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A SINGAPORE ON THE THAMES?

POST-BREXIT DEREGULATION IN THE UK

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Executive Summary

- The so-called ‘Singapore on the Thames’ scenarios for post-Brexit UK tend to envisage a country that has abandoned the red tape of EU regulations, likely adopted a unilateral free trade approach and introduced a low taxation regime for the corporate sector.

- Technically, it is possible to make Britain into a low corporate tax jurisdiction. However, while the abolition of corporation tax would create an entirely tax-free environment for foreign shareholders in UK companies, this measure would end up increasing taxes on UK privately owned businesses. In the financial sector post-Brexit, the deregulated fintech industry is likely to evolve along the historical path of the unregulated Eurodollar markets, creating additional risks for financial stability, transparency and the reputation of the UK.

- In reality, two sets of political-economic factors will influence the UK’s economic strategy post-Brexit: domestic alliances and the international policy context.

  - Domestically, the populist alliance that brought about Brexit is likely to be short-lived. Hyper-liberals, the minority element in this alliance, are unlikely to hold the balance of power in the UK. This makes the prospects for the unregulated, low corporate tax or the tax haven model, slim.

  - Internationally, both the political-economic context of global tax governance, as well as individual interests of major global players (the US, the EU and China), make the ‘Singapore on the Thames’ scenario an unlikely outcome for the UK. First, Brexit will unfold in the context of the emergent global profits split approach which aims to align taxing with genuine economic substance. This will inevitably undermine the viability of a tax haven-based development strategy.

- In the financial sector, the failure of the European Capital Market Union project will expose Europe, including the UK, to greater dependence on the US and dollar funding. London may capitalise on a new, if limited, role: that of facilitating transactions between the increasingly dominant US financial system and EU companies seeking access to US markets. However, the capacity of the UK to embark on a deregulatory race to the bottom is likely to be constrained by extraterritorial application of regulatory rules of other major jurisdictions, including the US.
- The introduction of selected elements of the Singaporean economic model will generate tangible macroeconomic, political and market risks; a choice that would aggravate, rather than resolve, the socio-economic problems that informed much of the Brexit vote. A full re-orientation of a post-Brexit UK along the lines of the Singaporean economic model is therefore unlikely to come to fuition, because it would require a comprehensive overhaul of the existing political-economic structures in the UK towards a new system of public ownership of assets and a high state interventionism.

Introduction

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“We would have the freedom to set the competitive tax rates and embrace the policies that would attract the world’s best companies and biggest investors to Britain. And – if we were excluded from accessing the Single Market – we would be free to change the basis of Britain’s economic model”, so declared Theresa May in her Lancaster House Speech on 17 January 2017.[1] Days later, Chancellor Phillip Hammond explained that in case Britain gets a bad deal from the EU, “we could be forced to change our economic model, and we will have to change our model to regain competitiveness [...] We will change our model and we will come back, and we will be competitively engaged.”[2] While it is easy to dismiss such proclamations as acts of political posturing in the face of tough Brexit negotiations ahead, the business community seems very keen to stress the need to find a new anchor for the UK economy post-Brexit. According to a poll conducted by PwC on the eve of the EU referendum, four-fifths of UK chief executives were concerned about “over-regulation.” The Institute of Directors said 60% of its members want Britain to reduce the volume of “unnecessary red tape.”[3]

Such arguments are typically based on three interrelated assumptions.

1. The regulatory regime associated with Brussels and the European social model of capitalism have been a constraint on UK businesses. According to Open Europe,[4] outside the EU it would be “politically feasible” for the UK to save £12.8bn a year, through deregulating areas such as employment rights, health and safety,

[1] http://www.telegraph.co.uk/news/2017/01/17/theresa-mays-brexit-speech-full/
[2] https://www.theguardian.com/politics/2017/jan/15/philip-hammond-suggests-uk-outside-single-market-could-become-tax-haven
[3] https://www.ft.com/content/6e9f3e5e-12c9-11e6-839f-2922947098f0
[4] A think tank associated with Eurosceptics.

climate change and financial services."[5] Brexit opens up the opportunity to remove or ease the regulations imposed by the EU, thus making the UK business environment more appealing to global capital and more supportive of its domestic companies.

2. In the financial financial services sector specifically, the post-2008 financial regulations imposed by the EU are stifling innovation, productivity and growth. Brexit offers an opportunity to re-cast the place of the City of London as an agile, low-regulation hub for global capital that would be as competitive as other low-regulation niches such as Hong Kong and Singapore. Post-Brexit UK could even become a "serious competitor" to Switzerland as a "low-tax business location" in Europe.[6]

3. As a concrete example of a new model of economic integration for the UK, it is the Singapore model of a dynamic and open economy - defined by unilateral free trade approach and a low tax regime – that is being cited most often. A donor to the Leave.eu campaign and UK fund manager Peter Hargreaves argued that Singapore presents the best business model for the newly 'independent UK."[7] Susan Schwab, a former chief trade official President Bush Jr, suggested that the UK could become the "Singapore of the West", because post-Brexit it was in a "unique position to create a whole new template for free trade agreements."[8]

This report exposes all three sets of assumptions as (1) mistaken and (2) inapplicable to the case of the UK. There are two major reasons for this.

First, at the level of the global political economy, Brexit transforms the UK from being a rule-giver to being a rule-taker. This transformation imposes its own set of risks and constraints. Regardless of the specifics of the final deal with the EU (if any), the UK will have to abide by most global standards and rules governing major continental markets of North America, the EU and Asia, including China. Any pursuit of a deregulatory niche strategy will be imperilled by the political preferences of these major global players. And while in the financial sector specifically, domestic political and international institutional constraints may in fact appear less effective (see the pieces by Pagliari and Grahl), UK's capacity to pursue a strategy of competitive deregulation is likely to be constrained by other

[5] https://www.ft.com/content/6e9f3e5e-12c9-11e6-839f-2922947098f0

[6] https://www.ft.com/content/2354d3c0-0d8a-11e7-b030-768954394623

[7] http://www.telegraph.co.uk/news/2017/01/25/post-brexit-britain-could-singapore-effective-model-twenty-first/

[8] http://www.theaustralian.com.au/news/world/the-times/after-brexit-britain-could-be-the-new-singapore-says-trade-veteran/news-story/f9104ed9af8aa1f8b5aaf8a90bfb8a7f

jurisdictions – primarily the US – "by more extraterritorial application of their own regulatory rules" (Pagliari).

Second, perhaps the biggest illusion about a 'Singapore on the Thames' vision for post-Brexit UK is Singapore itself. The political economy of Singapore is based on principles that are vastly different to those of the UK. Singapore is a founding member of ASEAN and has been an avid promoter of regional economic integration in Asia. Singapore is a uniquely open economy: up to a third of its workforce at present consists of migrant workers; Singapore's liberalised financial centre, while among the top five in the world, caters primarily to the regional economy of Asia. Most crucially perhaps, the underlying asset structure of Singapore is unique: up to 90% of housing stock is government-owned and rents are strictly controlled by the state.

In fact, "far from being a poster-child for free-market globalisation the Singapore state is unapologetically interventionist […]The founding articles of the Peoples Action Party were cribbed from the British Labour Party, and the legacy of that post-war social democratic moment remains foundational to the success of twenty-first century Singapore."[9]

As Scott Antony explains further in the New Statesman, for the 'Singapore on the Thames' scenario to become a success, the British state "would not only have to reappraise its attitude to technocratic governance in the civil service, revolutionise its housing policies and intervene in industrial development, and it would have to develop a completely new type of immigration policy."[10]

It is possible that individual elements of this change – such as immigration or housing policies - may well feature in post-Brexit policy rhetoric, yet it is hard to imagine that a comprehensive overhaul of the UK's political economy may be achieved in the short and medium term. Not least because it will require a fundamental change in the structure of the UK's capital assets and most crucially, land ownership.[11]

In other words, the idea of replicating or even adapting the Singapore model in today's UK – with a population of 65 million, an economy dominated by the service sector and marked by low labour productivity,[12] and a financial centre tuned to

[9] http://www.newstatesman.com/politics/staggers/2017/02/heres-what-it-would-really-mean-if-britain-was-singapore

[10] ibid.

[11] Ryan-Collins, J, et al 2017, Rethinking the Economics of Land and Housing, London: Zed Books.

[12] https://www.ft.com/article-UK-labour-productivity-martin-wolf

cater to the global system by being, until now, an EU-protected 'inshore offshore' hub for global capital – is, quite simply, a non-starter.

In this report, we focus on the political, economic, fiscal and financial aspects of the UK economic system and the dilemmas of economic integration facing the country. We explain why a Singapore on the Thames model for post-Brexit UK – although technically, a possibility - is not plausible. The report is organised as follows.

Ronen Palan examines the fragile alliance of the Brexit vote and argues that the political will necessary to pursue a low-taxation deregulatory niche strategy in post-Brexit UK is unlikely to materialise. Stefano Pagliari examines the policy constraints on post-Brexit arbitrage in the financial sector, and finds that it is the national interests of the major global players – mainly the US, the EU and China- that will facilitate the extraterritorial application of national regulations and thus prevent the UK from becoming a deregulated haven. John Grahl brings the European dimension to this analysis, pointing at the prospect of over-dependence on the US and dollar funding following the failure of the EU capital market integration project.

Two case studies follow, showing that the technical implementation of a low taxation or low regulation post-Brexit strategy, while possible, will impose very high risks on domestic companies and public services by way of additional tax (Murphy) and may generate additional risks and costs in the financial sector by enabling further growth of grey and illicit financial innovations, such as initial token offerings (ITOs) currently spreading in the fintech industry (Kiminska). John Christiansen concludes our report arguing that the rhetoric of Singapore-on-the-Thames does not appear to match up to the reality of the likely post-Brexit financial services market.

Politics and the Fragile Alliance of the Brexit Vote

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The idea of a 'Singapore on the Thames' is not a well-thought out set of policy ideas for post-Brexit Britain. It is not based on anything resembling a serious analysis of the causes (and pitfalls) of the relative success of Singapore of Hong Kong and/or whether the city-state model applicable in any way to a middle size economic power with a 60+ million population. Rather, 'Singapore on the Thames' is a political project and an ideological roadmap for post-Brexit Britain driven by certain groups of vested interests that had most probably been supporting a Brexit for a long time, or at the very least since the signing of the Maastricht treaty. This essay centres on the politics of this project.

Strictly speaking, the tax haven strategy can work only for very small jurisdictions. Tax havens aim to garner income through extremely high volume of activity licensed at low costs or taxed at very low levels. But as there are many tax havens in the world, competition between them is fierce. Financial assets registered at the Cayman Island amount for about 400 times its GDP. The offshore financial centre generates certain income indirectly, but even such income is not enough to maintain the government of a nation of 55,000. Despite being the fifth largest financial centre in the world, The Cayman Island's government is practically insolvent.[1] Although the UK does have tax haven–like dimensions (which I discuss below), a fully-fledged tax haven strategy is not a viable policy.

The idea of a Singapore on the Thames refers, most probably, to a return to the heady days of the late 1950s, whereby through the establishment of the Euromarkets, the City of London had become in effect an offshore financial centre,

[1] `https://www.theguardian.com/world/2009/sep/01/cayman-islands-tax-haven-bankrupt`

subject to minimal levels of regulation. The idea may also refer to low or very low corporate taxation, perhaps even the abolishment of corporate tax altogether (See Murphy's contribution to this report). But what are the prospects for such policies to succeed? Not much. I believe Singapore on the Thames is more of a fantasy then a likely reality.

The Brexit campaign was successful in bringing together a tentative alliance of two disparate set of political projects and ideological positions united against the so-called 'metropolitan elites.' One group in this alliance, undoubtedly a minority of voters, consists of hyper-liberals: pro-business and anti-regulation, including corporate taxation (which is viewed by many economists, incorrectly in my view, as a form of regulation and a stealth tax on consumers). This group considers the host of new post-2007 financial regulations introduced by the EU and the USA as unnecessary and market-distorting. They view the EU as too interventionist, anti-business and anti-City. The other group, the majority of Brexit voters, appear to have taken a diametrically opposing view. These voters are concerned with 'globalisation', associated with intensified immigration, rising inequalities, unrestricted power of finance, and so on. The alliance of these two groups is now called 'populism': it backed Trump and other populist forces in the world.

The two groups share little in common except for their dislike of the 'establishment' or the metropolitan elites, which they associate, in the UK, with Westminster and pro-EU forces. In the US the 'establishment' is associated with the UN, the transatlantic trade and investment partnership, and the power of Wall Street. But the establishment was never defined very well. I will try and do so now. Contrary to common assumptions about unfettered neoliberalism, around the turn of the century a new established position evolved under the Clinton administration and supported by the G7 groups of nations. This view can be described as 'responsible globalisation'. The G7 meeting in Lyon, France, on June 27–29, 1996 established certain principles of responsible globalisation. The G7 tasked the OECD with dealing, among other things, with problems of fiscal leakages. The OECD published in 1998 a report titled 'Harmful Tax Competition: An Emerging Global Issue.' The report anticipated many of the issues that have led to the rise of populism. It argued that globalisation must be legitimised, and for that to happen, its benefits must be distributed more evenly around the globe. Harmful tax competition perpetrated by tax havens was singled out as undermining the legitimacy of globalisation. Since then, and in particular, following the financial crisis of 2007-8, there had been a concerted campaign led by the US, the EU and the OECD against tax abuse.

This background information is relevant for two reasons. First, the tentative populist alliance at the heart of the Brexit vote appears singularly tentative in the

UK. Such alliances do not appear to be built on solid foundations, and are likely to be pulled in conflicting directions. But some of these alliances have managed to survive in the past decade or so in countries like Italy under Berlusconi, Israel under Netanyahu, Turkey under Erdogan or even Russia under Putin. Such alliances appear to survive over time under three conditions:

1. A charismatic leader
2. who controls the media
3. and who plays up a heightened sense of insecurity or threat of war.

The conditions do not seem salient in the case of the UK. It is debatable, to begin with, whether Britain possesses a charismatic leader. Boris Johnson was supposed to be the one, but he failed miserably at the first hurdle. Theresa May does not appear as a likely charismatic leader, although perceptions may change. The media in the UK is still relatively independent and decentralised – although the attempt by Rupert Murdoch to gain control over Sky may be a significant move in the direction (and the attacks against the BBC for its 'anti-Brexit' bias). Indeed, in the US Trump is trying to wrest control of the media by discrediting serious media outlets as 'fake news.' Netanyahu is engaged in vigorous attempt to gain control over public and private media outlets in Israel. A heightened sense of insecurity is currently part of the favoured tactics of the current President of the United States, who, within the first 100 days of taking office, has managed to bomb Yemen and Syria and is now threatening North Korea as well. There is no sign that UK public is interested in war and violence right now.

My analysis suggests, therefore, that the populist alliance that gave us Brexit is unlikely to survive for long in the UK. Without those three conditions, the minority in this alliance – the hyper-liberals such as Fox or Johnson – are unlikely, in my view, to hold the balance of power in the UK. Hence, the prospects for the unregulated, low corporate tax (which, as Richard Murphy shows in this report, will lead to higher taxation and lower services to the rest of population), or the tax haven model, are slim. The domestic political context does not seem for the time being to favour the hyper-liberal developmental model.

Second, the international environment may not allow Britain to adopt the Singaporean model either. My point goes to the very heart of the argument about the so-called sovereignty gain achieved by Britain following Brexit. In the 1990s, globalisation was assumed to signal the decline of the state. But the 21st century has witnessed the rise of very large political entities as the controlling elements of globalisation, or as I call them, the rule-givers. The rule-givers consist of the largest political organisations, including the US (representing NAFTA), the EU, China and – we can anticipate – India joining this exclusive group within a decade or so. (Russia is making plans for joining as well through the formation of Eurasia; the prospects for Brazil leading a similar alliance in Latin America are currently slim). These rule-giving political entities are setting the rules of globalisation: trade and investment rules, fiscal and accounting rules and so on. These large political entities do not need to compete with each other in order to attract foreign investment or adopt pro-business policies: no large firm can afford to withdraw from any of these large markets.

With Brexit, Britain is joining the rank of the rule-takers, and that means that its ability to pursue independent set of policies, particularly during a period that it enters trade negotiations with the key rule-givers from a point of weakness, is highly circumscribed. To put it bluntly, *Britain could develop the so-called Singaporean model, provided the rule-givers will allow it to do so.* The EU has made it very clear that it will prevent the UK from pursuing this path. The EU could, and probably would, introduce various policies that prevent firms or financial institutions that may consider locating in the UK for tax and regulatory purposes from accessing the EU market. If this will be the case, then the UK will be far less attractive to firms and financial institutions because they will be barred from the second largest market in the world.

The UK, therefore, relies ever more on the consent of US for doing so. It was clear that under the Obama administration, or had Hilary Clinton won, the US would not have permitted the UK to pursue a hyper-liberal set of policies that could harm in any way the US' fiscal state or banking and financial regulations. Both the EU and Obama/Clinton shared the 'responsible globalisation' vision of the world. As the US FATCA template shows, if the UK ever developed into a tax haven, UK based or even UK linked firms or financial institutions could be barred from participating in the US economy. Without access to the EU and the US markets, UK would not be an attractive place.

The election of Donald Trump changes things quite drastically, but for the time being, entirely unpredictably. Trump is pro-Brexit, but how and why he is going to support post-Brexit Britain is not made very clear. Whereas Trump and his associates, as businessmen, may like to see the UK developing into a large tax haven for their own private businesses, it is difficult to see how to US would gain from Britain pursuing the Singaporean model. Trump's 'America first' is predicated on the assumption that business should return to the US, not move to take advantage of tax or regulatory lax environments offered by other states, including the UK. The Trump administration is about to embark on low tax policy in the US, combined with massive infrastructural expansion. It is difficult to see why the US would support fiscal leakages perpetrated through the UK.

It is still the case that in the general confusion that surrounds Brexit, and in a period of high misrepresentations and a climate of distrust of ‘experts’, and due to threat of relocation, the financial centre of London will be able to secure low regulation, perhaps even low taxation, to counteract the move of many of its institutions the continent or Wall street.

The UK holds on to domicile rules that favour the very rich born outside the UK. The UK also developed facilities such as the agency company, which is a tax structure using a UK company as an agent for an offshore company. In 2011, the UK removed taxation on the flourishing wealth management industry (tax on the corporate entities, not the individuals, serving perhaps as the template for the removal of corporate tax alto her), but it is difficult to see how the UK will be able to develop such policies more widely and fully over a long period of time in the current domestic and international political climate.

Financial Regulatory Arbitrage after Brexit: How Feasible?

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One of the benefits to come from Brexit according to different policymakers and financial industry representatives, is that Britain can 'take back control' over the way its financial services are being regulated. The process of deepening integration of European financial services since the 1990s has led a greater share of UK financial regulatory policies to be set in Brussels. While Britain has often been regarded as highly successful in shaping the design of the emerging European financial regulatory architecture, Brexit has been heralded as an opportunity to lower the regulatory burden imposed by EU financial rules over the attractiveness of the City of London. Leaving considerations of whether this strategy would be desirable aside, an important question is to what extent is financial regulatory arbitrage a feasible strategy for the UK after Brexit. In other words, what are the constraints upon the capacity of UK authorities to rekindle the competitiveness of the City of London by chart an independent financial regulatory path?

A first set of potential constraints on the capacity of UK authorities to pursue a strategy of regulatory arbitrage could come from the domestic context. The desire of policymakers to scale back established policies often runs into the opposition of those groups are the main beneficiaries of those policies. For instance, the literature on the resilience of the welfare state suggests that attempts to turn the British economy into a low tax jurisdictions are likely to be opposed by the numerous groups that would find themselves on the losing end from the reduction in spending required by the strategy.

In the case of financial regulatory policies, however, the domestic opposition to a relaxation of financial rules is unlikely to be as strong given the different distribution of winners and losers that are arise from the two policies. Attempts to relax financial regulatory requirements are likely to be supported by wide segments of the financial industry that are the beneficiaries of this strategy. On the contrary, the fact that the costs generated by this strategy in terms of higher financial vulnerability are likely to be widespread means that the financial industry will face only limited mobilisation from stakeholders opposing this strategy. Moreover, as the memories of the financial crisis fade, elected officials have little gain from opposing a relaxation of financial rules given the limited public salience of financial regulatory policies.[1]

A second set of constraints comes from the international institutional and legal framework within which British authorities will find themselves operating. Over the recent years international financial regulatory institutions, such as the Financial Stability Board, International Organisation of Securities Commissions, and Basel Committee have not only increased their standard-setting activities, but also increased their monitoring of the extent to which national authorities comply with these international standards. As a member of these bodies, the UK will continue to have its financial regulatory policies scrutinised through a variety of thematic and country-based peer reviews from the FSB, regulator monitoring exercises conducted by the Basel Committee, IOSCO, and FSB on the implementation of key international standards, as well as its financial regulatory system subject to the scrutiny by the IMF through its regular Article IV consultations, the Financial Sector Assessment Program (FSAP) and the Reports on the Observance of Standards and Codes (ROSC). However, the constraints posed by these monitoring mechanisms upon the UK financial regulatory policies should not be overstated. Unlike the multilateral trading regime where deviations from WTO commitments could result in costly legal disputes and retaliatory measures by other countries, the sanctions associated with deviation from international financial standards remain mostly a form of 'naming and shaming'. The reputational costs associated with being red-flagged by an international regulatory body as partially non-compliant with existing standards have so far remained negligible. In sum, similarly to the domestic context, also international institutions and set of international economic rules are unlikely to place significant constrains on the capacity of UK authorities to engage in regulatory arbitrage.

[1] The opposition to regulatory arbitrage is particularly likely to be low in the case of those regulatory policies where British authorities have found themselves trying to scale back the scope of more stringent rules supported by France and Germany. On the contrary, policymakers are less likely to support a relaxation of regulatory policies where they have invested significant capital during the crisis (e.g. higher banking capital requirements or structural reforms in the banking industry).

There is however a third domain where UK authorities are likely to face greater push-backs if they were to opt for a strategy of regulatory arbitrage: the inter-state context. The international nature of most financial activities means that the decision of a country to relax domestic regulatory policies in order to increase the competitiveness of its financial industry is likely to generate a response from other countries. In particular, it is possible to identify two competing types of responses. First, other countries may respond to the attempt of British authorities to relax regulatory rules by responding in a similar way. This type of "competitive deregulation" has been a key driver of many of the regulatory changes in the decade before the global financial crisis of 2008, where the battle between London and New York for primacy in international financial markets provided the justification for many deregulatory policies introduced in the US over the 1990s, as well as for the promotion of 'soft touch' regulation in the UK. While the financial crisis has brought this dynamic to a halt and most jurisdictions have engaged into international cooperative attempts at reregulating their financial sectors, recent developments suggest that competitive deregulation may be on the rise again. For instance, not long after being elected, US President Trump has signed an executive order calling for steps to "enable American companies to be competitive with foreign firms in domestic & foreign markets". This position was echoed by US regulatory authorities. The new chief regulator for US derivatives markets Chris Giancarlo has commented "Championing American markets means no longer asking U.S. market participants to go it alone and take it on the chin in implementation of global regulatory reform". Even before this, different jurisdictions in East Asia have engaged in different degrees of 'cherry-picking' and delays in implementation of elements of the G20 agenda in East Asia that can be explained in part by the attempt to attract financial activities and bolster the competitive position of their financial centres. The extent to which other major competitors abandon some of the post-crisis regulatory commitments in order to enhance the competitiveness of their respective financial industries will influence the likelihood that the UK will engage in a similar strategy.

At the same time, other countries may also respond to a strategy of competitive deregulation by adopting defensive measures to limit the impact of this strategy over their own markets. As the former head of the CFTC Gary Gensler wrote in 2012 commenting on the case of the "London Whale" (losses undertaken by JP Morgan from its London subsidiary), "trades overseas can quickly reverberate with losses coming back into the US." The possibility that US derivative dealers may escape the regulatory requirements imposed by Dodd-Frank by re-routing their derivatives trades through overseas affiliates based in London and other jurisdictions has led US authorities increasingly expand the territorial scope of US rules to incorporate also activities conducted by firms that were operating outside of the US jurisdiction. For instance, the CFTC has expanded the scope of the new derivatives rules to cover all transactions "arranged, negotiated or executed" by U.S. agents, even if conducted through a foreign affiliate or on behalf of an overseas client. Along the same lines, the new US rules governing trading platforms on which standardised OTC derivatives are being traded (SEF) includes a provision requiring all overseas trading platform on which US persons trade to comply with US rules. Along the same lines, also the regulation introduced in the European Union to govern derivatives markets (EMIR) has been criticised for its extraterritorial scope. From this perspective, the capacity of the UK to increase the competitiveness of its financial industry by lowering regulatory standards could be constrained by more extraterritorial application of their own regulatory rules undertaken by other jurisdictions. Both the EU and the US regulatory frameworks introduced after the crisis have included mutual recognition tools (called 'substituted compliance' in the US and 'equivalence and recognition' in the EU) to allow foreign actors to comply only with foreign rules if those rules were found to be substantially similar in delivering the outcomes that regulators seek. However, in practice the application of these mutual recognition tools has been limited and both the EU and US have used the threat of denying this mutual recognition in order to demand changes in the regulatory policies of a third country. For instance, during the implementation of European derivatives rules, the European Commission has for a long period withheld the recognition of US rules for clearinghouses as equivalent to the European ones, on the ground that their margin requirements for cleared swaps did not meet the same level of stringency as the EU rules. The protracted transatlantic dispute that emerged was resolved only when in 2016 US authorities agreed their clearinghouses should make targeted amendments to their margin rules to bring them into alignment with the EMIR rules, as a condition of equivalence and EU market access.

The importance of maintaining access to the EU market for the City of London gives the EU significant levers to prevent a regulatory race to the bottom by UK authorities by the threat of withholding the recognition of UK rules as equivalent to those of the EU.[2]

[2]This threat is particularly crucial in the case of the clearing of Euro-denominated derivatives. The fact that the large majority of EZ-denominated derivatives are cleared in London has been regarded by the ECB as a threat to its mandate of ensuring financial stability in the Eurozone. As the former governor of the Bank of France Christian Noyer stated in 2016, "with the UK outside the EU, maintaining the hyper-concentration of EU financial activity in London would be a permanent threat to our financial stability. No other major sovereign or monetary zone would allow itself to rely as predominantly on an offshore centre". While in the past the UK has been able to challenge the imposition of location requirements by the ECB in front of the European Court of Justice, after Brexit the UK will remain more vulnerable to the threat of the

Overall, while the domestic context and international legal environment are unlikely to exercise significant constraints over the capacity of the UK to engage in regulatory arbitrage, a more significant constraint is posed by the reaction of the EU and the US, and the extent to which these jurisdictions will either take measures to counter attempts at regulatory arbitrage or rather try to engage in a process of competitive deregulation.

equivalence of its regulatory framework being denied by the European Commission in the case this deviated from EU rules.

The Failure of Financial Market Integration in the EU and the Looming Dominance of Wall Street

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The EU's approach to capital market integration falls into four phases – each ending in failure. To begin with the problem was hardly seen. In most EU member states finance was dominated by bank credit which was allocated on a relational basis. Integration seemed to be essentially a matter of banking directives, although these did not lead to much in the way of cross-border financial activity. Different financial models had developed in different countries. In Germany, for instance, cross-holdings of equity supported industrial relationships; state-controlled finance was important in France; there were regional financial systems in parts of Italy which proved effective in development. However, it was just this diversity and the close adaptation to national or regional circumstances which turned out to be an obstacle – EU finance could not easily grow and expand beyond its home territories. The more anonymous, "arms-length", financial connections of US security markets, could though, be extended universally on the basis that "anyone can play" (obviously, provided they had dollars).

By the turn of the century the stagnation of EU output and productivity, relative to those in the US, had led to a virtual moral panic among European leaders. America's economic dynamism – in any case greatly exaggerated – was attributed to the scale and fluidity of its markets, especially its capital markets, ignoring the important role of supportive macroeconomic policies in the US. The imitation of US financial practices became a central theme in the Lisbon agenda, the EU's programme for the first decade of the new century – aimed, in the words of the Commission, at making the EU "the easiest and cheapest place to do business in the world." It was learned subsequently, and hardly for the first time, that cheap and easy business is not always good business. The capital market programmes associated with the Lisbon agenda were entrusted to D.-G. Internal Market which, under the forceful leadership first of Frits Bolkestein then of Charlie McCreevy, adopted a radically deregulatory approach. Two key Bolkestein initiatives – a complete liberalisation of mergers and takeovers and a service sector directive which would have put the regulatory regimes of all member states into competition with each other – ran into intense political resistance and were in the end adopted only in diluted form. Another scheme – to deregulate EU mortgage markets and stimulate the provision of sub-prime mortgages – was aborted after the sub-prime crash in the US.

However, in a deregulatory climate, and enthused by the euphoric response of US capital markets to the monetary easing known as the "Greenspan put", European banks built up massive exposures to the US economy. Contrary to Commission claims these banks had neither well diversified assets nor adequate capital buffers – in fact they were even more leveraged than their US counterparts and held even greater amounts of dubious or "toxic" assets. There followed acute banking crises across the EU, leading to immense bailouts at the expense of the taxpayer before triggering the latent crisis of the eurozone, which had itself been disguised only by speculative capital flows into unbalanced economies.

The deregulatory approach to financial integration then gave way to intense efforts to compensate for the absence of the horse by attaching multiple bolts and padlocks to the stable door. Financial integration now meant the reinforcement of EU-wide regulatory bodies for banks, security markets and fund managers, the introduction of a macro-prudential board to be located at the ECB and no less than forty pieces of legislation to check the adventures of banks and other financial businesses which had in fact lost much of their erstwhile appetite for risk.

The phase of rapid, and in some cases dysfunctional, re-regulation was eventually followed to a renewed effort to build integrated EU security markets. The Commission feels its legitimacy weakening because of very high levels of unemployment, especially among the young, and low economic growth. Financial factors are not, in reality, the main cause of the malaise; austerity drives across the EU and the uncorrected malfunctions of the monetary union are more important factors. However, unable to address these central problems, the Commission eagerly set about tackling a secondary one with the project of a capital markets union. Renewed enthusiasm for security markets reflects impatience with the cautious, defensive, post-crash stance of the banking sectors which still dominate financial systems in most member states. It seems probable, also, that the capital markets project represents a certain shift of emphasis away from the eurozone towards the single market as a potential source of economic dynamism. The promotion of capital markets was clearly seen as enhancing the role of the City of London, site of the largest and most liquid markets in the EU. The appointment of British Commissioner Jonathan Hill to lead the integration drive symbolised this new centrality of the City within EU policy.

It seems unlikely that the capital markets project would have got very far even without Brexit. There is a chronic lack of marketable securities, especially low-risk ones, within the EU. Stagnation holds the private sector back from seeking funds while the attempt to reduce public debt through the German *Schuldenbremse* and similar policies elsewhere has led to a severe shortage of safe, government-issued, financial assets. This shortage provoked an astonishing disruption of EU debt markets in December 2016, with banks and wealth-holders prepared to accept interest rates of minus 6% in order to get hold of good quality securities. The eurozone's problems became an opportunity for US finance as any agent able to advance dollars could swap them into euros on extremely favourable terms. It seems likely that eurozone finance will become increasingly dependent on the dollar-based system to provide the liquidity which it is unable to supply on an autonomous basis. Integration will continue, but in an indirect, subordinated form, with links between EU agents mediated through US ones.

The future of the City of London now therefore depends on how successfully it can intermediate US-eurozone relations. It remains an irony that, just as EU leaders were preparing an enhanced role for the British financial sector, an electoral *coup-de-tête* moved London out of the EU. Hill's resignation immediately thereafter could signal the death of the project with which he was charged. Post-Brexit, the City of London can no longer hope to become the European equivalent of Wall Street – centre of a massive financial system. However, it may still prosper in a more limited role – facilitating links and transactions between the increasingly dominant US financial system and EU corporations seeking access to US markets.

How Might the UK be Turned into a Tax Haven?

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The press has been much taken with the idea that the UK might be turned into a tax haven in the case of a hard Brexit. Philip Hammond has hinted at the possibility.[1] The rhetoric of the government has been to suggest that the UK will continue to be 'open for business'; a phrase first created by George Osborne in 2010 when launching his own corporation tax reforms.[2] These reduced the large company corporation tax rate from 28% to 20%, with it forecast to fall to 17%. With the concurrent changes in the laws on the tax base that meant that territorial taxation is now a de facto reality in the UK the question has to be asked as to what more the UK can do on this issue, especially when noting that Singapore has a 15% territorially based corporation tax system?

The broad answer would appear to be 'not a lot' unless the government is willing to be especially bold in its attempt to create an even more relaxed tax environment for some businesses than the UK already provides. And I stress, only boldness would work because so long as the UK has a corporation tax then its room for manoeuvre is constrained either by OECD rules and double tax agreements, to which the UK is committed, or by existing facts such as the already low tax rates, generous tax base and de facto weak regulation of companies that mean that the UK is the centre of tax abuse to which the government turns a deliberate blind eye. There is then not much more the government can apparently deliver in this area unless, I suggest, it decides to do the one thing that no one expects, and that would be to abolish corporation tax altogether.

[1] See https://www.theguardian.com/politics/2017/jan/15/philip-hammond-suggests-uk-outside-single-market-could-become-tax-haven accessed 21-4-17

[2] See https://www.gov.uk/government/publications/the-corporation-tax-road-map accessed 21-4-2017

Abolishing corporation tax has, of course, long been a favourite idea amongst right wing think tanks there isn't a Treasury minister who cannot be aware of that.[3] The appeal to them is obvious: an apparent lifting of the 'burden' on business would happen overnight. The UK would signal in the clearest possible way that it was 'open for business', even if of the tax haven variety, and the right wing would get what they want because such a move would let the UK claim it had the friendliest corporation tax regime of any major state in the world.

Appearances can, however, be deceptive. Corporation tax is expected to raise £52 billion in revenue this tax year.[4] That may be just 7.5% of total tax revenues,[5] but when the government still wishes to pursue balanced budgets that means that there have to either be substantial tax cuts as a result of this abolition or, like so many tax changes in recent years, the abolition would have to be more like a sleight of hand. The latter is more likely: cuts are already proving to be hard to find and politically difficult to deliver.

This sleight of hand is possible. The abolition of corporation tax would not create a tax-free panacea in the UK. What it would instead create is an entirely tax-free environment for foreign shareholders in UK companies, which is the tax haven bit of the idea. I however, also strongly suspect that abolishing corporation tax would actually increase taxes on UK privately owned businesses. This would be because the obvious move for the UK government to make when abolishing corporation tax would be to deem that the UK based owners of UK based companies are the actual literal owners of the profits that those companies in which they have shareholdings make, and then require that those UK based shareholders be charged to income tax at their highest marginal rate on this income, maybe whether they have actually received that income, or not.

The argument for imposing this charge on UK resident taxpayers would be three-fold. First, it would be said that this stops tax avoidance. There is some logic to this. The currently attractive arbitrage of shifting income into companies to avoid income tax might end. Second, it would be argued that the self-employed do not pay enough tax now (a line that is already rolling out, maybe in anticipation of this move) and that this move just levels the playing field. Third, it would be argued that this is a tax simplification, which it will be in the same sense that

[3] See for example `https://iea.org.uk/publications/why-corporation-tax-should-be-scrapped/` accessed 21-4-2017

[4] `https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/597467/spring_budget_2017_web.pdf` page 4 accessed 21-4-17

[5] ibid.

this government says that submitting six tax returns a year in the future is a tax simplification compared to submitting one as at present.[6]

A rhetoric to support a change that does, therefore, make the UK a tax haven for foreign investors who would suffer no tax charge at all on the profits that they earn in this country whilst increasing the tax charge ion UK resident shareholders to make good the revenue lost as a result could be created.

I also stress that technically the scheme is possible. It is based on what were called close company tax laws that were commonly used until the mid-1980s.[7] The Crown Dependencies all tried such schemes a decade ago before discovering they were not legal in EU law if they only applied to resident people (as I am sure any UK scheme would do).[8] This obstacle may, of course, now fall away.

In addition, the books may still balance despite this change. With the new tax charge on UK resident individuals that I note and with a basic rate, non-refundable, tax charge being required of UK charities and pension funds who might otherwise do rather well out of this, it is not impossible that the scheme could be revenue neutral with a 17% corporation tax rate.

So why might a UK government be tempted to do this? There are at least six reasons. First it would signal a change not possible in the EU. When Brexit will actually produce so little obvious change in the UK the government might be desperate for such a measure. Second, such a move might show aggression towards Europe, and maybe the US come to that, when both might threaten our own tax base. Third, it will be claimed that this will draw inward investment into the UK without breaching competition rules (although I doubt it will achieve that investment goal in practice).

Fourth, this will appease the Tory right who are going to be mightily upset by any Brexit deal, including no deal at all.

Fifth, such a move will neuter a tax favoured by all other political parties of all other persuasions who will then have problems reintroducing it creating clear political difference.

[6] http://www.taxresearch.org.uk/Blog/2017/04/06/the-uks-tax-simplification-now-means-submitting-six-tax-returns-a-year-not-one/ accessed 21-4-17

[7] For discussion of what a close company is see https://uk.practicallaw.thomsonreuters.com/4-107-5926?__lrTS=20170421083449092&transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 accessed 21-4-17

[8] http://www.taxresearch.org.uk/Documents/JerseyEUCodeReport15-6-05.pdf accessed 21-4-17

And last, but by no means least, this walks right round the OECD rules and constraints in double tax agreements by simply letting the UK claim there is no corporation tax left for them to refer to.

The question to then be asked is how this might impact quoted companies? My suggestion is straightforward and is that I do not think it would: I suspect they would be exempted in full from the corporation tax charge and from the rules deeming their shareholders to have received an income they might not really enjoy, further biasing the tax system to big business.

So, who would the winners be? Those outside the UK. They could trade in this country tax free. They would pay no UK source tax on profits earned here despite enjoying the benefit of all the facilities we provide. This would be a direct subsidy from the UK to those not resident here, in classic tax haven style.

And the financial services sector – bankers, lawyers and accountants – would win, of course.

The cost would be to British business and its owners, as well as to the opportunities foregone because British companies would lose their competitive advantage and they still employ most people in the UK. How likely is this? That's for an election to decide.

Brexit as a Catalyst for Reinventing the Eurodollar Markets

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In spring 2017, London has topped the list of fintech capitals of the world. [1] In the space of JUST a few years, the financial technology sector has grown from a few start-ups challenging established financial institutions to an industry in its own right, having generated £6.6 billion in revenues and having attracted around £524 million in investment.[2] Fintech companies employ about 61,000 people — about 5% of the total financial services workforce - making the UK larger than rival techhubs in New York, and Singapore, Hong Kong and Australia combined. [3]

But with competition from other cities getting more intense, many seem to believe that it is the withdrawal from the EU that will help London sustain its leadership in this area of financial activities. Although experts warn that a bonfire of regulations is unlikely to benefit fintech,[4]Brexit does allow London become as a *de facto* base for risk in the grey markets. In fintech, these opportunities exist outside of conventional regulated finance.

A case example is the rise of the ITO "Initial Token Offering" market. ITO is the digital equivalent of the Initial Public Offering. Using blockchain technology, instead of buying shares, investors use cryptocurrencies such as Bitcoin or Ether

[1] http://www.cityam.com/262644/london-keeps-hold-global-fintech-lead-but-these-global

[2] https://www.gov.uk/government/publications/uk-fintech-on-the-cutting-edge

[3] https://www.ft.com/content/08c52e4a-3c6d-11e6-9f2c-36b487ebd80a

[4] http://www.cityam.com/261244/why-red-tape-bonfire-wont-help-fintech-fcas-christopher

to buy digital tokens without paying the high commissions associated with equity investing.[5] Via the ITO, capital locked in the cryptocurrency world finds a way to funding legitimate business. ITOs therefore, performs a maturity transformation function for capital which would otherwise decay much more quickly.

The phenomenon closely resembles the rise of the Eurobond markets in the late 1960s. The Eurodollar market stemmed out of the Suez Canal crisis of 1956 and the imposition of restrictions on the use of sterling in trade credits with non-residents. At the time, many City banks, who saw their core business of international lending disappear, responded to the new rules by using US dollars in their international operations, and explained to a receptive Bank of England that such transactions have no bearing on UK balance of payment issues.[6] The Bank classified certain types of financial transactions undertaken between non-resident parties and in foreign currencies as non-UK transactions. Yet as these transactions were taking place in London, and since they could not be regulated by any other regulatory authority, they effectively ended up in a regulatory black hole. This black hole, soon to be joined by others and to become known as the offshore financial markets or Euromarkets, was the most important enabling factor behind the rise of London as a global financial centre in the 20th century.[7]

In essence, the ITO process represents an asset swap which exchanges cryptocurrency funds for assets entitling holders to legitimate fiat income stream. The ingenuity of the swap relates to the fact that it allows legitimate companies to formally liquidise cryptocurrency stock, and illegitimate companies to remain offshore beneficiaries of legitimate revenue streams.

Like the Eurodollar market, the fintech sector is predicated on ignoring existing regulations and moving in-between the crevices of existing regulatory structures. While Brexit withdraws a lot of funding from start-up fintech firms, at the same time it also allows them to explore entirely new avenues in the grey area. Interestingly, while most fintechs were originally very worried about Brexit, now collectively they see it as an opportunity. ITO markets do not need passports and thus are posed to expand, at least in the short term, despite Brexit uncertainty and risks.

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[5] `https://medium.com/@tokenfunder_53555/the-tokenfunder-project-initial-token-offerings-as-a-revolutionary-equity-crowdfunding-platform-on-205b3337f957`

[6] Burn, G., 2005, The State, City and the Euromarkets, Basingstoke: Palgrave.

[7] Ibid.; Lysandrou, P., A. Nesvetailova, R. Palan, 2017, "The City of London: Economies of Scale and Discriminatory Policies behind the Global Financial Centre", Economy and Society, forthcoming.

Singapore-on-the-Thames: Slogan or Strategy?

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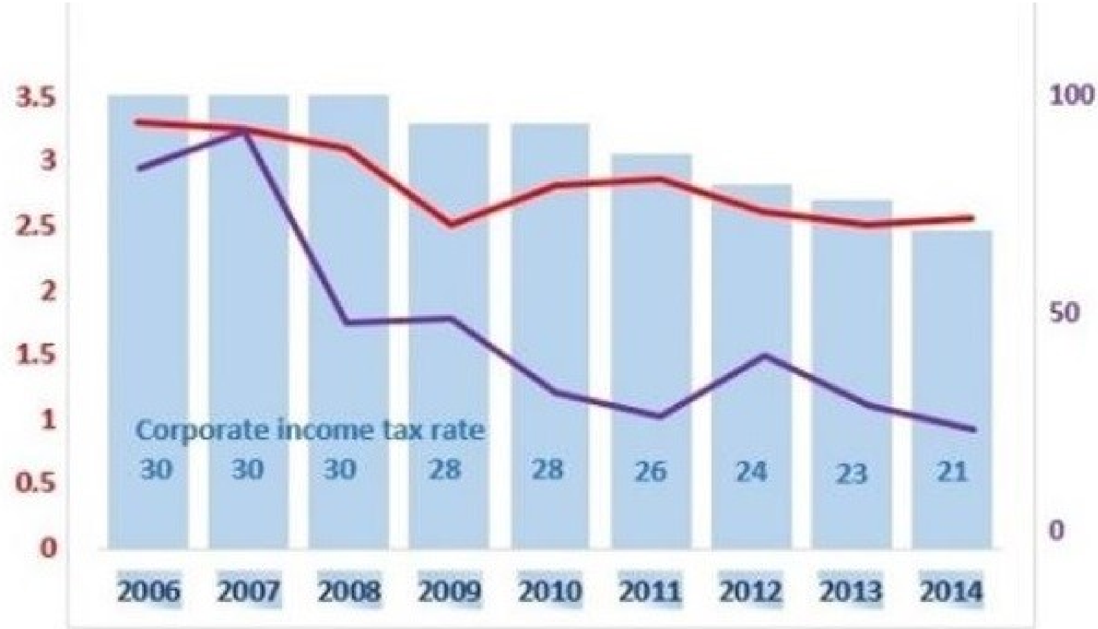
Brexit was largely sold to the British public under the slogan of "taking back control". In reality withdrawal from the European Union will remove Britain's ability to block EU attempts at strengthening financial market regulation, leaving the City of London's light-touch regulation and offshore secrecy vulnerable to international reform pressures. The UK remains trapped by the Finance Curse, which limits its post-Brexit development options.

For decades successive British governments have placed 'light-touch' regulation and corporate tax cuts at the core of their economic development strategies. So-called 'competitiveness' is seen as key to attracting mobile foreign direct investment to Britain, with particular focus on securing London's status as the globally pre-eminent offshore financial centre. The assumptions behind Prime Minister May's proposed post-Brexit strategy of enlarging London's tax haven role offshore the European Union is that further cuts to the CIT rate, and more tax reliefs alongside even greater regulatory and compliance laxity, will be sufficient to match Singapore's success as the fastest growing offshore finance centre in Far East Asia.[1] The key question here is whether such a strategy is viable, especially within a fast evolving international ecosystem of rules and regulations that previously allowed Britain's offshore secrecy jurisdictions to flourish.

Since the 1980s government and opposition parties have taken it as self-evident that expanding London's offshore financial centre would benefit the rest of the UK economy. Former London Mayor Boris Johnson said in 2012 that *"a pound spent in Croydon is of far more value to the country than a pound spent in Strathclyde.*

[1] `http://www.economist.com/news/leaders/21714986-government-promises-truly-global-britain-after-brexit-plausible-theresa-may-opt`

Chart 1: Corporate tax rates, inward FDI flows, and corporate tax yields (2006-2014)



Red line: corporate tax receipts as a percentage of GDP – left axis
Purple line: Net FDI flows into the UK (£ billion) – right axis

Sources: Tax Justice Network; UK Office for National Statistics

You will generate jobs and growth in Strathclyde far more effectively if you invest in Hackney or Croydon or other part of London." This London-centric development strategy was reinforced by government responses to the 2008 great financial crisis, which largely focussed on rebuilding the balance sheets of the larger banks while massively reducing funding to public services and infrastructure investment in most regions apart from south-east England.

Despite accumulating evidence that beyond a certain size financial sector growth does not deliver benefits to the host country and renders it vulnerable the Finance Curse,[2] and despite overwhelming evidence that cutting CIT rates (see chart 1) and deregulating financial services is counter-productive, the current British government threatens to go further and faster if it is unable to secure favourable post-Brexit trading terms with the EU.

[2]See Shaxson, N. and Christensen, J. (2013) The Finance Curse: How Oversized Finance Sectors Attack Democracy and Corrupt Economics, Commonwealth Publishing, London

Chart 1 tells an important story about the effectiveness of using corporate tax cuts as a means of attracting inward FDI flows. The UK CIT rate was cut from 30% to 21% between 2006 and 2014 (and has since been cut further to 17 percent), but inward FDI flows fell significantly and have largely involved investment in real estate and mergers and acquisitions. Furthermore, and contrary to Laffer Curve theory, corporate tax yields have continued their long-term secular decline, notwithstanding the fact that private sector companies have expanded their role in the overall economy and returns to capital have increased as wage rates have remained largely static. The evidence suggests that cutting CIT rates does not achieve the claimed benefits and, worse, trying to compete with other corporate tax haven economies like Ireland, Luxembourg and the Netherlands, will merely lead to even lower tax yields with no measurable gain (as the Patent Box fiasco demonstrated[3]). Furthermore, the long term international trend away from the OECD's past reliance on the arm's length method to determine corporate profits allocation between different jurisdictions is steadily giving way to a profits split approach which more clearly aligns taxing rights with genuine economic substance. This will inevitably reduce the potential for profits shifting to tax havens, undermining the viability of a tax haven-based development strategy.

Looking to the medium and longer term the Singapore-on-the-Thames development strategy is likely to face strong head winds from a combination of heavy competition – not least from Singapore itself, which has geographic advantage in the fast growing south east Asian financial markets – and from international efforts to resist tax haven activity. Brexit confronts the City of London and its offshore satellites in the British Overseas Territories (BOTs) with the political challenge of trying to resist EU pressures for improved cooperation and enhanced transparency while no longer being able to act as a blocker at the European Commission. For the BOTs, which have acted for decades as the secretive conduits of dirty money flows in to London, the UK's withdrawal from the negotiating table in Brussels threatens major disruption. We can reasonably anticipate that major concessions, for example on transparency of trusts and public disclosure of company ownership information, will be a bargaining chip in return for financial passporting rights for banks and law firms seeking to sell cross-border services into the Single Market.

The City of London faces an additional political hurdle arising from widespread perceptions around the world that the contagious effects of light-touch regulation have spawned a culture of financial rent-seeking combined with money-laundering on an industrial scale. For prudential reasons EU27 politicians and negotiators

[3] See Picciotto, S. (2014) here http://www.taxjustice.net/2014/11/17/patent-boxes-progress-racing-bottom/

are likely to require that a considerable range of services currently provided on a cross-border basis out of London will need to relocate to commercial establishments operating within the Single Market. Needless to say, commercial establishments located in Amsterdam, Frankfurt, Luxembourg or Paris will come under the regulatory regimes of the respective host countries.

Most City banks and law firms are currently evaluating which of their services can remain in London (under so-called Mode 1 arrangements, that largely relate to some types of insurance services, a limited range of deposit-taking and loan activities, and some fund management activities), and which services will require commercial establishment in a financial centre within the Single Market under Mode 3 arrangements. Given the level of uncertainty surrounding the nature of the trading arrangements that will eventually emerge from forthcoming negotiations between Britain and the UK, many City businesses are likely to default to the less risky option of relocating key operations to commercial establishments with the Single Market.

In conclusion, the rhetoric of Singapore-on-the-Thames does not appear to match up to the reality of the likely post-Brexit financial services market. Britain will no longer have a role as a rule-maker in Brussels, but London-based banks and law firms wanting to sell services into the Single Market will need either to relocate some (maybe all) activities to commercial establishments operating within the Single Market, or will need to secure passporting rights that comply with regulations set by EU27 member states, who are likely to take strong positions on exercising their rights to prudentialism. BOTs like the Channel Islands will no longer be protected by Britain's presence in Brussels and may well face existential threats to the offshore secrecy that underpins their role as offshore financial centres adjacent to Europe. To further complicate matters for the UK government, having succumbed to the Finance Curse, the UK economy is trapped by a legacy of underinvestment in research, infrastructure, training and industrial diversification. Overcoming the Finance Curse will require a sustained effort to reduce Britain's dependence on an over-sized financial sector in order to create opportunities for development of other sectors.