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The Political Economy of Brexit and the Future of British Capitalism

First symposium

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In March 2017, the British government invoked article 50 of the Treaty on European Union, officially beginning the negotiations for the withdrawal of the United Kingdom (UK) from the European Union (EU) – the so-called Brexit. At the time of writing (May 2018), negotiations are ongoing. The political economy of Brexit generates new challenges for the UK's national business model and for European capitalism more broadly. Two symposia that bring together academic experts in various policy fields examine the implications of the UK's withdrawal from the EU in key economic policy areas. This first symposium on 'Brexit and the international orientation of British capitalism', covers finance (James and Quaglia <THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>), the balance of payments (Perraton and Spreafico < THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>) and the labour market (Lindstrom THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF). The second symposium deals with 'Brexit and the "reproduction" of British capitalism' and covers the British growth models (Rosamond, <NEXT ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>) and trade policy (Siles Brugge <NEXT ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>). The symposia and the papers they include set out to contribute to two main bodies of academic literature: the political economy literature on varieties of capitalism, with a specific focus on the UK, and the political economy literature on key economic policy areas of the EU.

In this short introduction to the first symposium, we first outline the key features of the British variety of capitalism and highlight the main questions raised by Brexit in that respect. We then summarise the main findings of the papers of the first symposium and tease out some common themes. The symposia mostly draw on a selection of papers from the 2016 workshop series 'Britain and Europe: The Political Economy of Brexit' funded by the White Rose Consortium. The papers were substantially revised, reviewed and updated throughout 2017 and 2018.

The UK business model and Brexit

The UK economy is underpinned by a distinctive 'national business model', organised around a dominant financial sector, flexible labour market, service-sector led growth and openness to international capital flows (see Baker 1999, Hay 2013, Christensenet al., 2016, Hopkin and Alexander Shaw 2016). The core elements of the British capitalism comprise:

- Dominant financial sector: An open and lightly regulated international financial services centre concentrated in the City of London.
- Flexible labour market: A labour market regime consisting of limited employment protections, high levels of atypical employment and restrained levels of real wage growth.
- Service sector-led growth: An increasing drift towards low-skill, low-wage and low productivity service industries.

- Investment: Openness to Foreign Direct Investment (FDI) flows, extensive capital markets and lending bias towards property over productive investment.

The UK's national business model is both dynamic and dysfunctional. It is associated with high levels of employment, a large in-take of FDI and strong growth relative to the EU average. However, it also generates huge wealth and income inequalities, precarious forms of work and reinforces stark regional inequalities, evident for much of the late 20th Century. The UK's internationalised and lightly regulated financial sector also poses a persistent threat to (domestic) financial stability (Bell and Hindmoor 2015a). In the past, the UK's membership of the EU bolstered this national business model (Thompson 2017a,b). Despite some convergence amongst national varieties of capitalism across Europe, the UK business model remains rather distinct, especially if compared to those of the other largest member states, notably, France and Germany.

The contributions to the symposia examine the extent to which Brexit challenges, reinforces or potentially transforms British capitalism. The contributions set out to answer some common questions: i) How has the UK's membership of the EU supported the UK's national business model in the past?; ii) To what extent might Brexit undermine or further consolidate the UK's national business model?; iii) To what extent has the UK's EU membership increased or decreased the 'power' of finance or labour as well as deepened or mitigated processes of financialisation, liberalisation, labour market precarity and low wage shares ? How might Brexit affect these dynamics?; iv) In what ways might Brexit impact on the political economy of the EU? And, last but not the least, what does a political economy perspective bring to our understanding of Brexit?

Overview of the first symposium: Brexit and the international orientation of British capitalism

The first symposium explores the implications of Brexit for the international orientation of British capitalism by examining finance, the balance of payments and the labour market. These three policy areas are strictly interconnected because the UK has an overall deficit in the balance of payments. Such deficit is primarily linked to trade in goods, and is partly compensated by the surplus in the trade of services, first and foremost, financial services. At the time of writing, the UK seems to have opted for a 'hard' Brexit, meaning leaving the Single Market and the Customs Union, rather then a 'soft' Brexit, for example, through a Norway-style membership of the European Economic Area (EEA).

In finance, the City of London greatly benefited from membership of the Single Market in the past and the UK financial sector substantially contributed to the development of the Single Market in finance. Internationally and in the EU, the UK financial industry was highly competitive and London was a leading financial centre, which by far out-competed continental financial centres. Domestically, the UK financial industry was a powerful player vis-a-vis the public authorities (Thompson 2017b), given its structural and instrumental power, even though this power was considerably curtailed after the international financial crisis (Bell and Hindmoor 2015b). The City and the UK authorities were also very influential in shaping EU financial regulation, albeit somewhat less so after the crisis (Quaglia 2012).

Brexit poses a profound challenge to the economic fortunes of the City of London. Recognising this, the UK financial sector campaigned for a Remain vote in the June 2016 EU referendum, and subsequently lobbied for a 'soft' Brexit policy to guarantee continued unrestrained access to the EU's single market. Despite this, government led by Theresa May initially pursued a 'hard' Brexit policy, which would see the UK withdraw from both the Single Market and the Customs Union. Only after the June 2017 elections, this stance was partly softened. The City's limited influence on the UK's Brexit policy is puzzling because Brexit is potentially highly damaging for the UK national business model, characterised by a large, internationalised and competitive financial sector that is dependent on exports to the EU. The paper by James and Quaglia (2018) <THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>) explains this puzzle by arguing that while the UK financial sector continues to wield formidable 'latent' structural power, its capacity to translate this into instrumental forms of influence within government has been constrained by three factors: the high political salience of Brexit; institutional reform within government that challenged the traditional City-Treasury-Bank of England 'nexus'; and internal divisions in the City.

The British economy has long been associated with a weak balance of payments, reflecting 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 has been central to Britain's external position (see James and Quaglia, (2018) <THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>). 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. Prior to the referendum, the UK ran its largest peacetime current account deficit. Since June 2016, sterling has depreciated by approximately 15 per cent. Financing Britain's external position remains a key challenge post-Brexit. The paper by Perraton and Spreafico (2018) <THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>) discusses the evolution of the UK's current account position, particularly in relation to the EU. It highlights how Brexit potentially aggravates the UK's weak balance of payments position and argues that a fundamental shift in the UK business model is necessary if large deficits are to be averted in the future. Ultimately, the UK's future balance of payments position will depend on the nature of the Brexit deal with the EU.

With reference to the labour market and the free movement of workers across the EU, the UK has consistently promoted the liberalisation of transnational labour markets at the EU level, while resisting EU initiatives to strengthen supranational regulations and protections (the so-called 'Social Europe'). The UK's position at the EU level has been consistent with domestic efforts to increase labour market flexibility, via limited employment protections, high levels of atypical employment and restrained real wage growth (Lavery 2018). The paper by Lindstrom (2018) <THIS ISSUE: PUBLISHER TO ADD /UPDATE DETAILS AT PROOF>) argues that with respect to the regulation of transnational labour, the UK has been in control of this policy agenda at home as well as in the EU. The UK's shift towards relaxing its opposition to 'market-correcting' EU initiatives, like the revised posted workers directive, can partly be explained by the demands of British workers for stronger protections against liberalisation. However, the debate concerning Brexit has marked a turning point. The UK government now faces a 'dilemma': how to reconcile pro-market principles, with growing domestic pressures to protect British workers from the vagaries of open and deregulated labour markets.

Besides its effects on the UK and its business model, the political economy of Brexit will also affect the EU, European capitalism and the international economy more broadly. Over the last few years, the European Commission has promoted economic policy initiatives that fitted well with British business model: Capital Markets Union, the Transatlantic Trade and Investment Partnership and REFIT, which was part of the Commission's better regulation agenda. After Brexit, future EU initiatives are less likely to be in line with the UK's priorities.

In finance, depending on the terms of exit, the UK's access to the single financial market will be restricted and the UK's export of financial services to the EU will diminish (Howarth and Quaglia 2017). Again, depending on the specific terms of Brexit, the UK is likely to be more of a rule-taker, rather than a rule-maker, albeit the Bank of England has ruled out this possibility (see Carney 2017). Furthermore, the option for the UK of becoming a lightly regulated off shore financial centre on the EU doorstep remains open (Pagliari 2017). There is also the possibility that equivalence between the EU and the UK will be agreed with reference to several pieces of financial market legislation (Alexander et al. 2017; Ferran 2016; Moloney 2017). Since the UK is Europe's investment banker, the EU potentially faces more limited access to capital for investment (Howarth and Quaglia 2018). Yet, the EU is in the process of re-launching the project of Capital Markets Union, which is designed to create 'deeper and more integrated capital markets' in Europe, making it easier to mobilise investment capital. Capital Markets Union will have a more limited scope without the UK. At the same time if, after Brexit, UK banks might be less able to use their capital market activities to subsidize their retail operations in the UK.

Since the UK is the main non-euro area country in the EU and has traditionally hampered further economic and political integration, Brexit is likely to trigger greater integration in the euro area. Internationally, Brexit will diminish the size and potential attractiveness of the single financial market, as well as the clout of the EU in international financial regulatory fora. In turn, the UK might be able to take more independent positions in international financial negotiations as compared to the past, when the UK's position had to be fine-tuned with the rest of the EU. In trade, EU trade policy is likely to become less liberal and more protectionist, privileging bilateral agreements (including, eventually, an EU-UK trade deal) and mini-lateralism.

Conclusion

This symposium discusses the political economy of Brexit with reference to the UK business model. Three inter-related economic policy areas are examined: finance, the balance of payments and the labour market. Three other inter-linked economic policy areas will be covered in a second symposium. We have decided to cover key economic policy areas but, for reasons of space, there are economic policy areas that are important, but are not included in the symposia, such as development policy, regional policy, energy policy, as well as policy areas that have important economic implications, such as migration policy (Parker 2017; Dennison and Geddes 2018), etc.

The main findings of the papers in this first symposium suggest that Brexit will pose major challenges as well as opportunities for the UK and the EU. In the policy areas examined, the challenges seem to be greater for the UK and its business model. That said, the EU's economy and its economic policies will also be substantially affected by Brexit. The challenges posed by Brexit mainly concern the terms of access to the Single Market (Armstrong 2018), especially in finance, and the effect this will have on the UK balance of payments; the main features of future trade deals (including that with the EU) for the UK; the evolution of the UK balance of payments and its funding.

Several caveats about the themes discussed in the symposia are in order. First, some assessments can only be provisional and will depend on the final deal reached (or not) in 2019 (or afterwards, if an extension of the talks is agreed by both parties). However, the trends and challenges highlighted by the various contributions will influence the course of the Brexit negotiations, their final outcome and the UK-EU relations after Brexit. Second, the various contributions have primarily focused on the political economy of Brexit in the UK in order to fill a blind spot in the emerging literature on Brexit. Indeed, the implications of Brexit for the international political economy are discussed elsewhere (e.g. Review of International Political Economy 2016, especially Owen & Walter 2017; Farrell and Newman 2017). Similarly, the implications of Brexit for the EU are discussed by other special issues (British Journal of Politics and International Relations 2017a,b; Journal of European Public policy 2018), which cover non economic policies, such as security (Rees 2017), transatlantic relations (Wilson 2017) and so on.

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