Third Way Reforms

Social Democracy after the Golden Age

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Theorizing the Third Way

1. A THEORY OF THIRD WAY IDEOLOGY

1.1. 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 (Stjerne 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; Stjerne 2005), a principle that went on to have major policy legacies in welfare state services.

A Theory of Third Way Ideology

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 (Holtsug 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 prioritarians 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 from mechanical to organic solidarity, the latter based on complementarity between different skills as a result of increasing division of labor. As mentioned earlier, social democracy adopted this organic interpretation for its own solidarity discourse, relying heavily on the urging of ethics and compassion. If anything, such emphasis on the emotional aspects reflected precisely the fear that the inevitably more instrumental nature of heterogeneous and unequal solidarity can undermine its strength. Fundamentally, if solidarity among the poor becomes solidarity between the poor and rich, how is this different from charity? Without some reciprocity from those helped, it is difficult to make the distinction. One sees an early hint of communitarian notions of rights and responsibilities, which later came to constitute an important component of third way discourse in many countries.

Here, it is important to emphasize the contingent nature in the relationship between electoral needs and inclusive solidarity. Heterogeneity in electoral composition necessitates the broadening of solidarity as an ideology, but to what extent and how fast the corresponding ideological adaptation can take place depends on other factors. Very often, the ideological responses lag considerably behind, and when this happens, the heterogeneous social democratic electorate operates more as a trade-off between conflicting constituencies than solidarity across them. This electoral dilemma makes it very difficult for social democratic parties to present a coherent ideology attractive to both workers and their electoral allies. When social democrats make appeals to other constituencies, they inevitably dilute the class consciousness on which their core constituency rests. This problem is especially serious where the labor movement is itself weakly organized, where there is strong communist competition, or where other partisan forces appeal to workers on cross-cutting social cleavages, such as ethnicity, religion, and language. When this happens, a heterogeneous social democratic electorate indicates as much electoral failure as success because it often means that a large number of core working-class voters are lost as a trade-off. For example, the French Socialists historically made major inroads into the farmers' constituency due to the highly differentiated social structure and radially divided politics of rural areas. However, at the same time, the Socialists had a very weak hold on their core constituency due to competition from both communists and the center Right (Bartolini 2000: 484–485; Knutsen 2006: 47–94; Przeworski and Sprague 1986: 147–167).

It is in Scandinavia where such trade-off is least steep. Not only is the labor movement strongly organized and centralized, but these societies are also most homogenous on ethnic, religious, and other cultural grounds. Historically, the social democratic parties in these countries were the first
to establish a coherent ideology of broader solidarity among workers and other constituencies. The ability of such ideology to appeal to different sectors rests on its strongly productivist and developmentalist orientation (Stjernø 2003). Here, the fundamental purpose of solidarity is to help the worse-off so that they can produce more and better. The premise, in other words, is on work, and better work.

The Rehn-Meidner model in Sweden is an explicit representation of this logic. Through its solidaristic wage arrangement, more productive workers show solidarity with less productive ones so that the latter increase their productivity, rather than just getting a wage increase. If the less productive lose their jobs, they are helped with active labor market training so that they can rejoin in more productive employment. The policy effect from such ideological transformation is especially strong in Sweden (and Norway, to a lesser extent), given the social democratic political dominance in these two countries. This discussion provides a philosophical basis for the uniquely pioneering role in emphasizing labor market activation of Swedish and Norwegian social democracy. They are the ideological prototype for today’s third way transformation. Outside Scandinavia, the social democratic electoral dilemma of trade-off was more serious by comparison, due to stronger competition from other cleavages (such as religion in continental Europe and Australia) and the relative political weakness of the Left (such as in Anglo-Saxon countries). As Chapter 3 shows, a fully coherent ideology of productive and inclusive solidarity did not come to fruition until after the early 1980s.

Despite the timing differences across countries, at a fundamental level the adaptation of solidarity followed a similar internal logic: The inclusion of more heterogeneous and unequal interests reduced the importance of shared consciousness and increased the need to differentiate solidarity from charity. This led to greater reliance on reciprocity and a productivist outlook, and this is the key to the third way focus on enabling to work. The heterogeneity of the social democratic electorate is an important factor beyond the broadening and productivist orientation of its ideology. However, clearly there are also more idiosyncratic factors that affect the nature of social democratic ideology in particular countries in distinct ways. In both Australia and the UK, for example, the historical influence of Fabianism led to a pragmatic and reformist orientation in social democratic thinking, with an early focus on production and wages. In France, by contrast, the strong historical legacy of orthodox Marxism has presented additional barriers toward reaching out to other classes on an ideological level.

Besides increasing electoral fragmentation, another systematic and related factor in the creation of work-centered ideology is the presence of unemployment. As unemployment becomes more serious, it is easier for productivism to compete for ideological attention with other noneconomic issues, such as ethnicity and religion. There is greater need for work-oriented beliefs also because the growing size of the nonworking population directly compromises the integrity of solidarity based on reciprocity and mutual contribution. By contrast, where unemployment is virtually negligible, it is difficult for a discourse on labor market activation to resonate with the public. In the Antipodes, for example, the heavily protected manufacturing industries and the scarcity of labor meant that there was little substantive meaning to either productivism or combating unemployment. As detailed in Chapter 3, the primary social democratic focus in Australia and New Zealand had instead been on wage arbitration, and the issue of enabling to work or human capital upgrading did not become important until liberalization forced the protected sectors to compete internationally, in the process unleashing a rapid increase in unemployment.

Another major dimension of social democratic ideology is egalitarianism, which, as said earlier, is instrumental rather than for its own sake. The purpose, in other words, is to show solidarity with the less fortunate, rather than leveling down. This is reflected in the ideological belief in wage compression when there is work and in highly de-commodifying wage replacement when work is lost. A key question here is “equality of what?” Ronald Dworkin (1981a, b) made the hugely influential distinction between misfortune due to “bad brute luck” or “bad option luck,” and he suggested that egalitarianism should not be extended beyond those who fell on hard times due to factors out of their control. The preference for equality of resources over equality of welfare is endorsed by most contemporary egalitarians, such as Richard Arneson (1989), John Roemer (1996), G. A. Cohen (1989), and Peter Vallentyne (2002). However, this debate about the “currency of egalitarian justice” did not fully begin until the end of the capitalist Golden Age, and before then, neither wage compression nor wage replacement was under threat as fundamental principles. When this debate took place in due course, the changing conceptualizations of egalitarianism and solidarity joined hands to influence the third way ideological adaptation.

1.3. Fully Third Way: Prioritizing Egalitarianism and Productivist Solidarity

Compared with the times of Bernstein and Wigforss, after the Golden Age there was even greater ideological pressure to broaden solidarity in response to the growing fragmentation of traditional electorates. Among other things, demographic changes, the transition to a service economy,
expansion of the female labor force, and the rise of individualism, plus a serious slowdown in economic growth, all meant that solidarity with the working class as a social justice principle now has to accommodate even more heterogeneous and fragmented interests. In addition to being productivist and reciprocal through employment, solidarity now also needs to be gender egalitarian and relevant to new types of social risks. These latter requirements, in particular, turned out to be difficult, and they duly presented further electoral and policy dilemmas for some social democratic governments. I will discuss this implication later. For now, I focus on a key development since the 1970s that forced social democracy to further revise both solidarity and egalitarianism: the unemployment problem.

A major consequence from the folding of les trente glorieuses was a rapid increase in unemployment to levels not seen in the postwar period. In addition, the nature of such unemployment (as well as the remaining jobs) also became very different. In Chapter Four, I will provide more empirical details about the rise of unemployment for specific countries. Here, it suffices to highlight the ubiquity of this issue: It deeply affected each country covered in the book. Fundamentally, the source of such an unemployment problem was the secular structural shift in the economy, from manufacturing to service industries, as well as demographic changes leading to increasing labor market exclusion for vulnerable groups, such as single mothers and the young. Strict employment protection and the consequent insider-outsider divide directly contributed to this worsening labor market exclusion problem (Rueda 2005, 2007). During the 1980s, these structural problems were confounded with a series of policy mistakes by governments in their attempt to deal with changes in the international economy, especially the rapid deregulation of credit markets followed by insufficient restraint in aggregate demand. At the same time, for national governments, traditional economic stimulants such as devaluation, interest rate manipulation, or deficit spending became infeasible due to increasing capital mobility. Wage compression and replacement are two key representations of traditional social democratic egalitarianism. Now, this crisis of work threatened the legitimacy of both.

Wage compression, as the Rehn-Meidner model demonstrated, worked very well with a manufacturing-dominated economy, where low productivity sectors, in order to stay competitive with their rising wages, are encouraged to rapidly increase their productivity. As the economy shifts further to services, however, wage compression becomes a problem. By observing the process of performing chamber music, William Baumol (1967) formulated the well-known thesis of the “cost disease of handcraft industries.” Because of the much lower capacity to rapidly increase productivity in service industries, their productivity will become progressively lower relative to the rest of the economy. Their wages, however, are affected by the overall wage rate in the economy, especially when there is significant wage compression. Consequently, over time, the cost of labor in service industries will become progressively higher than the rest of the economy, pricing them out of the market and contributing to job losses. In turn, the consequently rising unemployment and newly emerging social risks significantly increase the pressure on the social security system, stretching its capability to sustain income parity between those in and out of work. In addition to their shrinking revenue base, a further problem for unemployment benefits is the potential work disincentives they create.

These employment problems forced social democrats to reevaluate wage compression and wage replacement on a policy level, but the direction of change also manifested itself on a broader intellectual level, amid the ongoing debates between libertarians and their opponents. The consequentialist libertarians advocate individual liberty for its welfare-maximizing potential, and they are deeply grounded in the economics discipline (for example, Friedrich Hayek, Milton Friedman, and James Buchanan, all Nobel laureates). Their thoughts constituted the fundamental basis for neoliberal doctrines and policies. Friedman, for example, deeply influenced the economic policies of conservative governments in the United States and UK. By contrast, social and political theorists such as Robert Nozick and Isaiah Berlin questioned egalitarianism by directly focusing on the right to liberty as natural rights. Berlin (1969) is well known for making a clear distinction between positive and negative liberty, and emphasizing the asymmetry between them. In other words, negative liberty (freedom from interference on individual actions) has clear priority over positive liberty (the opportunity to fulfill one’s own potential). In this light, there is little justification for collective resource mobilization by the government to safeguard social rights (such as welfare state transfer programs).

Dworkin (1985) criticized this asymmetry proposition, arguing that without some basic level of social resources (and hence the guaranteeing of positive liberty), it is difficult for an individual to exercise negative liberty. For example, without adequate food, clothing, and basic education, there is little substance in the freedom to participate in democratic deliberations. Therefore, positive and negative liberties should be symmetric, and egalitarian distribution of social resources can be justifiable. This relates directly to the “equality of what” question, another key contribution from Dworkin, who argued that individuals should be held fully responsible for their own
choices (option rather than brute bad luck). Therefore, equality of resources is preferable to that of welfare, and along similar lines, Arneson (1989) promoted “equality of opportunity for welfare.” On a policy level, this more stringent definition of equality provides a philosophical basis for shifting attention away from straightforward income/wage parity to the goals of creating more opportunities for the excluded to return to employment.

These “opportunity rather than outcome” theories of egalitarianism, however, treat “desert” as a key criterion for resource redistribution. In other words, there will be those who, all things considered, are responsible for their own misfortune. The implication for welfare state policy is that for some people, benefits should ultimately be reduced or withdrawn, even if they are, in terms of outcomes, the worst-off. Rawls (1971), on the other hand, denies that questions of desert can be used to defend inequality. He argues that those who behaved more responsibly do not necessarily deserve better because they do not deserve the causes leading to their more responsible behavior, such as more disciplined upbringing or frugal parents (Holtug and Lippert-Rasmussen 2007b: 19–20). Instead, inequality should only be justifiable when it improves the welfare of the worst-off, as Rawls argues in his now classic Second Principle of Justice.

Rawls’s theories prevented a possible degeneration of desert-affirming egalitarianism into a theoretical justification for harsh workfare principles premised on cutting benefits “for the scoundrels.” His arguments also provided a prioritarian logic for shifting the attention of social protection from equality per se to protecting the worst-off. As said earlier, social democratic egalitarianism is more pragmatic (as a means) than radical (as an end for itself). It shares key common principles with prioritarianism (Parekh 1984, 1991), as both are opposed to “Leveling Down” and both believe in the social purpose of equality. However, a distinction for prioritarians such as Parekh and Rawls is that they also believe it is socially just to improve the situation for the worst-off, even if this does not affect the gap between the worse- and better-off. On a policy level, the crisis of unemployment demanded the relaxation of traditional egalitarian mechanisms, such as wage compression and replacement. Prioritarianism provided the intellectual justification for the corresponding policy reforms, such as shifting from wage parity to protecting the really worst-off: those who work in poverty or are simply excluded from work.

In short, the crisis of unemployment forced a rethinking over traditional social democratic egalitarianism. The response, by shifting resources away from wage compression and replacement toward employment (making work pay and enabling to work), reflected an increasingly prioritarian orientation in social democratic egalitarianism. For the “equality of what” question, the new emphasis on enabling to work also suggests that it is equality of resources rather than of welfare. The increase in unemployment also affected the nature of solidarity, the other key social democratic ideological principle. As economic and social changes further fragmented traditional social structures, “inclusive solidarity” became even more heterogeneous in its composition and reliant on reciprocity. If more and more people stop working, the sustainability of such solidarity will come under serious threat. Therefore, it became urgent to prioritize and highlight the productivist purpose of solidarity. This direction of change, with its growing emphasis on active participation, found some intellectual support from communitarians.

Communitarians question the emphasis on individuality in liberalism. Michael Sandel (1982, 1996), for example, criticized Rawls’s theory of justice for its thought experiment about the “veil of ignorance” as a mechanism for determining justice. He suggested instead that people are not “unencumbered selves” and that the interconnection between them makes it impossible to hypothesize a veil of ignorance about each other. Some key principles of communitarianism include shared responsibility, reciprocity, and participation (Shapiro 2007: 30–31), all friendly to the concept of productivist solidarity. Some communitarians, such as Sandel, Alasdair MacIntyre (1981), and Michael Walzer (1983), focus on the ontological and epistemological aspects of communities and therefore engage directly with their libertarian counterparts, such as Nozick. Other communitarians, such as Amitai Etzioni (1993) and William Galston (1991), are more consequentialist, focusing on the policy implications of their communitarian principles, and for this reason they had more direct influence on government thinking. Etzioni, for example, was a senior advisor to the White House under the Carter administration and served in an unofficial advisory role on communitarian issues for both Bill Clinton and Tony Blair. In his book, Etzioni (2000) openly praised and identified the policies of the Blair government as a good representation of his communitarian principles and called New Labour the “third way.”

Despite the common emphasis on participation and responsibility, there is one key difference between communitarianism and social democratic solidarity. Communitarians prioritize civil society over the state as the key player in cementing mutual responsibility and providing help, and there is closer affinity with Christian democratic solidarity on this issue of subsidiarity. By contrast, collective resource mobilization through the government remains central to social democratic thinking. From a different
perspective based on themes of postmodernity and deliberation, Anthony Giddens (2000), as another key advisor to Blair on third way policies, also emphasized the importance of reciprocal and inclusive solidarity. However, he was skeptical about the role of traditional social communities in sustaining solidarity.

The preceding discussion has offered a theory about the ideological adaptation of social democracy leading to the third way. The purpose of the ideological changes was pragmatic, a combination of electoral needs and changes in economic circumstances. As solidarity became more inclusive to account for the growing heterogeneity of traditional constituencies, it also became more dependent on reciprocity, work, and productivity. Therefore, when rising unemployment after the Golden Age threatened its foundation, enabling to work became the core of social democratic solidarity. The unemployment crisis also transformed the concept of egalitarianism, which became more prioritarian, focusing increasingly on protecting the worst-off. The policy impacts from changing egalitarianism and changing solidarity converge: Enabling to work and eliminating poverty in work are increasingly prioritized over wage compression and replacement.

Diverse country and historical contexts have left their own imprint on social democracy, leading to varying policy traditions and strategies. French social democracy, for example, has a particularly strong self-image of socialism through state ownership. Australian and New Zealand social democrats have relied particularly heavily on wage arbitration to deliver social justice. More broadly, labor market activation and female employment is more strongly encouraged in Nordic countries than in continental Europe. By contrast, redistribution through the manipulation of means testing is more frequent in Anglo-Saxon countries than elsewhere (Pontusson 2005). Nevertheless, this book shows that despite all these variations, social justice focused on enabling to work and making work pay occupies a central place in contemporary social democratic ideology and policy. With its philosophical origins explained in some detail, I now discuss why this new way toward social justice can be referred to as the third way.

1.4. More Than Three Ways to Social Justice

Out of its context, the label “third” conveys little information about the substantive content of the ideology, beyond saying that some traditional notions of “left” and “right” are transcended. Instead, it primarily serves as an analytic and rhetorical construct in public discourse. For this reason, over the past century various third ways appeared, which in content had little to do with the social democratic transformation examined in this book. For example, during the interwar period, both fascists and the antifascist Italian social liberals resorted to a “third option” rhetoric, and today the Greens also regard their philosophies as beyond the traditional Left and Right (Bastow and Martin 2003). To appreciate the “thirdness,” it is important to examine the first and second ways, which are themselves specific to historical and political contexts.

Based on the third way discourse from various social democratic parties (outlined in greater detail in Chapter 3), the Right and Left in question are typically neoliberal doctrines and traditional social democracy (for argument’s sake, respectively the second and first way). Earlier, I discussed in detail traditional social democracy and its evolution toward the third way under the pressure of soaring unemployment. Here, as a contrast, I briefly outline the parallel responses from secular Right and Christian democratic parties to these economic problems.

As I showed earlier, neoliberals combine the beliefs from the economics discipline and the natural right to individual liberty. Their key verdict over the collapse of the Golden Age was that the state became too large and interfering. Therefore, the main logic for reform was cost cutting and the retreat of the state. In Anglo-Saxon countries, the neoliberal doctrine led to large scale privatization and the drastic reduction of welfare state benefits. For the Christian Democrats, responding to the crisis was more difficult because their social and religious origin shaped their attitude toward welfare and family relative to work. Historically, in Catholic strongholds, large swaths of concentrated land ownership employing massive cheap farm labor often constituted the de facto continuation of a typical feudalist economy, characterized by noncommodified mutual obligation and patronage between lords and peasants. Politically, this was the fertile ground for upper-class conservatives. They were anticapitalist, against class division, and simultaneously paternalistic with a belief in the idea of noblesse oblige. The Bismarckian welfare states served to re-create the precommodified feudalist arrangement (Esping-Andersen 1990). To preserve hierarchy and prevent social mobility, the rural and Catholic conservatives strongly encouraged loyalty and attachment to the existing social status, through the accumulation of a long and stable employment career. This uninterrupted career history was made possible by very strict employment protection and
was strengthened with generous contribution-linked welfare benefits. In addition, the religious importance of natural organic communities reduced the possibility of mobilizing the substantial untapped female labor force. Faced with economic crisis, the social democrats increased the emphasis on enabling to work, while the secular Right focused on downsizing. By comparison, the Christian Democrats were heavily constrained by their own social and religious legacies from following either option. To counter unemployment, they resorted to encouraging an early exit from the labor market.

Neoliberals directly question the legitimacy of solidarity and egalitarianism, and this is where they differ from the third way. For traditional social democracy, egalitarianism relied on wage compression/replacement, and solidarity had little work emphasis; this is where it differs from the third way. Christian democracy has a more complicated relationship with third way social democracy. Both oppose the individualism advocated by libertarians and accept the communitarians' notion of mutual help. Both, in addition, welcome the infusion of Christian values into morality, compassion, and ethics. However, whereas the state is subsidiary under Christian democracy, collective resources pooling through the state remains fundamental for social democracy. Furthermore, while neither embraces equality for its own sake, social democrats are much less tolerant of inequality than their Christian democratic counterparts and are more ready to redress the situation through redistribution. Finally, on (especially female) employment, Christian democracy is more passive.

It is important to examine more than specific third way labels used in public discourse, which, while often reflecting values and principles, are also affected by other political considerations. In fact, other than New Labour, the label "third" has very limited currency within contemporary social democracy. Even its adaptation to the German Social Democratic Party (SPD) as the Neue Mitte was accepted with little enthusiasm. In France, Lionel Jospin publicly distanced the Socialists from the "third way" characterization. However, empirical analysis in the next few chapters shows that in values and policies, these parties do share many similarities. Therefore, the third way should be defined by productivist solidarity and prioritarian egalitarianism, rather than whether a party made explicit reference to some notion of "thirdness" in public discourse (and in most cases, there was no such reference at all). Table 2.1 outlines key components of the third way ideology and its policy implications, in contrast with Christian democratic, neoliberal, and traditional social democratic approaches to social justice.

### Table 2.1: Three Ways to Social Justice

<table>
<thead>
<tr>
<th>Philosophy of social justice</th>
<th>First Way (Social Democracy)</th>
<th>Second Way (Neoliberal)</th>
<th>Christian Democracy</th>
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</thead>
<tbody>
<tr>
<td>Solidarity</td>
<td>Productivist solidarity</td>
<td>Individual liberty</td>
<td>Solidarity within natural communities</td>
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<tr>
<td>Egalitarianism</td>
<td>Prioritarian egalitarianism</td>
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<td>Hierarchy is natural</td>
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<td>Policy principle</td>
<td>Wage compression</td>
<td>Eliminating poverty in work</td>
<td>Retrenchment and privatization</td>
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<td></td>
<td>Wage replacement</td>
<td>Enabling to work</td>
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2. **A THEORY OF POSITIVE EXTERNALITIES OF ORGANIZATION**

Historically, a key difficulty in broadening social democratic solidarity had been winning over better-off groups as allies, for instance, farmers and the rising middle class. When solidarity was no longer based on shared experiences and common consciousness, the instrumentality of its purpose increased, especially for those who came from a relative position of strength. While it might not be very easy to convince the worse-off about the need for a common bond with the better-off, this convincing is even more difficult for the better-off. It is clear what benefits the worse-off can get from being helped, but what actual benefits the better-off get in return is not immediately clear. For a long time, the core blue-collar workers remained a worst-off segment of this cross-class electoral alliance. However, changes in socioeconomic circumstances over the past three decades have shifted the relative social position of the blue-collar constituency. For the first time, as a major group they are no longer the worst-off. Therefore, there is less ground for supporting a notion of solidarity that continues to prioritize those (others) who are worst-off. Potential resistance from the historical core constituency of social democracy hence poses an increasingly serious problem for inclusive solidarity as a key component of the third way.

The newly emerging worst-off segment of society includes single mothers, youth with inadequate skills or education, and part-time workers,
organization has positive externalities that flow to the politically weak when their preferences overlap. Among the various new social risks, two interrelated primary categories are risks related to the inability to maintain typical work patterns and the lack of sufficient human capital. I will now examine each category in detail. In both cases, it is clear that when the necessary organizational capacity within the labor movement exists, the benefits spill over into even weakly organized groups, and hence reduce the problem of their exclusion as outsiders.

People unable to maintain typical work patterns are diverse in their circumstances, including part-time workers, females balancing family and work, and individuals with frequent disruptions in their careers. Among them, females have the greatest potential for political influence within social democracy, not only due to their large numbers but also to intellectual support from feminist thinkers. In many cases, women have made only limited headway in gaining political influence inside social democracy, but in Nordic countries they are relatively successful. As noted earlier, Scandinavian social democracy benefited from friendly socioeconomic cleavage conditions and quickly extended its support base into constituencies often considered hostile in other countries. In addition, the lack of Catholic doctrine about the traditional role of women in the family also reduced the barrier between females and the working class. As an indication of the significant female integration into the core blue-collar constituency, Nordic women are close to parity to men in union membership and are actually more likely to join the union than men today. Therefore, a distinctive feature of the Scandinavian labor movement is that male and female workers are equally integrated organizationally, whereas in most continental European countries, more men than women are organized (Ebbinghaus 2006: 137–138).

Olson (1965) offered two related arguments about the benefit of being organized. Firstly, the hierarchical nature of organization, and its ability to assert authority, simply force people to put aside some of the differences in their interests and act in concert. In other words, for the same number of individuals with conflicting interests, collective action is more likely when they are constrained by a common organization than if they remain as floating individuals. Secondly, and this is the more widely utilized part of Olson's arguments, organization reduces the cost of information for its members. It provides channels for communication, and mutual monitoring, and it acts as a shortcut for strategic information about how other individuals are likely to act. By reducing uncertainty and strengthening communication, again organization makes collective action more likely.
For these two reasons, core unionized male workers accept gender-egalitarian normative principles and policies more easily when women are organizationally integrated into the labor movement, as in Scandinavia. For example, in Sweden, the Swedish Trade Union Confederation (LO) started to demand the expansion of public child care beginning in the 1960s. With women’s federations supporting day care from within the social democratic party, Olof Palme linked gender egalitarianism to labor market policies as early as the 1972 party congress (Daguerre 2006: 216–217). The goods delivered by such an advocacy coalition (extensive welfare state services, large public sector, relatively flexible labor markets) flow much farther beyond women, reaching other politically more vulnerable groups with overlapping interests. These groups include part-time workers, fixed-contract workers, people with disrupted careers, and in general anyone suffering from the bias of the labor market toward stable careers in core manufacturing industries. The benefits from organization are not only policies but also stronger preferences among core workers for continued expansion of these very policies. This latter type of benefit is also important because it is the conflicting preferences between insiders and outsiders that result in the divide in policy outcomes. Rueda (2007) argues that a key factor that reduces the conflict in preferences is the absence of strict employment protection, and for similar purposes K. Armingeron (2006) highlights the size of public sector employment. These two favorable conditions, of course, are more likely to be present the more fully women are integrated into the labor movement, which in itself speaks of the greater strength of social democracy.

I now illustrate this logic of the positive externalities of organization for the other major type of new social risk, inadequate skills or education. Like part-time workers, the unskilled are weakly organized inside the labor movement across countries, even in Scandinavia. If anything, the unskilled are least underrepresented in unions in the UK and Ireland, given the dominance of general unions in these countries. On this basis alone, social democratic parties have little electoral incentive for taking their interests on board. By contrast, as a group, the unemployed have greater political clout, again especially in Scandinavia, and the Ghent system of worker-managed unemployment benefits (in Denmark and Sweden) provides further incentives for the unemployed to remain organizationally integrated despite losing their jobs. However, in continental Europe, due to weak union representation, the unemployed are sometimes forced to organize their own protests outside the labor movement, such as in France (Ebbinghaus 2006: 135–137). The organizational integration of the working and nonworking within one movement makes collective action easier. Insiders are stronger in their preference for policies that primarily benefit the unemployed, such as active labor market policies premised on training and education, as well as some flexibility in the labor market. Especially significant are the training and education opportunities bundled into active labor market policies. These human capital investment measures serve many purposes, such as maintaining contact with the labor market, smoothing disruptions in career patterns, and up-skilling. All unemployed, rather than just the unskilled or least educated, can benefit from them. This is where the interests overlap, between groups that are politically stronger (unemployed) and weaker (unskilled), and the weaker receives positive externalities from the better organization of the stronger.

Outside Scandinavia, there is mostly weaker organizational capacity for integrating either women or the unemployed (often both), and social democratic governments face a greater electoral dilemma when core constituencies resist third way policies that primarily benefit new social risk groups. This is especially so when the countries in question already have a strict employment protection system. This theoretical perspective provides a helpful interpretation of the difficulties, documented frequently in the empirical chapters, for social democrats in securing union consent for their active labor market measures or labor market flexibility measures.

In this section, I offered a theory of the positive externalities of organization. It modifies the Rueda thesis that social democracy leads to the insider–outsider divide and an electoral dilemma in covering new social risks. It really is the political weakness of social democracy that leads to these problems. When the labor movement is strong enough, at least some outsiders are in, and once they are in, it is much easier to integrate than to exclude their interests; this kick starts the mechanism of positive externalities. Clearly, this theory is contingent rather than deterministic. The positive externalities of organization offer the possibilities for including outsiders, but to what extent this can happen is an empirical question, depending on the actual organizational capacity in the labor movement specific to each country. Table 2.2 is taken from Ebbinghaus (2006: 128), based on calculations from International Social Survey Program data for 1998/2002. While all countries with both strong female and unemployed unionization are in Northern Europe and all with the opposite properties are in continental Europe, there are clearly some intermediate cases. In France, for example, integration is strong for women but weak for the unemployed, and similar is the case for Norway. The impact of these intermediate patterns of organizational integration is reflected in policy outcomes. For example, Norwegian employment measures for social assistance recipients are heavily
TABLE 2.2. Organizational Integration of Women and the Unemployed 1998/2002

<table>
<thead>
<tr>
<th>Country</th>
<th>Employed Density</th>
<th>Unemployed Density</th>
<th>Ratio U/E</th>
<th>Men Density</th>
<th>Women Density</th>
<th>Ratio W/M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>85.7</td>
<td>79.5</td>
<td>0.93</td>
<td>87</td>
<td>89</td>
<td>1.02</td>
</tr>
<tr>
<td>Finland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>75</td>
<td>83</td>
<td>1.11</td>
</tr>
<tr>
<td>Norway</td>
<td>64.9</td>
<td>77.7</td>
<td>0.27</td>
<td>55</td>
<td>60</td>
<td>1.09</td>
</tr>
<tr>
<td>Sweden</td>
<td>84.9</td>
<td>71.7</td>
<td>0.84</td>
<td>79</td>
<td>85</td>
<td>1.08</td>
</tr>
<tr>
<td>UK</td>
<td>34.3</td>
<td>15.8</td>
<td>0.26</td>
<td>30</td>
<td>29</td>
<td>0.97</td>
</tr>
<tr>
<td>Ireland</td>
<td>42.6</td>
<td>15.4</td>
<td>0.36</td>
<td>40</td>
<td>46</td>
<td>1.14</td>
</tr>
<tr>
<td>Austria</td>
<td>41.4</td>
<td>36</td>
<td>0.87</td>
<td>35</td>
<td>35</td>
<td>0.61</td>
</tr>
<tr>
<td>Belgium</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>59</td>
<td>49</td>
<td>0.83</td>
</tr>
<tr>
<td>Germany</td>
<td>35.3</td>
<td>21</td>
<td>0.44</td>
<td>37</td>
<td>21</td>
<td>0.56</td>
</tr>
<tr>
<td>Netherlands</td>
<td>32.4</td>
<td>17.4</td>
<td>0.54</td>
<td>31</td>
<td>20</td>
<td>0.65</td>
</tr>
<tr>
<td>Switzerland</td>
<td>34.1</td>
<td>17.7</td>
<td>0.52</td>
<td>38</td>
<td>29</td>
<td>0.77</td>
</tr>
<tr>
<td>France</td>
<td>18.5</td>
<td>2</td>
<td>0.11</td>
<td>19</td>
<td>18</td>
<td>0.91</td>
</tr>
<tr>
<td>Italy</td>
<td>36.3</td>
<td>5.7</td>
<td>0.64</td>
<td>36</td>
<td>37</td>
<td>1.05</td>
</tr>
<tr>
<td>Portugal</td>
<td>21.3</td>
<td>7.7</td>
<td>0.34</td>
<td>23</td>
<td>19</td>
<td>0.83</td>
</tr>
<tr>
<td>Spain</td>
<td>18.6</td>
<td>7.9</td>
<td>0.42</td>
<td>21</td>
<td>13</td>
<td>0.63</td>
</tr>
</tbody>
</table>


coercive rather than enabling, by Scandinavian standards, and French public child care is more generous than other continental European cases. In addition, while unionization is important, political influence within the parliamentary party is an alternative route serving the same purpose of organizational integration. Where feminists had strong influence within the social democratic cabinet (such as in the Netherlands and the UK), social policies also became more gender friendly. I will discuss these policy details more fully in the empirical chapters.

3. A THEORY OF INSTITUTIONAL INNOVATION

3.1. The Existing Literature: New Politics of the Welfare State

In this book, I not only examine the ideology of the third way but also its projection onto real policy changes in third way reforms. A key question here is whether these changes faithfully reflect the ideological principles or are constrained from doing so by prior institutional legacies. In short, what incentives can ideologies offer for actors to carry out costly institutional innovation? To set the scene for this broader theoretical discussion, I now outline how the contemporary welfare literature has approached the impact of institutional constraints.

In contrast with discussions of welfare state expansion up to the 1970s, the current literature has offered markedly different explanations for welfare retrenchment, aptly characterized as the “new politics of the welfare state” (NPWS) (P. Pierson 2001a; Huber and Stephens 2001; Scharpf and Schmidt 2000; Green-Pedersen 2002). Compared with the old politics of welfare state development, a distinctive feature of the retrenchment literature is that partisan government matters much less for policy changes. In the literature on welfare expansion during les trente glorieuses, the power resources theory was the dominant theory. It argues that welfare state development is a result of political organization by wage earners, through both unions and social democratic parties. Incumbency of left parties is the most important predictor for welfare state expansion (Stephens 1979; Esping-Andersen 1980; Korpi 1983). On this basis, several theoretical extensions have been developed. Incumbency hegemony from the Right, for example, is a major impediment to welfare state development (Castles 1982; Hicks and Swank 1984), and in the absence of strong social democratic parties, electorally dominant centrist parties can take over the role of welfare activism (Hicks 1999). On the whole, the power resources thesis offers a clear argument that ideological differences matter in welfare state development.

However, this line of argument has suffered a clear setback in the NPWS literature. This literature addresses a different macrocontext from the 1950s and 1960s. Today’s welfare states face a set of complex but common challenges. Domestically, these challenges include persistent unemployment, escalating budget deficits, and an increasing burden on social security. Internationally, capital has become increasingly mobile, and the growing possibility for businesses to move abroad threatens traditional economic stimuli, such as lower interest rates, devaluation, or deficit spending. Most European countries are now under the additional constraint of the Stability and Growth Pact and the tight monetary policy of the European Central Bank. Domestic or international, these common changes are not reversible in the immediate future. They have created a macrocontext for today’s welfare state development, which P. Pierson (2001b) aptly characterizes as “permanent austerity.” Faced with this common pressure, different countries have responded in different ways. For each country, its strategies are heavily path dependent on, and constrained by, prior institutional contexts. On a macro level, these institutional settings encompass both welfare state and labor market regimes. On a micro level, they constrain the preference distributions and policy assumptions of government officials,
employers, and employees (Hall and Soskice 2001; Swank 2002). In NPWS, the interaction between path dependency and permanent austerity has led to “diverse responses to common challenges” (Scharpf and Schmidt 2000), and the dominant welfare reform pattern is “refracted divergence” (Myles and Quadagno 2002: 51).

In this theoretical framework, there is no uniform welfare retrenchment across the advanced industrialized countries. According to Pierson (2011b), the retrenchment pattern is a combination of cost control and recommodification in liberal welfare regimes, cost control and rationalization of existing social programs in social democratic welfare regimes, and cost control and updating of existing social programs in continental welfare regimes. Along a similar line, D. Swank (2002) suggests that international capital mobility is either neutral or even positive for welfare state development in countries with a strong institutional basis for social interest representation, such as social corporatism and universally available benefit programs. By contrast, there is much greater pressure for retrenchment where welfare interest representation is fragmented and social programs characterized by narrower constituencies.

The role of partisan government has been clearly overshadowed by this dominant path-dependent thesis of welfare retrenchment. In NPWS, the programmatic objectives of parties are significantly diminished. Social democrats are constrained from delivering comprehensive social protection, while the secular Right is constrained from drastically reducing government involvement in social protection. Welfare retrenchment is limited, regardless of partisan color. Where politics still plays a role in NPWS, it is now largely nonideological, based instead on the balancing between vote or office maximization (Kitschelt 2001; Green-Pedersen 2002). Rather than spurts of new thoughts coming out randomly, ideological adaptations have always occurred as practical responses to changes in realities (Freedman 1996). The need to maintain a broad electoral alliance has always been an important factor in the evolution of a more inclusive concept of solidarity. However, the NPWS literature has expanded this logic significantly further. In policy changes where electoral needs conflict with ideological principles, rather than adjusting the latter to accommodate the former, parties all but abandon the latter, leaving policies to be largely dictated by median voter needs. In other words, left parties are unwilling to expand social security and the secular Right unwilling to cut, but in neither case has the policy decision been accurately reflective of their ideological beliefs. Instead, the motive has been to hold onto votes, which can be lost either due to an economic crisis or unpopular cuts in benefits.

The power resources theory was developed during the Golden Age to refute the Marxist accusation that social democracy has achieved little for the working class. Now, NPWS implies that, short of a past legacy in generous welfare, there is little further potential for social democracy to cater to wage earners. The pragmatic orientation within social democracy has more or less made its programmatic orientation irrelevant, and social democratic parties are no longer seriously constrained by ideologies. This book makes a different argument. In the following sections, I will compare the mechanisms through which institutions and ideologies limit options for individual action, and explain how the intrinsic properties of political ideologies provide the potential for radical policy changes against institutional constraints.

3.2. Defining Institutions

The institutional economics literature has offered rigorous and internally consistent definitions of institutions (North 1990; Aoki 2001; Mantzavinos 2001). These conceptualizations significantly enriched theories not only within economics, such as financing, technological innovation, and the firm, but also within institutional comparative political economy, ranging from comparative welfare states to the varieties of capitalism. In short, institutions are rules of the game. They are humanly devised constraints that limit options for behavior. The ability of institutions to constrain behavior relies on enforcements. Institutions enforced through state and legal sanctions are formal institutions, such as laws (including policies enacted from legislation) and contracts. Informal institutions, including norms and conventions (such as corporatism), rely for enforcement on mutual or third-party (non-state) monitoring and sanctions (North 1990). Through enforcement of various kinds, institutions prevent actors from taking certain actions and reward them for taking others. For example, in contribution-based continental welfare states, income transfer payments are generous (often enough for the whole family), but not available without a stable and uninterrupted working record. Constrained by this formal rule of the game, male workers all but abandon family duties to their wives, and they agree to have a portion of their wages deducted, for future benefits. Meanwhile, the option of sharing family duties between couples and working part time is automatically closed by the rewards and sanctions of continental welfare institutions. This illustrates the power of institutions in limiting options for individual action.

Formal organizations, such as parties, unions, and business chambers, are not institutions in the definition of D. C. North (1990), M. Aoki (2001),
or C. Mantzavinos (2001). Instead, these organizations are makers and players of the institutional rules. Third way reforms are primarily attempts to change formal institutions: welfare state and labor market policies. Compared with informal ones, formal institutions are easier to make and unmake because the power to devise formal rules is more narrowly concentrated in one actor, the government. Such power is enormous, given the small number of rule makers relative to the large number of population to be affected by the rules. Meanwhile, this power for rule making is also highly uncertain, disappearing instantaneously with the change of government. As will be noted later, the contested as well as power-laden nature of formal institutional design is a key reason why political agents are willing to absorb the (sometimes enormous) cost of abandoning old institutions and devising new ones, in this process triggering institutional innovation rather than just reproduction.

In order to discuss how ideologies overcome institutional barriers, it is important to first examine how these barriers function. Two ostensibly obvious properties of institutions are (1) history: they persist (for at least a reasonable period of time), and (2) large numbers: they intend to affect all players of the relevant game. Because of history and large numbers, institutions increase the difficulty of change through both dynamic and cross-sectional mechanisms, that is, path dependency and collective action failure. Clearly, in their role as institutional constraints, these two mechanisms are inseparably intertwined. The path-dependent cost of change accumulated through time is often intensified as a result of the inability among actors to cooperate. However, conceptually, it is probably more accurate to regard collective action failure as one contributing factor to path dependency, rather than simply equating it with path dependency, because on its own the logic of collective action operates not through time but through large numbers (of players). Throughout the book’s analysis of path dependency, where collective action failure is a contributing factor, its role in path dependency will be highlighted. Now, I examine these two mechanisms in some detail.

3.3. The Constraint of Time: Path Dependency

Earlier, through the example of contribution-based benefits in continental welfare states, I illustrated the capacity of institutions to discourage acts that break the existing rules of the game. On its own, this is still different from path dependency because here, the severe costs of choosing closed rather than open options are directly part of the institutional rules. If the rules do not prescribe them, there will be no such costs. However, as institutions persist through time, they lead to additional costs of switching to closed options. These costs are not part of the original institutional rules. Instead, they are simply generated by, and increase with, the accumulation of history (P. Pierson 2004).

These time-related costs are the defining characteristics of path dependency: Given enough history, early rules of the game, even if imposed by random, become increasingly costly to reverse. Time, in other words, provides a major exogenous source of institutional self-reinforcement. As institutions persist, players become better players over time due to iterative learning-by-doing and information accumulation about existing rules of the game. Two highly distinctive characteristics of information are its indivisibility and non-exhaustibility. In other words, information will not diminish either by more people using it or by repeated usage over time. The capacity for the same information to be utilized with more intensity and variety constitutes, respectively, the economy of scale and economy of scope. Such benefits are often conceptualized as the externalities of (information) networks (Chandler 1990; Foray 2004). Actors can therefore avoid having to reinvent the wheel, and they can progressively reduce the costs of obtaining the necessary information to evaluate each next decision to be made.

By comparison, the information cost of designing entirely new institutions is enormous due to the absence of history (hence, no economy of scale or scope) for these new rules. For example, for continental European governments planning to increase in-work incentives, the information cost (such as trial and error, policy debacles, and the inefficiency of policymaking under uncertainty) of devising new negative income taxes will be significantly greater than simply lowering existing social security contributions. The information cost of unmaking old rules is ex post, occurring after the old rules are abandoned. There might also be ex ante cost of innovation, occurring and growing steadily even before new rules are adopted. Actors sometimes make unrecoverable investments in accommodating existing rules of the game, and once the rules are changed, these unrecoverable investments become sunk costs. An important reason behind the difficulty in retrenching continental social security is the fact that workers give up a portion of their wages as deductions into contributions. These unrecoverable investments become the sunk costs of abandoning existing rules, and they steadily accumulate with the passage of time.

Because of information and sunk costs, institutional changes are highly path dependent. For the same reform, different starting points will lead
to increasingly diverse trajectories of change over time. This is the fundamental logic behind the “refracted divergence” observation in the NPWS literature. However, this “divergence in change” argument leads to more fundamental questions: Where did the changes come from in the first place, and how did these changes overcome their own information and sunk costs to get started?

3.4. The Logic of “Public Evils”

Institutions as rules of the game are not the only form of constraint on options for action. Another major constraint on individual action is ideology, a coherent belief set that serves as an information shortcut for evaluating policy issues and making strategic decisions (Downs 1957; Aldrich 1995). Just like institutions, values and ideologies are option-limiting devices, constraining individuals from taking certain actions while encouraging them to take others. With some accumulation of time as a certain ideology is implemented through policy, the consistent selection of some policy options over others leads to an increasingly distinct set of policy patterns. When power reverses to other partisan groups, a different ideological constraint sets in, leading to different policy patterns. This is the fundamental logic behind the power resources thesis that partisan color matters in welfare state changes. Now, both institutions and ideologies are essentially option-limiting devices, but why does one reinforce path dependency while the other triggers institutional breakthrough?

Both institutions and ideologies constrain individual action, but there is some fundamental difference between them. Institutions, as North said, are rules of the game. They intend to affect all agents in the relevant game. It is appropriate to emphasize “intend” here because there is the possibility for shirking and not playing by the rules, such as free riding or even breaking the laws. But at least these rules are meant to bind everyone, and to make these rules meaningful, the number of shirkers has to be trivial relative to nonshirkers. Institutions, in other words, are in effect public goods. Secondly and related to the first point, no mutually conflicting institutions can stably coexist. Ideologies have the opposite set of properties. Each ideology constrains only some people but not others, and for ideologies to be a useful device for differentiation and identification, conflicting ideologies must coexist stably. In other words, people agree to disagree. Therefore, due to differing beliefs, people have conflicting preferences for rules of the game, and meanwhile they have to abide by the same uniform set of rules. The potential for conflicting preferences is especially great when the rules in question are formal institutions, such as government policies. This is because, unlike informal institutions (such as conventions or norms), only some individuals get to make the formal rules, and everyone else has no choice but to play by the rules, despite their different preferences. For those unhappy with the rules, should they absorb the information and sunk costs to change the rules?

Albert Hirschman (1970) observed responses to the decline of product quality in consumer markets and extended the logic to product decline in political markets. Hirschman’s “exit, voice, and loyalty” arguments provide a fundamental logic for the reason people do sometimes choose to make costly changes to existing situations. There are two distinctive characteristics of consumer markets that typically do not exist in political markets. Firstly, when product quality declines, there is unlikely to be more than a trivial difference among individual consumers’ evaluation of the situation. Regardless of the nature of their belief sets, few consumers will interpret malfunctioning batteries or deteriorating tastes of food as improvement in product quality. Fundamentally, ideological beliefs are irrelevant in consumer markets, and people typically do not agree to disagree. Secondly, when a certain product declines, consumers can typically exit and switch easily to comparable substitutes. They can switch to a different brand of battery with negligible personal cost. In this way, they escape the negative consequences of product decline without having to assume the cost of improving the product in question.

On both these dimensions, political markets have the opposite characteristics. Firstly, when the product in question is a government policy, people often do disagree in their opinion on the policy. Because ideologies serve as filters for assessing policy issues, conflicting ideological preferences lead to conflicting assessments of the same political product. When budget austerity leads to drastic increase in unemployment, those from the Left believe this to be utter failure, while neoliberalists regard it as the early sign of success in exercising economic discipline. In political markets, therefore, people agree to disagree, and often many remain unhappy with what is on offer. Secondly, unlike consumer markets, individuals typically cannot exit from the political market, especially if the goods in question are public goods, such as policies. Hirschman made the insightful observation that for the unhappy many, the public goods become “public evils.” The term “public” is important, as it indicates the nonexcludable nature of these goods: Even if the consumers do not make or agree with the rules, they live with their consequences. Even for welfare policies that ostensibly target a minority of the population, such as means-tested benefits, everyone
is affected, either by being excluded from the benefits or paying for them through income taxes.

Hirschman pointed out that if the low-cost option of exit is closed, the only other response to product decline is the more costly strategy of voice. The public evil nature of institutional rules and the political contestability of rule-making power are important incentives that can potentially offset the information or sunk costs of pathbreaking institutional changes. I emphasize the qualifier “potentially” due to the contingent nature of this argument. Public evils provide incentives for assuming the costs of institutional change, but whether the incentives are actually strong enough to overcome the costs depends on the situation. The more intensively people disagree, the more objectionable the policy in question for the unhappy, and the greater the incentive for change relative to its information and sunk costs. This is what Thelen (2004) refers to as the “political contestability” of institutions. Under what circumstances do people have relatively strong conflicting preferences, and when do they remain more indifferent? To answer this question, it is helpful to more closely compare the role of policy paradigms versus policy implementation.

As the key behavioral manifestation of ideological principles, policy paradigms should include some fundamental policy objectives plus a summary representation (Aoki 2001) of the policy tools that can attain these objectives. I use the term “summary representation” to emphasize the highly parsimonious nature of paradigms: They set out a small number of defining attributes of all relevant policy tools that can lead to the same objective. Among the various policy tools that fit the summary representation, which particular tool to pick out is a question of implementation. The fundamental third way policy objective, for example, is enabling to work. A summary representation of policy tools that serve this purpose can include active labor market measures, in-work incentives, labor market flexibility measures, and so on. From the in-work incentive toolkit, whether one chooses negative income taxes, reductions in social security contributions, or expansion of public child care becomes a question of implementation. To the extent that these different policy tools all serve the same policy objective, actors are indifferent about which particular one to choose, and the absence of conflicting preferences lowers the political contestability of policy implementation,

relative to policy paradigms. In the last paragraph, the logic of “public evils” suggested that more (less) politically contested institutions provide greater (smaller) incentives for absorbing the costs of creating new rules that accommodate ideological preferences. Therefore, policy paradigms are more likely to be guided by the partisan color of government, while policy implementation within each paradigm is more likely to be path dependent. In other words, the third way reform policy paradigm of enabling to work should be distinctively associated with social democratic incumbency, and meanwhile, the implementation of activation strategies should still be path dependent, reflecting diverse historical legacies of different welfare and labor market regimes.

3.5. The Constraint of Large Numbers: A Contributing Factor to Path Dependency

Institutions typically affect a very large number of players, and this creates some additional difficulty for change, in terms of how each individual actor evaluates his or her own contribution to changing the rules, relative to the community of actors as a whole. Hirschman’s argument that goods in the political market are often public evils has important implications because it connects us directly to Olson’s (1965) well-known thesis about public goods and the logic of collective action. Good or evil, products that are public share the common characteristic of nonexcludability: No individual can be excluded from their positive (or negative) externalities, regardless of whether he or she has contributed to the products. For public goods of this kind, the possibility for collective action failure increases with the number of beneficiaries. The larger the group, the smaller the weight of each individual’s contribution to the delivery of the goods and the greater the individual incentive to shirk, by avoiding the cost of contribution while still deriving positive utilities from the goods.

From public goods, the logic of collective action can be extended to public evils, which are just the mirror image of public goods: Everyone derives positive utilities from the goods’ absence. For social democratic governments to transform passive welfare states to active ones, it is often necessary to obtain from the labor movement the consent to, for example, reduce existing welfare benefits. To do so, each union has to absorb the enormous communication and other costs in persuading its own members. However, with many unions all having to do this, the contribution to doing so from any single union becomes trivial, and the individual cost of persuading its own members also becomes not worthwhile. As R. Tuck (2008)
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Institutions is often crucial in whether third way reforms are stalled due to resistance from social partners, on issues ranging from reforming passive benefits to relaxing employment protection. When these reforms fail to occur and traditional institutions reinforce themselves, it is undoubtedly correct to identify the process as path dependent. However, it is theoretically important to highlight the non-time-related factor behind such path dependency: collective action failure.

1.6. The Third Way Policy Paradigm

After having discussed in detail the theories of institutions and ideologies in constraining individual action, now I outline the third way paradigm in detail. This paves the way for later empirical comparison of how ideology affects policy paradigms versus policy implementation. The third way ideology focuses on enabling to work and making work pay. On this basis, social democratic solidarity is productivist, and egalitarianism is prioritarian. Strategies of social protection can be active or passive, and the third way ideology leads to distinct strategies for these two types of protection.

1.6.1. Active and Passive Social Protection: Key Third Way Strategies

Active social protection primarily operates by facilitating entry into the labor market, whereas passive protection facilitates exclusion from the labor market. The most important component of active protection belongs to active labor market policies (ALMPs). Diverse in design, different ALMPs share the common characteristic of making an offer to the unemployed, either in the form of job placement or training and education. The act of making an offer is significant because, different from any other social and labor market policy instrument, ALMPs move the labor market to the unemployed. In other words, ALMPs are the primary strategy that brings the labor market to the door of the unemployed by offering direct interaction between the two parties. Compared with other policies, the extent of state intervention and resource commitment involved in the making of an activation offer is innovative. In active social protection, ALMPs can be supplemented by two other types of measures. Unlike ALMPs, they do not offer the unemployed any direct interaction with the labor market. Instead, they indirectly increase the possibility for such interaction, by adjusting the structure of the labor market so that it becomes more accessible to people who cannot work with normal schedules or conditions for family or health reasons. At the same time, job security for atypical workers and
social security for those temporarily excluded from the labor market are also enhanced. Therefore, these strategies are called “flexicurity” measures (Wilttgen 1998), a combination of flexibility and security. In the event that interaction with the labor market does occur, there are further measures that increase the financial return or reduce the family-related cost of working. Such measures are called in-work incentives.

While active protection is in the labor market, passive protection belongs to the formal social security system. Whereas active protection helps individuals regain income, passive protection compensates for income loss by replacing income with welfare benefits. Passive income compensation can be reactionary or anticipatory. Reactionary compensation targets persons already outside the labor market, and anticipatory compensation targets those still inside the labor market. The former is reactionary in the sense that compensation occurs after loss of income, and the most typical example is unemployment benefits. The latter is anticipatory because compensation actually triggers exit from work. Anticipatory compensation includes a wide range of labor market-clearing measures, which serve the purpose of reducing the labor force. Also known as early exit pathways, these measures can be age related, health related, or in the form of leave schemes. In the former two cases, exit from the labor market is permanent, whereas in the third one it is temporary. While reactionary compensation such as unemployment benefits reduces the incentive for returning to work, anticipatory compensation goes one step further, by removing people from work. In other words, the early exit pathways are ALMPs in reverse.

For these reasons, in third wave reforms, active protection would expand significantly, but passive protection will more likely go through either restructuring or retrenchment. For reactionary compensation such as unemployment benefits, there is no clear ideological reason for blanket cuts. These benefits can create disincentives to enter the labor market, but they also provide a vital source of income for those who really can’t work. The prioritarian principle of egalitarianism implies that while there might be selective cuts to remove the welfare trap, at the same time the cuts should be limited. More importantly, these cuts should be balanced by some redistribution toward the most needy, for example, through changes to the taxation system or to welfare financing patterns. While such restructuring strategies are suitable for reactionary compensation, there can be more straightforward cutbacks on anticipatory compensation because of the “activation in reverse” nature of these early exit pathways. By turning people with earning power into those without earning power, these pathways conflict with both the principles of productivist solidarity and prioritarian egalitarianism.

In general, in order to effectively activate the labor market, the primary policy focus would be on expansion in active protection. Adjustment to passive protection is a useful supplement, but this alone will not be sufficient to increase labor market activation. Active protection, especially ALMPs, is the primary medium through which direct interaction between the unemployed and the labor market is established. This is also where significant further growth for the future is possible, as for most countries active protection started from scratch only since the mid-1980s. By comparison, the long-term potential for adjustments in passive protection is more limited. Passive protection, intrinsically, does not directly create any opportunity for interaction between the individual and the labor market. Instead, adjustments to passive protection can only reduce the potential for work disincentives. What is more, reforming social security often involves taking away the existing financial or administrative privileges of social partners, especially unions, who have developed a proprietary interest in the benefits. This problem is especially serious in insurance-based continental welfare regimes, where changes to unemployment insurance benefits, pensions, or existing work regulations are often fiercely opposed by unions and consequently aborted.

Blanket dismantling of social security without corresponding expansion in active measures is not the way to labor market activation. On an ideological level, reactionary compensation serves the social justice purpose of protecting the most vulnerable. On a more concrete policy level, adequate out-of-work benefits, as long as they are combined with appropriate targeting and limited duration, can potentially encourage people to more effectively search for jobs fitting their skills. Combining expansion in active measures with rollback in passive measures is more likely to be effective in employment promotion than relying only on cutting passive measures. In this book I make a clear distinction between expansion of active protection and the restructuring of passive protection, but it is important to keep in mind that in actual third wave reforms, active and passive strategies always occur simultaneously. Expansion of active measures inevitably involves corresponding changes in passive measures, and tightening passive benefits are often part of an ALMP strategy. Changes to unemployment benefits, for example, often imply strengthening the obligation to accept activation offers, and the jobs offered in ALMPs are often paid as benefits in social security. Nevertheless, although changes to active and passive
sides of protection happen simultaneously and interactively, they do follow
distinct logics and strategies.

3.6.2. Macroeconomy and Corporatism: Key Third Way Contexts

Jobs, and well-paid jobs, are the core practical purpose for the third way
ideology of social justice. This ideology addresses the post-oil-shock con-
text where Keynesian demand management is no longer as effective. For
this reason, third way policies, active or passive, focus more on facilitating
labor market entry than on directly expanding the size of the labor market
through economic stimulants. This also brings a potential problem of its
own. When the labor market shrinks, opportunities for labor market entry
also decline. The main third way strategies are largely powerless in reversing
this situation. Besides some direct job creation schemes, most activation
measures aim to bring existing jobs and the unemployed together, and they
cannot significantly affect the actual size of the labor market. Activation in
the context of shrinking labor markets cannot lead to major improvements
in employment opportunities for those excluded.

Job creation, of course, is technically not a labor market or social policy
issue. Instead, the creation of investment, growth, and employment is
more directly influenced by monetary and fiscal policies on a macro level.
Therefore, for the core strategies of third way reform to be effective in
the long run, a larger macroeconomic context of growth and competi-
tiveness is necessary in order to keep the labor market growing. The options
for fueling economic growth, however, have been greatly narrowed in the
last two decades. Internationalization of finance, hard currency, and the
Stability and Growth Pact have all ruled out some traditional economic
stimulants, such as competitive devaluation, public sector borrowing, or
lowering interest rates. The remaining viable option for stimulating growth
is to pursue wage restraint and maintain a cautious anti-inflationary prin-
ciple. In other words, core activation strategies of the third way require
a job-growth economic context characterized by prudence and wage
moderation.

Compared with wage moderation, a prudent approach to the economy
appears to be easier to enforce because the domain of economic policy is
precisely where changes in the external context (the Stability and Growth
Pact and the internationalization of finance, for example), as well as in the
domestic context (secular shift toward the service economy), are occur-
ing. Being directly implicated by these changes, the pressure to adapt is
relatively strong, and the potential for resistance for institutional reasons
relatively weak. On this front, governments are forced to make serious
efforts in enforcing a policy of economic prudence. They prefer supply-
to-demand-side measures and cut social security contributions to reduce labor
costs. Where third way reforms start from a basis of strong regulation or
protection, governments have to follow up with comprehensive deregula-
tion and privatization, including not only the loosening of credit or interest
rate control but also the transfer of industrial assistance from uncompeti-
tive to competitive industries.

Ideologically, economic prudence is probably not an end in itself. It is,
instead, merely a macroeconomic context, creating the necessary condi-
tions for sustained economic and job growth, which helps labor market ac-
tivation policies. This instrumental feature of social democratic economic
prudence is worth highlighting, because where a prolonged period of auster-
ty was already excessive enough to actually hurt employment, such as in
New Zealand, Germany, and France in the late 1990s, the government
responded with some expansionary measures rather than further austerity
(more details in the empirical chapters). In addition, economic prudence
also serves social purposes. Revenues saved as a result of economic effi-
ciency can be channeled into increased public expenditure (such as spend-
ing on combating social exclusion), rather than into blanket tax cuts.

Compared with economic prudence, wage moderation as the other part
of the economic context is more difficult to achieve because incomes policy
is where social partners have historically come into conflict to a great ex-
tent. A voluntary incomes policy in the framework of corporatist concer-
tation is often crucial for wage moderation. For this reason, next to the
macroeconomy, corporatism should also be part of the third way policy
paradigm, serving as another important context for core activation stra-
gies. Essentially, corporatism is important in this book for two reasons:
Theoretically, as discussed in Section 3.5, it is an important mechanism
for ensuring collective action. Empirically, it happens also to be a major
component of the third way policy paradigm, through its connection to
wage moderation and economic prudence as the contexts for core third
way strategies.

4.6.3. The Paradigm and Its Contingent Relationship
to Theories

Overall, on a policy level, the third way ideology manifests itself in adjust-
ments to both active and passive social protection. Adjustment strategies
are diverse, including expansion, restructuring, or retrenchment, and the adoption of specific strategies depends on the actual policy area in question. The third way policy paradigm cuts across the social security system and labor market, and it also involves changes in the macroeconomy and in industrial relations. Figure 2.1 outlines the key components and structure of this third way paradigm.

In Sections 3.3 through 3.5, I provided a set of theories about the institutional barriers to ideologically motivated policy changes, as well as the circumstances under which it is possible for ideologies to overcome these barriers. Path-dependency theorists argue that accumulation of time leads to information and sunk costs in unmaking old institutional rules. In response, the theory of public evils suggests that the impossibility of exit and the conflicting ideological preferences over public policies offer incentives to incur these costs for making institutional changes. It is important to reemphasize the contingent nature of this theory. It merely suggests the possibilities for ideologies to trigger pathbreaking institutional changes. Whether such possibilities are sufficient is a question of a more empirical nature, depending on the circumstances for each specific case. In between policy paradigm, on the one hand, and policy implementation within a given paradigm, on the other, the former is more likely to be determined by partisan ideology. The latter, by contrast, is more likely to display patterns of path dependency. As a further indication of the contingent nature of this theory, path dependency can also be broken simply through mechanisms unrelated to the framework of public evils. For example, the economic situation of permanent austerity led to a radical but bipartisan turn toward monetarism in macroeconomic policy across the advanced industrialized countries.

Reflecting the same logic, while corporatist institutions generally help reduce collective action failure and path dependency, there is nothing deterministic about this process. Institutions affect all actors, but not necessarily all actors pay a cost in changing institutions, especially when cost is understood as some decline of personal utility or welfare. In fact, in some instances of rule changing, such as the introduction of monetary rewards for working, most individuals derive benefits rather than costs. In such cases, strong corporatism is less important to the outcomes of reforms. Similarly, in reforming unemployment benefits, corporatist breakdown is more likely to be a stumbling issue in countries with Ghent and insurance-based systems (such as Sweden) than non-Ghent (such as in Norway) or tax-based (such as in Denmark) systems. In other words, collective action (and by association corporatism) is not a relevant mechanism in all policy changes and all contexts. This is different from the information cost for policymakers, which is more or less ubiquitous with any attempt to replace old rules with new ones. Another reason why the corporatist explanation should be nondeterministic is what J. Mahoney and G. Goertz (2006) call "equalfinality": Many other factors can also prevent (or facilitate) reforms taking place. In New Zealand, for example, the government pushed forward highly radical reforms without corporatist cooperation, and in the Netherlands, some reforms can occur only through the removal of old corporatist institutions.

These instances will be discussed in greater detail in the empirical chapters, but the general argument here is that unlike path dependency, corporatism (as a contributing factor to path dependency) does not affect the institutional constraint on third way reforms in all cases. In addition, there are other exogenous factors that do not even relate to path dependency (for example, permanent austerity in the macroeconomy), which can further affect both the reform process and its outcome. Now, it is possible to connect these theoretical arguments to the one ideologically contested paradigm examined throughout this book: the third way.
3.7. Power Resources in the Third Way Paradigm

In Sections 1.2 through 1.4 of this chapter, I explained in detail the fundamental difference between the third way ideology and its center-right alternatives. A key task for the book’s empirical chapters is to demonstrate, on this basis, that social democratic incumbency indeed uniquely leads to the third way policy paradigm highlighted in Figure 2.1, while governments of other partisan colors offer distinctively different policy packages. The NPWS literature, by contrast, argues that partisan differences have by now diminished significantly. In other words, the conventional retrenchment literature and this book offer rival hypotheses about the extent of partisan differentiation in contemporary policy reform paradigms.

Since the third way ideology is premised on enabling to work, the left-right differentiation in incumbent policies should be greatest in active social protection. The core of active social protection is ALMPs. These measures have significant potential for growth, and they also require substantial state spending. By means of these policies, the state takes a proactive role in social protection by bringing together the labor market and the unemployed. They are the essential means for increasing labor market participation. For these reasons, social democrats would significantly expand active social protection, including not only ALMPs but also in-work incentives and flexicurity measures where necessary. For precisely these characteristics of active protection, both Christian Democrats and the secular Right would be much less enthusiastic about expansion. The former are skeptical about activation per se, while the latter are opposed to increased state involvement. Especially for the secular Right, the concern with cost saving can drive the government to roll back some existing ALMPs. In contrast, the NPWS hypothesis will suggest a different outcome. Active social protection is where the potential for expansion is greatest. However, with the exception of Sweden (and partially Norway), a historical institutional legacy of passive welfare states would create enormous costs in switching to active protection across all these countries. On top of this path-dependency barrier, the external context of permanent austerity in the economy further limits the center-left ability to increase state spending. Therefore, based on NPWS, both social democratic and center-right incumbency should refrain from expansion in active protection.

In comparison with active protection, partisan differentiation should be less notable in passive protection. For reactionary compensation such as unemployment benefits, parties from both the Left and Right want to remove work disincentives. For anticipatory compensation, all governments want to limit these early exit pathways. However, there should still be some reflection of ideological difference between the third way and center-right alternatives. In reforming unemployment benefits, which can potentially sustain the status of loss in earning power through income replacement, social democrats should emphasize restructuring rather than drastic retrenchment. The purpose of restructuring is to reduce work disincentives by putting some limit on benefit eligibility, while intensifying benefits for the worst-off. In contrast to such prioritarian egalitarianism, the secular Right would favor significant cuts in benefit levels to save cost, while Christian Democrats would be more hesitant about both drastic cuts and removing work disincentives. In other words, their main reaction would be inaction.

The similar is true for anticipatory compensation. These early exit pathways create the status of loss in earning power through income replacement. While all governments want to restrict such measures, the social democratic focus would be on encouraging labor market retention or reentry, by enabling measures targeted at early leavers. By contrast, the secular Right would emphasize cutting benefits for cost reduction. Christian democracy, again, would be reluctant to remove these labor market-clearing measures. Nevertheless, as NPWS has shown, in reality the center Right is often constrained from drastically retrenching social security due to the unpopularity of cutting benefits. Therefore, on the whole, the rival hypotheses on passive protection offered by this book and the retrenchment literature will be more similar, as both predict limited reform in social security, featuring more restructuring than drastic cuts.

Finally, partisan differentiation would be most limited beyond the key strategies of active and passive protection, especially in the macroeconomic context for the third way. The economic arena is where permanent austerity is most directly reflected. Traditional policy options for stimulating economic and job growth are now limited due to capital mobility. To the extent that economic austerity does not hurt employment growth, social democrats would converge toward the center-right position on the macro-economy, especially in their efforts to control inflation and a budget deficit. This is where the competing hypotheses from the conventional literature and this book are essentially the same, because both arguments acknowledge the need to adjust economic policy to permanent austerity. Nevertheless, here it should still be possible to observe some limited partisan difference between social democracy and the center Right, especially with regard to whether economic prudence should be continued when it evidently deflates
the economy, and whether revenues from prudence should be reinvested in public spending in the long run.

The core of the third way is active protection, and here there would be significant difference in policy paradigms between social democracy and center-right governments. Across countries, the initiation of social democratic incumbency would involve a shift of policy paradigm toward enabling to work and making work pay. Such significant association between incumbency ideology and policy paradigm strongly suggests a power resource theory of third way reforms: They depend heavily on the Left coming into government. In other words, contrary to the conventional understanding that partisan government matters less in the era of welfare retrenchment, in third way reforms partisan government still determines the fundamental nature of reform paradigms. Table 2.3 outlines the main competing hypotheses between NPSW and this book's power resources thesis. In the table, cells with darker shades indicate more limited partisan differentiation and smaller contrast between rival hypotheses. It is evident that the difference between power resources and NPWS is greatest for the most crucial component of the third way and least so for the external context of the third way.

3.8 Path Dependency in Third Way Implementation

The earlier theoretical discussions made clear that while partisan ideologies tend to dominate in policy paradigms, within a given paradigm its implementation tends to be path dependent. It is abundantly clear that the book's purpose is not to dispute the presence or importance of path dependency in welfare reform patterns, which is the core argument underlying NPWS. In fact, the book's empirical chapters show many examples of how, for the same third way reform, different institutional legacies across countries lead to divergent patterns of implementation over time. Instead, the primary challenge for the book is to highlight what NPWS perhaps overlooked: the coexistence of path dependency and path departure for the same set of reforms, and the relationship between these two patterns of institutional evolution. In other words, while institutional legacy does dominate the practical implementation of a given policy paradigm, it is partisan ideologies that actually differentiate one paradigm from the other. The essential argument for the book is that path-dependent institutionalism in third way reforms can be regarded as a midrange causal variable, nested within political agency and ideologically motivated policy innovations. This is why in Table 2.3, the rival hypotheses focus on the extent of partisan differentiation, rather than whether there is
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Table 2.4: Power Shifts Between Left and Right

<table>
<thead>
<tr>
<th>Country</th>
<th>Social Democrats out of Government</th>
<th>Social Democrats in Government</th>
</tr>
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</table>

The pressure of permanent austerity will lead to convergence toward economic prudence and wage moderation, as long as these two objectives can help employment growth. Compared with the era of Keynesian demand management, this is a pathbreaking and yet largely bipartisan change in economic policy.

4. The Methodology of the Book

The book's macrocausal analysis (Ragin 1987; Przeworski and Tenure 1970) covers three country cases for each of G. Esping-Andersen's (1990) three main types of welfare regimes: social democratic (Sweden, Denmark, and Norway), continental (the Netherlands, France, and Germany), and liberal (United Kingdom, Australia, and New Zealand). These three institutional traditions are the primary basis for the path-dependency thesis in NPWS, and furthermore, there are also country-specific institutional legacies (such as statism in France and arbitration in Australia) that can further constrain institutional changes. As Table 2.4 shows, all these nine countries also have relatively clear alternations between periods when social democracy was in and out of government, making it possible to track changes in welfare reform patterns in association with changes in the partisan color of government.

The primary empirical focus of this book is third way policies. As third way reforms took place against the background of the Golden Age that has ended, the overall time frame for the empirical analysis is the period since the early 1980s. Within this general time frame, periods of analytical emphasis vary among the nine country cases, focusing on periods of significant third way reforms to flesh out sufficient details and complexities.
in core third way strategies. To avoid choosing on the dependent variable, while the analytical focus is on periods of third way reforms during social democratic incumbency, contrasting policy paradigms under center-right incumbency are also briefly discussed, which helps highlight the association between social democracy and the third way paradigm. Based on process tracing, this comparison utilizes the method of agreement: Across nine different cases, the similarity in the third way policy paradigm is traced back to the similarity in the partisan color of incumbency (social democratic). Meanwhile, I also use the method of difference: Differences in third way implementation among nine cases of social democratic reforms are traced back to different institutional legacies in each welfare state regime.

Besides narratives, the two key approaches in macrocausal analysis are nominal and ordinal strategies (Mahoney 1999). Nominal comparison directly implements the method of agreement, the method of difference, or Boolean algebra. Here, variables have mutually exclusive categories, and causality is established by eliminating alternative variables. Key works of this methodological tradition include J. Goldstone (1991) and T. Wickham-Crowley (1992). In my book, process tracing from third way paradigm (present or absent) to social democratic incumbency (in or out of power) is an example of nominal comparison; so is process tracing from policy implementation patterns to institutional legacies (differences in kind rather than in degree).

J. Mahoney (1999) argues that while this approach has the advantage of significant parsimony, it suffers from excessive determinism. In other words, one negative case out of nine invalidates the entire causal relationship. For this reason, I supplement the nominal strategies with ordinal analysis. Ordinal comparison can still utilize the logic from the method of difference or agreement, but variables have ordinal rather than exclusive categories. Rueschemeyer, Stephens, and Stephens (1992) is a good representation of this approach. In my book, for example, I use the more ideologically contested nature of policy paradigms to explain why they are more influenced by the partisan color of government than policy implementation. Similarly, I use the weaker coordination capacity of social partners in some countries (such as Germany) than others (such as the Dutch Wassenaar) as one factor to explain less successful flexicurity reforms in the former. While the ordinal strategy is less deterministic in its causal relationship, it is also less parsimonious because it cannot eliminate alternative causes. Not unexpectedly, the best approach for balancing the strengths and weaknesses of nominal and ordinal strategies is to combine them, and this book adopts what Mahoney (1999) calls the “triple combination”: narratives, nominal comparisons, and ordinal comparisons. Well-known examples of this approach include T. Skocpol (1979), B. M. Downing (1992), and A. S. Orloff (1993).