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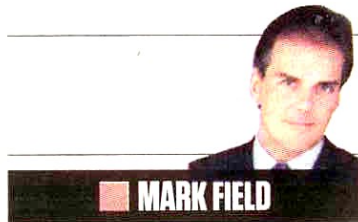
## There's no third way for the City in Britain's relationship with the EU

**T**ODAY David Cameron travels to Brussels to take part in a critical summit on the EU's budget from 2014 to 2020. The occasion will involve more than just budget negotiations, however.

This summit has implications for both the City of London and the UK's broader position within the EU – areas where the coalition's approach is more short-term tactical expediency than long-term strategy. Consequently, its ability to dictate terms on these two vital matters is fast eroding.

Historically, there are two models of a successful financial centre. The first – an onshore version – is a hub city that services a sizeable domestic market. Think New York. The alternative is an offshore approach, which depends on attracting business via competitive tax rates and other selling points like a respected legal system and a skilled workforce. Think Switzerland.

Until the 2008 financial crisis, the City enjoyed elements of both and benefited handsomely. It took on the



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role of an offshore-onshore financial centre to the European continent and developed a light-touch regulatory approach that attracted huge volumes of foreign money. But the arrival of the financial crisis fundamentally changed the rules of this game.

Since 2008, the Eurozone has demanded greater oversight of its financial infrastructure. It has asked awkward questions about the ability of UK regulators to prevent the system silting up, and about whether it is sustainable for euro-denominated risk to be cleared offshore in London. In turn, the City has questioned how long it can avoid being infected by EU financial directives without its competitiveness being fundamentally damaged.

The invoking of the British veto at last December's EU summit was billed as an aggressive demonstration of the UK's intention to retain the City's offshore/onshore model. But to many EU partners, it was seen as an unrealistic and petulant attempt to maintain an unsustainable status quo.

In reality, that veto was less about the future of the City and more a political gesture aimed at keeping eurosceptic wolves from the door, ideally until well beyond 2015. The backdrop to that last summit was an unexpectedly large "rebellion" in support of an EU referendum. Yet the Prime Minister's superficially popular move only hardened eurosceptics' resolve to extract further concessions.

Since then, matters have moved on apace. The EU is finalising work to set up a single bank supervisor. Meanwhile, the coalition has failed to see off another rebellion on the UK's relationship with the EU, this time over its budget. Another summit showdown is surely inevitable.

The uncomfortable truth is that there is no third way in the UK's rela-

tionship with Europe. The Prime Minister's understandable instinct is to play for time – to placate eurosceptic passions with aggressive talk about renegotiating our relationship with Brussels, while smoothing relations with European partners behind the scenes. But this approach is no substitute for a clear view about how

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Britain's economic interests are best served, and particularly how the City – our only substantial, globally competitive industry – should evolve.

If the Prime Minister sees our future in the EU, with the City remaining closely integrated into the vast domestic European market, a collaborative approach with our European partners

is now required. This path will involve facing down UK eurosceptics. Time will also need to be spent extracting the best deal for the City through careful diplomacy and the building of alliances.

If, however, he truly believes that the raft of EU directives coming this way are anathema to the long-term interests of the City, and that its future is best served by adopting an offshore model, a path towards British withdrawal from the EU will need to be sketched out before long.

Talk of fundamental renegotiation is illusory. We may not like it but, when it comes to the EU and the City, the choices ahead for the UK are increasingly binary. This has arisen because of the absence of any strategy on how we see the City operating in future and what relationship Britain should enjoy with the EU in the years ahead. As it stands, the UK government has no clear answer on either of these issues. This is a perilous position for the national interest.

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