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The Internal and External Face of New Labour’s Political Economy

To grasp fully the nature and significance of the economic policies at the heart of dominant political projects, those policies have to be studied in the round. They have to be grasped as complex totalities which touch all aspects of the political agenda; and they have to be seen as constructed and contested wholes, whose contradictions, internal inconsistencies and conceptual limits are as vital to their trajectory as are their axioms, theories and content. Academically and professionally, the study of policy in this rounded way is often a more difficult task to complete than might be expected, in part because of the powerful divisions within and between the intellectual disciplines which comprise the social sciences. The division between politics and economics is well known, its costs well demonstrated. That within political science, between the sub-discipline of international relations and the rest, is less discussed, but equally potent. Its effect too often has been to separate the study of foreign and domestic policy to such a degree that the relationship between the two is insufficiently explored. This has been a particular feature of much of the scholarship on the British Labour Party; it is an emerging tendency in much of the recent writing on New Labour. There are important exceptions in past scholarship of course — Stephen Blank’s important work on the adverse effect on UK domestic economic growth of the Attlee government’s foreign commitments is a classic example — but as yet we are aware of no systematic attempt to explore the relationship between foreign and domestic policy in the literature on ‘third way’ politics in the UK.¹

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Material is appearing which charts New Labour policy in both the domestic and international sphere; but we know as yet of nothing that focuses specifically on the character and interaction of foreign and domestic policy. The purpose of this article is to begin to fill that void, by focusing on the character and interaction of foreign and domestic economic policy under New Labour.

Two factors make such an assessment particularly essential in the contemporary British context. Arguably, both reflect different aspects of New Labour’s attitude towards globalization. First, both in opposition and now in government, Blair’s Labour Party has, to an unprecedented extent, emphasized the degree to which international (indeed, global) processes, pressures and tendencies serve as external constraints circumscribing the parameters of political possibility. Secondly, and at times in seeming opposition to this (a point to which we return), Labour has sought to project itself, again in a largely unprecedented manner, as a dynamic international economic force in the promotion of globalization. One sense indeed in which New Labour is both different from Old Labour and at one with its Thatcherite predecessor lies in its powerfully held conviction that the UK ‘economic model’ being developed by its policies is one that should be canvassed and pressed for in the international arena. Blairism, like Thatcherism, sees itself both as an ideological project for export, and as one whose domestic success requires the resetting of international (and particularly of Western European) institutions and practices in its image.

The enthusiasm with which Labour has sought to export its vision of a domestically deregulated capitalism actively promoting trade and financial liberalization on an international stage should not lead one to overlook the party’s recent conversion to such ideals.


3 In making this observation we are, of course, not suggesting that the Blair government is the first Labour administration to promote vigorously its political and economic model. Rather, we suggest that there is something qualitatively distinctive about the highly concerted public packaging and external promotion of the ‘third way’ which invites comparison with Thatcherism.
For the assumed superiority of the Anglo-US model of deregulated capitalism upon which this export has been publicly predicated reflects a relatively recent revision of New Labour’s economic thinking. Until 1996 at least (and thereafter in an ever more diluted formulation), Labour’s political economy (domestically and internationally) was animated by a Huttonesque vision of the comparative (and competitive) advantage of a distinctly Germanic capitalism. This was somewhat crudely characterized by the principle of ‘stakeholding’ which Labour came enthusiastically to embrace. Yet where once New Labour sought to internalize the Germanic model, it now seeks to export the British model. There is a New Labour economic message of a complex and integrated kind which is regularly delivered by leading New Labour figures in a string of international venues; and it is a message which has been so delivered from very early in the New Labour project. In opposition, Tony Blair was prone to use overseas venues for the delivery of major policy statements: in East Asia in 1996, and again later in South Africa. In power, Blair immediately addressed the European Socialist Movement in Malmo, and subsequently repeated his call for reform before European and world leaders in a string of gatherings from Edinburgh and Amsterdam to Bangkok and Davos. At home he (and other ministers) have used public conferences and lectures (from the ‘New Policies for the Global Economy’ conference of 1994 to the Mais lectures of the late 1990s) to put their message across; and leading New Labour figures (from Gordon Brown to Clare Short) have regularly surfaced on the international stage pressing the same New Labour case. Time and again, New Labour ministers have called in international forums for the deregulation of labour markets, the liberalization of trade, and the resetting of the role of government — calls which in every case have linked New Labour ‘reforms’ within the UK to a New Labour vision of how best to organize and govern the (European) regional and global economy. There is thus already in existence a distinct body of primary data demonstrating the character and interaction of domestic and foreign economic policy in the New Labour project, and indicating the centrality of that interaction to much New Labour thinking. These data now need

systematic organization and evaluation. The second section of this article tackles the first of those needs, the last two sections tackle the second.

THE INTERNAL AND EXTERNAL DIMENSIONS OF NEW LABOUR’S ECONOMIC POLICIES

The ‘internal’ face of the New Labour economic strategy is one concerned primarily with the establishment of economic competitiveness. The policy package here consistently speaks to two related but distinct audiences. It speaks to the UK labour movement, and it speaks to UK and overseas business and financial institutions. To the first, New Labour Ministers have projected a new trinity of concerns with ‘labour market flexibility’, ‘welfare reform’ and ‘welfare to work’. To the holders of capital, New Labour Ministers have emphasized their parallel commitment to the restraint of public spending and to a growth strategy built on the openness and transparency of economic decision-making.

The commitment to labour market reform was evident even before New Labour came to power, when the party was seeking to establish a political gap between itself and previous Conservative administrations for which greater labour market flexibility had long been a cornerstone of economic policy. New Labour chose, as is now well known, to retain the vast majority of the Thatcherite labour law changes against which Old Labour had set its face, and was in consequence vulnerable to the accusation that, in its newness, it was buying into the entire Thatcherite industrial relations package. New Labour in opposition was adamant that it was not: that it was not committed to labour market deregulation solely or at any price. Tony Blair insisted rather that ‘the benefits of deregulated labour markets have not been unqualified, and increased flexibility has not been won without costs’, and that New Labour would not take ‘the cheap labour route’ to economic success adopted by its Conservative predecessors. But even in opposition, when the political need to distance itself from neo-liberal market reforms was far greater than it would be once power was won, this condemnation

of the ‘sweat shop’ growth strategy associated with Thatcherism entered the argument only as a precautionary caveat to a much clearer and more strident call for greater ‘labour market flexibility’ both within and beyond ‘the firm’. The assertion in opposition was one of complementarity: a belief that there was no ‘conflict at all between sensible minimum standards at work, including on pay, and a successful labour market’ so long as unions and employers could generate ‘a new partnership’. When in power, however, with those partnerships far from evident, the New Labour concern with flexibility took centre stage and the ‘cheap labour’ growth strategy began inexorably to reappear, no matter how regularly Labour Ministers denied its impending arrival. This was evident in the New Labour government’s lack of enthusiasm for a generous National Minimum Wage. It was evident in the limited content of the *Fairness at Work* proposals and it was evident in the rhetoric with which those proposals were presented. New Labour offered the modest accretion of individual and collective rights in its 1998 Employment Protection Bill as a once-and-for-all corrective to the Thatcherite industrial relations settlement, and Tony Blair famously defended the new package as still leaving the UK with ‘the most lightly regulated labour market of any leading economy in the world’.

Alongside that modest resetting of the labour codes inherited from the Thatcher era has come a much more energetic resetting of the scale and scope of welfare provision. This again was signalled in opposition and triggered quickly when in power: the New Labour belief that welfare reform was vital because taxpayers would not tolerate the costs of an unreformed system, and because the Party had now discovered what Gordon Brown called ‘a modern agenda to tackle poverty’. The squaring of the circle of modest labour market reform and major welfare resetting lay — as far as New Labour Ministers were concerned — in this new agenda, central to which was the pursuit of policies of welfare to work. As Gordon Brown put it late in 1997, ‘achieving high and stable levels of growth and

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6 Tony Blair, Mais Lecture, 22 May 1995, p. 15.
employment will require new approaches from national governments, modernising social security systems, improving work incentives through the tax system, removing barriers to growth and encouraging the job-creating potential of small business’. The great trick, for New Labour, was so to reset the welfare state that it would promote work, not dependency: by making (as Tony Blair put it) ‘major changes in unemployment benefit, disability, the treatment of single parents, and pensions . . . to preserve flexibility in our labour markets [while reshaping] the Employment Service around an active strategy for work’.

New Labour set its labour market and welfare reforms alongside new mechanisms for influencing capital flows and investment levels. It has not returned to any Old Labour form of direct controls, but neither has it accepted the Thatcherite dictum that ‘deregulation of labour, product and financial markets’ was ‘enough to deliver medium term supply side improvements’. What New Labour has done instead is to prioritize the achievement of macro-economic stability by the pursuit of what Ed Balls later called policies of ‘constrained discretion’ (the creation, that is, of a stable long-term macro-economic framework within which companies could plan and invest with genuine certainty, by the setting of definite economic targets and pre-fixed limits to government spending). New Labour in consequence (and even in opposition) committed itself to ‘the golden rule of public finance . . . that public borrowing will be used only to finance investment, not public consumption’ and, even then, only ‘prudently undertaken’. It accepted the constraint of existing Conservative spending plans for its first two years in office; it set a long-term inflationary target; and it moved quickly to grant the Bank of England independent responsibility for the setting of interest rates to attain that target. The thinking here was clear, as Gordon Brown later explained to the Council for Foreign Relations in New York:

in today’s global economy, there is little place for the fine tuning of the past which tried to exploit a supposed long-term trade-off between inflation and unemployment which proved elusive. But equally in today’s deregulated liberalised financial markets, governments can no longer try to deliver stability through the rigid application of rigid monetary targets. Instead the answer to the uncertainty and unpredictability of ever more rapid financial flows is clear long-term policy objectives, the certainty and predictability of well-understood procedural rules for monetary and fiscal policy, and an openness that keeps markets properly informed and ensures that objectives and institutions are seen to be credible.

It is vital to grasp that New Labour has not simply pushed this agenda internally, or used its presence at international forums merely to describe and justify its internal reform programme (though of course ministers have taken every international opportunity to make that defence). Ministers have also pushed for a resetting of the (European) regional and global economic order in the image of their internal settlement. For the package of policy measures just described — what we might term the internal face of New Labour — has been accompanied by a developed external face as well. The call for greater labour market flexibility has been matched by an enthusiastic endorsement of the ‘globalization processes’ that were supposedly making labour market flexibility so vital. The Protestant work ethic so evident in Labour’s internal New Deal has been matched by its Adam Smith-like endorsement of the merits of free trade. The sensitivity of New Labour ministers to the adverse effects on investment flows of the taxation burden of the welfare state has been paralleled by an enthusiastic endorsement of foreign direct investment. And the determination of New Labour to trigger internal growth by restraining state spending has a definite parallel in the reform packages advocated by New Labour for international organizations such as the IMF, and in the policy role canvassed for East Asian governments by New Labour ministers during their occupancy of the European presidency. The internal face of New Labour, keen on flexibility, welfare reform, work-fare and limited public spending, sits within the emerging New Labour canon alongside an external face keen on global change, reduced trade barriers, unregulated capital mobility and state moderation.

In particular, the enthusiastic endorsement of globalization as a process has been a marked feature of New Labour rhetoric from

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the very beginning. Time and again, both in opposition and in power, New Labour leaders have emphasized ‘the growth of increasingly global markets and global culture’, and the emergence of ‘24-hour round the world, round the clock capital markets in which the daily flows of foreign exchange are already almost as much as twice the monthly flows of trade’, a world characterized by ‘the global sourcing of companies’ and ‘a new wave of technological change’. And New Labour leaders have consistently drawn a particular policy message, that of free trade, from this new global reality: ‘the best way to promote efficiency in production is through competition, liberalization and open markets — not through monopoly, state subsidy or preferential procurement’. Not surprisingly, therefore, New Labour ministers have regularly positioned themselves at the forefront of the call for unregulated world trade, as they certainly did at the WTO meeting in Seattle. With protesters camped outside the meeting, and parts of the city under martial law, DTI Minister Stephen Byers reasserted the New Labour view that ‘a shared commitment to open trade and commerce has been a driving force for growth’ and that in consequence ‘the essential answer to the problems of the moment is not less globalization — not new national structures to separate and isolate economies — but stronger international structures to make globalization work in harder times as well as easy ones’.

One consequence of this enthusiasm for unregulated trade has been a particular propensity to push stridently for a resetting of European labour market institutions in the New Labour image. That was the message at Malmo in 1997, and again at Davos in 2000, and at all European stops in between. The Blair call for reform was clear in 1997: that European labour costs needed to be cut, that the achievement of labour market flexibility was central to enhanced European economic competitiveness, and that this flexibility was being denied largely owing to outmoded notions within the European left itself. How else are we to interpret his observation at

16 Tony Blair, *New Britain*.
Malmo that ‘our aim must be to tackle the obstacles to job creation and labour market flexibility — cutting unnecessary bureaucracy for the small firms that are likely to be the main job creators, completing the single market, promoting welfare to work initiatives which bring real jobs within reach of those now excluded from the labour market, making sure the Social Chapter and Employment Chapter help job creation, not hinder it.’\textsuperscript{20} The Blair message at the Hague in 1998 was sharper still: ‘in the sensitive area of labour market reform, Europe had made some limited progress’ but that the EU still needed ‘to make a modern labour market work better. High levels of unemployment are not social protection.’\textsuperscript{21} And the message had not changed, or softened, at Davos two years later. If anything, it was yet more strident — at the Lisbon Special European Council the EU would have to choose, either ‘to continue with the old social model . . . rooted in the 60s and 70s’ or make ‘a definite turning point towards the reform agenda, retaining the values of the European social model but changing their application radically for the modern world’.\textsuperscript{22}

A second consequence of the New Labour enthusiasm for unregulated trade has been New Labour inertia on calls for the re-regulation of labour markets and for the public management of capital flows. The new Labour government was able to avoid full involvement in the Multilateral Agreement on Investment (MAI) row at the WTO, but subsequently pressed for a renewed round of trade negotiations that would include investment. It has been bullish on the benefits (particularly those which might accrue to the UK economy) of unregulated capital flows and foreign direct investment. Tony Blair’s opposition to something as modest as the Tobin tax is also on record. Such a move, he suggested in an interview with John Humphreys, ‘is the wrong thing to do too, because you actually want people to be able to move money very, very quickly’, and because its introduction would open the door first to exchange restrictions and then to import controls.\textsuperscript{23} And on the issue of labour standards in international trade, the New Labour silence has been

\textsuperscript{20} Tony Blair, Speech to the Congress of European Socialist Parties, Malmo, Sweden, 6 June 1997, p. 5.

\textsuperscript{21} Tony Blair, Speech at Nieuwspoort Dinner, p. 7.

\textsuperscript{22} Tony Blair, Speech at World Economic Forum, p. 4.

deafening. New Labour was even outflanked on this by the Clinton administration. The Clinton response to the protesters in Seattle was quite different from that of New Labour; and in consequence Clinton went to Davos with one message, Blair with another. Clinton took the Seattle protest as a ‘wake up call’ to the international community, as an opportunity to widen the groups involved in trade negotiations and to stop ‘viewing with contempt those new forces seeking to be heard in the global dialogue’. Tony Blair, by contrast, argued that ‘the worst thing we could do for developing countries would be to shelve the trade liberalization agenda and sit back while trade barriers were re-erected round the globe’. His response to the events at Seattle — what he called ‘the right conclusion’ — was ‘that we have an enormous job to do to convince the sincere and well-motivated opponents of the WTO agenda that... trade liberalization is the only sure route to the kind of economic growth needed to bring their prosperity closer to that of the major developed economies’.  

New Labour ministers have also played a key role in the orchestra- tion of reform at the level of international economic agencies. To some extent this enthusiasm for global reform has been understood, within New Labour circles, as the international parallel to New Labour’s attack on poverty at home. Certainly when Gordon Brown was floating his long-term claim for party leadership early in 1998, he was prepared to make that linkage, presenting, as a supplement to his ‘modern agenda for tackling poverty’ in the UK, proposals for debt relief for the poorest of the less developed economies (and to his credit, those proposals have remained high on his personal agenda). But the main thrust of New Labour’s advocacy of reform within the IMF and WTO has derived not from its anti-poverty agenda so much as from its general growth theory, where the call for reform acted as the international parallel to New Labour’s internal exercise of ‘cautionary discretion’ in monetary and fiscal policy. Abroad, as at home, New Labour has consistently argued that economic growth is best guaranteed by the absolute requirement for fiscal and monetary policy to be oriented towards ‘discipline, stability and transparency’ in order to produce macroeconomic conditions of stability and certainty.  

at home, New Labour has argued that this in turn requires ‘reform of the financial architecture’ by the establishment of ‘a framework of internationally agreed codes and standards, new disciplines’, greater levels of international financial regulation, ‘new frameworks for crisis prevention and resolution’ based on private–public sector cooperation, and ‘new social principles allowing for immediate debt reduction’.26 At home and abroad, that is, the New Labour alternative to either renewed capital controls or total capital market deregulation has been the establishment of financial regimes characterized by ‘openness and transparency’, ones based on what Edward Balls listed as New Labour’s four key economic principles: ‘stability through constrained discretion, credibility through sound long-term policies, credibility through maximum transparency, and credibility through pre-commitment’.27

CREDIBILITY AND COMPETITIVENESS IN THE THINKING OF NEW LABOUR

Throughout its first term, then, Labour’s activism on the domestic economic front has centred on its dual aims of promoting credibility through a new institutional architecture for the conduct of monetary policy and on the promotion of a strategy of competitiveness through an ambitious programme of labour-market and welfare reform. As internal economic goals, both credibility and competitiveness require external, indeed international, validation — validation regularly invoked in rhetoric which is strikingly Social Darwinian in tone. As Tony Blair told the international elites gathered at Davos in 2000:

The key to the management of change is reform. The pace of reform has to match the pace of change. Societies that are open, flexible, able easily to distinguish between fundamental values, which they must keep and policies which they must adapt, will prosper. Those that move too slowly or are in hock to vested interests or what I have called elsewhere the forces of conservatism, reacting negatively to change, will fall back.28

As with Margaret Thatcher before him, Tony Blair is not for turning; and the resulting consistency with which credibility and competitiveness have been (and continue to be) pursued give New Labour’s

economic policy a striking unity across policy areas and over time. New Labour therefore seems poised to score high for policy continuity as Old Labour did not. But how will New Labour score for policy effectiveness? Will its record be better on this than Old Labour’s? Here, as we will now argue, there is room for some scepticism. New Labour may have ‘joined up’ its internal and external economic policy in a way that Old Labour did not; but the substance of the policies so conjoined — and the theoretical systems underpinning them — are of a kind that are likely in the end to disappoint both Old Labour enthusiasts for social justice and New Labour economic modernizers alike. Neither New Labour’s courting of credibility nor its supply-side concerns for competitiveness are problem-free in this regard.

**Studiously Courting Credibility.** Within a week of Labour’s electoral triumph the new Chancellor, Gordon Brown, announced that operational responsibility for the setting of interest rates would be ceded to the Bank of England. The theoretical origins of this institutional overhaul of the governance of monetary policy are not difficult to trace. ²⁹ They derive from public choice theory, Friedmanite monetarism and, most explicitly, the rational expectations revolution of the mid-1970s. They also mark a return to a far older tradition of liberal political economy and to a conception of central bank independence on which the Bank of England was once predicated. Closely following the work of Friedman, who had challenged the (Keynesian) notion of a long-run trade-off between inflation and unemployment, the rational expectations school derived what it identified as the ‘time-inconsistent’ inflationary preferences of elected governments. Given a (belief in the) short-term trade-off between inflation on the one hand and unemployment and/or growth on the other, governments would seek to engineer a ‘political business cycle’, over-inflating the economy in the run-up to an election in order to reap the short-term electoral benefits of growth with little consideration for the longer-term consequences (a suppression of long-term growth potential and an increase in the ‘natural’ or ‘equilibrium’ rate of

²⁹ Space prevents a full consideration of the practical motivations underpinning this significant institutional overhaul. Nonetheless, the significance of the adoption by the EU in the Maastrict Treaty of an independent European Central Bank should not be underemphasized.
unemployment). What this meant, in essence, was that governments could not be trusted to stick to any inflation target they had set for themselves, given that it was rational for them to renege on any such bargain. Market actors, assumed here to be similarly rational in their expectations, would anticipate this, thereby coming to adapt their investment decisions in the anticipation of inflation arising from the political business cycle. Such rational expectations served to set in place a hysteresis effect for which there is simply no solution whilst monetary policy remains in the hands of elected politicians. Thus as Ed Balls argued, in an admirable summary of the new orthodoxy, an incoming government might declare that it wanted to achieve low inflation, but this government’s incentive would always be to cheat and dash for growth, knowing that the resulting recession would only come along later. But, as Friedman pointed out, the result of trying to exploit this short-term trade-off between unemployment and inflation was simply to build in higher inflation expectations (and therefore higher long-term interest rates) with no long-term gain in terms of output and employment.

On this thinking, it was only by ceding responsibility for monetary policy to an independent authority (an independent central bank) mandated constitutionally to deliver price stability (in the case of the Federal Reserve or European Central Bank) or a specific inflation target (in the case of the Bank of England), that credibility could be restored, with consequent (beneficial) effects for the trade-off between interest rates rises and resultant deflationary outcomes. Hence came New Labour’s rapid and dramatic paradigm shift from discretionary to rules-bounded and institutionally-guaranteed inflation targeting.

New Labour ministers understandably presented this ceding of authority as a positive as well as a radical move; but in doing so they claimed too much. True, by empowering the MPC of the Bank of England, they aligned the UK with a dominant international paradigm requiring monetary policy to be restricted to

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31 Edward Balls, ‘Open Macroeconomics’, pp. 120–1; see also Brown, Mais Lecture, pp. 7–14.
the adjustment of interest rates by an independent monetary authority. But they also tied their own hands as policy-makers in significant and potentially damaging ways. For interest rate hikes are a particularly blunt instrument of monetary policy, imposing as they do deflationary pressures across the entire economy. Particularly in an economy characterized by both regional and sectoral segregation, such bluntness in the key policy instrument can only serve to institutionalize a deflationary bias in the most disadvantaged sectors and regions of the economy. In this sense, the institutional architecture established by ceding operational responsibility for monetary policy to the Bank of England has backed the Chancellor into a corner of his own making. Either he simply ignores the adverse economic consequences (say, for export-oriented manufacturing sectors of the economy and for Northern England, Wales and Scotland) of a monetary policy inappropriate for the conditions of the entire economy, or he reneges on the spirit of operational independence by intervening directly to counter sector-specific inflationary pressures. Insofar as identifiable inflationary tendencies are currently associated with the housing market, such interventions might take one of two forms: a further increase in the stamp duty payable on properties over a specific sum; or a more general increase in the burden of direct taxation, which might serve both to douse demand in the property market whilst providing the exchequer with resources to encourage investment in research and development, physical and human capital formation. The government’s half-hearted endorsement of the former and existing pledges on fiscal policy which effectively eliminate the second (hypothetical) option altogether, indicate that the burden of monetary policy is likely to remain with the MPC. Thus Britain will continue to pay an interest rates premium for suppressing sector- and region-specific inflationary tendencies (associated, in particular, with comparatively low rates of taxation for high earners).32

32 Of course, the problem here is not strictly the ceding of operational independence to the Bank of England, but the absence of compensating fiscal and supply-side policies at a regional level which might militate against the bluntness of monetary policy as a means to deal with unevenly distributed inflationary pressures. It should also be noted that, regardless of the formal status of the Bank of England, interest rates in Britain have consistently been set with little consideration of their effects for manufacturing industry or regional inequalities. In this sense, operational independence has merely served to institutionalize a series of already well-established tendencies.
Nor is this the only difficulty created for New Labour by the ceding of authority to the Bank of England in this way. There are others, more intimately connected to the long-term structural weaknesses of the British economy. Throughout the post-war period manufacturing activity within the UK has been characterized by relatively low rates of productive investment, reflective of the high cost of capital and the endemic short-termism, risk-aversion and overseas orientation of UK-based financial institutions. Consequently, UK manufacturing has suffered (and continues to suffer) from significant capacity constraints, such that relatively modest rates of economic growth (currently somewhere between 2.0 and 2.5 per cent per annum) see the economy operating at full capacity. Clearly growth rates in excess of this figure will inject further inflationary pressures (and consequent expectations) into the economy, necessitating pre-emptive hikes in interest rates from the monetary authorities. The consequences are easy to see. If monetary policy is restricted to the setting of interest rates, then Britain will endure an interest rates premium over competitor economies if it is to meet a given inflation target. Here, too, path-dependent feedback (hysteresis) effects can be identified. For any comparative interest rates rise increases the relative cost of capital, further depressing levels of productive investment with direct effects for physical capacity. Britain’s new institutional architecture for monetary policy seems foredoomed to exacerbate and institutionalize the long-term structural weakness of the British economy, to say nothing of its implications for the exchange rate upon which the competitiveness of export-sectors of the economy is premised. Whilst an over-valued currency may be good news for the City this is likely to provide precious little comfort for already beleaguered manufacturers producing for export markets.


The Competitive Imperative: Rendering Welfare Conditional. Of course, credibility is not an end in itself, even for a Labour Party long out of office and so more keen than perhaps longer-established governments to establish its capacity to govern. Rather, and as frequently reiterated by the Chancellor, credibility is seen by New Labour as ‘a necessary pre-condition to deliver [its] . . . objectives for growth and employment’. It is, in short, seen as a necessary but not sufficient condition of competitiveness in an era of globalization, as a key ‘external’ precondition for growth, sitting alongside New Labour’s more ‘internally focused’ ones: greater flexibility in labour markets, investment in human capital formation and attempts to make ‘work pay’ through reform of the welfare state.

For, internally, New Labour’s chosen route to competitiveness lies primarily through its elimination of supply-side rigidities thought to impede wealth creation. In this respect, there are clear parallels between New Labour’s thinking and policy and the ‘trickle-down’ economics of the Thatcher/Major years, parallels that are staggeringly (even embarrassingly) clear when the content of ministerial speeches is analysed in detail. The quotation below is from Stephen Byers’s 1999 Mansion House speech, but it could equally have come from earlier Mansion House addresses by either Norman Tebbit or Lord Young. This is Byers on the role of the DTI:

The reality is that wealth creation is more important than wealth redistribution. It is successful and prosperous businesses which can employ more and more people and also ensure that public finances are sound, so that we have the resources to fund those essential public services like health and education . . . Entrepreneurs take risks in the face of uncertainty and open up new markets. Government should and must not hinder them, but work to ensure that the market functions properly and contributes to a strong, just and fair society. There can be no return to the outmoded interventionism of the old left. The corporatist state was tried and it simply did not work.35

Underpinning such a view, from New Labour spokesmen no less than from their Thatcherite predecessors, seems to be a submerged conception of market outcomes, under conditions secured by a regulative as opposed to interventionist state, as necessarily just, fair and equitable in their own right. On such a set of under-

35 Stephen Byers, Speech at the Mansion House, 2 February 1999, pp. 1, 2.
standings, the role of the state is then limited — to ensure labour market flexibility and, as Byers again suggests, to ‘resist burdensome regulation of the labour market’ originating in Europe. What New Labour means by labour market flexibility is certainly consistent with Thatcherism. If flexibility can be achieved either within the workplace, as highly skilled workers adapt themselves to a range of flexible tasks, or externally, within the labour market itself, as employers avail themselves of the opportunity to hire and fire, then it is clear that New Labour in power has prioritized the latter. Though the government is understandably loath to admit it, this does present difficulties for an administration which, at least publicly, predicates its policies upon a conception of social justice. For without an active and interventionist industrial strategy, there is little chance of any revision to the regime of the competitiveness of the British economy; and the problem becomes one of inheritance. As Donald Sassoon notes, ‘after eighteen years of Conservative government, the distinctive competitive advantages of British industry are low wages, low taxes, weak trade unions, poor working conditions, a flexible labour force and limited job security’. Labour’s attitude to what it sees as the dangers of an over regulated European-style labour market are not difficult to discern from this. As Anne Gray has argued, ‘arguing that a stronger Social Chapter might threaten jobs, Blair appears content with the Tory legacy of a national economic strategy which has attempted to secure competitive advantage through low labour costs, low social security charges and legal repression of trade unions’.

New Labour’s proximity to Thatcherism on these issues has clear implications for the one aspect of its articulated strategy to promote competitiveness that does set it apart from its Thatcherite, if not from the Major, predecessors: namely its enthusiasm for what it terms human capital formation. For the UK, as all the available empirical evidence makes clear, has comparatively high rates of

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36 Stephen Byers, Mansion House, p. 6.
labour turnover; and this, combined with its characteristically high cost of capital, its propensity to downsizing through mergers and acquisitions and a corporate culture which prioritizes dividends for shareholders over reinvestment, has long conspired to block high levels of physical and human capital formation. Consequently, and in comparison to its European partners, Britain is a relatively low-wage, low-skill economy, one whose comparative position is merely exacerbated by successive attempts to further liberalize Britain’s already flexible labour-market. If labour turnover is high and labour shedding is simple, why invest in the skills of your workers when you can poach those skilled by others and when any investment in human capital you do make will only enhance the mobility in the labour market of those in whom you invest? There is, then, a clear tension in Labour’s economic strategy. Were it serious about raising the level of human capital formation in Britain, with consequent benefits for the internal flexibility of the economy, it would be well-served by tightening rather than loosening its regulation of the labour market. New Labour will not do this, even though there is a trade-off between internal and external flexibility here which New Labour ministers simply fail to acknowledge.

A similar preoccupation with supply-side blockages characterizes and compromises New Labour’s determination to promote ‘welfare to work’. Here the government has increasingly sought to resuscitate its historical commitment to full employment, albeit a rather different conception of full employment than that characteristic of Old Labour. In the hands of New Labour, full employment refers to a condition in which there is rough parity between vacancies and those claiming benefits (i.e., what, elsewhere, would be seen as the economy’s ‘natural’ or ‘equilibrium’ rate of unemployment). On such a definition the economy is currently close to a condition of full employment, though this is not the case for a number of regional economies where sizeable disparities between the number


of benefit claimants and vacancies persist. Given such a conception of full employment and such a labour market situation, it is not difficult to see why New Labour ministers regard (any residual) unemployment as essentially a supply-side phenomenon, or why, as Jamie Peck has noted, that ‘the New Deal has been designed and represented as a resolutely supply-side program, framed in a policy discourse which downplays or even excludes issues such as job creation and job availability’. Quite simply, the demand for labour is assumed to exist if the benefits structure can be so reformed as to provide incentives to move from ‘welfare to work’ (such as stringent welfare conditionality, the National Minimum Wage and Working Family Tax Credit) and provided the unemployed can be rendered ‘employable’.

The strong element of compulsion which characterizes New Labour’s contract with welfare claimants is therefore both intelligible and central to its welfare-to-work strategy. The authoritarian tone was well-captured by Alistair Darling, Secretary of State for Social Security, writing in *The Independent* that ‘the new regime will be far tougher than people thought . . . We will end the something-for-nothing approach that has characterised the past’. But put like that, the New Deal has little to do with building a modern high-wage, high-skill economy, no matter what other ministers might claim. It has much more to do with promoting the ‘employability’ of welfare claimants such that they can satisfy the (assumed) demand within the labour market. In one sense, of course, this too is a strategy of human capital formation; or perhaps more accurately, a strategy of social capital formation, since as Keep and Mayhew have perceptively observed, ‘much of what is being labelled here as skills appears to be personality traits or attributes that may only partially be amenable to change and enhancement through training and education as traditionally conceived’. In the hands of New Labour,

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43 Alistair Darling, ‘We Make No Apologies for Our Tough Benefit Regime’, *The Independent*, 10 February 1999.

it is already becoming clear that — for all its good intentions — welfare-to-work is becoming more about instilling in those claiming benefit a resigned acceptance of the flexi-time, hire-and-fire labour market they must endure (as a condition of continued receipt of such benefits) than it is about providing a genuine ‘ladder to opportunity’. Indeed, given the path dependence of labour market trajectories, New Labour’s New Deal may actually serve to prevent skilled workers returning to highly skilled employment; and certainly while unemployment remains so regionally concentrated, it seems inevitable that ‘the welfare-to-work client base [will be] largest in precisely those parts of the country where the labour market is weakest, implying that the New Deal may have least purchase as a policy tool in those places where it is needed most’. In any event, the ultimate test of the welfare-to-work programme has to be not how it performs whilst the economy is operating at or in excess of full capacity, but how it performs in recessions. And as Kleinman and West have argued persuasively, ‘if the level of demand is low, if the economy is in recession, if business confidence is low, then the likelihood [that such] schemes [will have] any appreciable effect on employment or employability is also extremely low’.45

New Labour therefore finds itself caught between rhetoric and performance much as Old Labour did before it. It claims to have found a new route to competitiveness and prosperity based on human capital formation; but its attitudes to labour market regulation and to welfare reform lock it onto an older economic trajectory: one that consolidates a predominantly low-wage based niche for UK manufacturing in an increasingly competitive global economy. Preaching the virtues of deregulation and industriousness may well win New Labour credibility in international financial markets, as it did in earlier decades for the governments of Margaret Thatcher and John Major; but it is likely to prove more difficult to sustain domestically under less auspicious economic conditions.

REFLECTIONS ON THE TWO FACES OF NEW LABOUR’S ECONOMIC PROJECT

Whatever else may or may not be said about the adequacy of New Labour’s linking of the internal and external faces of its economic project, one thing at least is clear. Labour’s project is certainly as rhetorically coherent as its Thatcherite predecessor, and for the same reason: it rests on a clear theoretical base. The theoretical underpinnings of Thatcherism were neoclassical. The project was self-consciously anti-Keynesian. The theoretical underpinnings of New Labour’s project are post-neoclassical. The project is self-consciously inspired by the new growth theory, by (as Gordon Brown put it in 1994) ‘post-neoclassical endogenous growth theory’. This consciously-adopted theoretical inspiration provides the key to each of New Labour’s central economic concerns. It is the key to New Labour’s commitment to growth via macroeconomic stability. It is the key to New Labour’s prioritizing of investment in human capital. It is also the key to New Labour’s lack of enthusiasm for capital controls and re-regulated labour markets. New growth theory stands only one shade away from classical growth theory in its attitudes to the centrality of market forces as triggers to competitiveness, efficiency and long-term capital investment. New growth theory is now very fashionable in progressive economic circles, and New Labour has both succumbed to that fashion and done much to promote it.

In fact, New Labour’s policies seem coloured by a second and related fashion, too: one that is more hybrid in quality (and on which we will comment more fully in a later article). In British policy-making circles these days you find arguments of a neo-Schumpeterian and a neo-Weberian kind sitting alongside ideas gleaned directly from the new growth theory. The Schumpeterian theme is reflected in New Labour leaders’ understanding of the dynamics of capital accumulation in imperfect markets — their sensitivity to the crucial importance of technological innovation.


particularly by large companies, and to the associated and vital role of an economy's science and engineering base in the creation of long-term economic competitiveness. The neo-Weberian voice is there in New Labour’s enthusiastic endorsement of the ‘new economy’ as one that is primarily information-based.\textsuperscript{48} New Labour is not just concerned with human capital formation. It also sees itself as developing technologies, and investing in skills, to survive in the new ‘knowledge-based economy’ of computer-based machinery, information technology and genetic engineering. There are even echoes of a (rather dated) post-regulationist ‘flexible specialization’ argument in its glorification of small technology companies, research triangles and science parks. So whatever else this New Labour project is, it is more consciously theorized than any Labour project before it, and all its theories pull in one direction: towards investment in human capital, and in the science base of otherwise entirely unregulated large global companies.

This confluence of theoretical sources has already ensured that the political economy of New Labour in office is significantly different both from Old Labour’s more avowedly Keynesian economic understandings and from the party’s more recent (and extremely brief) flirtations with the Germanic tradition of ‘stakeholding’. In fact, New Labour’s enthusiastic endorsement of competitiveness and credibility as core parameters of economic policy has brought UK economic policy firmly into line with what Greg Albo has correctly identified as the growth strategy currently generally popular among European and North American centre-left parties — the strategy of ‘progressive competitiveness’. In the UK as elsewhere, this is a strategy for economic growth built around investment in human capital, and as such, one which stands in contrast to the more general propensity of centre-right parties to seek growth primarily through wage-cutting and demand constraints (Albo’s strategy of ‘competitive austerity’).\textsuperscript{49} Moreover, and as we have sought to demonstrate, the internal and external faces of New Labour’s pursuit of progressive competitiveness have been, and


remain, impressively consistent rhetorically. As we have shown in detail here, New Labour’s espousal of the politics of constrained discretion and fiscal prudence at home have regularly been matched, and are currently still being matched, by its persistent advocacy in international forums of an external financial order characterized by openness and transparency. Similarly, its domestic political economy of labour market flexibility and the elimination of supply-side rigidities has been mirrored on an international stage, and is still being mirrored, by consistent attempts to recast the European social model in the image of this domestic settlement (most recently at the Lisbon Special European Council).

Yet consistency and adequacy are not the same thing; and the impressive degree of coherence in New Labour’s political economy should not blind us to the continuing contradictions within the project (contradictions which the rhetorical coherence serves only to obscure). These continuing internal contradictions, problems and shortfalls are, in our view, best conceptualized as a series of tensions within and between a rule-bound fiscal and monetary orthodoxy on the one hand and a very particular reading of endogenous growth theory on the other. They are summarized in Table 1.

Taken together these contradictions seem to us to raise unavoidable and serious questions about the long-term viability of New Labour’s strategy of progressive competitiveness. In fact, the persistence of so all-pervasive a set of difficulties at the heart of New Labour’s enthusiastically advocated economic policy paradigm leads us at least to two general points of conclusion.

The first is this: that New Labour has certainly compounded its own problems by settling upon what seems to us to be a particularly limited (though certainly popular) reading of endogenous growth theory. Endogenous growth theory (post-neoclassical or otherwise) is not merely a synonym for the need for human capital formation, as much of the literature (and Labour speechwriters) seem to assume. As Nick Crafts explains, ‘the basic idea of endogenous growth is that long-run growth in income per head depends on investment decisions rather than, as in traditional growth theory, resulting from unexplained or exogenous improvements in technology’. Thus, in addition to investment in human capital (skills), endogenous growth

theory places at least equal emphasis (indeed, arguably rather greater emphasis) upon the positive externalities arising from investment in physical capital (capacity), research and development and new product development.\(^{51}\) Given Britain’s widely acknowledged capacity constraints (discussed above), New Labour’s tendency to relegate physical to human capital formation as an economic imperative in the name of post-neoclassical endogenous growth theory is therefore both perverse and ironic, leaving the government


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**Table 1**

*The Internal Contradictions of New Labour’s Political Economy*

<table>
<thead>
<tr>
<th>Credibility</th>
<th>Competitiveness</th>
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<tr>
<td>1. Interest rates hikes are a blunt instrument of monetary policy in a regionally and sectorally divided economy.</td>
<td>1. Labour flexibility achieved through the labour market is difficult to reconcile with an overriding commitment to social justice.</td>
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<tr>
<td>2. Inflationary pressures arising from existing capacity constraints are exacerbated by Britain’s new monetary policy regime. Interest rates rises increase the cost of capital, limiting productive investment, thereby compounding existing capacity constraints and stoking inflationary pressures.</td>
<td>2. Labour-market flexibility militates against human capital formation as labour turnover is a disincentive to investment in human capital.</td>
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<tr>
<td>3. Such a monetary policy regime institutionalizes an interest rates premium over Britain’s competitors and an uncompetitive exchange rate, penalizing exporters.</td>
<td>3. Human capital formation without prior physical capital formation is putting the cart before the horse.</td>
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<tr>
<td>4. The promotion of ‘employability’ may serve to drive highly skilled workers into low-skill labour with path-dependent lock-in effects.</td>
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<td>5. Labour’s supply-side ‘welfare-to-work’ programme is not counter-cyclical and is unlikely to prove effective with the economy operating at less than full capacity.</td>
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singularly ill-placed to address the long-term structural weaknesses of the economy, by prioritizing investment in human capital while Britain suffers from a distinct lack of investment in the physical capital which a highly trained workforce might deploy.

But in the end, the issue for us is not whether New Labour’s take on the new growth theory is or is not warranted, but whether new growth theory is up to the job that New Labour has set for it: to restore the competitiveness of UK-based industries in a manner compatible with the extension of social justice. The big question underpinning the unity of New Labour’s internal and external economic policy is whether New Labour has chosen theories that will last, theories which will enable it to square its (often laudable) social ambitions with its economic programmes. We argue that it has not, because of inadequacies in all three theories of growth and economic change which it has deployed. The neo-Weberian imagery of a ‘weightless economy’ just misses entirely the labour processes underpinning it — processes characterized not primarily by high-wage, high-skill technological innovation, but by low-skill, routinized white-collar and service work of a highly exploited kind. Schumpeterian fantasies of cost-free economies of scale emerging from the dynamic research and development initiatives of large corporations similarly miss the speed with which technological diffusion forces those companies back into competition on the basis of wage-cutting and work intensification. And post-neoclassical endogenous growth theory simply fails to appreciate the complexities and contradictions of processes of capital accumulation in a world system now rapidly proletarianizing peasantries across North and East Asia and South America. The cumulative strategy advocated from this mêlée of theories — the strategy of progressive competitiveness set against a backcloth of credibility — is indeed distinctive from the strategy of competitive austerity canvassed by the Thatcherites; but though different, it is just as limited. The cumulative strategy advocated from this mêlée of theories — the strategy of progressive competitiveness set against a backcloth of credibility — is indeed distinctive from the strategy of competitive austerity canvassed by the Thatcherites; but though different, it is just as limited. Indeed, it is as likely, as was Thatcherism before it, to generate a general ratcheting down of wages and conditions for workers in the UK (and Western Europe); and because its fate is similarly constrained, the likelihood of its reinvigorating the UK industrial base and guaranteeing longevity to New Labour in power is low indeed.