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Dublin's fair city beckons

Does Brexit mean London will cease to be Europe's leading financial centre? Dublin, Frankfurt and Paris are mentioned as possible alternatives. FW writers examine the case for each city. In this article, **Jonathan McMahon** discusses the appeal of the Irish capital

The result of the UK's referendum on EU membership has answered one large, if abstract, question. But it has left unanswered many more about what the vote could and should mean in practice.

The resulting uncertainty is now an issue and it seems to be a particular concern for financial services. In the near term, the main concern is about market reactions to political developments, of which we can expect a number as negotiations progress. The financial services industry is exposed to the resulting movements in asset prices and this will have some impact on the risk premiums of the issued debt and equity of UK banks, asset managers and insurers.

The longer-term question is whether the change in the UK's relationship with the EU will have a lasting negative effect on the industry. This is the more material issue given the contribution financial services makes to output and employment in the UK.

The question within this question is whether the City of London, the wealth-generating core of UK financial services, will continue more or less as it is today after Brexit.

It is assumed that there is an inherent mobility to the City's markets and its participants which, in turn, leaves the UK vulnerable to the movement of capital and people – it is easier to move a trading floor than a car factory. The City has excellent international links and requires international talent, much of which today comes from the EU. It needs access to the single market to sell its services. To a degree, it benefits from being able to trade and clear in euros. While only a handful of its workers actually live in the City, it is no surprise that three-quarters of Greater London residents voted to remain in the EU.

So, two questions arise. The first is: could Brexit erode the City's competitive advantage? The second is: even if it were to do so, would this be enough to cause some pivotal financial services firms to leave for another European city?

These questions are of particular interest in Dublin because the Irish government has very carefully created its own financial centre in the capital. This has been a success story, although a much smaller financial centre than London (Dubliners joke that it is "Canary Dwarf"), with incoming firms creating higher-paying jobs and ancillary industries benefiting from the increased demand for their services. The result is reflective of Ireland's wider achievement of importing capital to work with a well-educated labour force, countering a decades-long pattern of net migration.

Dublin's rise as a financial centre has changed its relationship to London without ever bringing it into direct competition. It has been said that this leaves the two cities sitting in relation to one another as do Boston and New York. The smaller cities benefit from the proximity of their large neighbours' markets but without replication of the same activities. Both Boston and Dublin have fund management and asset-servicing businesses. Perhaps the main difference is that Boston is also home to many more fund managers.

Could this change? As there is little prospect that Ireland will follow the UK out of the EU, it has been suggested that Dublin could become an attractive venue for firms looking to access the single market.

Dublin already has a concentration in funds, insurance, notably reinsurance, and ancillary and back-office activities. Ireland also has other advantages, such as a highly educated population. The country's favourable demographics mean that many young people enter the workforce each year. Its corporate tax rate is among the most competitive in the developed world. It has a system of common law, the judiciary is independent and the rule of law prevails. Contract certainty has, of course, long been one of the City's attractions.

Dublin itself is an appealing city that offers a high standard of living. The transport connections are such that anyone fortunate enough to live around Dublin Bay can travel easily from a seaside location to the city centre. There are excellent schools and good universities. Access to the rest of Ireland is straightforward as a result of the road building programmes of the 1990s and 2000s.

Dublin has also proved itself to be very welcoming for workers from overseas, helped by the influx of multinationals. The business culture is familiar. There is no language barrier. For Americans and Britons, in particular, it is culturally more familiar than any other EU capital.

On paper, therefore, Dublin exists as a credible rival to London; and as well as being secure in the EU it is also a member of the eurozone and so part of "core" Europe. Could we then see the rise of Dublin as a larger financial centre within the EU?

While there is every reason for Dublin to continue to grow as a financial centre, it is less likely that Brexit will lead to a great leap forward for Ireland's capital. There are factors outside the control of Irish policy makers that, when considered in the round, would seem to be impediments to material expansion.

The first issue is one of scale. While it has a young and dynamic workforce, Ireland is home to slightly less than 1 per cent of the EU's population. To make a direct comparison to London, there are fewer residents in the country than there were journeys made on the London Underground on 4 December, 2015 (its record day for passenger volume when 4.8m people travelled). While Ireland has successfully built an economy around highly skilled activities that, in turn, require low labour inputs, productivity cannot replace scale if a country wishes to build an industry concentration. While not the most reliable measure of economic activity for Ireland given the make-up of its economy, Irish GDP is more or less half that of London.

A related challenge for Dublin is its infrastructure, including housing. Prior to the banking crisis, the city's population faced headaches moving around as traffic volumes put pressure on its transport system. This was despite some material investments in road (the M50 and Port Tunnel, for example) and light rail (the Luas). The elongation of journey times is again a talking point for Dubliners because of the success of the Irish economy in recent years. In the absence of further investment in transport links, it is unclear that Dublin could absorb a significant growth in its population without some further consequence for the productivity of its firms and workers.

For highly skilled, highly mobile workers it also matters

that they can live somewhere attractive and educate their children in a school of their choosing. Dublin compares favourably with any capital city on both measures. But the arrival in Dublin of a thousand investment bankers or hedge fund managers would lead to significant competition for houses and school places. London can accommodate the comings and goings of large numbers of people. The same is simply not true of Dublin.

The issue of scale holds true in a less obvious but arguably more important way for financial services. This is Ireland's ability, and its perceived ability, to host risk-taking activities in a highly regulated sector of the EU economy.

This issue would be in particularly sharp focus for Ireland given that it has not long since emerged from one of the worst banking crises in history. In 2010, the Irish state could not meet the costs unaided, leading to a support programme that put the troika of the European Commission, European Central Bank and IMF in the driving seat.

The international members of Dublin's financial sector did not cause the crisis and many of them operated profitably during that period. Yet Dublin's reputation was at stake during the bail-out. Had the domestic banking system not been saved, there would have been a long-term impact on the financial centre, however removed its participants may have been (and have felt) from the travails of the lenders. A strong financial centre needs the backing of a state with deep resources. Confidence in the whole is as important as the strengths of the parts.

One result of the banking crisis is that Ireland no longer directly supervises its own banks. The ECB in Frankfurt now has overall charge of supervision as part of the Single Supervisory Mechanism (SSM). This points to a wider truth about Dublin's future as a financial centre: by virtue of its membership of the eurozone and, to a lesser degree, its membership of the EU, Ireland does not have unfettered discretion over the direction of financial sector policy. The ECB was never comfortable having to lend to Ireland's banks in extremis as it knew there was a small possibility that the country might walk away from its banking sector liabilities. This problem was partly a function of the construction of the ECB, which prior to the SSM needed to lend to banks it did not supervise. But now that the ECB has supervisory powers, it is hard to see it allowing the financial sector of any member state to accumulate risks that could outstrip the ability of the home or host state to stand behind losses.

If the ECB might serve as something of a brake on Ireland's ambitions for its future as a financial centre, so the EU may also inhibit growth in Dublin through the policies Brussels adopts towards the financial sector. One of the consequences for Ireland of the UK referendum is that the government in Dublin has lost the single biggest advocate for financial services in the European Council and Commission. That is important. The UK has been able to defend financial services from attacks elsewhere in the EU since the financial crisis. There does not appear to be much residual sympathy for finance and financiers on the continent. Is there, therefore, a home other than London, with its history of being, and being comfortable with being, a financial centre? Advocates for Brexit were keen to suggest that the City would do better outside the EU for this very reason.

If there are some reasons to be cautious about Dublin's ability to fulfil a larger role after Brexit, so there are other ones to test claims that Paris and Frankfurt could benefit from the referendum result as activities move from London. It is true that a number of continental banks have located specialist activities in London. Equally, a number of British and non-EU banks operate across the EU from London. How might this situation change after Brexit?

In simple terms, there would appear to be three basic scenarios. The first is that nothing actually changes, at least in the next few years: the UK remains within the single market and the City carries on as before. Alternatively, individual member states try to attract business from London, with a sort of free-for-all governing the decisions of EU governments. Or, without the support of UK negotiators in Brussels, the financial sector is repressed through new regulations and the activities that today occur in the Square Mile simply cease. In this scenario, one might imagine that Singapore or Hong Kong could be net gainers.

The third scenario could come about even if the UK is part of the single market. This is perhaps the most perverse outcome of the referendum: that the UK stays in the club but no longer has any say in its rules. It is doubtless for this very reason that financial services will be a focus for the UK's negotiators and the government has already made assurances.

There are other reasons why EU countries should want an amicable and mutually beneficial settlement with the UK, with trade access topping this list. As such, the most likely outcomehas to be that the City continues to be a major financial centre after Brexit.

In turn, the future for London and Dublin is, therefore, one of collaboration rather than competition. In this scenario, Dublin as a financial centre will continue to have a close relationship with the City's future. Ireland has a strong interest in seeing the UK achieve a good outcome in the Brexit negotiations. Indeed, if this same point holds for the EU economy as a whole, which it must, given the UK's value as an export market, there are many reasons to believe that a settlement that changes as little as possible is desirable and attainable. Let us hope so.

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