

## I

## Introduction

Since the start of the New Labor government under Tony Blair, the phrase “third way” has come to symbolize the transformation of contemporary social democracy. The Blair revolution played an indispensable role in stimulating today’s third way literature. Chronologically, it ushered in a new era in comparative research: No third way studies predated New Labour. Cross-sectionally, its impact reached many countries. The only two social democratic governments openly self-identifying as the “third way” were the Tony Blair and Gerhard Schröder administrations, but this notion has been utilized to evaluate center-left reforms across the industrialized world. This situation, however, creates some analytic dilemma. If the concept only describes governments that are Blair’s contemporaries, the analysis suffers from post hoc theorization. What caused such a qualitative change in contemporary social democracy since 1997? After all, the timing of New Labour’s rise was arbitrary. If the concept is extended backwards to describe center-left reforms well before New Labour, then does it really imply anything distinctly new? There had long existed a rich literature on social democratic transformation (Stephens 1979; Esping-Andersen 1980; Korpi 1983; Przeworski and Sprague 1986; Kitschelt 1994). Third way theories will become trivial if they are simply a new way of referring to well-known arguments about social democratic reforms.

By examining welfare and labor market reforms in nine countries, this book shows that not only can the third way account for social democratic transformation through a longer historical framework, but it also brings new insights to contemporary social democracy. Beyond the topic of social democracy, this book has a broader theoretical pursuit, to explore the mechanisms of institutional innovation, and it is on this bigger theme that the entire book’s arguments evolve. In the process of making these

arguments, I also propose a theory about the externalities of organizations. Now, I outline each of the major issues at stake in this book.

#### IS THE THIRD WAY A RETREAT FROM SOCIAL DEMOCRACY?

In the comparative literature, there are conflicting opinions about the prospect of social democracy. The more pessimistic perspective is that social democracy is gradually but increasingly becoming indistinguishable from the center Right (Thomson 2000; Moschonas 2002), and the more optimistic account suggests that it continues to make some fundamental difference (Scharpf 1991; Garrett 1998). To the extent that both arguments examine the correlation between social democracy and policy outcomes, it is difficult to draw a firm conclusion because they utilize different data, evidence, and method. In any case, as P. Hedsötrm and R. Swedberg (1998) point out, correlation alone does not establish causality because it does not show the “social mechanism” behind the correlation. The mechanisms identified so far have largely supported the pessimistic view. Electorally, the mechanism is the need to appeal to nonworking-class allies, and economically, it is the current era of budget austerity (Przeworski and Sprague 1986; Kitschelt 1994; P. Pierson 2001b). Both mechanisms increase the pressure for social democracy to make ideological concessions. On this basis, the third way becomes merely “between the Left and Right”: less social democratic, but not yet completely neoliberal. On this basis, the third way will be a truly sterile concept because it adds nothing new to what the existing literature has to offer.

I propose a different argument in this book. Cross-class appeals do not have to involve serious ideological compromises. In fact, one key concession made by social democracy to the allies has been to prioritize “enabling to work” over “passive help.” This tactic enabled two of the most important social democratic principles, solidarity and egalitarianism, to survive. The soaring unemployment since the 1970s further increased the value of this work-oriented strategy. In other words, electoral heterogeneity and increasing unemployment provided the necessary conditions for ideological adaptation: Solidarity became increasingly productivist and egalitarianism increasingly prioritarian, focusing on protecting the worst-off. Meanwhile, neither solidarity nor egalitarianism was abandoned as a fundamental principle. This is why there was no retreat from social democracy in the ideological revision. This substantiates the originality of the third way notion: Rather than just another way of measuring “de-social democratization,” the third way indeed refers to a new type of social democracy.

The third way ideology can be reflected in a policy paradigm that centers on labor market activation. This paradigm includes expansion of active social protection (especially enabling to work), restructuring of passive benefits, and retrenchment of early exit pathways, all situated in a macro-economic context of prudence and corporatist wage moderation. In the book, I show that this policy paradigm is distinctively associated with social democratic incumbency, which lends support to the power resources theory of the welfare state, challenging the dominant path-dependency literature.

#### HOW DO INSTITUTIONS INNOVATE?

To the extent that power resources has greater explanatory leverage than path dependency in accounting for third way reforms, it brings new insights to theories of institutional evolution. So far, path dependency has been a fundamental thesis of this literature: Options for changing rules of the game are limited by preexisting rules (Skocpol 1992; P. Pierson 2004). The third way paradigm requires changes to many institutions of many types: social security, employment policy, and industrial relations, to name a few. The range of possible changes that can be implemented on each such institution will be narrowed by factors associated with the rule's initial creation. A major contribution in the path-dependency literature is to reveal the social mechanism behind such pattern: Earlier institutions self-reinforce because of positive feedbacks; time accumulation increases the information and sunk cost of devising new rules (Olson 1982; Mahoney 2000). Institutional innovations, in other words, are costly changes.

In the real world there are clearly pathbreaking changes. Sometimes actors do not merely change the rules but also get rid of them totally, installing new rules that contradict all the earlier principles, for example, when passive welfare was turned into active social protection. These changes are often characterized by frequent reversals, as actors replace one another in their contest to control the institutional agenda. The "politics matters" thesis in comparative political economy literature has offered strong evidence for such patterns (Boix 1998; Korpi and Palme 2003). However, the social mechanism behind such changes remains unclearly specified. What, in particular, is the source of incentives for actors to absorb the cost of institutional innovation? On this issue, Kathleen Thelen (2004) broke new ground, arguing that when existing rules generate negative feedbacks for peripheral actors without the power of rule making, these rules create incentives for capturing the institutional agenda, and in turn, for innovation. In

this book, I explore in detail such mechanism of institutional innovation. Why do institutions generate positive feedbacks in some cases but negative ones in others? Path-dependency theories have made clear the nature of positive returns, but what is the source of negative ones? At what point do institutions' negative externalities overcome their positive ones, so that costly changes are no longer regarded as costly?

To answer these questions, I propose a “logic of public evils,” and argue that ideological beliefs are the fundamental source of negative returns from institutions. The premise for the logic is that both institutions and ideologies are constraints on individual action but that they operate through opposite mechanisms. Institutions constrain all actors and two mutually contradictory institutions cannot coexist stably. By contrast, ideologies mutually conflict, and each only binds some individuals but not others. In other words, people live with one common set of rules on which they agree to disagree. For those who disagree, the rules become “public evils”: The impossibility of exit and the conflict with their own beliefs create incentives for making costly changes to institutions. Are these incentives strong enough to even out the costs? The more intense the ideological preferences, the greater this possibility. To demonstrate this contingent relationship, I compare policy paradigms with policy implementation in various dimensions of third way reforms. To the extent that policy implementation is more ideologically indifferent than fundamental policy paradigms, I show implementation to be heavily path dependent, while different paradigms are strongly associated with different partisan ideologies.

#### IS IT STILL IMPORTANT TO GET ORGANIZED?

The emphasis on work over passive welfare has been an effective social democratic strategy in preserving solidarity across classes, but this solidarity is under new threat, as vulnerable groups are continuously created by socioeconomic changes. New social risk groups not only receive less social protection than the core blue-collar constituencies but also have little organizational influence within the labor movement (Taylor-Gooby 2004; Armingeon and Bonoli 2006). To what extent does this reduce the incentives for social democratic parties to extend solidarity to these vulnerable groups? Do the weakly organized have to suffer as a consequence of the strongly organized? If yes, is it still important for the labor movement to get organized?

In the book, I propose a theory about the positive externalities of organization: Those who cannot organize can enjoy the benefits of organization,

to the extent that their preferences overlap with those who can organize. Where women are organizationally integrated in the labor movement, there is greater public provision of welfare services and less rigid labor markets, and these benefits spill over to new risk groups, such as single-parent families and part-time workers (male and female). Similarly, where the unemployed are strongly unionized, labor market activation prioritizes training over cutting benefits, and this indirectly provides help for marginal groups, such as the young or those with low skills. Organization is important for another reason. Institutions affect a large number of actors, and in cases where the cost of institutional change is widely diffused, collective action failure can perpetuate preexisting institutions. Because this institutional constraint operates through cross-sectional cost diffusion rather than time accumulation, I treat it as an important contributing factor to path dependency, rather than equating it with path dependency. Organizational integration and coordination provide the necessary communication and monitoring channels for preventing free riding and collective action failure. In this book, corporatist coordination is often important in making radical policy changes possible, by securing cooperation from both unions and employers.

#### THE ORGANIZATION OF THE BOOK

In Chapter 2, I set out in detail the main theoretical propositions. As said earlier, the primary focus of the book is to compare how ideologies and institutions constrain individual actions differently and explain the circumstances where ideologies lead to pathbreaking institutional innovation. Chapter 3 sets the empirical scene for this comparison, by outlining the nature of third way ideology and traditional institutional settings for each of the nine countries covered. To put the third way reforms in context, Chapter 4 outlines the socioeconomic problems and government responses before the start of third way reforms, focusing especially on the increase in unemployment, which played a crucial role in stimulating labor market activation. Chapters 5 through 7 examine in detail the third way reforms, respectively, for active protection, passive protection, and the macroeconomic and corporatist contexts. Evidence for institutional innovation was especially strong for active protection, where third way ideology most intensely self-differentiates from other partisan philosophies. The ability of ideology to constrain government policy declines as one moves into passive protection and external economic contexts. In concluding, Chapter 8 emphasizes that the book's theories describe contingent possibilities rather

than certainties of outcome. Throughout, I present some conditions under which institutional innovations can happen, social democracy can adapt while remaining genuine, and the insider–outsider divide can be bridged. Clearly, the extent to which these outcomes eventuate depends on the extent to which these conditions are fulfilled.

Throughout the book, I utilize quantitative indicators for policies and socioeconomic outcomes to aid the case narratives. Since left–right policy contrasts are the primary mechanism in my examination of ideological influence on policy changes, in most cases the quantitative indicators capture changes across time, under different partisan governments. For specific countries and policy dimensions, the time frame varies, depending on different data availability and the timing of social democratic incumbency. Expenditure on active labor market measures will likely increase/decrease as an automatic consequence of rising/falling unemployment. In order to isolate partisan effects on these policies, unless otherwise noted I control for unemployment for all labor market expenditure figures, dividing them by the standardized unemployment rate. Expenditure is thus “share of GDP per unemployment percentage.” In addition to comparative historical research, in Chapter 5 I also use pooled time series analysis to highlight the fundamental association between social democracy and activation. This econometric analysis is taken from my collaborative work with Moira Nelson and John D. Stephens of the University of North Carolina at Chapel Hill, published in 2008 in the *Journal of European Social Policy* (vol. 18) as “De-commodification and Activation in Social Democracy: Resolving the Paradox.”

## Theorizing the Third Way

### I. A THEORY OF THIRD WAY IDEOLOGY

#### I.1. The Social Democratic Ideology

In order to properly evaluate the third way, I first examine the ideology of social democracy in general and then explain how its adaptation through time leads to the third way. There are some recurring key themes in social democratic ideology and discourse, such as social justice, fairness, solidarity, and egalitarianism. To serve as defining properties of social democracy, these concepts must have sufficient discriminating power to differentiate between social democracy and alternative values. On its own, neither social justice nor fairness satisfies this requirement. Clearly, no parties or interest groups advocate injustice or unfairness. By comparison, both solidarity and egalitarianism have more limited constituencies, and the varying importance accorded to these values is often crucial in determining what is socially just or fair for one party rather than another. Therefore, I will focus on them as two key philosophical principles that define social democracy and its adaptation through time.

By examining eight countries over a century, Steinar Stjernø (2005) identified solidarity as a principle shared but interpreted differently by social and Christian democracy. He traced the origin of solidarity as a value-laden discourse to French classic social theory, especially Auguste Comte's ([1852] 1973) idea of debt to past generations and Émile Durkheim's ([1893] 1984) mechanical and organic variants of solidarity. While Durkheim's mechanic solidarity is premised on homogeneity and common consciousness in closed primitive societies, the growing division of labor and specialization in modern societies leads to organic solidarity, based on interdependence

between complementary skills. The organic version of Durkheim later went on to become crucial in the social democratic incorporation of solidarity as a fundamental value. However, Durkheimian solidarity itself is pre-political, and it is Karl Marx and his revisionists, such as Karl Kautsky and Eduard Bernstein in Germany and Ernst Wigforss in Sweden, who introduced solidarity as a rallying principle for the labor movement and their political ambitions. Marxist (and its more restricted Leninist) solidarity is internal to the working class and against capitalists, and despite its utopian outlook, it relies on a strong assumption of class-based self-interest. This concept is echoed in Max Weber's ([1922] 1978) theory of solidarity, which, unlike Comte or Durkheim, is based on social relationship and class.

The irreconcilability of different class interests behind Marxist solidarity implies that conflicts, revolutions, and dictatorships are inevitable on the path toward working-class emancipation. Unconvinced by the enormity of these social costs, the social democrats split with Marxism. Despite its less utopian outlook, social democratic solidarity went beyond (but still retained) self-interest and incorporated morality, ethics, and emotions as the basis for solidarity. For this reason, the concept is surprisingly flexible (Stjernø 2005). It, for example, is not necessarily in conflict with either Protestant values (such as in the Norwegian Labour Party) or Catholic teachings (which, for instance, retained significant influence on the Australian labor movement). This concept is the basis for a decades-long process of forging alliances across classes to harmonize common interests. Social democratic solidarity, in other words, is of the wage earners, rather than just the working class.

The immediate question is, then, about the difference between social and Christian democratic solidarity. While both rely on empathy and compassion, in Christian democracy such feelings are taken directly from humans as God's image (and, hence, the dignity and value of each human being before God). To exercise such solidarity, collective mobilization through the state is subsidiary to the role of more natural constituencies of God, such as the family, church, and other similarly organic communities. This principle of subsidiarity was cemented through encyclicals, such as the *Rerum Novarum* of Pope Leo XII in 1891 and *Quadragesimo Anno* of Pope Pius XI in 1931. It is clearly incorrect to infer from this that Christian democracy is against state welfare, given the generous transfer-based Bismarckian welfare states. Instead, the primary difference is the greater willingness by Christian Democrats to balance subsidiarity against the state in welfare provision (van Kersbergen 1995; Stjernø 2005), a principle that went on to have major policy legacies in welfare state services.



A second defining component of social democratic social justice is egalitarianism. Unlike solidarity, egalitarianism's ideological constituency is more confined to the center Left. From the secular Right, libertarians such as Robert Nozick (1974) have trenchant criticisms against egalitarianism, and Christian Democrats are also ready to accept inequality as the natural order of society. These arguments cannot be taken to their extremes, and the "paradox of redistribution" clearly shows that there is also significant redistribution in Christian democratic welfare states (Korpi and Palme 1998). Nevertheless, the force of the paradox thesis is in comparing against policy consequences of market-based welfare, which is only marginal in social democratic welfare states. Therefore, it is still important to highlight the greater importance of egalitarianism in social democratic than Christian democratic ideology.

When it comes to social democratic egalitarianism, typical welfare redistribution and wage compression programs immediately come to mind. However, beyond these policies, it is important to ask how much genuine connection can be established with egalitarianism as a philosophical principle, which is itself exceedingly complex. One key question is whether social democratic egalitarianism is a means or end, because radical egalitarians like Larry S. Temkin (1993) made clear that they should value equality intrinsically rather than instrumentally (Holtug and Lippert-Rasmussen 2007b: 2; Shapiro 2007: 17). For example, Social Democrats who believe in income redistribution *as crucial for improving the welfare of the less fortunate* are not strictly egalitarians, but those who believe in it because it is intrinsically socially just probably are. This question of income redistribution has limited discriminating power because redistribution as a means does not necessarily conflict with redistribution as an end, as far as social democracy is concerned.

To clarify the position of social democracy, I turn to a scenario where means do not serve the ends. A key criticism against egalitarianism has been the "Leveling Down Objection" (Parfit 1991). In other words, to believe in equality as intrinsically good, one *has to* accept that, at least in some aspect, it is good to reduce welfare of the better-off without improving the welfare of anyone. Destruction of equipment, properties, and wealth belonging to capitalists, as an extreme example of Leveling Down, is intrinsically egalitarian. Not infrequently, such practice was seen in the process of communist revolutions, but social democracy has by and large shunned it completely. In other words, it is important to highlight the instrumentalism in social democratic egalitarianism, where the end is often simply to show solidarity toward the worse-off by improving their lot. The pragmatism here opens a bridge with prioritariness such as Derek Parfit

(1984) and John Rawls (1971), and, as will be explained later, this proves to be a crucial component of the social democratic ideological adaptation.

### 1.2. Setting the Stage: Solidarity with the Poor, not Charity

The third way transformation is closely intertwined with the gradual evolution in solidarity and egalitarianism as two key components of social democratic justice. Across countries, much of the third way policy package came into a coherent being after the 1980s, as did many of the contemporary thinkers and discourses associated with the third way, such as Anthony Giddens and Amitai Etzioni. But more of this later. The ideological momentum behind such thinking can be traced back to several decades earlier.

A key part of the split between communism and social democracy was the latter's redefinition of solidarity. Fraternity internal to the working class was extended across the class divide to become one for the wage earners. On a practical level, this became necessary because after the split, social democrats had to rely on the electoral dimension and their simply nonexistent working-class numerical majority (Przeworski and Sprague 1986). On an intellectual dimension, this presented a more complex problem. The rejected Marxist and Leninist solidarity was based on class self-interest, but not so clearly on rational calculation. Mancur Olson (1965), among others, made it clear that one does not have to be self-interested to be rational, or the other way around. The refusal by communist revolutionaries to defect when the alternative is execution cannot easily be explained as being "strategic" or "incentive compatible," especially when some simply died thinking it was the moral thing to do. Unlike norms or conventions, morality is largely reliant on self-censorship, rather than on the potential threat of third-party monitoring or punishment (Mantzavinos 2001). It is not difficult to account for the extraordinary strength of such solidarity because it was genuinely solidarity among the equals, based on a high level of homogeneity in experience and background (of extreme suffering and exploitation). This bears similarity to the mechanical version of Durkheim's concept, based on shared feelings and common consciousness.

When social democrats extended solidarity beyond the working class, it became more heterogeneous. Rather than *within* the working class, now it is *with* the working class (for farmers, and later white-collar workers). Solidarity across conflicting interests and unequal statuses has less "shared feelings or common consciousness" to rely on, and instead must rely on mutual needs. This is reflected in Durkheim's own gradual transformation