An Epitome or an Index: The Implications of UK Financial Services Industry (the City of London) for the UK's Entry into the Euro

Paper presented at the EUSA 8th International Biennial Conference, Nashville, Tennessee, US, 27-29 March 2003

Chih-Mei Luo
School of Economic and Social Studies
University of East Anglia, UK
c.luo@uea.ac.uk

March 2003

Abstract:

Being the only economic sector singled out for special treatment in the five tests set by UK Chancellor of Exchequer to evaluate the UK's euro membership, the interest of the City of London (the shorthand of UK financial services industry) and its attitude on the euro issue therefore is indicative to this debate. This paper aims to answer whether the movements of the City could be an index for observing the UK's readiness of entering into the euro as the conventional wisdom predicts through investigating the implications of the euro membership for the City's future development.

The paper proceeds mainly through three parts. The nature of the City as an international center and its main business interest will be introduced first. Second, its predominance, in terms of policy-making, in UK politics mainly derived from its economic power will follow to present. In the third part, the meaning of the European single currency, including the current debate of both sides within the City on the euro issue with the help of a few of first-hand interviews, for the City's future development will be discussed based on the analysis of its business interest.

It ends with the conclusion that, in contrast to its conventional ability to promptly and exactly distinguish advantages and disadvantages from a critical international or national event, the City fails to play a role as a policy index on the UK's euro membership this time. As the euro membership represents a far more essential choice for the City--either, transforming itself into a tangible onshore financial center backed by the industrial power of the euroland; or, adhering to its current offshore nature by excluding itself from the euro membership to secure a favorable institutional environment, the City is baffling between the two distinct paradigms. The indecision of the City is more like a reflection of the entire country—standing at the crossroad with an international-outlook, or globalization, on the one hand; and a more European-oriented approach, or Europeanization, on the other.

Introduction

No financial sector in any country can enjoy such a predominant status in its national economy as the British one. Being the only economic sector singled out for special treatment in the five tests set by the UK Chancellor of Exchequer, Gordon Brown, to evaluate the UK's entry into the single currency, the interest of the City of London (the shorthand of UK financial services industry) and its attitude toward the euro membership therefore is indicative to this debate. This paper aims to answer whether the movements of the City could be an index for observing the UK's entry into the euro because of its economic and political significance and what the euro implies for the City's future development based on the analysis of its business interest. The paper will proceed mainly through three parts. The nature of the City as an international centre and its main business interest will be presented first. Second, its predominance in UK economy and politics will follow. In the final part, the meaning of the euro membership for the City, including the current debate of both sides on the euro issue, and the implication for the City's future development will be analyzed.

Before entering the discussion, some definitions must be clarified first. The phrase 'the City' is broadly regarded as representative both of the UK's financial sector and the heart of London's financial district due to the high concentration of financial activities taking place within the one square-mile area. However, the word 'the City' in this essay stands for an industrial meaning rather than just a geographical term. It is then taken to represent the whole British financial services industry, whether activities are within the City or not. Also, the definition of the financial services industry in this essay, based on the official data, is adopted the broader concept, including financial intermediation, real estate, renting and business activities, rather than a narrower one, merely referring to financial services, insurance and pension funding.

1 The nature of the City as a global center

According to Morison and Shepherdson (1991: 71-75), there are two approaches to becoming an international financial center. The one is to develop under the support of economic growth and international trade, as the cases of New York and Tokyo show. The other way is to provide a favorable institutional environment, such as political stability, fiscal relief and less-regulation. In that way, international financial business can flourish in spite of the disproportionate scale of its domestic economy, the so-called offshore financial centers, like Grand Cayman and Jersey have become. The experience of the City has shown a combination of both of them. Its origins and early development is established on the first approach while its revival in the late 1960s is based on second one.

1.1 The rise, fall and transformation

As a historical trading and commercial center, it was natural for London to become a financial center. In the late 17th century, London became the largest port in the world. With the development of the UK as the world's foremost industrial and colonial power in the 19th century, the City in turn consolidated its leading position by the strength of its national economic power. The blows to the City first came when WWI broke out, following by the decline of the UK's industrial and imperial power from the inter-war years to the end of WWII (The Corporation of London, 2000: 1-4).

There is a general agreement that the revival of the City in 1960s was due to the emergence of the eurocurrency markets in which the euro-dollar is the most important. The City received the lion's share of this business for a variety of reasons. It is true that the advantages of English language, time zone, skilled professionals, existing infrastructure, political and social stability, as well as the globalization of the international economy and international financial activities after the 1960s, all in part contributed to this success. However, a more vital reason for the City's revival was because of its less regulation and favorable fiscal environment compared with that of New York or other European continental centers, and also much less regulated than in Tokyo (McRae and Cairncross, 1991: 260-262). That is to say, the City's revival as an international financial center in the late 1960s was not deriving from the UK regaining its previous status in the international trade and world economy as an industrial power, instead, it was purely a result of an artificial creation.

1.2 The Wimbledenization of the City

After experiencing the transformation for its revival in the late 1960s, the City has altered from a symbol of international sterling backed by a strong national economy to an offshore entrepot of euro-currencies in which most of its business and profits are not directly related with the performance of the UK economy. Financial markets of the City do serve the UK domestic customers, however, a great part of their transactions are international. For example, the majority of transactions in foreign exchange and euro-securities markets through London are conducted for non-UK residents. This offshore nature of City business can be expressed by the operations of following major financial markets.

• Banking

While the number of UK-owned banks has decreased to 200 in the last decade, the number of foreign banks has grown to 481, more than any other financial center. Over half of the assets in the City banking industry belong to foreign-owned banks. The majority business of foreign banks is to serve their overseas clients, conducted mainly in foreign currencies and in the wholesale market. One-fifth of cross-border international lending is originally raised from London, the world's highest proportion, of which foreign banks carry out 81 per cent of this external lending. Generally speaking, around 90 per cent of the UK banking sector's annual net income come from overseas earnings (The Corporation of London, 2001; British Invisibles, 2000:3).

• Bond market

60 per cent of eurobonds are traded in the City, the world's largest proportion, in spite of UK's non-participation in the single currency at the end of 2000. 70 per cent of world transactions in the secondary bond market, including euro-denominated issues, originate from London (International Financial Services London, 2001a: 1-10).

• Foreign exchange

According to the statistics of the Bank for International Settlements (the BIS, 1998), 31 per cent of the average daily turnover in the world market takes place in London, remaining the world's largest center in which 85 per cent of business is transacted by foreign institutions and more than 90 per cent transactions are in US dollar.

• Stock exchange

In terms of domestic turnover, London stock market (LSE) is the world's fourth largest, lagging behind Tokyo, Osaka and New York as the world's fourth. In terms of turnover in foreign equities, it is the global largest market, accounting for 58 per cent of world trading in foreign companies in 1999, compared with 24 per cent in New York and 3 per cent in Tokyo, Paris and Frankfurt combined (International Financial Services London, 2001a: 1-10).

• Insurance

The UK insurance industry is the world third largest market in terms of gross premiums, of which over half of those premiums come from overseas and over three-quarters of insurance companies in the London market (Lloyd's and the companies) are foreign-owned (International Financial Services London, 2001b: 10-11).

David Kynaston (2001: 771-772) comments this phenomenon of the heavy presence of foreign institutions as 'Wimbledonization', which describes the decrease of the UK institutions accompanied by significant increase of foreign firms, especially the Americans and German ones, in the City just like the Wimbledon Tennis Championship which is hosted by the UK but is dominated by foreign players.

2 The heavyweight in the UK economy and politics

While the controversy about the Wimbledonization of the City continues[1], the City's significance in the UK economy and politics is unquestionable. This section will explore how the City dominates the UK economy and how this economic dominance brings the corresponding political influence on UK policy-making.

2.1 The momentum of the UK growth

The dominance of the UK financial services sector can be expressed by the facts of its contribution to UK employment, output, balance of payments and overseas investment.

While total employment in the UK slightly fell over the 25 year-period from 22.14 million in 1971 to 21.89 million in 1995, the number of those employed in the financial services sector has continuously grown at an annual rate of approximately 3 per cent from 1978 to 1996, particularly strong in 'banking, finance, insurance and business services' sector. With this steadily upward trend, the financial sector has overtaken manufacturing to become the largest industry of employment provision, accounting for nearly one-fifth of total employment in 2000 (Center for Economics

[1] There exist both positive and negative arguments about the effects of the City's Wimbledonisation. From the positive perspective, held by Eddie George (the governor of the Bank of England), Stanislas Yassukovich (the chairman of Merrill Lynch Europe) and the British Banker Association (BBA), a liberalised market can maximise economic efficiency and hence wealth creation. Therefore, the UK can be benefited from hosting the activities such as the increase of jobs, taxes and invisible earnings. From the negative perspective, only 'ownership can bring influence', thus, the key decisions about the future of the UK-owned merchant banks and securities houses will be made in Frankfurt or New York. What is likely to happen is, as Hamish McRae and Philip Augar argue, the emergence of a hub-and-spoke model in which New York operates as a core with a number of subsidiary centers on the edge. London will be just another city at the end of a spoke and become, in David Kynaston's term, 'Hong Kong West'. Further discussion please see Philip Augar (2000), *The Death of Gentlemanly Capitalism*, NY and London: Penguin Books; David Kynaston (2001), *The City of London Volume IV*

and Business Research, 2001: 6-14).

Perhaps, the most powerful attraction of the City over UK employment is its considerably higher remuneration. Hundreds of top investment bankers, analysts and dealers were rewarded by at least 1 million pounds by the end of 1996, a level which is ten times that of top executives in the industry (Kynaston, 2001: 790-791). Hamish McRae (*The Independent*, 23 May 2001) pointed out during the election campaign in 2001 that the disparity between City earnings and those of the rest of the UK is wider than ever. According to the annual New Earnings Survey, the average gross salary for a full-time non-manual UK male in 1968 was 1,648 pounds a year while it was 1,966 pounds in the City. In 1995, the respective figures were 23,052 pounds and 40,986 pounds (Kynaston, 2001: 790-791). If ignoring the controversial impact of the City's high salaries on the rest of the country[2], as this remuneration gap is continuing to enlarge-- a level at least one-third higher than other sectors, the City is always a magnet to the young generation.

In terms of the output, the growth rate of financial services industry's output has increased more rapidly than its employment growth. With the growing trend of world output typically at 3 to 4 per cent annual rate in the post-war eras, the corresponding growth rate of global financial services output is about 5 per cent a year in which the international financial services is likely to grow at 7 to 8 per cent annually. Similarly, as a leading global financial center, the output growth of UK international financial services is in line with the global level, growing at least 7 per cent a year in the last decade. As domestic financial services usually do not rise as much as international financial business, the output of UK domestic financial services increases at 4 per cent

[2] The outcome of the high salaries offered by the City is that it is always able to pick the talent from universities and other professions such as accountancy and law. Some critics accordingly blame the City to let the industry starve of talent, which is hardly good for a country's economic development. More discussion please refer to A. Hilton (1987), *City Within A State: A Portrait of Britain's Financial World*, London: I.B. Tauris

a year. Taking these two businesses together, the average growth rate of the UK financial services' output is around 5 per cent annually as a whole (Lombard Street Research, 1998:23-28).

Given that the average growth of UK total output has been 2 to 3 per cent in the post-war period, the financial services industry has been the driving force of the UK economy, while its growth rate is double the national level. The financial services industry contribute to 28 per cent of UK gross value added in 1998 (OECD, 2000), while, at the end of 2001, it pays one-third of all UK corporation tax and is likely to rise still more as the global economy grows (The British Banker Association, 2001).

In trading terms, the UK is the world's largest exporter of financial services and records the largest surplus with 11 billion dollars in 1999 followed by the U.S and Switzerland. Since the UK's balance of payments has been featured by a deficit in trade in visible goods in the last three decades, a surplus in invisibles is therefore the most important source to compensate, of which the financial services sector is the largest generator. It accounted for four-fifths of the invisibles surplus in 2000. Moreover, while the invisibles surplus as a whole declined by a fifth from the previous year in 2000, the surplus on the financial services sector has continued to grow over the last 10 years (International Financial Services London, 2001c: 2-8).

2.2 The influence on the UK government's decision-making

Helmut Kohl, the former Germany's chancellor, judges that the UK will eventually join the euro only because the City is in favor and the government will do what high finance dictates (*The Economist*, 2 May 1998). Similarly, one City banker once told Paul Reichmann, the head of Olympia & York, the world's leading property company, that 'they would not consider putting their European headquarters anywhere else since even the most left-wing government in the UK had always been more beneficial to the financial services industry than the most right-wing in the U.S.' (Roberts and

Kynaston , 2001: 40-41).

They may overstate and may also be simplifying the complexity of the euro issue for the UK, but they no doubt point out the reality of the great influence of the City on the government's decision-making. Being the driving force of the UK's growth, employment and national income, the interest of the City is, to some extent, almost equal to the UK national interest and therefore occupies the most attention of the policy-makers. In static terms, the political influence of the City comes from its financing power to the government debt and its interest consistent with the centrality of political ideology of the post-war governments. In dynamic terms, the great amount of political donations and the ability to offer various posts for politicians are the main levers that the City uses to exert its political influence.

• The state's financier

The City's relationship with the government originates from a loan funding William III's nine-year War against France. Since then, the management of the national debt has become the central issue between these two parties, mainly through the government security market—the so-called gilt-edged market. This financial dependence further shapes the nature of their inter-relationship.

During the early 1970s, the gilt-edged market provided 73 per cent of the government's domestic borrowing requirements. The Stock Exchange issued 28,000 million pounds of government bonds whereas only 3,000 million pounds of industrial stock was launched during the years of 1976-78 (Ingham, 1984: 47-50).

This great 'monied power' of the City as a key financier subsequently brings corresponding political influence. As David Coates (1984: 60-63) and Anthony Hilton (1987, 107-109) argue, because of this heavy financial dependence, any general economic policy or programs will only be possible if the City is willing to buy government securities and any deviation from orthodox policy will directly threaten such willingness. The coordinated refusal to buy government securities is the most potent instrument of the City's sanctions and further cause considerable pressure on the government. The cases of the 1976 sterling crisis and gilt-edged strike in 1978 illustrated that how the government had to compromise with the City's 'monied power'.

Moreover, the City also owns the unique access to influencing the market mood, including the exchange rate, interest rate and stock markets because of the media's attention. This influential power over those financial markets further makes decision-makers always have to consider the City's reaction on any proposed or practicing policies (Coates, 1984: 60-63).

• The centrality of political ideology

In addition to the physical resources, in terms of abstract ideology, the consistency of the City's interests with the centrality of post-war British political orthodoxy also in part contributes of its political influence. Given that the core objective of the UK's post-war foreign policy was to maintain the UK's status as a world power, the appeal of preserving the international role of the pound and the City was always a successful and useful resort to the policy-makers. The response and measures of the Labour government to the pressure of the 1966 devaluation is an example of defending such orthodoxy. Keeping the strong exchange rate in part symbolized the UK as a world power, was the priority of policy choice; as a result, the reaction and opinions of the City were highly appreciated by the government. In a letter from the prime minister, Harold Wilson, written to the governor of the Bank of England in the midst of sterling crisis, he asked the governor 'to represent to the chancellor and the prime minister the things that were being said abroad or in the City; to indicate to the government the issues on which, in the City's view, it was necessary to win confidence if a disastrous hemorrhage were to be avoided' (Blank, 1978:118).

Indeed, as Stephen Blank (Ibid.) comments, the Bank and the City would not play such a major role in the policy-making at that time if the prior policy choice were not defending the sterling. As long as maintaining the UK's status as a world power underlines the government's policy priorities, the City's interest is indirectly protected and is endowed with extra influence under the governance of such a political orthodoxy.

• The effectiveness of the City's political influence

The effectiveness of the City's political influence is broadly acknowledged both by academic studies and officials. Longstreth (1979: 160-173), Coates (1989: 36-37) and Grant (1993: 76-83) all point out that the City has played a dominant role in determining the UK economic policy and has a stranglehold on the freedom of maneuver of all governments –Conservative no less than Labour. They assert that the perceived interests of the City have been the guideline for the pursuit of economic policy and may be able to impose policies on the government which are in its interests but may harm the economy as a whole.

The interviews of financial journalists with politicians and officials have proved the validity of these academic assertions. William Keegan and Rupert Pennant-Rea (1979: 131-137) (later the deputy governor of the Bank of England) point out that the majority of politicians and officials associated with British economic policy believe the financial markets to be the most important influences on policy-making. One senior Treasury official said that nearly all official statements on economic policy and all remarks made by the ministers and officials interviewed by the media were made with an awareness of the effect that they would have on the financial markets. The self-conscious prudence of fiscal policy in the 1970s verified such concerns.

Under the parameter of such a mighty financial market, any British ruling parties, whether their ideologies are prone to laisser-faire or welfare state, have to, more or less, accommodate the requirements of the City. In terms of party politics, the ideologies of the Conservatives traditionally encountered less conflict with the City's expectations, in part because of the personally close relationship with the City's financial institutions (Coates, 1884:63). However, the New Labour government also shows a significant change from what Gordon Brown calls 'old Labour language'of tax, spend and borrow, nationalization, state planning, and isolationism to a more active policy to court the City's support (*Financial Times*, 29 September 1994).

Perhaps, the most symbolic case of the Labour policy altered by the City appetite can be shown from the retreat of the stakeholder economy vision to the City's conventional vision of shareholder economy. The former, according to Will Hutton (1996: 298-306), emphasizes more on collective success, including the shareholder, employees, customers and suppliers while the latter only focuses on the shareholders' interest in spite the fact that long-term company development and the welfare of employees may be harmed during the short-term profit-seeking process.

• The channels of the City's political influence exertion

Conventionally, the Bank of England as a custodian of the City is an effective, but not the only, institutional channel for the City to exert its political influence. The cases of 'Competition and Credit Control' policy in the early 1970s and the deregulation of the UK financial market – the so-called 'Big Bang' in the mid-1980s illustrate how the Bank played a role as the City's advocate within the government (Hilton, 1987: 104-109). Although the nexus of the Bank and the City appeared to change after the enforcement of the Financial Services and Markets Act in 2000 – the Bank's role has been clarified as being more inclined to a City player and promoter rather than a policeman and regulator, it is still expected to be the most authoritative voice within the government.

However, maybe the most effective way for the City is non-institutional— through political donations to parties and employment provision for individual politicians, both incumbent and retired. As the City used to be close to Conservatives, the bulk of its donations flew to this party. In the 1983 election, more than two-thirds of total political donations from the largest 3,000 City quoted companies were to Conservatives[3]. However, as Labour came into power in 1997 and was re-elected in 2001, combined with the leadership's amicability to the City, it can be reasonably assumed that this situation has substantially improved accordingly.

Employment provision is another direct connection between the City and politicians. Junior ministers and backbench MPs are likely to be offered various positions, mostly as consultants or directors, while senior retired ministers like Reginald Maudling, Lord Anthony, John Nott, or even prime ministers such as Lord Wilson, Sir James Callaghan, are provided a non-executive directorship in many cases (Ibid: 119-122).

3 The implication of the euro for the City

Since the euro launched on the 1st January 1999 and the UK decided not to join at the first wave, there has been a prevailing alert within the City for any signs that this new currency will undermine London's predominance as a European leading financial centre. After an experiment of four years to the end of 2002, it is now broadly accepted that the City's position as the Europe's premier financial centre is still unchanged (The Bank of England, News Release, 22 November 2002) despite the potential threat from Frankfurt, the location of the European Central Bank (ECB).

According to the latest survey of the Bank for International Settlements (the BIS)

---

[3] According to the statistics published by the Labour Research Group, the total political donations by the financial industry among the 3000 largest UK quoted companies in the 1983 election were 875,302 pounds of which 660,860 were donated to the Conservative. Further details please refer to Hilton, *City Within A State*, Table 6.1 in p116

(*Financial Times*, 14 November 2001), 30 per cent of foreign exchange turnover is dealt with in London compared with 5.4 per cent in Frankfurt. In the OTC derivatives market -- interest rate swaps and options, 36 per cent of volume are traded in the UK compared with 12.7 per cent in Germany. Apparently, London leads far ahead of Frankfurt and remains the world's largest market in these fields. Coincidentally, another study conducted by the Anglo-German Foundation for the Study of Industrial Society (*Financial Times*, 20 November 2001) also had similar findings which were largely beyond the authors' original assumption. The study points out that there was an overwhelming belief in Germany that Frankfurt's position was enhanced because of the single currency and the size of the German economy. The changes, however, are not as strong as expected. In the conclusion, it states that the euro had not altered the standing of these two cities and London's financial predominance has not been challenged.

On the surface of it, the launch of the euro brings benefits of business creation to the present City. In spite of the UK's exclusion of the euro, the City dominates in most euro-related business. It is London, instead of Frankfurt or Paris, that has qualified as the financial center of the euro. However, the impact of the euro on the City should not be concluded merely by a three to five-year assessment or a superficial business perspective. There are, in effect, more profound and complicated meanings behind this than 'just a currency' would imply. From the historic perspective of developing and securing a financial center, the appearance of the European single currency which represents the industrial power of the Continent may trigger a substantial change for the City's future in essence.

3.1 An opportunity for business

Given that 70 per cent of the eurobonds transact in London, one-third of the foreign exchange between the euro and other currencies is traded in the City and the turnover in euroland stocks now accounts for two-thirds of foreign equity trading in the LSE, the City of London, as David Clementi (2001), the deputy governor of the Bank of England, described, is in effect already 'in' the euro though the UK is still 'out' (see http://www.bankofengland.co.uk). In terms of the wholesale market, London has already successfully grasped the opportunity of this new currency's introduction for maintaining a leading role in the euro markets with its proper preparation and the existing advantages of its market scale and favorable environment. This outcome is basically consistent with the evaluation of the City, including the Bank of England, that, from a pure business perspective, the euro is an opportunity for the City as it had reinvented itself in the 1960s on an essentially offshore basis, not a threat (Eddie George, 1997, see http://www.bankofengland.co.uk; The Corporation of London, 2000: 9-10).

Based on the support of statistics, the City seems to be confident of its financial predominance whether the UK joins the euro or not, and thus more complicates this controversial issue.

If the perspective is purely analyzed from the City's present wimbledonized nature and the momentum of its revival, indeed, just as Eddie George, the Governor of the Bank of England, said, 'the location of financial activity does not depend upon the local currency. It will continue to be carried on wherever it can most conveniently, efficiently and profitably be carried on…the City of London thrives on liquid markets regardless of the currency—and it will thrive on the euro, whether the UK is "in" or "out" (Eddie George, 1997, see http://www.bankofengland.co.uk)'. William Mason (*The Observer*, 6 January 2002), Director of the British Banker Association (BBA) had the same confidence in the City because in an era of electronic trading, it does not matter where the businesses are based. Ducan McKenzie, the director of economics of International Financial Services London (IFSL), also stated when he had a 40-minute interview with the author that, in the past, the uncertainty of the exchange rate has never affected London's ability to compete and the impact of the euro, in his opinion as with many other practitioners', is only one of the many currencies traded in London. Thus, the meaning of the euro for the international City, on the basis of the present business interest, is 'just another currency' (Roberts & Kynaston, 2001:187).

3.2 The divergent attitude within the City toward the euro: not only a business matter

Due to its offshore feature as a global portal and the City's ability to thrive, some of the City's leading figures, including Brian Williamson (the chairman of LIFFE), Stanislas Yassukovich (the former deputy chairman of LSE and chairman of Merrill Lynch Europe) and John Craven (the chairman of Deutsche Morgan Grenfell Group) (Lascelles, 2000: 7-16; *BBC*, 28 June 2001) find a firm standpoint for the UK remaining outside of the euro. They argue that the City has not suffered by the UK's exclusion of the euro, instead, the City's vital qualities—internationally competitive, innovative and independent will only be protected if the UK stays outside the EMU. They further argue that the City relies on operating in an open environment with close links to all parts of the world so that the global dimension matters more than the single European dimension. If there is any threat brought by the euro to the City, in their arguments, it is the potentially regulatory implications and financial burdens which risk one of the City's key competitive advantages rather than the UK membership. A similar concern is also issued from Eddie George. A recent example is the proposal of a cross-border withholding tax which was resisted by the UK government for its explicit harm to the City's bond markets (*CNN*, 23 May 2001).

On the other hand, despite the fact that the City has maintained similar levels or even gained more prosperity since the euro's introduction, some events can not be regarded just as coincidence. The number of companies listed on the LSE has fallen by a fifth while Paris Bourse has risen by 19 per cent and Deutsche Borse has grown by 49 per cent in the last decade. A similar situation also happened in the exchange-traded derivatives market. In the year to March 2000, the number of contracts of LIFFE contracted by 7 per cent while Paris Bourse increased by 28 per cent and Eurex (the derivatives exchange managed jointly by Deutsche and Swiss Future Exchange) rose by 46 per cent (The City in Europe, see http://thecityineurope.org.uk). The implication is clear and simple-- the rivals of the euroland are catching up though from a lower base.

These are the main worries of City advocates for the UK's membership of the euro. The main pressure organization—the City in Europe (Ibid.), including Peter Sutherland (the chairman of Goldman Sachs), Robin Kingdown (former Governor of the Bank of England) and Willem Buiter (the chief economist of EBRD: European Bank for Reconstruction and Development), warned that a protracted exclusion of the euro implies risks of losing business, leadership and influence for the City in the long term. Cliff Dammers, the secretary- general of International Primary Market Association (IPMA), in a personal answer to the author, particularly emphasized the importance of EU negotiations about financial services' regulations. The UK's influence and the City's interest, he said, would be only enhanced by the euro membership.

For most participants in the City, since there is no urgent pressure for losing ground to Frankfurt, their attitude toward the UK's membership of the single currency is also as subjectively divided as the UK public opinion. According to the MORI survey of senior City executives (chairmen and chief executives) for the Corporation of London in 2001 (see http://www.mori.com/polls/), the pro-euro part was bigger than the anti-euro part, but the margin was narrow. 43 per cent of respondents agreed that it would be in the best interests of the City if the UK joined the euro while 38 per cent disagreed. This survey also showed that the difference of the nationality is relevant to their stances. The senior executives of the non-UK-based firms were more prone to agree (64%) than UK-based ones (35%) while the extent of disagreement was significantly larger in respondents of UK-based firms (43%) than non-UK based ones (25%). It is noteworthy that the disagreement percentage of the UK-based senior executives outweighed the agreement part by 8 per cent.

Other surveys also confirm nationality-linked divergence of opinion. The CityScan's survey of 58 leading UK institutional investors (*The Observer*, 6 January, 2001) after the notes and coins of the euro came into circulation on 1st January 2002 reported that two-thirds of those who responded believed the euro will have no or little impact on the UK economy and 22 per cent thought the UK corporations would gain from being outside. This opinion was just 10 per cent in 2000. On the contrary, the City's foreign guests seem to be more affirmative on the euro issue. The London Chamber of Commerce's survey of 100 foreign banks of the City (The Press Release of the London Chamber of Commerce, 13 June 2000) found that one-third of them believed that the UK membership of the euro is necessary if London is to maintain its long-term global position although the euro issue currently ranked 21st out of 23 factors of influencing location.

In addition to nationality, divergence not only exists between different business sectors of the City but also in the same industry and even within the same company. While the finance sector agreed more with the euro's positive effect (53%), the IT/professional services disagreed (51%) (see http://www.mori.com/polls/). Members of the Association of British Insurers chose to keep neutral on the euro issue for its finely balanced costs and benefits to the insurance industry (The Association of British Insurers/Ernst & Young, 1999: 3-5). The majority of the UK fund managers (68%) believed it to be beneficial in an annual survey by Information Group Reuters

(*The Guardian*, 21 February 2001). Within the investment banking sector, Peter Sutherland, the chairman of Goldman Sachs favors joining the euro while Stanislas Yassukovich, the chairman of Merrill Lynch Europe, is against. Within JP Morgan, Howe of Aberavon of the international advisory council is for, whereas a director of the same company, Campbell Gordon, is opposed (see http://www.thecityineurope.org.uk; http://www.no-euro.com).

These national, inter- and intra-divergences of City industries simply reveal that, despite all arguments, whether for or against, analyzed from a business basis, the City's attitude of the UK membership of the euro is not just a business matter but already mixed with more non-business factors. In the words of Eddie George, these divergences 'reflect a broader assessment of the respective pros and cons for the country as a whole rather than strong views about the implications for the City in particular'.

3.3 A turning-point choice for future evolvement

One of the plausible explanations for the evenly divided City opinions on the euro membership is that it involves the fundamental differences between the two paradigms of developing financial centers. The meaning of the euro membership for the City's outlook could be either positive or negative dependent on which paradigms that commentators support. It is true that, from the viewpoint of its current offshore nature, the City should continue to maintain its outward global perspective rather than a regional inward-looking one and devote time to preserving the attractively less-regulated environment outside the euroland because those are vital sources to its prosperity nowadays, the so-called offshore-pattern approach. On the other hand, neither can it be denied that UK membership of the euro is highly likely to provide a great historic opportunity for the City to return to its pre-WWI position as an intrinsically international financial center, as New York and Tokyo are, backed by the huge 'domestic' economy of the euroland, namely, the industry-underpinned model.

Each approach to developing and securing a financial center has its strength and weakness and no objective criterion can be provided for judging which one is superior. However, it is noteworthy that London's advantage as the lowest-cost producer of off-shore financial services is not unchangeable forever as the balance of regulation around the world is toward more fundamental issues, such as protecting investors from petty restrictions. As McRae and Cairncross (1991:261-262) claim, once governments start to modify the illogicality of legislation which forces their domestic firms to shift business offshore, more business will be attracted back to their home countries. This prediction has already been proved by the case of Japan, which illustrates some offshore business shifted back to Tokyo after the government eased the restrictions of the use of derivatives and options from Singapore (*The Economist*, May18th-24th 2002). If this phenomenon becomes a world trend, the City of London, which largely depends on international financial business, will suffer most compared with New York and Tokyo. Furthermore, Hilton (1987: 182-183) points out that, as history shows, where the capital accumulates, financial markets nourish by surplus capital. That explains why financial power always emerges from those centers which own industrial power. He thus predicts that brains or favorable institutional design alone will not be sufficient to guarantee the City's pre-dominance in the long term. It has to utilise the industrial strength of continental Europe.

After all, a natural, inherent international financial center is more defensible and durable than an artificial, acquired offshore financial center backed only by a man-made favorable environment. In other words, how the context of the City evolves in the next few decades lies on which paradigms it is more inclined to, and this choice, accordingly, further decides its dependent relationship with the European single currency. The euro membership for the City thus is a turning-pointing choice between 'just another currency' (an offshore pattern), or a substantial onshore center of it (an onshore pattern).

Conclusion: An epitome rather than index for the UK's euro membership

If the interest of the GM (an American mobile company) were the interest of the U.S. as a US official once said, then it would be much truer that the interest of the City was the key to the UK's well being. After reviewing its importance both to the UK economy and politics, it is not extravagant to set a specific standard about the UK's prospect for joining the euro solely for this industry. From the perspective of the public, being the single largest contributor to UK employment, overseas earnings and the corporate taxation as well as the main driving force of future growth, no sectors other than the City deserves to be so emphasized in the UK economy. From a policy-making perspective, provided that the City plays a role as the state's financier, combined with its ideological, financially supportive and institutional nexuses with politics, policy-makers can only maneuver within the range of its requirement and expectation. In the extreme description of Hilton (Ibid:124), 'if it [the City] chooses it can make it virtually impossible for a government to function'. As history illustrates, any weighty decision about economic, trading, fiscal and monetary matters, at both domestic and international level, taken by successive UK governments can be traced back to the City factor behind it.

Since the viewpoint of the City is used as an index for the authority to evaluate a significant international or national affair, it should be expected to deliver a clear message of its attitude toward the euro issue as an explicit guiding reference for the decision-makers as the Chancellor requires in the five economic tests. However, as no acceptable consensus can be found within the City on this issue, the City unconventionally fails to be a positive factor in the formation of the policy-making.

Given that the City's role as an international financial center has not been weakened by the UK's exclusion from the euro so far, it makes harder to provide a neutral arbitration on this issue, in contrast to the case of the City's unambiguous favor of the UK's application for the EC entry in the early 1970s when it revived as an offshore entrepot of the euro-currency market. Moreover, in spite of some distinct remarks from the City's leading figures, including both positive and negative arguments, opinions within the City are just as divided as the rest of the country. More precisely speaking, British practitioners who really own the votes in the referendum are in general more skeptical than their foreign counterparts about the benefits that will be brought to the City by the UK's entry.

Considering the City's current position-- less regulation, light taxation, liberal environment and a sound and strong currency practically required by an international financial center, it is likely that the adoption of the euro will not satisfy these in the short term. A leading City critic, Gerard Lyons[4], opposes the UK's entry just because he predicted long before the launch of the single currency that 'the euro would be a soft currency and the pound strong...[for] Europe's dismal jobs record could undermine the euro and is a strong reason to deter the UK from joining'. His prediction is not too wrong according to the performance of the euro exchange rate against both the dollar and the pound since its introduction till mid-2002[5]. A weak euro which is not necessary disadvantageous for the euroland is not as attractive as the eurodollar appeared in the 1970s in the City's eyes. Moreover, even the strongest City proponents cannot hide their worries about future onerous regulations implied by

[4] Gerard Lyons was a chief economist of DKB International, Swiss Bank Corporation and Savory Millin and now is a global head of treasury research at Standard Chartered Bank. For his remarks please refer to http://www.euro-know.org/g-lyons.html.

[5] The exchange rate of the euro had considerably appreciated against the US dollar from its lowest point in 2001 since the mid-2002. However, this appreciation is not driven by the booming economy of the euroland, but rather by the factor of the US itself, including the serial scandals of US corporate governance and the war on Iraq.

the euro so that are more eager to advocate the UK's early entry in order to prevent those adverse effects based on such concerns.

Paradoxically, no matter what the City's opponents and proponents for the UK's euro membership argue, they all take a defensive perspective concerning the drawbacks of the euro membership rather than an aggressive perspective regarding the benefits. For example, the proponents argue that, in order to avoid the likely disadvantages brought by the euro membership, the UK should join in while the opponents contend, just because of these disadvantages, the UK should not join. This phenomenon is generally consistent with the diversity of other debates in the rest of the UK.

Why cannot the City express a consistent, clear and consolidated voice on the euro issue to deliver a reference for the public and policy-makers? The basic and key reason is that, in contrast to its conventional ability to promptly and exactly tell advantages and disadvantages from an important international or national event, the City itself cannot reach a minimum consensus concerning the benefits of the UK's euro membership and its implications. That is why a number of the City's euro debates are rather defensive than aggressive. But a further question is: why cannot the City decisively find and judge its value standard from the euro this time? The answer involves a more essential case. As the argument mentioned above, the choice of the euro membership not only represents a changeover to a new currency but more implies a substantial context change inside the City—it can be a historic point to transform itself again into a tangible onshore financial center backed by the continental Europe's industrial strength or, equally, it can be just another currency in its current offshore-center pattern. Accordingly, while the City is deciding its future development, the controversy of the euro issue continues—remaining baffled between which benefits it should capture and which liabilities it should endure. To that extent, the indecision of the City is more like a reflection of the entire country—standing at the crossroad with an international-outlook or globalization on the one hand, and a more European-oriented approach or Europeanization on the other.

References:

Blank, S. (1978), 'Britain: The politics of foreign economic policy, the domestic economy, and the problem of pluralistic stagnation', in P.J. Katzenstein (ed.), *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, Wisconsin: The University of Wisconsin Press

British Invisibles (2000), *Banking*, London: BI

Centre for Economics and Business Research (2001), *London's Contribution to the UK Economy: An Annual Report for the Corporation of London*, London: The Corporation of London

Clementi, D. (2001), *The City and the Euro: Innovation and Excellence*, http://bankofengland.co.uk/cgi-bin/html.pl?db=website-full&stemmer=en&wor12/15/01

CNN.COM (23May 2001). http://cnn.worldnews.printthis.clickability.com/pt/printthis?clickmap

Coates, D. (1984), *The Context of British Politics*, London, Hutchinson
-(1989), 'Britain', in T. Bottomore and R. J. Brym (eds.), *The Capitalist Class: An International Study*, New York and London: Harvester Wheatsheaf

Financial Times, 'Blair shuns high taxes and backs market economy', 28 September 1994, p1
- 'London remains dominant financial centre', 14 November 2001 http://specials.ft.com/euro/FT3UZLMZLSC.html
- 'Frankfurt fails to steal London's financial crown, 20 November 2001, http://specials.ft.com/euro/FT3XW1FV8UC.html

George, E. (1997), *Prospects For the City-In or Out of EMU*, http://bankofengland.co.uk/cgi-bin/html.pl?db=website-full&stemmer=en&wor12/15/01

Hilton, A (1987), *City Within A State: A Portrait of Britain's Financial World*, London: I.B. Tauris

Hutton, W. (1996), *The State We're In*, London: Vintage

Ingham, G. (1984), *Capitalism Divided? The City and Industry in British Social Development*, London: Macmillan

International Financial Services London (2001a), *Securities Dealing*, London: IFSL
-(2001b), *Insurance*, London: IFSL
-(2001c), *World Invisible Trade*, London:IFSL

Keegan, W. and Rupert Pennant-Rea (1979), *Who Runs the Economy: Control and Influence in British Economic Policy*, London: Maurice Temple Smith

Kynaston, D. (2001), *The City of London Volume IV: A Club No More 1945-2000*, London: Chatto & Windus

Lascelles, D (2000), *The City and the Euro*, London: The No Campaign

Lombard Street Research (1998), *Growth Prospects of City Industries,* London: The Corporation of London

Longstreth, F. (1979), 'The City, industry and the state', in C. Crouch (ed.), *State and Economy in Contemporary Capitalism*, London: Croom Helm

Mayhew, J (1999), *The City and the Euro*, The Newsletter of the Corporation of London, http://www.context.co.uk/news/archive_mayhew.html

McRae, H and F. Cairncross (1991), *Capital City: London as a Financial Center*, London: Methuen

MORI-Corporation of London (2001), *The Survey of Senior City Executives*, http://www.mori.com/polls/2000/corpland.shtml

Morison, I. and I. Shepherdson (1991), *Economics of the City*, Oxford: Heinemann Educational

OECD (2000), *OECD in Figures,* Paris: OECD

Philip Augar (2000), *The Death of Gentlemanly Capitalism*, NY and London: Penguin Books

Roberts, R and D. Kynaston (2001), *The City State: How the Markets Came to Rule Our World*, London: Profile Books

The Association of British Insurers/Ernst & Young (1999), *Economic and Monetary Union: Survey of Insurance Companies*, London: ABI

The Bank for International Settlements (November 1998), *Quarterly Review: International Banking and Financial Market,* Basel: BIS

The British Banker Association (2001), *Banking and Financial Services: Contribution to the UK Economy*, http://www.bba.org.uk/html/2647.html

The City in Europe (2002), -'The City of London',
http://www.thecityineurope.org.uk/briefings.php?id=3
- 'City leaders unite to press case for euro',
http://www.thecityineurope.org.uk/briefings.php?id=7

The Corporation of London (2000), *London-New York Study: The Economies of Two Great Cities at the Millennium*, London: The Corporation of London
-(2001), *The Global House*, London

The Economist, 'Who wants the euro and why', 2 May 1998, p55
'The regulator who isn't there' (in a survey of international finance), May 18^{th} 2002, p12-16

The Guardian, 'Go in, City says. And never mind the bottom line', 21 February 2001, http://www.guardian.co.uk/emu/story/0,2763,440809,00.html

The Independent, 'Hamish MaRae: it's time for City folk to go clubbing again', 23 Many 2001

The London Chamber of Commerce (13 June 2000), The Press Release, http://www.londonchamber.co.uk/viewarticle.asp?areaid=19&subarea=50&page

The Observer, 'Square mile fears continental drift';
http://www.oberver.co.uk/euro/story/0,10818,628150,00html
-'No tear in the City over missed boat',
http://www.observer.co.uk/euro/story/0,10818,628182,00.html, both on 6 January 2002.

Townend, J. (2001), *The Completion of the Euro as a Currency: A UK Perspective*, www.bankofenglad.co.uk/links/setframe.html