EU exit and London's businesses

April 2017

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London is home to a wide range of business sectors which together deliver a highly productive and competitive economy generating 30 per cent of the UK's tax revenues.[1]

The Mayor should lobby Government to adopt a set of principles which will underpin the UK's EU exit negotiations, to ensure the London economy continues to thrive.

These should include:

1. ***Clarity and stability on the UK's negotiating position on future trade arrangements.***
2. ***A whole economy approach which acknowledges the interdependence between London's small and large businesses.***
3. ***Specific consideration for the financial sector, recognising the pivotal role it holds in the London and UK economies.***
4. ***The simplest possible access to the European single market.***
5. ***Rapid regulatory alignment.***
6. ***The need to avoid cliff-edge scenarios and to ensure adequate transition periods.***
7. ***Incorporating the voice of business in the UK's negotiation stance.***

Businesses of all complexions and sizes are gearing up to navigate the departure from the EU and establish ways of doing business under new terms. It is crucial that businesses across London and the UK remain active partners in developing the templates for future UK trading and regulation with our EU and world partners.

The London Assembly Economy Committee has taken evidence from London business representatives to understand the challenges and opportunities that lie ahead for businesses, as the UK prepares to exit the EU. This report summarises the views shared, into a set of principles that should shape the Government's negotiations to support the London economy as we exit the EU.

The London Assembly Economy Committee held a series of meetings exploring the effect of EU exit on London's key sectors and the people who work in them. If you have any comments or would like to find out more you can get in touch via carmen.musonda@london.gov.uk.

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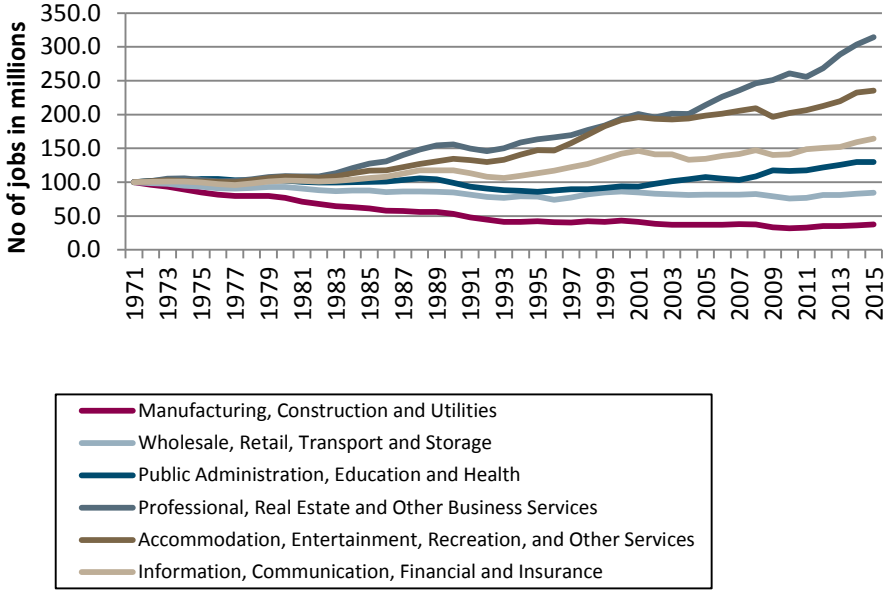
A productive and competitive London economy

London is home to a diverse and vibrant economy. A wide range of business sectors, from financial and business services, through to construction, technology, and the life sciences, plus the creative and manufacturing sectors, together deliver a highly productive and competitive economy. The collective economic output (measured in gross value added), across the sectors represented in the London economy, is estimated at £364 billion.[2] This equates to almost one quarter (23 per cent) of the UK's overall economic output; while the capital's tax yield[3] accounts for almost 30 per cent of national taxes.[4]

Our evidence gathering has focused on the following sectors:

- A uniquely diverse financial sector which contributes nearly one fifth to London's economic output.[5] It is an "anchor tenant" to many other sectors including a thriving business services sector, which continues to drive growth and job creation across the city. Together with the professional services sector, business services is expected to generate almost two-fifths of all jobs increase in London to 2036.[6]
- The science and technology sector, which has also seen a boost in recent years, largely driven by the Tech City initiative launched in 2010. Tech City started out as a modest grouping of around 250 tech firms, growing to in excess of the 5,000 seen today. The Frances Crick Institute, part of the Med City initiative, will be Europe's largest centre of biomedical research, bringing together six of the UK's most successful scientific and academic organisations to drive innovation in new technologies.[7] Figure 1 below shows both diversity and evolution of the London economy over the past four decades, and the shift towards professional and business service activities, measured in terms of workforce jobs, during that time.

Figure 1: Workforce jobs by selected broad industry sector, London, 1971-2015



Source: GLA Economics, Greater London Authority, March 2017

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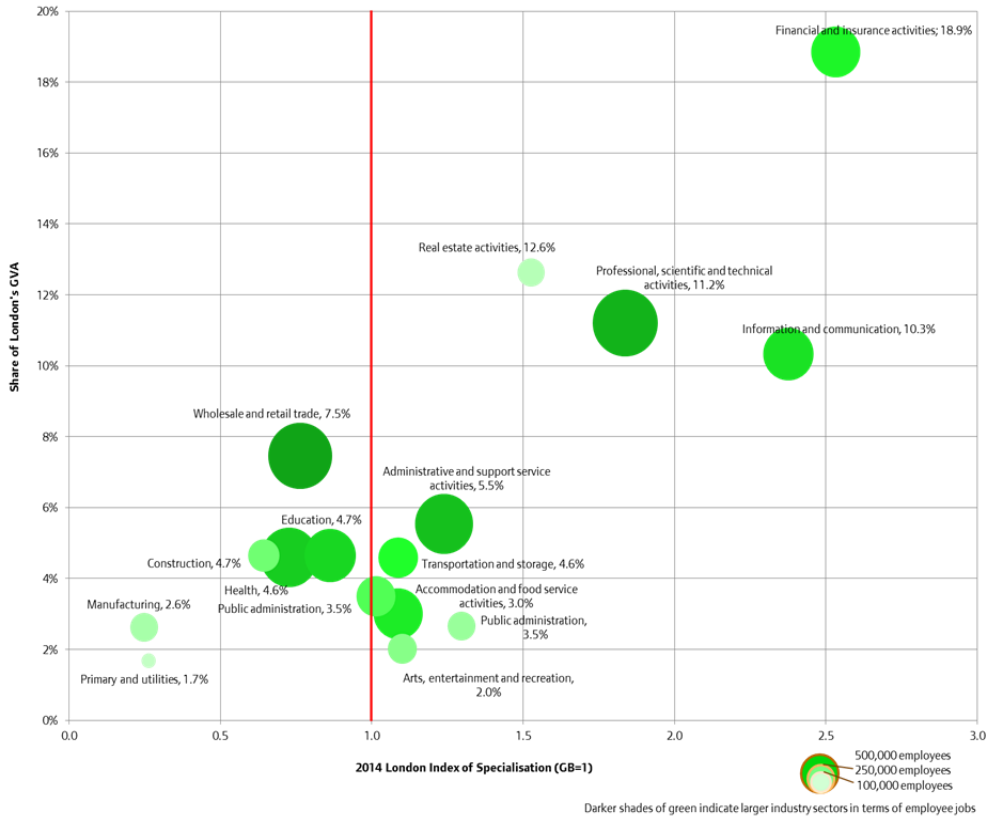
Figure 2: Index of specialisation compared to total output share, 2014



Source: GLA Economics, Greater London Authority, March 2017

Figure 2, again illustrates the diverse range of sectors represented in the London economy, alongside the degree or level to which it has become specialised in certain sectors, shown in terms of their proportion of the economy's total output, measured in gross value added. Sectors shown to the top right quadrants of the chart would be considered as highly specialised and contributing significant levels of output. The London economy is particularly specialised in the services sectors, the most significant of these being financial and insurance activities.

The need for stability in a rapidly changing landscape

The Prime Minister's speech in January outlined elements of the Government's aspirations for the UK's exit from the EU. However, the Prime Minister set out the scope for a trajectory which goes against a number of key asks previously expressed by businesses, across the range of sectors that make up the London and UK economies – the most noticeable one being continued access to the European single market. For many London businesses, this has left the outlook unclear, and therefore uncertain.

The Prime Minister has ruled out maintaining existing access to the single market, which for some businesses is essential to their day-to-day functioning. She proposes, instead, that the UK leaves the single market and seeks to establish a redefined customs agreement with the EU, which will exclude the Common Commercial Policy and Common External Tariff. These changes are likely to result in increased expense and bureaucracy in the short term and potentially for the medium and

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longer term, and could put at risk the ability of many small firms to trade easily with their European counterparts. The Prime Minister has stated that 'no deal' is better than a 'bad deal' and as a result there is a possibility that the UK could fall back on World Trade Organisation (WTO) rules.[8] Although it has since been reported that this is no longer being seen as desirable by some cabinet ministers.[9]

While some initial nervousness has abated, business confidence remains precarious. The Government could do more to allay ongoing concerns. A poll of 500 businesses by courier group CitySprint found that two-thirds of London firms polled thought that an exit from the EU would disrupt their business. This compares to around half of businesses in the rest of the UK. Furthermore, more than half of London SMEs felt less confident than a year ago, compared to less than a third of UK businesses. The Federation of Small Businesses' (FSB) London Small Business Index, published in July 2016, dropped into negative territory for the first time since 2012.[10] The index measures both confidence levels and the costs of doing business.

While more recent indications are that business confidence is recovering, common areas of concern across all business sectors in London remain.[11] In particular, uncertainties over the timetable for exiting the EU, along with the type of trade agreements to be secured and the possible impact.

The committee also heard about particular concerns for different sectors. For the services sectors, it might be the need for the simplest possible access to the single market; for those trading in goods, the new administrative burdens and tariffs to pay. For others, such as the pharmaceutical sector, the potential for higher purchasing costs is a key concern. For the tech sector, it is the uncertainty around whether it will continue to attract world class talent, and the knock on effects on the continuing development of the industry at pace.

Some clarity on the timing for the UK's exit from the EU was reached with the European Union (notification of withdrawal) Bill receiving royal assent on 16 March; and the triggering of Article 50 on 29 March.[12] The Prime Minister now has the mandate from Parliament to get the necessary negotiations with our European partners underway.

A clear set of principles to shape a UK exit from the EU

The Government needs a clear set of principles to guide negotiations on the UK's exit from the EU. Negotiations over the next two years will form the basis for future business operations, trading, and wider interactions, not just with our EU partners, but with global ones too. The clear message from London business representatives is that these discussions must be underpinned by core principles to ease the transition, and minimise any risk to the capital's competitiveness and attractiveness as a business location.

The committee therefore calls on the Mayor to lobby for a set of principles to guide the UK's government's actions as we exit the EU. These should include:

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1. ***Clarity and stability on the UK's negotiating position on future trade arrangements***

Clarity and stability on the UK's future trading framework are top priorities for London business. In the lead up to the 2017 Budget, the CBI called on the Government to prioritise stability. CBI Chief Economist Rain Newton-Smith said "prioritising stability will inject further confidence in the economy now, and help boost the country's productivity and prosperity for the future." The City of London maintains that certainty and clarity are its key priorities.[13] These statements echo the sentiments of those heard by the committee. The committee agrees that the fundamental tenets of stability, certainty, and clarity, along with the space to boost jobs and growth, are vital prerequisites to the continued success of the London economy.

Current membership of the EU customs union provides clarity and stability in day-to-day goods trading, for the most part doing away with tariffs and barriers that would otherwise apply.[14] It simplifies trade between the member countries, and establishes a common set of rules on trade with third countries. The Prime Minister has confirmed that while she is keen to preserve some form of customs union, the UK will not be part of those elements–the Common Commercial Policy and Common External Tariff–that she considers will inhibit the UK's ability to strike trade agreements with other countries.

The likely fallout for business, as Government seeks to clarify the shape of future trading relationships, is a considerable concern. Extricating the UK from the EU customs union could prove to be a long and arduous task potentially resulting in increased bureaucracy and higher costs for business. Re-defining the relationships and frameworks currently associated with single market membership could prove challenging. The sheer scale and complexity of the challenge ahead was made clear by Dr. Hilary Coles of Janssen Research and Development United Kingdom, who represented the pharmaceutical industry. She said, "with a complex business that is multi-transactional and not just about goods but about standards, regulations and safety, we see a mountain of paperwork ahead of us."[15]

"Talking to our members the thing that comes through is that it is going to take time to have these new international trading agreements and it will, inevitably, lead to more costs in terms of reorganising the supply chains. There is a considerable amount of uncertainty as to how you would adapt it, how long that would take and what the cost implications would be." Dr David Lutton, Director of Policy, London First

2. ***A whole economy approach to acknowledge the interdependence of large and small businesses' procurement and supply chains.***

Any agreements reached on new trading relationships with our European and global partners must recognise and promote a whole economy approach. Some of the largest companies in the world are headquartered in London. According to research by Deloitte, London is

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host to 40 per cent of the European headquarters of the world's top companies. It also shows that 60 per cent of top non-European companies with headquarters in Europe chose London as their base.[16]

However, small and medium-sized enterprises (SMEs) are integral to, and account for, the vast majority of both the London and UK economies. SMEs make up well over 99 per cent of all London's private sector businesses, and represent around half of all London employment.[17] In terms of their contribution to the UK economy, London SMEs account for 17 per cent of all UK private sector SMEs and 30 per cent of the turnover generated by all UK private sector SMEs.[18] Currently, 32 per cent of small businesses nationally trade overseas, with most trading with the single market – 92 per cent in exports, and 85 per cent in imports. According to recent research by the FSB, access to the EU single market continues to be a top priority for small business.[19] And while most SMEs do not export to the single market, many of them are part of EU-wide supply chains.

"Leaving the EU will be a highly complex process, and all sectors of the economy are making their priorities clear in order to get it right. The Government will need to take a whole economy approach to avoid leaving sectors behind." Carolyn Fairbairn, CBI Director-General

3. ***Specific consideration for the financial sector, recognising its pivotal role in the London and UK economies.***

A sectoral deal to allow the financial services sector access to the European single market should be considered. The Prime Minister has confirmed that the UK will not seek to remain in the single market.[20] The financial services sector is the life-blood of the London economy, and dependant on open access to the single market for continued operation across the EU. Together with insurance services, it accounts for around a fifth of the London's economic output.[21] Dr David Lutton, Director of Policy at London First, told the committee that while London's economy is not entirely dependent on professional services, the financial services sector "is an anchor tenant" to many of the varied clusters which make up the London economy. He said, "anything that affects that, could have a detrimental knock-on effect to the rest of the economy. While things like 'passporting' might seem a very narrow interest for financial services, it is important for all of business to get around what is right for London's economy generally."[22] The committee recognises that the ramifications of the loss of access to the single market for the financial sector will be felt far beyond, and as such warrants special consideration in the Government's future negotiations.

The Government has indicated a willingness to consider sector-based deals. The agreement reached with Nissan would appear to suggest the UK is prepared to negotiate EU access for certain sectors without tariffs and bureaucratic impediments.[23] In December 2016, Rt. Hon David Davis MP, Secretary of State for Exiting the EU, told the House of Commons

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that getting the best access for goods and services to the European market was a 'major criterion'.[24] The committee would like to see the Mayor hold the Secretary of State to that claim.

4. The simplest possible access to the European single market

Businesses need the simplest possible access to the European single market. The single market removes barriers to trade and other regulatory obstacles, and harmonises national rules at EU level. It provides a single set of rules across EU countries governing the free movement of capital, services and goods.

Loss of single market access will present significant challenges for other sectors, not just financial services. Dr. Hilary Coles, Associate Director, Janssen Research and Development United Kingdom, told the committee "access to the single market is incredibly important for our continued operation and prosperity (…) loss of access (…) means we are going to have to be involved in negotiations on tariffs and taxes, etc. It will be very, very complicated in a complex organisation such as ours where these are already structured, in place and agreements already exist. You can imagine the complexity of trying to renegotiate that across the world."[25]

Similarly, Tech London Advocates, speaking on behalf of the tech sector in London, also stressed the importance of single market access. Simon Kleine, Director of Corporate Communications, Tech London Advocates said, "a lot of the start-ups that have been based in London or the scale-ups that have been developed have attracted foreign investment because of the access the single market gives. The removal of that adds a barrier (…) That success is jeopardised by the removal of the single market."[26]

Small businesses will also face significant challenges to keep trading in Europe without easy access to the single market. Their key concern is to maintain the simple ability to trade with an EU-wide VAT system as is currently in place, and uninterrupted supply chains. As Sue Terpilowski OBE, London Policy Chairman, FSB, told the committee "they would rather have the simple access and keep the bad rules, than not [have] the simple access."[27]

5. Rapid regulatory alignment

Early clarity on how future regulation will take shape is crucial. Outside of the single market, the City will need to demonstrate regulatory equivalence to secure continued access to "passporting" rights.[28] However, the principle of regulatory equivalence is yet to be fully tested, and this is unlikely to take place before early 2018, when the relevant regulation comes into force.[29] Furthermore, the process to establish equivalence is likely to be protracted, as seen in the America/EU negotiations in relation to trading and clearing derivatives. These took over three years to settle.[30] A similar approach would be needed across other sectors, such as the pharmaceutical sector, where access to the single market is key to its success.

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Close alignment to EU regulation will be needed, to ensure continuity and credibility. For the pharmaceutical sector, for example, anything less, could prove particularly challenging. Dr. Hilary Coles told the committee, "probably the first point for our industry is making sure that our regulations are very much aligned to the EU regulations (…) in whatever shape, so it has credibility across the world."[31] This echoes the views expressed by Dr Virginia Acha from the Association of the British Pharmaceutical Industry, in her evidence to the House of Lords EU External Affairs Sub-Committee. She was clear that securing alignment and cooperation with EU medicines regulation should be a primary objective in any EU exit negotiations.[32] The pharmaceutical sector is calling on Government to prioritise talks to secure an appropriate regulatory framework, as part of the overall negotiations for an EU exit.

6. *The need to avoid cliff-edge scenarios and to ensure adequate transition periods.*

Businesses are keen to avoid a 'cliff-edge' scenario. Businesses are particularly vocal about the need to build in sufficient time and adequate support to aid the transition to EU exit. A major concern for SMEs is the support to pursue global trading opportunities. The committee heard that the quality of support for overseas trade missions–vital to establishing international trading links–is variable. Financial support can be quite difficult to come by and tends to focus on the initial trip, not taking into account that several may be needed before any agreement can be reached between the counterparties.[33]

The lack of alignment and coordination between the various bodies responsible for providing trade support is unhelpful. At a national level, the Government Department for International Trade (DIT) provides support to SMEs to export and grow their businesses overseas. Support is also available at regional level for London businesses, through the Mayor's International Business Programme, as well as through the various membership bodies, such as the Chamber of Commerce and Industry (CCI), and FSB.[34] According to Sue Terpilowski OBE, London Policy Chairman, FSB, the DIT and GLA lack synergy in their programming, and streamlining and better working, instead of having the two different factions is needed.[35] She said "you could do this nurturing through a system if you had the two working together so that you start in one and progress up through into the other and get help through [the CCI](…)sometimes they are almost competing with each other for the same business".[36]

The Prime Minister has committed to developing a clear timetable for concluding EU exit negotiations, and a phased process of implementation to allow business to plan and prepare. She has confirmed that negotiations will conclude within the two-year time frame following Article 50 being triggered[37] on 29 March, it is now time for the Government to begin to set out more detail on what phased implementation will look like, and how businesses might best prepare for the months ahead.

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7. Incorporate the voice of business in the UK's negotiation stance

Businesses should be active partners in developing the template for future trading and regulation. The emerging template for future trading relationships and regulation will need to provide the right framework to enable a thriving economy.

The recent open letter to Government by a collective of business leaders adequately summarises the position. "Industry input into the Brexit negotiations is critical. The Government must enter negotiations with the evidence it needs to understand the implications of the decisions and trade-offs that lie ahead. This evidence must be drawn from the on-the-ground experience of small, medium and large enterprises."[38] The committee agrees with this stance. It is vital that those leading negotiations on the UK's exit from the EU fully engage with, and take on board, as far as possible, the views of businesses both large and small; to mitigate the potential impact that leaving the EU will have on London's businesses and its economy.

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Endnotes

[1] 10 years of tax, How cities contributed to the national exchequer from 2004/05 to 2014/15, Centre for Cities, July 2016
[2] **GDP and GVA:** The size of an economy is measured by looking at the total value of new goods produced and services provided in a given time period – i.e. the total output. This is calculated at a national level using a measure called Gross Domestic Product (GDP). GVA is GDP excluding taxes and subsidies on production (so GVA would not include VAT, for example).
[3] The taxes referred to here, relate to 'economy taxes', which include all tax revenue dependent on the growth of the economy, such as income tax, land and property taxes, and VAT.
[4] 10 years of tax, How cities contributed to the national exchequer from 2004/05 to 2014/15, Centre for Cities, July 2016
[5] A description of London's economy – Working paper 85, Greater London Authority, March 2017
[6] Draft Economic Evidence Base for London 2016
[7] The Medical Research Council, Cancer Research UK, the Wellcome Trust, University College London, Imperial College London, and King's College London.
[8] The government's negotiating objectives for exiting the EU: PM speech, 17 Jan 2017
[9] The Telegraph, 12 March 2017
[10] FSB London Index report sharpest drop in small business confidence – Q2 2016 (FSB)
[11] The FSB London Small Business Index for Q4 2016, shows that business confidence in London remains in negative territory with a reading of -3. In Q2 2016, it stood at -10.
[12] Theresa May to trigger Article 50 on 29 March, Guardian, 20 March 2017
[13] Budget: what do businesses want, BBC news, 5 March 2017
[14] But excise duty and VAT may apply in some cases
[15] Transcript of Economy Committee meeting, dated 13 December 2016
[16] London Futures, London crowned business capital of Europe, Deloitte, April 2014
[17] SMEs in London's economy, Greater London Authority, 2012
[18] Business population estimates 2016, Department for Business, Energy & Industrial Strategy, October 2016.
[19] What small firms want from Brexit: A preview of FSB's Brexit, Federation of Small Businesses, January 2017
[20] The government's negotiating objectives for exiting the EU: PM speech, 17 Jan 2017
[21] A description of London's economy – Working paper 85, Greater London Authority, March 2017
[22] Transcript of the Economy Committee meeting, dated 13 December 2016
[23] BBC News, October 2016
[24] BBC News December 2016
[25] Transcript of Economy Committee meeting, dated 13 December 2016
[26] Transcript of Economy Committee meeting, dated 13 December 2016
[27] Transcript of Economy Committee meeting, dated 13 December 2016
[28] Passporting gives bank and other financial institutions the right to do business across the Economic European Area without needing further authorisation in each country. EU exit and the financial services sector, November 2016
[29] Markets in Financial Instruments Directive (MiFID 2): The decision rests with the European Securities and Markets Authority (ESMA), based in Paris.
[30] A similar clause in the European Market Infrastructure Regulation, which governs the trading and clearing of derivatives, was tested between America and EU. It took over three years before American regulations on clearing-houses were deemed equivalent by the ESMA. Financial tonic, The Economist (9 July 2016)
[31] Transcript of the Economy Committee meeting, dated 13 December 2016
[32] EU External Affairs Sub-Committee evidence hearing, 17 October 2016
[33] Transcript of Economy Committee meeting, dated 11 October 2016
[34] The three-year programme is delivered by London and Partners, the Mayor's official promotional agency for London, and aims to support 800 London businesses to generate new sales overseas.
[35] Transcript of Economy Committee meeting, dated 11 October 2016
[36] Transcript of the Economy Committee meeting, dated 13 December 2016
[37] The government's negotiating objectives for exiting the EU: PM speech, 17 Jan 2017
[38] Business Groups' 2017 priorities, 1 January 2017