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Is European Social Democracy Dead?

Why is there so little social democratic opposition to Europe's austerity policy? Why did Social Democratic and Labor parties become agents of the turn to neo-liberalism and more recently of the austerity consensus? Does the beginning of a Franco-Italian-ECB axis against Merkel's austerity portend the revival of a social democratic opposition? Or will the bond market continue to serve as Merkel's enforcer?

Europe's main problem today is that the continent's economy is being crushed by an austerity regime. That regime, in turn, is the consequence of a rather ironic twist in the post-Maastricht structure of the EU, combined with the ascendance of neo-liberal ideology and the role of private finance, and Germany's role as hegemon.

The conjuncture of financial deregulation, a financial collapse, rigid Maastricht fiscal rules, and a conservative government in Berlin led to an intensification of the slide to neo-liberalism. This seems highly paradoxical, given the origins of the E.U. as an essentially social democratic political community. Even more strangely, social democrats are part of the austerity consensus; or to the extent that they would prefer more growth; they are not functioning as an opposition patry.

At the time of the Delors cabinet, and the push for a more solidaristic and stronger EU, and the common currency, both Europe's admirers and Europe's detractors saw in the run-up to Maastricht a kind of fortress Europe. The detractors meant an inward looking Europe, one that would protect its home industries and be a continent-wide expansion of Deutschland A.G. The admirers meant a Europe large enough to defend a social democratic, solidaristic model of managed capitalism against the sort of neo-liberalism that the Anglo-Saxons were seeking to export to the world, as the only possible model of capitalism. Mrs' Thatcher famous TINA – There Is No Alternative.

But then something strange happened. *Somewhere between Delors and the financial collapse, Maastricht mutated into an instrument of neo-liberalism*. Yes, the legacy elements of the stronger welfare state continue, though they are on the defensive. Europe's income distribution is on track to equal that of the U.S., with a lag of ten or fifteen years. If anything, neo-liberalism is at least as potent in Europe as it is in the U.S.

How did the E.U. become a prime agent of neo-liberalism? You can look at this question constitutionally, ideologically, and geo-politically.

I. First, as a constitutional matter, Europe ended up with both a weak continental government and a regime that weakened nation states as well – a victory for markets over political democracy. If you look at the history of European confederation, you appreciate that the defender of the social market or social democracy in the period from the '50s through the '90s was the nation-state, while the agent of market liberalization was the EEC, then the EC, then the E.U. There was a rough balance until Maastricht. But then Europe replicated the dilemmas of the US Articles of Confederation—a weak continental government with multiple veto points and the rules of the E.U. also served to weaken nation states as well. This came as something of a surprise.

With a stronger E.U., few the architects of Maastricht imagined, for example, that the ECJ would issue rulings weakening basic social protections as inconsistent with fundamental European law? But take a close look, and Maastricht privileges free movement of capital, services and persons over national social protections. So at a time of market resurgence, we have a weakened state as counterweight to the market—and in an economic crisis we need a stronger state to counteract the economic perversity of a market stuck in an equilibrium well below full employment—a secular stagnation

So Europe, as a constitutional matter, backed into a version of the American problem of the Articles of Confederation – a central government too weak to redeem the promise of democracy. At the time of the constitutional founding in the U.S., this was merely a problem of democratic theory and practice. What is the role of the state in assuring liberty, common purpose, the will of the majority and the rights of minorities? American federalism was an effort to achieve a good version of that balancing act. But Since the 20th century, the state has had another role – to housebreak capitalism.

Until Maastricht, if you think about it, the nation state was the instrument of the mixed economy – with a strong welfare state, public planning, some public ownership, regulation of labor and of capital. If a national government wanted to institute a substantially left program with significant regulation of labor., capital and social standards, it had the ability to do so. Meanwhile, the emergent European Community was the instrument of freer commerce—but not at the expense of the mixed economy. The early European project was mainly about reducing barriers to ordinary commerce, not to dismantling regulation of capitalism. However Maastricht seriously weakened the constituent states without strengthening the center. On the contrary, the function of the center came to be to weaken the state's capacity to regulate capitalism, and to impose a one-side-fits-all neo-liberalism.

Was this predicable? In 1939, an enthusiast of a federated Europe wrote that with European federation, "Certain economic powers, which are now generally wielded by the national state, could be exercised neither by the federation nor by the state." The author was Friedrich Hayek. It was the truest thing Hayek ever said; maybe the only true thing. A weak state serves the libertarian purpose.

A further complication is coalition politics. There are fully 20 social democratic parties as coalition leaders or partners in the 28 E.U. member states. But with the exception of France, every one is either a junior partner as in Germany and the Netherlands, or depends on a center or center-right party, as in Denmark and now Sweden. This tends to seriously blunt the role of social democrats as an ideological or political opposition, to say the least. In nations such as Denmark or Sweden, the dependence on centrist coalition parties makes for a very tepid form of social democracy. The more the center erodes, due to the increasing influence of the far right and far left, the more that social democrats feel compelled to participate in center or center-right governments—which locks them all the more into defending the hated austerity consensus.

Yet another element of this story is the perverse role of the euro. When the Euro was invented as a common currency, the assumption was that investors could ignore the risk of devaluation and capital would usefully flow to poorer regions of Europe. Nearly everyone forgot the risk of default, the risk of speculative bubbles, the risk of wide divergence in economic performance within Europe, the risk of bond-market speculation against vulnerable economies, and the risk of depression. The Euro and the ECB might have performed well, if they had another decade or two to mature before having to deal with a severe financial and economic crisis. But they are part of a dysfunctional system.

The ECB is a pseudo central bank, and the euro is a currency without a country. Unlike the Federal Reserve, the ECB has neither the franchise nor the political will to engage in massive quantitative easing—open market purchases of sovereign bonds. That would not only violate its charter, but would violate the fiscal discipline that is so central to the Maastricht design as stringently interpreted and enforced by Berlin. The feints by ECB President Mario Draghi provide a kind of loyal opposition to Merkel. He and the Bank are severely constrained, and Draghi is neither frontally challenging the supremacy of the bond market nor fiscal austerity. Like the rest of the E.U.'s institutions, the ECB is hamstrung by multiple masters and multiple veto points.

This year happens to be the 70th anniversary of Karl Polanyi's masterwork, *The Great Transformation*, and the 50th anniversary of Polanyi's death in 1964.
Polanyi taught that the extreme version of economic liberalism that caused the great catastrophes of the Twentieth Century rested on three pillars – free trade, unregulated labor markets, and the gold standard to protect currency parities (and investors). The gold standard in turn required budgetary austerity to reassure the bond market. If you substitute "the euro" for "the gold standard," the euro plays the same role within Europe of locking currency values and compelling appeasement of the bond market above all other goals. The E.U. now promotes free trade and free labor markets over social

protections with the same ferocity as its ancestors in the 19^{th} century. And you have exactly the conditions that Polanyi warned about, and similar social consequences— the bond market as king, very high unemployment, with ugly social backlash.

II. The second element of our story is ideological. In the 1990s, the leading social democrats of that era – Blair, Schroeder, egged on by Clinton, and even social democrats in nations like Sweden, embraced elements of neo-liberalism—Thatcherism with a human face: More market, tempered by a reformed welfare state. They accepted much of the neo-liberal critique that the old social democratic formula produced rigidities—in labor markets, in the quest for innovation; and in welfare state excesses. Some of this critique was principled, if overstated. You can find a principled version of it in the Swedes' effort to introduce more competition into elements of the welfare state, or the Danish and Dutch effort to refine active labor market policy later rebranded as flexicurity. In fact, however, much of Europe's problem was and is macro-economic. Neo-liberalism did not cure that—indeed, neoliberalism only worsened the macro-economic problems by giving the bond market far more power over macro-economic policies, a latent problem that became extreme after the crisis of 2007.

But a lot of the embrace of neo-liberalism was also opportunistic. Blair was looking for a political alliance between New Labour and the City of London, and making a huge bet on rampant, deregulated finance as the salvation of a post-industrial Britain. Schroeder was looking for approval from his friends in industry and finance, dismantling many of the elements of Rhenish stakeholder capitalism, and then profiting personally when he left office. Clinton looking for a way to insulate Democrats from the charge that they were soft on welfare cheats, while making a tight financial alliance with Bob Rubin and the proponents of financial deregulation. The embrace of some neo-liberalism turned out to be cumulative. Some financialization led to more. Some deregulation led to more. Combined with the constitutional elements of the E.U., which were supercharged in the crisis, the result was to dismantle much of the European social and economic model.

III. Third element is geopolitical. Because of the historical timing of the collapse of the Soviet Union, German reunification and the rise of Chancellor Merkel, we have Germany playing the hegemonic role, and it is a conservative Germany with an obsessive commitment to fiscal balance no matter what the costs. Some of this was a historical accident, as I recount in my recent book, *Debtors Prison*. At the moment that the wall came down, the sponsors of more intimate European Union were deadlocked over the proposed single currency. They further deadlocked over German unification.

Francois Mitterrand, alternately Helmut Kohl's ally and nemesis, was convinced that a grand bargain could be had. In exchange for the blessing of allies who were very uneasy about the prospect of the Federal Republic simply absorbing the DDR, what if Germany dropped its opposition to monetary union? In a stroke, this would accomplish two goals dear to Mitterrand and Delors. It would accelerate the march to a single currency, which in turn would deepen the integration of Germany into Europe. This was the bargain that was eventually made. In return for the sacrifice of its cherished Deutsche Mark, emblem of postwar prosperity, the Germans agreed to join the Euro. But they insisted on tough, German-style fiscal conditions, including a national debt ceiling of 60 percent of GDP and an annual deficit of 3 percent, so that the euro would not be an instrument of inflation. This deal became part of the Maastricht Treaty defining the next phase of European Union.

In retrospect, it's clear that this was far from being a grand bargain in which each party gave something and got something. Germany won four different ways. Very uneasy neighbors accepted the fait accompli of German reunification; the euro became successor to the Deutsche Mark, amplifying rather than diffusing Germany's monetary dominance; the terms of engagement imposed Germany's fiscal model on Europe. And though it was not appreciated at the time, the euro also was to give Germany a chronically undervalued currency and an artificial export advantage. The 2 trillion euro cost of reunification to the German Federal Republic increased Germany's national debt and redoubled the German wariness of inflation. Relatively high interest rates imposed first by the Bundesbank and later by the successor ECB left the rest of Europe captive to German tight money policy.

The economic imbalance within Europe has allowed Germany to play fiscal role model and fiscal scold, ignoring that some of Germany's ostensible virtue depends on an undervalued currency. The government is popular, the Greeks are unpopular, and German Social Democrats, now in the government, quibble only around the edges. The SPD, once again in coalition with the CDU, epitomizes the failure of social democrats to function as an opposition to austerity.

I observed in *Debtors Prison* that Merkel draws the wrong lesson from Twentieth Century history. She draws the lesson of the Weimar hyper-inflation. Instead, Merkel should recall the debt relief that the allies granted Germany as part of the currency reform of 1948 and the postwar program of reconstruction. Hitler ran up the largest debt to GDP ratio in the history of the world – 675% GDP. This was written off. The prewar Weimar debt was reduced, and the Federal Republic was given 50 years to pay, at very low interest rates. The last of the Weimar debt was retired in 2013. Imagine if Germany has given such generous treatment to Greece. However serious Greece's sins may have been, they were pretty mild compared to Hitler's.

One other element of German history that Chancellor Merkel might recall, and I thank Peter Gourevitch for this insight.:In 1932, the German trade unions put forward the WTB plan, for 2 billion marks worth of job-creating public investment. But the WTB plan, named for the trade union economist Wladimir Woytinsky (a Kenyesian *avant la lettre*) and his colleagues Tarnow and Baade, was rejected by Chancellor Bruening, who insisted in a deflationary fiscal policy. Germany, however, soon got a very effective economic stimulus plan--via Nazi re-armament.

No such program of reflation can even be discussed seriously today because of the role of Chancellor Merkel and her allies, the bond market and the European constitution. Social democrats have been enablers of all this. The government of the one nation with a Socialist president who can govern without depending on neo-liberal or centrist coalition partners, France, thinks itself very bold to tell Merkel that France won't hit the 3 percent fiscal deficit target for two more years, largely because France is pursuing a program of tax cuts. No serious person in France or elsewhere thinks this program will address the crisis. But this feeble gesture passes for defiance of Brussels and Berlin. And that's because there are plenty of neo-liberals within the nominally socialist French government and they in turn feel constrained by the bond market.

European elites, in the face of prolonged stagnation, are doubling down on neo-liberalism with the proposed TTIP (Trans-Atlantic Trade and Investment Partnership) and agreement. This supposed trade deal is actually intended as a battering ram to create private rights to further undermine what's left of economic and social regulation though its so called investor-state dispute resolution and other provisions that increase the rights of private capital and further weaken the necessary regulatory role of the state.

TTIP also it diverts attention from the true policy and political challenge – how to break the bonds of austerity. Not even TTIP's most euphoric sponsors argue that it would more than trivially increase growth. The most optimistic projection in the official negotiating documents forecast a one-time increase in growth of about half a point of GDP. Austerity cuts growth by several multiples of that. TTIP is emblematic of the focus of European elites—including many social democrats—on deepening neo-liberalism rather than in combating austerity that is rooted in neo-liberal principles. Some of the social democratic support for TTIP is rooted in the traditional Nordic support for open trade. The U.S. Government and its counterparts in Brussels have done a very effective job selling TTIP as nothing but trade liberalization. The Swedish government, now led by social democrats, is a big proponent.

IV. Today, despite the badly compromised social democrats, there is in fact a left opposition program. One encounters it at conferences of academics and of trade unions. There is even something close to a consensus on the program's elements. It includes:

*Mutualization of Europe's sovereign debt, and open quantitative easing by the ECB

*Explicit debt relief for the more acute victims of the austerity policy such as Greece.

*Suspension of the Maastricht fiscal limits.

*A massive program of public investment, both for its own sake, for green transition, and as necessary reflation.

*Serious re-regulation of finance.

*Re-assertion of labor market and other social protections.

There is no way this program can be entertained either by Europe's current constitutional set-up, or as a matter of politics. Nations would have to secede either from the Euro-zone or from the E.U. itself, and that is a practical impossibility. Social democrats would have to withdraw from coalition governments. Also, for half a century, social democrats have been the most enthusiastic partisans of the European project, even as its ideological meaning has shifted almost 180 degrees—I say almost because even the Delors design had some neo-liberal elements. So social democrats continue to accept and defend a brand of European union that has become toxic, because they think they have no practical alternative. In private conversation, it's clear that many leading and rank and file social democrats hate the path Europe is on, almost as much as their constituents do. But they are not in the role of serious opposition party.

Where will the opposition come from? We have seen this story before, and it is not a happy one. It will come from the far right. In a very few places, there are left parties embracing a more robust democratic left opposition. In the Netherlands, the Dutch Socialist Party plays that role, as does Syriza in Greece. But political forces to the left of mainstream social democrats are for the most part weak and divided. On issues of neo-liberalism and opposition to austerity, the greens are not much help. An arithmetically possible red-red-green coalition in Berlin was rejected by the SPD because of their contempt for the Links Partei.

Most European voters detest and fear the current economic trap, but they have few if any progressive champions in electoral politics. The press, reporting election results, invariably casts social democrats as “part of the pro-E.U. mainstream,” is if there were no possible alternative to the current role and policies of the E.U. And since voters see things that way as well—social democrats are the quintessential establishment party--social democratic political support continues to erode. It is now all but impossible to imagine a social democratic cabinet anywhere in Europe without centrist partners that would further dilute the potential for social democratic opposition to the austerity consensus, France being a special case. Opposition thus passes to the right. It was the right that gained in the recent European parliamentary elections, and that is poised to make gains in several national elections. The role of immigrants in high-unemployment makes the backlash more severe and the situation more toxic.

It would be nice to end on a hopeful note, to see the slight gestures of fiscal defiance on the part of the French and Italian governments as the beginning of some progressive green shoots. But these governments continue to be intimated by the power of Berlin, Brussels and their enforcers in the bond market. I can’t imagine a scenario that includes social democrats playing the role of robust opposition party any time soon. More likely is continuing slow losses for social democrats, increasing gains for the far right, and fragile center-right/center-left coalitions unable to contest the neoliberal austerity regime. With Gramsci, one has to be a pessimist of the mind and an optimist of the heart.