Trade – what might change?

With the changes in rules post Brexit and supply issues during the pandemic, issues of trade and whether globalisation can, or will, continue were much debated

What are the futures for world trade?

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"Globalisation is dead." It is argued that the rise of populism, and its two most obvious successes – the Trump administration and Brexit – have proved it. "America First", claimed Mr Trump in his Inaugural Address. The British government focus on sovereignty above all during the Brexit negotiations could have had "UK First" written as its headline. President Macron has called for a "European sovereignty". The Biden administration seems to be pursuing the main core of the Trump "decoupling" from China. "Onshoring" is rising as jobs are brought back to the countries that only ten years ago, had happily farmed them out overseas. The goal of a worldwide marketplace is collapsing in the face of protectionism, a fear of China, a rise of bilateral agreements over international ones and a worldwide growth in nationalist sentiment.

So many analysts would have you believe. It is possible they are wrong.

The first reason is that there is not, and never has been, the sort of globalisation implied by the term "globalisation". The post-World War II trade environment exemplified by such bodies as the WTO, and such concepts as the rule of law, developed a common basis for trade between nations. But the world never became a common marketplace. There were always barriers – of distance, of cost, of availability of raw materials, even before one looks at the artificial barriers of tariffs, taxation and quotas. It is easier to sell and buy, to move people and products, yes – but this varies from place to place, from product to product. “Globalisation” is a grand term for “more trade”, but fails to live up to what is claims to be.

The second reason is more practical. Business, of any kind, has dependencies. Consumers want cheap products. Businesses need to attend to the bottom line. Resources – wood, steel, iron, diamonds, rare earths, farmland, plentiful productive agricultural land – only exist in certain places in the world. Those resources need to be moved from where they are to where they need to be simply for economies worldwide to function. “Deglobalising” is impossible, unless nations are prepared to do without. Pressingly, in an era of digitisation, rare earths are overwhelmingly in China, Vietnam, Brazil and Russia. Without them, not only are there no computers, no electric cars, no wind turbines, and also no meeting of the 1.5% climate change target.

Where globalisation is useful is as a rallying cry for those who want to restrict trade – it sounds like a bad thing, taking away jobs, work and livelihoods.

What does this mean for the future? When we look forwards, we tend to use one or other model to organise our thinking: the two most common being PESTLE and STEEPLE. Both are derivations of Francis Aguilar’s 1967 PEST methodology (in “Scanning the Business Environment”, now out of print) and cover Political, Economic, Social, Technological, Legal/Regulatory and Environmental factors (STEEPLE includes Ethical, and many of the headings can be reworded to meet specific needs). Trade fits into, and is influenced by, all of the categories, as well as – it seems to me, one which is not included, which one could describe as “Compulsion”. Some things about trade are simply compulsory – if you want to have something, whether it be cheap clothes or rare earths, spices or vaccines, one has to trade, and that almost always internationally.

So if trade is compulsory (as an aside, it is also a source of employment, tax revenue, increasing the quality of life of oneself and one’s country, as well as a powerful tool of international diplomacy) then what should futurists make of the view that trade is changing, and will change, as a result of the retreat of globalisation?

Three factors have affected international trade most substantially in the last fifteen years. The financial crash of 2008 damaged the world economy so badly it has still not recovered, and led almost directly to the rise of populism. China’s attempts to conquer more of the world’s physical and economic space have led to a backlash against it, and its trade. And the collapse of supply chains during the pandemic has been a stark warning that international trade is fragile, leading to a wholesale re-evaluation of its benefits. All of these factors will continue to play out. Populism is now part of the body politic, leading to its co-option by mainstream political parties (by, for instance, the concept of “European sovereignty”, or the acceptance by the Labour Party(!) in the UK of the Brexit vote and its consequences). China, Asia and India will be the focal point of world growth and development in the twenty-first century, through simple population size, let alone anything else. And the breaking of supply chains, the failure of just-in-time manufacturing, and the fight over access to vaccines, will prove to states and companies that having suppliers close, and developing local supply networks, makes good business and good politics.

Should populism return (and it will – that genie is once again out of the bottle) then the support for international structures such as the WTO will decrease as nations seek individual advantage over the collective. Trump understood that withdrawing from these organisations has political power, but defunding them kills them, and it would not take much, despite its efforts to regain relevance, to kill the WTO.

Further, we have said much in our recent work about the rise of a “multipolar world”. Such a world sees the rise of regional power and trading blocks, replacing the globalised order with a regional one, replacing the US hegemony with a more distributed, and confrontational, power structure of blocs.

Globalisation is not dead. It should remain as a potential future, simply because the world is small, and the resources we all need are not equally distributed around it. But there are other futures alongside it – of interregional trade assuming ever more importance, of jobs, skills, and employment being reshored; of trade regaining its nineteenth century use as a tool of diplomacy and quasi-warfare (imagine if China refuses to export rare earth metals, accruing all the benefits of digitisation and clean energy to itself whilst depriving the west of technological leadership).

We cannot stop trading with each other. We cannot – yet – leave the planet. Trade will remain global. But it may look very different in many of our possible futures.

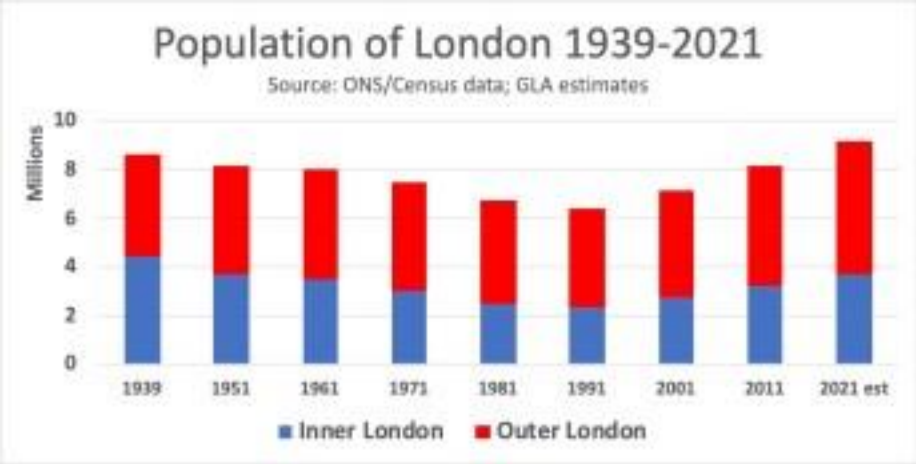
Written by Jonathan Blanchard Smith, SAMI Fellow and Director. Published 24 February 2021.

The Future of London looks uncertain

Image by Ana Gic from Pixabay

The future prosperity of the United Kingdom depends in no small part on Financial Services, mostly based in London. This blog therefore sets out one scenario for the future of London. A subsequent blog will set out an alternative future.

Decline in the seventies



In the 1970's, big cities did not fare well. New York famously faced bankruptcy, and London was losing population. The docks had moved down river to Tilbury and to Felixstowe. Many factories had moved out of the capital, with jobs and people following them. The population of London reached a low point in the 1980's. (See chart of ONS data and 2021 projection.)

London as a financial centre was similarly weak. The 1976 Sterling crisis forced Britain to apply for an emergency loan from the IMF. And the chancellor at the time, Dennis Healey, railed against the power of the “Gnomes of Zurich”, who had the financial clout to take positions against sterling, thwarting his attempts to support the pound.

Growth in the nineties

But then something extraordinary happened. London started to grow again.

- The “Big Bang” of 1986 deregulated the London Stock Exchange, allowing full-service investment banking, and enabling inward investment by big American banks and other global players.
- The growth of the Eurobond market helped London to grow as a financial centre.
- Derivatives trading found a natural home in the deregulated free-wheeling markets of London.

Wider economic shifts contributed to London’s growth.

- The UK economy continued its shift from manufacturing to services, which were concentrated in London.
- The predictability of Common Law systems, and the business-friendly commercial courts, helped the English Law to become the preferred standard for the contracts of much international commerce.
- Increasing capacity of rail networks allowed commuting by more people from ever greater distances.
- Co-location effects became more important in the global economy. These applied to London as much as they applied to Silicon Valley. The largest metropolitan areas consistently delivered greater productivity and value added per head.

In the eighties and nineties, London again started to create jobs, sucking in people from across the country and driving up property prices and thereby increasing the wealth of Londoners and bolstering balance sheets.

European scale

These factors were compounded in the nineties and the noughties. The natural hinterland supporting the growth of London expanded from one country to twenty-eight.

- After the EU single market was created in 1993, passporting allowed many global investment banks to service the whole of Europe from a single base in London.

- Free movement of people sucked in people from across the European Union, driving up the population. By 2012, more French people lived in London than in Bordeaux or in Strasbourg.
- The enlargement of the EU in 2004 brought in ten new countries, with poor but mobile young workers seeking opportunities abroad.
- In the financial crash of 2008, EU law protected the free-wheeling financial services ethos of London from the more *dirigiste* tendencies of continental European finance ministries.

All of these factors led to the current situation where London had become the dominant financial centre in the European time zone, with particular strengths in derivatives trading, investment banking and in fintech.

Current outlook

But we are now in a situation where the growth of London has become highly uncertain. Some commentators expect the population of London to shrink again for the first time in a generation; share trading volumes on the Amsterdam Stock Exchange now exceed those in London; and the future of Financial Services based in the UK has been thrown into confusion by Brexit.

In the remainder of this blog we use three different Futures techniques to explore the implications for London.

Drivers analysis

Most of the most recent drivers of London's growth listed above are vulnerable to being reversed after Brexit:

- Passporting will no longer apply to UK services. And even if it is allowed, this privilege can be unilaterally withdrawn by the EU at a moment's notice. Global banks need to set up operations within the EU in order to continue business there. And more and more of their functions will follow.
- The free movement of people that has underpinned the growth of London's population has ended.
- Whatever arrangement may be negotiated between the UK government and the EU for mutual recognition of regulations, it seems difficult to see how the successors to Merkel and Macron will tolerate un-fettered "Anglo-Saxon capitalism" when that is blamed in Europe as the root cause of the next financial crash. EU law will not protect the UK financial industry again. And crashes are an inevitable result of free-market capitalism.

The only driver listed above which supports the continuing growth of London is that of co-location. The combination of the full range of financial services and the legal and accounting services that underpin London create a powerful feedback loop. But of course, positive feedback loops can work either way: Weakening any component of the virtuous circle weakens the others.

Analogy

One common analogy for the future of London is “Singapore-on-Thames”, where Singapore acts as a hub providing commercial, financial, transport and other services throughout its region. But Singapore’s neighbours in South East Asia are separate less powerful states, with different agendas and no easy vehicle to allow them to act together.

In Europe, trade policy is set at EU level. A more compelling analogy is therefore the relationship between Canada and the USA. The USA is by far the more powerful partner, as evidenced by the unilateral renegotiation of the NAFTA free-trade deal by Donald Trump in 2019. The USA welcomes Canada as a peaceful neighbour on its northern border and as a useful source of primary products (grain, lumber, oil etc.). Congress and the SEC would never tolerate Toronto being the predominant supplier of financial services on the North American continent. They would find some way to use their economic might to wrest control of trading and services and bring that crown back to New York.

War-gaming

The military use scenario planning in tactics. Even the most junior officers are taught to analyse a situation before acting: “*What is your situation? What is the most damaging thing the enemy could do? What do you think they’re going to do? What else might they do? What are you going to do?*”

In terms of financial services, the worst-case scenario would be that the EU actively uses its economic weight to engineer the growth of continental financial services at the expense of London. It could actively use equivalence, and the threat of its removal, to undermine London’s attractiveness as a financial centre, and as a useful tool to force compliance on the authorities in London.

The EU might also choose to avoid damaging internal conflicts by cooperating between member states. One possible “share-out” could be:

- Share trading and derivatives trading to Amsterdam, where the mercantile tradition is strong
- Insurance and fund management to Frankfurt, which has big national champions already
- Legal services to Paris
- Fin-tech to Berlin, where there is already a strong fintech industry

Conclusions

Looking at the future of London through the lenses of drivers analysis, analogy or wargaming gives similar results. It may take a generation or so, but the expectation must be that London will lose its crown as the predominant financial services metropolis in Europe.

And for those who think that financial services in London are too big and too entrenched to be at risk, just remember what happened to the dockworkers in the seventies. And who hears about the all-powerful Gnomes of Zurich now?

Written by Martin Duckworth, SAMI Principal. Published 4 March 2021

Factors in developing scenarios for the future of London

Image by Pierre Blaché from Pixabay

The combination of the UK's departure from the EU, and the coronavirus pandemic, has caused uncertainty across the UK business ecosystem. As the UK's largest city and the contributor of some 22% of GDP, London has come under particular stress. The pandemic has comprehensively changed working patterns, influencing everything from the public transport infrastructure to retail, hospitality and entertainment spaces within the city. London's primary business is the provision of business, financial and tech services throughout the world and – at least until now – to Europe.

At a time like this, the future of the city itself looks uncertain. Barely a day goes by without newspapers reporting on the departure of business from the City. Twitter is a battleground between people showing evidence that our exit from the EU is hurting British business, ranged against those whose emotional attachment to that departure seems to blind them to its negative consequences. Britain and the EU have seen drops in the exports to each other each way.

Red tape, new regulations, and the occasional piece of apparent madness (ham sandwiches taken at the EU border, HMRC expecting European companies to charge VAT on its behalf, to select one on each side) have caused real and dangerous interruptions to supply chains. One startling figure reports that "Italy recorded a 70.3% decline in UK imports in January, compared with a year earlier". Exports to the EU fell by 40.7% in January.

We have analysed some approaches to the future of London in a previous blog.

The weaknesses and threats to London caused by the combination of the pandemic and the UK's exit from the EU are widely known. Since we are used to using the SWOT (Strengths, Weaknesses, Opportunities, Threats) matrix in futures work, perhaps we should also consider some strengths and opportunities.

Examining the premises

Let us start with some hopefully uncontentious premises. The Brexit process has been a shambles. The withdrawal agreement came too late for people to plan, and its implementation has been chaos from day 1. Further, the Withdrawal Agreement included nothing on the services sector (the gov.uk website is quite infuriating in its guidance). While we are promised an agreement on equivalence and the recognition of professional qualifications, white smoke has yet to be seen from the Berlaymont. Euro trades have left the City to the benefit of Amsterdam. Many foreign workers have left the UK. London's population is shrinking.

Except – at least there is a withdrawal agreement. It may be clumsy, but as with any third country, the UK is now starting to enter into an endless round of negotiations with Europe which will continue to develop as both sides see advantage. The UK government has shown itself to be prepared to bend and flex in some quite surprising ways. Euro trades order flow has started to go through Amsterdam. This change is a natural consequence of Brexit – there are many, some of which seem to surprise its greatest supporters who seem to have thought nothing would change. But Euro traders are in London, and simply directing their trades through Amsterdam. Foreign workers have left the UK in large numbers, as people have left London in large numbers because there is a pandemic. Remote working and being with your family is more important than staying. It is too early to say whether this is a permanent change or one which will reverse once the pandemic has passed.

London has no right to succeed. But it has many reasons why it might.

Strengths and Opportunities

Let us complete the SWOT table by looking at some of the Strengths and Opportunities.

Ten Strengths

1. London has by far the deepest pool of capital in Europe.

2. London is the largest city in Europe. It is number 1 in Schroder's Global City Index. Access to arts, culture, restaurants, hotels and leisure facilities is excellent.
3. UK corporate governance is widely respected
4. English law is the jurisdiction of choice for business contracts and dispute resolution
5. London has access to a range, quality and quantity of expertise unavailable to the EU cities.
6. London is the second-largest financial centre in the world.
7. London leads the world in business and financial services.
8. London is a desirable residential destination for the world's wealthy, with a "large pool of prime properties in central locations that will be attractive. In addition, the UK capital offer higher yields than many European cities such as Paris and Frankfurt."
9. London generates some 22% of the UK's GDP.
10. The UK benefits from a time zone between the US and Asia.

+1. The UK is home to the world's best universities and MBA programmes.

Five Opportunities

1. Europe is not everything. Since 2006, the EU27 have seen their share of global financial activity fall from 20 per cent to just 13 per cent. Asia now accounts for 40 per cent and is growing far more quickly. The UK financial services industry should focus on competing with the US and Asia rather than the EU.
2. The UK's strength in education makes it not only the place people want to come to; it also provides ambassadors for the country who speak English and have a real connection with the country.
3. As our Meta-megatrends analysis makes clear, the world is becoming multi-polar. Sitting outside all three blocs – the US, China and Europe – allows the UK to engage with and be the meeting place for all of them.
4. Both Google and Apple chose London as their European headquarters. Media and technology are faster-growing sectors than finance for London, developing skills and opportunities for an information age which, when combined with access to capital, and a light-touch regulatory regime, provides real opportunities for future development.
5. The opportunity to develop and engage with new financial products (such as SPACs) is both greater and faster in a centre such as London, with its depth of experience, expertise and capital.

Separating from the EU may well be a mistake. But it need not be a mistake for London. That separation may force the government to introduce initiatives that make London more attractive to the rest of the world. It will force London's businesses, and especially the financial and services firms, to adapt and change to seek other markets and other opportunities, building on the inherent strengths of the City, of London, and of the UK.

Written by Jonathan Blanchard Smith, SAMI Fellow and Director. Published 12 March 2021.