



Perspectives by Ruth Lea

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The City of London is the world's top international financial centre - for now

Introduction

The current difficulties of the global financial industry, as it struggles with the “credit crunch”, are still frequently reported in the press. This is of great significance to the people closely involved with the financial sector, obviously, but it also has significance for the rest of the British economy – not least of all because of the knock-on effects on the real economy. But it is also worth noting just how much the City of London’s activities contribute to the economy.¹ If the City fails to prosper, London’s economy and by extension the British economy will be adversely affected.

According to the Economist, London’s international financial services industry makes a disproportionately important contribution to the UK’s prosperity in terms of output, tax and overseas earnings.² UK wholesale financial services contributed around £50bn to GDP in 2007, 3.9% of the total.³ In 2005, UK financial services firms and individuals contributed £22bn in tax, around 5% of total tax revenues, including 25% of corporation tax receipts and 13% of income tax receipts. Furthermore the City’s overseas earnings play a crucial part in the UK’s balance of payments as an offset to the long-standing deficit in the visible balance. Over the years 1992 to 2006 the financial sector’s net exports rose fivefold from £4.9bn to a record £24.4bn.

London as an international financial centre

The City’s workforce is around 340,000, over 1% of the total British labour force. This represents much the largest cluster of wholesale financial services jobs in Europe, substantially bigger than the Paris region, 100,000, and Frankfurt, 60,000. An estimated 475,000 people work in financial services in the New York Metropolitan area, but this probably includes some retail financial services.⁴ In addition, in New York a substantial proportion of wholesale financial services activity serves domestic clients, reflecting the scale of the US economy.

London surpasses New York in the volume of international business that it transacts, including international banking, foreign exchange dealing, trading in international equities, international bond issuance

and trading. It is also the world's leading market for international insurance.

London's international competitiveness

The key to London's success is, of course, its overall international competitiveness. This, in turn, depends on factors including the favourability of the tax and regulatory regimes, the skill levels of the staff and the physical infrastructure.

The City of London has commissioned research from the Z/Yen Research Group into the 50 world financial centres in order to calculate their overall international competitiveness. Using information from varied sources (including survey material on the opinions of senior financial practitioners) on a wide range of aspects of competitiveness, Z/Yen compiles an overall rating for each centre. On the basis of these ratings, the financial centres can then be ranked. The results are compiled biannually and there have been three reports to date: March 2007, September 2007 and March 2008. In all three reports London has been the top ranked centre with New York second.

The main results for the 3rd report are outlined in the table below along with comparisons from the 2nd report.

The 3rd Global Financial Centres Index report (GFCI 3) ratings of the top 10 financial centres (March 2008). The second columns give the ranking and ratings from the 2nd GFCI report (GFCI 2) (September 2007)

Centre	Rank		Ratings*	
	GFCI 3	GFCI 2	GFCI 3	GFCI 2
London	1	1	795	806
New York	2	2	786	787
Hong Kong	3	3	695	697
Singapore	4	4	675	673
Zurich	5	5	665	666
Frankfurt	6	6	642	649
Geneva	7	7	640	645
Chicago	8	8	637	639
Tokyo	9	10	628	625
Sydney	10	9	621	636

Source: City of London, *The Global Financial Centres Index 3*, March 2008. This report provided the data for the comparison with the 2nd report.

* The theoretical maximum GFCI rating is 1,000.

The first conclusion from this table is that London and New York are the clear leaders of the pack and, arguably, the only two truly global financial international centres. But Hong Kong and Singapore are clearly internationally important offshore financial centres.

Within continental Europe the three strongest contenders are Zurich (the strongest niche centre in the GFCI 3), Frankfurt (a key European hub for finance) and Geneva (which is rated very highly for asset management and banking). Dublin is ranked 13th, Paris 14th, (having slipped 3 places since GFCI 2), Luxembourg 17th, Edinburgh 18th, Brussels 34th, and Madrid 42nd.

Whilst it is doubtless comforting to note that London is maintaining its lead, there should be some disquiet at the fall in London's overall rating between September 2007 and March 2008 and, therefore, its lead over New York. Using findings from the GFCI 3 report, there are at least two possible major reasons for the reduction in London's lead.

Firstly, the reputation of the UK regulatory environment has been damaged in some markets by the financial instability at Northern Rock. It has been widely reported that the division of regulatory oversight between the Bank of England, the FSA and the UK Government (specifically the Treasury) has led to gaps in the regulatory control of banks. This has undermined the financial community's confidence in the current tripartite regulatory regime (introduced by Gordon Brown a decade ago) which probably requires a thorough reassessment - especially concerning the regulation of banks. The Chancellor's proposals announced in June 2008 are unlikely to be radical enough to satisfy the concerns of the financial sector.

Secondly, the proposed changes to the tax regime for non-domiciled UK residents (even though concessions have been made). One senior respondent to Z/Yen's survey commented:

“London is deluding itself to consider the Non-Dom tax factor as incidental to the success of the city as a financial centre. It's in for a rude awakening.”

In addition, the Z/Yen report noted that the negative impact of certain clauses of the US Sarbanes-Oxley legislation had been lessened and there was a reported reduction in the costs of Sarbanes-Oxley compliance in the US. The US authorities, aware of the damage to New York as a financial centre of Sab-Ox, have used their power to unilaterally mitigate some of its most difficult aspects. By comparison, the UK faced with an increasing volume of EU regulations cannot, unilaterally, amend or repeal any of them if they prove to be disadvantageous and damaging to the City of London.

London's lead cannot be guaranteed

London's position as the world's leading financial centre cannot be guaranteed. The international challenges from New York and other centres are only too real. The Z/Yen Research Group's analysis showed that the top two competitiveness factors relating to financial centres were the availability of skilled personnel and the regulatory environment. This is highly significant. For all the criticisms it receives, Z/Yen found that the FSA and its relatively light-touch,

principles-based regulatory approach came out well in international comparisons. It was greatly preferred to the heavy rules-based, prescriptive approach of the Continent or indeed New York.

Britain's regulatory regime is being increasingly influenced by EU legislation.⁵ Not only does the EU's legislation tend towards the prescriptive, but it is also expensive. The EU's mammoth Financial Services Action Plan (FSAP) could cost between £14bn and £23.5bn for the UK up to 2010. Suffice to say, costs will continue to be incurred past 2010. The minimum costs for MiFID, for example, were put around £1bn in initial implementation costs, with around £100m of annual ongoing costs.⁶

The FSAP is, arguably, the beginning rather than the end of major EU influence on the regulatory regime for London's financial services sector. By signing up to the FSAP, Britain comprehensively handed over the regulatory initiative relating to the City to the EU. The EU may or may not prove to be sensitive to the special needs of the City of London as a global centre. But, given the disinterest of many member states and the openly-expressed doubts about London's "casino economy" by others, the portents are not good.

It is likely there will be yet more, much more, regulation from the EU. It risks undermining the relatively benign regulatory regime and detracting from London's international competitiveness. If/when this happens, and other things being equal, London's ratings are likely to slip further. And London's position risks slipping down the ranks.

References

1. The term is used in its general sense to mean London as a financial centre, including Canary Wharf, and not just restricted to the Square Mile.
2. Richard Roberts, *The City: A guide to London's global financial centre*, The Economist, 2008.
3. Corroborated by analysis done by Oxford Economics for the City of London. See City of London Economic Development Research Programme, *Review of 2007*, City of London, January 2008.
4. Richard Roberts, op cit.
5. A relevant fact in delay in the rescue of Northern Rock was the apparent confusion over the role key EU legislation, including the EU's take-over code, the Markets Abuse Directive (MAD) and the EU's rules on state aid. See Tim Congdon, Northern Rock and the European Union, Global Vision, June 2008, available from www.global-vision.net.
6. Keith Boyfield, *Selling the City short?*, Open Europe, November 2006.

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