BUILDING A SUSTAINABLE POLITICAL ECONOMY:
SPERI RESEARCH & POLICY

Diverging Capitalisms

Britain, the City of London and Europe

Edited by
Colin Hay
Daniel Bailey

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Foreword

With rising inequalities in the context of the great financial crisis, the structural power of finance and the Brexit vote, parties of the left and centre-left have an important role to play. Jeremy Corbyn's Labour Party must be congratulated for its powerful campaign in the run-up to the 2017 UK General Election, in which it was clearly able to get its message across to millions of people and many more than was expected by opposition parties and those within the progressive community itself. The message of being "for the many, not the few" resonated with close to 13 million voters and it has a truly progressive basis. But progressives must not become complacent and think that the job has been done. Now is the time to build on that success.

In fact, if we can be confident of anything, it is that the relationship between the UK and the EU will be something completely different to what was promised by the Leave campaign during the referendum. The EU must remain firm and even more importantly, must remain united. There must be no option for the UK to look for potential trade alliances in countries such as Hungary, Poland and other new member states. Not because the UK must be made to suffer. Quite the opposite. The progressive community in the UK and Europe must stick together, must use each other, to ensure the best possible deal for everyone.

Given this political challenge, FEPS (Foundation for European Progressive Studies, Brussels), Policy Network and SPERI (Sheffield Political Economy Research Institute, University of Sheffield) joined forces in 2016 to convene a series of workshops in the framework of their joint project 'Diverging Capitalisms? Britain, the City of London and Europe'. The project also benefited from the financial support of the European Parliament. The aim of the joint venture was to consider the changing nature of the British economy, its place within the European economic space and the consequences of 'Brexit'. The work undertaken fed into a number of policy briefs, and, finally, in the publication of this edited book.

The research project was designed to allow for open discussion about, the socio-economic ramifications of Brexit, the changing nature of the city of London, the global financial crisis and social and economic inequalities across Europe. One objective of this research project was also to bring together a group of scholars to reflect about these issues of profound importance to the future of Europe and the role of Britain within the European economic space—even before Brexit became a reality. The roundtable debates that took place in London and Brussels allowed the authors featured in this book to pit their ideas and hypotheses against those of other academics, policymakers and think tankers in London and Brussels. Through this publication, FEPS, Policy Network and SPERI hope to spur innovative thinking to enrich the debate about the future of progressive politics and economic restructuring in Europe.

Brussels, Belgium
June 2018

Dr. Ernst Stetter
Foundation of European
Progressive Studies

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The research would also not have been possible without colleagues past and present at the Sheffield Political Economy Research Institute (SPERI), most notably Arianna Giovannini, Tom Hunt and Laure Astill to whom we are extremely grateful.

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CHAPTER 1

Introduction: Brexit and European Capitalism—A Parting of the Waves?

Colin Hay and Daniel Bailey

In the early 1990s it was *de rigueur* to argue that the challenge of competitiveness in an age of ever greater economic interdependence was likely to put pay to the institutional diversity of capitalism itself, certainly in the western world. Globalisation, in other words, was an agent of convergence like no other—driving down taxation, regulation and welfare spending. Lumped together, as it so often was, with the end of the Cold War's ideological battle, this prompted the liberal Right to herald proudly the 'end of history' with the global triumph of both Anglo-liberal capitalism and Anglo-liberal democracy (Fukuyama 1989). It political-economic terms, it was argued that the (largely) exogenous and (seemingly) agentless forces of globalisation compelled states to engage—and, ultimately, to succeed

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in—the interstate competition for internationally-mobile capital if they were not to endure a profound loss in economic performance. In short, they had no alternative other than to adapt their political economies to the (perceived) needs of global finance. This, it was posited, would necessitate a form of state transformation characterised by fiscal restraint, supply-side rather than demand-side forms of intervention, the prioritisation of low inflation over full employment, and the re-moulding and re-purposing of existing welfare state institutions to suit the goals of national strategies for attaining and sustaining competitiveness. The 'competition state', as it was termed (by critics as well as admirers), was thus identified as the successor to the Keynesian welfare state of *les trente glorieuses*, the model around which the contemporary nation-states would henceforth crystallise (Cerny 1997).

Yet despite this claim, hypothesis, hunch or conjecture—and perhaps unremarkably to students of the *longue durée*—capitalist diversity persisted. In 2001, Peter Hall and David Soskice published their now seminal text, *Varieties of Capitalism*. Based, as it was, on a fusion of rational choice and historical variants of the new institutionalism, it sought to demonstrate that the political economies of the advanced capitalism worlds were in fact clustering around not one but *two* models. These twin Pareto optima were, in effect predicated on, and sustained by, different institutional foundations of national competitiveness. The first of these model capitalisms they termed the Liberal Market Economy (LME). It was characterised by flexible labour markets, stratified wages, and mobile capital with a typically short-term focus. LMEs, thus understood, were seen as innovative, flexible, adaptive and responsive to changing competitive circumstances, a process lubricated by a liberalised financial sector allocating resources between opportunities as they presented themselves. Hall and Soskice's exemplary LME cases were the Anglophone economies—the USA, the UK, Ireland and Australia. The liberal character of their market governance was seen to be mirrored in the more individualistic character of their cultural tendencies. The second model capitalism identified and described by Hall and Soskice was the Coordinated Market Economy (CME) model. Here we find a more densely institutionalist configuration—a corporatist model in which non-market relations take on a far more important role. This model involves by a less arms-length role for the state—a coordinator and not just a regulator. CMEs are characterised by more tightly and actively regulated labour markets, a greater degree of social protection, and a virtuous self-reinforcing cycle of patient capital, long-term investment in skills and training, and collaborative rather than conflictual industrial relations in which employer organisations and trade unions play a central role alongside the state. The CME model is most commonly used to denote the economies of Germany, Sweden, Finland, Switzerland, Norway and the Netherlands.

Hall and Soskice's approach has proved phenomenally influential. Its central premise is that the variety of capitalism to which an economy belongs shapes profoundly the types of corporate strategy to be found within it, influencing in turn levels of productivity, domestic disposable income and so forth. The theoretical and conceptual tools proffered by Hall and Soskice are a touchstone for comparative political economists seeking to understand the role of national institutional configurations in shaping economic practices and strategies of competitiveness—with their broader implications for the distributional patterns, systemic risks and political contestation pertaining to national capitalist systems (Schmidt 2002; Hay 2004, 2005; Rhodes 2005; Hall and Gingerich 2009; Hall 2014; Soskice et al. 2016).

Yet it is important to note that the analytic distinction between LMEs and CMEs is an ideal-typical one. As many scholars have argued, the theoretical categories and empirical claims posited by the framework are highly contestable (Pontusson 2005; Bruff and Horn 2012; Bruff and Ebenau 2014; Bailey and Shibata 2014; Coates 2015). As such, and as Hall and Soskice themselves made clear, no country can be expected to conform to either model in its entirety. The specificities of institutional change interact with relatively distinctive national growth models which incentivise the privileging of particular sectors in economic governance (such as the City of London or the Bavarian manufacturing industry) resulting in idiosyncratic paths of economic development (Hall and Thelen 2009; Hay and Wincott 2012). However, the categorisation did succeed in emphasising the different strategies capable of achieving competitiveness. In so doing, it came to serve as an important corrective to the expectation, typical of the literature of the time, of a globalisation-engendered process of convergence. In place of this simple convergence thesis Hall and Soskice substituted a more complex and institutionally-differentiated dual convergence thesis.

That was then. Since the 2008 financial crash the world has changed significantly—and so has how we think about it. With the benefit of the hindsight the crisis affords, some of the limits of convergence theses (whether simple or dual) are more starkly exposed. Put bluntly, to understand the developmental trajectories of contemporary capitalism it now seems rather more important to focus on sources of disequilibrium and crisis, rather than to work with equilibrium models. In a world in which it is acknowledged that crises are possible, there are limits to the value of ideal-typical reflections on stylised models of capitalism. For such approaches, however well they might describe a current situation, fail to anticipate, and lack the conceptual resources to make even retrospective sense of, crises.

Arguably, then, one of the casualties of the crisis is our current understanding of the dynamic variability of capitalism institutionally. This volume is a contribution to the debate such a reflection presages.

An initial point of departure is the acknowledgment that the political attempts to navigate low levels of economic growth since the crisis do not lend themselves readily to a story of convergence (whether simple or more variegated). The 2008 crash was followed by the European sovereign debt crisis, increasingly fractious relations between the Eurozone's creditor and debtor countries, prompting attempts at capitalist restructuring intended to instigate national economic recoveries. The 2010s have thus seen European economies implement differing levels and types of fiscal austerity, monetary activism (within and beyond the Eurozone), welfare retrenchment and labour market reform. Simultaneously, the discontent fostered by low growth and the political attempts to navigate it have contributed to the rise in popularity of right-wing and Eurosceptic populist figures and parties particularly amongst unskilled or semi-skilled workers in deindustrialised regions (the so-called 'left behind'). Although it is an identifiable trend across Europe, the most conspicuous manifestation of the populist ascendancy so far is 'Brexit' itself; the withdrawal of the UK from the European Union and (it now seems clear) the Single European Market. The exact terms of the UK's withdrawal are subject to intense on-going negotiations. It is on the outcome of these negotiations that arguably the very feasibility of the UK's existing growth model will rest.

But the uncertainty that Brexit has prompted is not contained domestically; it has certainly heightened the sense of political indeterminacy (albeit to differing degrees) within European economies. The strategic disorientation within the UK created by Brexit itself suggests further bouts of fragmentation and capitalist re-structuring in the near future, matched in all likelihood by political-economic change within the EU now that its erstwhile 'awkward partner' is set on a different course (whatever that turns out to be).

For some, particularly the Conservative Party's 'Brexiteers', Brexit represents an opportunity for a further radical liberalisation of the UK economy. No longer bound by supra-national 'red tape' and the EU's regulatory disposition, the UK in such a conception might re-fashion itself as a European Singapore, paring back still further the vestiges of its labour market regulation whilst cutting taxation and reducing further welfare eligibility and generosity. Competitiveness would be achieved in this model through the offer of a 'good business environment' to internationally mobile capital, at the expense of hard-won workers' rights, environmental protections and the scope of the state's existing welfare policies. Central to this strategy would be the swift negotiation of trade deals with the emerging economies of Asia and South America, in particular, a precondition of which is that the UK cannot remain a member of the Customs Union. In the short term, the UK would fall back to the trade terms of the WTO, or would take the advice of the group formerly known as 'Economists for Brexit' (now rebranded 'Economists for Free Trade') to declare a unilateral strategy of trade liberalisation by eliminating any and all tariff and non-tariff barriers. This would represent a drastic deepening of the Thatcherite project (or at least its neoliberal elements) in the UK. It is at present by no means widely supported. But if no trade agreement has been reached between the EU and the UK at the point of withdrawal (on March 29, 2019, two years after the triggering of Article 50) then its proponents could feasibly swell in number. This is a proposal that many card-carrying Brexiteers within the ruling Conservative Party incline towards—including, of course, both Boris Johnson and Jacob Rees-Mogg. But the opposition to it, including within the current Conservative Cabinet, should not be underestimated. At times, during what has to date been a fraught negotiation process, its value to the government has seemed to be the tacit (if perhaps rather hollow sounding) threat that it might be seen to pose. It need hardly be pointed out that this is a potentially dangerous game to play—not least as it has given a platform that it might not otherwise have had to a hyper-liberalising idea of Britain after Brexit.

A very different conception of the post-Brexit scenario is reached in the UK were it to remain a member of the Customs Union and retain access to the European Single Market (and its attendant regulatory structure). Here the potential divergence between Britain and the EU would be far less drastic. This is the so-called 'Soft Brexit' option—the scarcely veiled preference of the UK Treasury in opposition to the Department for Exiting the European Union. Philip Hammond, the Chancellor of the Exchequer and chief proponent within the Cabinet of a 'Soft Brexit', believes that such a deal is likely and that any capitalist divergence resulting from Brexit will be modest. To the dismay of the many Brexiteers in his Party, he argued at the World Economic Forum in Davos that:

> Instead of doing what we're normally doing in the trade negotiations – taking two divergent economies with low levels of trade and trying to bring them closer together to enhance that trade, we are taking two completely interconnected and aligned economies with high levels of trade between them, and selectively moving them, hopefully very modestly, apart. (Hammond 2018)

The battle lines are drawn. As this suggests, the internal politics of the Conservative Party make it extremely unclear to what degree we will witness a significant change in UK macroeconomic strategy and an associated potential bifurcation of British and EU capitalisms in the decades to come. Even the short-term trajectory is unclear. It may well be that by the end of the current Parliament, Britain will actually conform less well than it does today to the LME template. Theresa May has already professed a certain critique of financialised Anglo-liberal capitalism. In her first Conservative Party speech as Leader, in the midst of the tense political climate after the EU referendum, she chose to denounce the stateless 'international elite' and vowed to re-unite the country by making 'capitalism' operate 'more fairly for workers' (*Financial Times* 2016). In a later speech in January 2017, she refuted the principles of Thatcherism by stating that 'people who are just managing, just getting by, don't need a government that will get out of the way, they need a government that will make the system work for them' (*Financial Times* 2017). She has since proposed worker representation on corporate boards and re-introduced the language of industrial strategy (if, as yet, not with a great deal of substance) back into British politics. These are sentiments which have divided the Conservative Party and have not at the time of writing been translated into major policy changes. The difficulties of overcoming the 'lock in effects' of existing competitive advantages and vested economic interests in order to change macroeconomic course appear to have been too great.

Yet Theresa May appears cognisant that the strategic considerations of economic re-orientation must be attuned to the broader context of the social crises precipitated by recent waves of capitalist restructuring. This is a febrile context in which to engage in macroeconomic strategising. The particular types of austerity measures and labour market reforms (chosen by ruling parties or demanded by the Troika) since the 2008 financial crash—and their impacts on the wage share, precarious work and inequality especially—have had profound political and social impacts. They have compounded deeper structural issues of socially and geographically unequal growth, the increasing importance of asset ownership in determining distributional outcomes (Piketty 2014), and the incremental dismantling of the welfare state and the concomitant rise of private debt (Soederberg 2014). These capitalist structures have contributed heavily to the spectrum of discontentment evident in Europe today. As already alluded to, one manifestation of this has been political polarisation. The precariousness in deindustrialised low-growth areas outside the major cosmopolitan cities amongst unskilled or semi-skilled workers has seemingly contributed to anti-establishment sentiment and rise of right-wing populism, as discontent has bred distributional conflicts on racialised lines and anti-immigration feeling. Meanwhile, the younger generations and the poorest (particularly but not exclusively in the UK) are looking further to the left as a result of being so deeply affected by policy decisions and being almost entirely excluded from the asset appreciation which is so central to the UK's current growth model. The decade of sluggish economic performance since 2008 has also had ramifications for geo-political fragmentation, with many in Scotland and Northern Ireland uncomfortable with their place in a 'Brexiting Britain'; reflected by separatist movements in mainland Europe under similar economic conditions. These developments seem to be, and indeed should be, of serious concern for Theresa May's government as it wrestles with strategies to improve the UK's economic performance. May has already gained the reputation of being a cautious politician, and the performance of the Labour Party in the 2016 UK General Election will only have intensified her caution further. Alternative economic thinking is not imprudent in such a context, but there is a danger that certain strategies could exacerbate rather than alleviate social instability.

This is to say nothing of the environmental threats to European prosperity, which threaten to very foundations of wealth creation. The consequences of ecological degradation to economic performance were most famously assessed by Nicholas Stern, whose findings have been seen as conservative in order to garner political support by some (Stern 2006; Anderson and Bows-Larkin 2012). Environmental degradation represents not only the threats to capitalist production still to come, but trends which are already feeding into economic performance. Pessimism about the future of economic growth itself, the levels of which have been in steady decline since the mid-1970s, suggests that the current malaise is not necessarily a punctuation of the equilibrium (Streeck 2014). This is a politically and economically tumultuous period which threatens to get even worse.

So what are the foundations of competitiveness upon which European political economies can achieve greater prosperity in the twenty-first century? What are the sectors of growth in the coming decade and what are the political strategies capable of nurturing them? And, perhaps just as significantly, what are the potential institutional means of sharing the proceeds of economic success equitably?

These are questions of profound importance for the parties of the left and centre-left, whose vote share has declined in recent years, at least in part because of their inability when in office to halt the trend towards rising inequality (Crouch 2012). As Patrick Diamond (2016) has noted, in its electoral appeal the left has tended to depoliticise economic choice since the 1980s, opting to deploy a more technocratic language vis-à-vis economic policy options. This has undermined its ability to respond to the subsequent economic crisis and created an ideational vacuum in political-economic thinking in sites of power. As a result, many progressive parties were seen as complicit in the choice for and implementation of austerity in the period since the 2008 financial crash. And they have suffered electorally as a consequence. The offerings of many traditional parties of the left are greeted with more muted enthusiasm today, with core sections of their traditional support base having become less and less enamoured by the cause and in some cases even defecting to right-wing populist parties (Mair 2011). In this context, it is crucial that the debates on developmental capitalist models return to prominence. How do social democratic parties adapt to the economic realities facing their electorates? How can progressive political-economic strategies address the economic, social and environmental issues raised by, and ultimately transform the dysfunctional capitalisms of Europe? Can socially just economic models be based on sustainable foundations of competitiveness? Is redistribution alone enough to mitigate the rise of inequality in the context of Piketty's analytical insights about the distributional patterns of capitalist societies? In short, where does progressive politics go from here (see also Coates 2018; Hay and Payne 2015)?

To respond to the failure of Europe's social democratic parties in the last decade, we must begin with a sober analysis of the character of European capitalisms, the inequalities they generate, the models of growth being nurtured, the evolving nature of the financial sector, and the UK's changing role in the European economic space in the context set by the vote for Brexit.

This edited collection brings together some of Europe's most eminent political economists to address these key questions. Its aim is to stimulate a reflection on how the financial crisis, the Eurozone crisis and Brexit have changed the political economies of the UK and Europe since 2008, and how they alter the conditions for British and European prosperity in the future. As such, the scope of the book incorporates reflection upon how recent developments have impacted upon economic instability, the City of London, inequality, economic governance, and the dynamics of the UK growth model. The authors draw upon the analytic resources of the varieties of capitalism debate (if not necessarily that of Hall and Soskice themselves), as well as their knowledge of British and European political economy, to make sense of these developments.

This analysis also serves to inform a conversation about progressive politics for the 2020s. What are the prospective progressive political strategies which are best attuned to this new economic terrain? What strategies can nurture new dynamics of prosperity and mitigate social inequality? Can Social Democracy re-invent itself to meet these challenges or should it now be considered obsolete?

The project from which this book is derived was a collaboration between the Foundation of European Progressive Studies (FEPS), the Sheffield Political Economy Research Institute (SPERI) and Policy Network. The joint mission was to reflect on the changing nature of the British economy, its place within the European economic space and the consequences of Brexit, in the context of a series of ongoing crises in the global economy and the escalation of political unrest. Our ambitious agenda sought to bring together and better articulate concerns with the particular structural imbalances characterising the British economy, the role of the City of London within it, the foundations of British and

European competitiveness, the attempts to coordinate economic governance at the European level, and the implications of Brexit for each. The agenda was deliberately inclusive, a breadth justified by the importance and timeliness of the issues with which we were dealing. This volume, the final output of the project, retains that breadth and ambition. Each of the commissioned chapters offers, we feel, a provocative argument based on significant and original research.

As with any volume of this nature, the book's empirical scope is wide-ranging and its analysis multi-tonal. However, four key themes underpin the collective enterprise, marking out we hope its distinctive contribution to the existing literature. They are as follows:

- the long-term development of the UK's growth model and the potential strategies, both macroeconomic and in the UK business community, which will ensure competitiveness beyond Brexit;
- the City of London's role in the architecture of global finance, its relationship with imbalances and instability in the British and European economies, the City's evolution since the global financial crisis, and the opportunities and risks presented by a Hard Brexit;
- the role of the UK in, and the implications of Brexit for, EU economic governance;
- the prospects of social democracy in the midst of a dividing Europe.

In the opening chapter, Andrew Gamble locates the current political-economic plight of the UK in its proper historical context, charting the evolution of the UK's economic growth model and the cornerstones of its competitive advantage throughout the post-war period. He details the impact of the loss of empire, various post-war crises and the influence of successful CMEs in mainland Europe on the UK's macroeconomic strategy before contemplating potential post-Brexit re-orientations of strategic direction for the UK's LME. He argues that three political-economic scenarios are foreseeable for the UK after Brexit: a 'soft Brexit' whereby the UK would remain part of the European Single Market and capitalist divergence would be limited, the adoption of an ultra-libertarian Singaporean model entailing the declaration of unilateral free trade, and a protectionist turn which would profoundly re-shape the character of the UK economy. He considers the implications of each for the future of British and European capitalisms and the conditions of existence of each.

In the following chapter, Leila Simona Talani makes the case that the relationship between the City of London, the Treasury and the Bank of England (the famous 'City-Bank-Treasury nexus' first identified by Perry Anderson in the 1960s) will ensure that the City of London will continue to thrive as a global financial centre in spite of Brexit. She argues that Brexit will allow the financial institutions that together comprise the City to more credibly threaten to re-locate their operations elsewhere, and as such we are likely to see a governmental response which assuages their fears and compensates for the (still hypothetical) loss of access to the European Single Market. As such, policy-making in the UK Treasury and the Bank of England will become even more attuned to the City's needs precisely because of Brexit. The implication is that we are likely to see the protection of the square mile's competitive advantage, not its erosion. This would represent the continued privileging of financial activity over productive activity, and the privileging of capital over (unskilled or semi-skilled) labour, in UK public policy; the key characteristic of what Talani refers to as 'pragmatic adaptation'.

Helen Thompson asks herself why the City of London, given its pivotal role in the UK's growth strategy, failed to prevent the referendum on the UK's EU membership and consequently Brexit itself. The Conservative Party's decision to jeopardise the UK's historical competitive advantage in finance in such a way has been a source of consternation particularly for those who believed that the 'structural power of capital' would prohibit any political outcomes which threatened profitability. Thompson, however, puts forward a compelling three-pronged case which recasts and, in so doing, resolves this apparent paradox. Firstly, she argues the City's interests are no longer as dependent on Sterling as they were, due to the gradual development of the offshore Dollar, Euro and Renminbi markets in the 1950s, 2000s and 2010s respectively. This decreasing importance of Sterling in the City meant that the interests of the latter were not as bound up with the domestic UK economy as is commonly believed. This in turn provided David Cameron with more 'room for manoeuvre' than he would otherwise have enjoyed when it came to attempting to resolve the divide on Europe within his own party. Secondly, the City had come to fear re-regulation and the imposition of additional forms of taxation (likely a ban on short-selling, rules on bankers' bonuses and the introduction of a Financial Transactions Tax) from Brussels as part of the fall-out of the 2008 financial crisis and the subsequent Eurozone sovereign debt crisis.