

Third Way Economics

Also by Philip Whyman

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Third Way Economics

Theory and Evaluation

Philip B. Whyman

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To Barbara

I believe that the only important structural obstacles to world prosperity are the obsolete doctrines that clutter the minds of men.

– Krugman, 1999: r168

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economists. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

– Keynes, 1936: 383

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Preface

The concept of the Third Way has risen to prominence during the past two decades, with a significant number of progressive-social democratic political movements associating themselves with its general philosophy and/or more detailed policy programme. Indeed, a number of leading figures on the democratic Left have participated in international summits to discuss the ramifications of an evolving Third Way. Consequently, the Third Way has become an issue worthy of study in order to understand its motivations, influences and theoretical foundations.

The intent of this book is to seek to outline and evaluate the Third Way. One distinctive feature of this book, however, is that this will be undertaken from an *economic* rather than political science point of view. There have been a large number of books that have sought to debate the Third Way from a political theory or comparative politics perspective. However, there have been only a handful of previous texts which have sought to analyse the economic policy platform promoted by Third Way supporters – the success or weakness of which will partially determine the potential for realisation of social and other political objectives.

The book has been written in a political economy style, so that it should be accessible to non-economics specialists without losing any of the detail. It is intended that the book should be of interest to students following an economics and/or politics course, when understanding of the policies pursued by 'new' social democracy governments is an important issue. However, it is anticipated that the subject matter will be of much wider interest across supporters of trade unions, social democratic political parties, policymakers and their advisors.

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I thank Amanda Hamilton, Katie Button and colleagues at Palgrave for their patience during the almost inevitable over-runs. I hope you are pleased with the final product, and agree that it was worth the wait?

My appreciation goes to my employer, the Lancashire Business School (University of Central Lancashire), for supporting this project through freeing sufficient time for me to be able to complete the manuscript, despite the myriad of competing demands upon research time.

Thanks also go to my colleagues in the Lancashire Business School, together with Mark Baimbridge (University of Bradford), for their guidance and input into this project, particularly in its embryonic state. Furthermore, I offer my thanks for the comments made by two anonymous referees on the initial book proposal – many of which were extremely insightful and have improved the text that you see before you.

Lastly, but certainly not least, I would like to offer my deepest gratitude to Barbara Keward for all her help offered during the lifespan of this project. This ranged from assisting in cataloguing the mountains of material I collected through the duration of this research project, to taking charge of quality controlling the bibliography. Without her willingness to offer assistance above and beyond the call of duty, this book would have been less substantial and undoubtedly further delayed. It is, therefore, on this basis that I would like to dedicate this book to Barbara.

Despite the help and assistance freely given by all those individuals named, as always, all errors that remain within the text are entirely mine.

I hope I have repaid all your kindness with a work that you will enjoy, and which will, in some small way, contribute towards a saner political economy in the future.

Philip B. Whyman
Heaton Norris, Stockport.

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Introduction

The creation of a Third Way between unfettered capitalism, on the one hand, and ‘traditional’ Keynesian-corporatist forms of social democracy, on the other, has proved a potent element of social democratic thought. Indeed, it has become the driving force behind the policy programmes of many left-of-centre political parties in the industrialised nations of the world today.

This Third Way is distinct from previous versions of social democracy in that it rejects the Keynesian consensus that aggregate demand management is an essential feature of a successful macroeconomic strategy. In its stead, Third Way theorists concentrate upon reforming social and economic policy to enhance competitiveness within a world dominated by globalisation and technological change, which they believe renders previous forms of social democratic strategy powerless. Thus, the Third Way represents a form of ‘new’ social democracy, occupying a middle path between neo-liberalism and traditional forms of social democracy itself.

A practical phenomenon, designed to solve perceived problems from a centre-left perspective, the Third Way has suffered from the absence of a unified theoretical base – particularly when adopting an international comparative perspective. Indeed, it is the multi-faceted nature of the Third Way label that represents both its strength and weakness, since its lack of formal definition facilitates a dialogue between conflicting concepts of social reform, yet the approach suffers from a lack of ideological cohesion. Nevertheless, there are sufficient elements that all variants of the Third Way share, and which therefore enable their association within a common definition that embodies elements of a relatively homogenous strategy. Most notably, the Third Way can be defined according to its strategic reaction to the challenges provided by globalisation, through combining neo-liberal economics with a conception of government activism intent upon realising endowments for all citizens, to improve their opportunities *within* global markets and not seek to protect them *from* the consequences of these enhanced market forces.

The Third Way has been particularly evident in the USA during the Clinton Presidency and in the UK throughout the Blair Premiership. However, it has had notable influence in many European economies,

for example Schröder's Germany, the Netherlands and Sweden. It is little exaggeration to suggest that the Third Way approach has had a significant influence upon all of the European social democratic movements, and indeed it has left its mark upon the policies pursued by the European Commission. Furthermore, the phenomenon is not restricted to Europe and North America, since similar strategies were adopted in Australia long before Clinton and Blair came to power.

This book develops a workable Third Way model, derived from a synthesis of the most important elements of the programmes pursued by 'new' social democratic movements. It explores the theoretical foundations to the Third Way approach, before evaluating its economic strategy against conclusions drawn from contemporary economics literature. It further contrasts the Third Way economic programme from a traditional form of social democratic economics, and comments upon the viability of each approach in adapting to the challenges posed by today's economy.

The book begins with an evaluation of the philosophical and practical determinants of the Third Way approach. It outlines essential elements of the generic Third Way model, formed from elements of 'new' social democracy distinct from traditional variants of this type of political economy.

Chapter 2 examines what is presented as one of the key defining features of the Third Way, namely its response to the perceived challenges (or threat) provided by globalisation. Third Way theorists share the perception that globalisation has undermined the attempts made by nation states to regulate and tax financial capital, trans-national corporations (TNCs) and mobile, highly skilled employees. Therefore, the Third Way holds that globalisation has imposed limitations upon fiscal redistribution and undermined policies previously forming a central part of a social democratic-Keynesian strategy. The 'strong state' is replaced by the 'competitive state' as, rather than oppose globalisation, national governments compete for international capital and improve international competitiveness in order to realise and distribute benefits from globalisation to all groups within society. Thus, the Third Way argues that economies should embrace the opportunities provided by greater competition through deregulation, creating a flexible labour market and competing to attract mobile capital through the creation of a superior business environment. At the same time, however, government should empower its citizens through extending human capital investment in education and training, in order to ensure that citizens are better able to compete in the global marketplace. Individuals are equipped to deal with the increase in labour market competition generated by globalisation,

rather than seek to protect them from its worst excesses by shielding people from market forces, through social means.

Chapter 3 focuses upon Third Way macroeconomic strategy. In particular, it highlights its rejection of the former social democratic-Keynesian consensus and its replacement by a synthesis of monetarist and neo-liberal economic precepts. Government no longer uses all tools under its control in order to pursue multiple economic objectives simultaneously, the most important of which being to sustain full employment. Thus, demand management is replaced by supply-side economics, fiscal policy is constrained within orthodox rules, and exchange rate management is rejected as ineffective. The new definition involves the creation of a stable framework for business activity, implying price stability having become the principle goal of economic strategy. Institutional factors are considered of lesser importance to assumptions of economic actors displaying rational expectations which, when combined with the natural rate of unemployment, results in the ineffectiveness of government policy. The Third Way therefore holds that there is no medium- or long-term Phillips-curve trade-off between lower unemployment and higher inflation, and therefore governments should limit their intervention in the economy for fear of worsening the situation. This stance is compatible with the theoretical perspective associated with the New Keynesian and monetarist schools. Fiscal policy becomes a largely passive instrument, concentrating upon reducing public expenditure as a proportion of national GDP, together with reinforcing the budgetary position.

Chapter 4 continues where the previous chapter ended, through its examination of Third Way monetary policy. The replacement of full employment by price stability as the prime target for government policy confirms the supremacy of monetarist over Keynesian schools of economic thought, and consequently monetary policy is considerably tighter. Moreover, its operation is increasingly delegated to 'independent' central banks, whose insulation from political influence is intended to deliver lower inflation rates, but which suffer from problems of lack of accountability and deflationary tendencies. The evidence supporting this strategy is, however, sparse and contradictory.

Chapters 5 and 6 examine Third Way microeconomic policy. Chapter 5 concentrates upon Third Way strategy relating to the labour market. It examines the different approaches to the promotion of labour market flexibility pursued by Anglo-Saxon and 'Polder' economies, before evaluating the efficiency of such measures in reducing unemployment and attracting foreign direct investment (FDI) to the national and/or regional

economy. The chapter additionally examines the potential for differing patterns of wage formation to facilitating micro- and macro-flexibility.

Chapter 6, by contrast, concentrates upon initiatives made to improve the productivity of the public services, together with welfare reforms intended to promote individual incentives for work, savings and investment. In terms of the former, the introduction of New Public Management techniques, the introduction of private sector service provision (through privatisation, the contracting-out of services and/or public-private finance schemes) and introduction of competition within public services are all outlined. Labour market policies and institutional frameworks underpinning industrial relations processes are discussed, before the chapter concludes by evaluating the ability of welfare reforms to promote employability and equip individuals for a more competitive labour market, without having an adverse impact upon social solidarity and income redistribution.

Chapter 7 considers the potential for regional economic integration as an alternative means of pursuing Third Way economics. It begins by noting that regional economic integration is a direct reaction to globalisation, as groups of nations – through the creation of larger single, internal markets – seek to maintain an element of control over the integration process and produce a cost-competitive advantage for their firms. In North America, this has resulted in North American Free Trade Agreement (NAFTA); in Europe, this has led to the European Union (EU). However, these models are quite distinct. Whereas in NAFTA, the emphasis is almost entirely upon free trade, the EU approach embodies more far-reaching reforms, such as a common social policy, Economic and Monetary Union (EMU) and potentially ultimate political union. For some, the European ‘project’ is a means of regaining control over trans-national capital, within a larger European super-state, and thereby the creation of a form of Euro-Keynesianism dedicated to traditional social democratic aims. For others, it is a means to further embrace the *laissez faire* elements of the Third Way and rollback national state regulation. The Stability and Growth Pact (SGP) and European Central Bank (ECB), introduced under EMU, relate to the latter, whilst the demands made for a European Social Model relates to the former. However, the two approaches are fundamentally incompatible and hence one model will ultimately have to prevail, to the detriment of the other.

Chapter 8 provides a (necessarily brief) evaluation of Third Way economics in action. In this regard, it draws upon the experience of ‘Clintonomics’ in the USA, New Labour in Britain, Germany under Schröder, Sweden under Persson, the Olive Tree coalition governments in Italy, the various Dutch governments in which the Labour Party has

participated, together with precursor administrations including the Spanish Socialist governments led by González and the Australian Labor Party governments under Hawke and Keating. Overall, the evaluation contained within this chapter points to the transience of much of the Third Way economic legacy. It emphasises the importance of fiscal policy as one effective policy instrument to help prevent a deflation of the economy. Moreover, it re-emphasises the necessity to avoid restrictive exchange rate and monetary policy. These are fairly traditional lessons. Indeed, it appears that the most successful policy measures, introduced during the Third Way period, owed more to traditional social democratic-Keynesianism than a new style of economic policy. However, the long-term legacy of the Clinton period may be less favourable than the contemporary assessment, due to the unsustainable nature of the ‘engine’ of the economy being private consumption, rather than investment, which itself was largely driven by transient asset bubbles.

In the final chapter, alternatives to Third Way (new) social democracy are evaluated. It questions the extent to which the Third Way can accurately claim to represent a legitimate part of the social democratic tradition, and it rejects the assertion that there is no alternative to a choice between the Third Way and neo-liberalism. It presents a number of alternative policy options available to contemporary progressive-social democratic movements, all of which have the potential to make a greater contribution towards ‘traditional’ social democratic goals of full employment, redistribution and social protection.

Box 1 Third Way administrations used as case study examples in the remainder of this book

- Clinton, Democratic Party, USA: 1994–2000
- Blair, New Labour, UK: 1997+
- Hawke–Keating, Labor Party, Australia: 1983–96
- Persson (Sveriges Socialdemokratiska Arbetarpartiet, SAP), Sweden: 1994+
- K ok, Labour Party [Partij van de Arbeid, PvdA], Netherlands: 1982–85, 1988+
- Schr oder (Sozialdemokratizche Partie Deutschlands, SPD), Germany: 1998+
- Prodi–D’Alema Olive Tree (I’Ulivo) coalition of the Left, Italy: 1996–2001
- Gonz alez, Socialists, Spain: 1982–96