Section 3 and Section 4 discuss, respectively, the structural power and the instrumental power of the City with reference to Brexit. Section 5 analyses three factors that have constrained the capacity of the City to shape the UK's Brexit policy: political salience; institutional reform; and industry divisions. The paper concludes by reflecting on the significance of the findings.

2. Business power

The literature on business power identifies two main types of power that can mutually affect and often reinforce one another (Baker 1999; Bell and Hindmoor 2016; Culpepper and Reinke 2014; Woll 2014): structural power and instrumental power. Structural power (Lindblom 1977, 1982; Block 1977; Hacker and Pierson 2002) derives from the dependency of the state on capital because the state relies on firms to generate economic growth (Culpepper and Reinke 2014). As a result, business wields an 'investment veto weapon' as it can implicitly threaten to disinvest or 'exit' from a national jurisdiction. Structural power therefore serves as a constant background variable which forces policy makers to refrain from adopting policies that are detrimental to business interests, even in the absence of explicit lobbying. The structural power of finance, given the sector's importance in underpinning economic activity in the 'real' economy and as a source of revenue for the state, is well documented and has been referred to as the 'state-finance nexus' (Harvey 2011) or 'Wall Street – Treasury complex' (Bhagwati 1998). In this tradition, Woll (2016, p. 373) argues that the 'structural power is strongest when finance remains collectively inactive'; for example, in the bank bail-outs (Woll 2014).

Instrumental power comprises the mobilisation of financial and human resources for the purpose of lobbying policy makers. This includes the role of campaign donations (Hacker and Pierson 2010a), regulatory capture and 'revolving doors', and privileged access to the policy process (Jabko and Massoc 2014). Hacker and Pierson (2010a) describe it as 'organized combat' (for a critical view on the politics of finance as a 'not so organised combat' see Woll 2016; Hopkins and Shaw 2016). Instrumental power is shaped by the logic of collective action, whereby concentrated economic interests, such as the financial industry, are better able to organise themselves than broader diffuse interests, such as consumers or taxpayers (Olson 1967). In a similar vein, the ability of the business community to form broad coalitions (for example, between the financial industry and the real economy, see Pagliari and Young 2014; Keller 2017) can also strengthen business power. Recent studies suggest that, despite the financial crisis, the instrumental power of finance has been pivotal in diluting regulatory reform efforts (Carpenter 2010; McCarty and Poole and Rosenthal 2015).

Recent contributions emphasise the mutual dependency of the two forms of business power. Culpepper and Reinke (2014) distinguish sources of business power (structural v's instrumental) from how they are mobilised (automatically or strategically). From this perspective, structural power often has to be asserted strategically. For example, firms may use their lobbying resources to deliberately amplify policy makers' concern over disinvestment by making claims about the detrimental economic impact of new regulations (Fairfield 2015: 422). Equally, a firm's structural position in the economy directly shapes its bargaining strength in negotiations with policy makers (Culpepper and Reinke 2014: 436). Applying this framework to bank bail-outs in the UK and US, they argue that those institutions capable of asserting their structural power strategically secured the best deal from government. While this represents an important step forward, we argue that business power remains under-specified. In particular, it fails to specify the scope conditions under which the 'latent' structural power of business is translated into instrumental forms of influence within the policy process. Drawing on existing empirical studies of business power, particularly in the realm of finance, we identify three critical factors which mediate the relationship between structural and instrumental power.

The first concerns the level of political salience of an issue (Culpepper 2011; Pagliari 2013). Under conditions of low salience, the financial sector is in a strong position to strategically assert its structural power because policy makers are more likely to defer to the expertise of business. This is because low salience issues tend to be managed through informal institutions, enabling industry lobbyists to exert instrumental influence through the 'quiet politics' of access, networks and knowledge (Culpepper 2011). By contrast, as the salience of an issue increases, the structural power of finance is weakened as policy makers seek wider sources of public legitimacy for decisions (see Woll 2013). In response policy issues are escalated to formal institutional arenas, eroding the instrumental influence of industry lobbyists by exposing their claims to greater media and public scrutiny. Political salience is at its highest after 'focusing events' (Baumgartner and Jones 2009), such as major policy failures (notably, the international financial crisis) and crucial political events (such as the Brexit referendum).

Second, the institutional setting for business-government relations mediates financial power. In countries with a large financial sector, the structural power of finance is often augmented by the constitutive relations between the financial industry and the state apparatus, which facilitates the alignment of their preferences (Bell and Hindmoor 2015). Moreover, domestic institutions can provide suitable access points for the financial industry through which it articulates its policy preferences and mobilises its instrumental influence. Indeed, a distinctive feature of the UK polity has traditionally been the close interaction between the City, the Treasury and the Bank of England. This so-called 'nexus' has been at the centre of British economic policy making for decades (Grant 1993; Moran 1991) and has served the interests of the financial sector well (Baker 1999; Hopkins and Shaw 2016; Quaglia 2010). Yet institutions can change suddenly in response to external shocks, challenging pre-existing channels of instrumental access and influence within the polity. For example, Bell and Hindmoor (2015, 2016) argue that bank power has been constrained since the financial crisis by the enhanced capacity of the state, the increasingly politicised regulatory environment, and declining threat perceptions amongst policy makers.

Third, the heterogeneity of preferences and the cohesiveness of industry has important implications for business power. The projection of coherent narratives and ideas about the financial sector's contribution to economic growth, government revenue and employment is critical to its ability to wield structural power (Hopkins and Shaw 2016). Threats to disinvest or 'exit' are neither fixed nor exogenously determined; rather, they are discursively constructed by business and interpreted by policy makers (Bell and Hindmoor 2015). Business can also determine its relative structural power by reshaping the availability of its exit options, which Farrell and Newman (2015) refer to as 'structuring power'. Business divisions weaken the instrumental influence of industry lobbyists because they prevent the construction of coherent narratives about the impact of policy and undermine the credibility of industry's structural claims or implicit threats (James, forthcoming). Conversely, the ability of the financial industry to form broader coalitions with firms in the wider economy, particularly those in the manufacturing sector, can enhance instrumental power by providing greater legitimacy to their structural claims (Pagliari and Young 2014). For example, the formation of a broad alliance between financial firms and the 'real' economy was effective in shaping regulatory outcomes on capital requirements and bank structure in continental bank–based financial systems, where banks provide most of the funding to the non-financial sector (Keller 2016).

By mediating between structural and instrumental power, these three factors can constrain or facilitate industry's capacity to translate its latent structural power into instrumental forms of influence in the policy process. The following section outlines the City's structural and instrumental power with respect to the Brexit issue, before we analyse the impact of the three factors on the City's lobbying capacity.

3. Brexit and the structural power of the City

The pre-eminence of the finance services sector in the UK national business model underpins the City of London's latent structural power. In the literature on varieties of capitalism, the Anglo-Saxon model of capitalism has the following characteristics: a large, internationalised and competitive financial sector; mobility and flexibility in the labour market; limited social welfare provisions; minimal public intervention in the economy; deregulation and often de-industrialisation; the separation between the financial sector and the manufacturing sector; and the arms-length relations between the source of finance and the firms, promoting short-term financial profitability and short-term contracts (Amable 2003; Hall and Soskice 2001; Schmidt 2002). The source of the City's structural power derives from the large size of the financial sector in absolute terms, and as a share of the UK economy, its contribution to economic growth, the level of employment, tax revenues that it generates, and its export performance.

In 2013, the service sector accounted for 79% of the UK national economy, the manufacturing sector was approximately 14%, construction was about 6%, and agriculture accounted for the rest.[4] The financial services sector contributed more than 7% of UK GDP. It contributed 12% of PAYE income tax and national insurance, and 15% of onshore corporation tax in the UK. Financial and related professional services paid over £60 billion a year in tax. Of that, banks paid about £31 billion, of which about half was paid by foreign banks based in the UK. The financial sector in the UK employed an estimated 1.1 million people, while the number of employees reached nearly 2.2 million when related professional services were added (House of Lords 2016).

The consultancy Oliver Wyman (The CityUK 2016d) calculates the annual financial revenues at around £200 billion, £90–95 billion of which was domestic business, £40–50 billion related to the EU, and £55–65 billion related to the rest of the world. Around a quarter of revenues in banking and asset management, and nearly half of revenues in market infrastructure and others, were related to the EU. The UK net exports of financial services were the largest in the world: $71 billion, and uis thus a major contributor to the UK balance of payments. The EU was the biggest market for UK exports of financial services: the UK's exports to the EU were £26 billion, the UK's imports from the EU were £3 billion. Reflecting the economic contribution of the City, the Governor of the Bank of England, Mark Carney, warned that Brexit would test 'the kindness of strangers' on which the UK relied to fund its large current account deficit with the rest of the world. He also pointed out 'the possibility of a risk premium being attached to UK assets' in case of Brexit.[5]

London is ranked as the world's leading financial centre, just ahead of New York and significantly ahead of other EU cities. The London Stock Exchange is by far the largest in Europe and the second largest in the world in terms of stock market capitalization and daily trading turnover. The UK has the second largest banking sector in the EU. The UK is, after France, the second location for managed collective investment funds in the EU and is the

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[4] The Guardian (2014) 'Seven things you need to known about the UK economy', 24 April 2014.
[5] The Guardian (2016) 'Mark Carney fears Brexit would leave UK relying on "kindness of strangers"', 26 January 2016.

prime location for alternative investment funds, first and foremost private equities and hedge funds, in the EU. The UK hosts four-fifths of hedge funds managers in the EU, and internationally it is the second main location for hedge fund managers, after the US (Quaglia 2014: 69). About 70% of the EU's foreign-exchange trading and 40% of global trading in euros takes place in the UK. London in the main centre for clearing euro-denominated securities, despite being outside the euro area. Over 90 per cent of the £440 billion of euro denominated swaps, options and other derivatives traded each year are cleared in London. Finally, the British insurance sector is the largest in the EU and the third largest in the world. The UK has half of EU pension assets and international insurance premiums, and Lloyds of London is the largest re-insurance market worldwide.

Certain parts of the financial industry, first and foremost, banking, reinsurance and clearing of derivatives are highly concentrated, which structurally augment the influence of these parts of the sector. Retail banking is dominated by four UK banks, two of which, Standard Chartered and HSBC, have substantial activities abroad. Foreign banks mainly deal with wholesale investment banking, whereby the UK serves as point of entry for many non-EU banks, first and foremost US investment banks[6] (but also Swiss, Chinese and Japanese banks), which have subsidiaries and branches in London and from there operate across the EU (Schoenmaker 2013). Half of the EU's investment bank activity is based in the UK, and London Clearing House (LCH), which is owned by the London Stock Exchange (LSE), dominates derivatives clearing. These parts of the financial sector therefore have the most to lose from the loss of access or 'passporting' rights into the EU single market, and a 'hard' Brexit policy with limited 'equivalence' and 'mutual recognition' (see for a definition of these technical terms see The CityUK 2016c, 2016d; Howarth and Quaglia 2017).

The high level of internationalisation of the UK financial sector, as host to many large global financial firms, provides significant opportunities for relocation and 'exit' in response to unfavourable public policies. The financial industry therefore wields considerable latent structural power, which it has frequently sought to deploy strategically around the Brexit issue. In the run up to the EU referendum, the City was keen to point out the contributions of the financial industry to the UK economy, the benefits ensuing from EU membership of the single financial market, and consequently the economic damage that would ensue from Brexit (The CityUK 2014, 2015, 2016a,b,c,d; BBA 2014, 2016). For example, the BBA (2014) argued that 'the Single Market is a significant factor in the success of the UK as a financial centre and therefore of considerable value to the British economy'. In the aftermath of the referendum, banks were the first that threatened to relocate in part to the EU27. On 22 October 2016, Anthony Browne, Chief Executive of the BBA, wrote a letter to *The Guardian*, [7] arguing that a hard Brexit was a 'fast track to financial jeopardy', and that banks were 'quivering over the relocate button', adding that 'delegations from Frankfurt, Paris, Dublin and Madrid are all coming to the UK to pitch to bankers'. The main US banks operating in London publically warned they would move thousands of jobs out of Britain if passporting rights were lost (*Business Insider*, 11 November 2016). Beside banks, in a public hearing

[6] In 2016, 90 % of European turnover and employees of the five large US investment banks (Goldman Sachs, JP Morgan, Citigroup, Morgan Stanley, Bank of America Merrill Lynch) were located in London (Schoenmaker and Véron 2016).
[7] The Guardian (2016) 'Brexit politicians are putting us on a fast track to financial jeopardy', 22 October 2016.

before the House of Lords (2016) and House of Commons (2016b), other parts of the financial industry, notably the LSE and Lloyds, expressed concerns about potential loss of business deriving from Brexit, as well as threats of 'Jenga tower' effects on the financial eco-system in the UK (House of Commons 2016b).[8] For example, those parts of the sector, such as LCH, which are directly involved in the clearing of euro denominated derivatives are threatened by Commission moves to introduce 'location requirements', which would necessitate such trading to be cleared within the EU.[9] Brexit also poses a threat to Lloyds of London if an agreement on (re)insurance is not reached with the EU27. More recently, Lloyd Blankfein, CEO of Goldman Sachs has warned that London 'will stall' as a result of the uncertainty and risk surrounding Brexit.[10]

The UK financial industry has not only sought to signal structural power through the discursive construction of credible threats to disinvest, but has actively taken steps to exert 'structuring' power by seeking to expand the availability the exit options to it. From the early 2017, several financial institutions made provisions to relocate staff to the EU27, mainly Frankfurt, and to a more limited extent Paris, Dublin, Luxembourg and Amsterdam (e.g. *The Independent*, 21 March 2017). The first to move were the large global banks out of concern that they would lose valuable EU passporting rights. For example, Goldman Sachs, Citigroup, JP Morgan and UBS began shifting resources to Frankfurt in early 2017; Bank of America Merrill Lynch, Standard Chartered and Barclays targeted Dublin; whereas HSBC augmented its existing operations in Paris. Major EU27 banks that had large branches in London, including Deutsche Bank, BNP Paribas, Societe Generale, ING and UniCredit, also began to repatriate some of their activities (Schoenmaker and Véron 2016). These job losses mostly concern a limited number of foreign banks and the jobs of (mainly) non-UK nationals employed by them. Yet the tax revenues of these foreign banks and their employees accrue to the UK Treasury and the main UK banks have also begun to strengthen their operations in the EU27. Relocating staff prior to the commencement of the Brexit negotiations therefore constitutes sensible contingency planning on the part of financial firms, but – more importantly –a strategic act intended to signal the credibility of banks' structural power to threaten to exit the UK in the event of a bad deal.

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[8] Douglas Flint, chairman of HSBC, likened the impact of Brexit to a 'Jenga tower… you don't know what will happen if you pull pieces out' (House of Commons 2016b).
[9] Financial Times (2017) 'EU outlines 3 options for London's euro clearing business', 4 May 2017.
[10] BBC News (2017) 'Goldman Sachs boss: City "will stall" over Brexit risk', 5 May 2017.

4. Brexit and the instrumental power of the City

The City has sought to shape the public debate around Brexit through a plethora of internally produced and externally commissioned reports (e.g. The CityUK 2013, 2014, 2015, 2016a,b,c,d), by organising joint meetings with public authorities, and by establishing a regular dialogue with policy makers. Below we analyse how the City organised and mobilised resources in an effort to assert instrumental power both prior to, and following, the EU referendum.

The City and the EU referendum

The City and the financial industry mobilised in earnest in the run up to the EU referendum. In 2013, a study sponsored by the pan-City promotional body, CityUK, showed unequivocal support for Britain's continued membership of the EU across the sector (The CityUK 2013). In 2014, a similar study examined the economic benefits of EU membership and delivered a clear message that 'membership of the EU is essential for the UK's success and for the ability of our businesses to compete in world markets' (The CityUK 2014). This positive view was reiterated by the main financial associations in the context of the Balance of Competences Review organised by the UK government to assess the allocation of competences between the EU and the UK. In their responses to the consultation in 2014, the City's main representative bodies, including the CityUK, the City of London Corporation, the BBA, the Alternative Investment Management Association (AIMA), the Association of British Insurers (ABI), and Lloyd's of London,[11] argued that the Internal Market had been a major asset to the UK's financial services sector and concluded that the balance of national-EU competences was about right. They also stressed the need for the British government to remain fully engaged with its EU partners, participating constructively in the debate.

In the aftermath of the Eurozone crisis, important new steps had been taken by Eurozone members to strengthen the institutional framework of the currency bloc. These initiatives, the most important of which included proposals for Banking Union, was a catalyst for Prime Minister Cameron's attempt to re-negotiate the UK's terms of EU membership during 2015-16. The financial industry expressed concerns about 'differentiated integration' (Schimmelfennig 2016) which could result in a 'euro area market' within the EU single market (see BBA, ABI, AIMA etc). In response, the UK government sought new rules to protect countries outside the euro area from regulations made by those inside the group, which might be deliberately designed to disadvantage them. Specifically, the UK government wanted any non-euro area country to be able to stall new regulations for the euro area by triggering further discussions among all the member states. This request was principally designed to protect the City from an attempt by the euro area to challenge its dominance as Europe's main financial centre and to secure safeguards against euro area 'caucusing'. The financial industry broadly supported the renegotiation deal struck by the UK and the EU, not least because it was viewed as instrumental for the remain campaign to prevail in the subsequent referendum.

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[11] These responses to the Balance of Competences consultations are available at https://www.gov.uk/government/consultations/balance-of-competences-review-single-market-financial-services-and-the-free-movement-of-capital

In a last ditch attempt to influence the debate in the run up to the referendum in June 2016, the CityUK (2016a) commissioned the consultancy PwC to produce an analysis of the potential economic impact of a UK exit from the EU on the financial services sector. Given the very limited public support enjoyed by financiers post-crisis, the City's strategy during the referendum campaign was to make use of externally commissioned studies and 'facts and figures' that would highlight the detrimental impact of Brexit for the financial sector and wider UK economy, through lost tax revenue and reduced employment.

The City and the Brexit negotiations

Following the referendum, the City's main associations responded to the prospect of Brexit by gearing up their lobbying capability in advance of the forthcoming negotiations. The CityUK set up a Brexit Steering Group co-chaired by TheCityUK's Chairman of the Board, John McFarlane and Chairman of the Advisory Council, Paul Manduca, to oversee the post-referendum work and ensure a clear industry message was communicated to policymakers. A newly formed lobby group, European Financial Services Chairmen's Advisory Committee (EFSCAC) was set up to steer the City through Brexit and was chaired by Santander UK boss Baroness Shriti Vadera.[12] The EFSCAC established a sizeable secretariat and a series of work streams for each of the main sub-sectors (including commercial, investment and retail banking, insurance, market infrastructure, and investment management), each headed by a dedicated industry 'sherpa' and supported by the relevant trade associations. These work streams aim to interrogate every piece of EU financial legislation for the purpose of assessing the impact of different Brexit scenarios and transition arrangements. This activity played to the City's strengths by enabling it to accumulate vast technical and legal expertise on the regulatory implications of Brexit, with a view to lobbying the government during the negotiators.

This new group has sought to unify and strengthen the City's call for the preservation of the sector's access to the EU single market, advocating a 'soft' Brexit and a long transitional period. To influence the policy debate, they have produced detailed research and analysis highlighting the economic costs of a hard Brexit. In August 2016, for example, the CityUK (2016b) called for sustained access to the single market and for 'mechanisms approximating single market passporting'. In September 2016, another report reiterated the priority to preserve 'access to the Single Market on terms that resemble as closely as possible the access the UK currently enjoys' (The CityUK 2016c). In October 2016, Oliver Wyman estimated that if UK were to be able to preserve access to the Single Market on terms similar to those that UK-based firms currently had, there would be only a modest reduction in UK-based activity. But if the UK moved to a relationship with the EU defined by terms set out under the World Trade Organization (WTO) and without any regulatory equivalence (a hard Brexit), it warned that the economic consequences would be dire (CityUK 2016d).

The City has sought to exert instrumental influence over Brexit using their traditional channels of access through the Treasury and the Bank of England – the so-called City-Treasury-Bank 'nexus' (Baker 1999). In an initial meeting with Chancellor Philip Hammond, the EFSCAC pointed out the need to preserve passporting, or replace it with a bespoke alternative, and that curbs on employing EU nationals should be avoided, given the fact that

[12] Reuters (2016) 'Britain's finance sector at odds over Brexit lobbying', 2 October 2016.

some investment banks rely on non-British Europeans for 20-30 per cent of their UK workforce. Governor Mark Carney also met senior figures in the City to stress the need for a smooth path out of the EU (*The Guardian*, 27 November 2016). Both the Governor and the Chancellor have argued that banks and other financial institutions would need to be given time to put new rules in place after a deal had been struck with the EU (*The Guardian*, 12 December 2016). The City has also mobilised actively outside the UK. For example, it wrote to key embassies to ensure that the industry's messages were understood and communicated back to national capitals. It also organised public events in the main member states, particularly Germany, with a view to highlighting the costs of a hard Brexit with no transition, or a 'no deal' in finance, for the financial sector and real economy on the continent.[13]

Despite these considerable lobbying efforts, the City's ability to shape the Brexit debate to date has been limited. In January 2017, Prime Minister May announced in her Lancaster House speech that she intended to negotiate the UK's withdrawal from the EU single market and customs union. This held out the prospect that some 'elements of current single-market arrangements' might remain in place as part of a future trade deal. In addition, the Brexit White Paper published in February 2017 highlighted 'a legitimate interest in mutual cooperation arrangements that recognise the interconnectedness of markets' in finance (UK Government 2017). Nonetheless, these commitments fall far short of the 'soft' Brexit advocated by the City's main associations and have done little to stem the steady flow of announcements about financial jobs shifting to the continent. The following section sets out to explain this apparent ineffectiveness.

[13] Interview, London, March 2017.

5. Mediating factors of financial power

We argue that the City's capacity to translate its latent structural power into instrumental forms of influence has been constrained by three factors: political salience, institutional reform, and industry divisions. We suggest that this helps to explain the City's apparent failure to shape the Brexit debate, both in the run up to the EU referendum and in the formulation of the government's 'hard' Brexit policy.

Political salience

The Cameron government's commitment to hold a referendum on EU membership ensured that Brexit would become an issue characterised by heightened political salience and high levels of polarisation amongst voters (Clark et al 2017). The hard-fought and increasingly bitter referendum campaign removed the European issue from the quiet politics of Whitehall, and even the 'noisy' politics of Westminster, to the febrile public arena. This exposed discussion about the costs and benefits of EU membership to greater public and media scrutiny, but also enabled the debate to be framed around broader and more emotive themes, such as immigration and national sovereignty. The unexpected victory for the Leave campaign, the political turmoil unleashed by the resignation of Prime Minister Cameron, the uncertainty surrounding the new May Government's position on Brexit, and the 2017 general election campaign, have ensured that the issue has remained firmly in the political spotlight.

Business is generally more successful at articulating its preferences when insulated from public scrutiny and democratic politics (Culpepper 2011; Pagliari 2013). But in the context of the referendum, the influence of the financial industry, reputationally damaged by the legacy of the financial crisis, the bank bail-outs, and a series of industry scandals, was minimal. Historically, the City is largely ineffective when it comes to open lobbying and 'organised combat', and is poor at generating wider sources of public support (Moran 2009; Hopkins and Shaw 2016). Although the financial crisis led UK banks to expand their lobbying capability, they were still not well-equipped or experienced in public lobbying or fighting political battles with government ministers. As a senior bank lobbyist suggested, 'We had no political engagement at all until four years ago…We've had to build a bit of an apparatus to engage politically, but we're still not comfortable with it'.[14] While influential at the level of technical detail, industry was consequently far less effective at shaping wider political debates: 'Banks are the most awful lobbyists ever. They're all obsessive with small details, and quite incapable of telling a big picture story that a minister might grasp in a minute. As a result, we might win some detailed arguments, but we lose all the big picture ones that matter'.[15] Another City lobbyist confirmed that the financial sector 'can't fight political battles, it has no political capital…The only weapons it has are reason and logic, and in a political argument those are weak and easily broken records. Once you've run out of reason and logic…you pretty much have to sit on the sidelines and watch the big political arguments going past you.'[16] In this environment, the relative size and importance of the City's voice is inevitably diminished. Reflecting this, in recent months the City has backtracked on its

[14] Interview, London, November 2013.
[15] Interview, London, October 2013.
[16] Interview, London, May 2013.

demands for full passporting rights, and now instead advocates the weaker regulatory 'equivalence' as the best way to preserve the benefits of EU trade.[17]

Institutional reform

The early literature on business–government relations in the UK highlighted the importance of the City-Treasury-Bank of England 'nexus' in economic policy making (Grant 1993; Ingham 1984; Moran 1991). This refers to the close institutional and interpersonal ties between city financiers and policy makers at the Treasury and Bank of England, and the alignment of their interests and preferences (Kynaston 2001; Reid 1988). In recent decades the nexus has been reconfigured through institutional reform. In 1997, for example, the re-allocation of banking supervision from the Bank of England to the Financial Services Authority (FSA) loosened the ties between the central bank and the financial sector.[18] Yet the FSA proved highly responsive to the preferences of financial sector as it favoured light-touch, principles-based regulation, and actively sought to promote this 'market making' model across the EU (Posner and Veron 2010; Quaglia 2010). Moreover, the scrapping of the 'tripartite' system and the re-centralisation of banking supervision to the Bank of England since 2010 can be interpreted as re-constituting the traditional nexus.

It is therefore unsurprising that the Treasury and the Bank of England have remained sympathetic to the concerns of the financial industry over Brexit. In the run up to the referendum, the Treasury (2016) produced a report on the long-term effects of Brexit, suggesting that the UK could face a year-long recession, the loss of up to 500,000 jobs, and suffer from rising inflation and falling property prices. It also calculated that the country's GDP would shrink 3.6 percent within a year with each household to be over $6000 worse off after 15 years faring outside of Europe. Similarly, Governor Mark Carney warned that in the event of a vote for Brexit, the value of the pound could fall sharply, while households would delay spending and cause rising unemployment.[19] Following the referendum, Philip Hammond, appointed Chancellor in the new May Government, was reported to favour a soft Brexit with unrestricted market access and a long transition period.[20] In March 2017, a leaked Treasury document expressed concern about the prospect of a hard Brexit and warned of a painful 'economic shock' if the UK exited on WTO terms.[21] The Bank also reported that the risks of Brexit were already starting to impact on the economy, leading to accusations of political bias from the Treasury Select Committee.

Despite this, the impact of Brexit has been to accelerate the erosion of the City's traditional channels of access into government. Since the EU referendum, the City-Treasury-Bank nexus has been challenged by the reconfiguration of EU policy making within Whitehall. Prior to Brexit, the model for EU policy coordination since the UK's accession in 1973 revolved around the 'quad' of the Cabinet Office, Foreign and Commonwealth Office (FCO),

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[17] Financial Times (2017) 'City of London lobbying group drops demand for EU "passport"', 12 January 2017.
[18] Interview, London, November 2005.
[19] The Independent (2016) 'Mark Carney denies Bank of England tried to scare people to vote Remain during EU referendum', 12 July 2016.
[20] Financial Times (2016) 'Philip Hammond becomes standard bearer of soft Brexit', 13 December 2016.
[21] The Independent (2017) 'Leaked Treasury report warns of painful "economic shock" if Britain crashes out of the EU without a deal', 11 March 2017.

the UK Permanent Representation (UKRep) in Brussels and, on economic and budgetary issues, the Treasury. This involved the provision of light-touch coordination and strategic direction from the centre, with day-to-day EU policy responsibility delegated to line ministries (James 2011). Under Theresa May, the Conservative government wasted little time putting new arrangements in place. The unexpected decision to establish a dedicated Brexit department represented a subversion of the traditional EU coordination process. The new Department for Exiting the European Union, headed by Secretary of State David Davis, was responsible for leading the Brexit negotiations, coordinating activity across government, and undertaking policy work in support of the UK's future relationship with the EU (see Rutter and Macrae 2016; Wright 2016). In addition, a new Department for International Trade was established to prepare and negotiate new trade agreements with non-EU countries after Brexit.

These institutional reforms challenge the City's instrumental influence within Whitehall. First, the centralisation of Brexit policy-making has left the sector's traditional defender of its interests – the Treasury – unclear of its own position in the new arrangements. Moreover, there is the potential for the Treasury to become increasingly marginalised from the main locus of decision-making on Brexit which was tightly controlled by No.10 and the Brexit department (Owen and Munro 2016). Second, the establishment of a new Department for International Trade has further weakened the City's traditional institutional channels within Whitehall by exacerbating inter-departmental tensions and turf-wars over the Brexit agenda (House of Commons 2016a). Furthermore, the department is headed by Liam Fox who was widely viewed as one of the most outspoken advocates for a hard Brexit policy (*Financial Times*, 25 September 2016).[22] It was therefore unclear who, and how well, the City's interests would be represented within government during the Brexit negotiations.

Evidence for the City's diminished influence comes from reports that business leaders have found Theresa May 'elusive' compared to her predecessor and that meetings with industry are notably less frequent. No.10 reportedly favours meetings with business representatives that speak positively about Brexit, rather than those that warn about the potential risks or seek special treatment: 'What really gets you a good hearing is if you come in and say that you see opportunities around Brexit and come up with solutions to any problems.'[23] For example, CBI Director-General Carolyn Fairbairn was initially 'frozen out' of meetings with senior government officials after she publicly accused the Prime Minister of 'closing the door' on the UK's open economy. Moreover, according to one business lobby group, officials have made it clear that lobbyists making any critical statements in the media about immigration, trade or the rights of EU citizens will be punished with an immediate cessation of access.[24]

Industry divisions

The third factor that has constrained the power of industry has been the limits to the cohesiveness of the City's message on Brexit, linked to its historic fragmentation of its representation, but exacerbated by divisions between key sub-sectors and financial firms. These have generated deep-rooted collective action problems that have hampered the City's

[22] Financial Times (2016) 'City of London feats May government is shifting towards hard Brexit', 25 September 2016
[23] Financial Times (2017) 'Theresa May ensures only Brexit key allows entry to No.10', 12 April 2017.
[24] Ibid.

capacity to project a clear, consistent and credible message about the structural implications of Brexit for the financial sector and wider economy.

The banking sector is dominated by a small number of large global players that, on the whole, are concerned to maximise access to lucrative EU financial markets. Moreover, the UK government's hawkish stance on bank capital since gave the UK banking industry an incentive to support EU's membership, as industry often found itself supporting the EU's efforts to resist UK demands (James 2016). Following the referendum, attempts to centralise and augment the City's lobbying capacity in advance of the Brexit negotiations met with resistance from some sections of the sector. In particular, powerful US banks opposed the push to channel their message through the new EFSCAC, Chaired by Baroness Vadera, preferring to undertake their own, direct lobbying within government. The new arrangements also generated confusion over the institutional division of labour between groups, with one describing the situation as a 'complete dog's breakfast'.[25] Following protests from trade associations, investment banks and smaller firms that they were under-represented, and that the larger banks would dominate relations with government, the EFSCAC was been subsumed into the CityUK.

These divisions in part reflect the differentiated impact of Brexit on individual banks. Although for many the prospect of barriers between the UK and the EU single market poses an existential threat, for large, globally-oriented banks – particularly US banks, but also UK banks like HSBC and Barclays – Brexit is arguably less problematic. This is because they already have significant operations based in other European capitals and thus considerable flexibility to relocate staff (Hay 2017). Indeed, one senior lobbyist for a large UK bank described Brexit as more of an 'administrative inconvenience'.[26] Moreover, for domestic retail banks, such as Lloyds, access to the EU is less important. Hence, many prominent financial institutions in the City have little incentive to lobby collectively.

Furthermore, a sizeable section of the City, centred on the diverse and fragmented non-banking sector (which includes the private equity and hedge fund industries), is more comfortable with the prospect of Brexit. These firms are less dependent on EU markets and, prior to the international financial crisis, largely unaffected by Brussels-based regulation. Their view of Europe was shaped by their post-crisis experience, particularly Franco-German led efforts to regulate the so-called 'vultures' of capitalism (Woll 2013). Although the largest trade associations were firmly in the pro-Remain camp, important sections of the City therefore supported the Leave campaign and established a rival 'City for Britain' group (Politico 2016). For many in the non-banking sector, Brexit constituted a second 'Big Bang' which would force the City to reorient itself away from Europe and towards the emerging market economies. The 'hyperglobalist' view of the UK as an offshore financial hub (Baker, Gamble and Seawright 2002) had important supporters within the May Government, including Brexit Secretary David Davis and International Trade Secretary Liam Fox.[27] To counter the influence of the EFSCAC since the referendum, pro-Leave City figures have established the Financial Services Negotiating Forum, and actively supported the Global Britain and Leave Means Leave groups. The Forum describes its role as one of supporting UK negotiators by supplying 'evidence-based research' and identifying opportunities to

[25] Reuters, 'Britain's financial sector at odds over Brexit lobbying', 20 September 2016
[26] Interview, London, May 2017.
[27] Financial Times (2016), 'Full memo of David Davis meeting with the City' 9 December 2016.

strengthen the UK's 'best alternative to a negotiated settlement (BATNA)' position.[28] However, support for Brexit within the City remains diffuse and weakly organised, hindering its influence within government.

On balance, the UK-based financial sector is far more fragmented and contains a greater diversity of views on the prospects of Brexit than the City's official representative bodies would suggest.

[28] See http://www.fsnf.uk/p/about.html.

6. Conclusion

The British variety of capitalism based on a large and internationalised financial sector has greatly benefitted from EU membership. The City's growth as a global financial centre since the 1980s has been based in large part on the opportunities afforded by the free movement of capital and labour within the EU single market. In turn, the expansion and profitability of the financial services sector has been a key driver in the transformation of Britain's political economy and a defining characteristic of the UK business model. The interests of the financial services sector are therefore directly challenged by the UK's decision to leave the EU, and by the government's pursuit of a hard Brexit policy which explicitly excludes single market and customs union membership. This paper set out to explain how and why the City has not been more effective in defending its interests around Brexit.

Our paper seeks to make a broader contribution to theories of business power. We argue that while the financial sector wields latent structural power, this has to be asserted strategically in order to exert a causal effect over the political agenda or policy decisions. This is achieved through instrumental forms of influence, such as public campaigning and lobbying of decision makers. We claim that the City has considerable latent structural power at its disposal and that this has remained constant, owing to the sector's continued pre-eminence in the UK economy. The paper also shows that it has frequently sought to deploy this strategically in an effort to shape the agenda and discourse of the political debate, both before and after the EU referendum. This relies on instrumental mechanisms of power, including the regular publication of policy reports, frequent meetings with ministers and officials, and augmenting its collective lobbying capacity in anticipation of the start of the Brexit negotiations.

Despite this, the City has to date been surprisingly unsuccessful in shaping the UK government's Brexit strategy, in such a way as to protect its own interests. We argue that this is because the City's capacity to translate its latent structural power into instrumental influence has been weakened by three factors. First, the influence of the financial sector has been constrained by the rising political salience of EU policy in recent years. This poses a serious challenge to the ability of the banks to shape policy decisions because UK banks traditionally exert influence within government through the 'quiet' politics of informal and closed networks. By contrast, they are neither comfortable nor well equipped to engage in highly politicised debates, public campaigning, or the explicit lobbying of government ministers. Second, the assertion of structural power in the UK traditionally operates through closed, institutional ties centred on the Treasury-Bank-City nexus. We show that these ties have been eroded by institutional reform within Whitehall associated with the organisation of the Brexit negotiations within government. Consequently, the ability of industry to access and influence key decision makers has declined. Third, the City suffers from deep-rooted internal divisions between different sub-sectors of finance over Brexit which have constrained its ability to project a coherent message or lobby effectively. As evidence, we find that large banks have resisted efforts to augment the City's collective voice, preferring to lobby alone; while significant sections of the City are relaxed about the prospects of being outside the EU, and have actively campaigned for Brexit.

The paper makes a broader contribution to the business power literature by suggesting that these three factors can be considered as scope conditions for the effective translation of latent structural power into instrumental forms of influence. As a case study, our analysis of the UK financial services sector suggests that the effective assertion of structural power is dependent on three conditions: low political salience, institutionalised access, and industry coherence. These facilitate the ability of industry to send clear signals to policy makers about the anticipated economic impact of policy change, or even directly threaten to disinvest. For example, low political salience allows firms to target a single audience (policy makers) and minimises the risk that their messages will be distorted or challenged by other policy stakeholders. Moreover, institutionalised channels of access help to foster trust between business and policy makers, enabling lobbyists to accumulate reputational capital. Finally, industry's ability to act and speak coherently sends a powerful signal to policy makers about the credibility and veracity of their claims. It is possible that some or all of these conditions may be context-specific. Future research would do well to test whether these conditions hold in different national contexts and/or in different policy areas.

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