DOI:
10.1080/13563467.2018.1484717

Document Version
Peer reviewed version

Citation for published version (APA):
James, S., & Quaglia, L. (2019). Brexit, the City and the Contingent Power of Finance. *NEW POLITICAL ECONOMY*, *24*(2), 258-271. https://doi.org/10.1080/13563467.2018.1484717

Brexit, the City and the Contingent Power of Finance

Scott James (King's College London)[1]

Lucia Quaglia (University of Bologna) [2]

Abstract

Brexit poses a profound challenge to the economic fortunes of the financial services sector in the United Kingdom (UK) because it threatens to sever access to the single market in the European Union (EU). Recognising this, the City of London's largest financial firms and main representative bodies supported a Remain vote in the June 2016 referendum, and subsequently lobbied for a 'soft' Brexit policy to preserve the City's lucrative passporting rights. Despite this, the government led by Theresa May pursued a 'hard' Brexit policy which threatened to leave the UK outside the single market. How can we explain the City's apparent failure to influence the UK's Brexit policy? We argue that whilst the UK financial sector wielded formidable latent structural power, its capacity to translate this into instrumental influence in the policy process was constrained by three factors: the *political statecraft* of Brexit, leading the government to downgrade the concerns of the financial industry; the reconfiguration of *institutional structures*, which undermined the City's voice within government; and constraints on *business organisation*, caused by collective action problems and heterogeneous preferences. These three factors constitute important scope conditions which highlight the contingent power of finance in liberal market economies.

Keywords

Brexit, City of London, financial services, business power, statecraft

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, which is characterised by a large, internationalised financial sector and the status of London as a leading global financial centre. The City, used here as shorthand for the financial industry in the UK, benefitted greatly from EU financial integration over recent decades, with over 30% of financial services exports destined for the EU27 in 2015. The impact of Brexit, which threatens the 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 will defend its national business model by protecting and promoting the interests of one of its largest and most competitive sectors (Fioretos 2010, Howarth and Quaglia 2016). Similarly, the literature on business power would predict that the City will exert significant influence in the UK policy process, given the dependency of the British state on financial services and the formidable lobbying capacity of the industry (Bell and Hindmoor 2015, 2017, Hopkin and Shaw 2016, Thompson 2017a,b). Furthermore, a distinctive feature of the UK business model has historically been the institutionalised relationship between British state and the City of London (Baker 1999, Moran 1991, 2009).

Despite this, the City's main lobby groups were surprisingly ineffective at shaping the UK's Brexit policy. It is 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. Although the outcome of the June 2017 General Election led to a change of tone regarding Brexit and improved relations with business, the government's official position remained unchanged. This was potentially highly damaging for the City's interests, and the wider UK national business model. Two questions arise. How did the City seek to influence the Brexit policy of the UK government? Why was it not more successful in doing so? The aim of the article is twofold. First, we set out to provide an account of the preferences and influence of the UK financial services sector on Brexit. Second, we explain its apparent lack of success in shaping the government's Brexit policy.

We argue that the City wielded formidable 'latent' structural power owing to its pre-eminence in the UK economy. Yet, its ability to translate this into instrumental influence was constrained by three factors. First, Brexit transformed the political statecraft pursued by elected officials, resulting in the downgrading of the concerns of the financial sector. Second, the reconfiguration of institutional structures within government undermined the City's access to key decision makers and weakened the representation of its interests. Third, business organisation around Brexit was constrained by collective action problems and heterogenous preferences within industry. These three factors gave the May Government significant autonomy from organised financial interests in defining the UK's Brexit policy. As such, they constitute important scope conditions which highlight the contingent power of finance in liberal market economies.

This paper contributes to the literature on theories of business power in two ways. First, Brexit illustrates the highly contingent nature of business power, which can change suddenly and unexpectedly in response to electoral developments. Second, the study highlights how the strategic assertion of latent structural power is dependent upon effective instrumental channels of influence. The empirical research for the paper is based on twelve anonymous interviews conducted between June and August 2017 with representatives from the main City trade associations, UK and US banks, the investment fund industry, and financial regulators. The interview findings are corroborated using a systematic analysis of public documents from trade associations, regulators and legal firms, together with media coverage on Brexit, since the EU referendum. The material is organised as follows.

Section 2 reviews the literature on the power of the financial industry. Section 3 discusses the structural and instrumental power of City firms with reference to Brexit. Section 4 analyses three factors that have constrained the capacity of the financial sector to shape the UK's Brexit policy. Section 5 concludes by reflecting on the wider theoretical contributions of the paper.

2. State of the art on business power

The literature identifies two main sources of business influence: structural power and instrumental power (for a review see Culpepper and Reinke 2014, Woll 2016). Structural power recognises that governments are dependent on investment decisions by business to sustain economic growth and fund public services (e.g. Lindblom 1982,). Business therefore wields an 'investment veto weapon' as it can implicitly threaten to disinvest or 'exit' from a national jurisdiction. In anticipation of negative inducement effects, and the wider electoral and fiscal consequences, policy makers avoid policies that threaten to undermine business confidence. Instrumental power comprises the mobilisation of financial and human resources for the purpose of influencing policy makers. This includes the role of campaign donations, lobbying activity, and the existence of 'revolving doors' between government and industry, all of which provide privileged access to the policy process (Hacker and Pierson 2002).

Recent contributions emphasise the mutual dependency of the two forms of business power. Culpepper and Reinke (2014) distinguish the sources of business power (structural vs instrumental) from how they are mobilised (automatically or strategically). From this perspective, structural power has to be asserted strategically through costly instrumental political action. 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 . Firms can also manipulate their relative structural power by reshaping the availability of exit options, which Farrell and Newman

(2015) refer to as ‘structuring power’. We seek to contribute to this literature by defining the scope conditions under which the ‘latent’ structural power of business, reflecting the state’s dependency on private sector investment, is translated into instrumental influence within the policy process. Drawing on existing empirical studies of business power, we identify three critical factors which mediate the relationship between structural and instrumental power.

First, we argue that business power is contingent on elected officials’ pursuit of *political statecraft* (Bulpitt 1986). Statecraft theory assumes that the primary motive of elected officials is to win elections by building a successful electoral strategy and demonstrating effective party management (Bulpitt 1986: 21). Political statecraft is important because it determines how business power is inter-subjectively constructed by elected officials (see also Bell and Hindmoor 2015, 2017). When parties pursue an electoral strategy based on articulating a pro-business agenda, policy choices are typically justified on the basis of maintaining global competitiveness in the face of firms’ capacity to shift investment. By contrast, when elected officials decide that electoral support can be maximised by addressing non-economic issues, or even formulating a populist ‘anti-business’ agenda, they will deliberately downplay or disregard the concerns of firms. From this perspective, business power can therefore vary over time, and change suddenly, in response to unexpected electoral losses. These force elected officials to re-evaluate and revise their electoral strategy, often to the detriment of business interests, in an effort to address voters’ immediate concerns.

Second, the importance of *institutional structures* in mediating business power is well-established. For example, Hacker and Pierson (2002) argue that the centralisation of power and the strengthening of state capacity reduce the structural power of business. Conversely, Bell and Hindmoor (2017) show that in the run-up to the global financial crisis the changing institutional context in the UK strengthened banks’ influence on public policy. Culpepper (2011) highlights the link between institutional setting and political salience. When policy issues are low salience, they are dealt with by informal networks which institutionalise the role of powerful interests. As an issue becomes increasingly salient, however, governments are forced to escalate issues to new or formal institutional arenas which challenge informal patterns of business influence (Culpepper 2011, James 2017).

Third, the *organisation of business* is an important determinant of firm influence. Theories of collective action tell us that the concentrated nature of the economic costs and benefits of regulation provides a powerful incentive for individual firms to work together when lobbying (Olson 1965). This encourages the mobilisation of powerful coalitions of firms and interest groups capable of 'capturing' regulators and shaping policy outcomes in their favour. Yet, the capacity of business to organise effectively is often undermined by inter-firm divisions. Regulation creates winners as well as losers, generating heterogenous preferences and encouraging firms to compete against one another for influence (Pagliari and Young 2014).

The following section outlines the City's structural and instrumental power with respect to Brexit, before we analyse the impact of the three mediating factors discussed above on the power of the financial industry.

3. Brexit and the power of the City

The source of the City's latent 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 2015, the sector contributed more than 7% of UK GDP, 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, and employ nearly 2.2 million people (House of Lords 2016). The UK net exports of financial services were the largest in the world: $71 billion. 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.

The UK financial services industry contained a diversity of views on the desirability of EU membership. However, the majority of financial firms, including the large global banks, were strongly supportive of the UK's continued membership of the EU (for a good overview, see Thompson 2017a,b). The City's main trade bodies (TheCityUK, the British Bankers' Association [BBA], and the Association for Financial Markets in Europe [AFME]) represented this majority position and mobilised support by commissioning a plethora of public reports that detailed the benefits of EU membership for the sector (e.g. The CityUK 2016a, b). They also actively lobbied individual MPs by targeting them with information about the costs of Brexit for businesses within the constituencies.

> 'As a sector, they felt they could make more useful targeted interventions with policy makers than trying to do big hits in the media. Not all politicians are experts on financial services, so engagement was about trying to explain what the impact of Leave would be for financial stability, employment and tax revenues.'[3]

The international character of the UK financial sector provides considerable scope for firms to use the threat of 'exit' to assert structural power. For example, in January 2016 JP Morgan warned that it would 'quit' the UK in the event of a vote for Brexit.[4] Following the referendum, Anthony Browne (2016), Chief Executive of the BBA, argued that banks were 'quivering over the relocate button', while US banks publicly warned they would move thousands of jobs out of Britain if passporting rights were lost. To communicate these points directly to ministers, the BBA commissioned the consultancy, Oliver Wyman, and legal firm, Clifford Chance, to produce a confidential report on the impact of different Brexit scenarios, which was delivered to the Treasury at the end of July 2016.

The industry also wielded 'structuring' power by expanding the availability of exit options to it (Farrell and Newman 2015). From autumn 2016 onwards, several large global banks announced plans to relocate staff to the EU27.[5] 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; while 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. Relocating staff constituted contingency planning in the event that passporting rights were lost. But it was also a strategic act intended to signal the credibility of banks' capacity to exit the UK in the event of a bad deal.[6]

These threats had little impact on the UK's Brexit strategy. At the Conservative Party conference in October 2016, the Prime Minister announced that the government intended to end free movement and ECJ jurisdiction. This 'hard' Brexit strategy caught the financial industry off guard; over the following weeks it responded by undertaking a substantial reorganisation of its lobbying activities. To provide more effective coordination, Santander UK boss Baroness Shriti Vadera established a new lobby group, the European Financial Services Chairmen's Advisory Committee (EFSCAC). The EFSCAC established a sizeable secretariat and a series of dedicated work streams representing each of the main financial sub-sectors in the City, the task of which was to interrogate all EU financial legislation to assess the impact of different Brexit scenarios. This activity played to the City's strengths by enabling it to accumulate vast technical and legal expertise which could be used to influence the UK-EU negotiations.

In January 2017, the government's Brexit strategy hardened further. The Prime Minister's Lancaster House speech explicitly ruled out membership of the single market, a pledge that was subsequently enshrined in the Government's White Paper in February 2017. In response, the City's main bodies took the strategic decision to drop their demand for the maintenance of full passporting rights beyond any transition period, calculating that this was no longer politically feasible.[7] This left three potential hard Brexit scenarios: leaving the single market and customs union with a bespoke comprehensive free trade agreement that included financial services; a bespoke agreement that did not include financial services; or no trade agreement. The least worst of these options, certainly from the perspective of the largest global banks, was for a bespoke agreement. This was defined as a comprehensive financial services chapter based on principles of 'mutual market access', the 'mutual recognition' of regulatory regimes, and 'close cooperation' between UK and EU supervisory authorities (The CityUK 2017). They also favoured a three-year transition period composed of a separate 'bridging period' (from the date of the UK's exit until a new deal is agreed) and an 'implementation phase' (to provide additional time for business to adapt to the deal).

Henceforth, the City's main groups re-focused their lobbying efforts in two ways. First, they set out to quantify the economic costs of no deal being reached, and to analyse why existing third country equivalence rules provide an inadequate basis for future UK-EU relations (IRSG 2017). This work formed the basis of key industry 'asks' which were communicated to DExEU and the Treasury to feed into Whitehall impact assessments on Brexit and to help 'inform' the strategy of UK negotiators.[8] Second, in anticipation of a prospective UK-EU Free Trade Agreement (FTA), trade associations and legal firms began the process of drafting the details of a future financial services chapter, intended to provide UK and EU negotiators with a 'blueprint' for a post-Brexit agreement.[9]

The City also mobilised to communicate directly with EU political and business audiences, and to differentiate its position from the UK government. For example, its Brussels office engaged with commission officials, MEPs and key national embassies, while its special representative, the former minister Jeremy Browne, undertook a six-month tour of national capitals. In addition, the BBA established a European Banking Policy Network to encourage national associations across the EU to lobby their home government to maintain existing market access arrangements post-Brexit.[11] International financial groups also became increasingly active in lobbying around Brexit. The US Chamber of Commerce stepped up its engagement with UK and EU negotiators, while international trade associations, including the Global Financial Markets Association (GFMA), lobbied senior US administration officials to push for a long transition period.[13]

4. Mediating factors of financial power

We argue that the City's capacity to assert its latent structural power through instrumental channels of influence have been constrained by three factors: political statecraft, institutional structures, and business organisation.

Political statecraft

The single biggest obstacle to the City's influence was political statecraft. Prior to the 2016 referendum, the Cameron-led Government pursued an electoral strategy aimed at restoring the UK's public finances through fiscal austerity, and by creating conditions for growth with a pro-business agenda. At the EU level, this meant defending the interests of the UK financial services sector from new regulation and securing special protections from potential Eurozone caucusing – a key objective of Cameron's renegotiation of the terms of UK membership in February 2016 (Thompson 2017a).

The outcome of the referendum, and the election of Theresa May as Prime Minister, heralded a sudden shift in political statecraft in response to the immediate demands of party management. In the political vacuum that followed, the formulation of the government's Brexit policy over the summer of 2016 was strongly influenced by an unofficial Brexit Cabinet, whose members were close to the Eurosceptic 'All Souls Group' within the party. Given the Conservatives' slim parliamentary majority, they concluded that the government had little choice but to adopt a hard Brexit position, which meant ending freedom of movement, to secure the support of pro-Brexit backbenchers.

> 'I think there was a sense in Number 10 that they had to go for the more radical option in order to maintain party unity, given that the Brexiteers seem to be on the ascendency post the referendum, and they were the ones calling the shots.'[17]

During the autumn of 2016, the May Government set out to craft a new electoral strategy. To address the wider social grievances that were perceived to have contributed to Brexit, No.10 strategists, led by Chief of Staff Nick Timothy and Director of Strategy Chris Wilkins, used focus groups to build a new narrative based around 'fairness' (Wilkins 2018). This developed into a broader policy agenda which deliberately recast business power by seeking to ensure that 'big business lived up to its responsibilities' and protected the interests of 'ordinary working people' (see also Shipman 2017: 140-44). Private opinion polling suggested that this narrative was electorally popular and had the potential to attract significant numbers of non-traditional Conservative voters.

An industry lobbyist complained that the May Government deliberately sought to tap into 'a clear dislike for international finance' by downplaying warnings about disinvestment and avoiding being seen to 'protect banking jobs':

> ‘They are deaf by choice…They did not know when they made those initial choices at the Party Conference. But they went ahead anyway, which was gross negligence on their part. But once they were told they carried on anyway, because what you then saw was the Lancaster House speech.’[19]

The City’s ability to push back against the government’s new political statecraft was constrained by the fact that historically it rarely had to engage in open lobbying of the UK political process: rather, it tended to exert ‘quiet’ influence through institutionalised networks and informal connections within the British state (Moran 2009). Its influence was also weakened by the financial crisis: after a decade of perceived industry special pleading, ministers were highly sceptical of industry claims about job losses. For example, several industry claims about potential financial sector job losses made prior to the referendum, such as the 4,000 figure quoted by Jamie Dimon of JP Morgan, were viewed as counterproductive. In the eyes of many MPs, banks were too quick to ‘scream’ about Brexit, reinforcing the impression that the sector had a tendency to ‘scaremonger’.[20] In addition, ministers warned industry that public threats to disinvest risked weakening the position of UK negotiators, thereby contributing to a worse deal for UK financial services. For this reason, Chancellor Hammond privately appealed to industry leaders in late 2016 to tone down its rhetoric directed against the government.[21]

To rebuild its credibility with ministers, the sector was therefore forced to adopt a low-key role.

> ‘We took the lesson that we needed to observe a degree of restraint and comparative silence…There was a massive toning down from the industry post-referendum. It wasn't that our messages were no longer true, it was simply that we saw only downside risk in communicating them publicly.’[22]

This meant deliberately avoiding issues which were regarded as ‘too politically sensitive’:

> ‘The big issue that the industry didn't engage in is free movement of people…I was told at the time was that there was absolutely no way we can discuss that, because we’ve not felt the sharp end of the effects of globalisation.’[23]

Instead, trade bodies focused on developing analytical work in the belief that their ability to shape Brexit would ultimately rely on negotiators’ reliance on technical expertise, rather than efforts to influence the direction of travel.[24] As evidence, lobbyists cited ministerial acceptance that some form of transition period was necessary as a significant win for the City. Despite this, there was a widespread belief that the financial industry’s capacity to shape technical discussions about post-Brexit arrangements was hostage to the May Government’s higher-level political statecraft:

> ‘There’s a disconnect between technocratic arguments and the political arguments. We can have all the support that we want for some kind of pragmatic solution from the Bank of England and the Treasury. But no one’s willing to say anything or speak to European counterparts until such time as they have political cover to do so.’[25]

The Conservative Party’s failure to secure a parliamentary majority in the June 2017 General Election led to a re-evaluation of its political statecraft. In recognition that its Brexit policy failed to build an electoral winning strategy by alienating many Remain voters (Heath and Goodwin 2017), the government deliberately toned down its hard Brexit rhetoric. Despite this, the City was acutely aware that the government’s official position on Brexit was highly unlikely to change.[26] This was because the demands of party management, which became even more challenging as a result of election, effectively ruled out single market membership.

Institutional structures

A distinctive feature of the institutional context for business-government interaction in the UK was the so-called 'nexus'. This referred to the informal and closed networks that existed between the City of London, the Treasury and the Bank of England, which historically ensured that the financial sector's voice was well-represented in government (Moran 1991, Baker 1999, Hopkin and Shaw 2016). For this reason, the Treasury and Bank remained broadly sympathetic to the concerns of the industry over Brexit, and staged a series of interventions prior to and after the referendum detailing the economic costs of the UK's withdrawal.[27]

However, the impact of Brexit eroded the City's traditional channels of access into government by triggering major institutional reform within Whitehall. Since the UK's accession in 1973, the model for EU policy coordination revolved around the 'quad' of the Cabinet Office, Foreign and Commonwealth Office (FCO), the UK Permanent Representation (UKRep) in Brussels and, on economic and budgetary issues, the Treasury (James 2011). Following the referendum, Prime Minister Theresa May subverted this structure by establishing a new Department for Exiting the European Union (DExEU) responsible for leading the Brexit negotiations, coordinating activity across government, and undertaking policy work related to the UK's future relationship with the EU (House of Commons 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 changes challenged the City's instrumental influence within Whitehall. By centralising Brexit policy-making around No.10 and DExEU, the May Government deliberately closed down well-established channels of access. Prior to the 2017 General Election, business leaders reported that Theresa May was 'elusive' compared to her predecessor and that meetings with industry were far less frequent: 'Cameron and Osborne were very willing to associate themselves with the City, but we don't have that warmth with the current PM at all.'[28] Another lobbyist suggested that the financial industry 'struggled to get dialogue with No.10' because it was not used to dealing with a 'Home Office-led government'.[29] Senior ministers, including Theresa May and David Davis, reportedly favoured meetings with business representatives that spoke positively about Brexit: '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.'[30] By contrast, those who appeared too critical of Brexit were excluded.

At departmental level, DExEU was a 'black hole' to the industry: 'It was impenetrable, deliberately so, because they didn't want people coming and lobbying.'[31] Initial lobbying efforts therefore focused on the Treasury:

> 'We definitely focused on the Treasury. Is it easy to get to access some of the senior people in DExEU? Probably not. Is David Davis interested in us? No. His views on the banking sector are pretty well known.'[32]

Yet this strategy was undermined as the position of the Treasury was effectively downgraded following the Conservative Party conference, sparking a turf war with DExEU over ownership of financial services in the Brexit negotiations. A senior bank lobbyist noted: 'It became very clear what the relative standing of the Treasury was going to be and where financial services stood in the political hierarchy.'[33] Relations with the Bank of England also became increasingly strained by Brexit. While the trade associations continued to push for the retention of passporting rights into the EU, Governor Mark Carney clarified the Bank's position by stating that it did not want to be a 'rule taker' from the

EU after Brexit (Carney 2017a). In the eyes of industry, this intervention effectively ruled out a soft Brexit beyond a temporary transition phase:

> 'HSBC in particular were pushing [the EEA] as an option. But I think it was quashed by the Bank of England who were adamant that a financial services sector of this size could not realistically operate on that model.'[34]

In response, several banks decided to disengage altogether from trying to influence government policy:

> 'We didn't see any point as a bank in asking for a meeting with the Chancellor, let alone with anyone in No.10, because we didn't see any point in talking to them…By mid/late October, even some of the US banks, who had still been in very wishful thinking mode throughout August and September, suddenly started to hunker down and ramp up their contingency planning.'[35]

Far from asserting power over the UK's Brexit policy, one lobbyist suggested that the government's ability to control access created the risk of industry itself being captured:

> 'We constantly have to challenge ourselves about whether we are just being captured by the UK government. How the government shuts the financial sector out if it's not saying things that it wants to hear is a real big risk for us. Because over time the financial sector has ended up singing to the same tune as the government.'[36]

In response to the outcome of the June 2017 General Election, the government took steps to repair relations with business. To this end, a summit was convened by Brexit Secretary David Davis for UK business leaders in July 2017, and the Chancellor Philip Hammond established a new Brexit business advisory group to formalise consultation.[37] However, although relations with the business community certainly improved, there is little evidence that this translated into greater instrumental influence within government. Hence although firms became more vocal in their concerns after June 2017, they remained deeply sceptical that this would translate into a shift in the government's Brexit position:

> 'We were preparing and making contingency plans for a harder Brexit, and we took comfort in that. But now the election has opened it up and we're more uncertain. It could be positive, but it could also be even more negative as the chance of a disruptive Brexit, in which the negotiations break down, has probably increased.'[38]

The reshaping of institutional structures within Whitehall reflected a characteristic feature of the Westminster model of government. Governments frequently use ministerial reshuffles and departmental reconfiguration to further their party-political interests and policy goals (see Richards and Smith 2016). By centralising responsibility for Brexit in a new department, the government subverted pre-existing channels of business influence during a critical phase in the formulation of the UK's Brexit strategy.

Business organisation

The third factor constraining financial power was the historic fragmentation of business organisation in the City, compounded by divisions between key sub-sectors and firms over Brexit. This generated deep-rooted collective action problems that hampered the City's capacity to project a clear, consistent and credible message about the implications of Brexit.

During the referendum, the financial industry was constrained by electoral rules that required organisations to register with the authorities if they wished to campaign. Although the Corporation of London officially backed Remain, the main trade associations all decided to abstain from doing so, forcing them to go 'silent' during the final ten weeks of the campaign. This reflected a diversity of views on Brexit amongst their membership and the desire to 'hedge their bets' in light of the finely-balanced opinion polls. Most UK banks also withheld their formal support from the Remain campaign to avoid antagonising their retail customers, while Lloyds' Chairman Lord Blackwell was a vocal supporter of Brexit:

> 'If you have retail customers, it's a much more difficult decision. We all saw the backlash against firms that got involved in the Scottish referendum. If I was HSBC, I wouldn't finance the campaign. What do you do after the vote? You could end up being boycotted.'[39]

By contrast, US investment banks Morgan Stanley, JP Morgan, Goldman Sachs and Citigroup all donated money to the Remain campaign and were encouraged by government ministers to campaign publicly in the UK. Yet, some in the Remain campaign viewed these interventions as counterproductive.

> 'The big US investment banks have always been cheerleaders for the EU single market. We gave money to the Remain campaign which I think was unprecedented for us…We did a lot during the campaign, but we were very cautious as to how we pitched it, because we know it's not always helpful for big American investment banks to be telling people how to vote.'[40]

Following the referendum, efforts to augment the City's lobbying capacity were hampered by 'trade association politics' as competing groups vied to play the lead role.

'What you saw was a slightly unseemly scramble in the form of EFSCAC. Which was partly a vehicle for self-promotion, partly a sense of desperation. In any event it was badly executed, not representative, not very influential…I would argue with no output at all in terms of influencing government policy.'[41]

Resistance was apparent from certain parts of the sector: for example, powerful US banks opposed the push to channel their message through EFSCAC, 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 executive describing the situation as a 'complete dog's breakfast'.[42] Following protests from smaller financial firms that they were under-represented, and that the large banks would dominate relations with government, the EFSCAC was eventually subsumed into the The CityUK in early 2017.

The ineffectiveness of the City's organisation reflected the differentiated impact of Brexit on sub-sectors and individual firms, making it difficult to form a coherent industry position. While the preference of the main financial trade associations was to retain mutual access to the EU single market, around a third of organisations in the City openly supported Brexit. Eurosceptic views were mostly concentrated within the non-banking sector, particularly amongst investment funds and asset managers. These firms were generally less dependent on passporting into the EU single market, and their experience of Brussels regulation was shaped by post-crisis Franco-German efforts to regulate what they perceived as the vultures of capitalism (Quaglia 2011). As a result, many hedge funds were prominent contributors to the Leave campaign, funding a rival 'City for Britain' group during the referendum, and establishing the pro-Brexit Financial Services Negotiating Forum to counter the influence of the City's official bodies. Since the referendum, many 'pushed hard' to use Brexit as an opportunity to roll back EU financial legislation, such as the Alternative Investment Fund Managers' Directive.[43] For its part, the investment fund industry deliberately sought to differentiate itself from the banks by not presenting Brexit as a binary choice over single market membership:

> 'As an industry, we haven't said this is a disaster for us because there are ways in which our industry can, on a very technical level, overcome obstacles without access to the single market… We have a different set of priorities [from the banks] and they are not quite as polarised…That puts us in a better position to have a more constructive dialogue.'[44]

As Brexit negotiations got underway, new fault lines even emerged within the banking sector. For example, US and EU wholesale banks, together with UK banks with large investment operations (HSBC and Barclays), were vocal in lobbying the government for a soft Brexit because their business models rely on using London as a hub to passport services across the EU. By contrast, retail-focused UK banks were 'less engaged' and more relaxed about the prospect of hard Brexit, and were more concerned about the prospect of the UK becoming a regulatory rule-taker post Brexit:

> 'As a wholesale bank, we would rather give up the influence over rules being made and have access to the single market than not…Now the Bank of England, and banks that have just a domestic footprint, they don't want to be rule takers and they're not really very fussed about the single market. So the trade-offs are different.'[45]

The different priorities of retail and investment banks were also apparent over the content of a future UK-EU Free Trade Agreement. Work conducted within the City on a prospective FTA focused on addressing the needs of the investment banks; how to incorporate the interests of retail customers was far more problematic and an area that highlighted 'the difference in the interests of the industry'.[46]

Finally, the ability of wholesale banks to 'credibly' threaten to disinvest was undermined by the lack of a coordinated sectoral response. For example, while Deutsche Bank and JP Morgan initially warned of the need to relocate up to 4,000 staff, Morgan Stanley and Citigroup referred to moving only a few hundred jobs.[47] This reflected significant variation in bank business models: while some US banks concentrated staff in London (JP Morgan) and therefore had greater potential to relocate staff, others already had staff spread across several EU states (Citigroup) and therefore had less reason to do so.

In summary, the financial sector centered in the City faced multiple obstacles to effective business organisation. These were rooted in disincentives for collective action generated by the variegated impact of Brexit on different financial sub-sectors and firms' business models. This not only explains why the industry often struggled to project a coherent message, but also why policy makers became increasingly sceptical of industry claims about the longer-term economic costs of Brexit.

5. Conclusion

A defining characteristic of the British national business model is a large, internationalised financial sector. The growth of the City 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. The interests of the industry were 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 excluded single market membership. This article set out to explain how and why the 'City' (represented by its main lobby groups and most prominent financial firms) were not more effective in defending their interests around Brexit, and to make a broader contribution to theories of business power. We claim that the City had considerable latent structural power due to the sector's pre-eminence in the UK economy. Our findings also show that it frequently sought to deploy this strategically in an effort to shape the political agenda around Brexit, both before and after the EU referendum. The clearest illustration of this was how large banks signalled their intention to 'exit' by relocating staff and/or investment activities to the EU27 in the event of a bad Brexit deal. The City was also active in using instrumental mechanisms of power, augmenting its collective lobbying capacity in anticipation of the Brexit negotiations, and generating independent analysis on the economic costs of Brexit aimed at feeding into Whitehall impact assessments and shaping the thinking of ministers and officials.

Despite this, the City was surprisingly unsuccessful in shaping the UK government's Brexit policy due to three factors. First, the influence of the financial sector was severely constrained by political statecraft. Motivated by the need to build a new electoral winning strategy (focused on capturing pro-Leave voters) and the demands of party management (satisfying the demands of Eurosceptic backbench MPs), the new May Government pursued a hard Brexit policy which led to the downgrading of the City's interests. Second, departmental reconfiguration associated with the Brexit negotiations, together with deliberate attempts by ministers to control and restrict access to key decision makers, undermined the influence that City lobbyists had historically enjoyed within the UK polity. Third, the financial sector faced significant obstacles in its ability to organise and lobby collectively around Brexit. This stemmed from the variegated impact of Brexit on different financial sub-sectors and firms: for example, while large US investment banks continued to campaign for full passporting rights to protect their business model, UK retail-focused banks were notably less vocal in their concerns about the UK's withdrawal from the EU, while many firms in the non-banking sector actively campaigned for Brexit.

The article aims to make a broader contribution to the development of a new research agenda on Brexit, drawing on both comparative and international political economy. For example, Farrell and Newman (2017) have called for the analysis of electoral politics to be better incorporated into theories of new interdependence. They argue that Brexit highlights how globalisation is not simply an exogenous shock interpreted by domestic political institutions, but can lead to the transnationalisation of policy issues and create new opportunity structures for parties and voters to mobilise for or against economic interdependence. Brexit can be viewed as a populist challenge to globalisation to the extent that it drew support from the economically-disadvantaged and 'left-behind' (Hopkin 2017). Paradoxically, it was also supported by 'hyper-globalisers' (Rodrik 2011) who advocated a 'Global Britain' unencumbered by EU regulation and free to sign new trade deals. In setting out their vision for 'third generation' research on Brexit from an Open Economy Politics perspective, Owen and Walter (2017) suggest that scholars should focus on explaining when and why material economic interests dominate preferences on international economic policy issues, and when and why ideas and values matter more.

Our case study contributes to both calls for further research by showing how and why the interests and influence of powerful transnational firms in the City of London declined in the wake of the Brexit vote. It does so by specifying a series of scope conditions for business power; that is, the boundaries or parameters of the theory which identify the empirical phenomena to be explained. Our analysis of the UK financial services sector highlights three scope conditions under which business can translate its latent structural power into effective forms of instrumental influence. First, business power is conditional on the nature of the incentives generated by political statecraft. Brexit highlights the importance of electoral 'shocks' and the demands of building an electoral winning strategy and party management, both of which can lead governments to marginalise the concerns of powerful interest groups in the pursuit of electoral success. Second, business power relies on institutionalised structures which enable firms to strategically exert their structural power by signalling that their claims about economic costs are credible and trustworthy (James 2017). Equally, however, Brexit reveals how business power can be constrained when institutions are reconfigured and established channels of access are deliberately closed down by ministers. Finally, business power is dependent on the capacity of industry to organise collectively and to send a coherent message to policy makers. Where the effectiveness of business organisation is limited by heterogeneous preferences and weak coordination, policy makers have reason to doubt the veracity of firms' threats to 'exit'.

Brexit highlights in stark terms the extent to which business power reflects: a deliberate *choice* on the part of policy makers to facilitate business influence in the policy process; and is consciously *constructed* by policy makers to justify particular policy decisions and outcomes. Overall, governments have considerable autonomy to push back against business influence, even when large firms are actively taking steps to relocate jobs and investment overseas. A critical remaining question is how long the political imperatives driving hard Brexit can take precedence over economic pressures, or indeed whether these can ultimately be reconciled? As the negotiations unfold, the City of London therefore promises to provide an important test case for future research on the contingency of business power over time.

---

[1] The research for this article was conducted while Scott James held a visiting position at the Blavatnik School of Government, University of Oxford.

[2] This paper was partly written while Lucia Quaglia was a research fellow at the BIGSSS (University of Bremen) and the Hanse-Wissenschaftskolleg (HWK) and subsequently research fellow at the Scuola Normale Superiore, Florence.

[3] Interview, UK bank, 12 June 2017.

[4] See The Guardian (2016) 'JP Morgan backs campaign to keep Britain in the EU', 21 January 2016.

[5] Reuters (2017) 'Bank planning to move 9,000 jobs from Britain because of Brexit', http://uk.reuters.com/article/uk-britain-eu-banks-idUKKBN184132.

[6] Interview, UK bank, 14 June 2017.

[7] Financial Times (2017) 'City of London lobbying group drops demand for EU "passport"', 12 January 2017. See also HM Government (2017).

[8] Interview, trade association, 12 July 2017.

[9] Interview, trade association, 19 June 2017. See also Financial Times (2017) 'City of London delegation to press Brussels for free-trade deal', 3 July 2017.

[11] Interview, trade association, 19 June 2017.

[13] Interview, US bank, 26 July 2017.

[17] Interview, UK bank, 10 July 2017. See also Huffington Post (2017) 'Theresa May Has Just Promoted The Man Who Could Have Destroyed Her', 13 June 2017.

[19] Interview, UK bank, 18 July 2017.

[20] Interview, UK bank, 14 June 2017.

[21] Interview, trade association, 19 June 2017.

[22] Interview, UK bank, 18 July 2017.

[23] Interview, trade association, 18 July 2017.

[24] Interview, UK bank, 14 June 2017.

[25] Interview, UK bank, 14 June 2017.

[26] Interview, trade association 19 June 2017; and private conversation with City lobbyist, 6 September 2017.

[27] For example, the Treasury (2016) predicted up to 500,000 job losses and a reduction in GDP by 3.6% a year. See also The Guardian (2016) 'Mark Carney fears Brexit would leave UK relying on "kindness of strangers"', 26 January 2016 and.

[28] Interview, UK bank, 14 June 2017. See also Financial Times (2017) 'Theresa May ensures only Brexit key allows entry to No.10', 12 April 2017.

[29] Interview, trade association, 19 June 2017.

[30] Financial Times (2017) 'Theresa May ensures only Brexit key allows entry to No.10', 12 April 2017.

[31] Interview, UK bank, 18 July 2017.

[32] Interview, US bank, 17 July 2017.

[33] Interview, UK bank, 18 July 2017.

[34] Interview, UK bank, 10 July 2017.

[35] Interview, UK bank, 10 July 2017.

[36] Interview, trade association, 18 July 2017.

[37] Financial Times (2017) 'Ministers set up business advisory group with Brexit focus', 27 June 2017.

[38] Interview, UK bank, 14 June 2017.

[39] Interview, trade association, 16 June 2017.

[40] Interview, US bank, 17 July 2017.

[41] Interview, UK bank, 18 July 2017.

[42] Reuters, 'Britain's financial sector at odds over Brexit lobbying', 20 September 2016.

[43] Interview, US bank, 17 July 2017.

[44] Interview, trade association, 18 July 2017.

[45] Interview, US bank, 26 July 2017.

[46] Interview, UK bank, 10 July 2017.

6. References

Baker, A. (1999), 'Nebuleuse and the 'Internationalization of the State' in the UK? The Case of HM Treasury and the Bank of England', *Review of International Political Economy*, 6 (1), pp. 79-100

Bell, S. and Hindmoor, A. (2017), 'Structural Power and the Politics of Bank Capital Regulation in the United Kingdom', *Political Studies,* 17 (1), pp. 103–121.

Bell, S. and Hindmoor, A. (2015), 'Taming the City? Ideas, Structural Power and the Evolution of British Banking Policy Amidst the Great Financial Meltdown', *New Political Economy* 20 (3), pp. 454-474.

Brown, A. (2016), 'Brexit politicians are putting us on a fast track to financial jeopardy', *The Guardian*, 22 October.

Bulpitt, J. (1986), ‘The Discipline of the New Democracy: Mrs Thatcher’s Domestic Statecraft’, *Political Studies*, 34 (1), pp. 19-39.

Carney, M. (2017) Hearing before the Treasury Committee, January, London.

The CityUK (2016a), *Leaving the EU: Implications for the UK financial services sector*’, April, available at https://www.pwc.co.uk/financial-services/assets/Leaving-the-EU-implications-for-the-UK-FS-sector.pdf

The CityUK (2016b), *The Impact of the UK’s Exit from the EU on the UK Based Financial Services Sector,* October, available at https://www.thecityuk.com/assets/2016/Reports-PDF/The-impact-of-the-UKs-exit-from-the-EU-on-the-UK-based-financial-services-sector.pdf

The CityUK (2017), *Brexit and UK-based Financial and Related Professional Services*, January, available at https://www.thecityuk.com/assets/2017/Reports-PDF/Brexit-and-UK-based-financial-and-related-professional-services.pdf

Culpepper, P. (2011), *Quiet Politics and Business Power: Corporate Control in Europe and Japan,* (Cambridge: Cambridge University Press).

Culpepper, P. and Reinke, R. (2014), ‘Structural Power and Bank Bailouts in the United Kingdom and the United States’, *Politics and Society* 42 (4), pp. 427–454.

Farrell, H. and Newman, A.L. (2015), ‘Structuring Power: Business and Authority beyond the Nation State’, *Business and Politics* 17 (3), pp. 527-552.

Farrell, H. and Newman, A.L. (2017), ‘BREXIT, Voice and Loyalty: Rethinking Electoral Politics in an Age of Interdependence’, *Review of International Political Economy* 24 (2), pp. 232-247.

Fioretos, O. (2010), ‘Capitalist Diversity and the International Regulation of Hedge Funds’, *Review of International Political Economy* 17 (3), pp. 696–723.

Hacker, J. and Pierson, P. (2002), ‘Business Power and Social Policy’, *Politics and Society* 30 (2), pp. 277–325.

Heath, O. and Goodwin, M. (2017), ‘The 2017 General Election, Brexit and the Return to Two-Party Politics: An Aggregate-Level Analysis of the Result’, *The Political Quarterly* 88 (3), pp. 345-58.

HM Government (2017), *The United Kingdom’s Exit from, and New Partnership with, the European Union White Paper*, CM 9417, 2 February 2017, London: HM Stationery Office.

HM Treasury (2016), *Analysis of the Long-Term Economic Impact of EU Membership and the Alternatives*, April, available at https://www.gov.uk/government/publications/hm-treasury-analysis-the-long-term-economic-impact-of-eu-membership-and-the-alternatives

Hopkin, J. (2017) 'When Polanyi met Farage: Market fundamentalism, economic nationalism, and Britain's exit from the European Union', *British Journal of Politics and International Relations*, online first, DOI: 10.1177/1369148117710894.

Hopkin, J. and Shaw, K.A. (2016), 'Organized Combat or Structural Advantage? The Politics of Inequality and the Winner-Take-All Economy in the United Kingdom', *Politics & Society* 44 (3), pp. 345–371.

House of Commons (2016), 'Equipping the Government for Brexit', Report of the Foreign Affairs Committee. Accessed at http://www.publications.parliament.uk/pa/cm201617/cmselect/cmfaff/431/43102.htm. On 20 September 2017

House of Lords (2016), *Brexit: Financial Services*, EU committee, December, London.

Howarth, D. and Quaglia, L. (2017), 'Brexit and the Single Financial Market', *Journal of Common Market Studies Annual Review* 55 (S1), pp. 149-64.

Howarth, D. and Quaglia, L. (2016), *The Political Economy of European Banking Union* (Oxford: Oxford University Press).

International Regulatory Strategy Group (IRSG) (2017) 'The EU's Third Country Regimes and Alternatives to Passporting'. Report produced with Hogan Lovells for The CityUK and the City of London, 23 January 2017. Available at https://www.thecityuk.com/assets/2017/Reports-PDF/The-EUs-Third-Country-Regimes-and-Alternatives-to-Passporting.pdf. Accessed on 20 September 2017

James, S. (2017), 'The Structural-Informational Power of Business: Credibility, Signalling and the UK Banking Reform Process', *Journal of European Public Policy*. DOI: 10.1080/13501763.2017.1349166.

James, S. (2011), *Managing Europe from Home: The Changing Face of European Policy Making under Blair and Ahern* (Manchester: Manchester University Press).

Lindblom, C. (1982), 'The Market as Prison', *Journal of Politics*, 44 (2), pp. 324–336.

Moran, M. (2009), *Business, Politics and Society: An Anglo-American Comparison* (Oxford: Oxford University Press).

Moran, M. (1991), *The Politics of the Financial Services Revolution: The USA, UK and Japan* (Basingstoke: Macmillan).

Olson, M. (1965), *The Logic of Collective Action* (Cambridge: Harvard University Press).

Owen, E. and Walter, S. (2017), 'Open Economy Politics and Brexit: Insights, Puzzles, and Ways Forward', *Review of International Political Economy* 24 (2), pp. 179-202.

Pagliari, S. and Young, K. (2014), 'Leveraged Interests: Financial Industry Power and the Role of Private Sector Coalitions', *Review of International Political Economy* 21 (3), pp. 575-610.

Quaglia, L. (2011) ‘The ‘Old’ and ‘New’ Political Economy of Hedge Funds Regulation in the European Union’, *West European Politics,* 34 (4): 665-682.

Richards, D. and Smith, M. (2016), ‘The Westminster Model and the “Indivisibility of the Political and Administrative Elite”: A Convenient Myth Whose Time Is Up?’, *Governance*, 29 (4), pp. 499-516.

Rodrik, D. (2011), *The Globalization Paradox: Democracy and the Future of the World Economy*. (New York and London: W.W. Norton.)

Shipman, T. (2017), *Fall Out: A Year of Political Mayhem* (London: William Collins)

Thompson, H. (2017a), ‘Inevitability and Contingency: The Political Economy of Brexit’, *British Journal of Politics and International Relations*, DOI: 10.1177/1369148117710431.

Thompson, H. (2017b), ‘How the City of London lost at Brexit: a Historical Perspective’, *Economy and Society*, DOI: 10.1080/03085147.2017.1359916

Wilkins, C. (2018), speech by Chris Wilkins, former Chief Speechwriter to Theresa May and No.10 Director of Strategy to the ‘Brexit and Public Opinion Conference’, UK in a Changing Europe, 5 February 2018. Available at http://ukandeu.ac.uk/chris-wilkins-speech-from-the-brexit-and-public-opinion-conference.

Woll, C. (2016), ‘Politics in the Interest of Capital: A Not-So-Organized Combat’, *Politics and Society* 44 (3), pp. 373–391.