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Offshore, our natural role

One argument for full British membership of the European Monetary System is that, unless the pound is linked more definitely to other European currencies, the City of London will lose its position as Europe's pre-eminent financial centre. Noted supporters of European unity such as Lord Jenkins and Mr Michael Heseltine warn that the City is in danger of being marginalized in an increasingly integrated European financial market after 1992.

The argument suffers from a serious omission; it fails to explain why the City acquired its role as Europe's main centre for international financial business and its success in that role during the 44 years since the war.

For most of that period Britain did not belong to the European Community and, for almost all of it, has abstained from European fixed-exchange rate arrangements. But, over these years of relative indifference to Europe, the City has gone from strength to strength.

Those who worry about the City's ability to compete in Europe have overlooked the most basic trend in international financial activity in the last three decades: the shift of financial business from traditional domestic centres to offshore markets. Companies and individuals have been involved in a constant process of re-packaging and re-labelling their financial wealth so that it comes to be associated more closely with a foreign nation or jurisdiction than with their own. Indeed, in many cases it may be associated with no specific nation or jurisdiction at all.

Nowadays many financial transactions are so thoroughly cosmopolitan that it is a matter of debate where they occur. For example, a wealthy individual from an Arab Gulf state may leave a dollar deposit with a French bank in Bahrain. The money is immediately transferred to an account in London and lent out — as part of the French bank's involvement in a syndicate including banks from South Korea and Finland — to finance the leveraged buyout of a company whose shares are traded on the New York Stock Exchange. The wealthy Arab may, in the meantime, have left Bahrain and taken up residence in his apartment in Geneva.

How are the various stages in this transaction to be described? To what nation do they belong? If he does not want to return to the Gulf, the ultimate depositor could be described as Swiss. But he is Swiss by residence and not nationality and — if he also has houses in London and Paris — even the residence may be temporary. The bank in Bahrain may be French-owned, but registered in Bahrain and regarded as Bahraini in official statistics, or it may be just a representative office which is not Bahraini.

The loan may be made from London, but the participation of French, Korean and Finnish organizations argues that it is not a loan "from the UK".

The example may be hypo-

thetical, but it is certainly not unrepresentative. The sums involved in offshore transactions have become enormous and dwarf the amounts raised on any individual European financial market. In 1988 borrowing on international capital markets exceeded \$450 billion, more than four times larger than gross bond issues on West Germany's domestic market.

The scale and vitality of offshore borrowing activity contradict the notion that financial centres flourish because they are protected by political authority. In fact, the main reasons for shifting money offshore are to avoid taxation and regulation, and so to defy financially inhospitable governments. The underlying assumption of the case for early EMS entry — that financial activity depends on political sponsorship — is not just wrong, but the opposite of the truth.

Of course, despite the "offshore" label, all the advisory, legal and clerical work involved in international financial transactions has to be done somewhere on *terra firma*, and the favoured centre has been London.

Despite — or perhaps because of — Britain's late entry into the European Community and its abstention from the EMS, the City has captured the lion's share of the most rapidly growing form of financial business since the war. The principal currency used in this kind of business is the dollar — yet, significantly, Britain has not had to become the 51st state of the USA to dominate it.

The evidence is overwhelmingly that financial centres can flourish without the proximity of either central banks or parliaments. In the US the Federal Reserve Board meets in Washington, but the principal financial centre is New York. In West Germany the Bundesbank is in Frankfurt, but there are regional stock markets and banking activity has no recognized single centre. The capital of Holland is the Hague, but the financial hub is Amsterdam. Italy's largest stock exchange is in Milan.

Britain does not have to join the EMS for the City to maintain its premier position in European finance. Indeed, the City has become so internationalized that there is something absurd in suggesting that official reluctance to join the EMS could leave it on the periphery of international finance.

The view that full EMS membership is essential to protect the City is based on the naive, rather old-fashioned and somewhat paternalist view that governments and central banks can regulate international flows of money, and determine the success or failure of financial centres. The offshore explosion, and the City's ability to gain so much of the resulting business, refute that view convincingly.

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