

Global Vision Perspective

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The EU Reform Treaty and the City

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How will the EU Reform Treaty affect the City? Will this latest EU initiative give it a boost by producing better regulation and bigger markets, or will it merely transfer more power to Brussels and make London extra vulnerable to the whims of Eurocrats and politicians?

At the risk of piling on too many questions, will it make any difference at all? If the answer is no, then the City can get on with more urgent things than trying to understand a tortuously complicated document.

The short answer to the last question, however, is yes; it is bound to because its purpose is to alter the way policy decisions are made and implemented in the EU. The Treaty redistributes political initiative, mostly in the direction of Brussels; it shares out voting power more evenly among EU members, which means that large countries like the UK get less say; and it sets up a process of continuous change which creates a horizon of uncertainty.

All these changes contain risks and opportunities. The risks are that policymaking and regulatory enforcement increasingly shift to Brussels, where the City's interests have to compete more directly with those of the financial centres of 26 other countries, and be subjected to a regime which is less sympathetic to its needs. The opportunity is that a more streamlined system of government opens up markets faster and makes the EU more responsive to its members. But how will it turn out?

The difficulty in giving a clear answer is that the Reform Treaty says little or nothing about finance and regulatory policy, and makes only general statements about the need for open markets. So you can't point your finger at an Article and say (as you can for immigration or energy policy) "That's great!" or "That's terrible!". Instead, you have to examine the proposed changes and decide how they would play out in the real world. From the City's point of view, there is only one answer to that: badly.

The City's special position

Consideration of the Reform Treaty has to begin from the standpoint that the City is a unique organisation within the EU. Not only is it by far the largest financial centre (almost as big as Frankfurt and Paris combined), it is also the most complex and international, dealing in geographical and financial markets which are well beyond the reach of other centres.

In fact there is no comparable centre of excellence or concentration of activity in any other part of the EU economy: technology, engineering, pharmaceuticals, etc., are all more evenly spread. This is a key point because it means that the City's requirements are unique - not just in the financial sector but in the EU as a whole - and this immediately creates problems in a political system which is all about harmonisation and common rules. The City has a legitimate claim to

special treatment; the ability of the UK to influence EU policy to obtain it is therefore crucial.

But this is precisely where the Treaty threatens City interests: by making it harder for the UK to get its voice heard in Brussels, and to head off damaging laws and regulations.

Treaty proposals

What does Reform Treaty say about the re-distribution of power?

1. Voting. The Treaty removes the veto from more than 60 areas, and puts them under Qualified Majority Voting (QMV). This will weaken national control over the EU legislative agenda and also make it easier for the EU to cook up legislation, increasing the risk of bad legislation and adding to what is already a surfeit of financial regulation. The areas coming under QMV include the potential powers of the European Central Bank to make financial regulation. This will not affect the UK directly because it is not a full member of the ECB and does not participate in the single currency. But much City activity is in the eurozone, and this comes under the ECB's aegis.

At the same time, the hurdles for approval within the QMV voting system will be lowered to make it harder for countries to form blocking minorities.¹ In the past, the UK has been able to use these minorities to prevent harmful regulatory proposals, for example in the blockbuster Markets in Financial Instruments Directive. The devil is often in the detail that most countries don't care about, and this can only be stopped with blocking minorities.

Both these proposals on voting will severely weaken the UK's ability to obtain consideration of the City's special needs.

2. Commissioners. The Treaty will end the practice of having one Commissioner per country. Instead, the size of the commission will be cut down so that each country will only have a Commissioner for 10 out of each 15 years. In other words, a third of the time it won't have a Commissioner. On the face of it, this shouldn't matter since Commissioners are supposed to put national interests aside and act in the EU's general interest. In practice, of course, they don't. They press, subtly or not, their home country's case. Again, this direct presence in the Commission is crucial to the UK's ability to influence legislation that could affect the City, but about which few other countries care. Furthermore,

¹ Under the current system, laws have to pass three hurdles: 74% of the weighted votes in the Council, plus 62% of the population and a majority of member countries. Under the new system there would be just two hurdles: 65% of the population and 55% per cent of the member countries. Source: *A Guide to the Constitutional Treaty*, Open Europe, p 14.

having one's own Commissioner is not just about being at the top table, but knowing what is going on.

3. A 'self-amending' Treaty. The new provisions will make it easier for the EU to amend its Treaties. At present, key Treaties can only be changed by a large scale process which includes an intergovernmental conference, a unanimous vote and country-by-country ratification. Under the new Treaty the Council could, by unanimous vote, change any part of the founding treaties, subject to parliamentary ratification. This would make it easier to 'tweak' the Treaties and generate proposals which either seem insignificant, or get thrown into the horse-trading ring which produces so much of Brussels' poor quality legislation. The UK might find itself, for example, having to sacrifice an 'unpopular' City issue to win a 'popular' change in something completely unrelated like foreign aid policy. One of the treaty changes that could be made in this way is the abolition of the veto in the few policy areas where it still holds. Here a change would not need to be ratified unless a national parliament objected within six months, which would be very difficult if the Cabinet had already agreed to the change and wanted to see it pass. Altogether, these provisions open up huge areas of uncertainty: how can anyone possibly know what treaty changes will be made in future, and how they will affect us? Gordon Brown has said he will resist any further changes to the key Treaties, but will he be able to block them in the heat of the political moment?

4. Division of competences. The Treaty is supposed define how competences (Eurospeak for 'powers') are split between Brussels and member countries, but it creates a bias towards Brussels by giving preference to the Union in areas where competences are supposed to be 'shared'. It says that countries can only exercise their competence where the Union has ceased to, or has decided not to exercise its own. In other words, the Union decides. Shared competences include the implementation of the Single Market, which is obviously key to the City's interest in cross-border trade. The UK lost the battle to have competition policy defined as a shared rather than exclusive EU competence, and also failed to get another set of policies, including employment and consumer protection, defined as 'supporting competences', i.e. ones where national governments take the lead.

To complicate things further, several competences which are of interest to the City are not assigned to any particular category, including the creation of broad guidelines on the co-ordination of economic, employment and social policies. The presumption must be that these belong to Brussels and not to the members.

5. Parliament. The Treaty contains detailed measures which will both water down the power of national parliaments to stop EU legislation and increase the power of the European Parliament (EP). The EP has traditionally been the most

federalist of the EU institutions, but also the one keenest to protect local interests. The City's desire to see trade barriers removed in Europe could therefore face a bigger hurdle in the shape of the EP.

None of these proposals amount to a direct threat to the City's interests. However they create structures which transfer more authority to EU institutions and weaken the ability of individual countries to influence and block legislation. This will make it harder for the UK to promote the City's exceptional position.

The City's position within the EU

Although the City is located in the UK and is clearly identified with British interests, its value is much wider than that. It benefits the EU as a whole by providing efficient markets, by employing tens of thousands of non-British EU nationals, and by giving the EU a huge influence on the world financial stage.

So if the City is so obviously a valuable asset to the Union, why should we be worried if more power is transferred to EU institutions? The EU will surely do everything it can to promote and protect its interests. Moreover, a stronger EU will be better placed to eliminate internal barriers and speed up the Single Market. Good point, except that we have little reason to expect any of these things to happen.

Ostensibly, the purpose of the EU is co-operation, but in practice it is about rivalry. The behaviour of the EU over the years has shown that members will generally only agree to measures which enhance their individual competitive positions rather than the interests of the EU as a whole. If the EU gains in the process, it is more of a fortunate outcome than an intended result. This has been demonstrated countless times whether it be in the areas of budgets, economic regulation, the Common Agricultural policy or regional aid. Because of this, the fact that the City benefits the EU as a whole is liable to go unnoticed. Insofar as it is noticed, the credit is claimed by the EU even though London accounts for most of it.²

This approach creates a bias against success. Why should a country agree to a measure that will boost the competitive position of another member more than its own? To go directly to the point: why should members make an exception for the City, unless it is in return for some equally large benefit for themselves? There is nothing cynical about this; it is a classic feature of group behaviour. Indeed, countries which did 'give something away' without getting something equal in

² A revealing anecdote. When Charlie McCreevy, the Commissioner responsible for the Single Market, addressed the Association of Corporate Treasurers annual dinner in London in 2006 he said that 'EU financial markets' were clearly leading the US in the areas of commercial banking, forex, OTC derivatives, insurance, reinsurance and foreign equity trading and were gaining in importance in the areas of investment banking, hedge funds and IPOs. He was criticised in the *FT* for failing to point out that this was largely due to London's strength in all these areas. When his speech was posted on his web site a few days later, an extra phrase had been inserted: "As the major European financial centre, London is contributing in an important way to this success."

return would rightly be accused of dereliction of duty. It does, however, make it very difficult for the EU to promote a point of excellence which is clearly identified with one member country, and whose wider benefits are imperfectly understood.

The City suffers from further problems in the EU's eyes. It is 'Anglo-Saxon' and therefore an object of instinctive mistrust. It is an outpost of Wall Street, and as such linked to American imperialism. It gives off an aura of wealth and power which provokes fear and envy on the Continent, just as it does in the UK, and it breeds activities such as hedge funds, private equity groups and hostile takeovers which are seen to destroy jobs and wrest control away from the locals. The EU's feeling of resentment towards the City is also tinged with a sense of annoyance that London managed to achieve this powerful position without joining the euro, (though this compelling evidence of the benefits of local control and diversity has not, to the knowledge of this writer, ever been analysed). To resentment of the City's success has recently been added an element of *Schadenfreude* at its misfortunes over the credit crunch and the Northern Rock *débauche*.

If anything, the EU is moving in an anti-City direction, led by France where public opinion has always been hostile towards centres of power and wealth. One of President Sarkozy's early coups was the removal of 'free and undistorted competition' from the list of the EU's objectives on the grounds that the EU had become 'too Anglo-Saxon'. More recently, during a visit to the US, Sarkozy used a speech to Congress to denounce "the vagaries and excesses of a financial capitalism that currently leaves too much room for financial speculation" and called for "the introduction of necessary [financial market] rules and safeguards."³

Although EU officials said that the removal of the competition clause would make little difference in practice, lawyers have pointed out that it is bound to give an anti-free market bias to decisions at the European Court of Justice, for example if there were a challenge to the UK's opt-out on maximum working hours, which are crucial to the City. It could also undermine the protocol which the UK negotiated to the Charter of Human Rights as a protection against measures which might inhibit the free operation of its labour markets.

This atmosphere provides encouragement to those within the EU, and the European Parliament in particular, who want to rein the City in. Evidence of this is already emerging in the disappointing results of the drive by Mr Charlie McCreevy, the Internal Market Commissioner, to improve the EU's unwieldy Financial Services Action Plan (FSAP). Not only has he failed to trim this monster package of rules and regulations – many of them unnecessary – he has actually lost a major battle to improve shareholder democracy. He recently conceded defeat in his two-year campaign to introduce 'one share, one vote' into EU companies. Although the French have been most obviously at the forefront of anti-City moves, their sentiments are widely shared. The Germans have been

³ *Financial Times*, 8 November 2007, p.6.

leading the campaign to regulate hedge funds and the Scandinavians were the strongest opponents of 'one share, one vote'.

None of this helps build a positive framework for the City within the EU power structure. Rather the opposite; it suggests that the City will have to fight an ongoing battle for its interests, one which it will increasingly lose as power shifts from London to Brussels.

As for the major opportunity that should come out of the EU process, the creation of bigger markets, this is still awaited. Petty local regulations, often portrayed as consumer protection measures, continue to dog the Single Market, and countries are dragging their feet about implementing the key parts of the FSAP which are supposed to end stock exchange monopolies. This could be an area where a more powerful EU would help break down barriers, though the elimination of the 'undistorted market' objective has taken away the EU's biggest sledgehammer.

A single financial regulator?

Behind any transfer of power to EU institutions lurks perhaps the greatest threat to City interests, the creation of a single financial regulator for the EU.

As has been noted, the new Treaty confers certain powers on the European Central Bank. These have mainly to do with the authority of the Bank to impose reserve requirements on banks operating in the euro area, and do not affect Britain directly. However, momentum is building up within the EU to centralise financial regulation more closely, either under the ECB umbrella or some new 'super-regulator', and the new voting arrangements could make it easier for the Commission or the Council to drive through an extension of the ECB's powers.⁴

The rationale is twofold. One is financial stability. With banks increasingly operating across EU borders, the current nationally-rooted arrangements to provide emergency funds in times of crisis are fragmented and complex, and may not be up to dealing with a full-blown international bank failure.⁵ This view has been strengthened by the recent credit crunch, though there is no evidence so far of banks failing through lack of international liquidity co-ordination.

The other is supervision. With banks operating in a supposedly Single Market with a single rule book, it makes sense to go over to a single regulator.

Both these arguments have a beguiling logic. A single structure would surely make banking more stable and supervision more efficient. Indeed, there are

⁴ Article 107 of the new Treaty says that Articles in the ECB statute "may be amended by the European Parliament and the Council, acting in accordance with the ordinary legislative procedure. They shall act either on a recommendation from the European Central Bank and after consulting the Commission or on a proposal from the Commission and after consulting the European Central Bank". This gives the Commission new powers to push through changes to the ECB statute by QMV; it currently can only do so with unanimity.

⁵ See for example, *Is Europe ready for a major banking crisis?* by Nicolas V éron, published by Bruegel, August 2007.

plenty of people in the City who take this view, exhausted as they are by having to deal with dozens of different regulators and central banks whenever they step abroad. But a questionable assumption underlies this view, that the quality of supervision over the City would be preserved or even improved by having a single regulator based in Brussels, Frankfurt – or London which would be the most logical. Could we count on having a super-FSA?

For all its failings, the FSA is the only regulatory agency in Europe which has the capability and experience to oversee London's finance industry. This is borne out by frequent practitioner polls.⁶ One reason is that the FSA is able to focus on the City's needs. This focus would be lost in a super agency with an EU-wide remit. A single EU regulator would also be buffeted by political pressures of the kind already described, and would be bound to take on some of the more heavy-handed features of the Continental regulatory tradition. Although there would be streamlining benefits in creating a singular regulator, the net outcome for the City would almost certainly be negative.

At the moment, a single regulator is not on the agenda. Mr McCreevy said recently: "There cannot be a top-down imposition of new working methods". Nonetheless, he wants to make financial regulation 'more European' by introducing more QMV into the rule-making process,⁷ which would create the thin end of a wedge for those who want a single regulatory agency.

A 'self-centred' view

To supporters of the new Treaty, many of these arguments will seem self-centred, even paranoid. The EU is not 'out to get' the City, they will say. To suggest that the EU is not aware of the City's value to the Union as a whole is profoundly mistaken. Pessimism about the EU's ability to advance the single market and provide light touch regulation is unfounded. Moreover, the whole point of the Treaty is to make the EU work better and allow institutions like the City to flourish.

It is hard to dispute these arguments because they depend on the view you take of the future. If you are optimistic that the EU will become more democratic, more tolerant of diversity and less obsessed with harmonisation, the fears expressed in this paper are indeed unfounded. The City could look forward to a future in which the heavy hand of Brussels was lifted, and national barriers fell away. It could be the beginning of a truly golden era.

But if you do not share that optimism, the future looks dark. The experience of recent years teaches us that the City gets a rough ride in EU institutions, and that ride would get even rougher if more power were handed over to those institutions. This is not merely because some people wish the City ill: it is

⁶ For example the September 2007 Global Financial Centres Index compiled by Z/Yen, London.

⁷ Speech in Frankfurt, 20 November 2007.

because the City's exceptional needs are difficult to grasp, let alone build into an increasingly harmonised system. Moreover, these needs are not shared by other members and are therefore liable to get trampled in a constitutional structure which makes it harder for individual countries to protect their particular interests. To be sure, there is an element of special pleading here: if the City wants special treatment, why can't the Italian banking industry, French cheesemakers, German auto manufacturers and Finnish mobile phone companies have it too? The answer to that is simple: stop transferring power to Brussels.

In actual fact, the purpose of this paper is not to ask for special treatment for the City, but to demonstrate that the interests of institutions like the City will do far better under national control than under some massive politico-bureaucratic mechanism serving 26 other countries as well. The Reform Treaty will transfer key decision-making powers to Brussels, will result in more lowest common denominator regulations, and grind down Europe's points of excellence. For all these reasons, it is bad news for the City.

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Global Vision is a new campaign group backed by economists and business leaders that argues for a looser British relationship with the EU, based on free trade and mutually beneficial cooperation, whilst opting out of economic and political union. Global Vision believes that this is the right relationship for Britain in the 21st century's rapidly changing world. For more details on Global Vision please visit our website: www.global-vision.net.