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Brexit, the City and the Contingent Power of Finance

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Abstract

Brexit poses a profound challenge to the economic fortunes of the UK financial services sector because it threatens to sever its access to the EU single market. Recognising this, the City of London's largest financial firms and main representative bodies supported a Remain vote in the June 2016 EU referendum, and have subsequently lobbied for a 'soft' Brexit policy to preserve the City's lucrative passporting rights. Despite this, the government led by Theresa May has pursued a 'hard' Brexit policy which will 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 while the UK financial sector continues to wield formidable latent structural power, its capacity to translate this into instrumental influence in the policy process is 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 has undermined the City's voice within government; and constraints on *business organisation*, caused by collective action problems and heterogeneous preferences. We argue that these three factors constitute important scope conditions which highlight the contingent power of finance in liberal market economies.

Keywords

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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, 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 UK financial industry, benefitted greatly from EU financial integration over recent decades, with over 30% of financial services exports now destined for the EU27. 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, Macartney 2010, Quaglia 2012, 2014). Similarly, the literature on business power would predict that the City should exert significant influence in the UK policy process, given the dependency of the UK state on financial services and the formidable lobbying capacity of the industry (Baker 2010, Bell and Hindmoor 2015, 2017, Hopkin and Shaw 2016, Thompson 2017a,b, Woll 2014, 2016). 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).

Despite this, the City has been 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.

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Although the outcome of the June 2017 General Election has led to a change of tone regarding Brexit and improved relations with business, the government's official position remains unchanged. This is potentially highly damaging for the City's interests, and the wider UK national business model. Two questions arise. 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 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 the City of London's apparent lack of success in shaping the government's 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 influence is constrained by three factors. First, Brexit has 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 has undermined the City's access to key decision makers and weakened the representation of its interests. Third, business organisation around Brexit has been constrained by collective action problems and heterogenous preferences within industry. These three factors have given the May Government significant autonomy from organised financial interests in defining the UK's Brexit policy. As such, we argue that 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.

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The empirical research for the paper is based on anonymous interviews conducted with twelve individuals between June and August 2017 from a cross-section of organisations, including 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 the City with reference to Brexit. Section 4 analyses three factors that have constrained the capacity of the City to shape the UK's Brexit policy. Section 5 concludes by reflecting on the wider theoretical contribution of the paper.

2. State of the art on business power

The business power literature identifies two main sources of business influence: structural power and instrumental power. Structural power recognises that governments are dependent on investment decisions by business to sustain economic growth and fund public services (Lindblom 1977, 1982, Przeworksi and Wallerstein 1998, Swank 1992). 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).

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Recent contributions emphasise the mutual dependency of the two forms of business power. Culpepper and Reinke (2014) distinguish 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 (Fairfield 2015: 422-3). Equally, a firm's structural position in the economy directly shapes its bargaining strength in negotiations with policy makers (Culpepper and Reinke 2014: 436). Blurring the distinction further, 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'. Ultimately, however, empirical analysis of business power must deal with the methodological challenge posed by the problem of observational equivalence between the effects of instrumental and structural power (Culpepper 2015: 396).

We seek to contribute to this literature through the further specification of the relationship between structural and instrumental power. In particular, the paper aims to define 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.

The first concerns the impact of *political statecraft* on business power. Theories of structural power rest on assumptions of voter rationality and economic self-interest; that is, the concerns of business

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are pre-eminent because governments fear the electoral consequences of business disinvestment. Empirically, however, this determinism is problematic because politics often trumps economics as an electoral priority (see Smith 2000, Hacker and Pierson 2002). To address this, we draw on the neo-statecraft literature (Bulpitt 1986, 1988, James 2016, Thompson 2017b) to argue that business power is contingent on elected officials' pursuit of political statecraft. Statecraft is a theory of executive politics which assumes that the primary motive of elected officials is to win elections, enabling them to wield power in government (Bulpitt 1986: 21). Electoral success is achieved through a series of 'political support mechanisms', including building a winning electoral strategy, effective party management, and demonstrating governing competence (Bulpitt 1986: 22). Political statecraft is important because it determines how business power is inter-subjectively constructed by elected officials.

Building on Bell (2012) and Bell and Hindmoor (2017), we argue that statecraft provides the ideational lens through which government confronts, interprets and reacts to threats of business disinvestment. Hence, when elected officials pursue an electoral winning strategy around pro-business issues, policy choices will be justified through a construction of business power which stresses the importance of private sector 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 interests of firms. From this perspective, business power can therefore vary over time, and change suddenly, in response to electoral developments. This is because elections serve as focusing events against which the effectiveness of political statecraft can be judged. When governments suffer unexpected electoral defeats, this can lead to the 'alarmed discovery' of new policy issues as elected officials seek to address voters' concerns and build a new electoral winning strategy (Baumgartner and Jones 2009).

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Second, the importance of *institutional structures* in conditioning business power is well-established. Streeck and Schmitter (1985) argue that the configuration of state authority, bureaucratic interests, legal norms, informational needs and sectoral specificities shape the character and effectiveness of business lobbying. According to this 'logic of influence', the state is capable of selecting and moulding interaction with business to serve its longer-term functional imperatives. Similarly, Hacker and Pierson (2002) highlight the importance of political institutions, arguing that the centralisation of power and strengthening of state capacity reduces the structural power of business. Vice versa, Bell and Hindmoor (2017) argue that in the run-up to the global financial crisis changing institutional context in the UK strengthened the banks' influence on public policy. Furthermore, powerful unelected officials may have their own institutional or bureaucratic interests and policy agendas, which are more concerned with the accumulation of power or the preservation of autonomy than with satisfying the demands of private interests (Dunleavy 1991). Culpepper (2011) highlights the importance of institutional governance. When policy issues are low salience, business can rely on the 'quiet politics' of access to influence government as issues are delegated to 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 (pp 180-1). By restructuring the institutional context of business-government interaction, political actors can reconfigure the players, the resources at their disposal, and the 'rules of the game' for decision making (James 2017).

Third, the influence of firms is constrained by *business organisation*. The capacity of firms to organise and lobby collectively through trade associations is an important source of business influence. Theories of collective action tell us that the concentrated nature of the economic costs and

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benefits of regulation provides a powerful incentive for individual firms to work together when lobbying (Olson 1965). This enables business to mobilise a broad coalition of firms and interest groups in order to leverage their influence in the policy process (Pagliari and Young 2014: 576). Yet the capacity of business to engage in collective action is frequently undermined by divisions within the business community (Hacker and Pierson 2002: 280, Smith 2000: 13-7). Regulation creates winners as well as losers amongst firms and sectors, creating the conditions for heterogenous preferences and encouraging firms to compete against one another for influence (Gray and Lowery 1998, Emmenegger 2015, Farrell and Newman 2015, Young 2015). The empirical literature suggests that a firm's decision over whether to lobby individually or collectively is a function of the importance and scope of an issue to the business (Hula 1995, 1999). Hojnacki (1997) adds that a firm's desire to retain autonomy, and the level of organisation of opposing groups, are also important determinants of business organisation.

By mediating between structural and instrumental power, these three factors condition industry's capacity to translate its latent structural power into instrumental influence within the policy process. 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 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. The sector contributes more than 7% of UK GDP, 12% of PAYE income tax and national insurance, and 15% of onshore

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corporation tax in the UK. Financial and related professional services pay 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 has been a consistent and vocal supporter of the UK's membership of the EU (for a good overview, see Thompson 2017a,b). During the referendum, the City's main representative bodies mobilised in earnest to translate its structural position into instrumental influence. It focused its efforts on providing 'hard facts and figures', commissioning a plethora of reports detailing the industry's contribution to the UK economy, the benefits of EU membership, and the economic cost that would ensue from Brexit (The CityUK 2016a, b, c, d, BBA 2014, Brown 2016). The trade associations also targeted key MPs during the campaign, supplying them with detailed information on 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.'[iii]

The international character of the UK financial sector provides significant opportunities for relocation in response to unfavourable policies. Global banks have explicitly used the threat of 'exit' in order to assert structural power over the Brexit debate. For example, in the run up to the referendum, JP Morgan publicly threatening to 'quit' the UK in the event of a vote for Brexit.[iv] Following the result,

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Anthony Browne, 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.[v] Douglas Flint, Chairman of HSBC, also 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). 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 has also wielded 'structuring' power by expanding the availability the exit options to it (Farrell and Newman 2016). From autumn 2016 onwards, several financial institutions have announced plans to relocate staff to the EU27.[vi] 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; 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 (Schoenmaker and Véron 2016). Relocating staff prior to the commencement of the Brexit negotiations constitutes contingency planning in the event that passporting rights are lost. But it is also a strategic act intended to signal the credibility of banks' capacity to exit the UK in the event of a bad deal.[vii]

The Prime Minister's party conference speech in October 2016, at which she announced that the UK intended to end free movement and ECJ jurisdiction, came as a huge shock to the industry.

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> 'There was an absolute stunned reaction which left us all at least for the next twenty-four hours in a complete funk because it was clear to us that Number 10 didn't understand what the impact of that announcement was in terms of the timescale for the Article 50 process.'[viii]

The sector responded by embarking on a more substantial reorganisation of its lobbying activities. To provide more effective coordination across the sector, Santander UK boss Baroness Shriti Vadera established a new lobby group, European Financial Services Chairmen's Advisory Committee (EFSCAC). The EFSCAC established a sizeable secretariat and a series of work streams for each of the main financial sub-sectors represented in the City, each headed by a dedicated industry 'sherpa' and supported by the relevant trade associations. These work streams set out to interrogate every piece of EU financial legislation to assess the impact of different Brexit scenarios and transition arrangements. This activity plays 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 quietly influencing UK negotiators behind the scenes.

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.[ix] It also organised public events in key member states to highlight the costs of a hard Brexit for the real economy on the continent.[x] International financial groups also became increasingly active in lobbying around Brexit. The US Chamber of Commerce stepped up its engagement with UK and EU

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negotiators, while international trade associations, including the Global Financial Markets Association (GFMA), lobbied senior US administration officials to push for a long transition period.[xi]

Since June 2016, the City's position on Brexit has shifted in response to political developments. In the immediate aftermath of referendum, the main associations united in calling for a soft Brexit to preserve the financial sector's 'access to the Single Market on terms that resemble as closely as possible the access the UK currently enjoys' (The CityUK 2016c). Following the Prime Minister's Lancaster House speech in January 2017 which ruled out membership of the single market, a pledge that was then enshrined in the Government's White Paper in February 2017, the City dropped its demand for full passporting rights.[xii] Instead, it called for a 'bespoke agreement' based on 'mutual market access', a framework for the 'mutual recognition' of regulatory regimes, 'close cooperation' between UK and EU supervisory authorities, and clear transition arrangements (The CityUK 2017).

Since then, the City's bodies have re-focused their efforts to shape the policy debate in two ways. First, they set out to quantify the economic costs of a 'cliff edge' scenario in which no deal is reached, and to analyse why existing regulatory practices, based on third country equivalence rules, provide an inadequate basis for future UK-EU relations (IRSG 2017). This work forms the basis of key industry 'asks' which have been communicated informally to DExEU and the Treasury to feed into Whitehall impact assessments on Brexit and to help 'inform' the strategy of UK negotiators.[xiii] Second, in anticipation of a prospective UK-EU Free Trade Agreement (FTA), trade associations and legal firms have begun 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.[xiv] The City's decision to back down on its demands for a soft Brexit is symbolic of an industry that has struggled to shape the May Government's Brexit policy. The following section explains why.

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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 has been political statecraft. From the perspective of industry, the formulation of the government's Brexit policy over the summer of 2016 was a product of the short-term demands of party management. Given the Conservatives' slim parliamentary majority, May calculated that she had to adopt a hard Brexit position to secure the support of her Eurosceptic backbenchers. In the political vacuum that followed the referendum result, government policy was shaped by an unofficial Brexit Cabinet, many of whom were close to the Eurosceptic 'All Souls Group' within the Conservative Party.

> '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.'[xv]

During autumn 2016, the May Government sought to build a new electoral winning strategy around Brexit. The referendum result was interpreted by the Prime Minister as a clear signal that voters wanted the government to end freedom of movement and control EU immigration, not 'protect

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banking jobs'.[xvi] An industry lobbyist complained that the May Government sought to tap into 'a clear dislike for international finance' and deliberately chose to ignore warnings about disinvestment:

> '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.'[xvii]

The City's ability to push back against the government's Brexit statecraft was limited by the fact that it is historically poor at fighting political battles (Moran 2009). This was compounded by the sector's response to the financial crisis and its opposition to regulatory reform. 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 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'.[xviii] In addition, ministers warned industry that public threats to disinvest risk 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.[xix]

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

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messages were no longer true, it was simply that we saw only downside risk in communicating them publicly.'[xx]

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.'[xxi]

Instead, trade bodies have focused on developing analytical work in the belief that their ability to shape Brexit will ultimately rely on negotiators' reliance on industry expertise and technical analysis, rather than efforts to influence the direction of travel.[xxii] As evidence, lobbyists cite ministerial acceptance that some form of transition period is necessary as a significant win for the City. Despite this, there is a widespread belief that the financial industry's capacity to shape technical discussions about post-Brexit arrangements are 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.'[xxiii]

The Conservative Party's failure to secure a parliamentary majority in the June 2017 General Election has 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

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government has deliberately toned down its hard Brexit rhetoric. Despite this, the City is acutely aware that the government's official position on Brexit is highly unlikely to change.[xxiv] This is because the demands of party management, which have been made more – not less – acute by the election result, effectively rules out single market membership. The incentives for the government arising from political statecraft therefore continue to point towards a hard Brexit.

Institutional structures

A distinctive feature of the institutional context for business-government interaction in the UK is the so-called 'nexus'. This refers to the informal and closed institutional networks that exist between the City of London, the Treasury and the Bank of England, which have historically ensured that the financial sector's voice is 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.[xxv]

However, the impact of Brexit has 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

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(House of Commons 2016a). 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.'[xxvi] 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'.[xxvii] 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.'[xxviii] 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.'[xxix] 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.'[xxx]

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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.'[xxxi]

Relations with the Bank of England also became increasingly strained by Brexit. While the City 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 post Brexit (Carney 2017a). In the eyes of industry, this intervention effectively rules out a soft Brexit, at least beyond a temporary transition period:

> '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.'[xxxii]

Prominent figures within the central bank are also known to view Brexit as an opportunity for UK regulators to 'goldplate' EU regulation and strengthen supervision of large EU banks based in London. 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

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> 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.'[xxxiii]

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.'[xxxiv]

In response to the outcome of the June 2017 General Election, the government has taken steps to repair relations with the business community. 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.[xxxv] Although this has encouraged firms to be more vocal in their concerns, they are sceptical that the election will lead to a softer Brexit:

> '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.'[xxxvi]

More fundamentally, the government's position on Brexit remains unchanged since the election. Hence, although relations with the business community have improved and been placed on a firmer

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institutionalised footing, there is no evidence that this has translated into greater instrumental power within government.

Business organisation

The third factor constraining financial power is the historic fragmentation of business organisation in the City, compounded by divisions between key sub-sectors and firms. These have generated deep-rooted collective action problems that have 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 last 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.'[xxxvii]

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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.'[xxxviii]

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.'[xxxix]

Resistance was apparent from certain parts of the sector: for example, powerful US banks opposed the push to channel their message through the new 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'.[xl] Following protests from smaller financial firms that they were under-represented, and

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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 is to retain mutual access to the EU single market, around a third of organisations in the City openly support Brexit. Eurosceptic views have traditionally been concentrated within the non-banking sector, particularly amongst investment funds and asset managers. These firms are generally less dependent on EU markets and their experience of Brussels regulation has been shaped by post-crisis Franco-German efforts to regulate what they perceived as the vultures of capitalism (Woll 2016). As a result, many hedge funds were prominent contributors to the Leave campaign, funding a rival 'City for Britain' group during the referendum (Politico 2016), and establishing the pro-Brexit Financial Services Negotiating Forum to counter the influence the City's official bodies. Since the referendum, many have been 'pushing hard' to use Brexit as an opportunity to roll back recent EU financial legislation, such as the Alternative Investment Fund Managers' Directive and the Solvency II Directive.[xli] For its part, the investment fund industry has 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.'[xlii]

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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 are 'less engaged' and more relaxed about the prospect of hard Brexit, and are 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.'[xliii]

The different priorities of retail and investment banks are also apparent over the content of a future UK-EU Free Trade Agreement. Work conducted thus far within the City on a prospective FTA has focused on addressing the needs of the investment banks; how to incorporate the interests of retail customers will be much more difficult and is recognised as an area likely to highlight 'the difference in the interests of the industry'.[xliv]

Finally, collective action problems at the EU level have hampered efforts by the UK industry to build a wider transnational coalition to lobby against Brexit. Many trade associations in other EU states have close links with their home government, and view Brexit as an opportunity to grow their own domestic industry by attracting business away from the City. In addition, the sector has made little progress engaging with the EU negotiating team, led by Michel Barnier, because of their refusal to discuss the future UK-EU relationship until they are given a formal negotiating mandate. UK trade

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associations face a particular challenge wielding influence in Brussels because they are perceived as representing narrow UK interests:

> 'We've found it very difficult to find a voice to express our issues in Europe…It's very difficult to express this as a kind of pan-European issue, and not be seen to be motivated by the self-interests of protecting your country. That's the reaction we get when we go across Europe: you're just interested in protecting the UK.'[xlv]

The financial sector therefore faces multiple obstacles to effective business organisation. These are rooted in disincentives for collective action generated by the highly variegated impact of Brexit on different financial sub-sectors/firms.

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 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 membership. This article set out to explain how and why the City has not been more effective in defending its interests around Brexit, and to make a broader contribution to theories of business power. It is argued that while business often 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 relies on instrumental forms of influence, such as public campaigning and lobbying of decision makers. We claim that the City

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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. Our findings also show that it has 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 is how large banks have 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 has also been 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 has to date been surprisingly unsuccessful in shaping the UK government's Brexit policy. 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 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 has pursued a hard Brexit policy which has led to the downgrading of the City's interests. Second, the capacity of the City to assert power through institutional structures within government has been eroded by reform. We show that departmental reconfiguration associated with the Brexit negotiations, together with deliberate attempts by ministers to control and restrict access to key decision makers, has undermined the influence that City lobbyists have historically enjoyed within the UK polity. Third, the financial sector faces significant obstacles in its ability to organise and lobby collectively around Brexit, both at the national and EU levels. This stems from the variegated impact of Brexit on different financial sub-sectors and firms: for example, while large US investment banks continue to

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campaign for full passporting rights to protect their business model, UK retail-focused banks are 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 to mobilise against economic interdependence. 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 the interests and influence of powerful transnational firms in the City of London has 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. As a case study, 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

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powerful interest groups in the pursuit of electoral success and governing competence. 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'.

In short, Brexit highlights in stark terms the extent to which business power reflects both 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. Hence, 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 question is for how long these political imperatives can take precedence over economic pressures. As the Brexit negotiations unfold, the City of London therefore promises to provide an important test case for future research into the contingency of business power over time.

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

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

[v] Business Insider, 11 November 2016.

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

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

[x] Interview, UK regulator, March 2017.

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

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

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

[xiv] 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.

[xv] 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.

[xvi] Interview, trade association, 18 July 2017. See also Thompson 2016.

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