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The Political Economy of Brexit and the UK's National Business Model.

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Charlie Dannreuther

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About SPERI

The Sheffield Political Economy Research Institute (SPERI) at the University of Sheffield brings together leading international researchers, policy-makers, journalists and opinion formers to develop new ways of thinking about the economic and political challenges by the current combination of financial crisis, shifting economic power and environmental threat. SPERI's goal is to shape and lead the debate on how to build a sustainable recovery and a sustainable political economy for the long-term.

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Introduction

Scott Lavery¹, Lucia Quaglia² and Charlie Dannreuther³

The UK's economy is underpinned by a distinctive variety of capitalism or 'national business model'. One distinguishing characteristic of the UK's business model is that it plays host to an open and lightly regulated *international financial services* centre concentrated within the City of London. Another is that the UK contains a highly *flexible labour market regime*, consisting of limited employment protections, high levels of atypical work and restrained levels of real wage growth. The UK's business model is also characterised by openness to *international capital flows*, with extensive capital markets and a tax regime which is favourable to international investors. Brexit is likely to impact in profound ways upon this national business model.

Since the 1990s, the UK's model of capitalism has been bolstered and sustained by the country's membership of the European Union (EU) and the Single Market. Membership of the trading bloc granted UK firms access to a highly integrated economic area with minimal non-tariff barriers and the so-called 'passport' for financial services. As a result, around 50 per cent of UK exports became destined for the EU throughout this period and UK manufacturers increasingly sourced components from EU supply chains. Investment flows associated with the UK's Single Market membership increased such that the UK became a key destination for inward FDI in the EU (Dhingra *et al.*, 2016). The UK also became *de facto* 'Europe's investment banker' (Carney, 2017). At the same time, the UK's 'flexible' labour market regime was left relatively unscathed by supranational 'social' legislation. Negative 'integration through law' deepened economic integration but the UK's labour market remained relatively unencumbered by minimalist social and employment legislation (Scharpf, 2010). As a result, despite a growing body of EU social and employment law, the UK continued to contain some of the lowest levels of employment protections of any OECD state.

Is Brexit likely to lead to a deepening, a transcendence or reconfiguration of the UK's national business model? These questions are of huge importance to the debate on Brexit and the future of the British capitalism. The UK's national business model is simultaneously dynamic and dysfunctional. It is associated with high levels of employment, large inflows of FDI and in recent years strong growth relative to the EU and Eurozone average. However, it also generates huge wealth and income inequalities, precarious forms of work and stark regional inequalities. The UK's internationalised and lightly regulated financial sector also poses a persistent threat to (domestic) financial stability (Christensen *et al.*, 2016). How Brexit is likely to impact on the UK's national business model is therefore a central issue, for academics, policymakers and citizens alike.

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This SPERI paper is drawn from contributions to a series of 'White Rose' workshops which ran throughout 2016, held at the Universities of York, Sheffield and Leeds. We wish to thank the White Rose for the funding provided and the Universities of York, Sheffield and Leeds for hosting the workshops. The contributions chart the ways in which the UK's historic vote to leave the EU is likely to impact on the UK's distinctive model of capitalism. As outlined in the contributions below, Brexit has important implications for the City of London, trade, the UK's balance of payments, labour markets, economic geography and EU integration more broadly. Brexit will impact on the structure of the UK economy in profound and unanticipated ways. But structural change is not determined simply by external, agentless forces. All social and political processes are mediated by political actors and social forces. The 'form' which Brexit takes, and whether this leads to a deepening, transcendence or reconfiguration of the UK's dysfunctional business model, is not preordained or inevitable. We therefore hope that in this body of papers, we outline some of the underlying constraints, challenges and opportunities which Brexit presents in the contemporary period.

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The political economy of finance in the UK and Brexit

Scott James⁴ and Lucia Quaglia

The variety of capitalism in the United Kingdom (UK) and the British 'national business model' are characterised by a large, open, internationalised and competitive financial sector as well as the status of London as a leading international financial centre. Other distinctive features of this model have been the close government-business relations in finance and the economic strength and political influence of the financial services sector in the UK. Prior to the international financial crisis, the 'City-Treasury-Bank of England nexus', which the Financial Services Authority (FSA) later disrupted, was at the centre of British economic policy. This meant that British policy-making institutions often made policy choices that served well the interests of the financial sector domestically, in the European Union (EU) and internationally (Baker, 1999). Domestically, light touch regulation carried the day in the UK. In the EU and internationally, British policy-makers promoted market-friendly regulation (Quaglia, 2010).

Membership of the EU and the development of the Single Market in finance have bolstered the UK's national business model, in particular its large financial sector. The UK had an open and competitive financial sector that was well positioned to take advantage from the removal of financial barriers, the introduction of passporting rights and the harmonisation of financial regulation across the EU. The EU became the biggest market for UK exports of financial services, generating a trade surplus of £15 billion, a third of the UK's total trade surplus in financial services, which totalled £46 billion in 2012. The UK's financial services trade surplus with the EU more than doubled over the past decade. About 70% of the EU's foreign-exchange trading and 40% of global trading in euros takes place in the UK. The UK hosts 85% of the EU's hedge-fund assets, 42% of EU private-equity funds, half of EU investment bank activity, half of EU pension assets and international insurance premiums (The CityUK, 2015). Over the last decades, the City greatly benefited from the free movement of capital and labour within the EU. In turn, the success of the financial sector was a driving force for the British economy and a linchpin of the UK business model.

Over the past decade, two factors have contributed to the gradual decoupling of the preferences of the UK government and the City of London. The first is the impact of the global financial crisis. First, the influence of British policy-makers and the City on EU financial regulation has diminished as continental policy-makers sought to capitalise on the crisis, tipping the balance of regulatory power in the EU in their favour (Quaglia, 2012). Second, the UK government's preferences on post-crisis financial regulation have become increasingly 'Janus-faced', pursuing much tighter regulation for some financial sectors (banking), but not others (non-banking). The shift has been driven by the need to restore financial stability and public confidence in the wake of the bank bail-outs. This has forced regulators to

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impose amongst the highest capital requirements in the world for UK-based banks and to introduce sweeping structural reforms aimed at ensuring that banks are no longer 'too big to fail'. In a stark reversal of pre-crisis experience, UK policy-makers in Brussels have therefore frequently found themselves opposed by their own financial industry, which on occasion has allied with France and Germany to resist UK demands for tougher EU rules. By contrast, in other sectors of finance where the political fall-out from the crisis has been far less pronounced, UK policy-makers have resisted strengthened EU regulation (such as for hedge funds, rating agencies and short selling) and continued to promote a liberalisation regulatory agenda (for example, Capital Markets Union).

This post-crisis de-coupling has contributed to the further weakening of the traditional City-Treasury-Bank of England/FSA nexus. The crisis has increased the political salience of financial regulation. The taxpayer-funded bail-outs and successive industry scandals, such as Libor, led to heightened political scrutiny, culminating with the establishment of the Parliamentary Commission on Banking Standards. Post-crisis reform of banking supervision and regulation has also reconfigured institutional relationships. The FSA was dismantled and its supervisory role handed back to the Bank of England. Since then the central bank has become the main advocate for stricter regulation, including strong support for the 'ringfencing' of retail and investment banking activities (James, 2017). The Treasury's traditional defence of the City's competitiveness has also been tempered by the need to restore domestic financial stability: a trade-off that Chancellor George Osborne referred to as the 'British dilemma' (Osborne, 2012). These developments have further strained the quiet networks of influence through which the City traditionally exerts political leverage within the UK polity.

The second factor that has contributed to the decoupling of UK government and City of London preferences is Brexit. From 2010 to 2016 the City's relationship with the Cameron Government became increasingly difficult over Europe. For example, although Cameron claimed that his 'veto' of the Fiscal Treaty in December 2011 was about protecting the interests of the UK financial sector, it was also intended to ensure that the domestic ringfencing reforms could be implemented in full. The financial industry contributed constructively to the Coalition Government's 'balance of competences' review, although they made it clear that on the whole they supported the regulatory status quo. The City was increasingly concerned, however, about the future regulatory implications of euro area caucusing and backed the Prime Minister's efforts to secure special protections as part of the government's renegotiation strategy. Although it maintained a low public profile during the subsequent referendum campaign, the positions taken by the main trade associations – TheCityUK and the British Bankers' Association – were strongly supportive of the UK's continued membership of the EU as a critical source of London's success as a global financial hub.

The referendum result can be seen as an instance in which the City lost out (Thompson, 2016) because the influence of the financial industry is greater when policy making is insulated from public scrutiny and democratic politics. Brexit, like financial regulation post crisis, was not an area of 'quiet' politics, removed from the political limelight. On the contrary, it was an issue that was highly salient for the public and was politically controversial. For this reason, the City was unable (and

largely unwilling) to influence the increasingly febrile public debate. The threat of the loss of business and lower profits for the financial sector were never likely to be arguments that could mobilise public opinion against Brexit, or even in favour of the 'soft' options favoured by the City. More fundamentally, the interests and influence of the City in shaping British EU policy since 2010 have been gradually 'crowded out' by the steady growth of domestic euroscepticism, epitomised by the rise of UKIP. Hence, the defence of the interests of UK financial services, which dominated Cameron's early EU strategy from 2010-2013, has gradually been displaced by concern over immigration, free movement and welfare entitlement. The City's voice within government has therefore been gradually marginalised as a result of the shifting electoral incentives facing the Conservative party.

The City's official response to Brexit masks deep-rooted industry divisions. Although the largest trade associations were firmly in the pro-Remain camp, important sections of the City supported the Leave campaign and established a rival 'City for Britain' group. These divisions reflect divergent models of political economy across different sub-sectors of finance, reinforced by their experience of post-crisis regulatory reform. On one side of the divide is the banking sector, dominated by a handful of large global firms concerned to maintain access to lucrative EU financial markets. The UK government's hawkish stance on bank capital since the crisis also shaped its attitude during the referendum, as industry often found itself supporting the EU's efforts to resist UK demands (James, 2016).

The City's main associations have responded to Brexit by gearing up their lobbying capability in advance of the forthcoming negotiations. This led to the establishment in August 2016 of the Financial Services EU Taskforce and Advisory Committee, chaired by Baroness Vadera and composed of senior industry figures, to coordinate the City's response. In a series of position papers, the EU Taskforce initially put forward proposals for a European Economic Area style arrangement or 'special deal' for finance to preserve its membership/full access to the single market. It soon became clear, however, that this was not politically palatable to either the UK government or the EU institutions. Since then, lobbying has focused instead on securing the best possible terms of access for UK banks to the single market post-Brexit. To this end, various mechanisms have been touted, such as a broad use of equivalence mechanisms and an ad hoc passporting (the so-called 'Swiss-plus' or 'Canada-plus' options). Overall, the City's official position continues to favour a 'soft' Brexit with a long transitional period, a stance which has recently received important political support from the Bank of England Governor, Mark Carney (Carney, 2017). Despite these efforts, however, the historic fragmentation of the City's representation hampers the emergence of clear leadership or the articulation of a coherent strategy.

In addition, a sizeable section of the City, centred on the diverse and fragmented non-banking sector (which includes the private equity and hedge fund industries), is more comfortable with the prospect of Brexit. These firms are less dependent on EU markets and, prior to the crisis, largely unaffected by Brussels-based regulation. Their view of Europe has been shaped by their post-crisis experience, particularly Franco-German led efforts to regulate the so-called 'vultures' of capitalism (Woll, 2013). For many in the non-banking sector, Brexit constitutes a second 'Big Bang' which will force the City to reorient itself away from Europe and towards the

emerging market economies. To counter the influence of the EU Taskforce, pro-Leave City figures have established the Financial Services Negotiating Forum, and have been active in supporting the Global Britain and Leave Means Leave groups. The 'hyperglobalist' view of the UK as an offshore financial hub which they promote has important sympathisers within the May Government, including Brexit Secretary David Davis and International Trade Secretary Liam Fox (Baker *et al.*, 2002).

Brexit poses a significant challenge to the success of the financial sector and to the pre-eminence of London as a global financial center. It also challenges the UK business model. However, the effects of Brexit are likely to be differentiated across the financial sector. They depend on the configuration of the financial sector, passporting rights, equivalence provisions and the amount of financial services sector-specific trade between the UK and the EU. Ultimately, the longer-term impact will fundamentally depend on the 'variety' of Brexit that is enshrined in the transitional and final 'deal' to be agreed by the UK and the EU.

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Taking back control? The discursive constraints on post-Brexit trade policy

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While discussions about trade policy were not at the heart of the UK EU referendum campaign, they were central to the post-Brexit visions of many Brexiteers, who hoped to free Britain of the perceived constraints of EU trade policymaking. This is still the case in the wake of the referendum. Brexit Secretary David Davis (2016), for example, has spoken of creating a trade area 'probably ten times the size' of the EU, with much talk before and since focusing on closer economic ties with Britain's Commonwealth partners (Murray-Evans, 2016). This contribution asks what we should make of such claims and aspirations, focusing on the ideational political economy of a putative British trade policy. On one hand, the UK government is increasingly aligned with the vision of a 'Global Britain', seeking increased trade and investment liberalisation in the mould of its extant national business model. However, the appeal to nativist rhetoric during the referendum campaign points to important discursive constraints in realising this vision.

It is important to begin by emphasising that the EU's external trade policy has, over time, increasingly reflected the liberal preferences of the UK government (see Johnson, 1998). While EEC/EC trade policy may have been marked in its early decades by defensiveness over agriculture, the advent of the Single Market Programme (SMP) in the mid-1980s eventually turned the EU into a decisively offensive multilateralist. It saw its interests as promoting non-discriminatory trade liberalisation via the World Trade Organisation (WTO), especially in 'new' issue areas such as services and investment. Under British Trade Commissioner Peter Mandelson, the slow pace and eventual stagnation of the Doha Round of WTO trade talks saw the EU turn from away its 'multilateralism-first' policy to pursue a slew of bilateral trade agreements with the emerging markets of East Asia (Siles-Brügge, 2014). Free trade agreement (FTA) negotiations with Canada (CETA, initiated in 2008 and recently completed) and the US (TTIP, initiated in 2013, currently on hiatus) also followed. Not only have successive British governments supported these EU-led talks, but their advocates also include prominent Brexiteers, notably the now Secretary of State for International Trade, Liam Fox (2017). This should not strike us as entirely unsurprising. One of the central thrusts of this new generation of FTAs has been deregulation (to an unprecedented extent in TTIP) by eliminating so-called 'non-tariff barriers' to trade (NTBs) – the term used to refer to (differences in) domestic regulation such as food safety standards or local ownership requirements for telecoms firms that may impede the free flow of goods, services and investment (De Ville and Siles-Brügge, 2016).

Despite this, British Eurosceptics within the Conservative Party have long felt that the EU has not gone *far enough* in the pursuit of free trade and deregulation. In fact, some attribute the rise of contemporary elite British Euroscepticism to their sense of 'betrayal' over the SMP. Having empowered supranational institutions with

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the Single European Act in 1985 as a means of deregulating the European economic space, many were incensed at then European Commission President Jacques Delors's rhetoric and measures in pursuit of a 'social Europe' (Geddes, 2014). Much vitriol was directed at the likes of the 'Working Time Directive', initially introduced in 1993. To this were added 'myths' about 'Commonwealth betrayal' when Britain joined the EC in 1973 and had to (in implementing the EU's Common External Tariff) abandon its existing Commonwealth Preference System. This saw the 'Old Dominions' of Canada, Australia and New Zealand no longer offered preferential access to the UK market (Murray-Evans, 2016). All in all, British Eurosceptics combined a desire to see the UK embrace 'globalisation' (read, greater trade openness and economic deregulation) à la Singapore with a nationalist argument about foreign regulatory and protectionist impositions on a (once) proud mercantile power still maintaining a privileged relationship with its former colonies (Baker *et al.*, 2002).

Such arguments, however, were unlikely to win over adherents to the Leave cause during the referendum. As Vote Leave's Campaign Director Dominic Cummings (2017) so starkly put it in a blog post on 'how the Brexit referendum was won', 'their "go global" message was a total loser'. Instead of an (admittedly consistent) combination of nationalist and 'hyperglobalist' arguments in favour of greater economic openness, both Leave campaigns focused around a set of simpler slogans: 'taking back control' (Vote Leave) and 'taking our country back' (Leave.EU). In doing so, they were appealing to a set of ideas that, in the words of Béland and Cox (2016: 432) possessed 'a high, positive valence engender[ing] strong attractiveness' and were thus effective 'coalition magnets'. 'Valence', the 'emotional quality' of certain ideas (Béland and Cox, 2016: 432) also often goes hand in hand with 'polysemy' (or ambiguity, the ability of ideas to be interpreted in multiple ways) as more abstract ideas 'evoke more fundamental levels of a person's identity' (Cox and Béland 2013: 316). Thus, the key message on immigration from the Leave campaigns was *both* that the EU was a source of 'uncontrolled' immigration (which could easily be read as there being *too many* immigrants) but also that an 'Australian points-based system' should be implemented (which, as a number of commentators pointed out, is actually *more liberal* on immigration than much of the current UK regime (see McTernan, 2016). On trade, 'taking back control', meant both realising Britain's global vision unconstrained by the protectionist EU *and* protecting the UK from the deregulatory instincts of the Brussels elite, which in TTIP were said to be threatening the public provision of healthcare in the NHS (Siles-Brügge, 2016).

There were thus underlying tensions in the referendum campaign between the liberal economic instincts of many of the long-time British Conservative eurosceptics and the (economic and other) nativism of much of the Leave rhetoric. This was arguably key to putting together a winning 'coalition' of voters with traditionalist views and those who felt 'left behind' by globalisation (although both did often overlap (see Goodwin and Heath, 2016; Kaufmann, 2016). The tensions have, however, also bubbled to the surface under the present government. At the Conservative Party Conference Theresa May adopted a more interventionist line on the role of the state (what elsewhere has been called her vision of the 'protective state' (Davies, 2016), speaking of the need 'to correct unfairness and injustice and put government at the service of ordinary working people' and of the negative impact of 'low-skilled immigration' on wages (May, 2016). Amber Rudd, the Home Secretary, followed by presenting a plan to force companies to publish the number of foreign workers

they employed. Some leading 'liberal Leave' voices, such as *The Spectator's* editor Fraser Nelson (2016) thus bemoaned that with former Remainers calling the shots in government, 'it is the very opposite to the direction the Brexiteers would have taken had any of them gone on to succeed'.

Since then, however, the government (and especially, Theresa May's) approach to and discourse on Brexit has returned to the more traditional Conservative Euro-sceptic marriage of 'hyperglobalism' and nationalism. In her January 2017 speech on Brexit she spoke of how 'the British people [...] voted to leave the European Union and embrace the world' as a 'truly Global Britain'. What is more, she approvingly quoted the views of those 'in Britain [who] have always felt that the United Kingdom's place in the European Union came at the expense of our global ties, and of a bolder embrace of free trade with the wider world.' Britain is to leave the EU's Internal Market and customs union and pursue an ambitious, independent trade policy targeting 'the fastest growing export markets in the world' (May, 2017). The government White Paper released at the same time as May's speech, speaks of 'the UK's ambitions for deepening trade and investment relations with the wider world'. It cites the 'interest' 'expressed' or the preliminary discussions already taking place with China, Brazil, the Gulf states, Australia, New Zealand, India and the US. (HM Government, 2017: 55). The broad strategy therefore is one of fostering *even more* cross-border flows of services and investment, which means that (at least in trade policy) the UK's approach on trade is thus more in line with consolidating its existing national business model rather than embracing a more interventionist role for the state.

Appealing to both nativist and liberal economic arguments may have been feasible during the course of the referendum campaign by speaking in the emotive and ambiguous language of 'taking back control'. It may also work to keep the 'coalition' in place in the wake of Theresa May's proposals for 'hard Brexit', as leaving the EU's Internal Market appeals to both those concerned about immigration as well as those committed to a vision of a 'Global Britain' signing its own trade agreements. But there are grounds for thinking that this discursive strategy may come to haunt and/or constrain the architects of this 'truly Global Britain' as the distributive and broader policy impacts of the UK's post-Brexit trade policy play out. Here I provide a couple of examples by focusing on two of Britain's much-vaunted partners: the US and India.

The UK government has been especially keen on an FTA with the US, with much hay made by Brexiteers following the election of Donald Trump of Britain's move 'to the front of the queue' (after Barack Obama intimated Britain would be a lesser priority for trade talks than the EU during the referendum campaign). But liberalising trade with the US raises issues regarding the potential distributional impacts of such an FTA, especially with a President who has actively espoused quite mercantilist views. It is, for example, relevant in the case of UK farmers, as the UK's agricultural market remains relative closed under the EU's CET, Common Agricultural Policy (which extensively subsidises domestic agriculture) and more restrictive Sanitary and Phytosanitary regime (laws related to animal and plant health and safety, e.g. the EU bans the use of hormones in beef production). US agribusiness, has been frustrated at the lack of progress in the TTIP talks on such issues, will likely be more influential in talks marked by asymmetric market size, with smaller-scale UK farm-

ers (many of which appeared to support Brexit) facing the prospect of increased competition from more markedly industrial-scale agriculture (see Beattie, 2017). Similarly, US pharmaceutical producers are likely to push for concessions on UK pricing and reimbursement policies for medicines in order to achieve more competitive market conditions. This could potentially drive up the cost of medicines for the NHS (on pricing and reimbursement in FTAs, see Lopert and Gleeson, 2013) and add to the longer-term sustainability issues faced by the organisation.

The other example is India, with which the EU had been negotiating an FTA since 2007. In advance of one of her first foreign visits as Prime Minister, May spoke in November 2016 of the possibility to 'reboot[...] an age-old relationship in this age of opportunity' (cited in HM Government, 2016), with a UK-India Trade Working Group having already been established in September 2016. But what became apparent during the state visit was that the UK's position regarding one of India's key areas of interest remained the same as during the EU-India FTA talks (Asthana and Stewart, 2016). Here, Theresa May's Home Office had been one of the main stumbling blocks during the negotiations over its opposition to the liberalisation of 'Mode 4' services delivery for Indian suppliers, namely the (temporary) movement of natural persons to deliver a service (such as intra-corporate transferees) (see Siles-Brügge, 2012). If the issue was contentious then, the post-referendum landscape on Mode 4 and the wider issue of immigration and visa relaxation looks even more fraught.

The potential impacts of trade agreements (notably the distributive sort associated with increased competition in agriculture or increased prices for pharmaceuticals), are of course often not just discursive. But what is crucial for my purposes is to highlight how it might undo the 'winning' narrative in favour of Brexit that still appears to legitimate the government's approach – if opinion polls putting the Conservatives consistently in the lead post-referendum are anything to go by. So far, as the psephologist John Curtice (2016) has highlighted, the British public appears to have no regrets over voting for Brexit and assumes that there are no 'trade-offs', such as between continued unfettered access to (or, more accurately, participation in) the EU's Internal Market and accepting freedom of movement of people – or between 'sovereignty' and a 'Global Britain'. Earlier I mentioned in passing that Conservative Eurosceptics were consistent when they married nationalism and 'hyperglobalism'. This is because they 'welcomed' 'the national policy-making constraints of globalisation [...] [as] they rule out the kind of social democratic and socialist measures which are viewed as incompatible with British national identity, forcing the government to set the people free whatever its ideological predilections' (Baker *et al.*, 2002: 409). While this is the vision of Brexit currently being pursued by the UK government, it hardly has the wider resonance of 'taking back control', especially if it means hurting farmers or making medicines more expensive.

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Paying Our Way in the World? Visible and Invisible Dangers of Brexit

*Jonathan Perraton*⁶

The UK economy has long been associated with a weak balance of payments. This reflects the underlying growth model: demand has been reliant on private household consumption and deficits in goods trade have been offset by surpluses in services trade and foreign investment earnings. The financial services industry is central to Britain's external position. The Single Market provided wider markets for the UK, but did not fundamentally alter Britain's structural weaknesses as evidenced by the deficit with the rest of the EU. The Brexit vote took place against the background of Britain running its largest peacetime current account deficit, despite subdued economic activity; since then sterling has fallen sharply. Financing Britain's external position represents a key challenge post-Brexit. Post-Brexit models of British political economy partially address this. Proposals for a 'Singapore' type model would accentuate key aspects of the current British model; its proponents see opportunities to pursue further trade agreements, particularly in services trade. Alternative proposals floated in terms of a new industrial strategy for Britain could provide the basis for a reorientation of the British economy towards key exports industries and a more interventionist state regime. Any emergent model will critically depend on the nature of the Brexit deal with the EU, not least in terms of the position of the City of London. This paper sets out the recent evolution of the UK's current account position, particularly in relation to the EU. It then highlights particular areas of potential disruption from Brexit and sketches out scenarios of possible evolution of Britain's external position in response to this.

In 2015 the United Kingdom current account deficit hit a peacetime record of more than 5 per cent of GDP⁷; although it has fallen back since it remains high. By definition such a deficit requires overseas financing, leading Bank of England governor Mark Carney (channelling Blanche DuBois) to comment that Britain is now relying on 'kindness of strangers' to finance this deficit. It is widely held that a country's current account enters the danger zone for sustainability at around 5 per cent of GDP; indeed, the 5 per cent limit is often taken as an early warning indicator for crises in emerging economies. There are of course fundamental differences between Britain and the emerging economies, but Brexit still poses an unprecedented challenge for the British economy. The potential impact of Brexit on Britain's trading relations and its ability to attract foreign investment is central to the expected negative effects on the economy. Much of the discussion has focused on the direct impacts of Brexit on trade, but the effects on the capital account are key too as the UK will continue to have to attract inflows to offset the current account deficit.

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⁷ See further my SPERI blog post 'The UK balance of payments: in the 'Red Signal' zone?', <http://speri.dept.shef.ac.uk/2015/02/03/uk-balance-payments-red-signal-zone/>

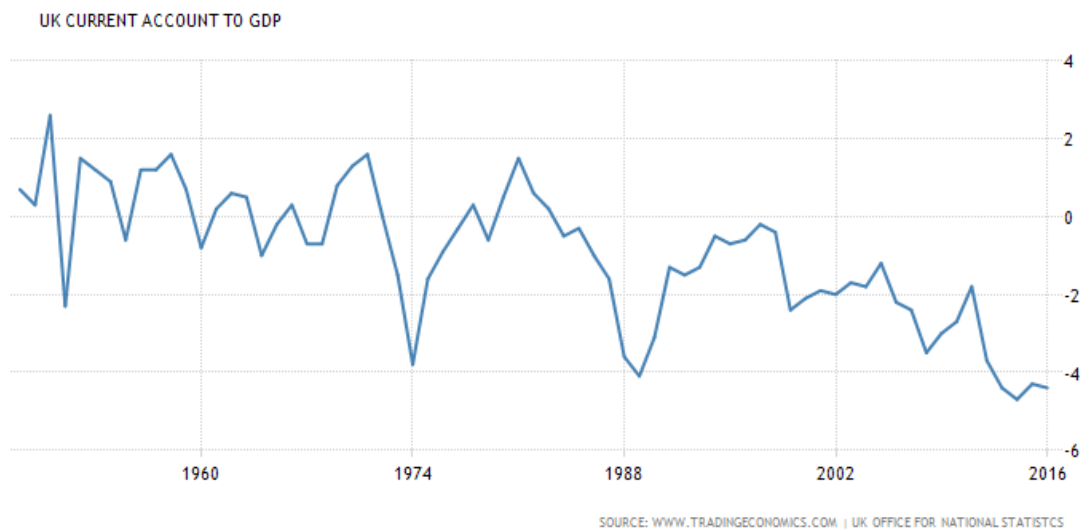


Figure 1: UK Current Account

More generally, balance of payments considerations are central to the operation of the British economic model. The 'privatised Keynesianism' (Crouch, 2009) underlying the British economic model has led to recurrent consumer spending booms based on rising property prices; the rising household debt and falling savings associated with these consumption booms have led to worsening trade deficits. Britain's longstanding deficit on manufactures trade has been partially offset by a surplus on services exports. Successive administrations have effectively banked on Britain being able to build on its relative advantage in services in the context of an expected global expansion in services trade. The position of the City of London, and the financial services sector generally, has been central to this strategy. Brexit has the potential to disrupt these arrangements.

Brexit – The Short Run Impact

Before the referendum official analysis predicted a range of negative developments in the event of a Brexit vote (HM Treasury, 2016a) with independent forecasters making similar predictions. As a number of commentators have noted, of these predictions thus far only the fall in sterling appears to have materialised. The economy did not fall into a recession with rising unemployment; instead the economy continued to grow, albeit fuelled by consumer expenditure as household savings rates have fallen to record lows and there has been a marked expansion in personal credit. The Bank of England has effectively signalled that it will accommodate the higher inflation arising from higher import prices as sterling fell. With limited wage growth, though, rising import prices will lead to a squeeze on living standards. Corporate investment remains subdued, particularly with heightened uncertainty over Brexit. The Office for Budget Responsibility (OBR) is forecasting a slowdown in growth as the consumer boom passes; even this growth projection is based in part on optimistic projections of investment (OBR, 2017).

Moreover, the record current account deficit occurred at a time when, although economic activity was recovering, it was not particularly strong. By comparison, the only occasions in the post-war period when the UK had a comparable current account deficit were in the mid-1970s during the oil crisis and in the late 1980s at the height of the Lawson boom. The projected narrowing of the current account deficit reflects expectations of slowing growth in consumer demand and a reduction in the budget deficit, as well as improvements on net earnings on UK investment overseas. A fall in sterling might be expected to boost exports, but there are limitations here. Following the referendum vote sterling has fallen to levels relative to major trading currencies not seen at least since the early 1990s.

As recent Bank of England analysis notes (Broadbent, 2017), this will not necessarily lead to higher investment in export industries – if the fall in sterling is in anticipation of Brexit then this presumably reflects higher expected costs of trading; alternatively, the fall may, at least in part, be a temporary response to short run developments – if so, sterling's fall would be expected to be temporary. Either way, sterling's post-referendum fall provides limited incentives for longer term investment in trading capacity. SPERI research into the effects of the earlier fall of sterling from 2009 showed only limited improvements in export performance as many companies used a lower pound to raise their margins rather than expand overseas sales (SPERI, 2014). The UK continues to run a substantial current account deficit; the fall in sterling since the referendum vote is likely to reduce that deficit, but through squeezing living standards and hence consumer expenditure on imports rather than through a lasting increase in trading capacity.

Brexit – The Medium Term Impact

The limited impact of the Brexit vote thus far may simply reflect that so far little has actually changed – the UK remains an EU member. The longer term expected negative impacts of Brexit are primarily expected to operate through its impact on trade and foreign investment. There is obviously considerable uncertainty over the impact of Brexit, not least over the nature of the final arrangements after leaving the EU. Treasury forecasts before the referendum predicted that GDP would be around 3-6 per cent lower against a baseline, depending on the nature of the final settlement (HM Treasury, 2016b). Most forecasts made similar loss projections, some warning that a hard Brexit in particular could lead to even higher losses with a relatively 'hard' Brexit of the order of 6-10 per cent of GDP (e.g. Van Reenen, 2017). Brexit would be expected to lead to a loss of trade and inward investment; beyond the direct impact on income, this would also be expected to feed through into lower productivity growth in the context of particularly weak UK productivity performance since the 2007/08 financial crisis. There are clearly margins of error around these estimates; some studies have highlighted a number of limitations in the Treasury results, particularly as an analysis of the UK's likely position (cf. Gudgen *et al.*, 2017).

The EU accounts for around 45 per cent of British exports, a large share that has fallen over recent years with relatively weak growth in the Euro-zone. Britain has a persistent deficit in goods trade with the EU, partially offset by a positive balance in services trade. The UK has a small surplus with the rest of the world (chiefly with the US).

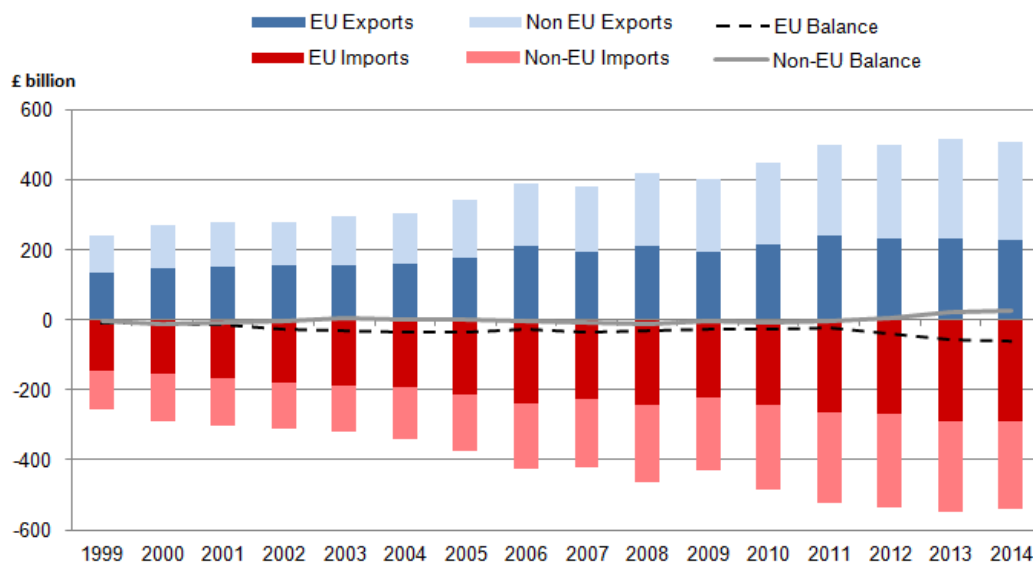


Figure 2.

The pro-Brexit Economists for Free Trade group predict a relatively smooth transition with the UK able to replace any reduction in exports to the EU as well as gains from lower prices if existing import tariffs are eliminated and from reduced regulation. This is implausible; others, though, have suggested that the likely negative impact of Brexit may be overstated in Treasury and other forecasts (Gudgen *et al.*, 2017) – a lower pound could largely offset the negative impact on exports; if investment is being held back by uncertainty over the Brexit deal then once this is finalised it may recover.

The UK's current position should be seen in context (see further Perraton, 2015). The UK current account was close to balance in 1997 for the first time since the early 1980s, but has been in continuous deficit since. The UK has seen its share of world manufactures decline; the OBR predicted that would continue even before Brexit; it may be worth noting OBR forecasts of current account deficits have tended to err on the optimistic side. The UK has continued to lose market share in a range of high technology manufactures. Although completion of the Single Market programme acted to raise trade levels within Europe, British exports rose less rapidly than those of other major European economies. India apart, the UK has relatively low exports to the major emerging economies. Its patterns of relative advantage and limited linkages with these economies do not augur well for expanding trade with these countries to offset any losses to EU markets.

Deindustrialisation and the effects of financial liberalisation and periodic house price booms have led to continued weakness in the current account. In response to those who argued that Britain needed an industrial renaissance (and a new economic model to deliver this) in order to achieve a sustainable balance of payments position successive British governments have effectively assumed that any deficit on the goods trade balance can be offset by rising services trade. The UK clearly does have a relative advantage in key business and financial service sectors. The UK's positive balance on services trade has grown strongly to record levels in the 21st century. Nevertheless, the issue here is whether the combination of global

growth and possible services trade liberalisation could generate the expansion in commercial services trade that could compensate for a deteriorating manufacturing goods balance. Thus far, there is limited evidence that services trade growth of such magnitude is likely. Successive British governments have pushed for deepening of the Single Market to promote services trade within the EU; Brexit by contrast threatens to undermine Britain's position in the EU market for services.

The UK's persistent current account deficit has led to a deteriorating net asset position; the UK's position worsened during the 1960s and 1970s, but improved substantially in the 1980s peaking in the mid-1980s. Since the mid-1980s the net external position has largely deteriorated back into negative territory.

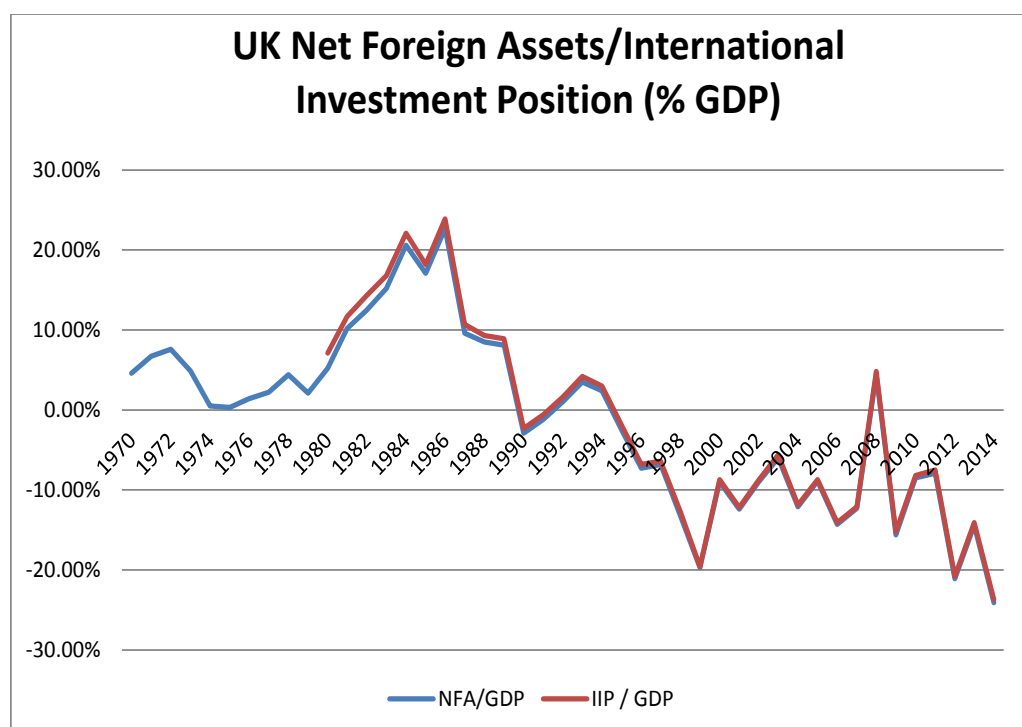


Figure 3.

There are some notable differences now from previous episodes. Previous deteriorations of the current account in the 1970s and 1980s were primarily driven by a worsening trade balance – rising imports and/or weakening exports. Britain's current account deficit since 2011 has been largely driven by a marked deterioration in the primary income balance – this is defined as the difference between income earned by UK residents from investment abroad and income earned by non-residents on their UK investments. In the late 1990s and 2000s before the crisis, although the UK's net international investment position was negative (foreign ownership of UK assets exceeded UK ownership of assets overseas, the inevitable result of persistent current account deficits), the primary balance had been positive. UK assets overseas received at that time a higher rate of return than foreign asset holders received on their investments in the UK. In part this reflected relatively high rates of return on UK direct investment (investment by UK-based multinational companies), but latterly rates of return on UK companies' overseas investments have weakened in large measure from weak returns on investments in the rest of

the EU. The recent improvement in the current account from the historic low point partly reflects an improvement on the primary balance.

A noteworthy feature here is that the UK economy, like the US, had appeared to be able to earn net investment income despite the fact that its net foreign liabilities exceed its foreign assets. Yield differentials emerged in the mid-1980s but largely persisted thereafter. There was something of a rentier economy element here, deficits elsewhere on the current account being offset by strong overseas investment earnings. These rates of return are volatile and not well understood; the US has, for example, long enjoyed a similar rate of return differential on overseas assets, but the UK's advantage here may be receding. It is notable that in recent years this differential has reversed; this effect is not fully understood.

Overall Brexit poses major challenges to Britain's external balance. Whatever the final settlement, trade is particularly vulnerable in two key areas – British manufacturing is embedded within European (and wider) supply chains; even relatively minor non-tariff barriers threaten the operation of these international production networks. Britain's strong position in commercial services trade, not least with the EU, may also be undermined. The UK is thus likely to continue to run a current account deficit. Some pre-referendum forecasts envisaged global markets regarding a Brexit Britain as a significantly riskier bet and so interest rates on British government bonds would rise, company financing would become more expensive. Thus far, this has not happened but of course the UK has not left the EU or finalised the terms of doing so. The UK has been able to attract inward investment as an EU member with access to the Single Market; leaving the Single Market (barring a Norway-style settlement) is likely to undermine this. Britain's weak external position reflects weaknesses in its underlying economic model; Brexit is likely to worsen this.

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Brexit Aesthetic and the politics of infrastructure investment

Charlie Dannreuther

The British Business model describes freely operating markets in finance and labour with a constitutionally limited state role. A focus on the aesthetics of infrastructure assumes a distance from the representation and reality of the debate to demonstrate how the aesthetics of infrastructure investment – as public good, as source of competitiveness and as an asset class – changed during the UK's membership of the EU. This altered what was possible for British governments. What had been publically accountable investments for serving socially defined public goods became income generating investment opportunities for private investors. Vignettes from Keynesian interventionism in the 1970s, privatisation in the 1980s, competitiveness in the 1990s and privatised Keynesianism from the late 1990s illustrate these moves. In each era the relationship between infrastructure need and infrastructure investment was redefined within EU state aids and public procurement regimes. These helped to depoliticise the politics of infrastructure investment. Today infrastructure is framed for its competitiveness enhancing capabilities or to spawn resilience in communities that infrastructure was once meant to protect. Theresa May's promise to upgrade infrastructure as part of her cornerstone industrial strategy therefore belies chronic shortages in public funding and a greatly weakened Infrastructure Projects Authority. But the aesthetic of infrastructure reveals a long standing weakening of the state role in the economy with significant consequences for post Brexit Britain.

We need to talk about infrastructure

The British Business Model (BBM) – which combines a dominant financial sector, flexible labour market regime and openness to international capital flows – describes a system that reproduces inequality and is economically unstable. Its precipitous decline has been discussed so frequently that 'declinism' is now a recognised thing (Tomlinson, 2009). High and increasing levels of social and economic inequality, low levels of political responsiveness, geographical polarisation of wealth and opportunity, financial predation, atomized labour markets, low productivity, failing welfare health and care provision, relentless indebtedness are now defining features of the BBM. Many of these factors have or will be linked to the Leave vote of June 2016 forcing the question: was Brexit the consequence of a constitutional failure in British politics or the cause of it?

Culture and economy have played an important role in the UK's EU Referendum and the rise of populist movements across the modern industrial world (see Inglehardt and Norris, 2016; Curtice, 2016). But their analytical separation has avoided the question of how they relate, especially in relation to policy decisions. Immigration, for example, played a key role in the Leave campaign but the impression that immigrant demand was overburdening social services cannot be understood without acknowledging how austerity agendas cut back on their supply. Austerity hit hard on structurally weak economies in the UK (Fothergill and Beatty, 2016) just

as refugees were more likely to be distributed to poorer wards as local authorities had to take on national obligations (House of Commons Home Affairs Committee, 2017). These are the areas that also voted Leave.

The BBM offers an institutionalist account for exploring the UK's economy after Brexit. We can see what reproduces the failures outlined above and how these relate to policy agendas. Infrastructure 'provides the services that enable society and the economy to function' (Armitt *et al.*, 2013: 17): it is central to the way a country operates, delineating the character of the economy, the relationship between state and society, the forms of public procurement and the ownership of critical assets. The procedures used for infrastructural investment and the agendas that they respond to transcend history and at their core differentiate one country from another. These long standing infrastructure investments are typically captured in institutionalist accounts. They may extend over a generation and certainly beyond the mandate of one government and the path dependency of infrastructural investment matches well with an institutionalist emphasis on the costs of change and the routines enabled by infrastructure investments.

One of the failings of an institutionalist approach is that it can normalise, rather than reveal, existing hierarchies. The "echo chamber" politics of the Referendum debates reinforced how representational bias informed both expert and post-truth positions in the debates over Brexit. The rejection of the political establishment (including EU membership) expressed in the scale of the Leave vote may have implied that the BBM failed to deliver the infrastructure capable of supporting society and the economy.

In identifying a 'new infrastructural turn' Ash Armitt aims to make sense of human being and sociality in the city, in ways that acknowledge the 'liveliness of socio-technical systems' (*ibid.* p138). Infrastructure, or the lack thereof, has agency and can be productive of social experience. It therefore offers a narration of the social life of a place that allows us to look beyond institutions and the capabilities they offer to recognize what informed that choice of institution, and that type of infrastructure.

The aesthetic experience this describes goes beyond an institutional ontology to explore how 'inevitable difference between the represented and its representation is the very location of politics' (Biersteker, 2001: 510). By exploring how the 'world strikes the body on its sensory surfaces' (Eagleton, 1990: 13) this new political economy of infrastructure allows us to locate an empathy for place and emotion in the process of recognition. This is more than an exercise in political inclusion, as Honneth (1995: 92) argues:

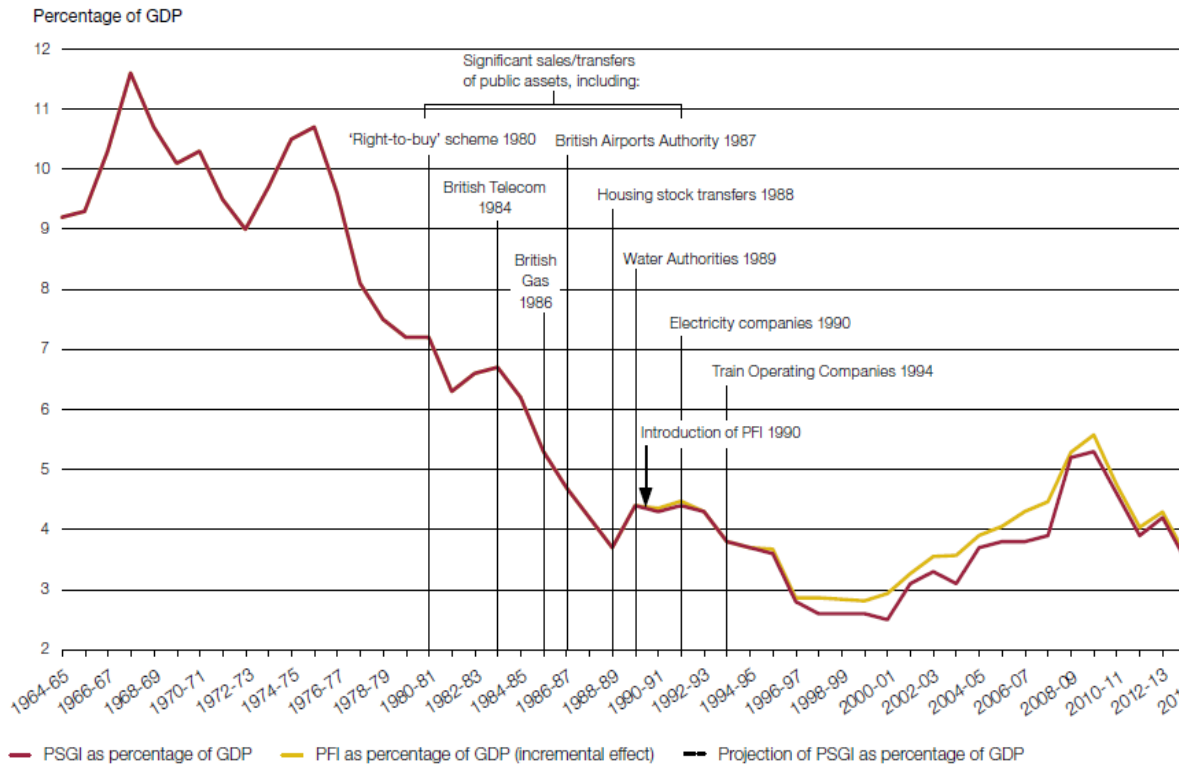
the reproduction of social life is governed by the imperative of mutual recognition, because one can develop a practical relation-to-self only when one has learned to view oneself, from the normative perspective of one's partners in interaction, as their social addressee.

Such an analysis of mutual recognition therefore extends far beyond the institutionalised rights of an individual to express their view of the world by forcing a reconsideration of what the BBM might mean after Brexit.

National infrastructure and change since accession

Public Sector Gross Investment (PSGI) and PFI investment – past 50 years

PFI has added to Public Sector Gross Investment



Notes

- 1 PSGI includes investment of local government and state-owned enterprises so these figures are not directly comparable to other data in this report on central government
- 2 The capital investment through PFI has been added to the PSGI figure. A small amount (approximately 10%) of PFI investment is on balance sheet for national accounts purposes included in PSGI spending figures.

Sources: Office for Budget Responsibility, Public Finances Databank, 25 January 2015; HM Treasury PFI database (updated 15 December 2014)

Figure 1⁸

Figure 1 shows the decline in public expenditure as a percentage of GDP since a peak under Wilson's White Heat of 1965. This shows the dramatic difference in the scope of the nation state as a location of infrastructural decision making between the referenda on EEC membership in 1975 and 2016. In 1975 governments could materially intervene to guarantee jobs, through regional policies. With increasing demands from a more complex society political agendas increased in complexity (John and Jennings, 2010). The rights of workers were formulated and protected in centralised political bargains, orchestrated in and through corporatist institutions (National Economic Development Councils) and delivered through wage bargaining and job guarantees. In part these were institutional but they also linked business, labour and the state interest into structured engagements and dialogues that could be reported on and interpreted against clearly demarcated political ideolo-

⁸ Page 5 of NAO Briefing by the National Audit Office 2015 "HM Treasury The choice of finance for capital investment" MARCH 2015 [viewed 21/4/17 at <https://www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf>]

gies (which could also guide a plebiscite). By privileging the wage labour relation in the organisation not only of employment and economic policies, but also in the parliamentary system, the material social and cultural manifestations of class cleavages dominated national politics in the mid to late 20th Century.

Infrastructure was a public asset realised at the national level that was both 'collective in the sense that they are used by a very wide variety of activities and individual users, and integrative in that they provide the necessary means whereby economic activities can interact' (Peck, 1996: 328). Strict rules, agreed by the NEDC in 1981, protected public infrastructure from private investments which,

... should not result in the schemes offering investors a degree of security significantly greater than that available on private sector projects (Allen, 2001: 13).

The nation state also exercised close control over EEC money. Despite European Commission protestations, the European Regional Development Fund, of which the UK secured almost 40 per cent of the Objective 2 budget in 1989 (Commission of the European Communities, 1990: 87), was managed centrally by Whitehall as PM Thatcher saw it as a side payment to offset the UK's budget contributions (Anderson, 1990). By the end of the 1980s, a decade defined by government attacks on organised labour, the BBM was elite dominated and making explicit reference to the EU was made in relation to the EU's Single Market as the state sponsored alternative to trade union radicalism of the 1970s (Hay, 2010). Infrastructure was national, elite managed and invested to support social and economic transformation towards markets and liberty and away from democracy and bureaucracy.

Competitiveness and the creation of a financial asset class

The extension of financial interests intensified in the 1990s in debates over competitiveness. Most explicitly this accompanied the development of the Private Finance Initiative (PFI) but was set within a broader focus on creating an infrastructure around an enterprise economy (Clark and Root, 1999). Framed as a necessary response to globalisation, the promotion of the competition state focused on a range of policy agendas that would replace collective, national compromises based around the recognition of social class with individual, market based contracts centred upon private interest. While good infrastructure was seen as a mechanism for attracting inward investment, the infrastructure, including skills training, would need to be tailored to the interests of the investors (Dawley, 2007).

These operated at many levels with enterprise policy attracting political interest at the global (Grant and Perren, 2002), EU (Dannreuther, 2007), UK (Dannreuther and Perren, 2013) and local levels. Of the latter EZs were promoted in the 1980s to create an infrastructure favourable to enterprise by removing regulation and encouraging start-up firms. In reality EZs placed planning requirements on landscaping, land use etc., that led to the greater use of tax incentives in planning (Jones, 2006). Such incentives included venture capital and risk finance and, under the Coalition government, Social Impact bonds, specifically designed to integrate financial interest with social problems and agendas (Dowling and Harvie, 2014). Local infrastruc-

tures, supported by government and EU funding, were used to create neoliberal identities of entrepreneurship that privileged markets over society within a global political economy (Peck and Tickell, 2002).

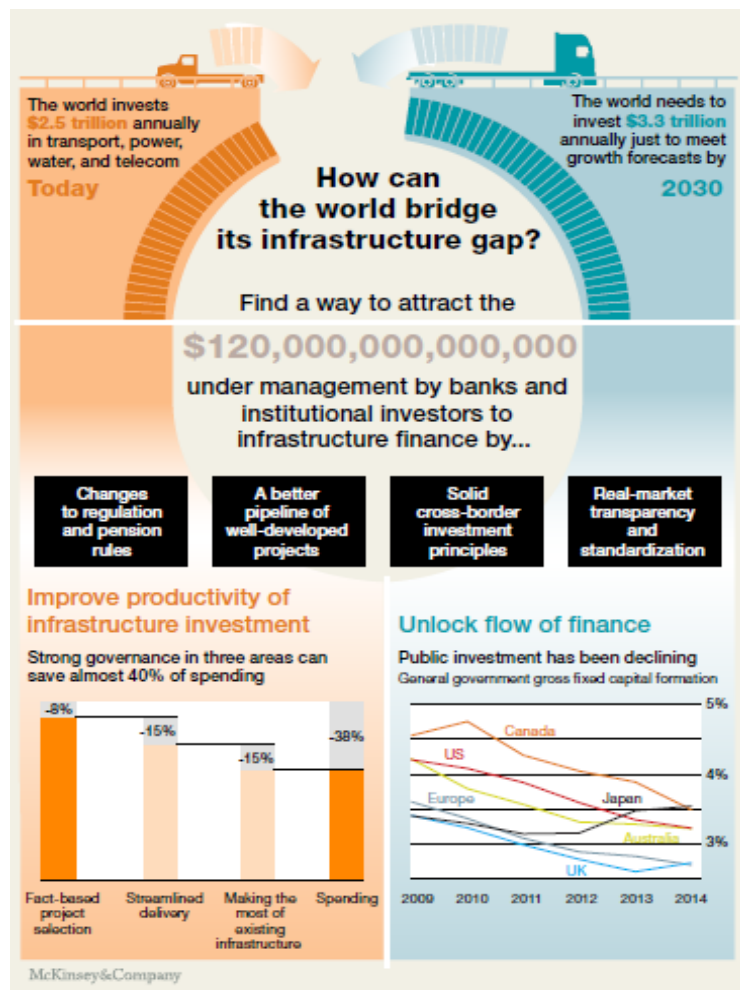
Yet in many contexts these infrastructures have failed to address the needs of their communities. In Cornwall, a region which voted Leave despite being a significant recipient of EU funding, there is a clear distinction between the rhetoric of Cornwall as a “great place to live” and the emigration away from Cornwall of those born there. An ‘outsider’ narrative, that highlight the laid back life styles enjoyed in Cornwall, is dismissive of ‘insiders’ from Cornwall. Joanie Willett quotes an interviewee as stating:

there’s a lot of people, there’s an awful lot of people that are a bit funny, there’s a load of them, and I suppose that’s a result of inter-breeding or something (Anonymous in Willett, 2016: 445).

Cornwall, Willett observes, has been dismissed as a place of consumption rather than action by its persistent portrayal ‘as a pastoral spirituality ... a land that time forgot, peopled with noble savages ... and a Cornwall of yesteryear with no counter-ing tomorrow (ibid. p446).

Infrastructure post Brexit

The commodification of local infrastructures into tradeable assets has become a central dimension of UK government policy in its pursuit of competitiveness. But it has been at the expense of recognising how local communities and society might be involved in the decision making process. This pattern looks set to increase post Brexit. Recent promotional literature from consultancy firm Mckinsey has highlighted the challenge of infrastructural investment in the 21st Century. Its solution, outlined below, presents a bridge between institutional investors and the \$120, 000, 000, 000, 000 needed that explicitly removes governments and society from these decisions.

Figure 2⁹

After Brexit the UK will no longer be able to secure infrastructural investment from the European Investment Bank or European Structural and Investment Fund. It will therefore be exonerated from the long term commitments to change set out by the EU's political system to invest in research and innovation, digital technologies, the low-carbon economy, sustainable management of natural resources and small businesses (see Clifton *et al.*, 2014). The National Infrastructure Commission, set up by the Coalition government to manage a pipe line of private investment into infrastructure, has only an advisory status. As well as limiting parliamentary oversight this is also counterproductive for securing private investment anxious to limit political risk.¹⁰

⁹ Source: Jonathan Woetzel, Nicklas Garemo, Jan Mischke, Martin Hjerpe, and Robert Palter 2016 "Bridging global infrastructure gaps" [viewed 21/4/17 at <http://www.mckinsey.com/industries/capital-projects-and-infrastructure/our-insights/bridging-global-infrastructure-gaps>]

¹⁰ In the words of Richard Threlfall, UK head of infrastructure at KPMG, 'The whole point of the National Infrastructure Commission is to provide long-term stability to the UK's infrastructure planning. If it is not established in statute then its very existence will be constantly under threat from political whim'. At: <https://home.kpmg.com/uk/en/home/media/press-releases/2016/09/national%20infrastructure%20commission%20is%20needed%20to%20provide%20longterm%20stability%20to%20the%20uk%20infrastructure%20planning.html>

So what can infrastructure tell us about the Brexit debate? During the 1990s the theme of competitiveness was related to a wide ranging debate around core principles initiated under New Labour's Social Justice Commission. These debates sought to redefine the relationship between economy and society, business and labour and state and the global (see Fairclough, 2000). During a time of dramatic political (post Cold War) and economic (post industrial) change these debates also played out in Brussels and in the USA around a common question: 'Who is us?' (Reich, 1990; Strange 1998). This debate about the constitution of a modern Britain revealed the limitations of the British constitution at the turn of the 21st Century. It sought solace in a BBM based on an extensive financial regime of accumulation that imploded in 2008.

But there has been no such debate since the financial crisis in the UK leaving financial interests in a privileged position to make investment decisions. Debates over infrastructure investment up to and since the Referendum vote have been dominated by whistle blowing populism presenting a poor pastiche of recognition as nativist identify politics. In infrastructure as in other areas of political life, empathy, mutual recognition and a greater attention on the aesthetic offer the possibility of just alternatives. This demands a fundamental reassessment of the suitability of the British political system. Perhaps the General Election will precipitate such a debate?

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What's left for 'Social Europe'? Regulating transnational labour markets in the UK-1 and the EU-27 after Brexit

Nicole Lindstrom¹¹

Since the re-launch of the Single Market in the 1980s, the UK's preference for liberalizing transnational EU labour markets has gone hand in hand with successive British government's commitment to creating a more flexible domestic labour market at home, characterized by a reliance on a steady supply of migrant labour, relatively limited employment protections, high levels of atypical work, and restrained levels of real wage growth. Brexit represents a potential critical juncture in the development of labour market models in both the UK-1 and the EU-27. Through a case study of EU legislation overseeing 'posted workers' the paper traces the process through which the UK has historically opposed EU regulations deemed to constrain free movement of labour and services. If, by pursuing a 'hard Brexit,' the UK surrenders its right to veto more socially minded regulations at the EU level, Brexit creates opportunities for building a more 'Social Europe' in the EU-27. The European Commission's 2016 proposal to strengthen EU posted workers regulations to ensure 'equal pay for equal work at the same place' represents a move towards more socially minded transnational labour market policies.

The fate of the EU-27 and the UK-1 will continue to be linked, regardless of the outcome of the Brexit negotiations. In the UK, the traditional pro-market factions within the Tory party are committed to pursuing a radical de-regulatory agenda post-Brexit. 'We must begin by deregulating the labour market,' International trade secretary Liam Fox declared, 'political objections must be overridden' (The Guardian, 2017). If this faction prevails in setting the Brexit agenda, the UK can continue 'Thatcher's plot' (Van Parijs, 2016) to undermine Social Europe, but less through active resistance in EU decision-making, and more through passive wage and social competition. Yet UK leaders, like their continental counterparts, face increasing pressure from domestic factions demanding less open borders and more protection for native workers. Thatcher always calculated that the Single Market would serve as a useful means of constraining these domestic demands, and that the EU's economic and cultural heterogeneity would undermine efforts to create a closer European political, social and fiscal union. But Brexit might undermine Thatcher's plot, with the UK losing an important counter-point (the EU) and the EU-27 gaining one ('Global Britain').

The UK and transnational regulation of 'posted workers'

One dimension of free movement of persons and services is the use of 'posted workers.' Posted workers are employees who are sent by an employer based in one EU member state to carry out work in another EU member state on a temporary basis. For example, a German construction firm winning a UK government contract to build a power station in Northern England could 'post' workers from

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Poland to lay the foundations. In 2015 over two million EU workers were posted to another EU state to carry out temporary contracts, with construction utilizing the largest percentage of workers. The posting of workers has raised concerns amongst many political parties, trade unions, and other civil society groups about the threat of 'social dumping', i.e. the practice of 'undermining or evading existing social regulations with the aim of gaining a competitive advantage' (Bernaciak, 2014: 4). Such concerns became stronger after eastward enlargement, with the threat of the 'Polish plumber' contributing to the defeat of the 2004 Constitutional Treaty referendum in France. This section examines the process through which the EU has sought to address the issue of posted workers, with a focus on the role of the UK.

Social dumping rose high on the EU agenda in 2004 when then Single Market Commissioner Frits Bolkestein proposed a new Services Directive. The aim of the Directive was to strengthen the rights of free movement of services within the EU by eliminating existing national regulatory barriers. One means of accomplishing this goal was a 'country of origin' principle whereby service providers would be subject to the sending country's employment rules and regulations. A Polish plumbing firm, for example, establishing a plumbing business in France could, under these new rules, pay its Polish plumbers the Polish minimum wage and be subject to Polish employment laws and regulations. New post-socialist EU member states supported the country of origin principle, arguing that it would strengthen the competitive advantage of lower wage countries and enhance single market competitiveness more generally (Crespy and Gajewska, 2010). But the proposed Directive spurred considerable protest in Western Europe, with trade unions and other civil society groups organizing large demonstrations in Brussels and Strasbourg. Most West European governments opposed Bolkestein's proposal, with one exception – the UK – which sided with new member states in supporting the country of origin principle and the Services Directive more generally.

The final 2006 Services Directive was a watered down version from Bolkestein's more radical proposal, with the 'country of origin' principle eliminated (Jensen and Nedergaard, 2012). Yet the Services Directive left open legal questions concerning how to balance the right to free movement of services with the right of governments and trade unions to uphold national labour and social rules and practices. A series of subsequent European Court of Justice (ECJ) cases weighed in on this question. In two prominent cases – *Laval* (2007) and *Viking* (2007) – litigants argued that industrial actions by trade unions to force firms to honor collective bargaining agreements violated their EU right to establishment (see Joerges and Rödl, 2009). In the *Laval* case, a Latvian construction firm, Laval, sued for damages against Swedish trade unions for organizing a blockade to protest Laval's refusal to pay Latvian posted workers Swedish industry-wide negotiated wage and benefits. In a similar case, *Rüffert* (2008), a Polish firm argued that a Lower Saxony law requiring any recipient of government contracts to abide by collective bargaining agreements violated their right to free movement under EU law. The ECJ sided with the firms in all three cases. In an analysis of member state legal briefs submitted to ECJ hearings on the *Laval* case, all new EU member states sided with the firm, while West European governments sided with the trade unions (Lindstrom, 2010). The UK was the only West European state to align with new EU member states in supporting Laval's claim. Not only did the UK argue that the litigants right to free movement had been violated; it went further, arguing that 'there is no legally binding 'fundamental social

right to take collective action' in Community law' (Lindstrom, 2010: 1315). Since these ECJ judgements, trade unions, with the support of many EU member states, have pressured the EU to close loopholes in the PWD, including cracking-down on employers who seek to bypass EU laws overseeing posted workers. In 2014 the EU passed an 'Enforcement Directive' designed to close many of these gaps. But Jean-Claude Juncker has promised to go further, supporting a revision of the PWD that would ensure, as he stated in his 2016 State of the Union speech, that all EU citizens would be entitled to 'equal pay for equal work at the same place' (European Commission, 2016a). The revised PWD proposal promises to enforce a stricter set of rules governing transnational labour. The proposed legislation targets so-called 'letter box companies', i.e. cases in which firms seek to circumvent national rules by securing legal status in another EU state to recruit temporary workers to carry out contracts. It also promises to put collective bargaining agreements on more equal footing as minimum wage rates, which is especially important to states like Denmark or Sweden that do not have statutory minimum wages. The proposal has been promoted more generally as way to counteract what EU Commissioner for Economic Affairs, Pierre Moscovici, describes as the 'surprising violence of the political and social reaction' to free movement of labour in many EU member states (Financial Times, 2016).

Two months after the Commission proposed the legislation in March 2016, parliaments from eleven member states triggered the subsidiarity control mechanism, or the so-called 'yellow card' procedure. Signatories included all new member states, minus Slovenia, and Denmark (who, diverging from the other signatories, argued that the revised PWD did not include strong enough protections for upholding collective bargaining agreements). The participating parliaments argued that the revised PWD violates the principle of subsidiarity in that posted workers should be covered by national rules. The signatories easily exceed the one third threshold and it was only the third time a yellow card had been successfully triggered since the mechanism was introduced in the 2007 Lisbon Treaty. One striking feature of the group triggering the yellow card was the UK's absence from the list. This marks a notable departure from the UK's close alignment with CEE states in negotiations around the 2006 Services Directive and the subsequent ECJ cases. Indeed, in the case of the revised PWD, the UK submitted opinions with France, Italy, Portugal, and Spain arguing that the Commission's proposal was compatible with the principle of subsidiarity.

The European Commission responded to the yellow card challenge in July 2016 arguing that the proposal would be upheld given that the posting of workers is a 'cross border issue by nature' and thus is in full conformity with the subsidiarity principle. CEE leaders condemned the Commission's judgement. The Czech Minister for Europe, Tomas Prouza, remarked, 'After the Brexit vote, the promise was to work on topics that are unifying, not divisive. Having such a divisive decision is not in anybody's interest at the moment' (Financial Times, 2016). Another senior diplomat remarked that discussions 'have become, just like in Britain during the referendum, about 'Bloody East Europeans taking our jobs' (ibid). The revised PWD proposal encountered another road block with France, who has spearheaded the tightened PWD rules at the EU level, witnessing the proliferation of so-called 'Molière clauses' by local French authorities, which require workers on public sites to speak French. A Republican MEP serving as rapporteur on the dossier fears

this will undermine the reform by justifying nationalist protectionist exemptions, remarking: 'Next they will create a Shakespeare clause, a Goethe clause, or maybe even an Orbán clause' (Euractiv, 2017).

Regulating transnational labour markets after Brexit

A central theme of the Leave campaign in the UK referendum on EU membership was to 'take back control.' But the campaign was short on specifics of what the UK government would do with that control. With the triggering of Article 50 in March 2017 the UK government is now forced to be much more specific. One of the clearest possibilities for concrete policy change after Brexit is rolling back EU labour regulations, in particular 'positive integration' measures such as the Working Time Directive or the Temporary Agency Workers Directive. Traditional free-market factions within the Tory party, as well as Eurosceptic think tanks and business associations, argue that the 'red tape' associated with such EU policies has undermined Britain's productivity, economic growth and competitiveness. This faction has also expressed commitment to immigration policies that ensure a steady supply of low-skilled workers post-Brexit. Yet Brexit has exposed a deeper ideological divide on the right between traditional liberal proponents in the Tory Party and the nationalist policies embraced by UKIP supporters demanding more protectionist measures. The poorer and low-skilled workers who voted for Brexit in large numbers were led to believe that Brexit will lead to a significant reduction in immigration and higher wages and benefits for British workers (Goodwin and Heath, 2016).

As for the EU-27, proponents of a 'more social Europe' consider Brexit as an opportunity to strengthen 'positive integration' in the form of employment rights and regulations with the UK as a historic 'veto player' no longer at the EU decision-making table. With the departure of the UK, the coalition of liberal market member states becomes weaker, with post-socialist new member states further marginalised in the EU-27. But building a stronger Social Europe faces two key challenges. First, although the UK government speaks of both of a more organized form of capitalism post-Brexit and a more competitive and de-regulated 'Global Britain', the latter scenario can be utilized as a bargaining chip. 'I personally hope we will be able to remain in the mainstream of European economic and social thinking,' Phillip Hammond warns, 'But if we are forced to be something different, then we will have to become something different' (Tooze, 2017). This 'something different' could be the UK as a deregulated, low-wage, low-tax offshore haven placing indirect competitive pressures on the continent (Posen, 2016). Second, member states in the EU-27 are not immune to the pull of exclusionary nationalist populism that fuelled Brexit. Thatcher, following Hayek, always believed that the pull of national identity and popular sovereignty would undermine an ever closer union. Progressive social forces in the EU-27 now have an opportunity to change 'Thatcher's plot', a task potentially made more feasible with the UK on the outside.

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Will Brexit deepen the UK's 'North-South' divide?

Scott Lavery

Brexit's differential impact on the UK's internal 'core' and 'periphery'

Commentators often speak of the British economy as if it is a singular, homogenous entity. But the UK's 'national business model' is composed of highly distinctive regional economies which vary markedly according to their economic structure, sectoral composition and trade performance (Gardiner *et al.*, 2013). The starkest spatial division in this regard is the UK's longstanding 'North-South' divide, exemplified by a dynamic and internationalised economic 'core' concentrated in London and the South East and a relatively depressed 'periphery' concentrated in the 'North' (Martin, 1988).¹² Whatever the outcome of the Article 50 negotiations, Brexit is likely to impact differentially on these distinct regional economies. In this paper, I argue that Brexit is likely to disproportionately impose costs on Northern peripheral regions which will further widen spatial divergence within the UK.

Vast regional inequalities have been a structural feature of the UK's economic development since the early 1980s. Under the Thatcher governments, uneven development between the 'North' and 'South' intensified at a rapid pace (Martin, 1988). The withdrawal of state subsidies for nationalised industries combined with rapid interest rate hikes quickly drove up unemployment in the UK's northern industrial regions. At the same time, the liberalisation of financial markets exemplified by the abolition of exchange controls in 1979 and the 'Big Bang' of 1986 differentially privileged London and the South East insofar as these regions enjoyed a strong comparative advantage in financial and business services (Peck and Tickell, 1992). New Labour's thirteen years in office did little to reverse deepening inequality between the UK's southern 'core' and internal Northern periphery (Martin, 2010: 44).

The emergence of Regional Development Agencies (RDAs) and substantial public expenditure increases supported Northern regions through expanded state-led employment and regional redistribution through the tax and welfare system (Buchanan, *et al.*, 2009). However, the financial services sector continued to outpace growth elsewhere. Between 1993 and 2007, output in banking and finance increased by 180 per cent whilst manufacturing (upon which Northern economies remained more heavily reliant) saw increases of only 11 per cent (Martin, 2010: 37).

Spatial divergence continued to intensify after the 2008 crisis (Martin *et al.*, 2015). London is the only city region to have exceeded pre-crisis levels of per capita output and is the only region to have increased employment in the financial sector since 2009 (Lavery, 2016). On current trends, London and the South East are projected to increase their share of total UK output to 40 per cent by 2022 whilst all regions in the North of England are projected to experience falls in their share of UK output (TUC, 2017). The continued polarisation between 'North' and 'South' has important implications for how we analyse the emerging politics and political economy of

¹² In these characterisations, the South is identified as areas below the 'Wash-Severn' line and the 'North' includes regions and nations above it (Wales, North of England and Scotland).

Brexit because the process of leaving the EU is likely to impact differentially on the UK's internal 'core' and 'periphery'. In what follows I examine both of these regional economies and draw out the possible impacts which Brexit might have on each.

The UK's Southern 'core' and Brexit

In the run-up to the referendum, powerful voices in the City made their opposition to Brexit clear (Thompson, 2016: 114). The CityUK, the British Bankers Association, the Confederation of British Industry (CBI) and representatives of large international banks voiced support for staying in the EU. The 'leave' vote therefore represented a defeat not only for the Remain campaign but also for large swathes of the UK's financial sector. There were many reasons why City actors opposed Brexit. The threat of instability and currency volatility may appeal to certain financial sub-sectors (notably hedge funds) but in general large international banks prefer to conduct their business in a stable regulatory climate free of constitutional uncertainties. Brexit also threatens the 'passporting' rights of City firms, which limits their capacity to trade and invest within the Single Market. Additionally, with the UK inside the EU, City actors could rely upon the initiative of UK policymakers to drive through beneficial supranational policies. Capital Markets Union (CMU) stands out as a policy area where private and public UK actors assumed the position of 'pace-setters' within the EU institutions, driving through an agenda which would differentially benefit private equity and hedge funds in the City (Quaglia *et al.*, 2016).

The City's future relations with the EU will of course be strongly shaped by the deal which is struck between the UK and the EU after the Article 50 process. Nonetheless, there is evidence that alternative financial centres (AFCs) within the Eurozone are positioning themselves to take advantage of Brexit. In a recent research, I analysed over 300 documents published by private and public actors in Frankfurt, Paris and Dublin in order to identify the extent to which these rival centres seek to 'capitalise' on the Brexit vote (Lavery *et al.*, 2017). All three AFCs identify vulnerable sub-sectors within the City which could be re-located to the Eurozone after Brexit.

Euro-denominated clearing is identified as a prime target. The vast bulk of the EU's clearing, around 70 per cent, currently takes place within the City and it has been calculated that this activity is associated with 80,000 UK jobs. In 2012, the European Central Bank and key EU member states attempted to move clearing into the Eurozone. However, this was struck down by the European Court of Justice. Post-Brexit, the issue of clearing is very much 'live' once again and this is reflected in the early strategic positioning of the AFCs. French policymakers have been particularly aggressive in this regard, with Manuel Macron insisting that clearing should be re-located to the eurozone (Lavery *et al.*, 2017). Fintech is a second sub-sector which AFCs seek to augment after Brexit. A report commissioned by the Frankfurt-based Deutsche Börse in January 2017 states, for example, that 'following the Brexit referendum all fintechs subject to the British regulatory regime will find that access to the European Single Market is more difficult and that having a Continental European branch appears sensible' (Schiereck, 2017). Deutsche Bank has taken a particularly pro-active role in this regard, setting-up a 'digital factory' in Frankfurt with 400 staff as well as an 'innovation lab' in Berlin. As these documents suggest, there is likely to be some re-composition in the sectoral structure of the City after Brexit.

It is notable, however, that the reviewed AFCs accept the City will remain Europe's dominant hub of global finance after Brexit (Lavery *et al.*, 2017). AFCs in the EU are right to note that the City is unlikely to lose its role as Europe's dominant financial centre. First, the City has a number of pre-existing comparative advantages relative to alternative financial centres. It ranks as number one in the Global Financial Index (compared to Paris, for example, at 29 and Dublin at 31) and unlike the French capital it is less likely to impose punitive tax rates on high earners. The City also dwarves rival EU hubs in terms of the size of its workforce (729,600 compared to 74,700 in Frankfurt, for example) and expertise. London's status as an English speaking centre, with high cultural capital and its embeddedness within a common law system are also viewed as advantages from the perspective of global finance (Palan, 2014). In addition, the British state has established an international reputation as providing a stable political environment for finance (Ingham, 1984; Talani, 2011). In the Bank of England, the UK has a central bank which can effectively perform a 'lender of last resort' function, as was demonstrated in 2008 (and starkly in contrast to the Eurozone) (Matthijs and Blyth, 2015). Finally, the City of London is highly internationalised and increasingly decoupled from the rest of the UK and indeed other EU economies, which means that the impact of the Brexit vote will likely be less severe for the City than in other regions of the country (Los *et al.*, 2017). For these reasons, although Brexit will likely result in a re-ordering of the UK's financial sector, it is unlikely to undermine the City's position as Europe's pre-eminent hub of global finance.

The UK's Northern 'periphery' and Brexit

Regions across the North are potentially far more vulnerable to fall-out from the Brexit vote than the City and the UK's southern 'core'. This can be seen across three areas: through the North's loss of EU structural funds, exposure to the trade effects of Brexit and vulnerability to future public expenditure cuts. EU structural funds have in the past played an important role in sustaining economic growth within laggard regions. For example, in Wales, projects funded by the European Regional Development Fund (ERDF) generated 44,331 jobs and 17,474 new businesses in the 2007 – 2013 funding round. Across the North of England, the corresponding job creation figures were 20,149 (Yorkshire and Humber), 20,602 (North East) and 29,795 (North West) (Hunt *et al.*, 2016). EU structural funding was therefore underpinned by a distinct regional geography in the UK. Of the ten local economic partnerships (LEPS) which received the highest structural funding, seven were located in the North. Of the ten LEPS which received the lowest level of structural funding, all were located in the South of England (Hunt *et al.*, 2016). Structural funds therefore provided a source of reliable and long-term investment which disproportionately benefited laggard regions located in the UK's peripheral regions outside of London and the South East. With Brexit, there is now a big question mark over whether this source of funding will be replaced by an equivalent scheme under the UK government.

The North and other regions outside London and the South East are also disproportionately exposed to a downturn in the terms of trade with the EU. As detailed in research by Phil McCann and his colleagues, London and the South East's export base is far more internationalised than other UK regions. Drawing on data from the World Input-Output Database (WIOD), the research shows that whilst EU exports

account for 7 per cent of London's GDP, other UK regions are 50-100 per cent more dependent on EU markets than the capital (Los *et al.*, 2017: 789). This is because globalisation has not resulted in the complete removal of barriers and the opening of a 'world market'. Rather, globalisation has increasingly meant regionalisation for exporters of goods and services concentrated outside London; it increases the volume and frequency of trade with markets which are geographically proximate to the home producers. For this reason, as McCann and his colleagues show, 'the level of local dependence on EU demand has increased between 2000 and 2010 in 34 of the UK's Nuts-2 regions' (Los *et al.*, 2017: 789). In contrast, only three regions saw a decline in their dependence on EU demand over this period: London, the South East and Berkshire-Buckinghamshire-Oxfordshire (*ibid.*).

The deepening integration of Northern exporters' into EU markets is not only reflected in EU demand. UK manufacturers also rely heavily on sourcing components used in the production process from the single market. For example, UK export 'success' stories such as the automotive sector source between 20-50 per cent of their components from EU supply chains (SMMT, 2014: 6). This undermines the potential of the recent sterling devaluation to produce an export 'boost' insofar as component costs denominated in euros will increase into the future. Regions outside of London and the South East, including in the North, are therefore vulnerable to Brexit in two respects. On the one hand, the increased cost of importing components from the EU threatens to erode the competitive advantage which may have otherwise emerged as a result of the falling exchange rate. On the other hand, a potential worsening in the terms trade with the EU – for example through the emergence of tariff and non-tariff barriers – threatens access to a market upon which Northern exporters have increasingly come to depend.

Conclusion

The UK has one of the most polarised spatial economies in Western Europe (Froud *et al.*, 2012). Although the form which Brexit will take will ultimately depend on the 'deal' struck during the Article 50 process, there are good reasons to believe that the UK's exit from the EU will intensify inequalities between the UK's North and South. The UK's 'core', concentrated in and around London and the South East, is distinctive insofar as it has a highly internationalised trade structure. Throughout the 2000s, these 'core' regions have become less reliant on EU demand. In contrast, the UK's peripheral regions have become increasingly reliant on the Single Market throughout this same period. 'Northern' regions - including Wales and the South West - have also differentially benefited from EU structural funds in the past. With the UK's exit from the EU long-term investment has come under threat. If Brexit leads to a contraction in investment and a worsening in the terms of trade, this will negatively impact on UK government revenues. In turn, this poses a risk to Northern economies who have disproportionately borne the brunt of fiscal consolidation since 2010, exemplified by large cuts to local authority budgets, high levels of public sector retrenchment and anaemic investment in infrastructure relative to London and the South East. In her first speech as PM in July 2016, Theresa May pledged to act on behalf of those who had been 'left behind' by globalisation and remote political elites. The emerging economic geography of Brexit suggests that numerous barriers stand in the way of this objective, not least the government's own commitment to a 'hard' exit from the EU and its Single Market.

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Putting the EU's crises into perspective

*Ben Rosamond*¹³

Brexit raises deep questions about the future trajectory of both British capitalism and the domestic political-constitutional order in the UK. At the same time, the UK's prospective departure from the European Union (EU) raises analogous issues regarding the sustainability of European integration.¹⁴ If Brexit raises the spectre of European 'disintegration', then it does so in the wake of two other recent existential traumas for the EU: the Eurozone and refugee/migration crises. What unites these three crisis moments is that all challenge the legitimacy of the EU's supranational order. The three crises are also associated with (often diverse) forms of politics that contest the 60-year old framework of European integration.

We could stop at this point and simply state that the EU faces a deep existential challenge because it stands at the confluence of these three 'wicked problems' – crises that separately and together are the source of conflict within and between member states and which seem more or less intractable, at least in anything approaching a positive sum manner. That they combine to create serious problems of legitimacy and (supranational) governability is undeniable, but they also need to be seen in a broader context. This paper tries to sketch out some key elements of that context.

The argument here is macroscopic and develops in two parts. The first part acknowledges what many scholars of European integration take as a given: that the EU is in large part a path dependent creature of institutional choices made some 60-70 years ago. Put simply, the standard claim here is that the imperatives of the post-war period shaped the institutional design and policy logics of the EU (Pierson 1996). Those institutional choices have survived the demise of the geopolitical and geo-economic conditions that gave rise to them. Part of the EU's problem is that the mature version of those institutional choices made in the 1950s is a poor fit for the radically altered political economy context that the EU now faces. The other thing to emphasise is that while post-war European integration was a solution to collective action problems faced by a group of European countries in the aftermath of World War II, it also embodied a series of tensions. These ever-present tensions of European integration have, in turn, been amplified by the current cluster of crises.

The second part of the argument here is that European integration should be understood in relation to the broader democratic capitalist compact that took root (temporarily) in the post-war period, particularly in Western Europe. The progressive weakening of this compact in recent decades (examined here through brief discussion of three key dynamics) has not only affected the capacity of European states to manage the onset of crises, but has also threatened to transform European supranational governance from its perceived status as a *solution* to exogenous pressures towards widespread understanding that European integration is the *source* of crises and/or part of the problem that must be solved.

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¹⁴ The broad contours of the argument outlined in this paper were first developed in greater detail in Rosamond (2017)

Three ongoing dilemmas of European integration

Post-war European integration was premised on the idea that the consolidation and progressive integration of markets across national borders would be a lasting source of peace and stability on the continent. Historical research also suggests that European elites used supranational integration as a means to recapture governing legitimacy in the face of both the deep uncertainties of the post-1945 world and the mobilisation of mass electorates (Milward 1992). The partial delegation of sovereign functions to new European-level institutions was a way of solving the perceived collective action problems of the original six member states and helped to secure domestic loyalties to somewhat fragile national governments. The upshot was that European integration was about both the making of a transnational market space and the creation of a legal-constitutional order to govern that market space. In addition, the creation of a common market, as envisaged by the 1957 EEC Treaty, was premised on the mobility of not only goods, services and capital, but also persons. As such, from the beginning, the European Communities encompassed three overlapping spaces: a market space of cross border transactions, a legal-constitutional space of regulation and governance and a socio-cultural space of citizen-worker mobility.

Within each of these spaces (or orders) resides a basic unresolved dilemma. In the first – the domain of the market – European integration establishes a tension between market making on the one hand and the preservation/enhancement of social solidarity on the other. This is another way of describing the well-known tension between the removal of barriers to market exchange and the establishment of institutions of market correction (Scharpf 2010). In the second legal-constitutional domain, the dilemma is best described as a tension between the logic of supranational rule-making versus the norm of democratic authorisation. In the EU context, this tension manifests itself in a disconnect between domestic politics where representative-democratic processes reside and the EU-level where the problem of the 'democratic deficit' is much discussed. Finally, the allowance of citizen mobility across borders creates the potential for opposition between visions of cosmopolitan Europe on the one hand and communitarian preferences for national community on the other.

The key point to make here is that, while these three tensions are recognisable in the recent and current 'crisis politics' of the EU, they are not recent in origin, but rather inscribed into the very DNA of post-war European integration. In other words, the three tensions have become radically intensified in the context of recent crises. They also reinforce one another. Thus the demand for the restoration of democratic control (the second tension) often finds itself expressed in nationalist-nativist terms (the third tension), which in turn produces a particular connotation of social solidarity (the first tension) associated with solidarism amongst pre-defined domestic groups. Such has been the case with the politics of Brexit. To understand why these three dilemmas have deepened we need to focus on the demise of Europe's democratic capitalist compact.

The democratic capitalist compact in Western Europe

Political elites in non-communist Europe were faced with two big questions in the aftermath of World War II: how to revive market capitalism and how to restore and ensure the sustainability of democratic political systems. That democracy and capitalism should go together has become a near axiomatic in political and academic discourse since that time, but there is nothing that necessarily binds them together. Indeed, as Wolfgang Streeck (2011, 2014) points out, capitalism and democracy are perhaps better understood as resting on contradictory principles of allocation. For the former, resources are distributed through the mechanism of the market, while for the latter distributive choices are a matter of societal preference, figured out (typically) through the mechanisms of electoral politics. Karl Polanyi (2001 [1944]) famously argued that the rise of the doctrine of the self-regulating market in the nineteenth century subordinated social purpose to the imperative of the market. Ultimately this proved unsustainable because the fetishisation of the self-regulating market provoked various forms of societal backlash, not least as the franchise expanded across European countries from the late nineteenth century.

A Polyanian analysis would urge policy elites to ensure that the market becomes a means to achieve negotiated social purpose rather than standing as an end in itself. And it is possible to argue that, for a short period, something like this was achieved across the capitalist world after 1945. John Ruggie (1982), using an explicitly Polyanian framing, described the international economic order negotiated at the 1944 Bretton Woods conference as 'embedded liberalism'. What this meant in essence was that policy-makers at the time understood the need to balance the respective goals of economic openness and domestic policy autonomy. The Bretton Woods solution for post-1945 capitalism was to limit the former in favour of the latter in the context of a fixed exchange rate regime. This formula was later theorised by economists as the so-called 'impossible trinity' (Mundell 1963, Fleming 1962). Assuming that domestic policy autonomy, fixed exchange rates and capital mobility were all good things, the impossible trinity theorem seemed to show that it was only possible to have two of the three any one time – a proposition that became widely accepted across the global economic policy community (Widmaier 2004).

Of course, the Bretton Woods formula made possible the establishment, with not insignificant national variation, of Keynesian welfare states and thus of domestic bargains that secured the reconstruction of representative forms of government across western European societies. At the same time the onset of the European Recovery Program (Marshall Aid) ensured the re-establishment of industrial capitalism as the mode of production across the same region (Hogan 1987). This was the political economy context within which the formalisation of European integration began. As such it is perhaps worth thinking about the European Communities of the 1950s as complementary to the post-war democratic capitalist compact rather than obviously corrosive of it (Bugarcic 2013). It is certainly possible to argue that the European integration formula of the 1950s was ultimately generative of its own kind of market fetishism, and we have already seen that the in-built tensions of the integration project were visible from day one. But we can also maintain that the creation of the early European communities was part of the 'spatio-temporal fix' (Jessop 2000) that produced the (fragile) democratic capitalist compact after 1945.

The compact unravelled and the crisis of European integration

It follows that to understand the crises of the EU and to comprehend why the three dilemmas have been so amplified of late, we need to examine how and why the democratic-capitalist compact of the post-war period fell into disrepair. The European democratic capitalist compact was forged within a period of exceptional economic growth. During the period between 1950 and 1973, west European economies saw real GDP grow at an average rate of 4.6 per cent per annum (Crafts 1995). The same period saw European capitalist economies catching up with the performance of the US economy (Eichengreen 2006). West European states were governed in this period by parties of the centre-right and centre-left, all broadly aligned to a version of the mixed economy and the Keynesian presumption of full employment as the central policy goal. This should not be read as an idealisation of European politics during the so-called *trente glorieuses* – the 30-year period after 1945 during which the democratic capitalist compact more or less held in place. Rather it is to point to its fragility and specificity. Indeed, we can go further and identify three basic conditions that were necessary preconditions for that compact to be sustainable: The first was the existence of those exceptional growth rates. The second was an ideational climate in which gung-ho market liberalism was seen as an anachronistic relic of nineteenth century thinking. The third necessary condition was the existence of strong political parties, capable of structuring electoral choices and interceding between societal will on the one hand and the imperatives of government on the other.

Since the 1970s all three of these conditions have severely weakened. First, the period of exceptional growth rates has seemingly given way to a sustained era of what is sometimes called 'permanent austerity' (Pierson 2001a, 2001b). From the 1960s emergent forms of transnational capital put paid to the Bretton Woods fixed exchange rate regime (Garber 1993), while cross border capital mobility was actively encouraged by governments from the mid-1970s. Inflationary pressures were injected in western economies while growth rates slowed down significantly, particularly in the wake of the oil crises of the mid-1970s. Low growth and inflation ('stagflation') were joined by rising unemployment (Crafts 1995, Blinder 1979, Blanchard and Wolfers 2001). While these acute crisis conditions eased over time, the condition of 'permanent austerity' did not. In essence, this describes the situation where government revenues are less and less able to finance welfare state expenditures, at the same time as greater proportions of the population exit the labour market by retiring and thus become more dependent on public services. This situation has created complex and frequently corrosive forms of politics across Europe, and is often blamed on 'globalisation'.

The acceleration of European integration since the mid-1980s is often understood as a response to a new globalised environment, and perhaps as a solution to the pressures globalisation has placed upon individual member states (Meunier and Jacoby 2010). Even if this is so, the shift to supranationally-driven growth through the single market was a major departure from the democratic capitalist compact where domestically-sourced growth would help to sustain citizen loyalties through a well-resourced welfare state. Put another way, as the politics of permanent austerity have gathered around the dismantling of domestic tax/welfare bargains, so 'Europe' has increasingly been posited as the solution to restore growth. With the

onset of crisis, all three of the built-in dilemmas have been amplified. Solidarism takes the form of welfare nationalism, which typically articulates hostility to the cosmopolitan space of intra-European citizen mobility. Hostility to migration in turn becomes a stress test for the viability of the single market regime and support for democracy becomes a defence of national representative space against the encroachment of EU norms. National polities are themselves potentially divided internally along these lines of cleavage – the UK perhaps being the most salient example (Jennings and Stoker 2016).

Second, at the same time the ideational climate has changed markedly. This is typically characterised in terms of the rise of neoliberalism (Harvey 2007, Peck 2010), which in turn is associated with a particular diagnosis of the problem of permanent austerity. In this narrative, the opening of markets and the protection of market society becomes imperative (Shäfer 2013). The revival of economic liberalism has thus provided ideological cover for not only the recalibration of policy instruments, but also the dismantling of institutions associated with the democratic capitalist spatio-temporal fix. A key part of this project has involved the internationalisation of certain state functions.

Thus, perhaps more than anywhere, Europe has been the site for experimentation with forms of state that seek to embody these market liberal principles. The EU, in its guise as a 'regulatory state' (Majone 1994) depends for its legitimacy on the capacity to initiate and protect a functioning pan-European market order. Advocates of the EU as a pure regulatory state (i.e. without significant redistributive capacity) are typically dismissive of the problem of the democratic deficit, in part because their case endorses the idea – fashioned by various economists associated with the neoliberal turn (e.g. Kydland and Prescott 1977) – that democratic contestation is corrosive of market efficiency (see Majone 1996).

What emerges is a situation where democracy and markets are once again posed as stark alternatives. In the contemporary EU, democratic backlash does not mobilise around attempts to create a supranational demos or some form of transnational solidarity. Rather it is typically associated with nationalist projects that seek to repatriate decision-making authority to domestic governments.

Third, one of the reasons that the dilemmas have been accentuated is the decline of political parties as key mediators between societal impulses and governing imperatives (Mair 2013). The Brexit referendum offers an instructive example of this trend. The mainstream party political position in the run-up to the vote on 23 June was that the responsible governing strategy for the UK was to retain its membership of the EU. Yet, the plebiscite delivered a result that expressed a societal preference for Brexit. This suggests that main political parties were not able to intercede effectively to channel the 'responsible' position to the electorate. Peter Mair's account of the decline of political parties and the consequent 'hollowing out' of western democracy relies on a detailed account of the decline of mainstream centre-left and centre-right parties as representatives of particular social constituencies (Mair 2013, Katz and Mair 1995). Instead, party elites have internalized the technocratic logic of governing. This obviously creates space for populist impulses to find expression through newer political parties. Once populism gains a discursive foothold in national polities, so it becomes harder for mainstream parties to control

the political agenda. In the context of the EU, this means that established centrist (usually pro-EU) parties increasingly struggle to narrate the benefits of European integration to the electorate (Gifford 2006). These are ripe conditions for the three dilemmas of integration to be amplified.

Conclusion

It follows from the foregoing that crisis politics in the EU will continue to be organised around the three basic dilemmas described here. Understanding these dilemmas and their interplay should give us a more thorough grasp of, for example, the politics of Brexit (and of Euroscepticism more broadly). Moreover, the story of Brexit is not merely a matter of the interplay between domestic politics and supra-national dysfunction. It needs to be understood within a broader story about the demise of the post-war democratic capitalist compact and the rather prickly question of how policy elites might once again reconcile the contradictory principles of allocation through the market and allocation through representative institutions.

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