



**Magnus Ryner**

## An obituary for the Third Way

*The financial crisis and social democracy in Europe*

The Third Way made a virtue out of the necessity to adapt classical social democracy to global market conditions, conjoining high finance with commodified forms of welfare provision. When the US system on which it was modelled collapsed, "modern" social democracy in Europe was in no state to offer an alternative, argues Magnus Ryner.

The financial crisis presents us with a political paradox. The contagion effect of the US sub-prime mortgage crisis damaged global financial markets so severely that the very institutional foundation of the world monetary system was cast into doubt. This was not only another speculative bubble that burst spectacularly (although it was that too). Given the highly complex packaging of financial products through processes of securitisation, it became impossible for buyers and sellers to sort out good debt from bad. Revelations about the balance sheets of the most iconic of "blue-chip" financial corporations generated an uncertainty in markets whose magnitude caused economic activity to seize up entirely. The destruction of values was such that even the most ardent of neoconservatives, such the former Secretary of the US Treasury Hank Paulson, were advocating massive nationalisations and state bailouts. It is hard to imagine a more damning indictment of the efficient market hypothesis, which had been the nodal point of decades of neoliberal policy prescriptions. Even the sturdiest of hegemonic discourses have difficulties surviving such dissonance.

Not surprisingly, the crisis raised questions about the possibility of a revival of social democracy. The financial crisis would seem to invite more tempered views about the market. The slogan associated with the Bad Godesberg Programme of 1959 captures the spirit of the time: "As much market as possible; as much planning as necessary." But here we encounter the paradox. Accompanying neoliberalism's loss of hegemonic aura is the absence of social democracy as an effective political agent. Social democratic parties were severely battered in the EU parliamentary elections of 2009. Notwithstanding recent success in the local elections, the French PS is a long way from the corridors of power. The Italian left is in a state of shambles. The German SPD, after suffering its worst election result of the post-war era, has been expelled to opposition. In the UK, the Tories — pioneers of financialisation and neoliberalism — look set to form the next government, their main opponents being the Liberal Democratic Party rather than Labour. Particularly telling is the state of affairs in Sweden — supposedly the most sturdy of social democratic citadels. Once again, a "bourgeois" coalition government has experienced an economic crisis during one of its rare tenures. This time around, however, the crisis has correlated with dramatic loss of support for the

SAP, so that the conservative Moderate Party, which leads the coalition, now has a serious chance of becoming the majority party. This is almost without precedence in Swedish electoral history.

Social democracy's perhaps counter-intuitive failure as a political contender in the current conjuncture is no coincidence. Ephemeral factors such as uninspiring leadership or the cumulative effect of incumbency are not primarily to blame (although these factors are real enough and hardly helpful). The causes for the travails of European social democracy are longstanding and organically ideological. Insofar as the social democratic Third Way sought to conjoin high finance with increasingly commodified forms of welfare provision through retail finance, the economic crisis is also a crisis of social democracy. Modern European social democracy is so closely imbricated with the system in crisis that it is in no position to offer an alternative.

This should not be seen as expressing the constructivist assumption that academic ideas such as the Third Way determine political projects. Clearly, European social democratic movements are too practical-pragmatic for that. As competing mass-parties, their practical pragmatism is driven by two imperatives. The Bad Godesberg Programme is paradigmatic for the first of these. It was at Bad Godesberg, in the face of successive electoral defeats at the hands of Adenauer's CDU, that the German SPD faced up to the fact that they never would become a governing party by representing the industrial working class alone. Rather, the party would have to appeal to a broad, composite and contradictory range of political subjectivities in German society. In the 1950s, this meant being able to mediate class and confessional cleavages via an appealing national-popular project. The need to appeal to a heterogeneous range of subjectivities is hardly less of an imperative in societies that have become more multicultural and more radically plural as a result of immigration and postmodern identity politics.

The second pragmatic imperative is to make this broad appeal compatible with coherent policy. Here, overtly intellectual and ideological treatises can, under certain circumstances, provide direction and clarity of vision. Giddens served this function for European social democratic leaderships in the mid-1990s. His Third Way engendered a euphoria in which imperatives to adapt were no longer experienced as the necessary response to constraints posed by globalisation, but as an opportunity to return with hegemonic vision after a decade-and-a-half in the political wilderness. As such, Giddens' treatise reveals with more clarity than any other source the ideological rationale of social democratic politics since the 1990s.

### **The Third Way of Anthony Giddens**

The key argument advanced by Giddens in *The Third Way* is summarised by two slogans: "No rights without responsibility" and "No authority without democracy". The first expresses European social democratic governments' conversion to the essentials of neoliberal economics in the 1990s. Indeed, Giddens' argument is a straightforward derivative of neoclassical economic prescriptions for global competitiveness. Giddens derides "classical" social democratic commitments to welfare state provisions that are independent of market performance and hence decommodified, as well as Keynesian aggregate demand management and industrial policy. These are seen as compromising economic efficiency, technological innovation and competitiveness. Above all, social policies characterised by decommodification are seen as a source of moral hazard. This is a term taken

from the economics of insurance to refer to the alleged paradox that insurance against calamity increases the probability of the calamity occurring. If the implications of the calamity are less severe for the individual, the individual engages in riskier behaviour. By extension, decommodifying social insurance affects working morale and the willingness of individuals to adjust their vocational expectations to the market. "Traditional" social democratic policy thus endangers productivity and growth, and employment and price stability. Instead of exploiting the opportunities of global markets, "traditional" social economies will result in diseconomies and generate budget deficits and capital flights.

By guaranteeing *no* rights without responsibilities, Third Way welfare and economic policy exposes individuals to market discipline. Third Way social democracy nevertheless differs from purer variants of neoliberalism in that it offers supply-side policies such as labour-market training and tax breaks for pensions savings as a *quid pro quo* for individuals' assumption of responsibility. These policies are seen as investments in the public good, generating positive externalities that improve economic performance.

More original and interesting, but at the same time deeply problematic and flawed, is the connection made by Giddens between this fairly conventional economic argument and the developmental-democratic tradition of political liberalism, which resonates with the thinking of the New Left. Deploying the key concept *Vergesellschaftung* ("societalisation") that can be found in the thought of Karl Marx as well as Max Weber, Giddens suggests that "no authority without democracy" is a principle that arises out of necessity of social developments. Central in this regard is his reading of Ulrich Beck's *The Risk Society*.<sup>1</sup> Beck, in Giddens's reading, saw the high modernisation that results from the development of global capitalism as being characterised by a social transformation of the ecological environment, so that that it no longer makes sense to conceive of the environment as an extra-social "original nature". "External" nature is transformed and manipulated by the contingencies of human socio-economic practices to such an extent that the effects, costs and benefits are highly complex and ambiguous. Hence, environmental impacts cannot be unambiguously and objectively established by scientists and technocrats. Rather, the merits of policies and practices with environmental impacts become subject to subjective judgement calls. If policies are to sustain legitimacy, citizens need to be involved in these judgements through an active and deliberative process.

Not only has high modernisation transformed external nature, it has also transformed the nature that is internal to the human subject. Since the nineteenth century, self-evident norms of traditional society have been progressively undermined and increasingly subjected to discursive thematisation and choice. In the current period, this extends to the very identities of subjects, resulting in the proliferation and diversification of lifestyles. In terms of political legitimisation, these developments point to "no authority without democracy" and to the redundancy of the bureaucratic preference for the male (heterosexist, white) breadwinner model characteristic of traditional social democracy. Giddens sees the increase in NGOs and the proliferation of single-issue movements at the expense of traditional political parties as symptomatic of this.

The problem is not the attractiveness of Giddens' argument concerning "no authority without democracy". It is rather that "no rights without responsibilities" undermines the conditions necessary to democracy, producing

what might be called an "architectonic fault". In order to deliberate and act for the general good, individual citizens have to be certain that the satisfaction of basic material needs is guaranteed. Furthermore, requisite amounts of leisure are required in order to nurture cognitive capabilities and the capacity to affiliate with fellow citizens. Note that the last point is relational, requiring that *all* citizens enjoy enough leisure for a deliberative–democratic to work. As Martha Nussbaum has suggested, the social democratic norms of decommodification and welfare universalism provide the modern form for providing this leisure that potentially could be provided with deliberative–democratic content.<sup>2</sup> But it is precisely this public sphere that Giddens would undermine with commodification, privatisation and means–testing.

Giddens can only sustain his contradictory ideological construction through elisions and conflation of radically different types of "risk management", where dealing with ecological risk, expressing one's own identity, being mobile on the labour market and managing one's pension fund portfolio become one and the same.

Providing citizens with security has long been a concern of social democrats. The welfare state has been seen as the vehicle of social security. One of the main lessons to be drawn from ecological questions is that just as much attention needs to be given to risk. The new prominence of risk connects individual autonomy on the one hand with the sweeping influence over scientific and technological change on the other. Risk draws attention to the dangers we face — the most important of which we have created ourselves — but also to opportunities that go along with them. Risk is not just a negative phenomenon — something to be avoided or minimised. It is at the same time the energising principle of society that has broken away from tradition and nature.<sup>3</sup>

Giddens prescriptions are also counter–productive from an economic point of view, however. They undermine the institutional conditions for a politics of productivity where technological change is generated and channelled so as to generate positive solutions that facilitate both healthy profit and social wage rates. This can be seen clearly in the wake of the financial crisis.

### **The Third Way in practice**

The emergence of the Third Way in the mid–1990s was largely a result of Tony Blair's ascent to the top of the British Labour Party and the party's electoral victory in 1997. It is in many respects surprising that British Labour would become the beacon of social democratic renewal. After all, if one were to look for past social democratic achievements in Europe, one would hardly look to the British Isles. In terms of electoral success, Scandinavian social democrats have been unrivalled. As small export–oriented economies, social policy objectives have always had to be achieved in the face of competitive pressures from the international market. True, Scandinavian social democracy faced strains as severe as anywhere else in Europe during the stagflation decade of the 1970s. But it would be grotesque to suggest that British Labour, with the IMF loans, winters of discontent and so on, was a role model for dealing with the crisis of the 1970s and its aftermath. This was rather the decade of "Modell Deutschland", a term that during the tenure of Helmut Schmidt referred to a country that (along with Austria under Bruno Kreisky

and the SPÖ) continued on the seemingly evolutionary post-war path of social and economic development, whilst keeping inflation low and current account balances in the black.

Despite this, it was with an eye to Britain and America that Ingvar Carlsson, Göran Persson, Paavo Lipponen, Wim Kok, Gerhard Schröder and even Lionel Jospin returned social democratic parties to government in the 1990s. Global financial dynamics, much more than global competition as such, are central to any attempt to understand this turn of gaze to the Labour Party. Europe's export-oriented social market economies were developed under the permissive structures of the Bretton Woods system, which resulted in a segmented set of national financial systems. Banking ensured long term relations between financial and productive capital, which in turn ensured growth via technological change, corporatist bargaining, and high social wage growth, flanked by full employment macroeconomic policies. The collapse of the Bretton Woods system and the growth of the global financial market — which started in the currency markets but increasingly extended into other areas, first via the bond market — increasingly strained the national systems. This became clear in the capital flights from France during the first years of Mitterand's presidency. In other countries, too, the aftermath of the collapse of Bretton Woods had corrosive effects. As the Palme/Carlsson administrations in Sweden experienced in the 1980s, Scandinavia was not exempt. Mitterand's U-turn is only the most famous of the strategic accommodations made by social democratic governments to global finance, in which they sought to subordinate institutions and policies in their jurisdictions to the exigencies of global finance.

The appeal of the Third Way in the 1990s was that it made a virtue out of such accommodations. Perceived necessity was engendered with positive vision through the embrace of the efficient market hypothesis and pragmatic monetarism.<sup>4</sup> This became all the more urgent in the 1990s, when the social democratic parties returning to office did so in a European Union that had just implemented a Single Market based on the negative-integrative principle of mutual recognition, and which was in the midst of completing the European Monetary Union (EMU). Financial markets were by no means exempt from this, but were rather at the centre of it all, a fact confirmed by the pivotal position of the Financial Services Action Plan (FSAP) in the Lisbon Agenda. The FSAP was connected to welfare policy through pension reforms, where pay-as-you-go was increasingly abandoned in favour of actuarial schemes. Outside the UK, Swedish social democracy has gone the furthest in this regard. Rather than merely hollowing out existing pay-as-you-go schemes through parametric fiscal austerity, and encouraging private pension savings as an auxiliary, the core of the Swedish pensions system after the 1999 reform contains decisive actuarial elements. Given the pivotal position of the City of London in global finance, it is no coincidence that the epicentre of ideas connected to the Third Way would reside in Britain, the country that most plausibly could develop an export-oriented niche strategy based on financial services. Yet it is exactly this system that was thrown into crisis as a result of the contagion effects starting in the subprime mortgage market in the United States.

However, the problems and inherent limitations of this strategy for European social democracy precede the financial crisis, which has merely produced the cataclysmic manifestation of a dead end. Whilst European social democrats looked to New Labour, New Labour was in turn taking inspiration from Bill Clinton's New Democrats and their pursuit of welfare objectives through

markets. The financial crisis has demonstrated the fallacy entailed in understanding the success of Clintonomics (high growth rates and low unemployment) as residing in the "supply side" of the economy and in an optimal clearing of markets, including labour, money and financial markets. A more plausible explanation, which also is more consistent with the persistence of the "twin deficits", is to be found on the "demand side" of the economy and in the manner in which the United States successfully managed to maintain its hegemonic position in the transnational monetary and financial system after the collapse of Bretton Woods in 1971.

Contrary to what was predicted at the time, US monetary hegemony survived the end of Bretton Woods. The American Dollar remained pre-eminent as the reserve and vehicle currency of the global financial system, and by abandoning the peg of the dollar to gold, the US actually gained rather than lost policy autonomy in the emergent flexible exchange rate system. Since US banks could accumulate liabilities in the key currency at zero-exchange risk, they augmented their competitive advantage in transnational financial affairs, which resulted in Wall Street becoming, more than ever before, the epicentre of "global" finance. This, in turn, consolidated the capacity of the US to shape the preferences of borrowers and lenders worldwide, imbuing the US with structural power. The US became the only state in an international system characterised by flexible exchange rates that could pursue expansionary macroeconomic policies on a consistent basis without the need of internal adjustment. Viewed from the more analytically precise concept of the "Dollar-Wall Street Regime"<sup>5</sup> rather than the amorphous concept of "globalisation", it becomes evident that, contrary to what Giddens contends, expansionary demand-side economics remains as relevant as ever. The difference is that after the 1980s it became the exclusive privilege of the US to pursue such policies. It is this that explains the higher rates of growth and employment in the US compared to Europe. It should also be pointed out that, in many respects, this system is characterised by lack of globalisation, in the sense that the US can defend a mercantilist "exorbitant privilege" by refusing international debate about an international reserve currency. As Leonard Seabrooke has put it, it is a system based on "national activism and international passivity".

Hence, in the course of the three decades preceding the current financial crisis, the US demonstrated an impressive capacity to convert debt into sustainable capital accumulation and growth. This capacity rested on three factors. The first is the seignorage privilege<sup>6</sup> that made it possible to finance huge current account deficits through the differential return of US investments abroad compared to foreign investments in the US. The second factor was the capacity to convert debt to corporate investments via highly capitalised securities markets, which in turn depended on its institutional complementarity with the market-based US system of corporate governance. The third factor pertains to another institutional complementarity associated with America's residual welfare state, namely the manner in which the US system of retail finance connected production with final consumption through consumer debt. In contrast to the post-war "Fordist" period, when wage increases were tied to growth, deregulated and numerically flexible labour markets meant that consumption could no longer be stimulated directly through the wage relation. Instead, consumer debt, backed by the collateral of pension savings and increased value of mortgaged properties, provided the impetus. This was a cornerstone to Clinton's welfare policy, which sought to extend private loans and home ownership to broader segments of the population through the sub-prime market. The privatisation of the New Deal housing institutions

Freddy Mac and Fanny Mae, making them dominant interlocutors between the mortgage market and securities market, were cornerstones in that policy.

The Third Way of European social democracy was based on the premise that it was possible to copy the American model. However, since the essence of its dynamism was not based, as thought, on the liberal supply-side principle of optimal market clearing, but rather on a mercantilist principle of debt-finance demand expansion, this was not the case. In contrast, European social democracy locked itself into a self-limiting institutional architecture resulting from the EMU and the Lisbon Agenda. Contrary to the stance of the US Treasury and the Federal Reserve, the European Central Bank and EU national governments have pursued highly restrictive macroeconomic policies. This is in part a question of deliberate action. However, another reason for the creation of the EMU was Europe's structurally subordinate position vis-à-vis the US. As Benjamin Cohen has argued, the Euro suffers from an "anti-growth bias".<sup>7</sup> European bond markets are fragmented. There is no European equivalent to the US Treasury Bill. Furthermore fragmentation and lack of depth of these and other capital markets in the Eurozone means that the cost of doing business in euros remains high compared to the US. Further, Cohen points to the "persistent inertia" in monetary behaviour, which in many respects is another way of pointing to the dominance of US denominated actors in financial sectors. This also means that the Euro is unlikely to enjoy the seignorage privileges in world financial markets that the US enjoys. If the Euro were to challenge the dollar, it would seriously undermine one of the central pillars behind its success. In some ways, this is the same as saying that, if Europe is to compete with the US, it needs deeper and more integrated markets. In short, the FSAP has not gone far enough.

The problem with this argument is that it does not appreciate the extent to which financial integration has been corrosive of Europe's national systems of innovation and modes of corporate governance, especially those upon which social democratic politics of productivity has been based. Availability of external sources of finance in highly securitised markets depends on high asset-yield ratios and an inflation of share values. But this in turn requires a hollowing-out of corporate "own resources", such as research and development capacity, upon which high value added competitiveness in the long run is based — the forte of the European Social Model. This is in marked contrast to the transmission mechanism between global finance and corporate governance that characterised the US model. A similar lack of institutional incompleteness characterises the relationship between global finance and consumption. In contrast to the US situation, the retrenchment of European welfare systems has had a dampening tendency on demand growth, which is further exacerbated when market reforms are pursued in a context of macroeconomic austerity.

### **Corrosive effects**

One of the key effects has consequently been economic stagnation in Europe. One indicator of this is GDP-growth in the Eurozone. Contrary to the promises that have been made since the Single Market Programme was launched in 1985, rates of GDP-growth have continuously stagnated over the years. This hardly constitutes a sound material foundation for a political ideology such as the social democratic one, whose acceptance of capitalism is based on it being a system that generates growth, which then can be distributed.

True, growth has been uneven, and at different times small export-oriented economies have done reasonably well and provided the material foundations for social democratic tenures of government in certain conjunctures (e.g. the Netherlands in the early 1990s and Sweden in the early 2000s). But these have been expressions of competitive austerity, where balance of payment surpluses have been based on containing domestic demand, hence cutting market outlets for the surplus production of others. This hardly constitutes the basis of a coherent social democratic vision for Europe, and such a vision has also increasingly given way to national parochialisms. The spat between Peer Steinbrück and Gordon Brown about "crass Keynesianism" at the height of the financial crisis at the end of 2008 was a rather unedifying expression of this, in marked contrast to the joint Blair-Schröder Paper a decade earlier.<sup>8</sup>

If the tendencies towards a social democratic alliance in the late 1990s have eroded at a European level, the same is also the case within countries. Stagnating output and productivity growth does not constitute a propitious terrain for sustaining the composite social alliances that mass parties must sustain, and for which the Third Way sought to provide a formula. All the while the Schröder government in Germany committed itself to the Third Way formula, it struggled to maintain support among its traditional working class voters and employees working in the public sector, and eventually collapsed. Similar problems can be observed elsewhere. The failure to sustain such alliances in the wake of decades of stagnation and austerity has generated a crisis of representation, which has provided fertile ground for other parties, Trotskyites in France, the Left Party in Germany, but more often than not for extreme rightwing parties.

Concomitant with the corrosion of Third Way social alliances has been the exposure of Giddens' equation of "no rights without responsibilities" with "no authority without democracy" as a charade. Ulrich Beck has identified the necessity to counter the condition of high modernity with a more democratic forms of politics. Yet the Third Way, by prioritising "no rights without responsibilities", has an abysmal record on that score. In the run-up to the War in Iraq, through the curtailing of liberties in the wake of the war on terror, and with a tendency to want to meddle in every detail in citizens' lives, at the same time shielding political elites from accountability, "modern" social democracy in Europe has been associated with an increasingly authoritarian form of politics rather than with a democratisation. Rather than building on the potentials of welfare universalism and filling it with democratic and pluralist content, social democracy increasingly turned to the liberal model of welfare residualism and means-testing, which has amplified all the problems of governability and legitimisation that Habermas and Offe warned against in the 1970s and 80s.

Hence, when the American model entered into a deep crisis as a result of its internal contradictions, European social democracy was in no state to offer an alternative. When it proved impossible to bridge the pent-up overproduction of the world economy<sup>9</sup> through the extension of ever more risky forms of debt to the American working poor, the speculative bubble eventually burst. Far from Europe being delinked from the US through macroeconomic prudence and microeconomic efficiency (following years of flexibility-reforms), export orientation and financial subordination ensured that the crisis quickly spread to Europe. Given the extent to which European social democracy had put its money on US-style neoliberalism despite depending on an entirely different social base, it is not surprising that it is one of the primary political casualties of the crisis. The tragedy is that in a situation where the radical right is on the

advance, Europe truly needs an agent capable of pursuing the Bad Godesberg formula in pursuit of a politics of "no authority without democracy".

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- <sup>1</sup> Ulrich Beck, *Risk society: Towards a New Modernity*, London: Sage, 1992.
  - <sup>2</sup> Martha Nussbaum, "Aristotelean Social Democracy", in B. R. Douglas, G. Mara and H. S. Richardson (eds.), *Liberalism and the Good*, London: Routledge 1990, 203–52.
  - <sup>3</sup> Anthony Giddens, *The Third Way. The Renewal of Social Democracy*, Cambridge: Polity Press 1998, 62–63.
  - <sup>4</sup> For an emblematic statement, see Ed Balls, "Open Macroeconomics in an Open Economy", in: *Scottish Journal of Political Economy* 45 (1998), 113–32.
  - <sup>5</sup> The term was coined by Peter Gowan in *The Global Gamble*, London: Verso, 1999.
  - <sup>6</sup> Seignorage privileges refer to the lower interest rates that the issuers of legal tender currency enjoy should they wish to borrow money. The reason why markets lend them at lower rates is that the risk of such loans defaulting is comparatively low, indeed next to nil. In the last instance, such borrowers can simply print more money.
  - <sup>7</sup> Benjamin Cohen, "Can the Euro Ever Challenge the Dollar", in: *Journal of Common Market Studies* 41 (4) (2003), 575–95.
  - <sup>8</sup> The spat was triggered by the nominally social democratic British Prime Minister Brown addressing the economic downturn in the instinctively Anglo–Saxon neoliberal style through tax cuts (requiring cutbacks in future social expenditure). This prompted an instinctively German and monetarist reply by the nominally social democratic German Finance Minister Steinbrück, who even at this stage of economic collapse was offended by the possible implications for fiscal balance and inflation.
  - <sup>9</sup> See Robert Brenner, *The Economics of Global Turbulence*, London: Verso 2005.

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