

Three Approaches to Analyzing Third Way Economics in the Global Political Economy

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A Thesis submitted to the Faculty of Graduate Studies of
The University of Manitoba
in partial fulfilment of the requirements of the degree of

MASTER OF ARTS

Individual Interdisciplinary Program
Department of Economics

University of Manitoba
Winnipeg

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FACULTY OF GRADUATE STUDIES

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BY

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OF

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Abstract

Tony Blair's New Labour governments typically have rationalized their often-dramatic shifts to the right on economic policy with reference to globalization. This interdisciplinary thesis examines Third Way economics' place in the Global Political Economy, with an emphasis on the intersection between global economic forces and domestic economic policies in the UK. To do so it employs three different theoretical perspectives: one attempting to locate Third Way economics within contemporary orthodox economic theories; one evaluating the extent to which the state's policy-making options in the context of globalization are limited by its structural dependency on capital; and the third employing the neo-Gramscian Global Political Economy approach of Robert Cox.

Acknowledgements

Thanks to my Advisor, John Loxley, who provided exemplary support, encouragement, friendship and inspiration before I started graduate studies, and throughout the preparation of this thesis. He has a judicious way of pointing out even the most egregious mistakes – a quality that no doubt comes in handy for anyone supervising my work. Thanks also to the other members of my committee: Fletcher Baragar, whose office doubles as the University of Manitoba's best library of progressive political economy literature; and George MacLean, in whose International Relations theory seminar I first encountered the work of Robert Cox. The lively and heterodox Economics department at the U of M is an oasis, intellectually challenging and personally welcoming. I wish to acknowledge the department's staff, in particular Betty McGregor, for supporting me and so many other students.

Generous financial support was provided by the Social Sciences and Humanities Research Council of Canada, the University of Manitoba, the U of M Students' Union, and the U of M Global Political Economy Research Fund.

My family is a lively and heterodox oasis in its own ways. So this little thesis is dedicated to Esyllt, Dylan, and Owen, with love and thanks.

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Introduction

In the 1970s in the West, the postwar Golden Age of stable growth and Keynesian economics began to unravel. At the global level, new political-economic forces came to the fore and started reshaping the global economy. At the national level in Britain, a similarly major political transformation was also being born. The Labour and Conservative parties both underwent major changes — in the case of Labour, the changes were slower to emerge and, when they did come, more extreme. This period of change culminated in 1997 when Tony Blair's so-called New Labour took office, ending 18 years of Tory rule. The parallel-track development of globalization and New Labour was no mere coincidence; the two phenomena were linked in complex ways, at the levels of policy, politics, and rhetoric. As Hay (1999) argues, New Labour's view of its own evolution into power "has been couched in terms of two principal narratives: the first a story of the conversion and wholesale transformation of a political party whose structure, fraternal allegiances, and ideology had become anachronistic; the second a story of the globalization and resulting transformation of the external social and economic environment in which that party was forced to compete for power" (12). New Labour is seen as a leading example of the Third Way political philosophy. This interdisciplinary thesis examines Third Way economics' place in the Global Political Economy, with an emphasis on the intersection between global economic forces and domestic economic policies. To do so it employs three different theoretical perspectives, the first grounded in Economics, the second in International Relations, and the third in International Political Economy.

Chapter 1 provides an intellectual history of the Third Way in the UK. It charts the development of Third Way ideas, focusing on work by the Third Way's leading proponent (and the architect of New Labour), Tony Blair, as well as three key academics, Anthony Giddens, Julian LeGrand, and Amitai Etzioni.

Chapter 2 is a review of the literature on the Third Way. It describes a shift in the critical literature that occurred around the time of the New Labour's first re-election, and highlights four key debates in the literature: whether the Third Way is a genuinely new and coherent ideology; whether and to what extent New Labour's economics represented a continuation of Thatcherism; how much the global economy restricts the domestic British economy; and does the Third Way have a distinctive economic plan?

Chapter 3 is a review of the literature on globalization debates. It highlights the standard categories into which the literature can be organized, which for the most part hinge on disagreement over the relative decline (or not) of the state in the context of a global economy.

Chapter 4, which is largely descriptive, uses Third Way economics in the UK as a case study. It first reports on New Labour's economic policy ideas before taking office, drawn from speeches by Blair and Brown, as well as from party documents such as election manifestoes. It then describes the economic policy measures actually taken by New Labour in government. The goal of this chapter is to establish what Third Way economics look like in practice.

Chapter 5 is the first of three theoretical chapters. It attempts to situate Third Way economics within certain contemporary debates in Economics. Specifically, it considers whether and how New Labour can be considered, as a number of authors propose, to be

new Keynesian. This chapter also compares New Labour's economics to other prominent macroeconomic theories closely related to new Keynesianism, including endogenous growth theory and the new monetary consensus.

Chapter 6 approaches New Labour's economics from a different point of view, by drawing on an important debate in the International Relations literature. This debate, which has been applied specifically to the case of Britain, concerns the extent to which globalization has imposed structural limitations on the economic policy options available to a social democratic government.

While the previous two chapters describe and evaluate theoretical approaches that have already been applied, at least to some extent, to New Labour, Chapter 7 is the most speculative. It describes the neo-Gramscian Global Political Economy model developed primarily by Robert Cox (1981, 1983), and sketches out how it could be used to analyse the emergence of the Third Way, focusing on the interaction of three broad categories of social forces: ideas; material capabilities; and institutions. The argument in this chapter is that a critical GPE model such as this, while not a substitute for the approaches outlined in Chapters 4 and 5, does help overcome some of the theoretical problems raised by those approaches.

In both Chapter 4 and Chapter 5, the analysis of New Labour's economics is divided into two sections. The first considers the subject in what we might call an academic or doctrinal sense – that is, what statements and writing by New Labour's political and intellectual leaders reveal about what they see as the intellectual foundation for their policies. This section is followed by an examination of actual economic policies in Britain since 1997, or what we might call "Third Way economics in practice." This

two-pronged approach is based on the assumption that policy-making is never perfectly consistent with the theory, or even with policy documents. The Conclusion offers some reflections on this point, briefly summarizes the findings in Chapters 5, 6, and 7, and considers the theoretical problems that remain most stubborn.

The Third Way emerged in the wake of the collapse of the Soviet Union, an emergence that coincided with the growth of “globalization” (both the phrase and, much more contentiously, the phenomenon) and “the new economy.” It offers a useful way into an examination of the way western governments responded to globalization. There are at least two main reasons to use the experience of New Labour in the UK in particular as a case study of the Third Way. The first is that New Labour’s intellectual leadership, most prominently Blair and Anthony Giddens, were more determined than Third-Wayers in any other country to extend their model out beyond their national boundaries and make the Third Way a truly international phenomenon. The second, related, reason is that “a British government with the kind of majority in the House of Commons that Blair enjoyed after May 1997 was uniquely well placed in the main liberal democracies to actually implement its policies;” so New Labour offers “an opportunity to analyse this purported renewal of social democracy in a chemically pure form” (Callinicos, 2001, 10).

Chapter 1

What is the Third Way?

In the 1990s, in the wake of the collapse of the Soviet Union, and coinciding with the growth of the “new economy,” a number of Western governments boasted of having developed a new direction in economic policy, one that US President Bill Clinton described as a “Third Way”¹ between “those who said government was the enemy and those who said government was the solution” (qtd. in Pollin, 2000). Both the Third Way’s strongest supporters (see Giddens, 2002) and its harshest critics (see Callinicos, 2001) agree that by the late 1990s the Third Way had set the agenda for centre-Left parties in Europe and North America. As Robert Reich, then-Secretary of Labour in the Clinton administration put it, “We are all third-wayers now” (quoted in Barrientos and Powell, 2004, 9).

In the 1980s and 1990s, the Labour Party lost four consecutive national elections to the Conservatives, and watched from the electoral sidelines as the massive political and economic changes associated with Thatcherism swept the country. During this period Labour itself underwent a series of deep changes at the levels of ideology and policy

¹ The term “Third Way” has been around at least since Pope Pius XII called for a third way between socialism and capitalism at the end of the nineteenth century (Halpern with Mikosz). Since then, it has also appeared in other contexts. For example, it was used to describe the “market socialism” practiced in postwar Yugoslavia (see, among others, Phillips and Ferfila, 1992). In the UK, in 1912 Ramsey MacDonald presented Labourism as “the third way” between state socialism and Syndicalism (Callinicos, 2001, 4). Later, Harold Macmillan proposed a “Middle Way” between capitalism and socialism (Freedon, 1999, 44). Although the modern Third Way has no official date of birth or country of origin, the US was the first country in which the Third Way led to electoral success, when Bill Clinton, leader of the so-called New Democrats, won the presidency in 1992. In this thesis the term Third Way refers to the version that appeared in the 1990s, unless otherwise specified.

—facilitated by equally deep changes to the party’s internal organization — changes that were widely considered to be consistent with the concept of the Third Way. The party that emerged at the end of this renewal process emphasized the magnitude of these changes by christening – or, to use a more 1990s-sounding phrase, re-branding — itself New Labour. By 1997 it had swept back into power with the largest parliamentary mandate Labour had ever enjoyed, and the UK’s largest in the postwar period – “one of the most stunning election victories of the twentieth century” (Ludlam, 2000, 1). In other words, in Britain the Third Way (manifest as New Labour) was at the heart of something significant. Yet there has been remarkably little agreement about what, exactly, the Third Way is. It has been both fiercely contested and “consistently underspecified” (Pierson, 2001, 130).

This chapter considers work by the leaders in the development of the British Third Way. In addition to Tony Blair himself, it looks at three academics whose ideas led to the development of the Third Way, two of whom advised Blair directly: Giddens, Etzioni, and LeGrand.

1.1 Blair

Blair’s (1998) first major written introduction to the Third Way was a pamphlet written for the Fabian Society. It begins, “I have always believed that politics is first and foremost about ideas. Without a powerful commitment to goals and values, governments are rudderless Furthermore, ideas need labels” (28). Unpacking this phrase offers a useful starting place for understanding what Blair meant by the Third Way. First, it is notable that the Third Way was never a political movement, nor even a coherent ideology. Rather, it is an *idea*, the product of an elite-led process, with a small group of

thinkers attempting to fashion a political philosophy that would allow Labour to form government again. Specifically, this group felt that Labour needed a “big idea” that would: set Labour apart from the Conservatives in voters’ minds; inoculate Labour against the political liabilities that had hurt the party in the past; provide a compelling narrative to explain the effects of the changing global economy; offer a plan to regain control over the domestic economy; and synthesize the best elements of a number of different strands of British political thought in a way that also positioned the party in the middle of the political spectrum, where elections were won.

For Blair, the Third Way is a powerful new force capable of sweeping away outdated ideologies:

I reject the rampant laissez-faire of those who believe government has no role in a productive economy; and I reject, too, as out of date and impractical, the recreation or importation of a model of the corporate state popular a generation ago. Today the role of government is not to command but to facilitate, and to do so in partnership with industry in limited but key areas. This is not a matter of ideology but of national interest (1995).

Blair “often placed the Third Way in the context of his own personal, almost religious, values as well as his political views....For Blair, at least, the Third Way was a moral compass as well as a political one” (Holmes, 2005, 205). In 1995 Blair gave a speech to the Confederation of British Industry, in which he explained that his political beliefs were derived from a mixture of “new liberals”: David Lloyd George, L. T. Hobhouse, William Beveridge and J. M. Keynes, as well as revisionist social democrats such as Tony Crosland. He argued that the history of progressive politics was made up of two main strands, the Labour Party and liberalism, which had been artificially separated

in the 1920s, and should be reunited.² Notably absent from this self-definition is socialism.

Other speeches he made shortly after becoming leader show that at that time he was still casting about for a political philosophy; the New Labour project was still in development. Blair had fought and won a bitter internal battle to revise Clause IV in the party's manifesto, which called for "common ownership" of the economy, a phrase that was usually interpreted as calling for widespread nationalization. And he had established himself as Labour's leading "modernizer." Yet he had not yet settled on the concept of the Third Way. In 1994 and 1995 he still drew heavily on the social-gospel component of Labour's past, using religious-tinged, highly emotional language to declare his allegiance to social values. In his speech delivered with "evangelical urgency" to the Labour party conference in October 1995, he described socialism as "how I try to live my life, how you try to live yours" (White, 1995). A lead editorial in *The Guardian* called it "an avowedly socialist speech, albeit in Mr. Blair's own carefully defined, high moral and even biblical version of the term" (*Guardian*, 1995).

Blair listed what he considered to be the Third Way's core values in the 1998 Fabian Society pamphlet, as well as on numerous subsequent occasions, and while they changed slightly over time, the core group are: equal opportunity, responsibility, and community (Blair, 1998). (Originally the list included a fourth value, "equal worth of each individual.") LeGrand (1998) sets out essentially the same three values, which are discussed in turn below.

² Holmes (2005) considers how much New Liberalism is an antecedent of the Third Way, concluding that the two political philosophies are similar in large part because they were both domestic responses to the same type of massive shifts in the international economic and political spheres triggered in large part by technological innovation.

1.1.1 Opportunity

Here Blair drew a sharp line between the Third Way and socialism, by replacing socialism's right to work with the duty to work. The state should help equip individuals acquire the skills needed for them to be employed. The socialist and social liberal concerns with redistribution of wealth in order to produce equality of opportunity are gone.

1.1.2 Community

Blair typically adopts a version of LeGrand's definition of community as a geographical space or locality. Secondly, the term also carries with it the idea of solidarity and co-operation, as well as a contractual relationship between individuals, organizations, and the state. This is consistent with the normative model of communitarianism set out by the American sociologist Amitai Etzioni.

1.1.3 Responsibility

According to Blair, a fundamental tenet of the Third Way is "no rights without responsibilities," a phrase that he would use countless times between 1996 and 1999. He argues the need to reclaim the issue of responsibility and duty from the Right, and to re-link the "demand for rights from the state" and "the duties of citizenship" (1998, 30). This, too, is a value heavily influenced by Etzioni.

As Rawnsley (2001) writes, "in the Blairites' lexicon there was nothing more distained than 'dogma'. Yet they were simultaneously gnawed by a ... hunger to possess an ideology." Therefore, a "quest to explain New Labour was a feature of his premiership as never-ending as the hunt for the snark" (309; 308). As part of this quest, Blair drew on

the ideas of, and established a dialogue with, a number of academics. As *The Economist* points out, however:

His is essentially a pragmatic style of government—“What matters is what works,” he is fond of saying—but he thinks that it needs to be dignified by a philosophy. Mr Blair already has a name for this: the “third way”. In essence, he has appealed to academics to design for New Labour a philosophy to fit the title (1999).

1.2 Giddens

Anthony Giddens was the academic who answered Blair’s call for a philosophy to fit the title. Other than perhaps Blair, Giddens has been the most active public contributor to the development of the Third Way in Britain. His book, *The Third Way: The Renewal of Social Democracy*, was published the year after the general election of 1997, in which New Labour took power. It was intended as “a contribution to the debate now going on in many countries about the future of social democratic politics” (1998, vii). This debate was based upon “the dissolution of the ‘welfare consensus’ that dominated in the industrial countries up to the late 1970s, the final discrediting of Marxism, and the very profound social, economic and technical changes that helped bring these about” (ibid). *The Third Way*, he explains, “refers to a framework of thinking and policy-making that seeks to adapt social democracy to a world which has changed fundamentally over the past two or three decades. It is a third way in the sense that it is an attempt to transcend both old style social democracy and neo-liberalism” (ibid, 26).

Giddens proposes a “third way programme” that would result in greater democracy in state policy decision-making, a more active civil society, the “democratic family,” a new mixed economy, “equality of inclusion, and positive welfare” (1998, 70).

And he outlines what he considers to be the five key dilemmas facing the UK: what does globalization really mean for the UK?; are Western societies becoming more individualistic?; is it true that the political labels of Left and Right are obsolete?; is there a new kind of political agency emerging that leaves behind traditional democratic methods and structures?; how should ecological problems be addressed, in particular by social democracy (1998, 28)? Giddens apparently sees these dilemmas less as problems to be solved than as evidence to support his thesis that a new kind of politics is required. He argues repeatedly that it is not enough to “reform” government; rather we need to “rethink” it (Holmes, 2005, 207).

One obvious question about the Third Way is, what were the first two ways? In general, Giddens is typical of the leadership of the Third Way in the UK when he situates Third Way politics between “classical social democracy,” which “thought of wealth creation as almost incidental to its basic concerns,” and neoliberalism, which “places competitiveness very much to the forefront” (qtd in Arestis and Sawyer 2001). By “classical social democracy” he seems to mean the approach to economic policies and planning pursued by social-democratic Labour governments – a philosophy that reached its peak in 1945-1951, but carried on well into the 1970s. The neoliberalism associated with the Second Way was represented in the UK by Thatcherism. Giddens frequently contrasts the Third Way’s willingness to undertake some limited degree of market regulation, with neoliberalism’s extremes of a “pure marketplace.” He argues that Thatcherism and Reaganism have failed because “you simply can’t run the world as though it were a gigantic marketplace” (cited in Holmes, 2005, 208). This is no less true

in an age of globalization: “the emerging global order cannot sustain itself as a ‘pure marketplace’ [without] a reassertion of the role of the nation” (1998, 129).

1.3 Etzioni

Amitai Etzioni is a sociologist who has published widely, a former advisor to President Jimmy Carter, and one of the highest-profile American intellectuals. His ideas proved very attractive to Third Way thinkers, in particular his notion of communitarianism. (Presumably they were also attracted by his popular communications skills and his interest in public policy.) Etzioni was one of a handful of writers (including Robert Putnam, author of the best-selling book *Bowling Alone*) who first articulated the modern communitarian movement, and he founded a network and a think tank on communitarian ideas and their policy applications.

Communitarian ideas include an emphasis on social capital, social networks, and civil society; typically citizenship is conceived of in such a way that rights and responsibilities are seen as inherently connected and interdependent. Communitarianism does not fit neatly into the standard modern definitions of left or right; many communitarians claim to represent a “radical middle.” On economic issues, such as regulation and public services, the communitarian position would normally be seen as close to that of a European social democrat. On so-called cultural issues, the communitarian position is more conservative, supporting, for example, community standards and the importance of faith (Etzioni, Rothschild, and Volmert, eds, 2004; Etzioni, 2003).

1.4 LeGrand

Julian LeGrand is a professor of social policy at the LSE, and health policy adviser to Tony Blair. As noted in the Guardian, “if there is a single defining thought about New Labour's approach to public services, it surrounds the benefit of choice....And if there has been a single leading intellectual exponent of this thesis, it is Julian Le Grand (Wintour, 2005). His 2003 book *Motivation, Agency and Public Policy: Of Knights, Knaves, Pawns and Queens*, angered the unions and the left of the Labour Party because it challenged the assumption that public sector workers are motivated by altruism (see *ibid*).

Not surprisingly, given its high profile, the Third Way has generated a large body of critical literature, and it is to that work that we now turn.

Chapter 2: Critical Perspectives on the Third Way: Review of the Literature

This chapter reviews the literature on the British Third Way, focusing on economic issues. It highlights four main debates in the literature: whether the Third Way is a genuinely new and coherent ideology, or merely a politically marketable catchphrase; whether and to what extent New Labour's economics accepted the basic assumptions of neoliberalism and thus represented a continuation of Thatcherism under another name; how much does the global economy restrict the domestic British economy, and the room to maneuver a national government has with regard to economic policies; and in the context of the previous two points, what options should a UK government pursue, and does the Third Way have a distinctive economic plan?

The changes enacted during Labour's years in the wilderness, formalized during the Policy Review Process and consolidated under Blair, were explained by the party leadership through a two-part rationale: that if Labour were ever to form government again, it needed a dramatic reorientation in economic policy; and that the global economic context required those changes to be consistent with neoliberal orthodoxy. This rationale has been adopted and, to varying degrees, supported by a number of authors (see Heffernan, 2001; Kenny and Smith, 2001; Anderson and Mann, 1997). Collectively these authors set out what Hay refers to as the "modernization thesis," which contains four basic tenets. These are: 1) that Thatcherism killed the postwar Keynesian consensus; 2) that this allowed Labour to make the adjustments to its economic platform needed to accommodate globalization (in particular the heightened mobility of capital; 3) that the Policy Review process was a matter of facing up to global economic reality; 4) that the

Review was therefore not a *concession* to Thatcherism, but rather a necessary modernization *facilitated*, ironically enough, by Thatcherism (1999, 59).

Ludlam (2000) provides a succinct yet nuanced version of the modernization thesis:

The New Labour project was....rooted in the failure of Labour's post-war program of reforming social democracy to sustain electoral success in the face of the financial, industrial and political problems arising from the decline of the British empire; of the collapse of the long world boom in the inflationary chaos of the 1970s; and of the changes in electoral behaviour related to these developments and to the transformation of British industrial society that eradicated, often brutally, much of the labour movement's industrial base. Such experiences, as much as the legacy of Thatcherism, account for the high profile of New Labour themes like anti-statism in economic and social policy, the priority of counter-inflation over employment policy, hostility to trade union activism; and mobilizing private sector funding, rather than personal taxes, to fund public service investment (29).

2.1 Is the Third Way Really a New Way?

There is no doubt that the third way was a brilliantly successful political strategy, a re-branding exercise that Blair and Brown used to win election and re-election when their party was on the political defensive. But did it offer an approach to economic policy-making that was both coherent and different? Or was it a collection of discrete but politically convenient measures thrown together under a label that may well have been coined in an early-1990s focus group?

Leggett (2004) divides critiques of the Third Way into two groups: those that dismiss it as "a 'smokescreen' with no substance in itself," and those that take it seriously (186). Ironically, the former group shares a critical stance with the Conservative Party in the UK, which has argued consistently that New Labour is really Old Labour in disguise.

However, the Conservative caricature of New Labour as a thinly disguised gang of union-bossed tax-and-spenders who can't be trusted with the keys to the economy and are hopelessly dovish on foreign policy has not stuck (Kenny and Smith, 2001; Heath, Jowell, and Curtice, 2001). This is not surprising, given the policy realities: New Labour has held down most taxes and public spending, has overseen nearly a decade of relatively strong economic expansion, rode shotgun with the US into Iraq, and has given organized labour the bare minimum it could reasonably have expected. From the Left, the idea that New Labour is nothing but a smokescreen has gained some traction, and Leggett sees most of it fitting into the Marxist model in which changes at the level of political formations and ideas mask enduring social relations of domination and exploitation. Here Leggett is unconvincing. It's true that New Labour has not altered the basic structure of capitalist relations, but this is so obvious as to be hardly worth mentioning. Has anyone anywhere made such a claim? However, Leggett's efforts to insert the question of political agency into the debate about the Third Way (efforts which are philosophically consistent with his anti-Marxism) emphasize how New Labour moves back and forth between claims that, on the one hand, its economic policies are merely necessary responses to the vicissitudes of globalization, and, on the other, that the Third Way is a bold new political philosophy.

2.1.1 The Issue of Values

The discourse of the Third Way frequently mentions values, and claims to offer, as a fundamental virtue, a way to apply "traditional values to the modern world" (Blair, speech to the Global Ethics Foundation, 2000, cited in Callinicos 10). As Callinicos points out, the issue of values is so central to Third Way discourse because of the Third

Way's strong pro-market stance (2001, 8). If the left were to abandon its historical opposition to capitalist markets, as the Third Way proposes, what does it have left with which to define itself? Specifically, how does it distinguish itself from the neoliberal alternative, if not through its values? This is why Blair and Schroder (1999) name and emphasize their commitment to certain "timeless" social democratic values, including "fairness and social justice, liberty and equality of opportunity, solidarity and responsibility to others" (in Chadwick and Heffernan, 110).

Yet the issue of "values" remains a highly problematic element of the Third Way, and has always been a central problem in analyzing the Third Way philosophy. Barrientos and Powell (2004) propose two reasons why this is the case. First, the one-word phrases used to describe values are often too abstract and vague to be of much use. For example, the Third Way names "equality" as a value, but this is contestable term that means different things to different people, and it is a value that *most* political philosophies also claim to hold dear, in some form or other. In order to arrive at a more rigorous definition, it is necessary to link values to specific goals. Second, it is never completely clear whether the Third Way is concerned with reasserting old values, updating old values, and/or putting forward new ones. Blair (1998) and Blair and Schroder (1999) claim that the goal of Third Way is to link timeless values – including the three identified by Blair, in addition to others they consider to be the bedrock social democratic values of social justice and solidarity — with modern means (13). Meanwhile. Le Grand creates the acronym CORA (community, opportunity, responsibility, and accountability), and Lister (2000) presents RIO, for responsibility, inclusion, and opportunity. This is all quite a pile-up of ideas. To sum up, Barrientos and

Powell emphasize that it is “conceptually important to disentangle the different elements of discourse, values, policy goals and policy mechanisms” in order to decide how significant a role values play in the British Third Way (20).

Along the same lines, Callinicos (1999) cites Giddens’ embrace of four different “Third Ways” in Europe, each located in a different country and each embodied by a range of different policy options, as evidence of stretching the definition of the term to the point where it is essentially meaningless.

2.2 Post-Thatcherism, or Thatcherism Continued?

Following the broad acceptance, in at least a general way, of the modernization thesis, the first wave of academic debate around New Labour focused on the party’s modernization process, and divided into two main interpretations: accommodationist and “neo-revisionist” (Ludlam, 2000, 27). Those in the first group argued that in New Labour’s first mandate its economic approach amounted to little more than a continuation of Thatcherism.

Anderson (2000) writes that the sweeping social and economic changes associated with globalization are complemented and stabilized by Third Way regimes in the US and UK. The Blair and Clinton governments carried on the central Reagan-Thatcher policies, even adding elements, such as welfare reform in the US and student fees in the UK, that their explicitly neoliberal predecessors did not dare pursue. These policies, Anderson writes, have been couched in a new, softer rhetoric, with the effect of reducing conflict and opposition to the radical right:

One might say that, by definition, TINA only acquires full force once an alternative regime demonstrates that there are truly no alternative

policies....the Third Way is the best ideological shell of neoliberalism today (11).

Moran and Alexander (2000) consider the most striking feature of the economic policy fashioned by the Labour Party to fight the 1997 election to be the party's general acceptance of "the great changes in both the conduct of economic management, and in the structure of the economy, introduced by the Conservatives after 1979." Similarly, Heffernan (2000), John Grieve Smith (2005), Hay (1999), and Arestis and Sawyer (2001) all largely agree with the assessment of Tony Benn, long an icon of the left of the party: "to cut a long story short, this is the Thatcherisation of the Labour party" (Benn, 1994, 546).

One of the harshest critical analyses is provided by Callinicos (2001), who rejects Giddens' starting point, the assumption that the Third Way offers a genuine alternative to the historical failures of both left and right. First, Callinicos notes that Giddens sees the rise of the Third Way as conjoined with the "death of socialism," but what, exactly, is meant by socialism in this context is far from clear, other than "the notion that capitalism can be humanized through socialist economic management." This definition of socialism is at best imprecise, and at worst inaccurate. Much of the Left has always argued precisely the opposite – that capitalism *cannot* be humanized (Callinicos, 6). The rise of the Third Way occurred at a time when many socialists, active in anti-globalization movements, renounced Soviet-style central planning in favour of other priorities and models, such as community-driven, decentralized decision-making, community economic development, and "affinity groups," among others (see, for example, Klein, 2000). Thus drawing the distinction between "socialism" and the Third Way according to their relative positions on state control of the economy was increasingly awkward. While

Callinicos does not make this particular point, he does argue that Giddens “comprehensively ignores the fact that many versions of socialism do not seek to transcend capitalism by increasing the power of the state” (6).

So Giddens, according to Callinicos, sees the third Way as transcending, on the one hand, an exceedingly narrow version of socialism that even socialists have abandoned. On the other hand, Giddens argues that the Third Way has also transcended the extremes of neoliberalism. Yet these ideas have not been transcended at all. Policies such as privatization, deregulation, reduced state intervention in the economy, and greater reliance on monetary policy relative to fiscal policy continued to be marshaled to meet goals such as low inflation and stability – all hallmarks of the Thatcher years – remained central to the Third Way. As a result, Callinicos argues, Giddens’ theoretical model of the Third Way is an asymmetrical and highly flawed one.

Others, such as Marquand (1998), dismiss the notion that “New Labour stands for a continuation of Thatcherism by other means” as “hopelessly wide of the mark” (cited in Chadwick and Heffernan, 2003, 77). Yet this argument is not a defense of the Third Way. “We know what the new regime is not;” Marquand wrote on the first anniversary of the Blair government, “we don’t yet know what it is. Patently it is not socialist....The Thatcher paradox — liberal economics combined with Tory politics — has been followed by the Blair paradox: economic continuity combined with political discontinuity” (ibid, 80). Marquand sees this latter paradox as holding the key to understanding the Blair government. He argues that it is rooted in the fundamental contradiction of Thatcherism: in the pursuit of economic liberalism, Thatcher attacked the traditional elites and institutions that made up the “old establishment.” Yet the tools she used to pursue this

goals were, by and large, also elitist state institutions. Thatcherism was, in other words, a program of state-imposed liberalization, and thus inherently unstable. The free-marketization associated with Thatcherism undermined many of the institutions through which it had been achieved. When Blair took power, Marquand argues, Britain had only recently undergone its own bourgeois revolution.

Martin J. Smith (2004) concedes that there are significant continuities between Thatcher's economic policies and those of New Labour, but cautions that "continuities and even policy convergence are not the same as consensus" (213). He argues that: Labour has been confronted by the success of certain Conservative policies (for example, renationalizing public communications utilities would be of little benefit, given the changing nature of the industry since privatization); it is very difficult for governments to change policies quickly, and so more changes will be seen as Labour's mandates continue; and, most important, the global economic context has imposed similar constraints on Conservative and Labour governments. Like Marquand, Giddens (1998), and Driver and Martell (1998) are much more sympathetic, claiming that the Blair government's economic policies have avoided the mistakes of both "old left" and "new right," and thus represent a genuinely new social-democratic approach (see Annesley and Gamble, 145). Another somewhat eccentric minority position saw Third Way economics as neither a new approach, nor a continuation of Thatcherism, but rather a long-delayed continuation of a modernization process started and abandoned within the party in the 1950s (Smith, 1994; Jones, 1996, both cited in Ludlam, 2000).

By New Labour's second term, these debates were refined. In addition to the important debate between Wickham-Jones, Coates, and Hay, discussed in detail in

Chapter 6, below, notable contributions include Driver and Martell (2002), who see New Labour's Third Way as a modest success. In contrast with what both Blair and many of his critics claim, it "does not transcend 'Old Left' and 'New Right'...but the Third Way does combine them in significant ways" (67). In other words, Third Way economics may not offer a coherent new political economy so much as post-Thatcherite modernization. Fielding (2003) rejects the accommodationist argument, instead proposing that New Labour is simply the latest stage – albeit an extraordinarily cautious one – in the history of a party characterized by "unremitting transformation and adaptation" (cited in Ludlam, 2004, 3). Ludlam also describes a number of recent works on related phenomena, which provide valuable context in interpreting New Labour. These include Callaghan's (2000) analysis of the retreat of European social democracy in the 1980s and 1990s, and Thompson's (2002) investigation of the lack of British social democratic economic alternatives produced during the same period (Ludlam, 2004, 3-4).

Maron and Alexander (2000) use the phrase "heroic" to describe the old economic policies abandoned by New Labour. To abandon such policies is to make a firm commitment to a smaller state.

2.3 Beyond Ideology?

One of the central claims made by Giddens, Blair, and other proponents of the Third Way, was that it offered an approach that was "beyond left and right," indeed, "beyond ideology" itself. While Blair argued that politics is "first and foremost about ideas," (1998, 1), he frequently emphasizes the need for politicians to "approach issues without ideological preconceptions and ... search for practical solutions to their problems through honest well-constructed and pragmatic policies" (Blair and Schroder, 199, 15). In

1995 the *Guardian* reported Blair telling a party convention that Labour was “above ideology, but not beyond ideals” (White, 1996).

Michael Freeden (1999) considers such a position, by its very nature, an “illusion”; in the modern world, such a “disavowal of ideology is a colossal act of self-deception” (42). Freeden’s thesis is that any declaration of the death of ideology made during the postwar Golden Years reflected a strengthening conviction in the western world that a combination of state-driven social policies and Keynesian economics had, in a sense, surpassed the need for ideological debate. The age in which we live now, however, “far from being post-ideological, is one of ideological experimentation, of the resurrection of past principles combined with new attitudes” (42). Freeden identifies the main parts of this contemporary ideology (which applies to the mainstream political discourse in general) as being the de-valuing of politics, in particular the roles of economic planning and the pursuit of public welfare. As we have seen, when it comes to New Labour specifically, the prevailing ideology is drawn from a number of different traditions of British political thought, most notably liberalism. New Labour has “abandoned the tradition once exemplified by such paladins of social democracy as Willy Brandt, Helmut Schmidt, Ernest Bevin, and Hugh Gaitskell. It has also turned its back on Keynes and Beveridge” (Marquand, 1998, 19). Blair in particular emphasized the British liberal tradition of individual freedom, and the view that markets were an important way to realize this goal. In addition to arguing that the Third Way is not “post-ideological,” Freeden also challenges the claim that New Labour really represents a third option. He notes that the postwar social democracy that stands as the so-called first way

was nourished on the new liberal tradition of the early part of [the twentieth] century, from which Blair has consciously drawn [but] it also

coexisted with a number of British socialist currents which cannot be reduced to social liberalism: Fabianism, ethical socialism, and a trade-union-oriented Labourism. If the second way is loosely coextensive with Thatcherism, it overlooks the robust Tory beliefs that have sustained much of middle England in the recent past, and still do...New Labour has assumed aspects of all these traditions at once (44).

Although this could perhaps be considered a quibble with New Labour's rhetoric, it is a revealing point that helps significantly clarify the Third Way's intellectual roots and demonstrates how a claim to being "beyond ideology" conceals more than it reveals.

At the same time as he attempts to locate New Labour's philosophy within a coherent intellectual tradition, Blair also places it *beyond* those ideologies. For example, "the political debates of the 20th Century – the massive ideological battleground between left and right – are over. Echoes remain, but they mislead as much as they illuminate" (1999). This line of thinking is consistent with the "end of ideology" debate that occurred in the middle of the twentieth century, in which it was argued that countries would become less ideological as they became more developed; liberal western nations, it was argued, had evolved beyond rigid (typically meaning Marxist) ideological positions (White, 2003, 133ff).

In a lively, lengthy analysis in the *Guardian*, David Walker (1999) takes a similar approach to Giddens, attempting to locate his roots in twentieth-century political thought. He finds them in the 1960s, arguing that Giddens' theories are

a characteristic Sixties' mix of faith in individual freedom mixed with a new sense of common membership of the world out there, playground and factory rolled into one.... [With the Third Way] that great Sixties' intellectual ambition of reconciling individualism (freedom to love and live as we please) with materialism (the inexorable force of history as discerned by Karl Marx) is achieved.

Emphasizing the role of the state in Third Way philosophy, Walker says that many of New Labour's proposals for reforming public administration have to do with a key Giddens formulation: social democrats want to expand the state, neoliberals want to shrink it. The third way proposes to reconstruct it.

An admirer, still, of Marx, Professor Giddens was nonetheless a premature Blairite, moving 'beyond left and right' before Mr Blair became leader of the Labour Party. The line of argument goes like this. We live in a new age which demands a new politics emanating from a radical centre located in an active civil society based on a democratic family supported by positive welfare whose watchword is equality [in the sense of] inclusion within the cosmopolitan nation. A cynic might say a lot of this sounds like Sixties' utopianism stripped of its marxist determinism and anti-capitalism....There's Tony Giddens in a nutshell: globalisation, emancipation, anxiety, escape from 'fate'. It's the Sixties all over again.

2.4 Giddens Responds to His Critics

In 2000, after self-defined Third Way parties had taken office at various levels across Europe, Giddens published a second volume on the Third Way, in which he declared the Third Way had become nearly hegemonic – “the point of view with which others will have to engage” (vii). In this volume he does not develop his theory of the Third Way so much as clarify it, and he also summarizes and responds to the critical responses to the first volume. He rejects the notion that the Third Way is a “continuation of neoliberalism”; instead it is “an alternative philosophy to it” (32). He emphasizes the core value of individualism in the context of globalization, and describes the Third Way as “a new social contract ... [which] stresses both the rights and responsibilities of citizens” (165).

Giddens groups the arguments against the Third Way into six categories, which can be summarized as follows:

- 1) That it is amorphous, poorly defined, conceptually vague;

- 2) That it abandons the basic left perspective and hence is a conservative philosophy;
- 3) That it is too accepting of neoliberalism, especially as regards the global economy;
- 4) That it is too much defined by the values of the “Anglo-Saxon” countries where it was developed;
- 5) That it offers no distinctive, coherent economic approach;
- 6) That it is very weak on ecological issues (2000, 22-26).

It is worth noting that these are all critiques from the left; he does not identify any from the right. Giddens promises to respond to each of these in turn. Yet his arguments, although brief, written in accessible language, and non-technical, can be very hard to follow. Part of the problem would seem to be that Giddens sees the Third Way as being uniquely capable of achieving balance on almost every imaginable political issue – balance between left and right, state and market, freedom and regulation, rights and responsibility. This results in a good deal of on-the-one-hand-this, on-the-other-hand-that arguments. To take one representative example, consider how he addresses the issue of labour market flexibility, chosen here because is central to this thesis. Giddens writes, “Product, capital and labour markets must all be flexible for an economy today to be competitive” (75). There is not much to such a statement, as, put this way, there really can be no opposition — who would argue that markets need to become more *inflexible*? Even Giddens fairly quickly abandons this somewhat disingenuous argument, as he appears to move into real political considerations:

’Flexibility’ for many is a red rag to a bull. Especially as applied to labour markets, flexibility implies deregulation, making workers more vulnerable

to economic insecurity and expanding the numbers of in-work poor. Flexibility does indeed entail deregulation – getting rid of, or reshaping, rules and regulations that hamper innovation and technological change. Increasing flexibility can't be costless – tradeoffs are involved. Yet it can't be stressed too strongly how high the social and personal costs are where there is large-scale unemployment, and especially where there are many long-term unemployed (76).

Even at its most substantive, this would appear to be little more than an argument against Luddism. Workers should not oppose innovation, nor fear increased productivity, Giddens says, because to do so is to oppose economic growth, and more growth means more jobs, and that benefits workers. Fair enough, but Giddens is attacking a straw target. Opposition to technology is an extremely marginal position in the modern labour movement. As this thesis shows, the position most left critics take on the British economy is precisely the opposite — that it suffers from a *lack* of real investment and innovation. Giddens' argument is hollow because it sidesteps the issue of political-economic power. On its face, Giddens argues that the Third Way offers a way for everyone – labour, capital, and society in general — to win, if only they would all be reasonable, avoid “extremism,” and cooperate. As with so much Third Way literature, however, Giddens believes that the real onus to change falls on labour.

In this book Giddens relies to a great extent on assertions, giving it something of the tone of a political party platform. For example, “Far from displacing social justice and solidarity, third way politics ... represents the only means of pursuing these ideals today. Far from being unable to deal with questions of inequality and corporate power, it is the only approach able to do so in the context of the contemporary world” (29). The qualifying phrase in that sentence — in the context of the contemporary world — reveals an idea that is absolutely central to Giddens' arguments. In general his responses to his

critics assume or appeal to the inevitability of globalization and the rising importance of a “knowledge economy.” Giddens makes the argument, so enthusiastically adopted by Blair, that the politics of an earlier time are not suited to the modern “globalized” world. The Third Way “accepts the logic of ‘1989 and after,’” which is why it moves “beyond left and right” (50). The very ways in which human identities are constructed have been altered by a new global level of interconnectedness facilitated by new information technologies.

Of course, Giddens’ is but one of a wide range of perspectives on the issue of globalization. The literature on that topic is surveyed in the next chapter.

Chapter 3: The Globalization Debates

Entering the last decade of the twentieth century, the term globalization was obscure. A decade later, it was ubiquitous in both academic and popular publications. Despite, or maybe because of, this reality, the concept of globalization is, to say the least, a fluid one, and the study of it, “expansive, potentially encompassing almost everything under the sun, interrelating apparently disparate elements into wholes so complex, multi-dimensional, and open-ended as to defy presumptive encapsulation in terms of particular theories or perspectives, is less a sub-field than an overdetermined meta-field” (Rupert, 2005, 457; see also McBride, 2003). Although the debates spawned numerous books arguing that globalization did / did not result in the homogenization of global culture, a clash of civilizations, unprecedented opportunities for popular movements and communications, this thesis focuses on the global economy.

In the UK, the debate around globalization began in the academic literature; it crossed over into the popular and political realms in the mid-1990s, with Giddens one of the main conduits. The political debate around globalization played a key role in shaping New Labour’s Third Way rhetoric, and the reverse was also true: New Labour repeatedly pointed to changes in the global economy as being a major influence on the government’s domestic economic policies.

3.1 Globalists and Sceptics

In the literature, the debate about globalization, especially as it occurred in the early 1990s, is frequently divided into two or three schools. The names of each school vary from author to author, and the boundaries between them can be somewhat fluid.

David Held is an important example for the purposes of this thesis as he was also one of the key thinkers in the inner circle of Third Way thought in the UK (Holmes, 2005, 34), and a colleague of Giddens at the LSE. Held (2000) identifies three main approaches to globalization.

The first is “globalist,” (alternatively referred to as “hyperglobalizers”) which takes the position that is a very real and wide-ranging phenomenon that operates at the cultural, political, and economic levels. There are both good and bad aspects to globalization. However, whether globalization is desirable or not is irrelevant to this camp, which takes a “weak state” position, and sees globalization as an inevitable and irresistible force.

The second approach is “traditionalist,” which argues that the globalists overstate the scope, the influence, and the novelty of globalization. According to this position the forces at work in the modern world are no different in kind from those that have been active throughout history. The traditionalists take a “strong state” position, and believe that states could do more to influence the global economy and exert independence and autonomy. A similar proposal for organizing the literature in the globalization debate into two groups uses the categories “boosters” and “critics” (Callinicos, 2001, 19).

Finally, Held describes a third group of writers – “transformationalists” – who occupy the theoretical space between the first two position, which they see as overly simplistic and a false dichotomy. Along with Giddens and authors such as Bauman (1998), Held’s own point of view fits into this category,³ which White (2003), for

³ Ironically when Held, in later work with McGrew, again surveys and categorizes the different perspectives on globalization in *The Global Transformations Reader* (Held and

example, calls “complex globalization theory.” According to these authors, globalization is complex, varied, and unpredictable. It is powerful and influential, “a central driving force behind the rapid social, political and economic changes that are reshaping modern societies and world order” (Held et al, 2000, 7) but not the result of the internal logic or laws of motion of the global economy – in other words, the future development of globalization is not inevitable. This is a more agnostic theoretical stance, one that takes seriously the reality of globalization, while also allowing for critical elements such as the idea of imperialism. Yet it is not nearly critical enough for Rosenberg (2000), who notes that while the “complex” globalization thesis sees globalization as being driven by a number of causes, it tends to downplay dramatically the significance of economic forces. Rosenberg argues that critics in this school have effected a “spatialization of social theory,” putting great emphasis on the notion that “‘distance’ is a social product” that modern transportation technology has effectively overcome (1). To Rosenberg, this is insufficiently grounded and largely unfalsifiable. Whereas the skeptics measure the extent (or, in some cases, test for the very existence) of globalization in economic terms, Held and others in his camp consider such an approach to be too narrow in scope, and overly empirical in methodology. Instead, they prefer to describe changes occurring at a number of levels, including the cultural, social, and spatial, as well as economic. As a result, while the “complex” or transformationalist school avoids a reductionist, narrowly economic take on globalization, the critique leveled by Rosenberg and others is a powerful one.

McGrew, 2000) they drop the “transformationalist” category, focusing instead on the two categories “globalists” and “skeptics.”

3.2 Giddens on Globalization

Giddens is one of the group of writers who divide the literature on globalization into two main points of view: the “skeptics” and the “radicals” (see 1999 and 2000). He dismisses both positions as simplistic in their focus on economics. In reality, “the most important factors shaping globalization are not those to do with finance and markets but with communication. The communications revolution ... coincides more or less completely with the origins of globalization” (2002, 70). Just as he sees the Third Way position being in between extremes of Left and Right, his skeptics-radicals formulation allows him to theorize globalization in a way that lets him come up the middle.

Giddens’ rejection of what he considers to be reductive, economistic theories of globalization is premised on his central idea: “globalization is not only, or even primarily, an economic phenomenon.” In fact, he continues:

Globalization is really about the transformation of space and time. I define it as action at a distance, and relate its intensifying over recent years to the emergence of means of instantaneous global communication and mass transportation....Globalization is not a single process but a complex mixture of processes, which often act in contradictory ways (1994, 5).

3.3 Business School Globalization

Another way of grouping the different positions on globalization is into “radical” or “business-school” globalization, and skeptics (see, for example, Holmes, 2005, 29-39). The business-school approach to globalization (see, for example, Reich, 1992, Sachs and Warner, 1995. cited in Watson and Hay, 2002) sees globalization as dominating all realms, but in particular it strongly emphasizes the economic level. The narrative of globalization set out through this position is that the global economic crises of the late 1960s and 1970s were caused by – and thus discredited – state control of nation

economies, or what Wolf (2004) and others call “naïve Keynesianism.” This period brought to an end the “first half” of the postwar economic history, during which relatively closed economies allowed national governments to implement interventionist and expansionary policies. The economic liberalization that occurred in the 1980s and 1990s was a necessary response to certain realizations arrived at through harsh reality: “the return of inflation discredited the view that monetary policy does not matter; the failure of nationalized industries discredited state ownership; the revolt of organized labour discredited wage controls; the distortions evident in the economy discredited price controls;...and, most important of all, the weakening and collapse of Soviet state-socialism discredited faith in allegedly rational central planning (Wolf, 2004, cited in Holmes 26). Once national economies became significantly more open, national governments had correspondingly less power relative to capital and were subject to a strict new discipline of the market (see White, 2003; Watson and Hay, 2002).

The business-school authors typically point to increases in international trade (at a higher rate than the growth of the global economy) and international capital flows (including foreign direct investment), the development and/or growing influence of organizations such as the WTO and IMF, and an increase in outsourcing (in particular of manufacturing) as the key manifestations of economic globalization. In addition to globalization resulting in, in effect, a single global economy, it also leads to drastically weakened and outdated nation-states, and a homogeneous world culture.

Ohmae (1990) and Cerny (1990), among others, made the concept of a “borderless world” central to their analysis. In such a world, the consequences for any country attempting to defy the strict international economic orthodoxy were severe.

Teeple (1995), writing from a neo-Marxist perspective very different from that of Ohmae, proposed that the global economic system has far surpassed national political systems in power and influence, making the possibilities for “social reform” increasingly distant. Burbach and Robinson (1999) declare that “the whole set of nation-state institutions is becoming superseded by transnational institutions” (cited in McBride, 2003, 2). In his best-selling *One World: Ready or Not*, William Greider uses the metaphor of “a wondrous new machine, strong and supple....a machine that throws off enormous mows of wealth and bounty while it leaves behind great furrows of wreckage” to describe global capitalism. There is “no one at the wheel of this machine,” he cautions. “In fact, this machine has no wheel nor any internal governor to control the speed and direction. It is sustained by its own forward motion, guided mainly by its own appetites. And it is accelerating” (1997, 11). Consequently, the state is diminished in the face of globalization, in some analyses even verging on obsolete.

A sub-set of the globalist position is what might be called “strong-state globalization,” first represented by Michael Porter’s hugely influential book, *The Competitive Advantage of Nations* (1990) (see also Fukuyama, 1992). This line of argument supports the general globalist position, except that it rejects the claim that globalization has rendered the state a weak anachronism. In fact, because competitive advantage is shaped by differences in local and national contexts, globalization makes governments even more important than before.

Sceptics challenged the globalist position on a number of fronts, in some cases saying its claims were exaggerated, in other cases that they were myths. Sceptics such as Hirst and Thompson (1998) argue that certain powerful states, such as Japan, Europe, and

the US, have retained a great deal of power to influence the most powerful global economic forces, such as financial markets and international trade organizations, provided they act in a coordinated fashion – although they remain highly reluctant to use this power. They also note that few corporations can accurately be called “transnational,” as most so-called TNCs actually have heavy investments in the country where they are headquartered, and just operate multinationally; that “global” investment flows are primarily regional and concentrated in the “triad” of the developed world — North America, Western Europe, and Japan/East Asia – and thus economic internationalization at the expense of the nation state is at best even and cyclical; and that nation states remain crucial to the functioning of the global economy (also see Sutcliffe and Glyn, 1999).

While the skeptics were portrayed by Giddens as “on the political left, especially the old left,” and saying that nothing had changed under globalization because it was “just talk” (1999; *ibid*), both such characterizations were off the mark. For example, Mann (2001) is one of many skeptics who say that the process of globalization is real and significant. However, he points out the many globalists tend to overestimate how “evenly” and how “fast” its progress has been; in particular Mann challenges the neoliberal position that globalization is peaceful, arguing instead that it causes “divisions” and “tensions” (51-71). Editorials in *The Economist* (1995), and writing by Kenneth Waltz (2000, ref. in Callinicos, 2001, 17), an icon of Realist thought in International Relations, provide several examples of skeptical responses to globalization whose authors could hardly be considered on the left, let alone “the old left” (see Callinicos, 2001, 17-20).

The globalist position, so prominent in the early globalization debates, eventually came under intense attack. Comparative public-policy studies concluded that policy convergence across national borders had, in many cases, failed to happen, making claims of globalization as an overwhelming homogenizing force untenable (McBride, 2003). “The suggestion of early globalization scholars that recent processes of structural economic change imply an inexorable process of neoliberal convergence has now been widely discredited,” both in theoretical and empirical terms (Watson and Hay, 2002, 290; see Berger and Dore, 1996; Boyer and Drache, 1996; Hirst and Thompson, 1999).

As well shall see in the next chapter, however, while the academic debate was largely settled in favour of the skeptics, in the view of New Labour the globalist positions remained very influential.

Chapter 4: Third Way Economics as a Case Study

4.1 The Political-Economic Context for the Emergence of Third Way Economics

The British economy that New Labour inherited after 19 years of Conservative rule had survived two recessions – a deep one in 1979-1981 and a long, shallow one in 1990-1994. It had undergone (ultimately unsuccessful) attempts, both by the Labour governments of the 1970s and the Conservative governments of the 1980s, to improve the national economic position relative to its rivals in Europe. And it now was “simultaneously prosperous and in trouble” (Coates, 2005, 5). Growth was quite robust and prosperity high relative to Britain’s own past — the generation born in the 1990s was “roughly twice as well off as its parents and roughly four times as well off as its grandparents,” (Armstrong, Glyn, and Harrison, cited in *ibid*) — but the country’s international economic position was still little improved. Table 1 shows how the British economy compared with the three other Western European G8 countries — Germany, France, and Italy — on per-capita GDP, productivity per hour worked, and total investment in 1996, the last full year before New Labour took office. On each of these indices the UK finished last of the four countries.

Table 1: The British Economy compared with other European G8 countries, general macroeconomic indicators, 1996

Per capita GDP, 1996, purchasing power standards; European Union (25 country) average=100

UK	109.0
France	112.8
Germany	118.0

Italy	115.5
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Total gross fixed capital formation as a percentage of GDP, 1996

UK	16.5
France	17.9
Germany	21.3
Italy	18.9

Labour productivity per hour worked, 1996, purchasing power standards; European Union (15 country) average = 100

UK	89.3
France	113.8
Germany	108.7
Italy	100.6

Source: Eurostat, various publications, various years

The British economy has been quite open historically, a situation that intensified in the Thatcher years. As Table 2 shows, over the period 1985-1995, average annual foreign direct investment (inward) stocks, relative to GDP, were 70% higher than in Europe as a whole, and nearly three times as large as the average in the other three European G8 countries, France, Germany, and Italy. Over the same period FDI accounted for more than twice as large a share of total domestic investment in the UK as in its European counterparts. While foreign firms solidified their place in the British economy, British firms also expanded internationally. In 1997, the year New Labour took office, cross-border mergers and acquisitions (by sales) involving UK firms accounted for more than one-third of the Europe total, and more than the sum of France, Germany, and Italy combined. Their Conservative predecessors bequeathed to New Labour a national

economy in which powerful market flows connected it firmly and deeply into the global economy.

	UK	Europe	France, Germany, Italy (average)
Stocks of Foreign Direct Investment (as % of GDP) inward; 1985 – 1995 annual average	17.1	10.7	6.3
Flows of FDI as % of fixed capital formation, 1985-1995 annual average			
Inward	10.2	5.0	2.5
Outward	16.7	7.6	8.4
Cross-border mergers and acquisitions (sales), 1997, US\$bn	39.7	116.7	32.9 (total)

Table 2: The UK and Europe in the Global Economy

Source: UN World Investment Report and author's calculations based on same, various editions

The Blair government assumed control of an economy whose industrial composition had been changing over the past century; these long-term trends were intensified by the restructuring of global production that resulted from increased capital mobility. By the 1990s British reliance on the Victorian industrial cornerstones of coal, cotton, and rail had already all but vanished. The textile industry had died in the 1950s, and rail in the 1960s. The sharp decline of mining did not happen for several decades after that. In 1956 the industry employed 694,000 people. By the 1970s that total was lower, but the workforce remained sufficiently militant and economically important to

trigger the 1994 general election. By the election of 1997, however, Thatcher had won her long battle against the miners, enforcing privatizations with a brutal year-long strike and effectively shutting down the British coal industry, which now employed just over 13,000 people (Coates, 2005, 5-9). Where Britain had once been known as “the workshop of the world,” by the time of New Labour the UK was largely a service economy. As a percentage of GDP, manufacturing fell from 25% to 21% between 1980 and 1997 (*Social Trends*, 2000). Measured by employment, the decline of manufacturing was even more striking. By the time of the election of the Blair government, deindustrialization had taken its toll. Manufacturing employed 22% of all full-time workers – exactly half the percentage it employed in 1961. In the 1990s commentators such as Michael Porter of Harvard Business School identified “consumer packaged goods,” financial services, and petrochemicals as the strongest sectors in the British economy. In contrast, the former stalwarts automobiles, machinery, and textiles collectively were responsible for three-quarters of the deterioration in the UK trade balance between 1978 and 1989 (*Social Trends*, 2000; Coates, 2005). Manual work became much less common, falling from about 50 percent of all jobs in 1979 to 36 percent in 1991. This, combined with a rise in temporary and casual employment, high rates of unemployment in the 1980s, and restrictions on trade-union rights produced a massive drop in union density (Leys, 2001, 46-47). That trend continued into the 1990s, although it would level off under New Labour. As Table 3 shows, trade union density for the UK declined from 32.2% in the final quarter of 1992, to 28.2% in the final quarter of 1996. By the final quarter of 2005 it had settled at 26%.

Table 3 Trade Union density for Great Britain, Autumn 1992 to Autumn 2005

Autumn 1992	32.2
Autumn 1993	31.5
Autumn 1994	30.1
Autumn 1995	28.9
Autumn 1996	28.2
Autumn 1997	27.3
Autumn 1998	27.0
Autumn 1999	27.1
Autumn 2000	27.1
Autumn 2001	26.5
Autumn 2002	26.4
Autumn 2003	26.4
Autumn 2004	26.4
Autumn 2005	26.0

Source: Department of Trade and Industry, Employment Market Analysis and Research, March 2006

The Conservatives under Thatcher (and to a lesser extent under Major) had proved that radical change was not the sole prerogative of the left (Holmes, 2005, 199). As we shall see in the next section, New Labour was clear that the sweeping economic changes enacted in the 1980s would not be undone.

4.2 New Labour Economics – Before Taking Office

In the 1980s and 1990s the Labour party experienced incremental but ultimately dramatic changes at numerous levels, including ideology, policy prescriptions, organizational structure, and rhetoric. These changes occurred in response to four consecutive defeats in the general elections of 1979, 1983, 1987, and 1992. There is no agreement in the literature as to when, exactly, this process began – in part because it was so wide-ranging. Some writers argue that the party’s “modernization” dates back to 1983, when Neil Kinnock succeeded Michael Foot as leader (Heffernan, 1998; Lent, 1997).

Others identify the starting point of the transition as being the election of Blair as leader in 1994; in particular because he made the most dramatic changes to the party's internal machinery and removed from the party's constitution the famous Clause IV (Chadwick and Heffernan, 2003, 3). The aftermath of the four election defeats were also important stages in Labour's long transition while out of power. However, from the point of view of economic policy, the most obvious starting point for the emergence of new Labour was the Policy Review of 1987.

The review was "not so much a review as a revision of policy, one conducted not merely as an attempt to reapply timeless principles to a modern setting but to respond to perceived changes in the nation's political and economic" context (Heffernan, 2001, 54). It was drafted through a three-year process in which the party leadership and a small number of trade union leaders exerted an increasing influence, and represented the party's first ever clear formal endorsement of the market. Labour no longer considered the government to be responsible for setting levels of employment, reforming the supply side of the economy, or generating sufficient demand. Beyond the state's responsibility to ensure essential public services and a fiscal and monetary context conducive to a strong private sector, there should be minimum interference in the market, which was seen as essentially self-regulating and self-correcting. As envisioned by the Introduction to the Report of the Review, the "economic role of government" is to "help the market system work properly where it can, will, and should – and replace it where it can't, won't, or shouldn't" (qtd. in Heffernan, 2001, 54). These may have been unremarkable ideas in Thatcher Britain, but they represented a major shift in Labour party ideology. With the

support of the trade union voting block, the review documents were endorsed without amendment at the 1989 Labour Conference.

It is worth emphasizing that the Policy Review process was one stage in the transition from the economic perspective of Foot to that of Blair and Brown; it maintained a vision of the state as performing an enabling role, with some commitment to regulatory management and some emphasis upon training and research and development. Blair's ascension to the party leadership in 1994 did not mark a dramatic turnaround for Labour. Rather, he consolidated the changes to the party's decision-making structures and carried on changes in policy positions that had already been underway for a decade. By the time of the 1997 campaign, the few remaining traces of Old Labour economic policies that the party had used to fight the election of 1979 had been removed from the party's platform, with Blair announcing to a business audience that the "'presumption' of his government would be 'that economic activity is best left to the private sector' [because] 'the post-war Keynesian dream is well and truly buried'" (Baldwin and Wastell, 1997).

The likely economic policies of a new Labour government were a matter of intense interest before the 1997 election, especially as opinion polls showed support for the Conservative government collapsing. With New Labour committed to meeting many of the Tories' key macroeconomic targets, would Britain's economic approach change after 19 years of Tory rule? In 1995 Will Hutton, then economics editor of the *Guardian*, published a best-selling book, *The State We're In*, in which he argued that Britain had fallen behind other economies because of the long-standing overwhelming influence of the financial community – the City of London – which was obsessed with short-term

dividends at the expense of real, long-term investment. This book is based on a revival of the Marxian line of analysis first developed in the “Anderson-Nairn theses,” published in a series of articles in *New Left Review* in the 1960s (Anderson, 1992; see Hay, 1999, 185). The argument is historical. Because Britain did not experience the creative destruction of a true bourgeois revolution, contemporary capitalism carries many residual elements – an aristocratic traditionalism, an outdated system of government, a reverence for exclusivity and reliance on clubby, old-boy establishment connections – that have their roots in feudalism. This legacy hinders innovation and development into the present day. Afraid of risk and focused on the short term, the British financial sector has failed to support investment and innovation, making Britain “an economic backwater where long-term gain is sacrificed to quick profit” (see Coates, 2005, 22). The City has been similarly opposed to anything more than minimal state investment, a position that dovetailed with the public-sector retrenchments pursued by Conservative governments since 1979. The result was a national economy characterized by inefficiency and low levels of real investment, coupled with high rates of wealth and income inequality, and an attendant decline in social cohesion. “Record levels of inequality,” he wrote, “had gone to the marrow of the British soul” (Hutton, 1995, 14).

Hutton proposed a number of measures, including reform of the financial system to increase long-term investment, a greater regulatory role for the state, and a moderately expansionary Keynesian macroeconomic program. He envisioned a labour market based upon “stakeholder capitalism,” similar to the German social market model, in which firms would have legal obligations to society as a whole, rather than simply to their shareholders. (Hutton became known as a strong advocate of stakeholding, and as we

shall see, the idea briefly generated a good deal of interest, including from Blair.) Hutton's sustained and passionate attack on the costs of Thatcherism, along with his proposed "reconstruction of the state and the economy" are notable because they were "embraced wholeheartedly by much of the Labour-supporting intelligentsia," and therefore might have been expected to have found favour with new Labour, possibly even as an economic template (Anderson and Mann, 93). Indeed, Coates (2005) refers to a "Will Hutton moment" that occurred in the mid-1990s (20). With Labour desperate to discredit the claim that only the Conservative party was fit to run the economy, one might have expected it to have been embraced by Blair, as well.

In the event, Blair did find Hutton's ideas useful, but mostly as a foil. Between 1995 and the election of 1997, he went to great lengths to distance his party from Hutton's Keynesianism and labour-market proposals. Blair boasted of having addressed "over 10,000 individual business people" over that two-year period, offering business what he termed "a new deal for the future," based on his party's support for "more flexible labour markets ... [even] less labour market regulation than in the USA" (Blair, 1997, 97). Blair and the "modernizers" in the party were firmly convinced that electoral success in 1997 depended on peeling Conservative voters away from that party and winning support from business. They declared unambiguous support for the Thatcher-Major economic legacy, including privatization, pro-business labour laws, and welfare retrenchment. New Labour would be a "party of business," exquisitely sensitive to the mood and demands of the business community (see Hay, 1999, Chapter 4).

These points found elaboration in the party's "business manifesto," which was issued separately from the standard platform document in advance of the 1997 election. It

rejected traditional industrial policy, dismissing the possibility of the state “picking winners,” and instead proposed six priorities to create a supportive environment for business:

- First, macro-economic stability with inflation low and government spending under control.
- Second, a dynamic economy with higher investment, modern infrastructure and competitive markets.
- Third, stable and co-operative relations between employees and employers and a flexible labour market.
- Fourth, improved education and skills.
- Fifth, a tax and benefit system which rewards work, encourages enterprise and promotes investment and saving.
- Sixth, leadership by Britain in Europe (The Labour Party, 1997).

Of these priorities, the strategy for pursuing the first is laid out in the greatest detail. Macroeconomic stability would be achieved through a “no-risk” inflation target of 2.5 per cent, plus or minus one percent (unchanged from that set by the Conservative government). Government spending would adhere to the “golden rule” of spending: over the economic cycle, borrowing would only be used to finance public investment and not to fund public consumption. The debt-to-GDP ratio will be kept stable over the cycle, and at a “prudent and sensible” level (The Labour Party, 1997). These ideas – in particular the “golden rule” – had pride of place in the rhetoric of the Third Way.

In a 1998 speech delivered at the start of New Labour’s first mandate, Brown set out a similar list of priorities. The government’s “central objectives [are] built from a platform of long-term stability.” He argued, “there are five barriers to success that this country has to tackle. We must overcome instability and imprudence in financial markets. We must address underinvestment and unemployment, and avoid the risk of

isolationism.” As a way to break through those barriers he identified five long-term commitments: to monetary stability; to fiscal stability; to higher levels of targeted investment in people and business; to a “modernization” of the welfare state in a way that would increase labour-market flexibility; and to free-trade and Europe. Not surprisingly, the priorities listed in this speech overlap considerably with those in the election manifesto, but Brown’s speech reveals a set of concerns that would underpin almost his entire economic approach: an emphasis on predictability, stability and prudence. Indeed, he goes on to declare, “‘prudence’ will be our watchword” (Brown, 1998).

As Arestis and Sawyer (2001) note, by “stability” Brown generally seems to be referring to a combination of stable policies and stable outcomes (particularly in terms of inflation) (264). Being able to set and meet inflation and spending targets was of massive importance to new Labour’s electoral prospects. Labour was taunted throughout the Thatcher years with charges of economic incompetence and blamed for the crises of the 1970s. The evidence strongly shows that voters did not begin to trust Labour on the economy until the disaster of Black Wednesday under the Conservatives in September 1992; even as late as 1996 there was still a widespread perception that a Labour victory would hinder economic recovery (Sanders, 1996; Wickham-Jones, 1996; Gould, 1998; and Gould 1998a, all cited in Kenny and Smith, 2001, 70; see also Heath, Jowell, and Curtice, 2001). Labour addressed this dilemma by adopting the self-imposed spending constraints established by the Conservatives. In fact, measured as a percentage of GDP, Labour would actually be more aggressive than its predecessors when it came to public-spending cuts. The reliance on this clear-cut objective measurement suggests that Labour did not believe it would be given the benefit of the doubt by the public. Much of new

Labour's economic approach has been designed to retain the confidence of voters – especially those in the “imagined community of ‘Middle England’” – and the financial markets (Kenny and Smith, 1997, 70). This strategy of prudence and stability was where the party's narrow electoral interests intersected with its economic theory, particularly as regards the global economy.

By the lead-up to the 1997 election, Labour had convinced nearly everyone that the party had bought into the main principles of Thatcherism. The challenge that remained was to craft an economic platform that would offer voters improvements on Thatcherism. To this end, Labour put forward a critique similar to that advanced by Hutton. Brown characterized the UK economy under Thatcher as “plagued by low levels of investment in industry, skills, and infrastructure ... low levels of investment which [have] led to a ever dwindling economic base, without the capacity to sustain anything other than slow levels of economic growth without inflation” (Brown, 1994 3). In 1997 Labour told voters, “many of the fundamentals of the British economy are still weak....We suffer from both high unemployment and skills shortages. There is no future for Britain as a low-wage economy” (cited in Coates, 2005, 55).

4.2.1 Stakeholder Society

For a brief time, the goal of a achieving a stakeholder society burned brightly in New Labour's plans. Stakeholding existed as a concept in the early twentieth century, with New Liberals as its primary advocates (Holmes, 2005, 218). It was an attempt to bridge the conceptual gap between the individual and the community (in the context of a market economy); thus it dealt with issues that were of central concern to Third Way philosophy. Early in 1996, Blair began introducing the concept through a series of

speeches, most famously the “Singapore speech.” In Will Hutton’s view, “stakeholder capitalism” describes a society in which firms have legal obligations, not just to shareholders, but also to the broader community, including their bankers, their consumers, and their workers, as well as to the environment and to their local communities. In contrast, Blair apparently understood a “stakeholder society” simply to be one in which everyone has a stake:

I believe in a stakeholder economy in which everyone has the opportunity to succeed and everyone has the responsibility to contribute. It is based on the idea that unless we mobilize the efforts and talents of the whole population, we will fail to achieve our economic potential, and continue to fall behind. A stakeholder economy ... requires more investment and better investment – notably capital spending through public-private partnerships to regenerate our infrastructure, investment by industry, funded by patient and committed provision of capital from the financial sector (Blair, 1996).

Individuals are connected because they have a stake in society, and to formally recognize this would ensure policy being developed with the longer term in mind (Anderson and Mann, 1997; Holmes, 2005; Driver and Martell, 2002). Such an approach may be slightly more communitarian than that of Margaret Thatcher, who once infamously claimed “there is no such thing as society,” but not by much. Significantly, there was nothing in Blair’s concept of stakeholding that would have necessitated meaningful retreat from Thatcher’s free-market policies. Blair suggests that the state can only properly support individual citizens if they meet their obligations to support a competitive market economy.

There were numerous critical analyses. A number of writers have noted that Third Way ideas are consistent with a shift away from seeing the individual as citizen, and toward seeing the individual as consumer. Crouch (1997), for example, writes

“stakeholding became little more than commending to employers the value of consulting their workforces. Nothing that might displease the neoliberal business community, especially the financial community, could be risked...this part of the institutionalist strategy involved adaptation of people to the needs of the markets rather than vice versa” (358). Holmes identifies a circularity at the heart of Blair’s argument: “that the market-driven economy is the engine of a successful country and therefore, that citizens need to be able to adapt to that rapidly changing environment if the country is to remain competitive” (220).

The intensity of Blair’s enthusiasm for stakeholding was matched by the speed with which he was willing to drop any mention of the concept. After less than twelve months, it had been purged from New Labour’s rhetoric. Apparently, Blair was first attracted to it as a “big idea” that would help provide a conceptual framework for Third Way ideas. But although he never saw it as a possible Rhineland-style capitalism (as Hutton did), Blair quickly realized that capital, which he was so assiduously courting, worried that that was what he had in mind. Blair’s assurances that he meant something different only seemed to make the idea more vague as that “something different” remained an elusive concept.

4.3 Third Way Economics in Practice

After taking power, new Labour pursued a two-pronged approach to economic policy-making. The first goal was macroeconomic stability, the second was to reduce perceived supply-side barriers to growth. Prudence and stability in the public finances were seen as the necessary conditions that would trigger a virtuous cycle of strong economic growth, followed by greater productivity and investments, which in turn would

allow for targeted increases in public spending to achieve social goals such as poverty reduction. The government placed one principle above all else: new public spending would follow growth and stability, not the other way around (Annesley and Gamble, 2004; Balls, 1998). This general approach was consistent with the party's manifesto commitments. However, the ideas associated with a 'Rhineland' model, or stakeholder society, which had also been a central motivating idea as late as 1996, would be stillborn, and never seriously pursued by New Labour in government. The reasons for this change of tack are not obvious. It is likely that the Labour party's reputation, however unfair it may have been, as fundamentally incompetent on economic management, proved so stubborn that such a repositioning seemed necessary. In addition to this cold political calculation, it may be that Blair and Brown actually believed in the validity of their own arguments. The psychology behind this is undoubtedly complex, and best left as the subject of another project. For the purposes of this paper, the key point is that, for whatever reason, New Labour felt that a stakeholder approach, even one as modest as that proposed by Blair, posed too much danger to their hard-won credibility in the eyes of the markets, and so it had to go (see Leys, 2001).

4.3.1 Macroeconomic Stability

As we have seen, fiscal stability was to be achieved through adherence to two rules: the "golden rule" that borrowing would only be used to fund investment, and not current spending; and the rule that public debt relative to GDP not increase over the cycle (Brown, 1997). The other primary means of achieving stability was through the target for inflation, which was set at 2.5%, plus or minus one percent. Here, too, the government saw credibility as a means to both economic and political ends. Most striking was the

decision to give the Bank of England operational independence, with a mandate to contain inflation, not to stimulate growth. This was the first major policy announcement after Blair took power. The move had not been a pre-election promise – indeed, it took nearly everyone by surprise, including the Governor of the Bank and the Cabinet (Rawnsley, 2001, 32-35). It was a move intended to send a clear, strong message. A government's first decision after taking power holds special symbolic value. Granting the Bank independence meant that the first impression Britons had of their new government reinforced several key themes: that Labour was serious about economic stability, and that Blair's government was more than willing to kill Labour's sacred cows (it was Labour that had nationalized the Bank in 1946) if doing so were to his own electoral advantage. Historically the Bank provided advice on the setting of interest rates, but the ultimate responsibility was held by the government. Brown's immediate predecessor, Conservative Chancellor Kenneth Clarke, had taken the first steps toward greater transparency in the setting of interest rates when he began publishing the discussions he held with the Bank's governor Eddie George. By acting as he did, Brown was attempting to demonstrate, once again, that new Labour could be trusted to run the economy, and that it would not allow any other considerations to interfere with its macroeconomic stance, under which controlling inflation was primary.

Brown had been impressed to learn from Alan Greenspan, then-Governor of the independent US Federal Reserve, that interest rates in the US rarely caused political controversy (Rawnsley, 2001, 32). (Apparently Brown did not solicit advice on the subject from former President George H.W. Bush, who bitterly blamed Greenspan's refusal to cut interest rates for the recession that contributed to Bush's losing the 1992

election to Bill Clinton (Blumenthal, 2003.) Ironically, this major policy move that was intended to prevent a government from manipulating interest rates purely out of its own short-term self interest actually appealed to Brown because of its short-term tactical benefit: several sharp interest-rate increases were likely to be needed soon in order to meet the 2.5% inflation target, and responsibility for them now could be dumped in the lap of the newly independent Bank.

It must be remembered that, while the Bank was made responsible for achieving inflation targets by manipulating short-term interest rates, the government retained the ultimate authority to set those targets, and to appoint a majority of the monetary policy committee responsible for setting rates. If inflation falls outside of the acceptable band, the Governor is required to write an open letter to the Chancellor explaining the overshoot or under-shoot. To date this has not happened (see Table 4).

Table 4: Real Annual Inflation, UK, 1989 – 2005

CPI (constant dollars), annual change

1989	5.2
1990	7.0
1991	7.5
1992	4.3
1993	2.5
1994	2.0
1995	2.6
1996	2.5
1997	1.8
1998	1.6
1999	1.3
2000	0.8
2001	1.2
2002	1.3
2003	1.4

2004 1.3
2005 2.1

Source: National Statistics time series data, various

The government's quest for credibility had a strong electoral component, and this was seen nowhere so clearly as in its early plans for taxation and public expenditures. It had promised not to increase the standard or higher-bracket income-tax rates, and to keep spending within the totals inherited from the Conservatives, even carrying through with planned cuts, such as a reduction in single-mothers benefits (Annesley and Gamble, 2004, 149).

Blair was determined to avoid the situation faced by previous Labour governments, which had increased spending early in their mandate, faced the wrath of the financial markets and the party's political opponents — who seized upon any budget deficit as evidence of Labour's incorrigible economic irresponsibility — and then had to had to rein in spending late in their mandate when doing so was politically most damaging. Instead, new Labour intended to inoculate itself against such problems by adhering to Conservative spending plans for the first two years, and concentrating on reducing debt. In its first term New Labour balanced the budget for the first time since 1992, and the public accounts remained balanced throughout the first term — during the same period public spending actually increased more slowly than it had under the Conservatives (Mullard, 2001 cited in Annesley and Gamble, 2004). Capital expenditures by departments fell particularly dramatically in the early years of the Blair government. In 1999-2000 the figure was lower than it was in 1996-1997 by nearly 50%. In consequence, overall public spending, measured as a proportion of GDP, fell from 40.8% in May, 1997, when Labour was elected, to 38.1% at the election of 2001 (Coates, 2005,

64). The sharp drop in capital spending was partly explained by Labour's Private-Public Partnerships scheme, which is discussed in detail below. This general restraint was unpopular with Labour party members, many of whom felt that restoring public services cut during the Thatcher years was the more pressing priority. The government turned this unhappiness into a political virtue, arguing that its willingness to weather the anger from its own political base demonstrated the iron will needed to establish confidence (especially in the financial markets), and lay the foundations for sustained growth.

Public-sector expenditure restraint was partially enforced through the spending reviews, a series of rolling reviews of public spending that set out "firm and fixed Departmental Expenditure limits" (HM Treasury website). The three-year window was established in the first Comprehensive Spending Review of 1998, presumably for strategic reasons – it extended up to the politically important period immediately before the next general election. The reviews were designed to provide a distinctive Labour approach to planning expenditures; the titles of the reviews have reflected key New Labour themes, such as "Investing for Reform" (1998) and "Prudent for a Purpose" (2000). The Comprehensive Review of 1998 was followed by smaller-scope reviews in 2000, 2002, and 2004. In 2007 a second Comprehensive Review will mark the tenth anniversary of the first. The main features of the reviews include the move to a three-year planning cycle, the linking of spending to performance indicators, and the attempt to find savings in low-priority areas that can be transferred to "front-line services."

Table 5: UK government spending and aggregate growth, years up to 2005

Financial Year Budget Balances, 1995-96 – 2004-05 (£b)

1995-96	-31.0
1996-97	-26.3
1997-98	-1.5
1998-99	12.0
1999-2000	22.7
2000-2001	23.8
2001-2002	11.1
2002-2003	-13.7
2003-2004	-21.8
2004-2005	-19.0

Source: Public Sector Finances Databank, 2006

Real GDP Growth (%)

1996	2.7
1997	3.2
1998	3.2
1999	3.0
2000	4.0
2001	2.2
2002	2.0
2003	2.5
2004	3.1
2005	1.8

Source, Eurostat

Government Expenditure as % of GDP

1977-78	38.4
1978-79	38.4
1979-80	38.2
1980-81	40.8
1981-82	42.6
1982-83	42.7
1983-84	42.3
1984-85	42.6
1985-86	41.0

1986-87	40.1
1987-88	38.6
1988-89	36.2
1989-90	35.7
1990-91	36.1
1991-92	38.4
1992-93	40.2
1993-94	40.0
1994-95	39.7
1995-96	39.1
1996-97	38.3
1997-98	36.9
1998-99	36.1
1999-00	35.5
2000-01	36.2
2001-02	36.5
2002-03	37.3
2003-04	38.4
2004-05	38.7

Source: *Public Sector Finances Databank, 2006*

A Treasurer who relinquishes so much of his maneuverability when it comes to taxation and spending also gives up much of his ability to achieve redistributive or spending goals. On the spending side, New Labour's spending restraint left the government dependent on meeting its growth targets if it is to follow through on its spending and public investment plans. Still, New Labour did effect some redistributive policy changes in the first term, even more "than Tony Blair and his Ministers allow themselves to earn credit for"; thanks mainly to targeted increases in child benefits and income supports for children, "the degree of redistribution to the bottom 10 per cent has been the greatest for a quarter of a century" (*Observer*, 2001).

In its second parliament, New Labour started borrowing to meet some of the pent-up demand. Even still, Brown was able quite justifiably to argue that he had overseen a great offensive against government debt. The positive public accounts balances racked up

in the first mandate allowed Brown to boast that during the final fiscal year of New Labour's first mandate, the national debt was reduced by an amount (£34 b) that was larger than the cumulative debt reduction accomplished by all UK governments over the previous 50 years (Coates, 2005, 64). In the second term the debt continued to fall as a percentage of GDP, and debt-servicing payments fell, as well. Between their first year in office and 2004-2005, New Labor had reduced the national debt from 44% of national income to 34%, and interest payments from 3.6% to 2% (HM Treasury 2006).

New Labour's economic approach was lauded by international financial organizations, most notably the IMF, which liked the country's "remarkable performance [which] owes much to the government's strong policy framework. This framework, through its emphasis on clarity of objectives, transparency, and accountability, has fostered policies that have been at once predictable and responsive to changing economic circumstances" (IMF, 2001). Meanwhile, several commentators, including Annesley and Gamble (2004), argue, "the early insistence on fiscal prudence and monetary stability made the government appear far more orthodox than it was" (148). According to this line of argument, new Labour's conservative rhetoric was a cover that allowed the party the freedom to pursue a more activist policy agenda. While Brown did not touch income tax rates in the early years, he found other sources of increased revenues, including; a one-time windfall tax on the profits of privatized utilities (announced in the 1997 Budget, this raised £5.2 billion); abolition of certain tax credits benefiting pension funds (£5.4 billion); abolition of tax breaks for married couples and on mortgages; and a new energy tax. In the 2001 election Labour again ran on the promise not to increase the standard or higher income tax rates, but in 2002 it adjusted National Insurance rates for employers

and high-income earners, which effectively raised the higher-income tax rate. On the spending side, Annesley and Gamble (2004) argue, the “drive to increase spending substantially on the core programs of the British welfare state was clearly demonstrated in the Budget of 2002 [but even] from the outset Brown had sought ways to increase spending in key target areas such as health and education” and other key government initiatives (148).

4.3.2 Industrial Strategy

As described above, when it took office in 1997 Labour inherited a national economy still being rocked by deindustrialization. This phenomenon was helped along by a macroeconomic policy context that systematically favored the interests of financial over industrial capital and a banking system that failed to make capital available to industry on a long-term basis at competitive rates (Hay, 1999, 185), in addition to a strengthening pound, which hurt exports (Elliot, 2003). Labour was elected in part on promises to address the UK’s gaps, relative to its major international competitors, in investment, productivity, and skills, all of which it blamed for Britain’s sluggish rates of growth. In his first speech in the House of Commons as Chancellor, Brown described the bleak reality:

Since 1980, the UK has invested a lower share of GDP than most other industrialized countries, and GDP per worker has been lower too. For every £100 invested per worker in the UK, Germany has invested over £140, the US and France around £150, and Japan over £160 per worker (1997).

Yet for Labour these goals existed alongside a rejection of the belief that government could or should lead successful economic development. Other than a commitment to achieving overall economic stability, Labour had relatively few ideas for

how to meet these economic gaps. As Coates (2000) argues, on the issue of industrial and employment policies, Labour attempted to distance itself from both the Old Left and the New Right, and achieve public credibility, by “developing a new vocabulary in which to describe its economic goals” (4). The two broad categories of policies included in this new “vocabulary” were a Third-Way industrial strategy, and the creation of a “stakeholder society” (Labour Party, 1996, 8-9).

In his introduction to the 1997 party manifesto, Blair told voters, “the old left would have sought state control of industry. The Conservative right is content to leave all that to the market” (Labour Party, 1997). Instead, Labour offered a “third way” that would “raise the trend rate of growth by strengthening our wealth-creating base.” It was based upon “government and industry working together,” with workers receiving only “basic minimum rights for the individual” (Blair 1997, 10, 3). New Labour would take “a co-operative approach” to industrial policy (Labour Party, 1996, 14).

Labour promised to establish a “partnership” with business, with a particular goal being to “develop the small and medium size business sector (Labour Party, 1996, 13). Specifically, Labour offered to: support training and R&D in science and technology; reduce bureaucracy to help small businesses; establish Regional Development Agencies; reform competition laws to enhance competition; and “put together the best combination of public and private finance to renew infrastructure” (ibid). Together this set of promised policies and initiatives was modest; it offered business the reassurance that, while a Labour government would be reluctant to provide direct subsidization, nor would it be returning to an interventionist strategy. Specifically, this would not be a government that would dedicate resources to attempting to revitalize the manufacturing sector.

The education and training promised to business was consistent with Labour's cherished commitment to education. The party was determined to train a workforce ready for the challenges of the global economy. The most dramatic promise was to establish a program, funded out of a windfall levy on the privatized utilities, that would "take 250,000 under-25-year-olds off benefit and into work" (ibid, 16). Also promised was a move toward a more market-based training system that would "place demand for skills in the hands of the individual" by establishing individual learning accounts (ibid).

Yet they did not meet their 1997 manifesto commitment for a training levy on companies. And as Moran and Alexander (2000) describe, they made at best only minor adjustments to a range of institutional changes enacted by the Conservatives. These included: reducing trade union influence through legal reforms and direct confrontations with powerful unions (most notably the mineworkers); "privatizing" the social housing market by selling a large portion of local authority housing stock; and privatizing massive public utilities. While there was no reason to expect New Labour to re-nationalize the utilities, they passed up the chance to do something much more modest when they chose to leave untouched the Conservatives' regulatory regime on the privatized utilities.

When the party actually took power, Labour soon faced the bleak industrial reality. While overall the economy was growing, manufacturing continued to bleed jobs – a net loss of 180,000 in the sector in Labour's first term alone – with much of the problem caused by a high exchange rate and poor productivity (HM Treasury, 2006; Annesley and Gamble, 2004, 150). Brown moved quickly with a three-pronged strategy designed to stimulate enterprise; develop small businesses; and support innovation (Coates, 2005, 70-71). In 1997 he introduced a tax package that:

- reduced corporate tax rates;
- doubled first-year tax credits on investment in plants and machinery;
- removed tax incentives to distribute profits rather than invest them.

In later budgets he kept up the trend, cutting the capital gains tax on business assets in four annual steps from 40% to 10%, and introducing additional tax cuts and credits aimed in particular at stimulating small business growth. Measures were also taken to improve small businesses' access to financing. Support for innovation became a central theme in New Labour policy development, manifesting itself in aid to science and R&D. The goal is to raise overall spending on R&D (both public and private) from 1.9% of GDP when Labour took office to 2.5% by 2014, which by current standards would put the UK at a level near to that of its main competitors. These investments show clearly what New Labour had in mind for a third-way industrial strategy. As Brown explained in 1999:

I do not believe that any of us can wish away the productivity challenge that Britain faces. While 30 years ago governments responded to the productivity challenge with top-down plans, and tax incentives and grants primarily for physical investment, today it is more complex: involving the modernization of capital and product markets, the encouragement of innovation and an enterprise culture open to all, and the building of a modern skills base (Cited in Coates, 2005, 72).

This three-pronged strategy was, as industrial strategies go, thin, and it operated at a very general level. To take one illustrative example, Toynbee and Walker describe a meeting between Brown and Sir Nick Scheele, CEO of Ford Motors, after Ford closed its Coventry plant. Scheele was expecting Brown to present him with Labour's plan for the automobile industry, including R&D, supply chain innovations, and ancillary industries.

Brown presented nothing of the sort, making it clear that “that was not the New Labour way” (2005, 141).

By 2003, manufacturing comprised 16% of GDP, and 13% of employment – these figures reflect the sector’s continuing decline, although it remains important for trade, making up 83% of exports in the same year (HM Treasury). According to the Bank of England, manufacturing’s falling share of the British economy should come as no surprise, because the same decline is happening in other large economies. This, it is argued, is in part because as countries get richer, they spend relatively more on services and relatively less on goods (Bank of England, 2003). Yet the crucial difference is that in other countries such as France, Japan, and the US, the manufacturing sector’s decline is relative. In the UK it is happening in absolute terms (Elliot, 2003). Manufacturing as a proportion of the UK economy was displaced by growth in other sectors, including financial and other services and, notably, energy resources. Energy production currently accounts for nearly 10% of GDP, which is one of the highest levels of any comparable industrialized nation (Eurostat). Due largely to North Sea oil and gas, in the 1990s the UK became a net exporter of hydrocarbon energy (Public Finances Databank, 2006).

4.3.3 Public-Private Partnerships

Another significant pro-business policy implemented in Labour’s first term was a massive expansion of the Private Finance Initiative, which had been established under the Conservatives, and which, under Labour, also came to include Public-Private Partnerships (PPPs). PFIs allowed for private investments in public services, particularly in education, health care, and transportation. PPPs are private entities that perform services normally performed by the public sector, but they differ from PFIs in that they

do not involve private financing. While critics have long seen such public-private ventures as a form of “back-door privatization,” strictly speaking both PPPs and PFIs are different from privatizations, a term that describes a business formerly owned by the public sector that has been sold to the private sector (Gerrard, 2001).

Under the PFI scheme, the private sector supplies equipment and builds buildings necessary for public services; the suppliers are paid in the future both for the cost of capital and management charges. In New Labour’s first term approximately 150 projects – including 35 hospitals, hundreds of schools, and four prisons — were funded this way, collectively worth over £12 billion. PFI repayments to the private sector were at £3.5 billion in 2004-2005, and will rise every year after that until at least 2012-2013; thereafter, payments will continue, as some of the projects were scheduled to run for 30 years. Simply put, the PFI scheme allowed the government to trade capital spending now for current spending in the future (Toynbee and Walker, 2001, cited in Chadwick and Heffernan, 126).

PPPs offered fiscal and political benefits for a government that saw debt reduction as a top priority and was politically committed to strict limits on current spending, yet wanted to be able to enhance public services. It therefore was not surprising that New Labour latched on to PPPs as enthusiastically as it did. Yet the scheme was as great an example of ideology and political expediency trumping genuinely responsible government as one could expect New Labour to produce. It was attacked by critics who pointed out that PPP projects were more expensive than if the government had financed the investment by borrowing: private firms built in a profit margin, on top of paying higher borrowing charges than the government would have done if it had borrowed

directly — by some estimates, PFI projects are 30% more expensive (see Monbiot, 2000). Indeed, the scale of some PFI projects in Health and Education is now having a serious effect on the budgets of those departments. The current crisis in the NHS is largely driven by the high fixed charges hospitals face to service leases on PFIs. (Annesley and Gamble, 2004; Toynbee and Walker, 2001, 137ff; Loxley and Loxley, forthcoming). There have also been numerous charges that the services provided by the private sector are inadequate and give poor value for money. Notoriously, the Skye Bridge cost £93m to build – 620% of the budgeted price – and sparked a massive controversy around the introduction of tolls (Monbiot, 2000). And more recently, in June 2005 the *Guardian* reported on a leaked government document that found that a new privately financed hospital in Leeds had “breached every section of the fire safety code” and was “putting the lives of 300 patients and staff at risk” (Hencke, 2005).

4.3.4 Exchange rates and the Euro

The precursor to the European Economic and Monetary Union (commonly referred to as the Euro, after the currency first adopted by a number of nations in 1999) was the Exchange Rate Mechanism (ERM), a system based on exchange rate margins introduced in 1979, and designed to provide exchange rate and monetary stability. The UK signed on to the ERM in 1990, but was forced to withdraw on Black Wednesday in 1992, when currency speculators attacked the pound, borrowing pounds and selling them for Deutsche Marks, planning to repay the loan in devalued currency and profit from the difference. The Bank of England’s attempts to prop up the pound was ultimately unsuccessful, and the UK left the ERM with very high interest rates and a weak pound. According to the Treasury, Black Wednesday cost the national economy an estimated

£3.3 billion (Giles, 2005). It may also have cost the Conservatives their cherished reputation as the only party able to keep a steady hand on the tiller of the economy and, by extension, the 1997 election (Heath, Jowell, and Curtice, 2001). All of this provides the backdrop for what happened to the pound under the Blair government⁴. Table 6 shows the value of the pound relative to the US dollar and the Euro (synthetic Euro before 1999). These are full-year averages, which mask wide spreads within years. Still, the effect of Black Wednesday can be seen clearly in the drop between 1992 and 1993. After that year, the pound steadily strengthened, eventually reaching, on an annual-average basis, the same level relative to the synthetic Euro in 1997 (it did not regain the ground it had lost relative to the US dollar until 2004). In recent years it leveled off and declined slightly relative to the Euro, although it remains strong, a phenomenon that has contributed to deindustrialization.

Table 6: Exchange Rates of UK Pound / US Dollar and UK Pound / Euro, 1990 - 2005

Year	£/USD	£/XEU	USD/£	XEU/£
1990	£0.5633	£0.7161	\$1.775	1.397
1991	£0.5675	£0.7022	\$1.762	1.424
1992	£0.5699	£0.7365	\$1.755	1.358
1993	£0.6663	£0.7795	\$1.501	1.283
1994	£0.6536	£0.7742	\$1.530	1.292
1995	£0.6338	£0.8200	\$1.578	1.220
1996	£0.6411	£0.8029	\$1.560	1.245
1997	£0.6106	£0.6909	\$1.638	1.447
1998	£0.6037	£0.6779	\$1.656	1.475
1999	£0.6185	£0.6595	\$1.617	€1.516
2000	£0.6609	£0.6099	\$1.513	€1.640

⁴ It is also likely that, at some level, lingering embarrassment over Black Wednesday helps explain the continuing reluctance to hold a referendum on joining the Euro, even by a pro-Europe Labour government.

2001	£0.6943	£0.6223	\$1.440	€1.607
2002	£0.6664	£0.6289	\$1.501	€1.590
2003	£0.6123	£0.6924	\$1.633	€1.444
2004	£0.5460	£0.6788	\$1.831	€1.473
2005	£0.5500	£0.6842	\$1.821	€1.463

Source: OANDA.COM

The relative successes of the British economy under New Labour, and the strong pound, have undermined some of the arguments for joining the Euro, allowing opponents to characterize such a move as a solution without a problem. In 1997 Brown and his assistant Balls (according to one well-known story, in the back of a taxi) wrote out the five economic tests they felt had to be met before the government would call a referendum on joining the Eurozone and adopting the Euro. These are considered by the IMF to be “broadly consistent with the economic considerations that are relevant for assessing entry into a monetary union” (IMF, 2001). They are:

1. Are business cycles and economic structures compatible with European interest rates on a permanent basis?
2. If problems emerge, is there sufficient flexibility to deal with them?
3. Would joining the euro create better conditions for firms making long-term decisions to invest in Britain?
4. What impact would entry into the euro have on the UK's financial services industry?
5. Would joining the Euro promote higher growth, stability and a lasting increase in jobs (Brown, 2001)?

While on their face these tests are fairly straightforward, several explanations are in order. The “economic structures” referred to in the first test are interest rates and exchange rates. The “flexibility” in test 2 is labour-market flexibility. If the UK were to give up the ability to devalue its currency, an unfavorable change in competitiveness compared with the rest of Europe would put downward pressure on wages.

The Treasury is responsible for assessing the tests. It first did so in October 1997, when it decided not to recommend membership. At the time, its view was that British entry would pass only the fourth test with any certainty. As well, the pound was still too high relative to the Deutsche Mark, and domestic interest rates were still uncomfortably higher than those in Europe. The current Treasury view is that the pound is competitive with the euro, and interest rates are converging. Nevertheless, again in June 2003 the Treasury published results very similar to those of 1997 (HM Treasury).

As Irvin (2003) notes, “the flexibility test is a curious one.” As we have seen, increasing labour market flexibility has been a central goal of New Labour’s, and the UK claims to rank among Europe's most flexible labour markets. Even still, as the decline of UK manufacturing over the past decade suggests, this vaunted labour market flexibility has not overcome low productivity growth and a strong pound. Yet in recent years the value of the pound relative to the Euro has dipped slightly, and labour productivity has improved slightly, and so

the current Treasury argument has changed. Instead of asking whether Britain is flexible enough, the Treasury asks whether the rest of Europe - notably Germany - is flexible enough? Clearly Gordon Brown and his experts think not, and much is now made of the need for the EU to reform its labour market along UK lines; i.e., employers' indirect labour costs should be lower, they should be able to shed labour more easily and the jobless should be encouraged, in Norman Tebbit's immortal phrase, to “get on their bikes and find work.” The implicit assumption is that, were Britain to join, it might catch the German disease ... [in large part] because of increased trade union power.... (ibid)

Brown’s tests comprise a set of ostensibly technical, objective criteria, but they are really subjective and political. (In this way they bring to mind the decision to give operation independence to the Bank of England, with the inflation target still being set by the Treasury.) The obvious conclusion is that if the government wanted to pursue a

referendum on the Euro, it could do so, even if current economic conditions did not change at all. Far from being technocratic, for the UK the issue of the Euro remains a deeply political one. Although such questions are beyond the scope of this thesis, a number of authors have argued that geo-political realities of the EU mean that Britain cannot stand pat – either it will join the ECM, or it will drift into ever-closer alliance with the United States (Irvin, 2003; Monbiot, 2003; Hutton, 1995). At the economic level, such a choice would appear to be between a European-style corporatist model, and an American neoliberal one.

In order to develop a more detailed understanding of New Labour economics, we now turn to a number of mainstream economic theories centred around new Keynesianism.

Chapter 5 — Theorizing Third Way Economics in the GPE: New Keynesian?

Despite the growing body of literature on the Third Way, there has been relatively little published on the economic analysis that underpins it (Arestis and Sawyer, 2001). Perhaps not surprisingly, given new Labour's self-image as pragmatic rather than ideological, New Labour itself has issued few theoretical reference points for its approach to economic policy. However, speeches by Blair and Brown, some work by academic advisors such as Giddens, and Labour party documents such as manifestos all provide a sense of how the government itself conceptualizes its economics. And it is possible to deduce from new Labour's actual policy decisions a more or less coherent political economy (Arestis and Sawyer, 2001; Hay, 2004).

New Labour's economic approach has been categorized variously as new monetarist, post-monetarist, new Keynesian, and post-neoclassical (Hay, 2004, 40). However, the greatest number of analysts view New Labour's economics as New Keynesian. Arestis and Sawyer (2001), working backward from the policies actually implemented by new Labour in order to infer the economic analysis of the Third Way, also see New Labour as New Keynesian, although they qualify this to a certain degree, proposing the terms "new monetarism" and "interventionist neoclassical economics of a new Keynesian variety" as workable alternatives (257). Hay (2004) believes that Arestis and Sawyer offer the most direct route through the debate about how to conceptualize New Labour's economics. He concedes that the way to arrive at such a categorization is the admittedly imperfect process of elimination: while New Labour's thinking is "decidedly non-Keynesian, neither, in any technical sense of the term, is it post-

Keynesian. Despite several significant qualifications, then, it is “best labeled new Keynesian or new monetarist” (40; also see Hutton, 1998). The new Keynesian label is one that New Labour thinkers also seem willing to embrace more than any other. Brown, in his Mais lecture (1999), and his advisor, Ed Balls (2002), gravitate to the term. And Giddens (2000) lauded the new Keynesian approach:

The ideas of the new Keynesians allow us to make more sense of how the modern economy works, particularly at its cutting edge, the global financial economy. Suboptimal consequences can happen in any market sector as a result of the interaction of imperfectly competitive markets with the less than rational actions of individuals. In some situations, such as those found in the finance markets, the consequence can be extreme. The tendency of the financial markets towards crisis is structural and needs to be coped with by collaborative intervention (37).

This chapter is organized around the idea that New Labour’s macroeconomics provide an example of New Keynesianism. The goals, which will be pursued using a largely non-technical approach, are: to delineate the theoretical foundations of New Labour’s economics; to situate them in relation to the recent body of work on New Keynesianism; and to identify and discuss any significant ways in which New Labour’s actual macroeconomic policies does not conform to the theory.

5.1 What is New Keynesianism?

In the context of the economic crises of the 1970s, new classical economists systematically attacked the Keynesian framework that had dominated macroeconomic theory and policy-making in the West since the Second World War. New Keynesianism emerged in the 1980s in response to the critiques of the new classical school, offering adjustments to the original Keynesianism. The main theoretical disagreement between new classical and New Keynesian economists has to do with how quickly prices and

wages adjust. New Keynesians reject the new classical models – built on the assumptions of rational expectations and flexible wages and prices — that prices clear the markets by adjusting quickly to changes in the money supply. In contrast, New Keynesians point to the costs associated with changing prices, known as “menu costs,” after the case of a restaurant forced to print new menus, to explain why wages and prices are “sticky” in the short run. New Keynesians also emphasize the role of monopolistic competition, imperfect information, and “coordination failure” to explain price stickiness (Mankiw, 2000; De Long, 2000). It should be emphasized that New Keynesians use this stickiness as a way to explain why monetary policy has a strong influence – this is an important point because it emphasizes the primary role to which new Keynesians assign monetary policy.

Once we move beyond the purely theoretical level to the level of policy implications, however, the definitional boundaries become blurred. It is probably more accurate now to refer to “New Keynesianisms,” as various strands have emerged. Indeed, it is ironic that, while “common sense” holds that Keynesianism is dead, “in the early twenty-first century Keynesianism, with a qualifying adjective, has become a church so broad that its doctrinal limits are difficult to determine” (Clift and Thomlinson, 2006, 7).

In order to define New Keynesianism, logically we first need to be clear what we mean by Keynesianism. In a forthcoming article in the *British Journal of Political Science*, Clift and Thomlinson (2006) make the important point that, in debates about the room modern governments have to achieve social-democratic reform, Keynesianism is frequently conflated with other issues, such as redistributive taxation or public spending, which are different from any specific definition of the term. Indeed, in analyses of the

Third Way, “Keynesianism” has come to be seen as coterminous with the “first way,” that is, postwar social democracy. Both are considered to be dead (see, for example, Giddens, 1998; Gray, 1998; Driver and Martell, 1998). This shorthand definition is understandable, but not rigorous.

For our purposes, certain core elements of what we mean by Keynesian policies can be identified. First is the belief that a capitalist economy is inherently unstable and that markets are imperfect (Clift and Tomlinson, 2006). Second is the emphasis on total effective demand, which is seen to play a determining role in long-run output, with relatively little emphasis placed on the supply side. These first two ideas are closely linked: as Arestis and Sawyer (1998) write, “our approach can be considered Keynesian in the sense that its policy implications arise from the perception of the role of aggregate demand in setting the level of economic activity and the lack of automatic forces leading a market economy to full employment” (181). The third core tenet (which follows the second) is the pursuit of full employment as a primary policy goal. And fourth, an emphasis on fiscal policy, particularly counter-cyclical fiscal policy, to fine-tune the macroeconomy. As a starting point we can assume that New Keynesian theories would offer a modified version of this very basic four-part Keynesian model.

De Long (2000) offers a definition of a new Keynesian research program that is cited by Arestis and Sawyer (2001); it is built upon five propositions:

1. The frictions that prevent rapid and instantaneous price adjustment to nominal shocks are the key cause of business cycle fluctuations in employment and output.
2. Under normal conditions, monetary policy is a more potent and useful tool for stabilization than is fiscal policy.

3. Business cycle fluctuations in production are best analyzed from a starting point that sees them as fluctuations around the sustainable long-term trend (rather than as declines below some level of potential output).
4. The right way to analyse macroeconomic policy is to consider the implications for the economy of a policy *rule* rather than discretion, that is not to analyse each one- or two-year episode in isolation as requiring a unique and idiosyncratic policy response.
5. Any sound approach to stabilization policy must recognize the limits of stabilization policy, including the long lags and low multipliers associated with fiscal policy and the long and variable lags and uncertain magnitude of the effects of monetary policy (83-84).

5.2 Is New Labour New Keynesian?

If we are to establish that New Labour's economics are New Keynesian, it is necessary (but not sufficient) to establish that they have left Keynesianism behind. There is, on the face of it, a near-consensus in the literature that the postwar Keynesian framework is well and truly dead, and therefore New Labour cannot possibly be Keynesian. Driver and Martell (1998) write, "in 1997 a Labour Party was elected to government that had rejected ... Keynesianism" (32). Hall (1986) refers to the "collapse of the Keynesian consensus" and the attendant monetarist "triumph" in the UK; "for all intents and purposes the Keynesian era was over in Britain" by the time of the 1977-78 public spending cuts (see also McNamara, 1998, all cited in Clift and Tomlinson, 2006, 3). However, while there is no doubt the crises of the 1970s saw a dramatic shift in the balance of influence between Keynesianism and monetarism, "Keynesian political economy has not been wholly de-legitimised by the crisis of the 1970s. The victory of monetarism over Keynesianism was not total, as the rise of various strands of New Keynesian economic thinking demonstrates" (ibid). Even Hutton, who, as we will see, leaves no room for ambiguity about his claim that New Labor has left Keynesianism

behind, argues at the same time that new Keynesiansism carries on many of Keynes' key insights, and "offers as vigorous a criticism of dynamics of the market economy." In particular, he points to Keynes' attention to the international financial system as a "locus of economic instability" (100).

In what ways might it be said that New Labour, at the level of theory, has repudiated Keynesianism? In his 1998 speech to the Mansion House, Brown argued:

The Keynesian fine tuning of the past ... will simply not work. Neither can stability be delivered in wholly deregulated markets ... the answer is to ensure stability through establishing the right long-term policy objectives and to build credibility in the policy through well-understood procedural rules that are followed for fiscal and monetary policy.

Perhaps the best technical explanation of New Labour's economic theory is the article published by Ed Balls in the *Scottish Journal of Political Economy*. Balls is Brown's economic advisor, and early in new Labour's mandate the Chancellor rarely made a decision without consulting Balls first. His influence was such that civil servants referred to him as "the deputy Chancellor," or even "the real Chancellor" (Rawnsley, 2001, 34). Balls placed a similarly strong emphasis on transparency, stability, and trust. In Balls (1998) he sets out four principles for macroeconomic policy in an open economy, principles which "flow logically from changes in the world economy and the world of economic ideas over the past twenty or thirty years":

1. Stability through constrained discretion;
2. Credibility through sound long-term policies;
3. Credibility through maximum transparency;
4. Credibility through pre-commitment (117-119).

5.2.1 Fiscal policy

Hutton (1998) argues that New Labour accepted

the new right consensus that budget deficit manipulation only disturbs the natural rhythms of the economy, and because all government debt eventually becomes monetized, is necessarily inflationary. High public spending and high taxation crowd out private spending and create an illegitimate burden on companies and individuals alike; there is some natural limit, around 40 percent of GDP, which should be the cap to the public sector's role. " (99).

Similarly, Arestis and Sawyer (2001) name, as the first of eight core elements they see as underpinning Third Way economics, that "the market economy is viewed as essentially stable and macroeconomic policy (particularly discretionary policy) as capable of destabilising the market economy" (258). Hay (2004) refers to New Labour's "fiscal passivity" as a core element in its macroeconomics, underpinned by the theoretical rejection of "any correlation between aggregate or effective demand and growth." This passive stance means that the government cannot use fiscal policy to fight inflation or to influence the business cycle (44).

Yet, Annesley and Gamble (2004) note that the government's public spending plans are broadly counter-cyclical, not to say Keynesian. Rather, the new-Keynesian idea that policy activism can improve economic performance has been a guiding light for the Blair governments (149). And, as Clift and Tomlinson (2006) point out, the crowding out argument does not actually appear in New Labour's policy statements, and Brown frequently justifies fiscal prudence by promising a payoff in the form of future investments in services. (And, as we will see below, to the extent that New Labour's policies are based on endogenous growth theory, the crowding out argument does not hold.) Balls (1998) also sees some room for governments to "use discretionary monetary,

or indeed fiscal, policy to deal with macroeconomic shocks,” providing they have first established credibility in the eyes of the markets (124, emphasis added). While hardly a call to arms in defense of Keynesianism, New Labour’s doctrinal position that “macroeconomic policy, if set correctly, should be a stabilizing force,” is more nuanced than some authors allow.

5.2.2 Monetary Policy

The decision to grant operational independence to the Bank of England was in some ways the centerpiece of New Labour’s first term in office, as well as occupying a central place in the party’s macroeconomic doctrine. The linked beliefs that monetary policy can be used to fight inflation, but only (or, most effectively), if set by independent experts, is consistent with the dynamic-inconsistency problem associated with the rational expectations school that was so active in challenging the dominance of Keynesian policy-making. This school built upon the work of Milton Friedman and others who challenged the belief that there was a long-term trade-off between inflation and unemployment, a trade-off that could be negotiated by governments using Keynesian policies. While rejecting the short-term trade-off between inflation and unemployment / growth, the rational expectations school noted that government policy-makers accepted it. Elected governments would then, quite rationally, attempt to manipulate the business cycle in such a way as to maximize their chances for reelection. Specifically, they would attempt to inflate growth when it was to their electoral advantage (usually in the year before an election), even if this meant over-heating the economy and triggering inflation. Thus, even if governments set inflation targets, they would be unlikely to stick to them, except by “accident,” as it would be rational for them to act in their own self-interest,

even if this meant missing the targets. Other actors, who are assumed to have high levels of knowledge about the structure of the economy and the objectives of the monetary authorities, come to expect the associated increases in inflation and will, quite rationally, make spending and investment decisions based on the “political business cycle” (see Healey, 2002; Blanchard, Johnson, and Melino, 2003, 551-554; Watson and Hay, 2002, 294). Balls (1998), summarizes:

An incoming government might declare that it wanted to achieve low inflation, but this government’s incentive would always be to cheat and dash for growth, knowing that the resulting recession would only come along later. But, as Friedman pointed out, the result of trying to exploit this short-term trade-off between unemployment and inflation was simply to build in higher inflation expectations (and therefore higher long-term interest rates) with no long-term gain in terms of output and employment (120-121).

This is the dynamic-inconsistency problem – an actor’s (in this case the government’s) preferences change in inconsistent ways over time. It is often associated with game theory (for a UK-specific example, see Goodhart, 1994). Goodfriend (2004) provides a slight variation from a different theoretical perspective: the new neoclassical synthesis (NNS) approach to monetary policy, made up of neoclassical and Keynesian elements. Consistent with the classical perspective, the NNS model sees interest rates affecting aggregate demand, which influences wages, which in turn influences the markup. This influence of interest rates upon employment is “the fundamental credibility problem of monetary policy,” arising out of a basic tension in the NNS (32). While firms attempt to set prices at profit-maximizing levels, the markup has the effect of a “tax” on consumption. The central bank is inclined to pursue an expansionary monetary policy so as to undo this “tax,” but the problem is that the temptation to do so is greatest when the bank’s credibility on inflation is highest – and thus, the consequences of such actions on

its inflation credibility most severe. "In short, credibility for low inflation is fundamentally fragile in the new neoclassical synthesis" (ibid).

These models take slightly different routes to arrive at the same conclusion. If we accept that conclusion, the necessary policy response is to take the setting of rates out of the hands of government, in favour of a monetary authority with the primary mandate to achieve price stability.

The move to grant independence to the Bank of England was just such a response. According to Brown, it was in keeping with "the new post-Monetarist economics," which he outlined in his first budget speech to the House of Commons in 1997:

- ... because there is no long-term trade off between inflation and unemployment, demand management alone cannot deliver high and stable rates of employment;
- In an open economy rigid monetary rules that assume a fixed relationship between money and inflation do not produce reliable targets for policy;
- The discretion necessary for effective economic policy is possible only within a framework that commands market credibility and public trust;
- That credibility depends on clearly defined long-term policy objectives, maximum openness and transparency, and clear and accountable divisions of responsibility (1997).

Brown's phrase "post-monetarist" stands out. It is true that, in the narrowest sense, New Labour can claim to have moved beyond monetarism by relinquishing control of the money supply. But is this not a distinction without a difference? As we have seen, a range of theories reject strict monetarism, and yet lead to the same end. As Kirschner describes the situation:

In an odd way, the monetarists have won. Keynesian and new classical economists have all come around to their way of thinking, except for the

part about money ... the essential tenets of monetarist philosophy – conservatism, the primacy of monetary policy, and above all else vigilance against inflation – have won. In practice, contemporary monetary policy is implemented by chastened Keynesians following monetarist instincts (1999, 612-613).

5.2.3 Pursuit of Full Employment

Several critics have noted New Labour's reluctance to pursue full employment as a primary policy goal, and deduced that New Labour's political economy includes the acceptance of "the natural rate of unemployment" (Hay 2002) or the non-accelerating inflation rate of unemployment (NAIRU) (Arestis and Sawyer, 2001, 259). According to the NAIRU theory, when unemployment falls below the NAIRU, inflation rises (relative to the expected rate of inflation) and the rate of inflation rises if unemployment is held below the NAIRU. In the long run, however, there is no inflation-unemployment trade-off – the inflation rate is a result of the rate of increase in the money supply.

Again, however, Clift and Tomlinson provide evidence that tempers such conclusions. While Brown and New Labour do accept the NAIRU theory, Brown does not go so far as to accept the natural rate theory, specifically arguing, "the idea of a fixed natural rate of unemployment consistent with stable inflation was discredited by the evidence of the 1980s" (cited in Clift and Tomlinson 14).

5.2.4 Credibility and Reputation

A number of critics have taken New Labour's commitment to credibility as an intellectual fig leaf for hard-line monetarism or belief in the NAIRU. Yet on balance it would appear that New Labour might see credibility as an end in itself. The linked issues of policy credibility and government reputation are central to the rational expectations hypothesis. Recall that private sector agents are assumed to be both knowledgeable and

rational, and thus they know how the monetary authority will respond to any economic scenario. This scenario is often characterized as a version of the prisoner's dilemma, in which both private actors and monetary authorities act rationally in their own self interest, with mutually harmful results – namely, sustained inflation. One possible solution is for policy makers to follow a strict monetary rule. This solution has been challenged on the grounds that the private sector has no guarantee the monetary authority will not “cheat” on the zero-inflation rule, so as to realize other social goals. In the literature, two broad categories of responses to this “credibility problem” have been proposed. The first involves setting very high-profile targets such that it would be politically damaging, if not impossible, for policy-makers to miss them. This approach could easily be combined with delegating authority to a politically independent entity, such as the Bank of England, which is given the sole mandate of inflation control. The second response is for the government to set a strict monetary rule and then stick to it over a number of years, even when doing so may have economic (not to mention political) costs in the short term; in this way it will build up a strong enough reputation to convince the private sector that inflation targets can be trusted (Healey, 2002).

The importance of credibility in monetary policy was a focus of attention in other jurisdictions in this period. For example, Dodge (2002) argues that Canada's experience in the 1990s provides strong evidence that there are important connections between fiscal and monetary policy on the issue of credibility. Transparency in decision making, strong communication, and the setting (and meeting) of clear targets are all essential if credibility is to be built. Dodge sites several interventions into the Philips Curve debate to argue that “the credibility of monetary policy has apparently led to a change in the nature

of the inflation process itself.” In fact, “credibility has stabilized the inflation process, and therefore, inflation itself” (194). As noted above, this understanding of the interface between credibility in fiscal and monetary policy and inflation was central to the institutional changes New Labour enacted to the management of monetary policy, the theoretical underpinnings of which are based in the “rational expectations” school of the 1970s.

While neoclassical theory appears to value a government’s reputation for consistency on economic issues in general, New Labour’s record demonstrates how the real focus is on consistently applied monetary policy. While the Blair government has revealed no time-inconsistent inflationary preferences, its fiscal preferences *have* changed – on such issues as spending relative to GDP, debt, and taxation, the government has, quite openly, expressed somewhat fluid preferences. According to Hay (2004), time-inconsistent fiscal preferences do not in themselves represent a problem within the contemporary neoclassical theory:

The reason for this is simple. Time-inconsistent *inflationary* preferences only pose a problem because of the vested interest politicians have in making – and then breaking – strong anti-inflationary commitments. Fiscal preferences are (generally speaking) revealed preferences. Consequently, they hold no secrets to market actors (48-49).

5.2.5 From Discretion-Based to Rules-Based Decision Making

One perspective on New Labour’s economics emphasizes the process through which policy is developed over the results. Since the mid-1970s, a transformation has taken place in the way economic policy (in particular stabilization policy) is developed in much of the developed world, in the form of a shift from a discretion-based to a rules-based system. Opportunities for individual planners to exercise discretion in policy-

making have come to be considered overly politicized and unpredictable (and thus, at the macroeconomic level, inflationary), and have been reduced steadily, replaced by sets of rules that proscribe government intervention in many individual decisions (Snowdon and Vane, 2002; Burnam, 2001, cited in Annesley and Gamble, 2004, 145). As Annesley and Gamble (2004) point out, the “new” approach is not completely new, as it actually revivifies some of the central features of the last rules-based economic order, that based on the gold standard in the years before the First World War⁵. Its adoption also reflects a larger move away from Keynesian fine-tuning and toward rational-expectations theories and monetarist policies. During the Keynesian era, discretionary counter-cyclical stabilization policies were largely seen as a simple matter – when the economy seemed to be approaching a recession, authorities would respond with expansionary fiscal policies and cheaper money. Clearly, a discretion-based system is a better fit for a Keynesian macroeconomic framework. Still, it is theoretically possible for the policies produced under a rules-based system to be expansionary or social democratic. Yet this is rarely what happens in practice, as the case of New Labour shows. Monetary policy now operates within a rules-based system, and Gordon Brown’s two “golden rules” are a determining influence on fiscal policy. (While being committed to balancing the budget over the business cycle, Brown has not gone so far as to adopt stricter balanced-budget legislation. This is almost certainly because such a rule has only been adopted in a small number of jurisdictions, mostly North American, and “few economists today would

⁵ Hay (2004) makes a similar point about New Labour’s macroeconomic regime in general, which is “in one sense a return to an older liberal tradition upon which the Bank of England was founded” (48).

support any form of strict fiscal rule requiring a government to attempt continuously to balance its budget” (Snowdon and Vane, 2002, 635.)

5.3 Endogenous Growth Theory

Endogenous growth theory (also known as “new growth theory”) is not identical to New Keynesianism, but there is extensive overlap between the two. It is particularly worth exploring for our purposes because while in opposition Brown briefly endorsed “post-classical endogenous growth theory,” an unfortunate name that was ridiculed by the opposition and the conservative press as hopelessly, pretentiously esoteric⁶ (see Maron and Alexander, 2000). Yet “the influence of endogenous growth theory is manifest in Brown’s economic policy and provides a central element in New Labour’s strategy for the realization of” its main political-economic goals (Buckler and Dolowitz, 2004, 23). It is also interesting to note that several authors point to endogenous growth theory as a potential basis on which social democratic parties could build a case for intervention and investment (Garrett 1998; Wickham-Jones, 2000).

Endogenous growth theory represents a rejection of neoclassical theories, which typically see the long-term rate of growth as being determined exogenously – usually by assuming a certain rate of technological progress. The political-economic assumptions behind a model built according to such theories are that rational actors will attempt to maximize utility in pursuit of their personal self-interest. Economic growth is produced by these free-market efficiencies. In contrast, endogenous growth theorists attempt to incorporate technological change (and often human capital development) into their

⁶ It was an open secret that the phrase was coined by Ed Balls, which prompted one Conservative to sneer, “It wasn’t Brown’s, it was balls” (*The Economist*, 1999).

model. Mathematical models of endogenous growth typically include a production function for total output, dependent on capital and labour as inputs. The key modification is the addition of productivity increases that can be generated endogenously – that is, by choices made within the model itself (Fine, 2000; Crafts, 1996; Buckler and Dolowitz, 2004). It is worth noting that the qualities that set endogenous growth theory apart are largely technical – what in similar models was a given, is here explained within the model. As several commentators, including Fine (2000) have noted, “it is simply a market imperfections theory of technical change in which, in contrast to static general equilibrium or exogenous growth theory, the impact of the imperfections is felt on the *rate of growth* rather than upon the *level of output*,” with the last point being the only new theoretical contribution (250).

It may be somewhat odd to consider endogenous growth theory in a section on (new) Keynesian macroeconomics, as the former is primarily concerned with microeconomics, through theories of economies of scale and inputs such as “human capital.” Theories such as these, which form the foundation of endogenous growth, “have nothing as such to do with the economy as a whole” (ibid, 248). Yet this is consistent with New Labour’s general political economy. The microeconomy – especially as regards the supply side – offers them a way in to macroeconomics.

As noted by Bertola (1994), work on endogenous growth theory almost inevitably ends with a policy discussion; yet there is no policy consensus, a reality probably explained by its highly formal and abstract approach (Fine, 2000, 261). The theory shares with new Keynesian economics the belief that the economy is imperfectly competitive, and points to the state’s role in correcting market failure (Arestis and Sawyer, 2001, 260-

1). Thus, at the level of policy application, endogenous growth theory accords the state a large role in determining the long-term rate of growth through the maintenance of a social context conducive to growth (law and order, intellectual property rights, trade and market regulations), as well as human capital, education, and R&D. In other words, policy decisions have a determining influence on long-run growth. It is central to the logic of endogenous growth theory that investments in innovation (which could mean human capital development or technology) made by individual firms offer benefits to the economy as a whole that are greater than the benefit enjoyed by the firm making the investment. Since short-term private returns on such investments may be fairly small, state intervention is required. In this way, public investment, rather than crowding out private investment, actually stimulates aggregate growth in the medium and long term (Buckler and Dolowitz, 2004, 28).

If endogenous growth theory is adopted as the core of a government's economic strategy, the role of the state in enhancing growth is neither completely passive, nor is it active demand management. Thus, to the extent that New Labour endorses endogenous growth theory, there is an apparent tension with strong commitments to fiscal prudence and anti-inflation monetary orthodoxy. Where this tension has been resolved, it has typically been achieved by backing off of the policy commitments that follow from endogenous growth theory. For example, Labour had argued during the 1997 election campaign that it would address the investment gap, the productivity gap, and the skills gap between Britain and other OECD economies. These gaps were held to be responsible for unnecessarily harsh boom-bust cycles and sluggish overall growth. In 1999, *The Economist* had fun at Brown's expense, noting that he wanted to be "remembered for

more than just stability, which he thinks is only a necessary first step towards a greater end: raising Britain's long-run rate of economic growth. He still cleaves to the theory that dare not speak its name" – in other words, endogenous growth theory. It was not the diagnosis, but rather the prescription, that was New Labour. In keeping with a desire for a less-active state, the party offered very few specific proposals to close the gaps, aside from a general strong pro-business, pro-competition orientation, which it was hoped would create the conditions necessary for improvements to occur (Annesley and Gamble, 2004, 150). Similarly, the major investments in training, education, and R&D that might have been expected under a Treasurer who accepts the premises of endogenous growth theory have yet to materialize.

5.4 New Keynesians in Practice?

In practice, the government's manifesto commitment to keeping within the Conservatives' targets for public spending forced it into a period of slow spending growth in nominal terms, and a slight decline in public spending relative to GDP. As we saw in Table 5, public spending relative to GDP declined in the first years of the Blair government, hit bottom in fiscal 1999-2000, and then began climbing again. The decline in real GDP growth — as a result of the global downturn, the high price of the pound, and the bursting of the "new economy" bubble, the combination of which hurt exports — from 4.0% in 2000, to 2.2% in 2001 and 2.0% in 2001, offered, in a sense, the first opportunity for Brown to demonstrate his Keynesian credentials regarding counter-cyclical spending. The slowdown was met by spending that was, broadly-speaking, counter-cyclical. From a peak surplus of £23.8b in fiscal 2000-2001, the public accounts showed a surplus of £11.1b in the following fiscal year, which was in turn followed by three consecutive

years of deficits. This occurred in the context of steady annual increases in public sector investment, which is projected to reach 2% of GDP in 2006 – a four-fold increase in real terms since New Labour took power in 1997 (HM Treasury). Such an approach to borrowing and spending was explained by Brown, with a distinctly Keynesian flavour, in his budget speech of 2004: “fiscal policy can and must take account of the economic cycle,” he argued, advocating for “allowing borrowing to rise when the economy grows below trend and reducing borrowing when the economy is above trend” (qtd. in *The Guardian*, March 17, 2004). As well, in addition to implementing modestly counter-cyclical fiscal policies in his second term, Brown explicitly rejected the idea of balanced-budget legislation, making the argument that to do so would “be an exact repeat of the mistakes of Britain's stop-go past and put at risk British stability and growth” (Milner, 2004).

New Labour’s fiscal policies were developed within the strict confines of the two “golden rules” set out by Brown in 1997. The first rule, that over the cycle borrowing would be undertaken only to fund investment and not current expenditures, was adhered to, and this represented a change from the approach dating back to the mid-1970s, when there was consistent borrowing to pay for current spending. Yet Clift and Tomlinson (2006) argue persuasively that, considered in historical context, adherence to this rule does not in and of itself disqualify the government from being considered Keynesian – during the hey days of Keynesian policy in the 1950s and 1960s Brown’s first golden rule was, in effect, obeyed (although it did not yet exist as a “rule”). And the second rule – that over the cycle public debt should be stable and at a prudent level – was also adhered to but, as with the rule on spending, this was equally true in the postwar years, when debt

relative to GDP was falling (thanks in part to inflation). So if on these grounds New Labour does not meet the test of Keynesianism, then neither did the postwar UK governments.

On the pursuit of employment, we can see from Table 7 that unemployment has seen a modest, steady decline over New Labour's years in power. This figure moves in parallel with overall growth; the uptick in unemployment in 2002 parallels the dip in GDP growth in 2001–2002.

Table 7: Annual unemployment rates, UK

Aged 16 and over; Seasonally adjusted

1976	5.4
1977	5.5
1978	5.6
1979	5.3
1980	6.1
1981	9.4
1982	10.5
1983	11.3
1984	12.1
1985	11.5
1986	11.5
1987	11.0
1988	9.0
1989	7.4
1990	7.0
1991	8.6
1992	9.8
1993	10.5
1994	9.8
1995	8.8
1996	8.3
1997	7.2
1998	6.3
1999	6.1
2000	5.6
2001	4.9
2002	5.2
2003	5.0
2004	4.8
2005	4.7

Source: Eurostat

Finally, how are New Labour's economics consistent with endogenous growth theory? This would include "an active supply-side policy" to complement the much-heralded macroeconomic stability (Brown 1999). In fact, New Labour did implement a range of microeconomic measures. These are scattered throughout various departmental budgets, but some of the most significant were collected by the Treasury in a document titled *Enterprise Britain: a modern approach to meeting the enterprise challenge*, included with the 2002 budget documents. They include taxation adjustments (including Research and Development tax credits), the Venture Capital Trust, the Corporate Venture Scheme, business mentoring and incubation schemes, and the National Information Technology Strategy. Buckler and Dolowitz suggest three broad categories into which these strategies can be organized: investments and incentives; education and skills development; and redistribution for opportunity (32). Measures that fit in the final category include the Phoenix Fund and the Community Development Venture Capital Fund, as well as various regional development agencies and the so-called New Deal for Communities – all of which are aimed at under-developed communities – and various tax credits aimed at working families, persons with disabilities, and so on. No doubt every government has implemented numerous targeted microeconomic measures; it is beyond the scope of this thesis (and would be largely beside the point) to evaluate the effectiveness of New Labour's efforts in this regard. However, the evidence shows that Brown put at least as much emphasis on the supply side of the economy as he did on any kind of Keynesian demand-management.

In conclusion, we can return to the definitions of Keynesianism and New Keynesianism set out near the beginning of this chapter. The results of such an exercise are set out below:

Table 8 Is New Labour Keynesian?

Sees economy as inherently unstable	Yes
Emphasizes demand side of economy over supply side	No, but demand side is not completely ignored
Full employment is primary policy goal	No, though unemployment has not been allowed to rise, and there has yet to be any serious "test" of how much gov't is willing to let it rise
Emphasizes fiscal policy over monetary policy; willing to employ it counter-cyclically.	No. Adheres to new monetary consensus. But not completely fiscally "passive," and has taken generally counter-cyclical steps
Attempts to fine-tune economy	No. Very coarse tuning

Table 9 Is New Labour New Keynesian? (as per De Long)

Sticky prices cause fluctuations in output	No clear statement on this theoretical point, but implied agreement
Under normal conditions, monetary policy is a more potent and useful tool for stabilization than is fiscal policy	Yes
Business cycle fluctuations in production are best analyzed from a starting point that sees them as fluctuations around the sustainable long-term trend (rather than as declines below some level of potential output).	Yes
Favour macroeconomic policy <i>rules</i> over the discretion of policy-makers	Yes

over the discretion of policy-makers	
Sound stabilization policy must recognize limits of such policy	No clear statement on this theoretical point, but implied agreement

Other commentators have addressed these questions and while there is a lot of common ground in the conclusions, these results shown above are not identical to the conclusions reached by any other commentators. While Arestis and Sawyer (2001), Hay (2004), Hutton (1999), and others see New Labour as being clearly New Keynesian or new monetarist, Clift and Tomlinson cite the “policy space” the government has carved out in which to “engage in coarse tuning inspired by Keynesian thinking” (1). This reminds us that in the real world economics rarely conform perfectly to the theory. This is true at the level of doctrine, and especially true when it comes to actual policy implementation. The point is not to try to nail down New Labour’s economics so that it fits into a neat definition. Rather, it is useful to situate it relative to the theory. While Hay (2004) characterizes New Labour as having a “consistent *academic* political economy,” at the same time the government has “no clear vision or political economic purpose” (49). Hay’s contribution on this point is to link the two sides of that equation: precisely because contemporary mainstream economic theory is so technical and technocratic, it leaves no room for forward-looking normative elements, and actively constrains the policy makers who would be responsible for realizing any bold economic vision.

But does this mean that theory doesn’t matter? At one level, clearly not. As Hutton (1999), writes:

New Labour’s Achilles heel is that, because it has no economic theory which is critical of capitalism, it is wide open to simple business

definitions of the public interest because it has no other reference point....The great advantage Keynesian economic theory offered social democrats was that it provided a non-Marxist critique of capitalism along with a workable economic and social programme, and allowed them to conceive the public interest as rather more than the interplay of private interests in a free market. Keynesian axioms defined the postwar common sense, and gave the left then as strong a position as the right today (99).

Despite his left critique of New Labour's New Keynesianism, Hutton sees some value in New Keynesianism, particularly certain parts which he associates with the same intellectual tradition that saw a need for the Bretton Woods institutions. Cutting-edge research on market failures and endogenous growth, he argues, provides a rationale for investment and intervention even within a New Keynesian context. It is odd for Hutton to critique New Labour from the left, lament the party's decision to "junk Keynes wholesale," and then move into a discussion of what there is to like about New Keynesianism – which, after all, is even more in keeping with the neoconservatism Hutton opposes. This may be an example of the phenomenon described by Lanchester (2005): "The [Labour] party's record in government evokes a range of responses on the left – from mild gloom to clinical depression, from irritation to rage, from apathy to horror – but one of the most consistent things it provokes is disorientation. This is a Labour government?" In other words, it would appear that what critics like Hutton really want is for New Labour to have a "coherent political strategy" (102). Embracing New Keynesianism, while far from ideal, is better than merely bouncing along on the waves of globalization. Is New Labour willing to push the policy boundaries imposed by globalization? Do we really know where those limits are? It is those issues that we now turn.

Chapter 6: The Structural Dependence Thesis

Most critical analyses of New Labour, written from the left, see its program as maddeningly conservative, and already a good deal has been written cataloguing the ways in which Labour has moved rightward, especially on economic policies. But there is nothing approaching general agreement on why this has happened, nor on how much it has been determined by globalization – which is what New Labour has argued. One theory that would appear to have strong explanatory potential is the structural dependence thesis⁷. This theory is at the heart of a long, complex, and illuminating debate in the literature. Wickham-Jones, Hay, and Coates all write from a broadly left perspective, but disagree about: which components of the British political economy in the context of globalization are structural, and which ones contingent; the evolution of the Labour party; and basic questions of political structure and agency. The debate contains a systematic and extensive effort to theorize the place of Third Way economics in the global political economy. It is worth examining in detail.

Structural dependence theory begins with the proposition that the state is structurally dependent on capital. Thus, the behavior of any government is limited by the need to create and sustain the economic conditions that lead to investment. In practice, this means meeting the policy demands laid out by capital. Social-democratic policies may be politically popular and economically beneficial for a majority of voters, which is

⁷ Structural dependence is distinct from structural realism, the International Relations theory first described by Waltz (1979). It is a systemic approach, in which the international structure acts as a constraint on state behavior, so that different states, acting rationally, behave in a similar manner, and outcomes fall within an expected range. Structural realism is now one of the dominant theoretical approaches in International Relations.

why social-democratic parties can get elected. Once in office, however, the state's structural dependence on capital means that social reform measures such as redistributive tax policies or labour-market regulation are largely unachievable without precipitating disinvestment; radical policies would result in economic crisis. Among the leading developers of this theory were Adam Przeworski and Michael Wallerstein, who set out clearly the dilemma facing progressive parties:

Politicians seeking re-election must anticipate the impact of their policies on the decisions of firms because these decisions affect employment, inflation, and the personal income of voters; vote-seeking politicians are dependent on owners of capital because voters are (1988, 12).

The strengths of the structural dependence thesis are its almost brutal clarity and theoretical parsimony, but those are also its weaknesses. The theory was developed and expanded in the late 1980s and early 1990s (see, for example, Swank, 1992), in the years just before International Relations and Global Political Economics scholars turned their attention to theories of globalization. As the globalization debates began to emerge, the theory seemed to have added validity, as globalization provided capital with dramatically increased mobility. However, even proponents of the structural dependency thesis believed the theory was too deterministic and did not take into account sufficiently differences in national context. In certain contexts, certain actors might achieve reforms. In particular, a powerful labour movement could buttress a social-democratic government (see Przeworski, 1991). However, structural dependency theorists remained pessimistic about the prospects for social reform, and the emphasis shifted to the process that would occur before a social-democratic government was elected. Knowing that undesirable policies would follow such an election, capital would act in advance, through a combination of what might be called "anticipatory" capital flight and threatened capital

flight. It would then become in the best interest of social-democratic parties to renounce radical economic policies because “the state may be structurally dependent in the dynamic sense that, given the costs of anticipations, left-wing governments may best promote the interests of their constituencies by assuring capitalists that they would not pursue such policies” (Przeworski, 1991, 95).

6.1 The Structural Dependence Thesis Applied to the UK

Mark Wickham-Jones (1995) applied Przeworski and Wallerstein’s modified structural-dependence thesis to the case of Britain between 1989 and 1992. He concluded that in the years leading up to the 1992 British general election, “Labor’s [sic] economic policy proposals were determined neither by party activists nor by the electorate. The central determinant was the attempt by Labour leaders to win over capitalists by meeting their policy preferences,” and thus confirmed the pessimism of Przeworski and Wallerstein (487). Since capital associated a Labour government with such undesirable policies as high taxes, labour-market regulation, and public-sector expansion, in an era of globalization any potential Labour government must go to great lengths to make reassurances that it will adhere to the new macroeconomic rules.

The structural dependence thesis is apparently completely consistent with New Labour’s stance on the interaction between international and domestic political economies. Blair’s Labour party has placed overwhelming emphasis on the degree to which global dynamics and pressures act as external constraints on domestic political economic changes. This has been the case in opposition, and then in government. When Blair told a business audience in 1996, “errors in macroeconomic policy will be punished rapidly,” he was offering reassurance that he knew the rules of the globalization game – if

business did not like New Labour's policies, or did not trust its anti-inflation orientation, then New Labour would be punished (4). The open markets associated with globalization, supported by free capital flows and new information technologies, made these rules even more stringent. And in policy terms, these ideas go a long way toward explaining Gordon Brown's declaration of "war on inflation." He accepted the idea that, as a result of the globalization of financial markets, any increase in inflation, or in public debt (relative to GDP), would lead directly to a corresponding increase in the cost of borrowing. This was all part of what Michael Heseltine famously called Labour's "prawn-cocktail offensive," a deliberate, systematic campaign to woo the financial community with the message that Labour was, indeed, primarily committed to fighting inflation.

Wickham-Jones emphasizes that it is "not enough for social democrats simply to make policy statements and assume that capitalists would adjust their attitude ... reformists had to be believed" (467). In some cases, the process involved backing off of previously held positions so as to send an even stronger message. For example, as Panitch and Leys (1997) point out, Brown's message on inflation simply grew less nuanced over time, presumably in response to a business community that was slow in coming around to supporting New Labour. As we have seen, Brown has stressed Britain's serious under-investment problem, and noted that the risk of inflation was higher in Britain because this problem reduced productive capacity. Therefore, according to this way of thinking, a range of "supply-side" measures designed to increase investment would be appropriate, if only to aid in the fight against inflation. Where Brown once saw two main potential inflation triggers – both external (the financial markets) and internal (sluggish real investment and low productivity) – by the time he was on the brink of becoming

Chancellor he had shifted emphasis significantly to the external realm. By the year leading up to the 1997 election, however, New Labour had effectively abandoned most of these options (250-251). For example, a strong belief in training expressed by the party while in opposition was not backed up in the election platform with funding to support interventionist industrial measures.

The primary critic of the “modified structural dependence thesis” developed by Wickham-Jones and others, was Colin Hay; the fulcrum of the debate was the degree to which the Labour party’s shift to the right on economic policies in the 1980s and 1990s was determined by the constraints imposed by capital (Hay 1994; 1997). Hay argued that the party had essentially chosen its own policy trajectory, one that led directly to convergence with the neoliberal policies of the Conservatives. Labour “sought assiduously to anticipate and appease fears on the part of industrial and financial capital alike that it might implement in government a traditionally social democratic programme” (Hay, 1998, 18). This had occurred through a process of “preference accommodation (whether directed at capital or the electorate) (Hay 1997, 235). As an antidote he prescribed a strategy of preference-shaping. For Hay, in other words, New Labour made the wrong decisions and believed the wrong ideas about economic policy.

6.2 Wickham-Jones’ Use of the Garrett Thesis

After the election of 1997, Wickham-Jones’ position shifted away from structural dependency, noting, “much recent research has thrown doubt on structural dependence theory” (1997, 263). In 2000, he abandoned the structural dependency thesis as the best way to explain New Labour’s place in the global political economy, and instead turned to arguments developed by Geoffrey Garrett in his influential 1998 book *Partisan Politics*

in the Global Economy. Garrett claimed that globalization has in fact had little impact on the “social democratic corporatist model,” which remains a viable option. While social democracy faces real challenges, these are the result of internal tensions and contradictions, not external forces. In the case of a national economy without a strong countervailing force such as trade unions, a social-democratic party will be inclined toward neoliberal economic policies, and a generally cautious approach to governing.

Garrett’s book is based upon a number of articles published over the course of a decade, and is highly empirical. As summarized in the Wickham-Jones – Coates – Hay debate, it argues that while globalization has shrunk the traditional working class, it has made more people more vulnerable to market forces. Thus there is a much larger constituency – and, it follows, greater political support – for market regulation and the social safety net. According to Garrett, in this way globalization actually *increased* the policy space available to a social-democratic regime. At the same time, there is no necessary conflict between policies that lessen the vulnerability of average citizens (such as redistributive tax regimes or social spending), and policies that promote investment and competitiveness. Capital benefits from certain goods provided by the state; in fact, this reality is only heightened by globalization, when state investments in education, training, and R&D become central to growth. Garrett conceptualizes the labour movement as being made up of a political wing and an industrial wing. When both wings are strong, or both weak, the economy benefits from greater competitiveness and growth – a social democratic corporatist model in the first case, a neoliberal one in the second. When a social democratic government faces a weak labour movement, or one with strong individual unions but weak overall leadership and discipline, it can be expected to move

to the right (see Garrett, 1998; Wickham-Jones, 2000; Coates, 2001). Building on these arguments in the British context, Wickham-Jones notes that, even in a context of globalization, “encompassing labour market institutions” can still exist and exert power. Were the British left to create or substitute for such institutions, a Labour government would be pushed to the left.

Part of the appeal of the Garrett thesis is that it contains a strong normative element. Rather than explaining why nothing (or, very little) can be done, this approach attempts to identify what “‘policy space’ a social democratic party in the UK enjoys and to consider whether a stronger reformist strategy is an achievable and more beneficial one than that taken by the present Labour administration” (Wickham-Jones, 2000, 3). Though that pull is understandable, it also seems to blind its proponents to its numerous theoretical weaknesses.

As Coates (2001) notes, while Garrett’s thesis is “superficially attractive to centre-left enthusiasts because of its optimism about social democratic possibilities ... [it] is very double-edged,” as it apparently lends legitimacy to neoliberal policies in countries where unions are weak (296). And like his critic Hay, Garrett denies the importance – or even the existence – of real changes in global class composition as a determining factor in Labour’s accommodation to neoliberal economic policies. Instead of such a structural explanation, either New Labour was fooled or suffered a failure of will (Hay’s analysis), or else Garrett underestimates the real policy constraints imposed by the threat of capital strike.

Hay does not explain why New Labour made the choices that it did. He sees globalization as a combination of processes and ideas, and concedes that this combination

does constrain national governments. Like Wickham-Jones, he sees ideas as primary, and the issue of agency is central to the analysis.

6.3 Coates' Critique of Wickham-Jones

Coates is often associated with a group of scholars whose theories on the British political economy are heavily influenced by the work of Ralph Miliband (see for example Coates and Panitch, 2001; Panitch and Leys, 1997; Leys 2001). They offer a direct alternative to both the Wickham-Jones theses and to Hay's own alternative. It is a semi-structuralist explanation, which pays close attention to the specifics of Labour's historical development.

New Labour's economics are "new" in the sense that certain policy elements, including weak support for trade unions and a disinclination to impose redistributive taxation, represent a break from the party's historical positions. But Labour governments have always been fairly willing to accommodate the demands of capital. There is a long-term continuity to the party's relationship with the business class, and the present scenario is "merely our contemporary moment in a longer story with its own internal logic – the story of British Labourism and its limited capacity for effecting social change" (Coates, 2001, 300). The party's ability to effect social reform is limited in large part by internal tensions, which result from a four-stage process. In the first stage, electoral success is built on fragile ground. In the second, there is a split within the party between the (relatively left-wing) membership and the (relatively centrist) leadership. The third stage is the periodic stints in government, when the party consolidates its conservative tendencies and turns toward internal bureaucratization in order to quell dissent. The effect of these moves is to alienate both voters and the party membership. Finally, as a result of

the conditions associated with the third stage, Labour loses power, pushes out the leadership, attempts to renew internal party democracy, and promises to “do better next time” (Coates, 1986, 421). This internal logic interacts with a range of external pressures from the business and financial communities.

Coates draws on the Anderson-Nairn theses, described above, to develop an argument that Labour’s historic inability to control British capital can be attributed to the historical dominance of finance capital in the UK. Although previous Labour governments attempted to build and consolidate electoral coalitions based on expanding the manufacturing base, the financial sector never relinquished its superior political and economic power, and Labour has been forced into at best extremely awkward attempts to accommodate it. This phenomenon has been self-perpetuating, and the “national industrial bourgeoisie” that would support a Labour government’s attempts to rebuild a strong manufacturing base is smaller than ever (Coates, 2001, 303). Moreover, the national economy that New Labour inherited was characterized by low wages and low levels of investment relative to the prosperous European countries. Thus foreign direct investors found the prospect of investing in British manufacturing and exporting to the European market very appealing — much more so, somewhat paradoxically, than if Labour had successfully strengthened the sector. In the context of a contemporary UK economy “already locked into ... [the] global order as a relatively low-wage, low-investment economy with a high level of capital export,” it is unrealistic to expect New Labour to pursue social reform; since “the Labour party was never very good at pursuing [radical] projects in power even when the space was greater, it is hard to see why it will be any more effective when the space is less” (Coates, 2001, 304; 1996, 71).

The notion of “credibility,” which, as we have seen, is so central to New Labour’s approach to economic policy-making, is also largely explained by global pressures. Strict adherence to fiscal targets, granting operational independence to the Bank of England, inflation targets – all are in large degree about establishing external and international credibility. This issue can be developed further. Watson and Hay (2002) draw useful comparisons between the concept of an “open economy” in the business-school globalization literature, and what they consider them to be its “direct and functional equivalent in orthodox economics theory – the assumption of frictionless markets (293; also see Watson, 2001).

Along the same lines, just as under the “structural dependence thesis” a social-democratic government need not actually implement social-democratic policies before triggering capital flight (capital will make certain assumptions and act without waiting to see what the government’s policies turn out to be), neither does an elected government have to *be* soft on inflation to increase inflation. In both cases, the model assumes that rational actors will know what to expect from a government, and act accordingly.

The structural dependence thesis and new Keynesian theories were both used by New Labour, sometimes by inference and sometimes quite explicitly, to rationalize and justify the government’s economic policies. In the next chapter we consider a critical theoretical approach that was not used by New Labour, but one that offers great explanatory value.

Chapter 7: Using Coxian Global Political Economy to Analyze New Labour's Economics

In the 1980s Robert Cox began re-reading the work of Antonio Gramsci as a way to understand his experience at the International Labour Organization, where he had worked for nearly three decades, ultimately in the position of Research Director. He developed a critical theory of hegemony in the global political economy that is based in the Marxist tradition, drawing in particular upon Gramsci (Sinclair 1996). Since then, building on Cox's contributions, numerous neo-Gramscian perspectives have emerged (see, for example, Gill, 1993, 2003; van der Pijl, 1984, 1997; Murphy, 1994; Gill and Law, 1988; for commentary on the rise of neo-Gramscian thought in International Relations see Germain and Kelly 1998). In these, typically emphasis is placed upon the construction of hegemony, which is established initially by social forces occupying a leading role within a state, and then projected outwards on a world scale.

According to Cox, a critical theory "does not take institutions and social and power relations for granted but calls them into question by concerning itself with their origins and whether they might be in the process of changing" (Cox, 1981, in Cox and Sinclair, 129).

A number of theorists have developed Cox's ideas. One particularly successful example is the so-called Amsterdam school (including Kees van der Pijl, Henk Overbeek, and Otto Holman), who use the notion of the "comprehensive concept of control" to clarify the specific contents within a hegemonic programme (see van der Pijl, 1984; Overbeek, 1990, 1993). As well, Cox's concept of hegemony is closely related to James Rosenau's "governance without government" (1990, 4). This critical tradition offers a way to theorize the rise of Third Way ideas.

7.1 Gramscian Roots

Antonio Gramsci (1891-1937) was a socialist leader and journalist in Italy who, in the wake of the Russian revolution, began work that attempted to explain why the revolution that had succeeded in Russia had failed in his own country, as well as in the rest of Western Europe. He focused on the political-social-cultural-ideological side of society (in classical Marxist terminology known as the “superstructure”). In this way Gramsci set himself apart from the increasingly economistic / objectivist version of Marxism that was ascendant in the early twentieth century under the influence of natural sciences and logical positivist philosophy (see McLelland, Bottomore). In Gramsci's time, the prevailing Marxist theories held that the ruling class maintained power primarily through the coercive efforts of the state (Hoffman 22). One of Gramsci's key innovations was the recognition that it is inefficient and, in the long term, ineffective, for a regime to sustain itself through constant, forceful oppression. He emphasized *consent* rather than *coercion* in the maintenance of social power. A class maintains its dominance not simply through force, but also by exerting moral and intellectual leadership. Gramsci's concept of the state was broad enough to encompass civil society – a vast range of institutions including trade unions, employers' organizations, cultural and sporting clubs, political parties, and so on. To illustrate the interaction between intellectual power (consent) and physical power (coercion), he drew on Macchiavelli's image of power as a centaur: half-man, half beast. The way to win power in such a society is to wage a war of position, making advances at the level of ideological consent in the civil society sphere, ultimately achieving hegemony; this power can then be transferred democratically into state power.

According to Gramsci's concept of hegemony, hegemony is present when consent is at the foreground; coercion is latent, threatened, and only used in deviant cases (Cox 126-7). Hegemony is a complex and hidden system that accounts for the widespread form of ideological manipulation that results in "spontaneous consent given by the great masses to the general direction imposed on social life by the dominant group."(qtd in McLelland 267) It is the saturation of all levels of society by a worldview that supports the established order. This worldview is spread and maintained by instruments of ideological control that Gramsci called the "dominant group's deputies," such as schools, churches, and the media (qtd in McLelland 267). The system of values then becomes internalized by the general population, and comes to be seen as "common sense" (qtd in McLelland 273). As described by Gramsci, hegemony is neither static nor a mechanical phenomenon, but rather a constantly shifting balance.

7.2 Hegemony and the Role of the State

Cox further developed Gramsci's model of hegemony so that it could be applied to the international level. While the institutions of hegemony are located in civil society, Cox stressed that the distinction between state and civil society is purely abstract. Hegemony of the dominant class provides a bridge between the state and civil society. This is then extended outward to the relationship between states.

A structure is defined by its material capabilities (technological, organizational, and natural resources) and ideas (historically conditioned meanings and conflicting images of social order) (218). In a hegemonic structure, the dominant interests secure power by co-opting the weak as they "express their leadership in terms of universal or general interests" (219). As in Gramsci, these processes are not static. They are "limited

totalities” of a particular time, and they contain the dialectic possibility of change. Social forces, forms of state, and world orders can all be seen as a series of “dominant and emergent rival structures” (220). “Power emerg[es] from social forces,” which interact at the global level, with states playing a mediation role. This is how Cox takes Gramscian ideas concerning hegemony and change, and incorporates them into a global political economy perspective (225-226).

Hegemony is constituted on three spheres: social relations of production; forms of state; and world orders. The construction of an historical bloc cannot exist without a hegemonic social class, and is therefore a national phenomenon. Yet once hegemony has been consolidated within one country it may expand out into the world through the expansion of a “particular mode of social relations of production” (238). Cox in particular stresses the importance of international monetary and trade rules. Hegemony is not simply an order or hierarchy among states. Rather, it is a structure of social, economic, and political dimensions – all three.

Structures operate within three spheres: social forces; forms of state, world orders. This allows us to explain gaps or “lurches” in hegemony: one of the three pieces has fallen behind, or exists in what Raymond Williams called, in a different context, residual form. But we need a theory to explain how and why the three aspects come together at some times but not others. Cox argues that this is due to “social forces shaped by production relations.” (105) The world can be represented as a pattern of interacting social forces in which states play an intermediate role; power emerges from social processes rather than taken as given as a result of accumulated material capabilities. This represents a move to a political-economy perspective.

It is worth noting the concept of hegemony has a long tradition in International Relations. But as theorized by Cox, it is different from – in some ways the opposite of – the realist and neorealist models of hegemony. For example, Hegemonic Stability Theory holds that international order may be maintained by one powerful state, which dominates all others through its relative military and economic power. Rather than “hegemony,” Cox used the word “dominance” to describe this phenomenon. We might say that where realists and neo-realists see hegemony as an attribute of a state, Cox saw it as a form of rule.

7.3 Applying the Theory

How might Cox’s ideas be used to theorize New Labour’s economics? The starting point would be the three social forces that, according to Cox, make up historical structures: ideas; material capabilities; and institutions. Cox’s approach is also strongly historical. This is reflected in the “frameworks for action” (1981, in Cox with Sinclair) he provides – these are, essentially, a framework for Coxian analysis, using the following steps:

- 1) Identify the social relations of production – the basic economic and class structures;
- 2) Identify and describe the dominant classes, including the history of their rise and how they maintain the social relations of production. In particular, what is the balance between coercion and consent?
- 3) Identify whether and how key elements of this “historic bloc” extend across national boundaries.
- 4) Conclusion – is there a hegemonic world order, or do coercive elements take precedence over the consent generated through civil society?

He stresses that determining the “lines of force” within a structure is “always an historical question to be answered by the study of a particular case.” He uses the phrase “limited totalities” to describe historical structures, emphasizing that they are “a particular sphere of human activity in its historically located totality” (1981, in Cox and Sinclair, 100; 102). Any such limited totality is shaped by the three broad categories of forces: ideas, material capabilities, and institutions. Sinclair (1996) suggests the Cold War as a familiar historical example that can be analyzed easily in this way – it was made up of ideas (McCarthyism and variations), institutions (NATO, for example), and materials capabilities (the military-industrial complex (12).

7.4 A Coxian Analysis of New Labour’s Economics

Given Cox’s attention to the specifics of an historical structure, the place to begin is by describing the ideas, material capabilities, and institutions that comprise it, including their historical development. The idea is to describe *what* happened to the political economy, *how*, and by whom, so as to avoid an overly general, ahistorical analysis. Such a description appears in Chapters 1 and 4 of this thesis, and will not be repeated here. Instead, this chapter will sketch out how Cox’s ideas can be used to organize and analyze that information, and will assess how such an approach can help overcome or resolve problems facing those described in the previous two chapters.

7.4.1 Ideas

Blair and Giddens worked hard to establish the Third Way roots in the history of British political thought. But these efforts were always somewhat incoherent, probably unnecessary (because there would appear to be no evidence that voters cared nearly as

much as Blair whether or not the Third Way fit into any particular tradition) attempts to prove that their approach had an intellectual pedigree. In any case, Blair is also equally determined to show that he is “beyond left and right,” a fundamentally pragmatic prime minister who knows that “what matters is what works.”

The core message of the Third Way might be the promise of *old values in a new world*. For, at the same time that Blair was portraying the Third Way as an internally coherent, stand-alone intellectual project, he was also indicating that Third Way economics were a necessary, almost technical response to global forces that simply had to be accommodated. At the national level, too, New Labour embraced the notion that the world had changed – Thatcherism could not be reversed, even if Blair wanted to do so.

The concept of hegemony is key to neo-Gramscian theory, and that gives it great explanatory power concerning the Third Way. The real success of the Third Way (manifest at the political level in the UK in the form of New Labour) lies in its enormous ability to absorb dissent and fashion a stable consensus in a country with a long history of class consciousness (and strife). Thatcher’s claim that “There Is No Alternative” stands as a simple, brutally direct declaration of hegemonic rule. And, as we have seen, numerous commentators including Anderson (2000), Moran and Alexander (2000), Heffernan (2000), Smith (2005), Hay (1999), and Arestis and Sawyer (2001) have argued that for New Labour, a founding intellectual principle was the assumption that there is, indeed, no alternative to neoliberal economics. As Coates (2005) writes, “like all good hegemonic politicians, Margaret Thatcher took a single and simple idea – in her case, the idea of the “market” – and embedded it institutionally in one policy area after another: such that long after she had left the political stage, her legacy had not” (203). New

Labour buttressed the notion of no alternative by conceding great power and influence to global economic forces, typically portraying them as imperatives that must be accommodated – with the question of how to do so being little more than a technical exercise.

As we have seen, the globalization debate, as it took place in the 1990s, was largely settled at the academic level. Yet despite what McBride calls “the triumph of the skeptics,” in the UK globalist ideas remained central to economic discourse, with special support from New Labour (2006). Indeed, New Labour’s economic strategy was to a large extent both shaped by and rationalized with reference to the relationship between the domestic and international contexts. So, even if the global economy could not necessarily exert restrictions on a national government in the way that New Labour said it could, just by thinking and saying this was the case, New Labor made it so. New Labour drew heavily on ideas associated with the hyperglobalist school, which is described above. These ideas were tempered somewhat – while global economic forces were assumed to have overwhelming, even determining influence, New Labour did see a role for the state in facilitating development led by the supply-side. This point is made by Weiss (1997), who is a prominent sceptic in the globalization debates of the mid-1990s. She challenged the weak-state thesis, arguing that it was a construct created by many national governments, which embraced their supposed impotency relative to the global economy:

Political leaders—especially those in the English-speaking world dominated by neoliberal economic philosophy—have themselves played a large role in contributing to [the] view of government helplessness in the face of global trends....many OECD governments have sought to “sell” their policies of retrenchment to the electorate as being somehow “forced” on them by “global economic trends over which they have no control (16).

A number of authors drew on the business-school globalist position to develop policy prescriptions for the UK (see, for example, Giddens, 1998, 2000; Gray, 1997); by the mid-1990s the argument that a globalized world economy forced national governments to cut social spending and the welfare state, and abandon historical commitment to the pursuit of full employment, was “the public face of the globalization thesis in Britain” (Watson and Hay, 2002, 292). Most significantly, from the point of view of direct political power and real policies, no one embraced the argument more strongly than New Labour. In 1995, Blair declared, “the determining context of economic policy is the new global market,” as result of which “the room for manoeuvre of any government in Britain is already heavily circumscribed” (cited in Callinicos, 2001, 16). The following year, he was even more direct:

Globalization has destroyed any notion of countries cutting themselves off from world markets. Go-it-alone inflation or spending policies will be mercilessly and immediately punished by capital markets that can overwhelm a nation’s currency (1996, 5).

As the 1997 election approached, Blair became even more insistent, his language even more blunt: “ We live in a global economy today. We compete in that or we fail” (1997, 1). Brown reinforced the message when he declared in a speech in Bonn in 1996 that, in an era of globalization, “true national sovereignty will have to be sought within the realities of the international economy” (cited in Wickham-Jones, 2000, 2).

In other words, from its early days New Labour embraced the idea that, as a direct result of globalization, a New Labour government would have few and modest options to change the direction of economic policy. By making the point that a future New Labour government *could not* take domestic economic policies in expansionary or interventionist directions, Blair implicitly reinforced his promises not to do so. It was not a matter of

asking voters simply to trust that Labour had turned over a new leaf; rather, he wanted to offer the additional reassurance that a return to old Labour's Keynesianism, pursuit of full employment, and commitment to nationalization had been rendered impossible. The double threat of international finance and capital flight would keep New Labour honest. This is what Watson and Hay (2002) refer to as "the logic of no alternative" (293).

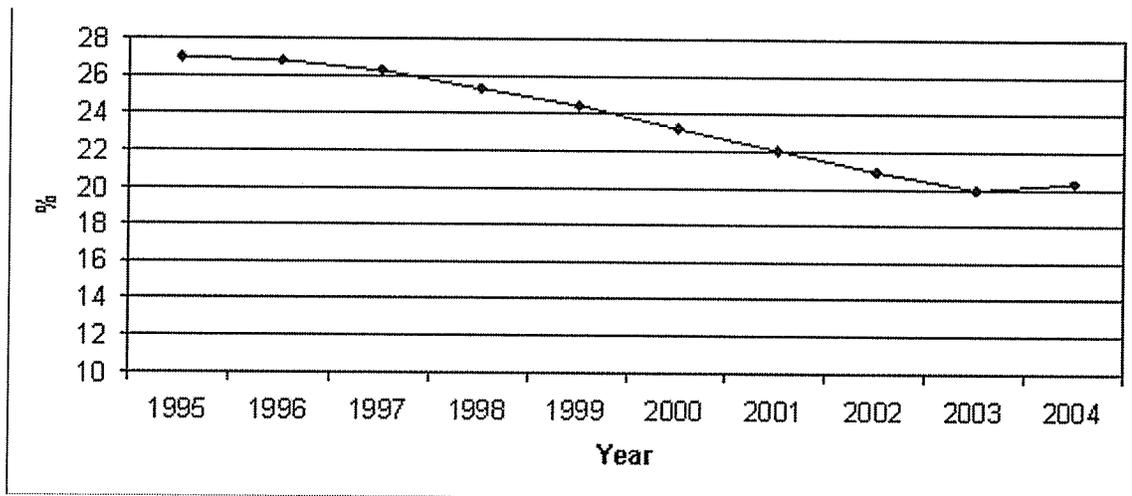
At the same time, New Labour has attempted to portray itself as a driver of globalization. Blair's government has worked assiduously to export its ideology outside the UK, promoting its economic model around the world in what Hay and Watson memorably refer to as "Third Way Adventism" (1999; also see Blumenthal, 298ff).

7.4.2 Material Capabilities

The concept of globalization put forward by New Labour was important as an idea – that is, by stating that the twin threats of capital mobility and the need to satisfy financial markets restricted their policy options, the government helped make this a reality. However, these ideas were more than mere ideas – they did reflect structural changes to the British economy in the context of globalization. Particularly important was the continuing privatization and de-industrialization. This was a trend of historic proportions — in January 2003, UK manufacturing jobs fell to their lowest level since record-keeping began (UK Blue Book 2005, 15). As Tables 10, 11, and 12 show, manufacturing contribution to the economy, measured as a percentage of GDP and as a percentage of Gross Value Added, declined steadily in the New Labour years. Manufacturing business registrations minus de-registrations also reveal an economy steadily shedding manufacturing businesses, to the point where, in 2003, there was a net drop of more than 3,500 registrations. This shift away from manufacturing led to a loss of

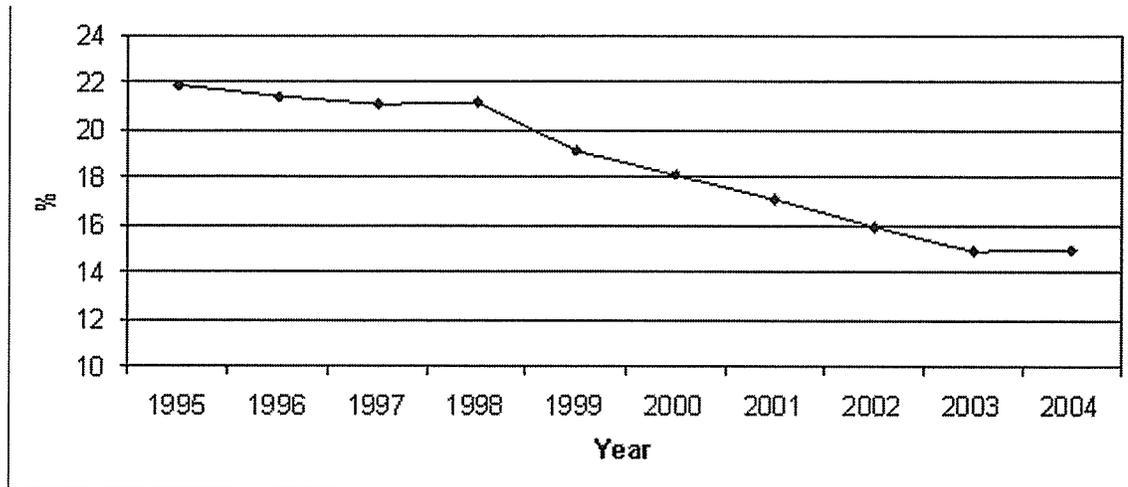
unionized jobs, the effects of which are seen in declining overall union density, as well as declining union density within the sector itself. As we can see from Table 13, union density in manufacturing fell from 32.7% in 1995 to 24.8% a decade later. In a situation when workers who are organized are on the whole less militant. These linked phenomena help explain why the opposition to New Labour has been so muted.

Table 10: Portion of GDP in Manufacturing, UK, 1995 - 2004



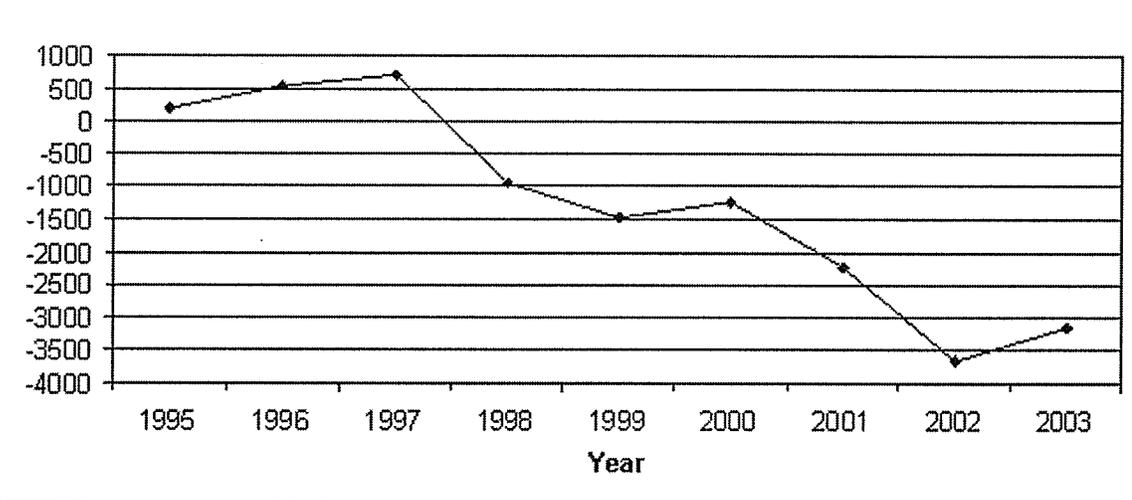
*Source: University of Cambridge Institute for Manufacturing
(<http://www.ifm.eng.cam.ac.uk/cep/mfgstatistics-macro.html>)*

Table 11: Portion of Gross Value Added in Manufacturing, UK, 1995-2004



Source: University of Cambridge Institute for Manufacturing
(<http://www.ifm.eng.cam.ac.uk/cep/mfgstatistics-macro.html>)

Table 12: Manufacturing VAT Registrations Minus Deregistrations, UK, 1995-2003



Source: HM-Treasury Small Business Service, cited by University of Cambridge Institute for Manufacturing (<http://www.ifm.eng.cam.ac.uk/cep/mfgstatistics-macro.html>)

Table 13: Trade Union Density by Major Industry, Autumn 1995 to Autumn 2005.

Industry	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005

Agriculture, forestry and fishing	7.4	8.6	8.8	12.3	9.0	10.5	8.8	8.9	9.3 *	8.6	
Mining and quarrying	35.8	37.7	31.4	29.9	36.2	31.8	25.3	23.6	28.0	27.3	21.2
Manufacturing	32.7	31.2	30.1	29.9	28.5	27.7	27.2	26.7	26.2	24.6	24.8
Electricity, gas and water supply	67.0	61.6	62.3	57.7	52.4	53.9	53.3	50.5	47.2	46.9	47.9
Construction	26.2	25.5	21.1	20.6	21.1	20.1	19.2	17.5	18.9	16.7	15.7
Wholesale and retail trade	11.4	10.8	10.6	10.9	11.7	11.4	11.7	11.3	11.7	11.5	11.0
Hotels and restaurants	8.1	6.8	7.1	6.7	6.2	5.4	5.4	5.9	5.4	5.0	4.2
Transport and communication	48.8	47.6	45.3	42.5	42.2	42.5	42.2	41.5	42.3	41.3	42.2
Financial intermediation	37.2	36.4	33.5	31.1	30.2	29.9	27.0	27.2	26.0	26.6	24.5
Real estate and business services	13.3	12.9	11.6	11.3	11.4	10.3	10.6	10.6	11.0	10.5	10.1
Public administration	58.8	60.7	62.3	60.7	60.7	59.4	59.3	59.5	56.8	56.3	57.1
Education	56.1	54.9	54.4	53.8	54.1	54.0	53.2	54.7	54.8	54.9	56.0
Health	48.1	47.2	46.6	46.1	45.0	46.3	44.7	44.9	44.4	43.8	44.2
Other services	25.6	23.4	22.2	22.4	23.4	23.0	22.4	21.9	23.1	18.9	19.3

Source: Labour Force Survey, Office for National Statistics.

As we have seen, some of the economic activity lost as a result of manufacturing's decline has been made up in other sectors. So what difference does it make? Manufacturing is important for a number of reasons. It remains a leading-edge sector when it comes to technological innovation that leads to quick productivity growth – which in turn ripples out through the economy as a whole. Manufacturing is also vastly more important to exports than is the services sector — a strong manufacturing sector is needed to preserve a healthy current-accounts balance (in the current UK economy, this means a manageable deficit). And, since growth in financial and other services has been concentrated in the south of England, good manufacturing jobs help ensure regional re-distribution of growth and income (Elliot, 2003).

Gordon Brown has made frequent and compelling observations about some of the structural problems facing the British economy, noting that it is too dependent on low-productivity, low-skill, low-wage jobs. Yet what can a Treasurer who has spent more than a decade banging the drum for globalization actually do to address such problems? His plans to use targeted training programs and tax measures as lures to attract foreign investment appear to be “not so much a growth strategy as a treadmill” (Coates, 2005, 207). The Thatcherite erosion of trade unions, labour-market regulations, and manufacturing capacity has not been reversed at all.

7.4.3 Institutions

The first institution to consider is the Labor party itself. While it has always been a deeply Parliamentarist (as opposed to revolutionary) left party (see Ludlam in Ludlam and Smith, 2000), for most of the twentieth century it represented the electoral-political wing of the labour movement, and of working people. The mere existence of such a party reinforces that the alternative is the party of capital. In the mid-1970s “it was still the social-democratic political wing (however semi-detached) of the trade-union movement, committed to a mixed economy and redistributive social policies. By 2000 it was an elite-controlled electoral machine, with an unprecedentedly large parliamentary majority, oriented to and increasingly funded by business and no longer even formally controlled by the unions” (Leys, 2001, 38).

State institutions have also been changed so as to limit their influence: the government no longer directly sets interest rates because it cannot be trusted to meet the needs of the market over those of its citizens; it relies on major private-sector

partnerships to fund capital investment in public services; and it relies to a much greater extent on “rules” than on the discretion of public servants.

The ongoing shift in the British economy away from manufacturing and toward services has been felt at the level of institutions. Ruggie (1994), alluding to Karl Polanyi, argues that service-based economies are “disembedded” – as goods lose their status as the country’s most important economic products, the ways in which the state can effect policy changes are reduced.

Conclusion

An examination of the interaction of ideas, material capabilities, and institutions in the UK under New Labour reveals, first, that these forces should not be thought of as independent and dependent variables. Rather, they are reciprocal or dialectical (see Cox and Sinclair, 1996, 276). The ideas of the Third Way (about the irresistible force of global capital, the irreversibility of Thatcherism, and the undesirability of government regulating the market) both reinforce and are reinforced by structural changes in the economy (the continuing rise of international finance and decline of manufacturing), as well as changes at the level of institutions (to perpetuate the falling influence of unions, to make state institutions more responsive to the market and less responsive to the public, and to make the Labour party an electoral machine with ever-weaker connections to working people). Of course there are other ideas, other institutions, that come into play. But this model provides a sense of how those at the heart of the New Labour / Third Way project interact. The result is a situation described by Leys (2001): “economic globalization has made states market-driven, rather than market-controllers, and left societies more fully exposed to market forces than ever before” (217).

8. Conclusion

This thesis has used three approaches to theorize Third Way economics, as practiced by New Labour in the UK. The first approach, which compared New Labour's economics in practice against the New Keynesian model and concluded that, on balance, New Labour is New Keynesian, has the advantage of working in detail with the specifics of economic policies in the UK. Its main disadvantage is that the messy reality rarely fits neatly with the doctrine, let alone with the theory, which is even more abstract. This approach also had little to contribute on the question of the extent to which New Labour may have had other real policy options. The second approach, which showed how a number of authors have debated the structural-dependence thesis, addressed this point head-on. Its main weakness was that it did not resolve in any significant way the question of agency. If Tony Blair had not existed, would someone else, buffeted by the same structural political-economic forces, have enacted the same policies? The third approach, Coxian GPE, partially overcomes these problems, by examining the relationship between ideas, material forces, and institutions.

8.1 Contradictions and Potential Problems in New Labour Economics

While New Labour has remained remarkably disciplined and successful at keeping power, there are deep contradictions in its project. By relying so heavily on traditionally right-wing arguments about the importance of unfettered markets, the need for traditional values, and law-and-order, New Labour has been able to play against type. But it has also left itself vulnerable in case the public should decide that these really are

the most important issues, and turn to the party that has traditionally owned them – the Conservatives. Many traditional Conservative supporters may have found a most comfortable temporary home in New Labour, but will it be able to keep them there? It is also quite clear that New Labour's legacy after leaving office will be thin, to say the least. Margaret Thatcher has in many ways seen her most cherished ideas carry on well into the second decade after she left power. The ongoing debates in the literature about what, exactly, the Third Way is, or even if it really exists, provide strong evidence that the economics of New Labour will prove ephemeral. The search for a "big idea" with which to define itself apparently continues – Blair and Brown, despite their great political and intellectual abilities, have proven themselves unable to break out of the legacy of their predecessor.

The decision to join the European common currency is also a problematic one for New Labour. Blair has used the nationalism of the contemporary Conservative party as a wedge issue, arguing that he is "for Europe," indeed, setting himself up as a kind of global ambassador for the Third Way. Yet the party's reluctance to pursue this end in any serious way only undermines its value, and a healthy Europe can provide the political and policy space needed to preserve the European model that New Labour has, also, been so reluctant to pursue.

8.2 Shifting the 'Bounds of the Expressible' in Order to Form Government

The subtext of much of this thesis has to do with the Labour party's need to form government after nearly a generation in opposition. As a number of authors have argued,

The essence of Blair and New Labour is an attempt to ... end electoral decline; to reduce the potential for party conflict; and to provide an

The essence of Blair and New Labour is an attempt to ... end electoral decline; to reduce the potential for party conflict; and to provide an ideology which can retain some of Labour's historical commitments to social justice without alienating the middle income support necessary for electoral victory (Smith, 2000, 143).

Thatcherism's legacy including changes to what we might call the bounds of the expressible. Public ideas about the role of the state in regulating the economy, class identity, equality, democracy and other profound political issues changed in the Thatcher years. This meant that if New Labour had wanted to pursue more expansionary fiscal policies, more redistributive taxation policies, greater support for trade unions, an active industrial policy, or any of the other traditional Labour positions from which it has drifted away, it would have had to not only withstand the disapproval of capital, it would also have actually needed to sell such ideas to "middle England." There is no doubt that Blair and Brown always had the option to tackle neoliberalism at the level of ideas. There is, however, no certainty that they could have done so while preserving New Labour's electability. Perhaps a visionary Labour leadership could have found the necessary new political vocabulary, though of course this will never be known. That they chose to move in exactly the opposite direction and turn their party into "a vehicle to capture and maintain power" (Skidelsky, 2002) came at the cost of accepting extremely limited room to maneuver. At the very least they are guilty of a massive failure of imagination.

Globalization is highly contested concept. The Third Way is a poorly defined one. The former occupies a central position in New Labour's conception of the latter. New Labour's intellectual leadership embraced a specific set of arguments and assumptions about the role of global economic forces, ideas which led to the conclusion that globalization is an irresistible force heralding a new economic reality. In other words, it

was less the economic realities of globalization than it was New Labour's conception of those realities that shaped domestic economic policies in the UK.

Consider the various debates described in this thesis: the globalization debate between business-school "globalists" and skeptics; the debates around New Keynesianism, endogenous growth theory, and the new monetary consensus; and the debate over the state's structural dependency on capital in the context of globalization. New Labour drew from each of these to construct a narrative – a story of a state rendered weak by globalization, dependent upon footloose capital, obedient to the laws of contemporary mainstream economic theory – rationalizing economic policies that had as much to do with political expediency as economic reality. By accepting certain orthodox macroeconomic theories, the party's leaders "were able to withstand the charge that its depoliticization of the economic agenda was merely an electoral ruse" (Watson and Hay, 2002, 301). New Labour argued that it had to shift economic policy to the right because of a combination of domestic pressures (the Labour party has always been vulnerable to capital flight and vengeful financial markets) and international ones (under globalization, everything changed, and a national government has no choice but to adapt). This story is inherently contradictory. Since the "tale of reformist governments defeated by economic constraints imposed notably through the flight of capital on the financial markets is almost as old as social democracy itself," it is hard to argue that globalization has imposed qualitatively new constraints on national governments (Callinicos, 2001, 27). For New Labour such a contradiction is irrelevant for, as Tony Blair often declared, "what matters is what works."

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