

Capital Accumulation Structure and Balance of Payments in the UK in Relation to Brexit

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Introduction

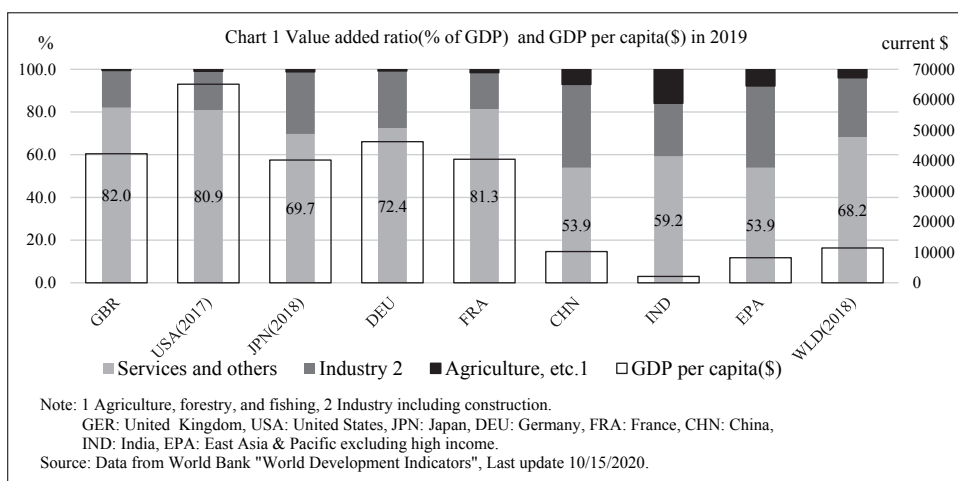
The UK Brexit scheme had been advanced with twists and turns. This paper introduces a framework of the UK economy in consideration of the financial structural effects of Brexit by examining the development phase of UK capitalism.¹ The structural feature of the UK economy is its large dependence on capital accumulation in the financial field compared to other countries, a result of being the first capitalist and consequently key currency country. This feature extends not only to the UK's domestic structure, but also to its external structure, and the impact of Brexit is largely derived from this. This point, in particular, brings a distinctive feature to the UK's balance of payments structure.

Another thing to consider is a common feature of modern capitalism that government debt is on the rise, not only in the United Kingdom, but in many developed countries as well. This is also derived from the historical nature of the development stage of capitalism. In this paper, we examine the effects of Brexit based on these unique characteristics of the United Kingdom and the characteristics common to developed countries.

Currently, despite the amount of research regarding the effects of Brexit published, few studies have focused on the country's development phase. Consideration of the development phase of the UK's capital accumulation structure is necessary, however, as the long term and structural effects of Brexit cannot be obtained from its present economy only.² The purpose of this paper is the consideration of Brexit from the historicity of the UK's present economy.

Section 1 summarizes the economic theoretical reasons why the British industrial structure depends heavily on the tertiary industry. Section 2 explains the reasons for the growth of the financial sector in the tertiary industry from the perspective of the expansion of monetary capital. Section 3 looks at the structure of the UK's balance of payments in recent years from the theory of the stage of development of the balance of payments. Section 4 outlines Britain's position as an international financial market. Then, Section 5 examines the risks of the UK financial crisis.

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1. There are a lot of gloomy scenarios painted in literature such as "Brexit: From Great Britain to Little England" (Kirchick, James, *The End of Europe -Dictators, Demagogues, and the Coming Dark Age-*, Yale University Books, Paperback Edition, 2017., p.153), "The end of the beginning of Britain" (Wilding, Peter, *What Next? -Britain's Future in Europe-*, I. B. Tauris & Co. Ltd., 2017, p.66). On the other hand, there is also a view that the negative economic effects might be exaggerated (Whyman, Phillip B. B. and Petrescu, Alina I. *The Economic of Brexit: A Cost-Benefit Analysis of the UK's Economic Relationship with the EU*, 6 Sep. 2017).
 2. Many estimations point to the decline of the UK economy after Brexit. For example, the economic output has been calculated to be 1.2% lower on average under a 'soft Brexit' and 2.3% lower under a 'hard Brexit' compared to remaining in the EU (Clayton, Naomi and Overman, Henry G. , " Brexit, trade and the economic UK cities," Centre for Economic Performance, Centre for Cities, July 2017).



1. Reasons for the change of capital accumulation structure

The tertiary industry sector occupies a large proportion of the UK's industrial structure. This structure derives from the history of Britain being the first country to establish capitalism and becoming a central country in the world market. First, I will explain why a mature capitalist country has such an industrial structure. Two reasons are could be provided by capitalism theory for the shift in main industrial sector as a country's economy develops, laying aside the theory from Colin Petty-Clark. One is related to divergence between commodity price and quantity of labour, while the other is related to differences of relative value of money between developed and developing countries.³

According to the former, each material commodity has a certain substance of value which has already been crystallised. In primary and secondary sectors, commodity prices are usually realised without large divergence from this value. However, in the tertiary sector, in particular the service industry, value is not crystallised in the same way material commodity is. Thus, service prices can easily become detached from labour quantity and capital in the field can expand into new fields just be influenced by fluctuation of demand and supply. Further, the non-crystallised

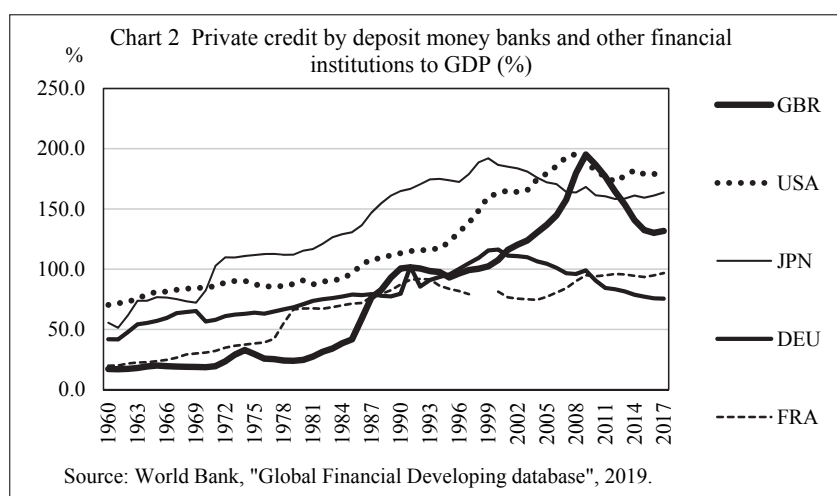
property has a possibility that many basic services with high reliability, new knowledge-intensive services and high-tech services can be provided to not only the country's population but also the whole world. This is an important reason as to why various service industries are able to expand even if manufacturing industries weaken in domestic markets.

According to the latter, the relative value of money corresponds to the amount of money which can be compared to the "deemed" input quantity of labour for the same period. The relative value of money in developed countries in which more labour is input over a period is less than that in developing countries. In other words, developed countries have higher labour productivity, per capita national income, and thus wage levels than developing countries.

Therefore, secondary sector capital in developed countries inevitably shifts material commodity production facilities to countries with lower labour costs, resulting in falls in exports. Moreover, less relative value of money creates advantages for outward investment in terms of larger capital size and higher productivity, often leading to increased global services (service exports) provided with advanced technology.

Chart 1 indicates how countries with higher GDP

3. Marx, Karl, *Capital*, Vol.1, Part6, Chap.32, English ed., 1887



per capita generally have larger tertiary shares than lower countries. Although the UK does not have the highest GDP per capita, its shares symbolically represent the most mature capitalist country with the highest share for the tertiary sector. This relates that the UK has high reliability on global financial services. The UK's economic structure, which relies heavily on the service industry, has a great influence on its external structure.

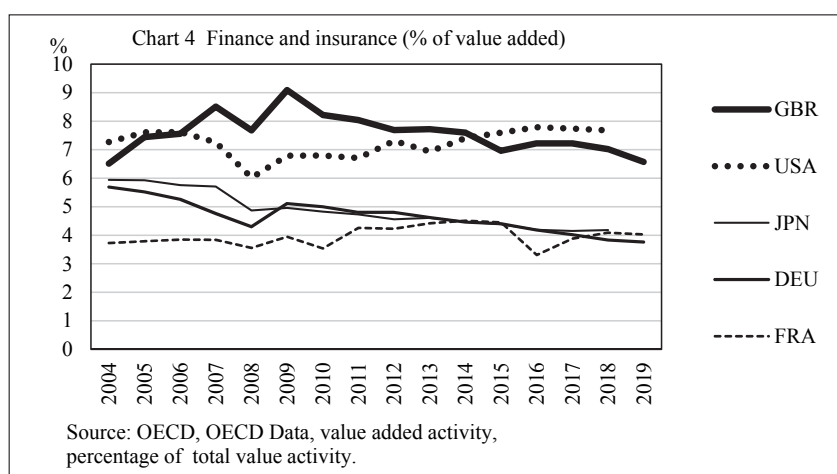
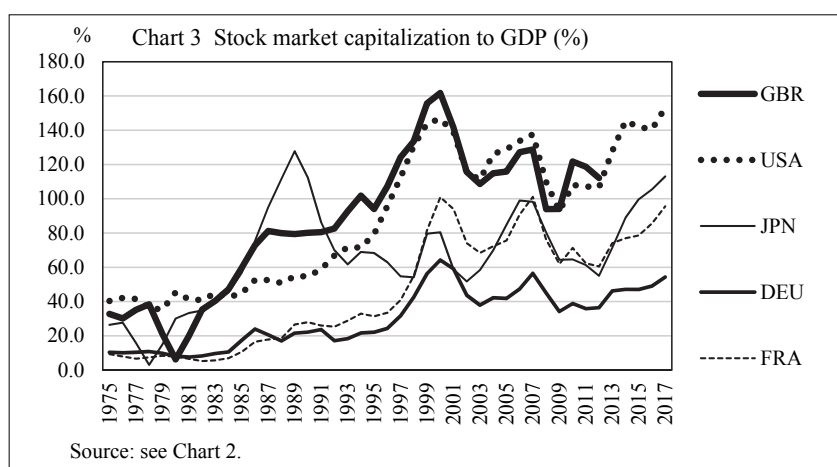
2. Expansion of financial and fictitious fields in developed countries

The financial industry has additional avenues for expansion outside of the general service industry due its relation to fictitious capital. Fictitious capital is not restricted “directly” to the size of real capital, meaning that its price can easily diverge from its original capital cost with frequent fluctuations. In addition, fictitious capital easily diversifies through financial derivatives and resecuritized products, and can attract money capital for the purpose of acquiring both income and capital gain.

Three reasons can be given for global financial expansion in recent times. First, commercial banks can create credit money as capital for both creditors and debtors toward fictitious capital fields even if real capital fields are stagnant. Second, the central bank can encourage the credit creation

of commercial banks through its own credit creation. Recently, central banks have almost directly supported fictitious capital prices through quantitative easing policies. Third, fiscal expansion policy resulting from difficulties in fields of real economy also encourages the expansion of money capital. The expansion of financial markets since the 1980s is a reflection of the difficulties of real capital fields in developed countries. Phenomena such as securitisation, financial globalisation, financial deregulation, increase of financial derivatives, and increase of government bonds reflect various difficulties of profit-making for real capital.

Chart 2 and 3 shows the expansion of money capital in five developed countries. Supposing that the sum of private credit by financial institutions and stock market capitalization can be regarded as an indicator of money capital, and the GDP as an indicator of real capital, we can see roughly increasing trends of money capital ratio to real capital for the shown countries. Recent percentages of “Stock market capitalization to GDP” in the UK and US are higher than other countries. Also, the increase trends of money capital to real capital means the growing importance of world financial market. In other words, the role of two big financial markets in the UK and US are growing more than before. Chart 4 shows the high share of GDP for “Financial and Insurance” in the UK



and US compared other developed countries. These features were formed by the maturity and history as capitalist leading countries. The United Kingdom and the United States, which have the world's two largest financial centers, differ greatly in the nature of their markets and their position on external debt.

3. Recent balance of payments in the UK and its stages of economic development

The Brexit problem must be also examined from the UK's external situation. Since World War II, the UK has not experienced a current account surplus with the exception of a few years only.⁴ Generally, a country with a current account deficit must maintain capital

Table 1 The UK's Balance of Payments (Billions of US\$)

Year	10	15	19
Current Account	-92.5	-149.8	-121.6
Balance on goods	-150.4	-181.2	-167.4
Balance on services	86.7	131.7	128.3
Balance on primary income	0.7	-65.5	-47.4
Balance on secondary income	-30.4	34.8	-35.2
Capital Account	-1.1	-3	-1.0
Financial Account	-123.2	-170	-136.5
Net Errors & Omissions	19.6	-14.4	-13.9

Note: Financial Account: minus means capital import

Source: IMF, International Financial Statistics Year book.

imports in the long term. The UK's recent balance of payments shown in Table 1 contains a deficit in current account, deficit in balance on goods, surplus in balance

4. Recently, the UK's current account deficit was reported at 4 to 6% of GDP.

Table 2 The balance of payments and stages of economic development

Stage	Nations	Current account			Capital
			Trade & Service	Income	
1	Immature Debtor	--	-	-	++
2	Mature Debtor	-	+	--	+
3	Debt repayment	+	++	-	-
4	Immature Creditor	++	+	+	--
5	Mature Creditor	+	-	++	-
6	Credit Disposition	-	--	+	+

Note: about "Capital," its minus means capital export.

on services, an uncertain balance on income, and deficit in financial account (= capital inflow).

According to the balance of payments and stages of economic development theory (Table 2), the UK and US's balances have already shifted to stage 6. This theory is usually explained from investment-savings balance, but should also take into account international value theory, and hence the relative value of money. Although the features of stage 6 can resemble stage 1, the possibility of foreign capital flow into a stage 6 country is not due to low the labour cost based on high relative value of money in stage 1 countries, but utilization of enhanced service systems with advanced technology based on low relative value.

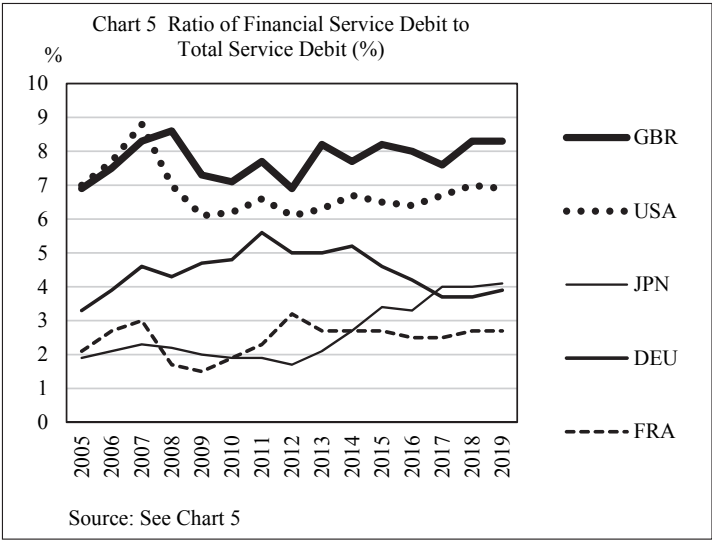
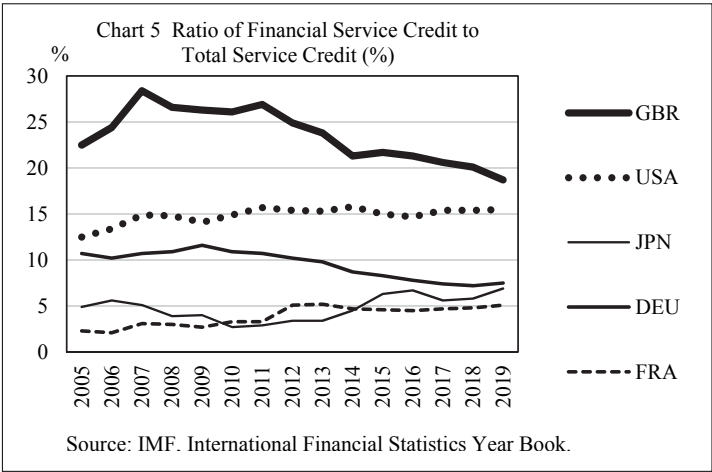
As a sixth-stage country, the balance of payments structure of the US and the UK are similar in that they have a current account deficit, a trade deficit, and a service balance surplus. Reflecting the active foreign activities of US capital, the United States has a primary income balance surplus, but the United Kingdom has a deficit. Both countries are in the same sixth stage of development of the balance of payments, but it can be said that the United Kingdom is in a more mature stage. In addition, as will be described later, the balance of payments of both countries seems to reflect the differences between international currency countries and non-international currency countries. Anyway, the UK

and US have constantly experienced a large financial service surplus compared to other countries.

However, the UK's situation differs significantly from the US in the following three ways. First, external financial services are more important for the UK than the US. The UK's proportion of financial service to total service credit/debit is far higher than the US and other countries (Charts 5, 6). Table 3 shows how important its external financial services are for minimising current account deficit. Compared to the United States and other countries, the UK's net exports of financial services are large and remain the number one in the world (Table 4).

What is important for the UK is how Brexit affects these structures. According to Table 5, the majority of the UK's financial services are exported to the EU, indicating that the influence of Brexit may have large consequences. It is worth noting that a think tank "TheCityUK" has begun to cover the EU and non-EU figures for net exports of financial services in its Research Paper since 2017. Although only the figures for 2017 and 2018, it may be worth noting that the net export ratio of financial services to EU countries has declined as a change since the 2016 Brexit Declaration. Although the Brexit program is progressing, it remains uncertain at this stage how the financial relationship between the UK and the EU will develop.⁵ The global position of Britain's

5. "From a regulatory perspective, details of the future EU -UK relationship in financial services are still highly uncertain and remain subject to, in particular, the extent of regulatory alignment between the two jurisdictions going forward." ECB, "Implications of Brexit for the EU financial landscape", 3 March 2020. URL: https://www.ecb.europa.eu/pub/fin/article/html/ecb.fieart202003_01~690a86d168.en.html#toc1



international financial markets will not change drastically, but it cannot be completely unrelated to the overall change in confidence in Britain. This point is also related to the position as an international financial market described in the next section.

Secondly, the UK as a previous key currency country cannot bear excess external debt over long periods, just as other non-key currency countries. Only the present key currency country can accumulate external debt without default risk, as it can make payments through its own credit creation. If the UK's external debt increases, debt risk will increase, apart from international transactions

Table 3 The UK's sectors generating trade surplus in £ billion, 2018

Financial service	63.2
Other business service	33.0
Computer and information services	10.2
Intellectual property	6.1
Transport	3.7
Other surplus-generating sectors	4.5

Source: TheCityUK "Key facts about UK-based financial and related professional services 2020", April.
Original source: Office for National Statistics, Pink Book 2019.

in London's offshore market. This is the biggest difference between the UK external debt and US external debt. Thirdly, while the UK and US contain the world's top two financial centres, the difference

Table 4 Largest global net exporters of financial services, \$bn, 2018

UK	82.7
US	63.2
Switzerland	23.4
Luxembourg	21.8
Singapore	21.0
Hong Kong	17.7
Germany	16.9
Ireland	4.4
Sweden	1.7
France	1.5

Original Source: TheCityUK calculations based on UNCTAD data

Source: TheCityUK, Key Facts about the UK as an International financial centre 2019, December 2019.

Table 5 UK financial services net exports by major countries, % of world

	2017	2018
EU countries	43.9	40.5
Non-EU countries	56.1	59.5
US	18.6	26.6
Japan	3.2	3.9
Switzerland	3.1	3.2
Rest of Non-EU	31.2	25.8

Original Source: TheCityUK calculations based on UNCTAD data

Source: TheCityUK, Key Facts about the UK as an International financial centre 2018 (October 2018), 2019 (December 2019).

of their respective roles implies that the UK could lose its position, as discussed in the following section.

4. The UK's position as financial centre

After WWII, the UK lost its position as a key currency country, and as a result the centre for

international settlements should have shifted to the US. However, by the Arab-Israel War, Arabian oil exporting countries opted to deposit their large proceeds in London offshore markets in the form of Eurodollars. Its markets had the relative advantage of being unrestricted by any financial regulations, presupposing of course the provision of substantial financial services in the UK.

In international financing trading (Table 6), funds for investment in the US are generally dealt as “stock” transactions. The US's market features stem from the fact that investment in its dollar-based domestic market avoids exchange risk for foreign dollar depositors in present key currency accounts. On the other hand, the concept of international financial trade “flow” is mainly dealt with in the UK market. The UK's market properties derive from its dealing in financial transactions such as short-term international settlements. Such financial transactions do not need to be made in the present key currency country market. This however indicates a possibility that the UK's market functions could shift to other countries.⁶ Table-7 shows that shares in UK financial markets have been roughly retained over the past 20 years. In light of the economic effects of Brexit, the possibility of even small changes to the position as a financial centre would pose an important problem.⁷

5. The probability of financial crisis in the UK

From the viewpoint of domestic economic

6. A serious concern for London is whether single market passporting will remain after Brexit, as “UK financial services institutions that sell products into the EU Single Market can currently do so via the pan-EU ‘passport’, which allows a firm authorized in one EU (‘home’) Member State, to provide services or open branches in other EU (‘host’) Member States, with relatively few authorisation requirements.” (House of Lords, European Union Committee (11th report of session 2017-2019), “Brexit: financial regulation and supervision,” published by the Authority of the House of Lords (HL Paper 66) Jan. 2018.)

7. Many research papers have pointed out the importance of the UK's financial function in regards to the effect of Brexit. Stiglitz has succinctly stated the most serious concern about Brexit as “The worry is not so much about tariffs, ... The concern is services, and especially those of the financial sector, which is particularly important in the UK, and that differences in regulations will create nontariff barriers.” (Stiglitz, Joseph E., *The Euro and its Threat to the Future of Europe*, W.W. Norton & Company, Inc., 2016., p.348).

Table 6 Financial Centre Indicators, share by country (%)

	GBR	USA	JPN	FRA	DEU	SG	HK	Others
Interest rate OTC derivatives turnover (Apr 2019)	50	30	2	2	1	1	6	6
Foreign exchange turnover (Apr 2019)	43	17	5	2	2	8	8	17
International debt securities outstanding (Q1 2019)	13	10	2	6	5	1	1	62
Cross-border bank lending (Q3 2019)	16	10	13	10	7	3	5	36
Insurance premium (end-2018)	6	28	8	5	5	1	1	45
Conventional fund management (end-2018)	6	45	7	4	-	-	-	-

Source: TheCityUK, "Key facts about the UK as an international financial centre", 18 12 2019.

Note: Initialised Country name is same as Chart 1, SG: Singapore, HK: Hong Kong

Table 7 UK share trends of financial markets (%)

year	95	98	1	4	7	10	13	16	19
Cross-border bank lending	17	20	19	20	18	18	17	16	
Foreign exchange turnover	30	33	31	32	35	37	41	37	43
Interest rate OTC derivatives turnover	27	36	35	42	44	46	49	39	50
Fund management (as source of funds)	-	8	8	8	9	8	8	7	

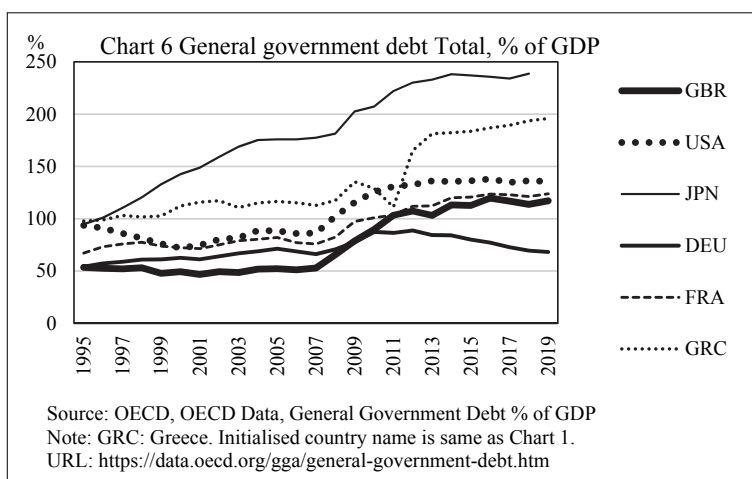
Source: TheCityUK, Key Facts about the UK as an International financial centre 2018 (2018 October), 2019 (December 2019).

structure, the UK's major industry has already shifted to the tertiary sector with the development of service industries, where among them, financial services have been the most remarkable fields for profit-making in the UK. Such a position comes from the UK's maturation in capitalistic development. In general, as capitalism progresses, capital tends to shift its main field of capital realisation from value crystallised industries to value-non-crystallised industries, because value-crystallised industries must be restricted in capital realisation by the amount of basic labour. In the field of real capital, capital must move production bases from countries with lower relative value of money to countries with higher relative value of money (thus, with low labour costs). In addition, as capitalism matures further, main profit-making fields become more and more dependent on money capital, thus financial and fictitious fields because the financial field is far removed from value-crystallised industries. In the case of fictitious capital, both price movements and trade objects are far removed from original real capital. Expansion of financial and fictitious capital can provide an investment field for money capital. The state of higher money capital ratio to real capital in the UK coincides with the fact that the UK

is in most mature development phase of capitalism of all countries.

From a viewpoint of the structure of international balance of payments, the UK is one of the two 6th stage countries with a current account deficit. The UK's balance of payments stage is a reflection of its mature domestic economic structure and a result of being a previous key currency country. Although both the UK and US have a large financial service surplus compared to other developed countries, in regards to the ratio of financial service credit to total service credit and the ratio of financial service credit to total service debit, the UK's data is much higher in both than other developed countries including the US. These features show how important the role of financial service surplus for minimising current account deficit is for the UK.

Both the United Kingdom and the United States are increasing their external debt, but only the current key currency countries can accumulate their external debt without the risk of default. On the other hand, other countries including the UK cannot accumulate large long term external debt. If Brexit affects the direction of current account deficit increase caused by decrease of financial service surplus, the UK's burden of external debt



will gradually increase.

Whether or not external debt triggers a debt crisis will depend on the following. As seen from the huge outstanding government debt in Japan, increase in government debt ratio to GDP as such will not cause financial problems. There is indeed a serious risk that government debt increases simultaneously with external debt. Using the equation of national income identity ($EX-IM=S-I+T-G$, $EX-IM$: current account balance, $S-I$: private balance of investment and saving, $T-G$: government fiscal balance), in the case of Japan, the current account balance is positive and fiscal balance is negative, and thus private balance is in a larger surplus than current account surplus. This means that domestic private saving would fund government debt, and an international debt crisis would never occur in Japan. However, in the case of Greece for example, current account and fiscal balance is both negative, meaning private balance is in a slight surplus or slight deficit. This shows that government debt must be mainly funded by inflow of money from overseas, and hence international credit risk and the ability to repay government debt becomes a serious problem for creditor nations and international lending organizations.

Chart 6 shows recent increasing trends of government debt indicating real capital difficulties in developed countries. The ratio in Japan is outstandingly high, with other countries also keeping

high level and increasing after the world financial crisis of 2008. In 2009, when the Greek debt crisis broke out, its government debt as a percentage of GDP was 135%. The UK government's debt ratio to GDP has increased since the world financial crisis of 2007-2008. The UK government debt to GDP ratio in 2019 is 117%, which is not a low level. Not only that, but as a general trend, the debt to GDP ratio of developed countries, with the exception of Germany, is on the rise. This means that modern capitalism, especially in developed countries, has an over-accumulation of capital and is at a stage where states must use their debt to support their capital activities.

As mentioned above, increasing government debt does not immediately lead to a debt crisis. However, in the UK, the current account balance is on a deficit basis, and external debt is also on the rise. There are many uncertainties about the impact of Brexit, but if the surplus of financial services, which is an important factor in the service balance, decreases, the current account deficit will definitely increase. And the risk of a debt crisis will increase. Furthermore, it cannot be denied that Brexit may affect the increase in government debt itself.

Conclusion

In the UK, financial services provide its most remarkable field for profit-making and capital

accumulation. Such a position comes from the UK's capitalistic maturation with lower relative value of money and history of being a previous key currency country. In regards to structure of balance of payments, the UK's stage is a reflection of its domestic structure. Although both the UK and US have a large financial service surplus, the UK is more dependent on it and is in a weaker position than the US.⁸

Through the equation of national income identity, in the case that domestic private excess savings can be used to fund government debt like in Japan, an international debt crisis would not occur. However, in the case of a country with international debt like Greece, increasing government debt must primarily be funded by inflow of foreign money, and the ability to repay it becomes a serious problem for foreign creditors.⁹ If Brexit affects the direction of the UK's current account deficit and is accompanied by rising government debt, the resulting increase in burden of external debt will no doubt need to be examined carefully.

8. In the case of current account deficit countries, if external debt accumulates and capital inflow destabilises, the possibility of a debt crisis increases. Dymski points out: "An international debt crisis arises when normal financial-market relations are disrupted because the cross border repayment obligations of borrowers in one nation to lenders in another cannot be met without radically altering repayment terms or borrowers' government policy." "Post-War International Debt Crisis and their Transformation." *The Handbook of Globalisation*, second edition, edited by Edward Elgar (2003), revised version of Chapter 10, 26 June 2018.

9. The fund circulation structures of Japan and Greece differ as follows.

Japan $EX-IM^{\oplus} = (S-I^{\oplus\oplus}) + (T-G^{\ominus})$ Domestic saving can fund domestic debt.

Greece $EX-IM^{\ominus} = (S-I^{\oplus\ominus}) + (T-G^{\ominus})$ Domestic saving cannot fund domestic debt