



'Diverging Capitalisms?' series
Brief No. 3



'Brexit Britain': Where does the UK growth model go from here?



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This Brief is the third of a series drawing on the project ‘Diverging Capitalisms? Britain, the City of London and Europe’ led by FEPS, Policy Network and SPERI, which aims to consider the changing nature of the British economy, its place within the European economic space and the consequences of Brexit. The findings presented here take the analysis developed as part of the workshop entitled ‘After Brexit: British and EU capitalisms at the crossroads?’ held in Brussels on March 24th 2017.

In this Brief we provide an overview of the sustainability of the existing British growth strategy, the potential development trajectories of the British model of competitiveness following EU withdrawal, and the strategic disorientation of British business groups.

Background

- The UK has a distinctive growth model which has emerged since the early 1990s in which domestic consumption is sustained by escalating asset prices and private debt, predicated upon the continuation of low inflation, low interest rates and deregulated financial institutions.
- At the same time there has been substantial convergence over the last four decades between British and European capitalism as the result of common membership of the European Union and the creation of the single market, and as a result of the more integrated and open global economy of the neoliberal era.
- The UK growth model has proven to be profoundly unstable and politically contentious in terms of its distributional outcomes. With the interventions of the UK government in the housing market, growth has returned to the UK economy since the crisis and this has yet to be challenged by the vote for Brexit itself.
- Article 50 was triggered on Wednesday beginning the UK’s two-year withdrawal from the European Union. The apparent preference for a ‘Hard Brexit’ in the Conservative government also entails the UK’s withdrawal from the European single market.
- ‘Hard Brexit’ threatens the buoyance of a number of economic sectors in the UK and the sustainability of many of the preconditions underpinning the UK’s growth model.

Summary

- ‘Hard Brexit’ threatens the economic and political sustainability of the UK’s growth model.
- Three development trajectories are foreseeable for the UK political economy after Brexit. The first is a Hard Brexit followed by a ‘Soft Br-entry’ which ensures as much economic continuity as possible despite political withdrawal through establishing new trade agreements. The second is the strategy of ‘Global

Britain' which will entail the jettisoning of social rights, dramatic deregulation, tax cuts and further state retrenchment based loosely on the Hong Kong model of economic success. The third is a protectionist regime aligned with a robust industrial strategy and tight controls over investment, trade and people.

- Simultaneously Brexit has problematised the strategic *modus operandi* of British business groups: to defend the deregulated British labour market from EU intervention whilst extending the UK's preference for liberalisation through the EU's institutions and seeking to open-up the single market to competition from the UK's export-oriented business services and financial sector.
- The search for a new growth strategy is now even more urgent than before. This moment of conjuncture demands a more active search for a new model of competitiveness and growth.

The past and future of the Anglo-liberal model

Andrew Gamble (SPERI)

Since the 2008 financial crash and the Eurozone crisis fundamental questions have been raised about the future of the post-war international market order and of regional orders such as the EU, but the liberal international market order proved resilient until the twin shocks of the vote for Brexit in June and the election of Donald Trump in November 2016. Brexit provides a new context for debates on the distinctiveness of the UK's political economy, because of the uncertainty which now surrounds Britain's future political and economic arrangements, not just its future trading relationships and control of its borders, but also the unity of the United Kingdom and Britain's wider role in the world. The peculiarities of the Anglo-liberal model of capitalism were shaped by the role it played in the international economy over three hundred years. Some of these distinctive features have disappeared but others, particularly the size and weight of the financial sector, the regulation of companies, unions and labour markets, and the size and centralisation of the British state, remain.

British capitalism has passed through three broad phases since 1945. Post-war reconstruction and the attempt to re-establish Britain as a world power was followed after 1956 by attempts to join the EEC and to modernise the UK economy along lines suggested by European models of capitalism. However, the resolution of Britain's relative economic decline by the Thatcher government reasserted core features of the Anglo-liberal model, and made the US not Europe the preferred model. The change of direction was consolidated in the third phase after 1992, with the consolidation of a financial growth model, which saw more sustained economic success and financial stability, but still persistent weaknesses in the UK economy, notably productivity and asset bubbles.

The consequences of Brexit for the future trajectory of British and European capitalism suggest three scenarios. In the first Britain regains formal sovereignty but conducts successful negotiations for an associate status which preserves most of the elements of the UK's current relationship with the EU. This might meet strong political opposition from Leave supporters, especially since the UK would continue

to converge in certain respects with the EU and would remain within its orbit. In the second scenario the negotiations fail and Britain falls back either on WTO rules or unilateral free trade. The distinctive features of the Anglo-liberal model are accentuated; employment rights, social rights and environmental protections are weakened; taxes and spending are cut. This project of 'Global Britain' depends for its success on an environment of strong growth in trade and output in the international economy which is not currently the case. In the third scenario the negotiations also fail but the response is to adopt national protectionism, with an active industrial and macro-economic strategy and tight controls over trade, investment and people, against a background of trade wars and fragmentation of the international economic and political order. Despite the rise of national-populism in many countries, including the United States, this last scenario is currently the least likely of the three, and would involve a radical reshaping of the British economic model. But none of the scenarios are without problems.

'Defend and extend': Business strategy and the emerging politics of Brexit

Scott Lavery (SPERI)

British business groups have historically attempted to 'defend and extend' a liberalising agenda within the EU by deploying the formal and informal power of the British state at the supranational scale. We can see this in the spheres of EU social and employment policy. Since the Delors Commission introduced qualified majority voting across a range of employment and social policy areas a distinctive – albeit relatively weak – body of supranational social and employment policy has emerged across the EU. British business has sought to limit the scope of these EU regulatory incursions. Business groups have long characterised 'gold plating', 'one size fits all' Commission policies and 'mission creep' as threats to the UK's flexible labour market.

In order to limit the supranational upregulation of labour standards, British business groups have sought to use the presence of UK policymakers within the EU institutions to advance a liberalising agenda. For example, business groups sought to make the UK's individual 'opt-out' from the working time directive permanent, whilst the Confederation of British Industry (CBI) pushed for the UK government to secure a 'moratorium' on EU employment policy in 2016 and also counselled that UK policymakers should seek to shape key bureaucratic positions in the European Parliament and Commission.

This attempt to 'defend' the UK's flexible labour market has been complemented by a second business objective: to 'extend' the UK's preference for liberalisation outwards by opening up the single market to competition from the UK's export-oriented business services and financial sector. For example, UK policymakers and City-based firms took a pro-active role in driving through the recent Capital Markets Union (CMU) initiative. Since 'alternative' financial instruments – such as hedge funds and private equity – are largely concentrated in the City, CMU represented a golden opportunity for the UK's financial sector to extend its influence further into the single market.

In short, British business has supported EU membership historically not only because of the ‘access’ to the single market which this affords; UK influence over EU legislation was an equally crucial consideration.

Given that Brexit fatally undermines the UK’s capacity to shape future EU regulation this raises a number of strategic dilemmas from the perspective of British capital. On the one hand, business interest groups such as the CBI have said that they want to secure an arrangement whereby tariff and non-tariff barriers are kept to an absolute minimum. However, existing ‘harmonisation’ models – such as the European Economic Area (EEA) option – would mean that UK businesses would have to continue to implement EU employment policy whilst being unable to shape this in the ways it has done in the past. Similarly, ‘third country regimes’ (TCRs) provide non-EU financial firms with (limited) access to the single market in services insofar as they are deemed to be ‘equivalent’ to EU standards. However, as recent reports from City lobby groups have warned, being subject to a TCR would mean that the UK could potentially become a ‘rule taker’, forced to implement rules over which it has little to no say.

British business therefore faces an important dilemma in the Brexit conjuncture: how to maintain a high level of access to the single market whilst at the same time limiting supranational incursions into the UK’s domestic regulatory environment. This is likely to shape business strategy as it seeks to ‘take back control’ of the emerging political economy of Brexit.

Conclusion

- The consequences of Brexit will be contingent upon the negotiation in which the UK and the EU are now engaged.
- In that negotiation, the degree to which the May administration treats Brexit and the vote for Brexit as a rejection of EU immigration will make it less likely that Britain will leave the EU on favourable trading terms (i.e. with some kind of privileged access to EU markets).
- The question of Euro passporting rights for the City of London is also crucial for the form and, indeed, size of the UK’s financial services sector in the years after the Brexit deal. Once again, the more the UK government equates Brexit with the rejection of EU immigration the less likely it is that a favourable deal can be struck.
- Finally, the Brexit agreement struck is likely to have major domestic political implications, not least in terms of the timing and outcome of a putative second Scottish Independence Referendum. The more the Brexit deal damages the current terms of trade between the UK and the EU, the more likely will be a vote for independence in Scotland and a ‘Brexit-Breakup’ double whammy.

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