Has Globalisation Killed Social Democracy?

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It has been fashionable to portray social democracy as finished. It is widely held that social democracy depended for the effectiveness of its economic and welfare policies on the temporary mid-century hegemony of the nation state. Now, however, only some form of economic liberalism is compatible with the new global economy dominated by international market forces. The nation state can no longer govern processes that are supra-national, chief of which are the world financial markets. The only remaining issue, if it is true, is whether it is possible to have economic liberalism with a human face, or just rampant and ruthless *laissez faire*. This is the rational core of the current debate about the Third Way, once one discounts the media hype.

In a world of growing inequality within and between nations, the *issues* that social democracy attempted to address are still there. The questions are whether there is a viable politics to articulate them and whether there are effective means to deal with them. Resolving these questions depends on the two others addressed in this article. Whether globalisation exists in the way that is frequently claimed, as the dominance of national economies by uncontrollable world market forces? Whether social democratic politics can redefine itself, outside of the institutions that prevailed in post-1945 Europe, and preserve the welfare state?

How 'Global' is the World Economy?

The state of the world economy is hotly debated. The evidence for and against globalisation is complex and its significance tends to depend on which of the competing hypotheses one inclines toward. However, there seem to be good grounds to dispute the thesis that there has been a rapid and recent process of economic globalisation. In *Globalisation in Question*, Grahame Thompson and I have argued against the notion of a truly global economy driven by supra-national market forces and dominated by trans-national corporations.[1] Rather, we claim that there is still an inter-national economy, based on flows of trade and investment (that are modest relative to GDP) between the three main economic blocs of North America, Japan and Europe. This we call the Triad. At the core of the Triad are two nation states, the USA and Japan, and the EU, an association of states that pool sovereignty for certain common purposes. Nation states are thus not declining in power per se. States now have radically different governance capacities and face different constraints. Small well governed states outside the Triad do have options for

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autonomous action, as the very different macro-economic policies of Singapore and Taiwan show. Both have either ridden-out or avoided the worst of the Asian crisis. The EU has not stripped its member states of sovereignty, rather it has enhanced their overall capacities by governing and stabilising key economic variables, and in particular by promoting co-ordinated action in external economic policy, giving most of the states an influence in international negotiations they would otherwise lack.

It is only possible to present the evidence against the extreme globalisation thesis here in summary form as follows.

- With the exception of the USA—where the ratio almost doubled from 10.5 per cent to 19 per cent between 1973 and 1995—for most major advanced economies the ratio of merchandise trade to GDP at current prices is only marginally higher or actually lower than it was in 1913—Germany had a ratio of exports and imports to GDP of 35.1 per cent in 1913 and 38.7 per cent in 1995 and the UK 44.7 per cent in 1913 and 42.6 per cent in 1994. This is hardly a revolution in international exposure.
- It is often argued that these figures are misleading. With widespread capital mobility, foreign direct investment (FDI) has become a major substitute for trade. Yet the figures show that the main flows of FDI are between members of the Triad and between them and a small number of newly industrialising countries. In 1981–1990 75 per cent of flows were between members of the Triad. In 1991–96 the Triad plus the ten most important developing country recipients of FDI (China being defined as the coastal provinces plus Beijing), some 30 per cent of the world's population, accounted for 84 per cent of FDI flows. The developed world is not being stripped of its capital.
- Whilst the stock of inward FDI as a percentage of GDP more than doubled in the developed economies between 1980 and 1995, nevertheless, the overall stock of FDI remains modest for most major countries: in 1980 the figure for Japan was 0.3 per cent of GDP and it was the same in 1995; for the USA it was 7.7 per cent in 1995 (up from 3.1 per cent) and for Germany 6.9 per cent (up from 4.5 per cent). The share of FDI in gross fixed capital formation confirms this. In Japan it was a negligible 0.1 per cent in 1994, in the USA it was 5.9 per cent in 1995 (comparable to the average for 1985–90), and in Germany it was 1.7 per cent in 1995 (again comparable to the 1985–90 average of 1.6 per cent). The vast bulk of investment is still domestically owned and there is little tendency toward escalating capital mobility, certainly not on a scale that would alter domestic capital markets.
- Most companies are multi-national rather than truly trans-national, that is, they produce and trade from a base in one of the Triad countries. Thus German multi-national manufacturing firms concentrated 75 per cent of their sales in the home region in 1992–3 (up from 72 per cent in 1987). The comparable figures for Japan and the USA being 75 per cent and 67 per cent respectively. In the case of assets, Japanese manufacturing firms had 98 per cent of their assets in their home/country region in 1992–3, and US

multinationals 73 per cent. This concentration of multi-nationals in their home bases is confirmed by the low share of the output of affiliates in GDP. On a world scale this rose from 5.2 per cent in 1982 to 6.7 per cent in 1990 before falling back to 6.0 per cent in 1994. For the European Union the share rose from 5.7 per cent to 8.6 per cent in 1990 before falling to 7.7 per cent in 1994. For North America, affiliates accounted for 5.1 per cent of GDP in 1982, rising to 7.0 per cent in 1990 and then falling to 5.2 per cent in 1994. The share of affiliates shows how much of the output of multi-nationals is produced by them outside of their main location. The figures hardly demonstrate a vast growing trend toward the internationalisation of production.

- Lastly, there is the issue of the internationalisation of financial trading. Much is made of the huge volumes of daily trading in the financial markets (about $1.3 trillion). This ignores the fact that a great deal of this is 'churning' the same stock of capital. Moreover, the role of these flows in the distinct national capital markets is still relatively minor. Thus foreign holdings of equity in major economies are quite low: 5 per cent in the USA, 11 per cent in Japan, 9 per cent in both Germany and the UK, all at the end of 1996. The degree to which pension funds invest in foreign assets varies enormously from 4 per cent in the USA, 3 per cent in Germany, 14 per cent in Japan, to 60 per cent in Hong Kong in 1993. The foreign assets and liabilities of commercial banks also vary greatly, from low figures like 2.6 per cent of assets and 8.2 per cent of liabilities in the USA in 1996, to very high levels like 47 per cent of assets and 48.8 per cent of liabilities in the United Kingdom. The figures for pension funds and banks reflect different institutional and regulatory structures. Policy has some real influence here. For example, Singapore's main compulsory pension fund is required to invest in domestic financial assets and its foreign holdings are, at least formally, zero.

Enough evidence has been presented to show a world in which trade and investment are still highly concentrated among the major developed countries, in which the major multi-national companies are still closely tied to their home bases in Triad countries, and in which, despite rapidly growing volumes of international financial trading, distinct national capital markets persist. World market forces have by no means erased national economies. If that is so, then the issue of the scope and objectives of national economic policy and of supra-national economic governance is at least open to debate rather than being foreclosed in favour of further global de-regulation.

What is Social Democracy?

Social democracy is generally presented by its critics and advocates of the new Third Way in the form of caricature. The caricature presents social democracy as statist and bureaucratic, as tied to an obsolete class system, as corporatist and dependent on a national economic sovereignty that has passed away in the era of open economies. Yet if we strip away this caricature and the historically contingent features, then social democracy can itself be seen as the original third way between *laissez-faire* capitalism and state socialism. Its aim was and is to stabilise and humanise capitalism, containing the scope of market forces. Three elements are essential and enduring in the social democratic project. First, that it attempts to minimise the cost of capitalism for individuals, either through growth and employment enhancing policies, and/or, through welfare state provision for the contingencies of unemployment, ill-health and old age. Secondly, and this distinguishes it from social market versions of the welfare state, that it attempts to tackle and reduce major unjustifiable inequalities in power and wealth. Thirdly, that it accomplish these objectives within the limits set by parliamentary democracy on the one hand, and private property and the market economy on the other.

These goals certainly require the exercise of the public power, but not rigid statism. It is debatable whether they require capital controls, or whether the economic sovereignty of the Bretton Woods states was as real as is now believed. Welfare provision certainly does not require top-down bureaucracy, and services can be provided to a substantial degree through the third sector, through publicly-funded citizens' organisations in civil society. Social democracy does not need to be conceived in class terms, it was always seen in the general interest of the mass of the population. As we shall see, traditional corporatist institutions may have declined, but negotiated social governance is alive and well across Europe. Business elites in much of Europe still see the need to co-operate with other social interests in order to maintain economic performance. It is interesting to note that even a confirmed moderniser like Anthony Giddens in *The Third Way*, though he sees the need to adapt to changed conditions, also sees that a radical centre worthy of the name can only be a revitalised social democracy.[2]

The question is whether these enduring tasks of social democracy can be accomplished in a new context. The key threat contained in the rhetoric of globalisation is capital mobility. Fritz Scharpf perceptively set the terms of the problem in *Crisis and Choice in European Social Democracy* in the late 1980s: mobile capital and immobile labour change the terms of the bargaining, capital can threaten to defect and is thus able to sanction policies and levels of tax to which it objects.[3] If policy is set by business interests and capital markets rather than the state, then democracy is irrelevant—the people can vote for what they like, business elites will decide what they get. The limits of the market system are then so severe that no worthwhile radical policy can be accomplished within them. John Gray argues in *False Dawn* that the 'social democratic regime presupposed a closed economy' (p. 88).[4] Such regimes will be threatened by downwards harmonisation as they 'progressively dismantle themselves, so that they can compete on more equal terms with economies in which environmental social and labour costs are lowest' (p. 92).

It is more difficult now to present the Asian economies as offering a fundamental challenge to the Triad as destined to grow uninterruptedly until they supersede the established economies. However, the real threat of capital mobility does not involve relocation to Indonesia: rather the options in Europe are more likely to be the Czech Republic or Portugal. Is the Czech Republic an Indonesia on Germany's doorstep? Hardly, it is more likely to be another Spain in which multi-nationals established branch plants and which grew dramatically on entry to the EU, but not at the expense of its neighbours.

The key question, not asked in the purely abstract account of the liberalisation of national capital accounts, is what 'capital' is? First it is firms, and, as we have seen, even most large multi-nationals have been reluctant to re-locate their core production facilities away from their main markets. Secondly, it is the funds mobilised by financial institutions, but these are in the main the savings, pensions and life insurance of the broad middle class of the advanced industrial countries. Capital is the financial assets not only of plutocrats, but of a large part of the household sector. This does not prevent the managers of financial institutions from making bad investment decisions in Latin America or Asia, nor from growing wealthy at the investors' expense, but it does show capital has to flow from and to the household sector. In the end those flows can be directed and controlled to some degree by public policy if need be. Singapore has done this with its pensions system. Capital is mobile, but it has sources and destinations that limit the scale of its migration. Domestic capital markets still provide 90 per cent of national investment. Modern economies are increasingly dominated by services, in the USA this sector now accounts for some 80 per cent of GDP. Although there is a growing trend toward the tradability of services, the vast bulk of this sector will continue to be domestically sourced, thus reinforcing the tendency toward localisation.

Thus the logic of modern economies tells against the international technocracy and many national business elites, whose current rhetoric centres on the inevitability of globalisation. It is the old lesson, clear from the 1930s, that the main job of social democracy is to rescue capitalism from the stupidity of its own leaders. Indeed, those elites in the UK and USA have become so insulated from democratic pressures or countervailing powers that they listen only to themselves. Thus the reform of corporate governance has to be central to the new social democratic agenda. Managerial power needs to be curbed, and mainly in the interests of economic efficiency through greater accountability. This is a million miles from most of the current platitudes of the Third Way. The fear of globalised capital has been central in promoting the retreat of labour parties from confronting the issues of wealth and power. This is clear in the UK, which has no shortage of capital and is a substantial net capital exporter. Yet British politicians behave as if the UK is absolutely dependent on foreign direct investment.

Can the Welfare State Survive in a Globalised Economy?

Social democracy should have a fourfold agenda. Tackling the international financial markets and monetary system. Promoting growth and employment.

Re-regulating to promote democratic accountability of companies. Maintaining and promoting welfare and public services. I shall concentrate on the issue of welfare here, since space prevents covering the other issues properly. The growing flows of international capital raise the issues of the international re-regulation of markets to prevent destabilising crises like that of 1997–8 and also the containment of volatility in exchange rates. This task is beyond the scope of single national governments, but it always has been, and it is not beyond the scope of co-ordined action by major states and international institutions. Attitudes on these issues are changing rapidly, even among elites. It is unlikely that radical action will happen quickly, although further international de-regulation is now likely to be shelved and some measure of co-ordinated action to prevent financial crises getting out of hand has already begun. The real obstacle to co-operation and especially to a new exchange rate regime is not global markets, but the diverging interests of the major states, especially Japan and the USA.

The scope for macro-economic policies to promote growth and employment is currently unclear. It appears that changes in economic structure have made it difficult to reduce the levels of high unemployment in Europe by classic Keynesian stimuli. Beyond a certain modest boost to demand, investment is needed to create jobs and, therefore, there is a time-lag during which demand is likely to be met by foreign competitors, especially in manufacturing. External pressures will then force a change of policy. This raises the prospect of the co-ordination of national policies to stimulate demand. Yet none of the members of the Triad is well placed for this: the USA at the moment does not need it, it has been booming; Japan's government seems unable to find stimuli sufficient to persuade consumers to spend (in a context of great uncertainty and without a welfare state to cover risks, they play safe and save, thus perpetuating the crisis); and the EU is locked into a low inflation regime to secure the birth of the Euro. At present, then, the scope for co-ordinated macro-economic action beyond that to reassure financial markets seems small.

The re-organisation of domestic financial institutions for the greater protection of investors and of corporate governance in the interests of greater external accountability are also issues central to the behaviour of managers and, therefore, of capital markets. Policy change is unlikely here until radical opinion becomes less cowed about tackling business elites head on. For the remainder of this discussion I shall concentrate on the welfare state. Its survival is central to the core social democratic goals outlined above. Welfare is the non-optional element in the project, and if it is destined to be cut back to Poor Law standards under international competitive pressures, then the wider agenda of social democratic reform is stalled and the only hope is a dogged defence of what entitlements can be salvaged.

In a sense, the question posed in the heading above is a foolish one, for clearly many welfare states have done just that. In the post-1945 period, a high degree of internationalisation has been typical of smaller advanced industrial countries like the Netherlands or Sweden, whereas countries like Japan and the USA have had much lower trade to GDP ratios. Thus the apparent paradox that the smaller more exposed countries have had extensive welfare states, and the larger, more insulated countries either very incomplete systems as in the USA, or, almost none at all as in Japan. The paradox is explained by the fact that small countries are not cushioned against the shocks transmitted by the international economy, and thus have had to adapt directly to them. Part of that adaptation was the widespread adoption of active industrial policies, and the corporatist co-ordination of economic actors, in order to enhance overall economic performance. Also crucial is an extensive welfare state that enabled individuals to bear the costs of economic dislocation whilst active policy measures were taking effect. Corporatist co-operation and high welfare spending have gone together. Thus wage restraint, tax levels and welfare provision were closely linked in unions' bargaining strategies.

Dani Rodrik in a valuable discussion, *Has Globalisation Gone Too Far?*, endorses this view of the past experience of small internationalised economies, but also argues like Scharpf that capital mobility has changed the terms of the bargain between labour and capital decisively in favour of the latter.[5] Yet if such strategies are so ineffective, why are they persisted in and why do they seem generally to lead to favourable outcomes in economic performance? In a period when British politicians assume corporatism is dead, it is interesting to note that social pacts have re-emerged as a major tool of economic management in several European countries in the late 1980s and early 1990s—in Finland, Ireland, Norway, Portugal and Spain.[6] Negotiated social governance is an asset that at least some national business elites are willing to accept in order to achieve economic stabilisation in an open economy. Capital is not threatening to defect or refusing to bargain in a wide range of small highly internationalised economies.

Sweden has been taken as the paradigmatic example of social democratic failure. John Gray argues that Sweden's difficulties have 'implications for social market economies everywhere' (1998: p. 82). A public sector that consumed 68 per cent of GDP, that had set a high floor for wages, and that had acted to maintain full employment as an employer of last resort had rendered Sweden internationally uncompetitive. These policies finally led to the widespread threat of business to defect abroad and the refusal of the employers to co-operate in the corporatist system: in 1990 the SAF withdrew from centralised wage bargaining and in 1991 from all corporatist forums. But Sweden is *not* a paradigmatic case of social democratic failure. Its policies were always highly distinctive and the crisis of the early 1990s had important conjunctural causes. Sweden's troubles followed on a series of major macroeconomic policy mistakes, such as the credit-fuelled and inflationary consumer boom that followed the precipitate loosening of credit controls in the mid-1980s. This negated the benefits of the earlier major devaluation of the Krona and forced policy back toward an explicit target against the Deutschmark. Also crucial to business threats in the early 1990s was uncertainty as to whether Sweden would join the European Union, a vital concern in such a highly export-oriented economy.

Sweden was not alone in making major policy errors. Thatcherite Britain had a similar experience with the dismantling of credit controls and the reckless 1988 budget, followed by the debacle of ERM entry in a period of rapidly accelerating inflation. Sweden is also unusual in having one of the most concentrated industrial structures in the world. It is dominated by a few large multi-national firms, heavily export-oriented and controlled by a tiny wealthy elite. Post-war social democratic policies boosted the export competitiveness and profitability of those firms, whilst leaving their management and ownership unchallenged. Only too late did social democratic strategists, like Rudolf Meidner, see that the effect of their wages solidarity policies had been to create super profits. The government's introduction of wage-earner funds to receive a share of equity came too little too late. By then the major firms had so much control over the Swedish economy that they could dictate the policies of the country. Thus did the Swedish social democrats pay for their arm's-length indulgence of the power to manage in the 1950s and 1960s.[7]

One has only to make a short ferry trip to see that Sweden is by no means typical of Scandinavia, let alone of social democracy in general. Moreover, Sweden is slowly recovering economically. It has been forced to accept unemployment, but it has not dismantled its welfare state. If high levels of public expenditure inevitably crippled economic performance and led to capital flight, then Denmark ought to be finished. In 1993 public expenditure was 63.8 per cent of GDP and taxes were 51.6 per cent of GDP in 1995, the highest in the EU. Yet, after a poor performance in the 1980s, Denmark has recovered well in the 1990s, with growth above the EU average, falling unemployment, and a positive balance of payments. Denmark's welfare state still enjoys majority public support and there has been little effective agitation against it from business. The reason is that Denmark has a very diverse industrial structure, heavily dependent on small- and medium-sized firms. Denmark also has a relatively weakly-regulated labour market, and whilst the rules for dismissal are highly favourable to employers, benefits have been readily available. The welfare state is funded mainly from general income taxes and VAT at 25 per cent: corporate taxes and employers' contributions to social security benefits are low. Thus, providing the general population is willing to pay for it, the welfare state imposes few direct costs on businesses. This is also a service-centred rather than a benefits-centred system. Most families benefit from good public services, like readily-available day-care for children. Hence there is a public perception that all benefit from the welfare regime. Denmark has one of the most egalitarian distributions of income in the world, with collectively funded services as an important part of the standard of living. The society is not divided into insiders and outsiders, with a distinct 'welfare class' that the employed pay for but do not identify with. Only 3 per cent of households in which the principal wage earner was unemployed were below the poverty line in 1988 compared to nearly 50 per cent in the UK.[8]

Denmark can be seen as exceptional, but other examples show that European welfare states can reform and adapt, boosting economic performance whilst maintaining levels of welfare that are high by comparison with other industrial countries. In the late 1980s the Netherlands appeared to be a failing economy and a clear demonstration of the employment-restricting effects of continental-style welfare systems, with high social insurance costs borne by employers. Firms adapted by boosting productivity and shedding labour. They were able to do so by using the pension system to fund early retirements and by using disability benefits to get rid of marginal workers. In 1983 the employment /population ratio was 52 per cent—the lowest in the OECD. In 1989 in a population of 15 million there were 1 million on disability benefits, and unemployment was still approaching 10 per cent.

As Jelle Visser and Anton Hemerijck show in their perceptive study *'A Dutch Miracle': Job Growth, Welfare Reform and Corporatism in the Netherlands*, the 1990s have seen a dramatic turnaround. Unemployment had fallen to 6.5 per cent in 1996, employment growth has been above the EU average at 1.5 per cent, and inflation remains low at 2.5 per cent.[9] These outcomes have been achieved by corporatist negotiation over wages and employment conditions, and vigorous government action to restrict access to benefits and promote employment. Whatever one's stance on economic theory, the Netherlands was carrying an unsustainable burden of those able to work living on permanent welfare. The employers and unions together used the consociational machinery to dump problems on the welfare state. Reform has been successful, even if cuts in access to benefits and benefit levels were very unpopular. Both coalition partners, Christian Democrats and Social Democrats, lost heavily in the 1994 elections amidst widespread protests. The social democratic response, however, must be that welfare is intended to protect individuals from contingencies, not to offer an unconditional alternative to work, or to employers an easy excuse to sack workers.

Disability benefits had become a problem that had to be tackled even if Holland had been an autarchic economy. The same can be said of the Italian state pensions system. The retreat here is not from 'globalisation', but from the cumulative effects of attempts by previous governments to buy industrial peace at the expense of mortgaging the future. In the early 1990s Italy was faced by the twin pressures of recession and the conditions of European Monetary Union. Italy had to contain the galloping growth of pensions expenditure and also cut public borrowing. Servicing the public debt had begun to consume some 10 per cent of GDP and was crippling expenditure on current services. Italy does not have an over-extensive welfare state by EU standards, public expenditure on social protection stood at the relatively low figure of 24.5 per cent of GDP in 1990. The pensions system imposed escalating costs, was unsustainable in terms of Italy's demographics, consumed an excessive part of the welfare budget, and was also chaotic and unfair in the entitlements it gave to different groups of workers.

Berlusconi's attempt to impose reform by fiat collapsed in 1994 in the face of mass mobilisation by the unions and the threatened defection of coalition partners. Thereafter, the centre-left governments were able to mobilise both unions and employers for a successful national dialogue on reform. The unions participated actively and secured a national majority of workers in favour of reform. This reform was partial, but did reduce costs and also achieved greater fairness between different schemes. Italy is not a small state, and it shows that national corporatist dialogue can still work in the larger economies if the conditions are right.[10]

The point of these examples is to suggest that welfare states can adapt despite intensified international competition: there is no inevitable 'race to the bottom'. Several lessons can be drawn from these examples. First, that welfare state crises are frequently the legacy of accumulated specific features and of past macro-economic policy failure and concessions. They have specific national and institutional causes and are not mere examples of a generalised crisis of the welfare state brought on by globalisation. Secondly, that reform need not be mere retrenchment, it can contribute to enhancing economic performance, as in the Netherlands, or to ensure sustainability and fairness, as in Italy. Thirdly, the scope for negotiated social governance remains substantial and the demise of traditional corporatist institutions has been prematurely announced, even if they are less representative and are playing new roles. Even in countries with difficult and antagonistic political and industrial relations systems, like Italy, negotiated reform and dialogue are possible. Fourthly, welfare systems that rely on general taxation and universal provision are more flexible in responding to changing economic circumstances and less likely to excite employer opposition than ones which rely on corporate taxation and employer-specific contributions.

The EU—Globalisation in One Trade Bloc?

The response to the foregoing might be to argue that European welfare states are not threatened by an abstract process of globalisation, but by the successful creation within the EU of the Single Market and the advent of Monetary Union. Capital is not forced to fly outside the trade bloc, it can still maximise its leverage by bargaining about its location in a continental-scale economic space. Fritz Scharpf has focussed on this problem in a series of seminal articles on the consequences of the further integration of the EU.[11] He argues that the EU has a chronic mismatch between its high level of economic integration and the weakness of governmental institutions at Union level, whilst national states no longer have the power to cope with the consequences of a continental-scale economy. This ushers in the prospect of regulatory competition, where national states seek economic advantage by cutting taxes and labour market regulations to attract capital. In a way this has already been happening, with the UK deliberately seeking to attract inward investment through low wages and poor employment protection, or with the Netherlands using wage restraint to boost its international competitiveness. Thus Martin Rhodes contends that many of the new social pacts across Europe are examples of 'competitive corporatism', oriented toward controlling costs and securing industrial peace but without the redistributive dimensions of traditional social democracy.[12]

Scharpf's point is that such a process of regulatory competition is above all a threat to democracy. French voters may have deliberately chosen to preserve their existing welfare entitlements, but the socialist government may be unable to secure them and at the same time meet the conditions for EMU. This sober analysis shows how naïve were the assumptions of many social democrats, especially the British Labour Party, in the late 1980s and early 1990s in expecting the EU to act as a bulwark against international competitive pressures. It was assumed that the EU would develop continent-wide welfare rights and be strong enough to prevent 'social dumping' from Asia. But the threat now seems to be less Asia than the neighbours next door. Large-scale welfare harmonisation, involving redistribution from north to south in Europe, is politically out of the question. Equally, Europe's welfare states and the entitlements they offer are so different, that real harmonisation on the model of the Single Market would involve comprehensive institutional reform across Europe and a reduction in benefits to the lowest common denominator.

Scharpf makes it clear that there are options both for national policy and at the Union level that could mitigate tendencies toward regulatory competition. A limited degree of tax and social welfare expenditure harmonisation between comparable countries like Germany and the Netherlands, rather than the impossible convergence of, say, Portugal and Denmark, would limit the scope of regulatory competition. Likewise states should shift toward forms of financing and delivery of benefits that do not provide disincentives for either employers or the unemployed. The point is that Scharpf's analysis is a worst case derived from rational choice assumptions. Even within it, there are clear options to contain capital flight. Yet most firms have other reasons for choosing to stay in a particular location. Capital markets are still stubbornly national and national business systems, including systems of industrial relations and skills formation, still offer real advantages. Thus there is another and more positive side to the fact that Europe has created a single market, but has not harmonised the institutions within which markets are embedded. Firms are insiders in one national context, and outsiders in another, with all the costs of learning and difficulties of adaptation.

Moreover, if there is a lesson from regulatory competition so far it is that it is by no means obviously a good bargain. Britain has not been more successful at attracting investment than has Ireland, in proportion to GDP, despite the latter's stronger union rights and active corporatist governance. The UK has followed the strategy of exporting capital to earn higher returns and relying on foreign firms to do its industrial investment. The effect has been to convert the UK into a branch plant economy, and major firms like LG or Siemens have withdrawn to their national productive core in times of crisis. The UK has a weak core of nationally-owned and managed firms in manufacturing. Its example shows that internationalised production and capital mobility have real limits in a world characterised mainly by nationally-based firms and distinct national production systems. The UK is an over-internationalised country in an under-globalised world.

'Globalisation' has become a key term in a minatory rhetoric aimed at silencing voices that are in favour of regulating markets rather than regulating for greater market freedom. If world free markets really prevailed and were ungovernable then national public policy would be irrelevant, and the voices that demand adaptation to global competitive pressures would be silent. There is still a clear choice in national and EU public policy between the goals of social democracy or the social market and state sponsored and subsidised *laissez faire*. This is most obvious in the Nordic countries, where there is still a vigorous advocacy of social democratic policies. It is also clear that the *laissez faire* globalist case is by no means victorious in France and Germany. It is quite possible that the EU, whilst unable to achieve welfare harmonisation, may be able to adopt policies that contain competitive pressures. The success of the Euro, a modest measure of tax harmonisation, and the capping of 'sweeteners' by local and national government in attracting inward investment would go a long way toward limiting the effects of financial market turbulence and the pressures of firms who threaten to move. Enlargement will increase the scope of such measures. In this respect the UK is once again the odd country out in both ideology and institutions. If social democracy does win the battle of ideas in Europe, then the UK will have to choose what content it will give to the Third Way.

Notes

1 Cambridge, Polity Press, 1996; 2nd completely revised edition 1999.
2 Cambridge, Polity Press, 1998—all data cited below are from these two sources.
3 Ithaca NY, Cornell University Press, 1991—originally published in German in 1987.
4 London, Granta, 1998.
5 Washington DC, Institute of International Economics, 1997.
6 See G. Fajertag and P. Pochet, eds., *Social Pacts in Europe*, Brussels: European Trade Union Institute/Observatoire Social European
7 On Sweden see A Martin, 'The Swedish Model: Demise or Reconfiguration' in R. Locke, T. Kochan & M. Piore, eds., *Employment Relations in a Changing World*, Cambridge MA, MIT Press, 1995; and J. Pontusson and P. Svenson, 'Labour Markets, Production Strategies and Wage Bargaining Institutions: the Swedish Employer Offensive in Comparative Perspective', *Comparative Political Studies*, Vol. 29, 1996, pp. 223–50.
8 On Denmark see J. Goul Anderson, 'The Scandinavian Welfare Model in Crisis?

Achievements and Problems of the Danish Welfare State in an Age of Unemployment and Low Growth', *Scandinavian Political Studies*, Vol. 20, No. 1, 1997, pp. 1–31; and E. Oddvar Eriksen & J. Loftager, eds., *The Rationality of the Welfare State*, Oslo, Scandinavian University Press, 1997.

9 Amsterdam, Amsterdam University Press, 1997; see also J. P. van der Toren, 'A ''tripartite consensus economy'': the Dutch variant of a social pact', in Fajertag and Pochet, eds., *op. cit.*, pp. 181–93; and the 1998 OECD report on the Netherlands which broadly confirms Visser and Hemerijck's findings.

10 On Italy see L. Baccaro & R. Locke, 'Public Sector Reform and Union Participation: The Case of Italian Pension Reform'; and M. Regini and I. Regalia, 'Employers, Unions and the State: The Resurgence of Concertation in Italy', *West European Politics*, Vol. 20, No. 1, 1997, pp. 210–30.

11 F. Scharpf 'Negative and Positive Integration in the Political Economy of European Welfare States' in G. Marks et. al., eds., *Governance in the European Union*, London, Sage, 1996; and F. Scharpf, 'Economic Integration, Democracy and the Welfare State', *European Journal of Public Policy*, Vol. 4, No. 1, 1997, pp.18–36.

12 M. Rhodes, 'Globalisation, Labour Markets and Welfare States: A Future Competitive Corporatism', Florence,, EUI Working Paper RSR No.97/36 1997.

