PREFACE

Are there fundamental differences in national political economies conditioning economic performance and social well-being? How should these differences be construed? Can we expect them to survive the pressures that integration into an international economy places upon nations? These have long been fundamental issues in the field of comparative political economy. They have acquired a new urgency in the contemporary era, as technological change and the developments associated with ‘globalization’ shift the climate for business around the world, calling into question many settled understandings.

This book outlines a new approach to the comparison of national economies that can be used to answer such questions. Building on the new economics of organization, it develops an approach to understanding the macroeconomy and the institutions within it that moves beyond earlier conceptions built on influential distinctions between ‘strong’ and ‘weak’ states or ‘neo-corporatist’ and ‘pluralist’ societies. It brings the firm back into a central position in our understanding of the political economy and, as such, should be of interest to scholars of business as well as political economists. It applies concepts drawn from game theory and the new institutionalism in economics to the problem of understanding national economies, effecting an integration between theories of the firm and conceptions of the macroeconomy relevant to economics as well as political science.

For many years, discussions of international trade have been dominated by theories of comparative economic advantage. However, recent patterns in the movement of goods across national borders have called into question classic theories of comparative advantage. At the same time, endogenous sources of growth based on economies of scope, learning by doing, and positive externalities have led some to argue that the institutional frameworks within which firms operate may condition what they can do. This raises the possibility that nations may derive comparative advantages from their institutional infrastructure, but few theories have been developed to explain precisely how institutions generate such advantages or in what they consist. The approach to comparative capitalism developed in this volume fills that gap, offering an account of how the institutions structuring the political economy confer comparative advantages on a nation, especially in the sphere of innovation.
This theory of comparative institutional advantage has wide implications. It generates predictions about what kinds of activities firms will move across national borders when international markets become more open and where they will move them. It provides a new analysis of the pressures governments experience as a result of globalization and one capable of explaining the diversity of policy responses that follow. It offers a novel perspective on the positions governments are likely to take in international economic negotiations. Perhaps most important, it calls into question the presumption that increasing international economic integration will force the institutions and regulatory regimes of diverse nations into convergence on a common model.

The implications for policy-making of this approach to comparative political economy are equally radical. It casts the fundamental problems facing economic policy-makers in a new light, suggesting that their principal task is not to identify endeavors in which firms can excel and provide incentives for pursuing them, but rather the more difficult one of improving the capacities of firms to coordinate with other actors in the economy. It calls for a reexamination of social policy and a reinterpretation of the welfare state. Social policies are often seen as measures that impede the operation of markets, forced on an unwilling business community by labor or the political left. However, the essays in this volume suggest that many kinds of social policies actually improve the operation of markets and enhance the capacities of firms to pursue distinctive strategies, thereby inspiring active support in the business community.

Building on the distinction between ‘liberal market economies’ and ‘coordinated market economies’ that is central to the approach, the contributors to this volume explore many of the institutional complementarities found in such economies. They show how firms develop corporate strategies to take advantage of the institutional support available in any economy for particular modes of coordination, deriving from this a new perspective on issues in strategic management. They examine how national legal frameworks for contracting and standard-setting reinforce specific patterns of business coordination and the ways in which monetary regimes interact with industrial relations systems to generate distinctive patterns of economic performance. The result is a textured account of how some institutions in the political economy can reinforce the operation of others to generate nationally distinctive forms of capitalism.

Although grounded in large bodies of empirical research, the contributions to this volume are bold and bound to be controversial. Even at this length, the volume covers only some of the issues raised by this approach
to comparative political economy and a few of the nations to which it can be applied. We construe the book, however, not as the end of a story but as its beginning. Above all else, it is an effort to open research agendas in multiple fields by suggesting new lines of inquiry and analysis. We hope that readers will find the contents as stimulating as we found the works on which we have built.

The artwork on the cover of this book, Work by Ford Madox Brown, is now in the Manchester City Art Gallery. Painted between 1852 and 1865 on Heath Street, Hampstead, it portrays two intellectuals, Thomas Carlyle and F. D. Maurice, observing work in its social context during an earlier era of intense economic change, much as the contributors to this book observe the processes of globalization today.

This volume has had a long gestation. It is the culmination of a project begun in 1992 as a collaborative effort between the Minda de Gunzburg Center for European Studies at Harvard University and the Wissenschaftszentrum in Berlin to bring together a group of young political economists to discuss the issues associated with varieties of capitalism that we led jointly with Suzanne Berger of MIT. The participants met twice a year over five years for intensive debate, and many spent extended periods of time at the WZB. These discussions provided some of the most exciting intellectual experiences of our lives, and we have learned more than we can ever acknowledge from those who took part in them.

We owe a particular debt to Suzanne Berger whose leadership was indispensable to the project and whose lively intelligence and empathetic criticism influenced many of the formulations in these pages. Tom Cusack, Geoffrey Garrett, and Jonas Pontusson were also mainstays of this project from the beginning whose intellectual contributions to it have profoundly influenced our thinking. Among those who participated in many of the sessions, we want to thank Carles Boix, Jonah Levy, Richard Locke, Paul Pierson, Peter Swenson, Anne Wren, and Nicholas Ziegler. Those who provided important contributions to specific sessions include: Richard Clayton, Elie Cohen, John Ferejohn, David Finegold, Andrew Glyn, John Griffin, Ellen Immergut, Wade Jacoby, Horst Kern, Desmond King, Peter Lange, Gerhard Lehmbruch, Ton Notermans, Claus Offe, Sofia Pérez, Fritz Scharpf, Wolfgang Streeck, Gunnar Trumbull, Steven Vogel, and John Zysman.

For the financial support that sustained this project, we are grateful to the Wissenschaftszentrum and the Program for the Study of Germany and Europe at Harvard. We thank Charles Maier, the Director of the Center for European Studies, Abby Collins, its Associate Director, and
Preface

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Over the years in which we have been working on this book, we have received encouragement and constructive criticism from so many friends and colleagues that it is impossible to list them all, but they should know we are grateful. Among those who deserve special thanks for the advice or close readings they provided are: Rainer Fehn, Peter Gourevitch, Michel Goyer, Rogers Hollingsworth, Peter Katzenstein, Stephan Leibfried, Margaret Levi, Philip Manow, Andrew Martin, and Jonathan Zeitlin as well as the anonymous readers for the press.

Finally, for intellectual stimulation and sustained support, we owe more than we can express to Nicola Lacey and Rosemary C. R. Taylor.

P.A.H.
D.S.

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An Introduction to Varieties of Capitalism

Peter A. Hall and David Soskice

1.1 Introduction

Political economists have always been interested in the differences in economic and political institutions that occur across countries. Some regard these differences as deviations from 'best practice' that will dissolve as nations catch up to a technological or organizational leader. Others see them as the distillation of more durable historical choices for a specific kind of society, since economic institutions condition levels of social protection, the distribution of income, and the availability of collective goods—features of the social solidarity of a nation. In each case, comparative political economy revolves around the conceptual frameworks used to understand institutional variation across nations.

On such frameworks depend the answers to a range of important questions. Some are policy-related. What kind of economic policies will improve the performance of the economy? What will governments do in the face of economic challenges? What defines a state's capacities to meet such challenges? Other questions are firm-related. Do companies located in different nations display systematic differences in their structure and strategies? If so, what inspires such differences? How can national differences in the pace or character of innovation be explained? Some are issues about economic performance. Do some sets of institutions provide lower rates of inflation and unemployment or higher rates of growth than others? What are the trade-offs in terms of economic performance to developing one type of political economy rather than another? Finally, second-order questions about institutional change and stability are of special significance today. Can we expect technological progress and the competitive pressures of globalization to inspire institutional convergence? What factors condition the adjustment paths a political economy takes in the face of such challenges?

The object of this book is to elaborate a new framework for understanding the institutional similarities and differences among the developed economies, one that offers a new and intriguing set of answers to
such questions.\textsuperscript{1} We outline the basic approach in this Introduction. Subsequent chapters extend and apply it to a wide range of issues. In many respects, this approach is still a work-in-progress. We see it as a set of contentions that open up new research agendas rather than settled wisdom to be accepted uncritically, but, as the contributions to this volume indicate, it provides new perspectives on an unusually broad set of topics, ranging from issues in innovation, vocational training, and corporate strategy to those associated with legal systems, the development of social policy, and the stance nations take in international negotiations.

As any work on this topic must be, ours is deeply indebted to prior scholarship in the field. The ‘varieties of capitalism’ approach developed here can be seen as an effort to go beyond three perspectives on institutional variation that have dominated the study of comparative capitalism in the preceding thirty years.\textsuperscript{2} In important respects, like ours, each of these perspectives was a response to the economic problems of its time.

The first of these perspectives offers a \textit{modernization approach} to comparative capitalism nicely elucidated in Shonfield’s magisterial treatise of 1965. Devised in the post-war decades, this approach saw the principal challenge confronting the developed economies as one of modernizing industries still dominated by pre-war practices in order to secure high rates of national growth. Analysts tried to identify a set of actors with the strategic capacity to devise plans for industry and to impress them on specific sectors. Occasionally, this capacity was said to reside in the banks but more often in public officials. Accordingly, those taking this approach focused on the institutional structures that gave states leverage over the private sector, such as planning systems and public influence over the flows of funds in the financial system (Cohen 1977; Estrin and Holmes 1983; Zysman 1983; Cox 1986). Countries were often categorized, according to the structure of their state, into those with ‘strong’ and ‘weak’ states (Katzenstein 1978b; Sacks 1980; Nordlinger 1981; Skocpol and Amenta 1985). France and Japan emerged from this perspective as models of economic success, while Britain was generally seen as a laggard (Shonfield 1965; Johnson 1982).

\textsuperscript{1} We concentrate here on economies at relatively high levels of development because we know them best and think the framework applies well to many problems there. However, the basic approach should also have relevance for understanding developing economies as well (cf. Bates 1997).

\textsuperscript{2} Of necessity, this summary is brief and slightly stylized. As a result, it does not do full justice to the variety of analyses found within these literatures and neglects some discussions that fall outside them. Note that some of our own prior work can be said to fall within them. For more extensive reviews, see Hall (1999, 2001).
Introduction

During the 1970s, when inflation became the preeminent problem facing the developed economies, a number of analysts developed a second approach to comparative capitalism based on the concept of neo-corporatism (Schmitter and Lehmbruch 1979; Berger 1981; Goldthorpe 1984; Alvarez et al. 1991). Although defined in various ways, neo-corporatism was generally associated with the capacity of a state to negotiate durable bargains with employers and the trade union movement regarding wages, working conditions, and social or economic policy. Accordingly, a nation’s capacity for neo-corporatism was generally said to depend on the centralization or concentration of the trade union movement, following an Olsonian logic of collective action which specifies that more encompassing unions can better internalize the economic effects of their wage settlements (Olson 1965; Cameron 1984; Calmfors and Driffill 1988; Golden 1993). Those who saw neo-corporatist bargains as a ‘political exchange’ emphasized the ability of states to offer inducements as well as the capacity of unions to discipline their members (Pizzorno 1978; Regini 1984; Scharpf 1987, 1991; cf. Przeworski and Wallerstein 1982). Those working from this perspective categorized countries largely by reference to the organization of their trade union movement; and the success stories of this literature were the small, open economies of northern Europe.

During the 1980s and 1990s, a new approach to comparative capitalism that we will term a social systems of production approach gained currency. Under this rubric, we group analyses of sectoral governance, national innovation systems, and flexible production regimes that are diverse in some respects but united by several key analytic features. Responding to the reorganization of production in response to technological change, these works devote more attention to the behavior of firms. Influenced by the French regulation school, they emphasize the movement of firms away from mass production toward new production regimes that depend on collective institutions at the regional, sectoral, or national level (Piore and Sabel 1984; Dore 1986; Streeck and Schmitter 1986; Dosi et al. 1988; Boyer 1990; Lazonick 1991; Campbell et al. 1991; Nelson 1993; Hollingsworth et al. 1994; Herrigel 1996; Hollingsworth and Boyer 1997; Edquist 1997; Whitley 1999). These works bring a wider range of institutions into the analysis and adopt a more sociological approach to their operation, stressing the ways in which institutions

3 An alternative approach to neo-corporatism, closer to our own, which puts less emphasis on the trade union movement and more on the organization of business was also developed by Katzenstein (1985a, 1985b) among others (Offe 1981).
generate trust or enhance learning within economic communities. As a result, some of these works resist national categories in favor of an emphasis on regional success of the sort found in Baden-Württemberg and the Third Italy.

Each of these bodies of work explains important aspects of the economic world. However, we seek to go beyond them in several respects. Although those who wrote within it characterized national differences in the early post-war era well, for instance, some versions of the modernization approach tend to overstate what governments can accomplish, especially in contexts of economic openness where adjustment is firm-led. We will argue that features of states once seen as attributes of strength actually make the implementation of many economic policies more difficult; and we seek a basis for comparison more deeply rooted in the organization of the private sector.

Neo-corporatist analysis directs our attention to the organization of society, but its emphasis on the trade union movement underplays the role that firms and employer organizations play in the coordination of the economy (cf. Soskice 1990a; Swenson 1991). We want to bring firms back into the center of the analysis of comparative capitalism and, without neglecting trade unions, highlight the role that business associations and other types of relationships among firms play in the political economy.

The literature on social systems of production accords firms a central role and links the organization of production to the support provided by external institutions at many levels of the political economy. However, without denying that regional or sectoral institutions matter to firm behavior, we focus on variation among national political economies. Our premiss is that many of the most important institutional structures—notably systems of labor market regulation, of education and training, and of corporate governance—depend on the presence of regulatory regimes that are the preserve of the nation-state. Accordingly, we look for national-level differences and terms in which to characterize them that are more general or parsimonious than this literature has generated.4

Where we break most fundamentally from these approaches, however, is in our conception of how behavior is affected by the institutions of the political economy. Three frameworks for understanding this relationship

---

4 One of the pioneering works that some will want to compare is Albert (1993), who develops a contrast between the models of the Rhine and America that parallels ours in some respects. Other valuable efforts to identify varieties of capitalism that have influenced us include Hollingsworth and Boyer (1997), Crouch and Streeck (1997b), and Whitley (1999).
dominate the analysis of comparative capitalism. One sees institutions as socializing agencies that instill a particular set of norms or attitudes in those who operate within them. French civil servants, for instance, are said to acquire a particular concern for the public interest by virtue of their training or the ethos of their agencies. A second suggests that the effects of an institution follow from the power it confers on particular actors through the formal sanctions that hierarchy supplies or the resources an institution provides for mobilization. Industrial policy-makers and trade union leaders are often said to have such forms of power. A third framework construes the institutions of the political economy as a matrix of sanctions and incentives to which the relevant actors respond such that behavior can be predicted more or less automatically from the presence of specific institutions, as, for instance, when individuals refuse to provide public goods in the absence of selective incentives. This kind of logic is often cited to explain the willingness of encompassing trade unions to moderate wages in order to reduce inflation.

Each of these formulations captures important ways in which the institutions of the political economy affect economic behavior and we make use of them. However, we think these approaches tend to miss or model too incompletely the strategic interactions central to the behavior of economic actors. The importance of strategic interaction is increasingly appreciated by economists but still neglected in studies of comparative capitalism.\(^5\) If interaction of this sort is central to economic and political outcomes, the most important institutions distinguishing one political economy from another will be those conditioning such interaction, and it is these that we seek to capture in this analysis. For this purpose, we construe the key relationships in the political economy in game-theoretic terms and focus on the kinds of institutions that alter the outcomes of strategic interaction. This approach generates an analysis that focuses on some of the same institutions others have identified as important but construes the impact of those institutions differently as well as one that highlights other institutions not yet given enough attention in studies of comparative capitalism.

By locating the firm at the center of the analysis, we hope to build bridges between business studies and comparative political economy, two disciplines that are all too often disconnected. By integrating game-theoretical perspectives on the firm of the sort that are now central to microeconomics into an analysis of the macroeconomy, we attempt to connect the new microeconomics to important issues in macroeconomics.

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\(^5\) There are a few notable exceptions that influence our analysis, including the work of Scharpf (1987, 1997\(a\)) and Przeworski and Wallerstein (1982).
Ours is a framework that should be of interest to economists, scholars of business, and political scientists alike. We turn now to an elucidation of its basic elements.

### 1.2 The Basic Elements of the Approach

This *varieties of capitalism* approach to the political economy is actor-centered, which is to say we see the political economy as a terrain populated by multiple actors, each of whom seeks to advance his interests in a rational way in strategic interaction with others (Scharpf 1997a). The relevant actors may be individuals, firms, producer groups, or governments. However, this is a firm-centered political economy that regards companies as the crucial actors in a capitalist economy. They are the key agents of adjustment in the face of technological change or international competition whose activities aggregate into overall levels of economic performance.

#### 1.2.1 A Relational View of the Firm

Our conception of the firm is relational. Following recent work in economics, we see firms as actors seeking to develop and exploit *core competencies* or *dynamic capabilities* understood as capacities for developing, producing, and distributing goods and services profitably (Teece and Pisano 1998). We take the view that critical to these is the quality of the relationships the firm is able to establish, both internally, with its own employees, and externally, with a range of other actors that include suppliers, clients, collaborators, stakeholders, trade unions, business associations, and governments. As the work on transactions costs and principal–agent relationships in the economics of organization has underlined, these are problematic relationships (Milgrom and Roberts 1992). Even where hierarchies can be used to secure the cooperation of actors, firms encounter problems of moral hazard, adverse selection, and shirking. In many cases, effective operation even within a hierarchical environment may entail the formation of implicit contracts among the actors; and many of a firm's relationships with outside actors involve incomplete contracting (cf. Williamson 1985). In short, because its capabilities are ultimately relational, a firm encounters many coordination problems. Its success depends substantially on its ability to coordinate effectively with a wide range of actors.

For the purposes of this inquiry, we focus on five spheres in which firms must develop relationships to resolve coordination problems central
to their core competencies. The first is the sphere of *industrial relations* where the problem facing companies is how to coordinate bargaining over wages and working conditions with their labor force, the organizations that represent labor, and other employers. At stake here are wage and productivity levels that condition the success of the firm and rates of unemployment or inflation in the economy as a whole. In the sphere of *vocational training and education*, firms face the problem of securing a workforce with suitable skills, while workers face the problem of deciding how much to invest in what skills. On the outcomes of this coordination problem turn not only the fortunes of individual companies and workers but the skill levels and competitiveness of the overall economy.

Issues of coordination also arise in the sphere of *corporate governance*, to which firms turn for access to finance and in which investors seek assurances of returns on their investments. The solutions devised to these problems affect both the availability of finance for particular types of projects and the terms on which firms can secure funds. The fourth sphere in which coordination problems crucial to the core competencies of an enterprise appear is the broad one of *inter-firm relations*, a term we use to cover the relationships a company forms with other enterprises, and notably its suppliers or clients, with a view to securing a stable demand for its products, appropriate supplies of inputs, and access to technology. These are endeavors that may entail standard-setting, technology transfer, and collaborative research and development. Here, coordination problems stem from the sharing of proprietary information and the risk of exploitation in joint ventures. On the development of appropriate relationships in this sphere, however, depend the capacities of firms to remain competitive and technological progress in the economy as a whole.

Finally, firms face a set of coordination problems vis-à-vis their own *employees*. Their central problem is to ensure that employees have the requisite competencies and cooperate well with others to advance the objectives of the firm. In this context, familiar problems of adverse selection and moral hazard arise, and issues of information-sharing become important (see Milgrom and Roberts 1992). Workers develop reservoirs of specialized information about the firm's operations that can be of value to management, but they also have the capacity to withhold information or effort. The relationships firms develop to resolve these problems condition their own competencies and the character of an economy's production regimes.
1.2.2 Liberal Market Economies and Coordinated Market Economies

From this perspective, it follows that national political economies can be compared by reference to the way in which firms resolve the coordination problems they face in these five spheres. The core distinction we draw is between two types of political economies, liberal market economies and coordinated market economies, which constitute ideal types at the poles of a spectrum along which many nations can be arrayed.

In liberal market economies, firms coordinate their activities primarily via hierarchies and competitive market arrangements. These forms of coordination are well described by a classic literature (Williamson 1985). Market relationships are characterized by the arm’s-length exchange of goods or services in a context of competition and formal contracting. In response to the price signals generated by such markets, the actors adjust their willingness to supply and demand goods or services, often on the basis of the marginal calculations stressed by neoclassical economics.

In many respects, market institutions provide a highly effective means for coordinating the endeavors of economic actors.

In coordinated market economies, firms depend more heavily on non-market relationships to coordinate their endeavors with other actors and to construct their core competencies. These non-market modes of coordination generally entail more extensive relational or incomplete contracting, network monitoring based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive, relationships to build the competencies of the firm. In contrast to liberal market economies (LMEs), where the equilibrium outcomes of firm behavior are usually given by demand and supply conditions in competitive markets, the equilibria on which firms coordinate in coordinated market economies (CMEs) are more often the result of strategic interaction among firms and other actors.

Market relations and hierarchies are important to firms in all capitalist economies, of course, and, even in liberal market economies, firms enter

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6 In other works by the contributors to this volume, ‘organized market economy’ is sometimes used as a term synonymous with ‘coordinated market economy’. Although all of the economies we discuss are ‘coordinated’ in the general sense of the term, by markets if not by other institutions, the term reflects the prominence of strategic interaction and hence of coordination in the game-theoretic sense in CMEs.

7 Although we do not emphasize it here, this is not meant to deny the observation of Granovetter (1985) and others that market relations are usually underpinned by personal relationships of familiarity and trust.
into some relationships that are not fully mediated by market forces. But this typology is based on the contention that the incidence of different types of firm relationships varies systematically across nations. In some nations, for instance, firms rely primarily on formal contracts and highly competitive markets to organize relationships with their employees and suppliers of finance, while, in others, firms coordinate these endeavors differently. In any national economy, firms will gravitate toward the mode of coordination for which there is institutional support.

1.2.3 The Role of Institutions and Organizations

Institutions, organizations, and culture enter this analysis because of the support they provide for the relationships firms develop to resolve coordination problems. Following North (1990: 3), we define institutions as a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive, or material reasons, and organizations as durable entities with formally recognized members, whose rules also contribute to the institutions of the political economy.

From this perspective, markets are institutions that support relationships of particular types, marked by arm’s-length relations and high levels of competition. Their concomitant is a legal system that supports formal contracting and encourages relatively complete contracts, as the chapters by Teubner and Casper indicate. All capitalist economies also contain the hierarchies that firms construct to resolve the problems that cannot be addressed by markets (Williamson 1985). In liberal market economies, these are the principal institutions on which firms rely to coordinate their endeavors.

Although markets and hierarchies are also important elements of coordinated market economies, firms in this type of economy draw on a further set of organizations and institutions for support in coordinating their endeavors. What types of organizations and institutions support the distinctive strategies of economic actors in such economies? Because the latter rely more heavily on forms of coordination secured through

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8 This point applies with particular force to market relationships in which one or more of the participants has substantially more market power than the others, as in cases of oligopoly, oligopsony, and the relations found in some supplier chains. We are not arguing that all markets in LMEs are perfectly competitive.

9 Note that, from time to time, we refer loosely to the ‘institutions’ or ‘organization’ of the political economy to refer to both the organizations and institutions found within it.
strategic interaction to resolve the problems they face, the relevant institutions will be those that allow them to coordinate on equilibrium strategies that offer higher returns to all concerned. In general, these will be institutions that reduce the uncertainty actors have about the behavior of others and allow them to make credible commitments to each other. A standard literature suggests that these are institutions providing capacities for (i) the exchange of information among the actors, (ii) the monitoring of behavior, and (iii) the sanctioning of defection from cooperative endeavor (see Ostrom 1990). Typically, these institutions include powerful business or employer associations, strong trade unions, extensive networks of cross-shareholding, and legal or regulatory systems designed to facilitate information-sharing and collaboration. Where these are present, firms can coordinate on strategies to which they would not have been led by market relations alone.

The problem of operating collaborative vocational training schemes provides a classic example. Here, the willingness of firms to participate depends on the security of their beliefs that workers will learn useful skills and that firms not investing in training will not poach extensively from those who do, while the participation of workers depends on assurances that training will lead to remunerative employment. As Culpepper’s chapter in this volume indicates, it is easier for actors to secure these assurances where there are institutions providing reliable flows of information about appropriate skill levels, the incidence of training, and the employment prospects of apprentices (Finegold and Soskice 1988; Culpepper and Finegold 1999).

Similarly, the terms on which finance is provided to firms will depend on the monitoring capacities present in the economy. Where potential investors have little access to inside information about the progress of the firms they fund, access to capital is likely to depend on highly public criteria about the assets of a firm of the sort commonly found on balance sheets. Where investors are linked to the firms they fund through networks that allow for the development of reputations based on extensive access to information about the internal operations of the firm, however, investors will be more willing to supply capital to firms on terms that do not depend entirely on their balance sheets. The presence of institutions providing network reputational monitoring can have substantial effects on the terms on which firms can secure finance.

In short, this approach to comparative capitalism emphasizes the presence of institutions providing capacities for the exchange of information, monitoring, and the sanctioning of defections relevant to cooperative
behavior among firms and other actors; and it is for the presence of such institutions that we look when comparing nations.

In addition, examination of coordinated market economies leads us to emphasize the importance of another kind of institution that is not normally on the list of those crucial to the formation of credible commitments, namely institutions that provide actors potentially able to cooperate with one another with a capacity for deliberation. By this, we simply mean institutions that encourage the relevant actors to engage in collective discussion and to reach agreements with each other. Deliberative institutions are important for several reasons.

Deliberative proceedings in which the participants engage in extensive sharing of information about their interests and beliefs can improve the confidence of each in the strategies likely to be taken by the others. Many game-theoretic analyses assume a level of common knowledge that is relatively thin, barely stretching past a shared language and familiarity with the relevant payoffs. When multiple equilibria are available, however, coordination on one (especially one that exchanges higher payoffs for higher risks) can be greatly facilitated by the presence of a thicker common knowledge, one that extends beyond the basic situation to a knowledge of the other players sufficiently intimate to provide confidence that each will coordinate on a specific equilibrium (Eichengreen 1997). Deliberation can substantially thicken the common knowledge of the group.

As Scharpf (1987: ch. 4) has pointed out, although many think only of a ‘prisoner’s dilemma’ game when they consider problems of cooperation, in the political economy many such problems take quite different forms, including ‘battle of the sexes’ games in which joint gains are available from more than one strategy but are distributed differently depending on the equilibrium chosen. Distributive dilemmas of this sort are endemic to political economies, and agreement on the distribution of the relevant gains is often the prerequisite to effective cooperation (Knight 1992). In some cases, such as those of collaborative research and development, the problem is not simply to distribute the gains but also the risks attendant on the enterprise. Deliberation provides the actors with an opportunity to establish the risks and gains attendant on cooperation and to resolve the distributive issues associated with them. In some cases, the actors may simply be negotiating from positions of

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10 One political economist who has consistently drawn attention to the importance of deliberation is Sabel (1992, 1994) and the issue is now the subject of a growing game-theoretic literature (see Elster 1998).
relative power, but extensive deliberation over time may build up specific conceptions of distributive justice that can be used to facilitate agreement in subsequent exchanges.

Finally, deliberative institutions can enhance the capacity of actors in the political economy for strategic action when faced with new or unfamiliar challenges. This is far from irrelevant since economies are frequently subject to exogenous shocks that force the actors within them to respond to situations to which they are unaccustomed. The history of wage negotiations in Europe is replete with examples. In such instances, developments may outrun common knowledge, and deliberation can be instrumental to devising an effective and coordinated response, allowing the actors to develop a common diagnosis of the situation and an agreed response.

In short, deliberative institutions can provide the actors in a political economy with strategic capacities they would not otherwise enjoy; and we think cross-national comparison should be attentive to the presence of facilities for deliberation as well as institutions that provide for the exchange of information in other forms, monitoring, and the enforcement of agreements.

1.2.4 The Role of Culture, Informal Rules, and History

Our approach departs from previous works on comparative capitalism in another respect.\footnote{Here we depart from some of our own previous formulations as well (cf. Hall 1986; Soskice 1990b).} Many analyses take the view that the relevant outcomes in economic performance or policy follow more or less directly from differences in the formal organization of the political economy. Particular types of wage settlements or rates of inflation and unemployment are often said to follow, for instance, from the organizational structure of the union movement. Because we believe such outcomes are the products of efforts to coordinate in contexts of strategic interaction, however, we reject the contention that they follow from the presence of a particular set of institutions alone, at least if the latter are defined entirely in terms of formal rules or organizations.

As we have noted, the presence of a set of formal institutions is often a necessary precondition for attaining the relevant equilibrium in contexts of coordination. But formal institutions are rarely sufficient to guarantee that equilibrium. In multi-player games with multiple iterations of the sort that characterize most of the cases in which we are
interested, it is well known that there exist multiple equilibria, any one of which could be chosen by the actors even in the presence of institutions conducive to the formation of credible commitments (Fudenberg and Maskin 1986). Something else is needed to lead the actors to coordinate on a specific equilibrium and, notably, on equilibria offering high returns in a non-cooperative context. In many instances, what leads the actors to a specific equilibrium is a set of shared understandings about what other actors are likely to do, often rooted in a sense of what it is appropriate to do in such circumstances (March and Olsen 1989).

Accordingly, taking a step beyond many accounts, we emphasize the importance of informal rules and understandings to securing the equilibria in the many strategic interactions of the political economy. These shared understandings are important elements of the 'common knowledge' that lead participants to coordinate on one outcome, rather than another, when both are feasible in the presence of a specific set of formal institutions. By considering them a component of the institutions making up the political economy, we expand the concept of institutions beyond the purely formal connotations given to it in some analyses.

This is an entry point in the analysis for history and culture. Many actors learn to follow a set of informal rules by virtue of experience with a familiar set of actors and the shared understandings that accumulate from this experience constitute something like a common culture. This concept of culture as a set of shared understandings or available 'strategies for action' developed from experience of operating in a particular environment is analogous to those developed in the 'cognitive turn' taken by sociology (Swidler 1986; DiMaggio and Powell 1991). Our view of the role that culture can play in the strategic interactions of the political economy is similar to the one Kreps (1990) accords it in organizations faced with problems of incomplete contracting.

The implication is that the institutions of a nation's political economy are inextricably bound up with its history in two respects. On the one hand, they are created by actions, statutory or otherwise, that establish formal institutions and their operating procedures. On the other, repeated historical experience builds up a set of common expectations that allows the actors to coordinate effectively with each other. Among other things, this implies that the institutions central to the operation of the political economy should not be seen as entities that are created at one point in time and can then be assumed to operate effectively afterwards.

Culpepper documents this problem and explores some solutions to it in this volume and Culpepper (1998).
To remain viable, the shared understandings associated with them must be reaffirmed periodically by appropriate historical experience. As Thelen emphasizes in this volume, the operative force of many institutions cannot be taken for granted but must be reinforced by the active endeavors of the participants.

1.2.5 Institutional Infrastructure and Corporate Strategy

This varieties of capitalism approach draws its basic conceptions of how institutions operate from the new economics of organization. We apply a set of concepts commonly used to explain behavior at the micro level of the economy to problems of understanding the macroeconomy (Milgrom and Roberts 1992). One of the advantages is an analysis with robust and consistent postulates about what kind of institutions matter and how they affect behavior. Another is the capacity of the approach to integrate analysis of firm behavior with analysis of the political economy as a whole.

However, there are at least two respects in which our account deviates from mainstream views in the new economics of organization. First, although we make use of the influential dichotomy between ‘markets’ and ‘hierarchies’ that Williamson (1975) has impressed on the field, we do not think this exhausts the relevant variation. Markets and hierarchies are features of LMEs and CMEs but we stress the systematic variation found in the character of corporate structure (or hierarchies) across different types of economies and the presence of coordination problems even within hierarchical settings (Milgrom and Roberts 1992). Even more important, we do not see these two institutional forms as the only ones firms can employ to resolve the challenges they confront. In coordinated market economies in particular, many firms develop relationships with other firms, outside actors, and their employees that are not well described as either market-based or hierarchical relations but better seen as efforts to secure cooperative outcomes among the actors using a range of institutional devices that underpin credible commitments. Variation in the incidence and character of this ‘third’ type of relationship is central to the distinctions we draw between various types of political economies.\(^{13}\)

Second, it is conventional in much of the new economics of organization to assume that the core institutional structures of the economy,

\(^{13}\) Williamson (1985) himself acknowledges the presence of institutionalized relationships extending beyond markets or hierarchies, albeit without characterizing them precisely as we do here.
whether markets, hierarchies, or networks, are erected by firms seeking the most efficient institutions for performing certain tasks. The postulate is that (institutional) structure follows (firm) strategy (cf. Chandler 1974; Williamson 1975, 1985; Chandler and Daems 1980). In a restricted sense, this is certainly true: firms can choose whether to contract out an endeavor or perform it in-house, for instance, and they enjoy some control over their own corporate form.

However, we think it unrealistic to regard the overarching institutional structures of the political economy, and especially those coordinating the endeavors of many actors (such as markets, institutional networks, and the organizations supporting collaborative endeavor), as constructs created or controlled by a particular firm. Because they are collective institutions, a single firm cannot create them; and, because they have multifarious effects, it may be difficult for a group of firms to agree on them. Instead, as Calvert (1995) observes, the construction of coordinating institutions should be seen as a second-order coordination problem of considerable magnitude. Even when firms can agree, the project may entail regulatory action by the government and the formation of coalitions among political parties and labor organizations motivated by considerations going well beyond efficiency (Swenson 1991, 1997).

As a result, the firms located within any political economy face a set of coordinating institutions whose character is not fully under their control. These institutions offer firms a particular set of opportunities; and companies can be expected to gravitate toward strategies that take advantage of these opportunities. In short, there are important respects in which strategy follows structure. For this reason, our approach predicts systematic differences in corporate strategy across nations, and differences that parallel the overarching institutional structures of the political economy. This is one of the most important implications of the analysis.

Let us stress that we refer here to broad differences. Of course, there will be additional variation in corporate strategies inside all economies in keeping with differences in the resource endowments and market settings of individual firms. The capabilities of management also matter, since firms are actors with considerable autonomy. Our point is that (institutional) structure conditions (corporate) strategy, not that it fully determines it. We also agree that differences in corporate strategy can be conditioned by the institutional support available to firms at the regional or sectoral levels (Campbell et al. 1991; Hollingsworth et al. 1994; Herrigel

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14 At the sectoral or regional level, of course, large firms may be able to exercise substantial influence over the development of these institutions, as Hancké shows in this volume (see also Hancké forthcoming).
Many of the works making this point are congruent with our own in that they stress the importance of the institutional environment to firm strategy, even though there has been fruitful disagreement about which features of that environment matter most (cf. Streeck 1992b). However, we emphasize variations in corporate strategy evident at the national level. We think this justified by the fact that so many of the institutional factors conditioning the behavior of firms remain nation-specific. There are good reasons why that should be the case. Some of the relevant institutions were deeply conditioned by nationally specific processes of development, as are most trade unions and employers’ associations. In others, the relevant institutions depend heavily on statutes or regulations promulgated by national states, as do many institutions in the financial arena and labor market, not to mention the sphere of contract law.

In sum, we contend that differences in the institutional framework of the political economy generate systematic differences in corporate strategy across LMEs and CMEs. There is already some evidence for this. For instance, the data that Knetter (1989) has gathered are especially interesting. He finds that the firms of Britain, a typical LME, and those of Germany, a CME, respond very differently to a similar shock, in this case an appreciation of the exchange rate that renders the nation’s goods more expensive in foreign markets. British firms tend to pass the price increase along to customers in order to maintain their profitability, while German firms maintain their prices and accept lower returns in order to preserve market share.

Our approach predicts differences of precisely this sort. We would argue that British firms must sustain their profitability because the structure of financial markets in a liberal market economy links the firm’s access to capital and ability to resist takeover to its current profitability; and they can sustain the loss of market share because fluid labor markets allow them to lay off workers readily. By contrast, German firms can sustain a decline in returns because the financial system of a coordinated market economy provides firms with access to capital independent of current profitability; and they attempt to retain market share because the labor institutions in such an economy militate in favor of long-term employment strategies and render layoffs difficult.

It is possible to apply the general analytical framework of this volume to variations at the regional or sectoral level, as the chapter by Hancke does in some respects. From the perspective of this volume, institutional variation at the regional or sectoral level provides an additional layer of support for particular types of coordination and one that enhances a nation’s capacity to support a range of corporate strategies and production regimes.
These are only some of the ways in which the institutional arrangements of a nation's political economy tend to push its firms toward particular kinds of corporate strategies. We explore more of these below with special emphasis on innovation.

To put the point in the most general terms, however, firms and other actors in coordinated market economies should be more willing to invest in specific and co-specific assets (i.e. assets that cannot readily be turned to another purpose and assets whose returns depend heavily on the active cooperation of others), while those in liberal market economies should invest more extensively in switchable assets (i.e. assets whose value can be realized if diverted to other purposes). This follows from the fact that CMEs provide more institutional support for the strategic interactions required to realize the value of co-specific assets, whether in the form of industry-specific training, collaborative research and development, or the like, while the more fluid markets of LMEs provide economic actors with greater opportunities to move their resources around in search of higher returns, encouraging them to acquire switchable assets, such as general skills or multi-purpose technologies.\footnote{For examples in one sphere, see the essay by Estevez-Abe, Iversen, and Soskice in this volume.}

\section{1.2.6 Institutional Complementarities}

The presence of institutional complementarities reinforces the differences between liberal and coordinated market economies. The concept of 'complementary goods' is a familiar one: two goods, such as bread and butter, are described as complementary if an increase in the price of one depresses demand for the other. However, complementarities may also exist among the operations of a firm: marketing arrangements that offer customized products, for instance, may offer higher returns when coupled to the use of flexible machine tools on the shop floor (Jaikumar 1986; Milgrom and Roberts 1990, 1995).

Following Aoki (1994), we extend this line of reasoning to the institutions of the political economy. Here, two institutions can be said to be complementary if the presence (or efficiency) of one increases the returns from (or efficiency of) the other.\footnote{Conversely, two institutions can be said to be 'substitutable' if the absence or inefficiency of one increases the returns to using the other. Note that we refer to total returns, leaving aside the question of to whom they accrue, which is a matter of property rights, and we define efficiency as the net returns to the use of an institution given its costs.} The returns from a stock market trading
in corporate securities, for instance, may be increased by regulations mandating a fuller exchange of information about companies.

Of particular interest are complementarities between institutions located in different spheres of the political economy. Aoki (1994) has argued that long-term employment is more feasible where the financial system provides capital on terms that are not sensitive to current profitability. Conversely, fluid labor markets may be more effective at sustaining employment in the presence of financial markets that transfer resources readily among endeavors thereby maintaining a demand for labor (cf. Caballero and Hamour 1998; Fehn 1998). Casper explores complementarities between national systems of contract law and modes of inter-firm collaboration, and we identify others in the sections that follow.

This point about institutional complementarities has special relevance for the study of comparative capitalism. It suggests that nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well. Several logics may be operative here. In some cases, the institutions sustaining coordination in one sphere can be used to support analogous forms of coordination in others. Where dense networks of business associations support collaborative systems of vocational training, for instance, those same networks may be used to operate collective standard-setting. Similarly, firms may pressure governments to foster the development of institutions complementary to those already present in the economy in order to secure the efficiency gains they provide.

If this is correct, institutional practices of various types should not be distributed randomly across nations. Instead, we should see some clustering along the dimensions that divide liberal from coordinated market economies, as nations converge on complementary practices across different spheres. Fig. 1.1 presents some support for these propositions. It locates OECD nations on two axes that provide indicators for the character of institutions in the spheres of corporate finance and labor markets respectively. A highly developed stock market indicates greater reliance on market modes of coordination in the financial

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18 Of course, there are limits to the institutional isomorphism that can be expected across spheres of the economy. Although efficiency considerations may press in this direction, the presence of functional equivalents for particular arrangements will limit the institutional homology even across similar types of political economies, and the importance to institutional development of historical processes driven by considerations other than efficiency will limit the number of complementarities found in any economy.
Fig. 1.1 Institutions across sub-spheres of the political economy

Note: Employment protection refers to the index of employment protection developed by Estevez-Abe, Iversen, and Soskice in this volume. Stock market capitalization is the market value of listed domestic companies as a percentage of GDP.


sphere, and high levels of employment protection tend to reflect higher levels of non-market coordination in the sphere of industrial relations.  

Although there is some variation within each group, a pronounced clustering is evident. Nations with liberal market economies tend to rely on markets to coordinate endeavors in both the financial and industrial relations systems, while those with coordinated market economies have institutions in both spheres that reflect higher levels of non-market coordination.  

Among the large OECD nations, six can be classified as liberal market economies (the USA, Britain, Australia, Canada, New Zealand, Ireland) and another ten as coordinated market economies (Germany, Japan, Switzerland, the Netherlands, Belgium, Sweden, Norway, Denmark,

19 The employment protection index developed by Estevez-Abe, Iversen, and Soskice in their chapter for this volume is a composite measure of the relative stringency of legislation or collective agreements dealing with hiring and firing, the level of restraint embedded in collective dismissal rules, and the extent of firm-level employment protection. Stock market capitalization is the market value of listed domestic companies as a percentage of GDP.
### Table 1.1 The economic performance of liberal and coordinated market economies

#### Liberal market economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth rate of GDP</th>
<th>GDP per capita</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>5.2</td>
<td>2.8</td>
<td>3.3</td>
</tr>
<tr>
<td>Canada</td>
<td>5.3</td>
<td>3.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>4.4</td>
<td>3.9</td>
<td>6.5</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4.0</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>UK</td>
<td>3.1</td>
<td>1.3</td>
<td>2.4</td>
</tr>
<tr>
<td>United States</td>
<td>4.0</td>
<td>2.2</td>
<td>2.9</td>
</tr>
<tr>
<td>LME average</td>
<td>4.3</td>
<td>2.5</td>
<td>3.2</td>
</tr>
</tbody>
</table>

#### Coordinated market economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth rate of GDP</th>
<th>GDP per capita</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria(^a)</td>
<td>4.9</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Belgium</td>
<td>4.9</td>
<td>2.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.4</td>
<td>1.8</td>
<td>2.2</td>
</tr>
<tr>
<td>Finland</td>
<td>5.0</td>
<td>2.7</td>
<td>2.2</td>
</tr>
<tr>
<td>Iceland</td>
<td>5.7</td>
<td>4.1</td>
<td>2.7</td>
</tr>
<tr>
<td>Germany</td>
<td>4.3</td>
<td>1.8</td>
<td>2.2</td>
</tr>
<tr>
<td>Japan</td>
<td>9.7</td>
<td>3.3</td>
<td>2.6</td>
</tr>
<tr>
<td>Netherlands(^b)</td>
<td>4.9</td>
<td>1.9</td>
<td>2.8</td>
</tr>
<tr>
<td>Norway</td>
<td>4.3</td>
<td>4.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.2</td>
<td>1.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Switzerland</td>
<td>4.4</td>
<td>.58</td>
<td>1.3</td>
</tr>
<tr>
<td>CME average</td>
<td>5.1</td>
<td>2.4</td>
<td>2.3</td>
</tr>
</tbody>
</table>

**Notes:** Growth rate of GDP: average annual growth in GDP, averaged for the time-periods indicated. GDP per capita: per capita GDP at purchasing power parity, averaged for the time-periods indicated. Unemployment rate: annual unemployment rate.

\(^a\) Unemployment series begins in 1964.

\(^b\) Unemployment series begins in 1969.

Finland, and Austria) leaving six in more ambiguous positions (France, Italy, Spain, Portugal, Greece, and Turkey). However, the latter show some signs of institutional clustering as well, indicating that they may constitute another type of capitalism, sometimes described as ‘Mediterranean’, marked by a large agrarian sector and recent histories of extensive state intervention that have left them with specific kinds of capacities for non-market coordination in the sphere of corporate finance but more liberal arrangements in the sphere of labor relations (see Rhodes 1997).

Although each type of capitalism has its partisans, we are not arguing here that one is superior to another. Despite some variation over specific periods, both liberal and coordinated market economies seem capable of providing satisfactory levels of long-run economic performance, as the major indicators of national well-being displayed in Table 1.1 indicate. Where there is systematic variation between these types of political economies, it is on other dimensions of performance. We argue below that the two types of economies have quite different capacities for innovation. In addition, they tend to distribute income and employment differently. As Fig. 1.2 indicates, in liberal market economies, the adult population tends to be engaged more extensively in paid employment and levels of income inequality are high. In coordinated market economies, working hours tend to be shorter for more of the population and incomes more equal. With regard to the distribution of well-being, of course, these differences are important.

To make this analytical framework more concrete, we now look more closely at coordination in the principal spheres of firm endeavor in coordinated and liberal market economies, drawing on the cases of Germany and the United States for examples and emphasizing the institutional complementarities present in each political economy.

1.3 Coordinated Market Economies: The German Case

As we have noted, we regard capitalist economies as systems in which companies and individuals invest, not only in machines and material

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20 Luxembourg and Iceland have been omitted from this list because of their small size and Mexico because it is still a developing nation.

21 The Gini Index used in Fig. 1.2 is a standard measure for income inequality, measured here as post-tax, post-transfer income, reported in the Luxembourg Income Study for the mid- to late 1980s. Full-time equivalent employment is reported as a percentage of potential employment and measured as the total number of hours worked per year divided by full-time equivalent hours per person (37.5 hours at 50 weeks) times the working-age population. It is reported for the latest available of 1993 or 1994.
technologies, but in competencies based on relations with others that entail coordination problems. In coordinated market economies, firms resolve many of these problems through strategic interaction. The resulting equilibria depend, in part, on the presence of supportive institutions. Here, we use the case of Germany to illustrate how non-market coordination is achieved in each of the principal spheres of firm endeavor. Of course, the institutions used to secure coordination in other CMEs may differ to some extent from those of Germany.

(i) The financial system or market for corporate governance in coordinated market economies typically provides companies with access to finance that is not entirely dependent on publicly available financial data or current returns. Access to this kind of ‘patient capital’ makes it possible for firms to retain a skilled workforce through economic downturns and to invest in projects generating returns only in the long run. The core problem here is that, if finance is not to be dependent on balance-sheet criteria, investors must have other ways of monitoring the performance

Fig. 1.2 Distributional outcomes across political economies

Note: Full-time equivalent employment is defined as the total number of hours worked per year divided by full-time equivalent hours per year per person times working age population. GINI refers to the gini coefficient measuring post-tax, post-transfer income inequality.

Sources: For full-time equivalent unemployment: OECD (1996a). For GINI index: Spain, Japan, New Zealand are from Deiniger and Squire (1996); the remaining countries are from OECD (1996a).
of companies in order to ensure the value of their investments. In
general, that means they must have access to what would normally be
considered ‘private’ or ‘inside’ information about the operation of the
company.

This problem is generally resolved in CMEs by the presence of dense
networks linking the managers and technical personnel inside a
company to their counterparts in other firms on terms that provide for
the sharing of reliable information about the progress of the firm.
Reliability is secured in a number of ways. Firms may share information
with third parties in a position to monitor the firm and sanction it for
misleading them, such as business associations whose officials have an
intimate knowledge of the industry. Reputation is also a key factor:
where membership in a network is of continuing value, the participants
will be deterred from providing false information lest their reputation in
the network and access to it suffer. CMEs usually have extensive systems
for what might be termed ‘network reputational monitoring’ (Vitols et
al. 1997).

In Germany, information about the reputation and operation of a
company is available to investors by virtue of (a) the close relationships
that companies cultivate with major suppliers and clients, (b) the know-
ledge secured from extensive networks of cross-shareholding, and (c)
joint membership in active industry associations that gather information
about companies in the course of coordinating standard-setting, tech-
nology transfer, and vocational training. Other companies are not only
represented on the supervisory boards of firms but typically engaged
closely with them in joint research, product development, and the like.
In short, firms sit inside dense business networks from which potential
funders can gain a considerable amount of inside information about the
track record and projects of a firm.\footnote{In previous decades, the German banks were also important contributors to such
networks by virtue of their control over large numbers of shares in industrial firms (Hall
1986: ch. 9). In recent years, the role of the large commercial banks has declined, as they
divest themselves of many holdings (Griffin 2000).}

The overall structure of the market for corporate governance is equally
important. Since firms often fund their activities from retained earnings,
they are not always sensitive to the terms on which external finance
is supplied. But they can be forced to focus on profitability and share-
holder value if faced with the prospect of hostile takeover by others
claiming to be able to extract more value from the company. Thus, the
corporate strategies found in many CMEs also depend on tax provi-
sions, securities regulations, and networks of cross-shareholding that
discourage hostile mergers and acquisitions, which were very rare until recently, for instance, in Germany.

(ii) The internal structure of the firm reinforces these systems of network monitoring in many CMEs. Unlike their counterparts in LMEs, for instance, top managers in Germany rarely have a capacity for unilateral action. Instead, they must secure agreement for major decisions from supervisory boards, which include employee representatives as well as major shareholders, and from other managers with entrenched positions as well as major suppliers and customers. This structural bias toward consensus decision-making encourages the sharing of information and the development of reputations for providing reliable information, thereby facilitating network monitoring.

In the perspective we present, the incentives facing individuals, whether managers or workers, are as important as those facing firms. In CMEs, managerial incentives tend to reinforce the operation of business networks. Long-term employment contracts and the premium that firm-structure places on a manager’s ability to secure consensus for his projects lead managers to focus heavily on the maintenance of their reputations, while the smaller weight given to stock-option schemes in managerial compensation in CMEs relative to LMEs inclines them to focus less on profitability than their counterparts in LMEs. The incentives for managers are broadly aligned with those of firms.

(iii) Many firms in coordinated market economies employ production strategies that rely on a highly skilled labor force given substantial work autonomy and encouraged to share the information it acquires in order to generate continuous improvements in product lines and production processes (Sorge and Warner 1986; Dore 1986). However, companies that adopt such strategies are vulnerable to ‘hold up’ by their employees and the ‘poaching’ of skilled workers by other firms, while employees who share the information they gain at work with management are open to exploitation.23 Thus, CMEs need industrial relations institutions capable of resolving such problems.

The German industrial relations system addresses these problems by setting wages through industry-level bargains between trade unions and employer associations that generally follow a leading settlement, normally reached in engineering where the union is powerful enough to

23 ‘Hold up’ is Williamson’s (1985) term for the withdrawal of active cooperation to back up demands.
assure the labor movement that it has received a good deal. Although union density is only moderately high, encompassing employers’ associations bind their members to these agreements. By equalizing wages at equivalent skill levels across an industry, this system makes it difficult for firms to poach workers and assures the latter that they are receiving the highest feasible rates of pay in return for the deep commitments they are making to firms. By coordinating bargaining across the economy, these arrangements also limit the inflationary effects of wage settlements (Streeck 1994; Hall and Franzese 1998).

The complement to these institutions at the company level is a system of works councils composed of elected employee representatives endowed with considerable authority over layoffs and working conditions. By providing employees with security against arbitrary layoffs or changes to their working conditions, these works councils encourage employees to invest in company-specific skills and extra effort. Their effectiveness is underpinned by the capacity of either side to appeal a disputed decision to the trade unions and employers’ associations, who act as external guarantors that the councils function as intended (Thelen 1991).

(iv) Because coordinated market economies typically make extensive use of labor with high industry-specific or firm-specific skills, they depend on education and training systems capable of providing workers with such skills. As Culpepper notes in his chapter, the coordination problems here are acute, as workers must be assured that an apprenticeship will result in lucrative employment, while firms investing in training need to know that their workers will acquire usable skills and will not be poached by companies that do not make equivalent investments in training. CMEs resolve these problems in a variety of ways.

Germany relies on industry-wide employer associations and trade unions to supervise a publicly subsidized training system. By pressuring major firms to take on apprentices and monitoring their participation in such schemes, these associations limit free-riding on the training efforts of others; and, by negotiating industry-wide skill categories and training protocols with the firms in each sector, they ensure both that the training fits the firms’ needs and that there will be an external demand for any graduates not employed by the firms at which they apprenticed. Because German employer associations are encompassing organizations

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24 Compared to general skills that can be used in many settings, industry-specific skills normally have value only when used within a single industry and firm-specific skills only in employment within that firm.
that provide many benefits to their members and to which most firms in a sector belong, they are well placed to supply the monitoring and suasion that the operation of such a system demands as well as the deliberative forums in which skill categories, training quotas, and protocols can be negotiated. Workers emerge from their training with both company-specific skills and the skills to secure employment elsewhere.

(v) Since many firms in coordinated market economies make extensive use of long-term labor contracts, they cannot rely as heavily on the movement of scientific or engineering personnel across companies, to effect technology transfer, as liberal market economies do. Instead, they tend to cultivate inter-company relations of the sort that facilitate the diffusion of technology across the economy. In Germany, these relationships are supported by a number of institutions. Business associations promote the diffusion of new technologies by working with public officials to determine where firm competencies can be improved and orchestrating publicly subsidized programs to do so. The access to private information about the sector that these associations enjoy helps them ensure that the design of the programs is effective for these purposes. A considerable amount of research is also financed jointly by companies, often in collaboration with quasi-public research institutes. The common technical standards fostered by industry associations help to diffuse new technologies, and they contribute to a common knowledge-base that facilitates collaboration among personnel from multiple firms, as do the industry-specific skills fostered by German training schemes (Lütz 1993; Soskice 1997b; Ziegler 1997).

Casper’s chapter in this volume shows that Germany has also developed a system of contract law complementary to the presence of strong industry associations that encourages relational contracting among companies and promotes this sort of technology transfer. Because of the many contingencies that can arise in close inter-firm relationships involving joint research or product development, tightly written, formal contracts are often inadequate to sustain such relationships. However, the German courts permit unusually open-ended clauses in inter-firm contracts on the explicit condition that these be grounded in the prevailing standards of the relevant industry association. Thus, the presence of strong industry associations capable of promulgating standards and resolving disputes among firms is the precondition for a system of contract law that encourages relational contracting (cf. Casper 1997; Teubner in this volume).

In these respects, German institutions support forms of relational contracting and technology transfer that are more difficult to achieve in
liberal market economies. One of the effects is to encourage corporate strategies that focus on product differentiation and niche production, rather than direct product competition with other firms in the industry, since close inter-firm collaboration is harder to sustain in the presence of the intense product competition that tends to characterize LMEs. The chapter by Estevez-Abe, Iversen, and Soskice examines the linkages between these product market strategies, skill systems, and social-policy regimes.

The complementarities present in the German political economy should be apparent from this account. Many firms pursue production strategies that depend on workers with specific skills and high levels of corporate commitment that are secured by offering them long employment tenures, industry-based wages, and protective works councils. But these practices are feasible only because a corporate governance system replete with mechanisms for network monitoring provides firms with access to capital on terms that are relatively independent of fluctuations in profitability. Effective vocational training schemes, supported by an industrial-relations system that discourages poaching, provide high levels of industry-specific skills. In turn, this encourages collective standard-setting and inter-firm collaboration of the sort that promotes technology transfer. The arrows in Fig. 1.3 summarize some of these complementarities. Since many of these institutional practices enhance the effectiveness with which others operate, the economic returns to the system as a whole are greater than its component parts alone would generate.

1.4 Liberal Market Economies: The American Case

Liberal market economies can secure levels of overall economic performance as high as those of coordinated market economies, but they do so quite differently. In LMEs, firms rely more heavily on market relations to resolve the coordination problems that firms in CMEs address more often via forms of non-market coordination that entail collaboration and strategic interaction. In each of the major spheres of firm endeavor, competitive markets are more robust and there is less institutional support for non-market forms of coordination.

(i) Several features of the financial systems or markets for corporate governance of liberal market economies encourage firms to be attentive to current earnings and the price of their shares on equity markets. Regulatory regimes are tolerant of mergers and acquisitions, including the hostile
takeovers that become a prospect when the market valuation of a firm declines. The terms on which large firms can secure finance are heavily dependent on their valuation in equity markets, where dispersed investors depend on publicly available information to value the company. This applies to both bonds, share issues, and bank lending. Compensation systems that reward top management for increases in net earnings

Firms in LMEs tend to rely on bond and equity markets for external finance more heavily than those in CMEs. However, bank lending in such economies also privileges publicly accessible, balance-sheet criteria, since banks find it difficult to monitor the less-
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or share price are common in such economies. Liberal market economies usually lack the close-knit corporate networks capable of providing investors with inside information about the progress of companies that allows them to supply finance less dependent on quarterly balance sheets and publicly available information. The relevant contrast is with CMEs, where firms need not be as attentive to share price or current profitability in order to ensure access to finance or deter hostile takeovers.

Of course, there are some qualifications to these generalizations. Companies with readily assessable assets associated with forward income streams, such as pharmaceutical firms with a ‘pipeline’ of drugs, consumer-goods companies with strong reputations for successful product development, and firms well positioned in high-growth markets, need not be as concerned about current profitability. New firms in high-technology fields can often secure funds from venture-capital companies that develop the resources and technical expertise to monitor their performance directly and trade ownership stakes in these firms for the high risks they take. On the whole, however, the markets for corporate governance in LMEs encourage firms to focus on the publicly assessable dimensions of their performance that affect share price, such as current profitability.

(ii) In the industrial relations arena, firms in liberal market economies generally rely heavily on the market relationship between individual worker and employer to organize relations with their labor force. Top management normally has unilateral control over the firm, including substantial freedom to hire and fire. Firms are under no obligation to establish representative bodies for employees such as works councils; and trade unions are generally less powerful than in CMEs, although they may have significant strength in some sectors. Because trade unions

obvious dimensions of corporate progress in an environment that lacks the close-knit corporate networks conveying such information in CMEs. Intense monitoring by a loan officer is feasible only when small sums are involved, since it exposes the bank to problems of moral hazard that are especially acute in countries where officers can take advantage of fluid labor markets to move elsewhere.

26 Note that we avoid a distinction often drawn between countries in which firms can raise ‘long-term’ capital versus those in which only ‘short-term’ capital is available because this distinction is rarely meaningful. Many companies in LMEs with established market reputations can raise capital for projects promising revenues only in the medium to long term, and firms often finance the bulk of their activities from retained earnings. Of more relevance are the rules governing hostile takeovers, whose prospect can induce firms to pay more attention to corporate earnings and the price of their shares.

27 Partly for this reason, the market valuation of firms in LMEs often depends more heavily on the reputation of its CEO than it does in CMEs.
and employer associations in LMEs are less cohesive and encompassing, economy-wide wage coordination is generally difficult to secure. Therefore, these economies depend more heavily on macroeconomic policy and market competition to control wages and inflation (see Franzese in this volume; Hall and Franzese 1998).

The presence of highly fluid labor markets influences the strategies pursued by both firms and individuals in liberal market economies. These markets make it relatively easy for firms to release or hire labor in order to take advantage of new opportunities but less attractive for them to pursue production strategies based on promises of long-term employment. They encourage individuals to invest in general skills, transferable across firms, rather than company-specific skills and in career trajectories that include a substantial amount of movement among firms.

(iii) The education and training systems of liberal market economies are generally complementary to these highly fluid labor markets. Vocational training is normally provided by institutions offering formal education that focuses on general skills because companies are loath to invest in apprenticeship schemes imparting industry-specific skills where they have no guarantees that other firms will not simply poach their apprentices without investing in training themselves. From the perspective of workers facing short job tenures and fluid labor markets, career success also depends on acquiring the general skills that can be used in many different firms; and most educational programs from secondary through university levels, even in business and engineering, stress 'certification' in general skills rather than the acquisition of more specialized competencies.

High levels of general education, however, lower the cost of additional training. Therefore, the companies in these economies do a substantial amount of in-house training, although rarely in the form of the intensive apprenticeships used to develop company-specific or industry-specific skills in CMEs. More often, they provide further training in the marketable skills that employees have incentives to learn. The result is a labor force well equipped with general skills, especially suited to job growth in the service sector where such skills assume importance, but one that leaves some firms short of employees with highly specialized or company-specific skills.

(iv) Inter-company relations in liberal market economies are based, for the most part, on standard market relationships and enforceable formal contracts. In the United States, these relations are also mediated by
rigorous antitrust regulations designed to prevent companies from colluding to control prices or markets and doctrines of contract laws that rely heavily on the strict interpretation of written contracts, nicely summarized by MacNeil's dictum: 'sharp in by clear agreement, sharp out by clear performance' (Williamson 1985). Therefore, companies wishing to engage in relational contracts with other firms get little assistance from the American legal system, as Casper observes.

In some fields of endeavor, such as after-sales service, companies can engage successfully in incomplete contracting by building up reputations on which other parties rely. But extensive reputation-building is more difficult in economies lacking the dense business networks or associations that circulate reputations for reliability or sharp practice quickly and widely. Because the market for corporate governance renders firms sensitive to fluctuations in current profitability, it is also more difficult for them to make credible commitments to relational contracts that extend over substantial periods of time.

How then does technology transfer take place in liberal market economies? In large measure, it is secured through the movement of scientists and engineers from one company to another (or from research institutions to the private sector) that fluid labor markets facilitate. These scientific personnel bring their technical knowledge with them. LMEs also rely heavily on the licensing or sale of innovations to effect technology transfer, techniques that are most feasible in sectors of the economy where effective patenting is possible, such as biotechnology, microelectronics, and semiconductors. In the United States, the character of standard-setting reinforces the importance of licensing. Since few sectors have business associations capable of securing consensus on new standards, collective standard-setting is rarely feasible. Instead, standards are often set by market races, whose winners then profit by licensing their technology to many users (see also Tate in this volume). The prominence of this practice helps to explain the presence of venture-capital firms in liberal market economies: one success at standard-setting can pay for many failed investments (Borrus and Zysman 1997).

In LMEs, research consortia and inter-firm collaboration, therefore, play less important roles in the process of technology transfer than in CMEs where the institutional environment is more conducive to them. Until the National Cooperative Research Act of 1984, American firms engaging in close collaboration with other firms actually ran the risk of being sued for triple damages under antitrust law; and it is still estimated that barely 1 to 7 per cent of the funds spent on research and development in the American private sector are devoted to collaborative research.
It should be apparent that there are many institutional complementarities across the sub-spheres of a liberal market economy (see Fig. 1.4). Labor market arrangements that allow companies to cut costs in a downturn by shedding labor are complementary to financial markets that render a firm’s access to funds dependent on current profitability. Educational arrangements that privilege general, rather than firm-specific, skills are complementary to highly fluid labor markets; and the latter render forms of technology transfer that rely on labor mobility more feasible. In

Fig. 1.4 Complementarities across subsystems in the American liberal market economy
the context of a legal system that militates against relational contracting, licensing agreements are also more effective than inter-firm collaboration on research and development for effecting technology transfer.

Special note should be taken of the complementarities between the internal structure of firms and their external institutional environment in liberal and coordinated market economies. In LMEs, corporate structures that concentrate authority in top management make it easier for firms to release labor when facing pressure from financial markets and to impose a new strategy on the firm to take advantage of the shifting market opportunities that often present themselves in economies characterized by highly mobile assets. By contrast, in CMEs, where access to finance and technology often depends on a firm's attractiveness as a collaborator and hence on its reputation, corporate structures that impose more consensual forms of decision-making allow firms to develop reputations that are not entirely dependent on those of its top management. By reducing the capacity of top management to act arbitrarily, these structures also enhance the firm's capacity to enter credibly into relational contracts with employees and others in economies where a firm's access to many kinds of assets, ranging from technology to skills, may depend on its capacity for relational contracting. Lehrer's chapter explores some of these linkages between corporate structure and the external environment in more detail.

1.5 Comparing Coordination

Although many of the developed nations can be classified as liberal or coordinated market economies, the point of this analysis is not simply to identify these two types but to outline an approach that can be used to compare many kinds of economies. In particular, we are suggesting that it can be fruitful to consider how firms coordinate their endeavors and to analyze the institutions of the political economy from a perspective that asks what kind of support they provide for different kinds of coordination, even when the political economies at hand do not correspond to the ideal types we have just outlined.

It is important to note that, even within these two types, significant variations can be found. Broadly speaking, liberal market economies are distinguishable from coordinated market economies by the extent to which firms rely on market mechanisms to coordinate their endeavors as opposed to forms of strategic interaction supported by non-market institutions. Because market institutions are better known, we will not explore the differences among liberal market economies here. But a few
words about variation in coordinated market economies may be appropriate, if only to show that variation in the institutional structures underpinning strategic coordination can have significant effects on corporate strategy and economic outcomes.

One important axis of difference among CMEs runs between those that rely primarily on *industry-based coordination*, as do many of the northern European nations, and those with institutional structures that foster *group-based coordination* of the sort found in Japan and South Korea. As we have seen, in Germany, coordination depends on business associations and trade unions that are organized primarily along sectoral lines, giving rise to vocational training schemes that cultivate industry-specific skills, a system of wage coordination that negotiates wages by sector, and corporate collaboration that is often industry-specific. By contrast, the business networks of most importance in Japan are built on *keiretsu*, families of companies with dense interconnections cutting across sectors, the most important of which is nowadays the *vertical keiretsu* with one major company at its center.

These differences in the character of business networks have major implications. In Germany, companies within the same sector often cooperate in the sensitive areas of training and technology transfer. But the structure of the Japanese economy encourages sharp competition between companies in the same industry. Cooperation on sensitive matters is more likely to take place within the *keiretsu*, i.e. among firms operating in different sectors but within one ‘family’ of companies. The sectoral cooperation that takes place usually concerns less sensitive matters, including recession cartels, licensing requirements, and entry barriers as well as the annual wage round (Soskice 1990a). Partly for this reason, the attempts of MITI to develop cooperative research projects within sectors have had very limited success; serious research and development remains the preserve of the laboratories of the major companies.

This pattern of *keiretsu*-led coordination also has significant implications for patterns of skill acquisition and technology transfer. Serious training, technology transfer and a good deal of standard-setting take place primarily within the vertical *keiretsu*. Workers are encouraged to acquire firm- or group-specific skills, and notably strong relational skills appropriate for use within the family of companies within which they have been trained. In order to persuade workers to invest in skills of this specificity, the large firms have customarily offered many of them lifetime employment. And, in order to sustain such commitments, many Japanese firms have cultivated the capacity to move rapidly into new
products and product areas in response to changes in world markets and technologies. This kind of corporate strategy takes advantage of the high levels of workforce cooperation that lifetime employment encourages. To reinforce it, Japanese firms have also developed company unions providing the workforce with a voice in the affairs of the firm.

Japanese firms tend to lack the capacities for radical innovation that American firms enjoy by virtue of fluid market settings or for sector-centered technology transfer of the sort found in Germany. Instead, the group-based organization of the Japanese political economy has encouraged firms there to develop distinctive corporate strategies that take advantage of the capacities for cross-sector technology transfer and rapid organizational redeployment provided by the keiretsu system. These translate into comparative institutional advantages in the large-scale production of consumer goods, machinery, and electronics that exploit existing technologies and capacities for organizational change. Although Japan is clearly a coordinated market economy, the institutional structures that support group-based coordination there have been conducive to corporate strategies and comparative advantages somewhat different from those in economies with industry-based systems of coordination.

The varieties of capitalism approach can also be useful for understanding political economies that do not correspond to the ideal type of a liberal or coordinated market economy. From our perspective, each economy displays specific capacities for coordination that will condition what its firms and government do.

France is a case in point, and the chapters in this volume by Lehrer, Culpepper, and Hancke explore some of the implications of this approach for it. Collaboration across French companies is based on career patterns that led many of the managers of leading firms through a few elite schools and the public service before taking up their positions in the private sector. Lehrer observes that the top managers of many French firms, therefore, have close ties to the state and weak ties to the rest of the enterprise. As a result, he argues, they are less likely to pursue the corporate strategies found in Britain or Germany and more likely to look to the state for assistance than their counterparts in other nations. Using the case of vocational training, however, Culpepper shows that there are clear limits to what states can do in the absence of strong business associations capable of monitoring their members. Hancke examines how large French firms are adapting to these limits, suggesting that many are taking industrial reorganization upon themselves, sometimes devising new networks to coordinate their activities.
In sum, although the contrast between coordinated and liberal market economies is important, we are not suggesting that all economies conform to these two types. Our object is to advance comparative analysis of the political economy more generally by drawing attention to the ways in which firms coordinate their endeavors, elucidating the connections between firm strategies and the institutional support available for them, and linking these factors to patterns of policy and performance. These are matters relevant to any kind of political economy.

1.6 Comparative Institutional Advantage

We turn now to some of the issues to which this perspective can be applied, beginning with a question central to international economics, namely, how to construe comparative economic advantage. The theory of comparative economic advantage is important because it implies that freer trade will not impoverish nations by driving their production abroad but enrich them by allowing each to specialize in the goods it produces most efficiently and exchange them for even more goods from other nations. It can be used to explain both the expansion of world trade and the patterns of product specialization found across nations. The most influential version of the theory focuses on the relative endowment of basic factors (such as land, labor, and capital) found in a nation and suggests that trade will lead a nation to specialize in the production of goods that use its most abundant factors most intensively (Stolper and Samuelson 1941).

However, recent developments have dealt a serious blow to this account of comparative economic advantage. The most important of these include the expansion of intra-industry trade and increases in the international mobility of capital. If the theory is correct, nations should not import and export high volumes of goods from the same sector; and there is a real possibility that international movements of capital will even out national factor endowments. As a result, some economists have become skeptical about whether comparative advantages really exist, and many have begun to seek other explanations for the expansion of trade and the geographic distribution of production.

Some explain the growth of trade, and intra-industry trade in particular, as the result of efforts to concentrate production in order to secure returns to scale (Helpmann 1984). Others explain the concentration of particular kinds of production in some nations as the result of firms’ efforts to secure the positive externalities generated by a group of firms
engaged in related endeavors at the same site, whether in the form of appropriate labor pools, the availability of relevant intermediate products, or technological spillovers. This approach predicts that companies making similar products will cluster together, whether in Silicon Valley or Baden-Württemberg (Krugman 1991).

Both of these theories are valuable as far as they go, and nothing in our own is inconsistent with them, but we think they do not go far enough. Both explain why the production of some kinds of goods might be concentrated in a nation, but they say little about why production of that type should be concentrated in that particular nation, while other nations specialize in other kinds of production. Agglomeration theory explains why firms engaged in similar endeavors cluster in places like Silicon Valley or Baden-Württemberg, but it cannot explain why firms engaged in activities that entail high risks, intense competition, and high rates of labor turnover cluster in Silicon Valley, while firms engaged in very different activities that entail lower risks, close inter-firm collaboration, and low rates of labor turnover locate in Baden-Württemberg. We still need a theory that explains why particular nations tend to specialize in specific types of production or products.

We think that such a theory can be found in the concept of comparative institutional advantage. The basic idea is that the institutional structure of a particular political economy provides firms with advantages for engaging in specific types of activities there. Firms can perform some types of activities, which allow them to produce some kinds of goods, more efficiently than others because of the institutional support they receive for those activities in the political economy, and the institutions relevant to these activities are not distributed evenly across nations.

The contention that institutions matter to the efficiency with which goods can be produced receives considerable support from the growing body of work on endogenous growth. Many economists have observed that national rates of growth cannot be explained fully by incremental additions to the stock of capital and labor and fixed rates of technical change. Endogenous growth theorists have suggested that the institutional setting for production also seems to matter to national rates of growth; and various efforts have been made to specify what features of that setting might be important, generating suggestions that include: economies of scale available from oligopoly positions, economies of scope arising from experience in related endeavors, network externalities generated by firms engaged in similar activities, and the nature of property rights regimes (Romer 1986, 1994; Grossman and Helpmann
There is now widespread recognition that the institutional context can condition rates of growth and technological progress.

To date, however, most efforts to specify these institutions have concentrated on market relationships and the legal framework for them, neglecting the non-market relations that may be equally important to such outcomes. The latter receive more emphasis in the literature on national innovation systems and some analyses of competitive advantage (Dosi et al. 1988; Porter 1990; Barro and Sala-i-Martin 1995; Edquist 1997). Most of this literature, however, looks for the ingredients of absolute advantage, i.e. it identifies factors more of which will improve the performance of any economy. We seek institutional features that might confer comparative advantage and, thus, be better suited to explaining cross-national patterns of product or process specialization (Zysman 1994).

The basic logic of our approach should be apparent. We have argued that, in some political economies, firms make more extensive use of non-market modes of coordination to organize their endeavors, while in others firms rely mainly on markets to coordinate those endeavors. Broadly speaking, these differences correspond to the level of institutional support available for market, as opposed to non-market, coordination in each political economy. Using a distinction between liberal and coordinated market economies, we have identified many of the institutional features of the political economy relevant to these differences and suggest that these correspond to cross-national differences in corporate strategy.

The important point to be added here is that the availability of these different modes of coordination conditions the efficiency with which firms can perform certain activities, thereby affecting the efficiency with which they can produce certain kinds of goods and services. In short, the national institutional frameworks examined in this volume provide nations with comparative advantages in particular activities and products. In the presence of trade, these advantages should give rise to cross-national patterns of specialization.

Although there may be types of comparative advantage that these institutional frameworks confer that we have not yet explored, we focus here on their impact on innovation since a firm’s capacity to innovate is crucial to its long-run success. The key distinction we draw is between radical innovation, which entails substantial shifts in product lines, the development of entirely new goods, or major changes to the production

Note that strategic trade theory focuses on a similar set of variables (cf. Krugman 1986; Busch 1999).
process, and incremental innovation, marked by continuous but small-scale improvements to existing product lines and production processes. Over the medium to long term, efficiency in the production of some kinds of goods requires a capacity for radical innovation, while, in other kinds of goods, it requires a capacity for incremental innovation.

Radical innovation is especially important in fast-moving technology sectors, which call for innovative design and rapid product development based on research, as in biotechnology, semiconductors, and software development. It is also important to success in the provision of complex system-based products, such as telecommunications or defense systems, and their service-sector analogs: airlines, advertising, corporate finance, and entertainment. In the latter, competitiveness demands a capacity for taking risks on new product strategies and for the rapid implementation of such strategies within large, tightly coupled organizations that employ a diverse personnel.

Incremental innovation tends to be more important for maintaining competitiveness in the production of capital goods, such as machine tools and factory equipment, consumer durables, engines, and specialized transport equipment. Here, the problem is to maintain the high quality of an established product line, to devise incremental improvements to it that attract consumer loyalty, and to secure continuous improvements in the production process in order to improve quality control and hold down costs.

Coordinated market economies should be better at supporting incremental innovation. This follows from the emphasis we have put on the relational requirements of company endeavors. It will be easier to secure incremental innovation where the workforce (extending all the way down to the shop floor) is skilled enough to come up with such innovations, secure enough to risk suggesting changes to products or process that might alter their job situation, and endowed with enough work autonomy to see these kinds of improvements as a dimension of their job. Thus, incremental innovation should be most feasible where corporate organization provides workers with secure employment, autonomy from close monitoring, and opportunities to influence the decisions of the firm, where the skill system provides workers with more than task-specific skills and, ideally, high levels of industry-specific technical skills, and where close inter-firm collaboration encourages clients and suppliers to suggest incremental improvements to products or production processes.

The institutions of coordinated market economies normally provide high levels of support for these relational requirements. Highly coordinated industrial-relations systems and corporate structures characterized by
works councils and consensus decision-making provide employees with the guarantees that elicit their cooperation. The training systems of CMEs typically provide high skill levels and the requisite mix of company-specific and more general technical skills. Appropriate contract laws and dense networks of inter-corporate linkages allow firms to form relational contracts with other firms; and systems of corporate governance that insulate firms against hostile takeovers and reduce their sensitivity to current profits encourage long employment tenures and the development of the inter-firm and employee relations that foster incremental innovation. By encouraging corporate strategies based on product differentiation rather than intense product competition, these inter-corporate networks also tend to promote incremental, rather than radical, innovation. A reputation for risk-taking or cut-throat competition is rarely an asset in such networks.

By contrast, although some can occur there, the institutional features of liberal market economies tend to limit firms' capacities for incremental innovation. Financial market arrangements that emphasize current profitability and corporate structures that concentrate unilateral control at the top deprive the workforce of the security conducive to their full cooperation in innovation. Fluid labor markets and short job tenures make it rational for employees to concentrate more heavily on their personal career than the firm's success and on the development of general skills rather than the industry- or company-specific skills conducive to incremental innovation. The complexion of contract law and antitrust laws discourages inter-firm collaboration in incremental product development.

However, the institutional framework of liberal market economies is highly supportive of radical innovation. Labor markets with few restrictions on layoffs and high rates of labor mobility mean that companies interested in developing an entirely new product line can hire in personnel with the requisite expertise, knowing they can release them if the project proves unprofitable. Extensive equity markets with dispersed shareholders and few restrictions on mergers or acquisitions allow firms seeking access to new or radically different technologies to do so by acquiring other companies with relative ease, and the presence of venture capital allows scientists and engineers to bring their own ideas to market. As Lehrer's study of the airline industry shows, the concentration of power at the top typical of corporate organization in an LME makes it easier for senior management to implement entirely new business strategies throughout a multi-layered organization delivering complex system goods or services. Such firms can also acquire or divest
subsidiaries quickly. *Inter-firm relations* based primarily on markets enhance the capacities of firms to buy other companies, to poach their personnel, and to license new products—all means of acquiring new technologies quickly.

By contrast, in CMEs, although dense inter-corporate networks facilitate the gradual diffusion of technology, they make it more difficult for firms to access radically new technologies by taking over other companies. Corporate structures characterized by strong worker representation and consensus decision-making make radical reorganization of a firm more difficult, as each of the affected actors contemplates the consequences for his relationship to the company. The long employment tenures that such institutions encourage make it less feasible for firms to secure access to new technologies by hiring in large numbers of new personnel.

In short, the institutional frameworks of liberal market economies provide companies with better capacities for radical innovation, while those of coordinated market economies provide superior capacities for incremental innovation. Therefore, to the extent allowed by transport costs and the efficiency of international markets, there should be national patterns of specialization in activities and products; and these should reflect rational responses to the institutional frameworks identified here rather than random geographic agglomeration.

Figs. 1.5 and 1.6 provide some evidence for these propositions. Using data from the European Patent Office, they report indices measuring the degree to which innovation in Germany and the United States is concentrated into any of thirty technology classes that vary according to whether technological progress in them is typically characterized by radical or incremental innovation. Higher scores reflect greater specialization in that kind of technological innovation, and the charts include data from 1993–4 as well as 1983–4 to assess stability over time.

The striking finding is that Germany specializes in technological developments that are just the reverse of those in the USA. Fig. 1.6 is almost the mirror image of Fig. 1.5. Firms in Germany have been more active innovators in fields predominantly characterized by incremental innovation, including mechanical engineering, product handling, transport, transport.  

29 The data are from the European Patent Office and calculated for thirty classes of technologies. For technology class $i$ (e.g. machine tools) Germany's relative specialization is measured by the share of German machine-tool patents in total German patents less the share of global machine-tool patents in global patents. We are grateful to Tom Cusack for substantial assistance with the calculations for Figs. 1.5 and 1.6. See Cusack and Frosch 2000 and Grupp et al. 1995.
FIG. 1.5

Note: Positive figures indicate the nation specializes more heavily in patents in that technology class. For details, see n. 29.

Source: European Patent Office data.
FIG. 1.6

Note: Positive figures indicate the nation specializes more heavily in patents in that technology class. For details, see n. 29.
Source: European Patent Office data.
consumer durables, and machine tools, while firms in the United States innovate disproportionately in fields where radical innovation is important, such as medical engineering, biotechnology, semiconductors, and telecommunications. These patterns are consistent over time and precisely the ones our analysis would expect. There does appear to be specialization in innovation across nations, with firms in the liberal market economy specializing in radical innovation, while those in the coordinated market economy concentrate on incremental innovation.

We have focused on innovation here because it is one of the most crucial dimensions of economic success. However, the institutional structures of LMEs and CMEs may confer other kinds of comparative advantages yet to be explored. Firms in coordinated market economies, for instance, are well placed to secure high levels of quality control, by virtue of their close relationships with workers and suppliers; and such a capacity may give them advantages in products for which demand turns more heavily on quality relative to price. Conversely, the ease with which firms in liberal market economies can cut costs by releasing workers, given fluid labor markets and high levels of managerial prerogative, may provide them with advantages in products for which demand is highly price-sensitive.

Economists have also long believed that skill levels can be important to comparative advantage, and our analysis suggests that the availability of labor with particular types of skills will be dependent on precisely the kinds of institutions that distinguish liberal from coordinated market economies. The extensive facilities for inter-firm collaboration that foster high levels of industry-specific skills in some CMEs and company-specific skills in others may provide those nations with advantages for producing goods that require such labor, while the fluid labor markets and support for the development of general skills in LMEs may make the production of goods and services that require less skilled but lower-cost labor more viable there.

We have stressed the paradigmatic cases of liberal and coordinated market economies, but the perspective can be extended to institutional variation of other types. As we have noted, for instance, the group-based coordination characteristic of some CMEs provides firms with better capacities for diffusing technology across sectoral boundaries than do industry-based systems of coordination; and these capacities may give nations with group-based coordination special advantages in particular industries (Soskice 1994a). We have provided an explicit basis for understanding how comparative institutional advantage might operate, but there are many dimensions to it that remain to be investigated.
1.7 New Perspectives on Comparative Public Policy-Making

Comparative political economists have been as interested in patterns of economic policy-making as in problems of economic performance. Accordingly, it is appropriate to note that the analytical framework developed in this volume also opens up substantial new perspectives on both economic and social policy-making with relevance for the domestic arena and international relations.

1.7.1 Economic Policy-Making

The approach we take to the political economy suggests some important revisions in the way we normally think about the problematic facing economic policy-makers, especially on the supply side of the economy. A substantial literature in comparative political economy, going back to Shonfield (1965), construes the problem facing policy-makers as one of settling on the actions that firms or other private-sector actors should take in order to improve economic performance and then devising a set of incentives, whether regulatory or financial, to induce them to take those actions. This was what the ‘strong’ states of France and Japan were once said to be so effective at doing (Johnson 1982; Zysman 1983). Broadly speaking, the problem was seen as one of inducing economic actors to cooperate with the government.

From our perspective, however, the principal problem facing policy-makers is quite different: it is one of inducing economic actors to cooperate more effectively with each other. This follows from our view of the economy as an arena in which multiple actors develop competencies by devising better ways of coordinating their endeavors with one another. When firms coordinate more effectively, their performance will be better, and the result will be better overall economic performance. In some cases, more effective coordination among other actors, such as trade unions and employers, will also enhance performance. Accordingly, one of the principal ways in which policy-makers can improve national economic performance is to secure better forms of coordination among private-sector actors.

30 The formulations in these paragraphs are influenced by the work of Pepper Culpepper (1998, forthcoming) and owe a good deal to conversations with him.

31 Here, as elsewhere in this chapter, when we refer to ‘more effective’ coordination, we mean coordination by the actors on actions providing equilibria that are Pareto-superior to those that preceded them in the sense that they make at least some of the actors better off without making others worse off.
In some cases, markets can be used to secure this coordination, and so the task facing policy-makers is to improve the functioning of markets. This is not always easy, but there are some well-known techniques for accomplishing this task. However, there are other cases in which firms can perform certain endeavors well (whether wage-bargaining, collaborating with other firms in research and development, or the like) only by coordinating with others in contexts of strategic interaction. Here, the problem is one of improving the equilibrium outcomes that arise from strategic interactions, and less is known about how to accomplish that. Culpepper describes this problem as one of securing 'decentralized cooperation'. It entails persuading private-sector actors to share information, improving their ability to make credible commitments, and altering their expectations about what others will do. As we have noted, the development of supportive institutions and the cultivation of a base of common knowledge may be crucial here (Ostrom 1990; Ramirez-Rangel 2000; Culpepper forthcoming).

This formulation highlights the difficulties facing economic policymakers, especially when they are seeking to enhance non-market coordination. In such contexts, states cannot simply tell economic actors what to do, not only because the outcomes are too complex to be dictated by regulation but because states generally lack the information needed to specify appropriate strategies. States may establish agencies, but what agencies can do is limited. In many cases, effective strategic coordination depends on the presence of appropriately organized social organizations, such as trade unions and employer associations, that governments can encourage but not create. As Culpepper’s analysis of vocational training shows, effective cooperation also requires common knowledge that may develop only out of experience over time. Where norms and institutions supporting effective cooperation already exist, policy-makers may be able to improve its operation with complementary regulations, but it is difficult to induce such cooperation ex nihilo (Culpepper 1998).

It follows that economic policies will be effective only if they are incentive compatible, namely complementary to the coordinating capacities embedded in the existing political economy (Wood 1997). In liberal market economies, where coordination is secured primarily through market mechanisms, better economic performance may demand policies that sharpen market competition, while coordinated market economies may benefit more from policies that reinforce the capacities of actors for non-market coordination. Because the institutional context of the British economy encourages the acquisition of general skills and militates against
sectoral coordination, its government is likely to enhance skill levels more by expanding formal education than by trying to foster sectoral training schemes modeled on the German. Conversely, competition policies that serve Britain well might erode the capacities of German firms for non-market coordination.

Wood (1997 and this volume) goes beyond this to argue that the viability of policy depends not only on the organization of the political economy but on the organization of the political realm (see also Katzenstein 1978b, 1987). Let us distinguish between ‘market incentive’ policies and ‘coordination-oriented’ policies. The former rely on market-based incentives to induce actors to perform more effectively. The latter attempt to improve the competencies of firms, such as their skill levels or technological capabilities, by addressing firm needs with relative precision. Thus, coordination-oriented policies must be based on high levels of information about the activities of the firm. But, as Wood points out, firms are reluctant to share such information with governments whose position as powerful actors under a range of unpredictable influences raises the risks that they will defect from any agreement and use the information they have acquired against the firm. The transaction costs to governments of coordinating the activities of many private-sector actors can also be prohibitively high. In short, this kind of policy-making is marked by information asymmetries, high transaction costs, and time-inconsistency problems.

The governments of coordinated market economies have taken advantage of the strong business associations, trade unions, and other para-public organizations in their political economies to resolve these problems. Because such associations are independent of the government and responsible to their member-firms, the latter are more inclined to trust them with enough private information to administer a coordination-oriented or ‘framework’ policy effectively. And because these associations are in a good position to monitor and even gently sanction their members, they can often secure the coordination that a policy demands with lower transaction costs. Thus, producer-group organizations enter into ‘implicit contracts’ with the government to administer the policy, drawing some benefits of their own in the form of enhanced resources and authority.

This is where the organization of the political realm matters. Business associations and their members will be willing to form such contracts,

32 The analysis in the following paragraphs owes a great deal to Wood (1997) as well as his chapter in this volume.
which usually entail some information-sharing, only if the government's commitment to abide by them is credible. As Wood (1997) observes, however, that commitment will be more credible where the relevant producer groups have enough structural influence to punish the government for any deviations from its agreements. This structural influence may rest on a number of bases: the authority of producer organizations inside political parties, the entrenchment of neo-corporatist practices in enough spheres of policy-making that defection in one can be punished in another, or policy-making procedures decentralized enough to allow producer groups many points of access and some veto points. Of course, the influence of producer groups will also depend on the character of those groups themselves: they must be encompassing and powerful enough to mobilize a serious constituency if they need to sanction the government. In short, coordination-oriented policies should be more feasible in nations with both a coordinated market economy and a political system in which producer groups enjoy substantial structural influence.

Coordination-oriented policies will be more difficult to implement in liberal market economies because their business and labor associations usually lack the encompassing character required to administer such policies well. In addition, producer groups may be less willing to enter into such implicit contracts in nations where they do not possess enough structural influence to sanction the government for deviations from them. This should be an especially important problem in nations where the powers of the state are highly concentrated in the political executive or where the influence of producer groups inside political parties is very limited.

In contradistinction to some others, then, this analysis suggests that the attributes normally associated with the 'strength' of a state may prevent governments from implementing many kinds of policies effectively. Wood (1997) shows that the failures of successive British schemes for industrial rationalization were rooted, not in the 'weakness' of the British state, as many who underline the limited levers in the hands of the authorities have suggested, but in its very strength: the Westminster system concentrates so much power in the political executive that producer groups were reluctant to trust it (cf. Sacks 1980; Leruez 1975; Shonfield 1965). Despite its many powers, the French state has also had difficulty implementing schemes for regional or technological development that require coordination among private-sector actors, partly because it concentrates power in Paris and cannot find encompassing producer groups to operate them (Culpepper 1998; Levy 1999a).
In general, liberal market economies should find it more feasible to implement market-incentive policies that do not put extensive demands on firms to form relational contracts with others but rely on markets to coordinate their activities. These include regional development schemes based on tax incentives, vocational programs focused on formal instruction in marketable skills, and government subsidies for basic research. Because of the bluntness of the instruments available to states and the importance of markets to these economies, deregulation is often the most effective way to improve coordination in LMEs.

This analysis of institutional complementarities between political regimes and political economies raises some intriguing issues about the patterns observable in the developed world. Many liberal market economies have Westminster systems of government that concentrate power in the political executive, while coordinated market economies tend to be governed by consociational, coalitional, or quasi-corporatist regimes. Several factors could lie behind this congruence. However, some amount of co-evolution cannot be ruled out. If regimes that provide structural influence to encompassing producer groups find it more feasible to implement coordination-oriented policies, while states in which power is highly concentrated have more success with market-incentive policies, the character of the political regime may contribute to the development of a particular type of economy. Levy (1999a) argues forcefully for a variant of this view in the case of France.

To put a similar point in more general terms, the character of the political regime may condition the levels of asset specificity found across nations (see Alt et al. 1996). We have already argued that the institutional structure of the economy encourages certain kinds of investments. The fluid market settings of liberal market economies encourage investment in switchable assets, while the dense institutional networks of coordinated market economies enhance the attractiveness of investment in specific or co-specific assets. Political regimes characterized by coalition governments, multiple veto points, and parties that entrench the power of producer groups may also be more conducive to investment in specific assets than ones that concentrate power in highly autonomous party leaders, because (i) regimes of this sort are well positioned to provide the framework policies that sustain the institutions supporting specific investments and (ii) because they provide producers with more direct influence over government and the capacity to punish it for deviating

33 Since many LMEs were once British colonies, the diffusion of cultural norms in the economic and political spheres may be a factor here, and, of course, the USA provides a notable exception to this rule.
from its agreements, such regimes offer investors more assurance that policy will not shift in such a way as to damage the value of assets that cannot readily be switched to other uses. Thus, we should expect to find more investment in specific assets in nations with such regimes. These are issues that merit further investigation.

1.7.2 Social Policy

The varieties of capitalism approach to political economy also opens up new perspectives on social policy. In particular, it highlights the importance of social policy to firms and the role that business groups play in the development of welfare states. Convention associates the development of social policy with organized labor and progressive political parties, on the assumption that business generally opposes such initiatives. However, Mares (1998a and this volume) shows that business groups have played key roles in the development of social policy for over a century and develops a parsimonious model to explain the policies in which various types of firms will have interests. Her work advances an important literature exploring the contribution that business groups have made to the construction of welfare states (Pierson 1995a; Martin 1999; Swenson 1997, 2001; Mares 1997b, 1998; Estevez-Abe 1999a).

The relational approach we take to company competencies naturally draws attention to the support that social policies can provide for the relationships firms develop to advance their objectives. Social policy is often thought to interfere with labor markets by raising labor costs or the reservation wage. But the contributors to this volume explore the ways in which social policies can improve the operation of labor markets, notably from the perspective of the firm. Unemployment benefits with high replacement rates, for instance, can improve the ability of firms to attract and retain pools of labor with high or specific skills. Disability benefits and early retirement benefits can allow firms that operate production regimes requiring employee loyalty to release labor without violating implicit contracts about long-term employment. There are many respects in which social policies can be crucial to the relational strategies of firms.

For this reason, there should be a correspondence between types of political economies and types of welfare states. And that appears to be the case. Virtually all liberal market economies are accompanied by

34 Katzenstein (1987) shows how the structural features of the German political system hem in most governments, while Gamble and Walkland (1987) show how frequently British governments have changed regulatory regimes important to business.
‘liberal’ welfare states, whose emphasis on means-testing and low levels of benefits reinforce the fluid labor markets that firms use to manage their relations with labor (Esping-Andersen 1990). As Estevez-Abe, Iversen, and Soskice note, liberal social-policy regimes also encourage individuals to develop the general, rather than specific, skills that corporate strategies in LMEs tend to require.

Although the social-policy regimes that accompany coordinated market economies are more varied, there are many respects in which their distinctive features lend support to the corporate strategies found in such economies. Large companies in Japan find it easier to secure employee loyalty and company-specific skills because they provide many of the social benefits that might otherwise be the responsibility of the state (Estevez-Abe 1999a). Many of the firms in CMEs operate product market strategies and associated production regimes that require a workforce equipped with high levels of industry-specific skills. Workers must be persuaded to invest in such skills, however, especially given the risk that, if they are laid off and must take employment in another sector, they may never realize their investment. In such contexts, as Estevez-Abe, Iversen, and Soskice point out, the pension and unemployment-benefit schemes offering generous replacement rates closely tied to wages often found in coordinated market economies help to assure workers that they can weather an economic downturn without having to shift to a job in which their investment in specific skills does not pay off.

Governments introduce social legislation for many reasons, some of them conditioned by partisan competition and the demands of labor. But the contributors to this volume argue that business also has important interests in social policy and a role in its development. Mares (1998) traces the way in which social policy emerges from alliances between business groups, trade unions, and public officials in Germany and France, while Estevez-Abe (1999a) and Iversen and Soskice (2000) explore the politics that leads specific types of political economies toward distinctive welfare states. In the sphere of social policy, the varieties of capitalism approach is helping to open up several new research agendas.

1.7.3 National Interests in the International Arena

The international arena is also an important sphere for policy-making. What states cannot secure domestically, because of political resistance or transnational externalities, they often seek in negotiations about international regimes (Krasner 1983b; Keohane 1984; Putnam 1988). These regimes now have a substantial impact on national societies, especially
in Europe where the regulations of the European Union have become almost as important as national policies. For this reason, it is important to understand how the rules or regulations of such regimes are determined, and a number of approaches can be taken to that problem. One of the most influential, however, argues that the character and regulations of regimes and of the EU are determined by their member states, operating from conceptions of national interest (Moravcsik 1991). In this context, it has become important to be able to specify what a government’s conception of its national interest will be and whence such conceptions derive, especially in the economic sphere.

Analysts have taken several approaches to identifying the conceptions of national economic interest that motivate governments in international negotiations. Some formulations associate them with prevailing economic conditions, such as the levels of inflation or unemployment in the nation (Moravcsik 1998). Others employ neoclassical economic doctrine to specify the welfare gains likely to accrue to the nation from a particular outcome, such as freer trade (Frieden and Rogowski 1996). The conceptions of national interest from which government officials operate in international negotiations are most often seen, however, as a response to pressure from domestic interests. The direction of that pressure can then be specified in a number of ways. Most who take this approach use an economic theory to identify the impact a decision will have on particular sectors and an institutional theory to predict which sectors will have more influence over the government (Milner 1988, 1997; Frieden 1991; Garrett and Lange 1996).

There is some value in all these approaches, especially for specific cases, but the conceptions of national interest they generate can be nebulous or of limited generality, especially when rooted in transitory economic conditions or shifting parallelograms of sectoral pressure. Without prejudice to the alternatives, the approach to comparative capitalism developed in this volume provides another way of specifying how states will define their national interests in international economic negotiations. It suggests that their stance toward new regulatory initiatives will be influenced by judgements about whether those initiatives are likely to sustain or undermine the comparative institutional advantages of their nation’s economy. Governments should be inclined to support such initiatives only when they do not threaten the institutions most crucial to the competitive advantages their firms enjoy.\footnote{Note, of course, that governments can misperceive the impact of a proposed regulation and that other factors will often also enter into calculations of national interest. These formulations are deeply influenced by the work of Fioretos (1998).}
In this volume and others (1998), Fioretos applies this perspective to the positions taken by Britain, Sweden, France, and Germany in negotiations leading up to the Maastricht Treaty. He argues that many of the conflicts between Britain and the other member-states of the EU, leading to its opt-out from the social charter, can be traced to British efforts to protect the institutions of its liberal market economy. The positions taken by member states in those negotiations toward the industrial policies of the EU also correspond to the concerns they were likely to have about preserving the distinctive institutional infrastructures of their nations and particular types of relations among firms.

This approach can be applied to a wide range of issues associated with the evolution of the European Union. Germany’s reluctance to accept deep financial deregulation may derive, for instance, not simply from a desire to maintain the rents of its financial sector but from a concern to preserve the capacities for network monitoring that sustain the terms on which domestic capital is available to its firms (cf. Story and Walter 1997). Britain’s efforts to secure regulations that enhance market competition in many sectors may reflect an interest in securing a competitive edge for its own firms, whose corporate strategies and structures are already appropriate for operating in such environments.

Even some of the positions that member-states have taken toward the development of the institutions of the European Union may be explicable in these terms. We have argued that the success of a national economy can depend on whether it is supervised by a state with institutions appropriate for supplying the kind of economic policies that sustain it. As the EU takes on additional economic responsibilities, its members may be concerned to ensure that the agencies and techniques used to administer them are congruent with the needs of their own economies. Thus, states and actors from coordinated market economies can be expected to seek institutions conducive to the formation of implicit contracts between public authorities and business associations, while those from liberal market economies should want to avoid agencies interventionist enough to interfere with the operation of market mechanisms. Such considerations cannot fully explain the design of European institutions, but they may figure in the process (cf. Schmidt 1997; Pollack 1997).

This perspective may help explain why it has been so difficult for the EU to secure full regulatory harmonization and why it has resorted, instead, to the ‘mutual recognition’ of national regulations (K. Nicolaides 1993). Transaction costs alone do not seem to provide enough of an explanation. If the structure of the European economies were broadly similar, it should be possible to agree on ‘best practice’, allowing a transition
period for laggards to catch up. But there are profound institutional differences among the political economies of Europe, on which the firms of each nation have come to rely for competitive advantage. Although, as market economies, all can agree on some measures, to enforce high levels of regulatory homogeneity on the member-states would be to compromise the institutions and firm strategies on which national comparative advantages depend. It is not surprising that there has been no consensus on such matters. More than national tradition has been at stake. This suggests that, despite some significant effects, international negotiations are unlikely to be vehicles for the cross-national institutional convergence that some expect from them.  

1.8 The Dynamics of Economic Adjustment

Although we have emphasized differences among political economies that have been relatively durable, ours is not a static conception of the political economy. On the contrary, we expect the corporate strategies, policies, and institutions of each nation to evolve in response to the challenges they face, and our approach contains a number of conceptual tools for understanding both the nature of contemporary challenges and the shape this evolution is likely to take. In this section, we discuss some of the dynamic elements of the analysis that are covered in more detail in subsequent chapters.

1.8.1 The Challenge of Globalization

The developed economies are currently experiencing profound changes. A technological revolution is creating entirely new sectors, based on biotechnology, microprocessors, and telecommunications, whose products are transforming business practices across the economy. A wave of managerial innovations has seen companies around the world adopt new forms of supplier–client relations, just-in-time inventory systems, quality control, and team production. Economic activity is shifting from the industrial sector into the service sector. Capitalism seems to be in the midst of one of those ‘cycles of creative destruction’ that Schumpeter (1950) identified.

As Streeck (1996b) and Scharpf (1995: ch. 2) have pointed out, precisely because they cannot legislate regulatory convergence, international regimes and the EU may resort to measures that enhance market competition, thereby intensifying the pressures for convergence that come from another direction, namely via processes of competitive deregulation. There is much to be said for this view. For further discussion, see the section on ‘globalization’ below.
If technology provided the spark for this revolution, the accelerant has been liberalization in the international economy. With declining transport and communication costs, more liberal trade and financial regimes have inspired vast new flows of goods and capital across national borders, including a large increase in foreign direct investment. All the developed economies are more open than they were twenty years ago, and intense international competition is enforcing innovation on many firms. The watchword for these developments has become globalization—a term summing up the hopes of some for global prosperity and the fears of many that their way of life will be lost to international forces beyond the control even of their government (Berger and Dore 1996; Keohane and Milner 1996; Friedman 1999).

For political economy, the principal issue raised by globalization concerns the stability of regulatory regimes and national institutions in the face of heightened competitive pressure (Boyer and Drache 1996; Rodrik 1997). Will institutional differences among nations of the sort we have identified remain significant or will the processes of competitive deregulation unleashed by international integration drive all economies toward a common market model?

To these questions, the conventional view of globalization prominent in the press and much of the literature gives an ominous answer. It is built on three pillars. First, it sees firms as essentially similar across nations at least in terms of basic structure and strategy. Second, it associates the competitiveness of firms with their unit labor costs, from which it follows that many will move production abroad if they can find cheaper labor there. And, third, these propositions generate a particular model of the political dynamic inspired by globalization, of the following type.

In the face of threats from firms to exit the economy, governments are said to come under increasing pressure from business to alter their regulatory frameworks so as to lower domestic labor costs, reduce rates of taxation, and expand internal markets via deregulation. What resistance there is to such steps will come from trade unions, seeking to protect the wages of their members, and social democratic parties, seeking to preserve social programs. The precise effects that each nation suffers in the face of globalization will thus be determined by the amount of political resistance that labor and the left can mount to proposals for

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37 We use the term 'globalization' in this chapter to refer to the developments that have made it easier for companies to locate operations abroad, including the liberalization of trade, the deregulation and expansion of international financial markets, the new accessibility and expansion of markets in what was the communist world, and declining transportation or communication costs.
change. But, because international interdependence provides capital with more exit opportunities than it does for labor, the balance of power is said to have shifted dramatically toward capital. In short, this is a model that predicts substantial deregulation and a convergence in economic institutions across nations. Conventional views of globalization contain a 'convergence hypothesis' analogous in force, but considerably less sanguine in implications, to an earlier one based on theories of industrialism (Kerr et al. 1960; Graubard 1964).

To date, the principal challenges to this view have come in two forms. Some scholars argue that the internationalization of trade and finance has not been as extensive or unprecedented as is often believed. Others argue that national governments are not as defenseless in the face of these developments as they appear, because governments have simply used international institutions or the excuse of global pressure to pursue reforms they wanted in any case (Wade 1996; Boyer 1996; Cohen 1996). There is some validity to both arguments. However, the analysis developed in this volume provides another basis for reevaluating the effects of globalization.

1.8.2 Reconsidering Globalization

The varieties of capitalism approach calls into question each of the assumptions underpinning the conventional view of globalization. First, it suggests that firms are not essentially similar across nations. On the contrary, firms in LMEs and CMEs develop distinctive strategies and structures to capitalize on the institutions available for market or non-market coordination in the economy. There is substantial evidence that firms in different types of economies react differently to similar challenges (Knetter 1989). Thus, we should not expect identical responses from them to globalization.

Second, our perspective suggests that firms will not automatically move their activities off-shore when offered low-cost labor abroad. Cheaper labor that comes with commensurate skill and productivity levels is always attractive, but firms also derive competitive advantages from the institutions in their home country that support specific types of inter- and intra-firm relationships. Many firms will be reluctant to give these up simply to reduce wage costs. Comparative institutional advantages tend to render companies less mobile than theories that do not acknowledge them imply.

Of course, with international liberalization, there will be some movement of corporate activities across national borders, as firms seek access to new markets and new sources of supply, but our approach suggests
dimensions to this movement that conventional views do not anticipate. It implies, for instance, that firms based in LMEs may be more inclined to move their activities abroad to secure cheaper labor than companies based in CMEs, because the former already coordinate their endeavors using the market structures that less developed nations usually provide, while the latter often pursue corporate strategies that rely on high skills and institutional infrastructure difficult to secure elsewhere.

Our concept of comparative institutional advantage also suggests that firms may exploit new opportunities for movement to engage in a form of institutional arbitrage. By this, we mean that companies may shift particular activities to other nations in order to secure the advantages that the institutional frameworks of their political economies offer for pursuing those activities. Thus, companies may move some of their activities to liberal market economies, not simply to lower labor costs, but to secure access to institutional support for radical innovation. This helps to explain why Nissan locates design facilities in California, Deutsche Bank acquires subsidiaries in Chicago and London, and German pharmaceutical firms open research labs in the United States. Conversely, companies may locate other activities in coordinated market economies in order to secure access to the quality control, skill levels, and capacities for incremental innovation that their institutional frameworks offer. General Motors locates its engine plant in Düsseldorf rather than in Spain. Over time, corporate movements of this sort should reinforce differences in national institutional frameworks, as firms that have shifted their operations to benefit from particular institutions seek to retain them.

Finally, our perspective calls into question the monolithic political dynamic conventionally associated with globalization. It predicts one dynamic in liberal market economies and a different one in coordinated market economies. In the face of more intense international competition, business interests in LMEs are likely to pressure governments for deregulation, since firms that coordinate their endeavors primarily through the market can improve their competencies by sharpening its edges. The government is likely to be sympathetic because the comparative advantage of the economy as a whole rests on the effectiveness of market mechanisms. Organized labor will put up some resistance, resulting in mild forms of class conflict. But, because international liberalization enhances the exit options of firms in LMEs, as noted above, the balance of power is likely to tilt toward business. The result should be some weakening of organized labor and a substantial amount of deregulation, much as conventional views predict.
In coordinated market economies, however, the political dynamic inspired by globalization should be quite different. Here, governments should be less sympathetic to deregulation because it threatens the nation’s comparative institutional advantages. Although there will be some calls for deregulation even in such settings, the business community is likely to provide less support for it, because many firms draw competitive advantages from systems of relational contracting that depend on the presence of supportive regulatory regimes. In these economies, firms and workers have common interests to defend because they have invested in many co-specific assets, such as industry-specific skills. Thus, the political dynamic inspired by globalization in these countries is likely to entail less class conflict and to center around the formation of cross-class coalitions, as firms and workers with intense interests in particular regulatory regimes align against those with interests in others (cf. Swenson 1991, 1997).

This analysis explains several outcomes in the spheres of policy and politics that are otherwise puzzling. Globalization was expected to weaken trade unions across the industrialized world. But comparative data show that trade union membership and the locus of collective bargaining has dropped far more substantially in some nations than in others (Lange et al. 1995; Ebbinghaus and Visser 2000). Our analysis predicts most of the patterns observed (see Table 1.2). Trade unions have been weakened by business initiatives and deregulation in LMEs but remain strong in CMEs where cross-class coalitions help to preserve them and some degree of wage coordination (see also Thelen in this volume).

Instead of the monolithic movement toward deregulation that many expect from globalization, our analysis predicts a bifurcated response marked by widespread deregulation in liberal market economies and limited movement in coordinated market economies. This is precisely

38 Note that we are not claiming all types of non-market institutions contribute to the efficiency of the economy. We have identified some specific types of inter- and intra-firm relations and supporting institutions that we associate with effective firm performance. There are other ‘non-market’ institutions in many economies that simply generate economic rents or detract from economic efficiency. The point is to distinguish among them and not to label all ‘non-market’ institutions efficient or inefficient.

39 Note that this observation corresponds to the predictions of Frieden and Rogowski (1996) that class conflict is more likely in economies where switchable assets predominate and sectoral conflict characterized by cross-class coalitions more likely in economies where asset specificity is high. However, because firms and workers share some interests in all economies, we do not exclude the possibility that some cross-class coalitions will also be formed in liberal market economies, as Swenson (1997) suggests.

40 We use ‘deregulation’ as a convenient shorthand to refer to policies that remove regulations limiting competition, expand the role of markets in the allocation of resources, or
Table 1.2 Changes in trade union density and the level of collective bargaining, 1950–1992

**Liberal market economies**

<table>
<thead>
<tr>
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<tbody>
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<td>49</td>
<td>3.0</td>
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<tr>
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<td>32</td>
<td>1.0</td>
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<td>1.0</td>
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<tr>
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<td>51</td>
<td>41</td>
<td>1.7</td>
<td>2.1</td>
<td>1.0</td>
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<tr>
<td>United States</td>
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<td>23</td>
<td>15</td>
<td>1.3</td>
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<tr>
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<td>34</td>
<td>1.7</td>
<td>2.0</td>
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**Coordinated market economies**

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<tbody>
<tr>
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<td>63</td>
<td>58</td>
<td>55</td>
<td>2.2</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Belgium</td>
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<td>68</td>
<td>69</td>
<td>2.0</td>
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</tr>
<tr>
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<td>77</td>
<td>81</td>
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<td>3.3</td>
<td>2.8</td>
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<tr>
<td>Finland</td>
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<td>78</td>
<td>88</td>
<td>3.2</td>
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<td>Germany</td>
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<td>40</td>
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<td>2.0</td>
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<tr>
<td>Japan</td>
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<tr>
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<td>2.0</td>
<td>2.0</td>
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<td>CME average</td>
<td>49</td>
<td>57</td>
<td>57</td>
<td>2.8</td>
<td>2.8</td>
<td>2.5</td>
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a 1 = plant-level wage-setting; 2 = industry-level wage-setting; 3 = central wage-setting without sanctions; 4 = central wage-setting with sanctions. Value recorded is the average for the period indicated.

b Trade union series ends in 1989.


The pattern of policy across the OECD in recent decades. Deregulation has been far-reaching in the liberal market economies of Britain, the United States, New Zealand, Canada, and Australia but much less extensive in the coordinated market economies of northern Europe and east sharpen market incentives in the economy. Of course, we recognize that all deregulation is implicitly a form of reregulation (Vogel 1996).
Asia (Vogel 1996; Ellis 1998; Story and Walter 1997; Wood 1997; King and Wood 1999). Moreover, Wood and Thelen report finding just the sort of politics this approach would lead one to expect in both liberal and coordinated market economies in recent years (this volume; Wood 1997; Thelen 2000).

Ultimately, it is not surprising that increasing flows of trade have not erased the institutional differences across nations. After all, world trade has been increasing for fifty years without enforcing convergence. Because of comparative institutional advantage, nations often prosper, not by becoming more similar, but by building on their institutional differences.

1.8.3 Developments in the Market for Corporate Governance

There is another side to globalization, however, with effects that some argue are more ambiguous. It lies in the pressures stemming from the internationalization of finance, where developments have recently been dramatic, if not unprecedented. International flows of capital have grown exponentially in the past two decades, raising levels of both direct and portfolio investment (cf. Simmons 1999). This puts pressure on the institutions of coordinated market economies in several ways. International financial markets have become increasingly important sources of capital for large firms. But, lacking the facilities to monitor the progress of a company closely, distant investors usually prefer to supply capital on arm's-length terms that emphasize transparent, balance-sheet criteria. Therefore, firms seeking access to these funds face pressure to revise their accounting standards, appoint independent directors, and deliver the high rates of return associated with 'shareholder value'.

Even more important is the wave of international merger and acquisition activity that has taken place over the past decade, as firms of all sorts reposition themselves to take advantage of the liberalization of world markets. It has had several effects. Firms based in coordinated

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41 We predict some, if more limited, deregulation in CMEs because, alongside non-market institutions, they also use market mechanisms whose operation can be improved by a measured amount of deregulation.

42 The effects of trade integration seem to have fallen, less substantially on the differences between CMEs and LMEs, and more heavily on practices of state intervention of the sort once prominent in France and the developing world, as governments found that dirigiste policies cannot ensure competitiveness on international markets (cf. Hall 1990; Ziegler 1997; McArthur and Scott 1969).

43 As Zevin (1992) points out, international capital markets were probably more integrated in the decades before World War I than they have ever been since.
market economies, such as Germany, that have usually not been as concerned about their rate of return on capital or share price as American firms have acquired a new interest in such matters because many hope to use their own shares to make foreign acquisitions to consolidate their competitive position in global markets that are opening and reconfiguring rapidly. Shares that are highly valued can be a significant asset in merger and acquisition contests.

Similarly, some of the large banks and insurance companies in CMEs that once cultivated close relations with manufacturing firms have been disengaging from them in order to free up resources for global expansion. The German government has recently facilitated such moves by lowering capital-gains taxes on the sale of corporate shareholdings. Where steps such as these reduce cross-shareholding enough to undercut the protection it provides firms against hostile takeovers or government regulations on such acquisitions are relaxed, the heightened dangers of takeover could also provoke changes in corporate strategy in CMEs. Many firms would have to become more attentive to the value of their shares and earnings in order to deter takeovers.

These developments threaten traditional practices in CMEs in several ways. On the one hand, they could disrupt the intricate systems of cross-shareholding and inter-corporate linkage that provide capacities for network monitoring, thereby reducing the access of firms to capital that is not tied to current profitability. On the other, they could force firms whose strategies and structure have reflected responsiveness to a wide range of stakeholders, including employees, to become more attentive to shareholders and rates of return; and this might reduce their capacity to make credible commitments to long-term collaborative relationships with other firms and employees. That could engender shifts in strategy extending all the way down to production regimes.

However, while important, the impact of international financial developments can easily be misinterpreted. There is no doubt that large companies in CMEs will have to make the long-run, risk-adjusted real rates of return demanded by world financial markets. But that is not inconsistent with internal management practices that maximize comparative institutional advantage. These pressures have led many companies to develop closer relationships with works councils rather than the reverse, simply because employee cooperation becomes more, not less, important in such contexts. Moreover, it is not a rational strategy for

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44 We are grateful to Michel Goyer for drawing our attention to this point (see Goyer 2001).
shareholders to insist on Anglo-Saxon management practices if that has
the effect of lowering rates of return.

Germany provides a case in point. Although the large German banks are seeking a global role, they are still engaged with German industry and regional banks maintain important Hausbank relationships (cf. Ziegler 2000; Griffin 2000; Vitols 2000). Many German firms have embraced international accounting standards, but there are still few independent directors on their boards and ‘shareholder value’ has been used mainly as a slogan to justify reorganizations that would have been dictated in any case. Although hostile takeovers have become more common in France, they remain rare in Germany, where regulatory regimes and cross-shareholding militate against them. The market for corporate governance is changing but at a pace that may allow firms to retain many aspects of their long-standing strategies.

1.8.4 Analyzing Change in National Systems

Much of the work on comparative capitalism lacks developed conceptions of how national systems change. As a result, the literature on globalization tends to cluster around two poles. On one side are works that focus on institutions and the ways in which they reproduce stable patterns of behavior. Their relatively static view implies that national systems are unlikely to change very much in the face of globalization. On the other are works that attribute great force to the pressures associated with globalization. They tend to see national practices as inertial factors that will be transformed by these pressures.

Our approach offers a more dynamic conception of national political economies in the sense that it anticipates change in them and contains specific propositions about the processes through which it will occur. Some of these should already be apparent from the account we have given of globalization. However, it may be useful to summarize some of the key implications about dynamics in this approach.

We see national political economies as systems that often experience external shocks emanating from a world economy in which technologies, products, and tastes change continuously. These shocks will often unsettle the equilibria on which economic actors have been coordinating

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45 The important role played by the German banks in the rescue of the construction group Philip Holzmann provides one example.

46 As of 1999, the combined equity stake of hard-core shareholders and the shares voted by German banks in the firms on the German DAX-30 still averaged 39% of those firms' shares (figures supplied by Michel Goyer).
and challenge the existing practices of firms. We expect firms to respond with efforts to modify their practices so as to sustain their competitive advantages, including comparative institutional advantages. Thus, much of the adjustment process will be oriented to the institutional recreation of comparative advantage. In its course, firms and individuals will modify their relational investments, seeking new competencies that entail new relations with other firms or employees.

To do so, they will call on the existing institutional structures supporting coordination in the economy, including those that allow for deliberation and the making of credible commitments. In many cases, firms will need the cooperation of government, but we expect governments to be responsive to efforts to restore coordination, because they will come under pressure from producer groups and voters with substantial interests in existing institutions to do so (Iversen and Soskice 2000; Wood this volume). If coordination entails strategic interaction, however, more than institutional support is required to establish it. As we have noted, this sort of coordination also depends on the presence of a common knowledge set of beliefs that reflect relatively complete understandings of the roles and interests of the participants in the arrangement, as well as some confidence in the trustworthiness of the relevant institutions. Economic shocks and interim attempts to cope with them can unsettle such understandings. Therefore, their restoration will be a crucial, and difficult, component of the adjustment process.

Several points follow from this perspective. First, although we expect firms to attempt to sustain or restore the forms of coordination on which their competitive advantages have been built, after an economic shock, these efforts may entail changes to existing institutions or practices in the economy. Second, the importance of common knowledge to successful strategic interaction implies some asymmetry in the development potential of these systems. Because they have little experience of such coordination to underpin the requisite common knowledge, LMEs will find it difficult to develop non-market coordination of the sort common in CMEs, even when the relevant institutions can be put into place. Because market relations do not demand the same levels of common knowledge, however, there is no such constraint on CMEs deregulating to become more like LMEs. However, we have noted that the business communities of CMEs will not automatically support deregulation, since many firms may want to retain competitive advantages that depend on high levels of regulation.

Institutional complementarities should play an important, if ambiguous, role in these processes of adjustment. On the one hand, they raise
the prospect that institutional reform in one sphere of the economy could snowball into changes in other spheres as well. If the financial markets of a CME are deregulated, for instance, it may become more difficult for firms to offer long-term employment. That could make it harder for them to recruit skilled labor or sustain worker loyalty, ultimately inspiring major changes in production regimes (cf. Aoki 1994). Financial deregulation could be the string that unravels coordinated market economies. On the other hand, institutional complementarities generate disincentives to radical change. Firms and other actors may attempt to preserve arrangements in one sphere of the economy in order to protect complementary institutions or synergies with institutions elsewhere that are of value to them. Many German firms have devoted energy to revising rather than abolishing their vocational training schemes because they operate production regimes that demand particular types of skills.

The types of adjustment problems encountered in a coordinated market economy are well illustrated by some of the recent difficulties afflicting the German system of wage coordination. For many years, the capacity of this system to generate wage increases moderate enough to sustain the competitiveness of German industry has depended on the ability of employers' associations to mount resistance to exorbitant wage demands, if necessary orchestrating lockouts of the workforce. In many cases, the major firms in a sector would resist high industry settlements, even if they could afford them, in order to maintain solidarity with smaller firms that could not afford them, increasing their own workers' wages only after an industry agreement had been reached.

In some sectors, the large firms have now rationalized their operations to take advantage of the opportunities presented by higher levels of international integration, moving some operations off-shore and reconfiguring supply chains. As a result, they have become increasingly sensitive to interruptions in production and inclined to veto lockouts. But this shift in stance has disrupted the existing equilibrium. Without the cooperation of large firms, employers' associations can no longer mount effective resistance to wage demands. As a consequence, some smaller or less efficient firms are dropping out of them; and trade union leaders who would normally be inclined to accept moderate wage increases in order to preserve employment are now finding themselves unable to do so because of pressure from their militants, who are no longer deterred by

47 We owe this example to Kathleen Thelen (see Thelen and Kume 1999a; Thelen and Wijnbergen 2000).
the threat of lockouts.\textsuperscript{48} The result has been a deterioration in the effectiveness of wage coordination and of employers’ associations in some German sectors (Thelen and Kume 1999\textsuperscript{a}; Thelen and Wijnbergen 2000; see also Manow and Seils 2000).

This is the type of adjustment problem that often arises in coordinated settings. However, there are good reasons for thinking that effective coordination can be restored in most such cases. As Thelen points out, such problems are not unprecedented in coordinated market economies. The equilibrium outcomes on which actors coordinate have been unsettled by economic shocks many times in the past. In each case, new equilibria have been found through processes of negotiation and compromise. The process of adjustment may well entail a period of conflict and suboptimal outcomes, as each side tests the power and resolve of the other. But the presence of institutions that entrench the power of the actors, whether employers or trade unions, give them strong incentives to cooperate with each other, and the availability of deliberative institutions facilitates coordination.

In ‘negotiated economies’ such as these, adjustment is often slower than it is in economies coordinated primarily by markets; but markets do not necessarily generate superior outcomes. Where encompassing producer groups have extensive ‘strategic capacity’ and strong incentives to reach agreement, the results can be equally satisfactory.\textsuperscript{49} Coordinated market economies have a track record of meeting these kind of challenges (Hall 1997; Global Economic Forum 2000). In Sweden, for instance, peak-level bargaining broke down during the 1980s because it was no longer meeting the needs of firms facing new technologies and greater international competition; but the trade unions and employers developed new forms of wage-bargaining recoordinated at the sectoral level rather than revert to purely liberal arrangements (Pontusson and Swenson 1996).

In sum, this is an approach to political economy designed not only to identify important patterns of similarity and difference across nations but also to elucidate the processes whereby national political economies

\textsuperscript{48} Of course, with the advent of economic and monetary union, the Bundesbank no longer has the capacity to discipline union members by threatening tighter monetary policies, and the capacity of the European central bank to do so is much lower now because it stands at one remove from the German economy (see Hall and Franzese 1998).

\textsuperscript{49} By ‘strategic capacity’, we mean the capacity to formulate a collective strategy for the group and to mobilize support for it among the group. Typically, this entails highly articulated organization.
change. It anticipates institutional change in all the developed democracies, as they adjust to contemporary challenges, but provides a framework within which the import of those changes can be assessed.

The chapters that follow elaborate many of the themes raised in this introduction. Each uses the basic approach outlined here to explore a more specific set of issues, but we have not imposed a rigid template on the contributors and there are differences of emphasis among them. These essays encompass a wide range of cases, issue areas, and methodologies. They illuminate both the potential in the approach and the scope of the research agenda it opens up. Since we have referred to many chapters in the course of this Introduction, we will simply outline the organization of the volume here.

Part I of the volume displays the wide range of topics for which the varieties of capitalism approach has implications. The first two chapters explore issues in industrial relations with an emphasis on the institutional complementarities relevant to this sphere. Thelen examines recent developments in the industrial-relations arena, showing how institutions at the macro and micro levels of the economy interact to generate a politics that produces different outcomes in liberal and coordinated market economies. Franzese shows how the institutions for wage coordination and monetary policy-making interact with each other and with the sectoral composition of the organized workforce to influence national patterns of economic performance. These essays show why different types of economies can be expected to react quite differently to economic challenges.

The next two chapters investigate some of the implications of this approach for our understanding of social policy. Estevez-Abe, Iversen, and Soskice examine the relationship between particular varieties of capitalism and social-policy regimes, emphasizing the way in which different types of social policies encourage workers to develop specific or general skills, thereby reinforcing the product market strategies characteristic of firms in various types of economies. Mares makes a more general case for the contention that employers have strong interests in social policy and will want to influence its development. She devises a parsimonious model to elucidate the interests of different types of firms in social policy and presents case-study evidence to show that the interests they have articulated conform to her model. This work suggests that it is time to reevaluate the welfare state: social policies that were once seen as impediments to the operation of markets, imposed by labor or the left on business in the name of social protection, may actually be important adjuncts
to markets with real value for firms who have been actively involved in their design.

Fioretos concludes this part of the book by indicating how a varieties of capitalism approach can be used to address important issues in international relations, particularly the problem of how national interests are constructed for the purposes of international negotiations. He argues that the conceptions of national interest applied in such contexts are often rooted in the organization of their political economy and shows that the differences between German and British capitalism can explain many of the positions taken by these nations in the negotiations leading up to the Maastricht Treaty of the European Union.

Part II of the volume displays some of the new perspectives on public policy-making that this varieties of capitalism perspective opens up. Wood compares the development of labor market policy in Britain and Germany with a view to showing how the organization of the political realm interacts with the organization of the political economy to generate distinctive patterns of policy across liberal and coordinated market economies. Culpepper takes on issues of reform, exploring efforts to transplant vocational training schemes of the sort practiced in West Germany to East Germany and France. His analysis shows how difficult it is for governments to secure such coordination and how dependent the results are on the presence of supportive employer organizations. Hancke focuses on the case of France, arguing, contrary to conventional images of its dirigiste regime, that recent industrial adjustment there has been led, not by the state, but by large firms using the business networks available to them.

Part III of the book explores issues of corporate governance, firm strategy, and the law. Vitols provides a detailed comparison of the systems for corporate governance found in Britain and Germany and argues that, despite recent challenges, they remain distinctive. Lehrer takes the analysis down to the level of corporate strategy, developing a varieties of capitalism approach to strategic management that links the structure of the political economy closely to corporate strategy. Using the case of the airline industry, he shows how the approach can be used to explain national differences in corporate strategy. The chapters by Casper and Teubner show how a varieties of capitalism approach can be used to integrate work in comparative political economy with legal studies. Casper explores the way in which contract law and corporate strategies interlock in Germany and the United States. He shows that specific types of legal systems support distinctive forms of business coordination and that the latter influence the development of the law. Teubner also explores
the co-evolution of law and corporate behavior. Taking up ‘good faith’
document in the British case, he argues that the character of a nation’s
production regimes will influence its receptivity to specific legal concepts
and the application of those concepts. Finally, Tate examines the dif-
erences in systems of standard-setting characteristic of different vari-
eties of capitalism, stressing the impact that collective arrangements for
standard-setting can have on corporate behavior.

Together these essays suggest that a varieties of capitalism approach
can be the basis for fruitful interchange among scholars interested in
many kinds of issues in economics, industrial relations, social policy-
making, political science, business, and the law.
Streeck, Wolfgang

Working Paper

E pluribus unum? Varieties and commonalities of capitalism

MPIfG Discussion Paper, No. 10/12

Provided in Cooperation with:
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MPIfG Discussion Paper 10/12

E Pluribus Unum?
Varieties and Commonalities of Capitalism

Wolfgang Streeck
Abstract

The paper reviews the origins of the comparative study of capitalism and of the diverse approaches applied to it in contemporary political economy. It distinguishes four models accounting for differences in the institutional make-up of national capitalist economies, which it refers to as the social embeddedness, power resource, historical-institutionalist, and rationalist-functionalist model, respectively. Special attention is given to the rationalist-functionalist account of capitalist variety and its reception in the research literature. The paper concludes with remarks on the likely effect of the global financial crisis after 2007 on theories of political economy in general and of “varieties of capitalism” in particular. It argues that in future the commonalities and interdependencies of national capitalisms deserve and are likely to receive more attention than their differences.

Zusammenfassung

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Introduction: E pluribus unum?

Nowhere on earth have the economic system and the essence of capitalism reached as full a development as in North America. (Sombart [1906]: 4)

Will the future social structures of Europe and America turn out the same or different? If the same: is America or Europe the “land of the future”? (Sombart [1906]: 24)

All the factors that till now have prevented the development of Socialism in the United States are about to disappear or to be converted into their opposite, with the result that in the next generation Socialism in America will very probably experience the greatest possible expansion of its appeal. (Sombart 1976 [1906]: 119)

That capitalism should take on different forms in different countries need not be surprising. If the economy is, according to Karl Polanyi, an “instituted process” (Polanyi [1957]: 1992), it follows that capitalism, being a specific kind of economy, must be based in an institutionalized social order by and into which it is formed and organized. Social orders, however, differ in space and change over time. Private property, free markets, wage labor, joint stock companies, and modern finance emerged in or spread to different historical contexts and local traditions, institutions and power structures that could not but imprint themselves on the ways in which capitalism became “instituted” in different societies.

The story of capitalist variety and of the theories devised to account for it is a complicated one, deeply intertwined as it is with domestic and global politics and the unfolding of the very history of capitalism itself. It is as much a subject for the sociology of knowledge as it is a theme for economic sociology. This paper discusses current theories of the variations between capitalist national political economies. I begin, however, with reflections on the origin of the theme in nineteenth-century social science, on the premise that

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1 E pluribus unum means “From many, one.” It appears on most US currency, as well as on Air Force One.
2 For a defining account of capitalism and its evolution, see Ingham (2008).
3 On the history of the concept of capitalism and how it has been used at different times in social science and public discourse, see Chiapello (2006). In brief, Marx did not invent the concept and seems to have employed the word only rarely. Its current usage derives mainly from Sombart and Weber. In the late nineteenth century, the term referred to a modern institutional configuration characterized by “the existence of an economic process oriented towards unlimited accumulation of capital, the importance of the firm as an agent of the system, private ownership of production resources, ‘free’ wage labour, free enterprise and competition, involvement of science in the process and increasing rationalization of economic activity” (Chiapello 2006: 36). While later the concept was appropriated by the Left, which gave it a polemical meaning, it was also adopted in the 1960s by American neoliberals, such as Milton Friedman, who used it with an aggressively affirmative connotation.
social theories, just like societies and their institutions, can be properly understood only in historical context. Next I reconstruct, in more specific terms, the successive moves in postwar accounts of political economy, first to a shared expectation of imminent convergence of differently institutionalized national capitalisms, or “industrial societies,” and then, by the end of the century, to a widespread belief in sustained political-economic variety or divergence. Following this I investigate the construction of the theories supporting such beliefs, in light of the criticism they have attracted in the meantime. Finally, I suggest that theoretical progress will require that more attention be paid to the commonalities of divergent capitalisms and their interdependent histories.

1 National differences: Past, present, future

One cannot write about capitalism without recalling Marx. It is probably true that he was the first “convergence” theorist, his general “model” of capitalism – in the sense of its most advanced version – being Victorian England, beyond which a unified socialist world society lay waiting. “The bourgeoisie,” Marx famously wrote in the Communist Manifesto,

has through its exploitation of the world market given a cosmopolitan character to production and consumption in every country. To the great chagrin of Reactionists, it has drawn from under the feet of industry the national ground on which it stood. All old-established national industries have been destroyed or are daily being destroyed … In place of the old local and national seclusion and self-sufficiency, we have intercourse in every direction, universal interdependence of nations. (Marx/Engels [1848]1977: 222)

This does not mean that Marx did not recognize differences, at least for his time and age. For one thing, while he saw capitalism as universal, its politics, as long as it lasted, remained national:

Though not in substance, yet in form, the struggle of the proletariat with the bourgeoisie is at first a national struggle. The proletariat of each country must … first of all settle matters with its own bourgeoisie. (Marx/Engels [1848]1977: 230)

But ultimately this was no more than an intermediate stage:

National differences and antagonisms between peoples are daily more and more vanishing, owing to the development of the bourgeoisie, to freedom of commerce, to the world-market, to uniformity in the mode of production and in their conditions of life corresponding thereto. (Marx/Engels [1848]1977: 235)

Secondly, while for Marx-the-theorist capitalism was the same thing everywhere, Marx-the-economic-historian understood that its emergence and ascendance was far from simultaneous and could, for this reason alone, take quite different forms in different countries, if only for an intermediate period of transition. In particular, Marx notes
that the history of “primitive accumulation” – the “expropriation of the agricultural producer, the peasant, from the soil,” which for him was “the basis of the whole process” – “assumes different aspects (in different countries), and runs through its various phases in different orders of succession, and at different periods. In England alone, which we take as our example, has it the classic form” (Marx [1867, 1887]1967: 669f.; italics added).

In fact, the last chapters of the first volume of Capital are replete with references to national differences and international interdependencies. England is compared to Italy, where capitalist development took off later, and the English enclosures movement is explained by the economic opportunities created by “the rapid rise of the Flemish wool manufactures, and the corresponding rise in the price of wool in England” (Marx [1867, 1887]1967: 672). As for his native Germany, Marx considered its economic backwardness as an indication of general cultural backwardness and of a need to be rescued by the global progress of the bourgeois revolution from what the Manifesto calls “the idiocy of rural life” (Marx/Engels [1848]1977: 225).

4 For example, in The German Ideology, Marx and Engels declared with biting sarcasm that it was impossible for a materialist, that is, economically based or, in other words, modern conception of history to take root in Germany “because the Germans lack not only the necessary power of comprehension and the material but also the ‘evidence of their senses,’ for across the Rhine you cannot have any experience of these things since history has stopped happening” (Marx/Engels [1844]1977: 164).

5 Given that the rise of capitalism by and large coincided with that of nationalism, this is hardly surprising.

Of course, Marx’s was just one voice among many in a continuing debate on national differences and similarities that accompanied capitalist development from the beginning. Throughout the nineteenth century, European countries compared themselves to each other, and were compared by their citizens, in a search for indications of their prospects in the international rivalry for power and preeminence, as well as for signs of coming convergence or lasting divergence, promising or terrifying as these may have appeared, depending on ideology and location. This story cannot possibly be told here. After Marx, the German fascination with England continued with Eduard Bernstein, the socialist revisionist, who considered English democracy and Victorian reformism a model for postrevolutionary Social Democracy, and with the liberal-bourgeois nationalist Max Weber. Differences between German and English industrial organization, labor relations, training regimes, technology, social policy, and the like were interpreted in terms of German backwardness, to be overcome by determined reformism, for the benefit of German labor (Bernstein 1899) or for German national survival in the coming wars (Weber 1895). Interestingly, whatever may have divided Bernstein and Weber, they no longer took it for granted, as had Marx, that the laggards in capitalist development would with time automatically catch up with the leaders: becoming like the English would take effort, but one that was very much worth making.

Just as England, and later the United States, was the country of reference for Germany, Germany was “the other,” and indeed often a mysterious other, for the British, and cer-
tainly also for France after its humiliation in the war of 1870/71. In 1885, the young Emile Durkheim was sent by the French government to Germany to study the enemy’s presumably superior education system. The British never quite recovered from the shock of the World Exhibition of 1862, where for the first time they had to face technologically superior German machinery and other manufactures (“very good indeed,” Sir Joseph Whitworth). It was then, at the latest, that German “competitiveness,” as it later came to be called, became a central topic of British political and economic discourse, a discourse that early on extended to what were perceived as differences not just in industry but also in social organization generally. How could a society whose traditionalism, authoritarianism, and collectivism contrasted so unfavorably to the Spencerian modernism, liberalism, and individualism (Spencer 1969 [1884, 1892]) of which Victorian Britain was so proud – how could such a society aspire to outcompete the most “progressive” society on earth? Was there something economically advantageous in social traditionalism? Had the progress of civilization destroyed economically valuable social resources? Was England already on the decline, like other empires in the past? Just as Tacitus had held up the virtuous Germanic barbarians to the decadent Romans of his time (Tacitus [98 AD]1894), growing segments of the British public began to wonder whether civilization had gone too far. Were the German savages, with their collective discipline and their authoritarian-interventionist state, better prepared for the impending struggle for supremacy between the nations of Europe?

Early on, perceived differences in social and economic organization between Germany and the Anglo-Saxon world were described in pairs of concepts, sometimes conceived as dichotomies, sometimes as continua, such as Gemeinschaft and Gesellschaft, collectivism and individualism, state and market, status and contract, or, from the German perspective, culture and civilization. Explicitly or implicitly, as we will see, they still figure prominently in contemporary constructions of capitalist variety. Moreover, Germany has remained the model alternative to standard capitalism, which continues to be ideally represented by Britain and, increasingly over time, the United States, regardless of the many differences between the two. Japan was admitted into the game only later, in the 1980s, when the “competitiveness” of Japan’s manufacturing industry made itself felt especially in Anglo-American markets, and was put, with whatever justification, into the German box or assigned to the “German” end of a continuum between more or less “normal” capitalisms.

One explanation for the lasting prominence of the “German model” in the discourse on the varieties of capitalism may be the strong presence of German institutional economics, especially in the United States, in the formative years of the discipline at the end of the nineteenth century. The Historical School, and in particular the Kathedersozialis-

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6 In response, Parliament in 1887 passed the Merchandise Marks Act that required German products to be labeled “Made in Germany,” to warn British customers to stay away from them. It is a source of lasting national pride in Germany that the measure backfired when, to the contrary, products with that label were sought out because of their assumed superior quality.
ten – the “socialists of the chair” – not only emphasized the role of institutions, thereby asking their non-German readers to acquaint themselves with “strange” practices in a faraway country, but also attributed a major role to the state and politics, quite unlike Anglo-American liberalism. Later, of course, the progress of economics towards abstract universalism made empirical differences between institutions disappear behind prescriptive principles of ideal institutional design. As a side-effect, this relieved non-German economists of the need to learn about German peculiarities, and indeed about any foreign peculiarities.

To organize the discussion of national variety in capitalism, both its analytics and its normative implications and practical intentions, we may, like Albert Hirschman, distinguish between a social condition of market dominance, on the one hand, and one of the persistence of precapitalist forms of social organization, on the other (Hirschman 1982), taking the former to represent the Anglo-American and the latter the German or Japanese “model” of capitalism as they figure in the debate. Both positive and negative effects may be attributed to each of the two conditions (Hirschman 1982: 1481). The positive effects of Anglo-American-style market dominance are captured by what Hirschman calls the “doux-commerce thesis,” a view that we may, by and large, identify with authors such as Weber and Bernstein, and certainly with Spencer. The negative effects of markets, by contrast, are captured by the “self-destruction thesis” – which, of course, is most explicit in the theories of Marx and his followers.

As to conditions, or countries, in which precapitalist institutional forms remain influential, liberal reformers find mostly negative effects, as summarized in what Hirschman calls the “feudal-shackles thesis.” Here one would presumably locate someone like Alexander Gerschenkron ([1952]1992), but also Max Weber with his fear of accelerated bureaucratization in “Lutheran” countries and cultures lacking the proper Calvinist-ascetic “spirit.” The most interesting case for our purposes, however, is when positive effects are ascribed to precapitalist institutions (what Hirschman calls the “feudal-blessings thesis”). Hirschman discusses such effects mostly in the negative, in terms of the possible problems that the absence of a feudal past may cause a society such as that of the United States. One can, however, turn the matter around, in the manner of British and, later, American observers looking at the rise of Germany and then of Japan as industrial powers, wondering whether a little more Gemeinschaft and a little less Gesellschaft might in fact be an asset rather than a liability, even – and indeed precisely – in the advanced industrialized world of the twentieth century (for Japan, see Dore [1983]1992). It is this intuition which still underlies much of today’s “varieties of capitalism” literature, although in Germany itself it took time to take hold, especially after Germany’s defeat.

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7 Authors such as Adolph Wagner, Gustav Schmoller, and Werner Sombart were well known to early American economists and studied extensively by them.

8 As Claus Offe recently pointed out, Weber was what one could call a pessimistic convergence theorist in that he foresaw the United States becoming like Europe, which in his view would amount to the historical elimination of the last remnants of a free bourgeois way of life (Offe 2006).
in the First and Second World Wars. In fact, as early as the 1920s economic progress became widely associated in Germany with Americanization, especially with large corporations, industrial engineering, and mass production. Hardly anyone in Germany at the time saw competitive advantage in social backwardness, the latter being identified among other things with artisanal production in small, owner-operated firms. The powerful German metalworkers’ union, DMV, kept sending delegations to Detroit to study Fordist and Taylorist “rationalization,” which it regarded as welcome tools for increasing productivity and raising wages, as well as for overcoming the despotism of the foreman on the shop floor. At the opposite end of the political spectrum, the Nazis belied their anti-modernist and anti-cosmopolitan rhetoric by inviting Henry Ford, who of course was far from finding National Socialism and in particular National-Socialist anti-Semitism repulsive, to help set up the Volkswagen plant in Wolfsburg on the model of (and with used machinery from) Dearborn, Michigan.

2 From convergence to diversity

The two decades after World War II were the high time of convergence theory. Clearly this reflected the unprecedented economic superiority of the United States during the period, and its position as both the uncontestable hegemon of the Western capitalist world and the envy of its Communist opposition. As Europe re-imported sociology from the United States, it gratefully received as part of the package a theory of social development, or “modernization,” that as a matter of course identified the US as the model for all other countries to emulate. In political economy, with the European economies destroyed and any German Sonderweg discredited, theorists of modern-

9 The claim that German traditions of social organization had, as early as the late German Empire, given rise to a distinct industrial order with specific competitive capabilities unmatched by the more liberal Anglo-American version of capitalism was made mostly retrospectively in the last third of the twentieth century. One of its most outspoken proponents is the historian Werner Abelshauser, who has described Germany as “the first post-liberal nation.” Recently, Abelshauser has described the country and its economy as embarked on a “German road to the twenty-first century” (Abelshauser 2005).

10 It is important to note that, early in the twentieth century, Europe viewed the United States not so much as a country with free markets, but mostly as one with huge firms, giant trusts, and modern management in the Chandlerian sense. Contemporary European expectations that capitalism would become increasingly “organized” (Rudolf Hilferding), fully shared by early emigrants such as Schumpeter, were certainly not discouraged by observation, even close observation, of the American case.

11 For an especially impressive example see Talcott Parsons’ treatise on “The System of Modern Societies” (1971).

12 Sonderweg means “special path.” The term was invented by German nationalists to distinguish German modern society from other modern societies, especially in the West. Today it is used by “Westernized” anti-nationalists to label claims of German national distinctiveness as politically dangerous.
ization defined as economic growth, which was defined in turn as market expansion, claimed that there was one and only one path of industrial and, which was the same, of social progress equally suited for and equally desired by everyone (Rostow [1960]1990). Differences between countries obviously existed, but to the extent that they mattered, they could safely be assumed to be eliminated in the course of the world’s consensual pursuit of the American way. Expectations of global convergence extended even beyond the West and the so-called “developing world” to include the Soviet bloc. Indeed, the USSR itself was found by prominent American scholars and policy intellectuals to be on its way toward a system of “pluralist industrialism” that looked conspicuously like postwar New Deal America.\(^\text{13}\)

It was only in the revolutionary period of the late 1960s and early 1970s that convergence theory came to be challenged by new approaches emphasizing diversity and insisting on the possibility and, indeed, desirability of alternative paths of socioeconomic development (on the following, see Crouch/Streeck 1997a; Streeck 2006). The Vietnam War, the domestic upheavals in the US that accompanied it, and the end of the long era of benevolent US hegemony encouraged a new generation of social scientists, especially in Europe, to look for and explore possible alternatives to the standard American pattern of modern democratic capitalism. The rise of “Euro-Communism” and the events of 1968 and 1969 revived a traditional view of political action as collective choice between competing “ideologies” and ways of life. Students of comparative politics began to consider institutional differences between the US and other countries no longer simply in terms of how far the latter still had to travel to catch up with the former. Similar developments occurred in other social sciences, assisted by rapidly improving access to foreign countries and fast-growing information-processing capacities making cross-national comparative research much easier than in the past.

Thus, in comparative industrial relations,\(^\text{14}\) collective bargaining institutions and shop floor representation regimes ceased to be looked at mainly in terms of how far they lagged behind the American standard, given the rapid decline of trade unionism in the

\(^{13}\) See Kerr et al. (1960). This was the time when a sociologist and ex-socialist such as Daniel Bell could proclaim the “end of ideology” (1965), in line with an American president of the period, John F. Kennedy, who in 1962 announced that “what is at stake is not some grand warfare of rival ideologies … but the practical management of a modern economy. What we need is not labels and clichés but more basic discussion of the sophisticated and technical questions involved in keeping a great economic machinery moving ahead … Technical answers, not political answers, must be provided …” (Commencement Address at Yale University, as quoted by Reich 2007: 58).

\(^{14}\) In many ways the last remnant of institutional economics in the United States, industrial relations was in fact typically housed in economics departments. In the immediate postwar era it was closely linked to the US government policy of the time to implant New Deal-like institutions in the labor markets of defeated enemy countries, relying, for example, on the International Labour Organisation (ILO). Well into the 1970s, the discipline produced highly sophisticated work on institutional development and diffusion, the economic effects of different institutions in different national contexts, and the methods of international comparison. See, among many others, Kassalow (1969).
US at a time of resurgence of organized labor in Europe (Crouch/Pizzorno 1978). In the study of electoral and party politics, the Scandinavian pattern of close cooperation between powerful trade unions and a strong Socialist Party, with the “power resources” this provided for a policy of encompassing social protection and economic redistribution, cast doubt on the general desirability of the American model of, at the time, ideologically indistinct catch-all parties (Korpi 1983). Also, research on and theories of interest groups were profoundly changed by the recognition that American-style “pluralist” lobbying was not the only way advanced industrial democracies could accommodate social collectivism and organized interests, and that “corporatist” arrangements— institutions that give organized groups political co-decision rights— were not only compatible with liberal democracy but had the capacity to impart to it a normatively desirable bias in favor of social classes whose needs and interests might otherwise be pushed aside (Schmitter 1974; Schmitter/Lehmbruch 1979). Here, as elsewhere, the discovery of structural variation made room for a discussion of normative and ideological alternatives to the postwar American “model” of advanced capitalism that had long been considered a universal norm.

The policy area in which institutional divergence between nation-states came to receive particular attention was incomes policy. In the 1970s, countries in which trade unions were recognized partners in national incomes policies seemed to be coping better with stagflation than the US and, in particular, Britain.16 Countries that, unlike these two, proved capable of engaging in “concertation” and “political exchange” consistently received lower values on the “misery index” popular at the time, the sum of their rates of inflation and unemployment.17 Institutions and institutional differences thus seemed to matter a great deal for a country’s position on the increasingly popular and sophisticated OECD league tables, and in fact it appears that this observation was one of the major inspirations for the subsequent development of the historical-institutionalist school in political economy (Thelen 1999). At some point, even economists took notice of the apparent relationship between social institutions and economic performance as observed by sociologists and political scientists, and introduced indices of corporatism in their own econometric equations (Bruno/Sachs 1985). In politics, it was then, in 1976, that Helmut Schmidt ran a successful election campaign on the slogan “The German Model,” (Modell Deutschland) implicitly claiming economic and normative superiority for a society able and willing to integrate strong trade unions in public policy-making through institutionalized sharing of power and responsibility.19

15 On the distinction between pluralism and corporatism, see Schmitter (1974).
16 Among many others, see Cameron (1984) and, recently, Streeck and Kenworthy (2005).
17 Invented by the economist Arthur Okun in 1965, under the name “discomfort index.”
18 “Historical” because and to the extent that institutions figure as less than fully pliable legacies from the past entailing specific opportunities and constraints for actors at present, rather than as “rationally” designed instruments easily adjustable to changing collective or individual purposes. For more on this, see below.
19 There is reason to believe that this was a euphemistic misrepresentation of a relationship that even at this time was, in fact, much more complicated (Streeck 2009: 108–119).
By the 1980s, convergence theories had almost entirely fallen into disrepute in the social sciences outside of economics proper. Studies abounded that extolled not just the distinctiveness, but also the equivalence – if not superiority – of non-Anglo-American patterns of social and economic organization, patterns that were more politically governed and socially embedded. An important influence was a British journalist working for The Economist, Andrew Shonfield, who, in a magisterial study on “modern capitalism” in the 1960s, had, in the spirit of the age, described what he saw as an ongoing shift of power from private capitalism to interventionist nation-states and their – highly diverse – planning regimes (Shonfield 1965). While the book was rather descriptive and atheoretical, very much in the manner of the Historical School, it highlighted in detail the enormous variation in the institutional arrangements devised by different countries to impose order and stability on their capitalist economies. Increasingly, Japan also came into view. Ronald Dore, author of the classic *British Factory, Japanese Factory* (1973), became a leading member of the Andrew Shonfield Society, which was founded after Shonfield’s early death in 1981 to continue making his case against market-liberal convergence and for the viability and indeed superiority of more communitarian forms of capitalism.

While not avoiding normative argument, most of the institutionalist political economy literature of the time – a period of widely perceived Anglo-American decline – emphasized the, from a standard economics perspective, surprisingly good macro-economic performance of non-standard versions of capitalism. The practical conclusion this seemed to suggest was that if Anglo-American economies wanted to recover from their “crisis,” they required major social reform, in the sense of redistributive intervention to mitigate inequality; more public investment in training; better social protection and so on – in other words, the opposite of the further marketization and competitive deregulation prescribed by the rising movement of neoliberalism. Ronald Dore, in a much-cited book entitled *Flexible Rigidities* (1986), pointed out that it was precisely the reliance of the Japanese on “relational contracting” based on mutual trust – on close long-term relations between employers and workers, as well as between manufacturers and their suppliers – that had enabled the Japanese textile industry to prosper in hard times. Similarly, Michael Piore and Charles Sabel, in *The Second Industrial Divide* (Pi-
ore/Sabel 1984), argued for the historical possibility of a new, post-Fordist production pattern, called “flexible specialization,” that was founded on community-like social relations rather than on market pressures or bureaucratic factory authority. Their favorite examples were the “industrial districts” of Northern Italy.

In the same vein, retracing the improbable rise of the apparently so institutionally “rigid” German economy to industrial preeminence in Europe and beyond during the 1970s and 1980s, Sorge and Streeck (1988) identified a “typically German” category of industrial output, which they called “diversified quality production,” that was obviously highly competitive in increasingly saturated global markets. Their point was that diversified quality production was not just compatible with but in fact favored and supported by a “virtuous circle” of mutually reinforcing “deviant” features of the German version of capitalism, such as strong trade unions, institutionalized worker participation on the shop floor and above, high wages with a low wage spread, high employer investment in workforce skills, and high employment security (Streeck 1991). What these authors and others had in common was that they were convinced of the possibility, sustainability, and even superiority of modes of production under capitalism that thrived on long-term, community-based social commitments that, while humanly more acceptable, were also at least as efficient as traditional mass production, on the one hand, and the rising model of market-driven neoliberalism, on the other.

In the United States, in particular, the possibility of alternative models of capitalism was held up, especially by opponents of neoliberal deregulation, as a genuinely American path to economic revitalization. Their idea was for the United States to learn from Europe and Japan, rather than vice versa. Emblematic in this respect was a book originating from the Massachusetts Institute of Technology, Made in America: Regaining the Productive Edge (Dertouzos et al. 1989). At the progressive end of the American political spectrum, more or less explicit preferences for an American version of Social Democracy also played a role, not least among “Europeanists” in universities and think tanks who longed for examples of a successful capitalism softer and kinder than the American one. Well into the first years of the Clinton presidency, the institutional reforms the progressive wing of the American public believed to be necessary for American capitalism to catch up with its Asian and Continental-European competitors were debated in terms of a distinction between a “high” and a “low road” toward industrial competitiveness. While the former was represented by Europe and Japan, the latter was identified with

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23 At the beginning of the 1990s, Dore and Streeck were planning to co-author a book on the superior productivity of “stickier,” more lasting social commitments compared to more liquid ones, taking a preference for “liquidity” in labor and capital relations, and in social relations generally, to be typical of Anglo-America. Countries to be covered were Germany and Japan, on the one hand, and the US and the UK, on the other. The publication of Michel Albert’s book (see below) and the reversal of economic fortunes between the two capitalist camps in the 1990s (with Japan entering its “lost decade,” Germany chafing under the burdens of welfare state expansion and reunification, and the United States and, to a lesser extent, Britain experiencing a new spell of prosperity) put an end to the project.
the neoliberal deregulation project pursued by growing sections of American business since the mid-1970s. In an unprecedented critical self-examination, what was seen as American industrial decline was attributed to decades in neglect of areas such as education, workforce training, industrial innovation, industrial policy, and industrial finance – areas in which countries less reliant on “free markets” excelled (Thurow 1992).

3 Capitalist variety and the neoliberal turn

By the early 1990s, all the core elements of what was to become the “varieties of capitalism” paradigm were in place and waiting to be assembled into a general framework for macro-level political economy and economic sociology, beyond single-case country studies and the comparative analysis of select economic institutions such as collective bargaining. They included, in particular, the notion of national systems – or “models” – of differently institutionalized capitalisms locked in international competition; the rejection of convergence in favor of lasting national diversity; the leading distinction between market-liberal capitalisms located primarily in the Anglo-American world, and less-than-fully liberal, more relationally-based capitalisms like those, supposedly, in Europe and Japan; routine reliance on the comparative statistics published by international organizations on the macroeconomic performance and institutional structures of member states; the idea of differential “competitiveness” of national institutions, implying a responsibility on the part of national politics and government to establish and maintain the economically most beneficial institutions for their countries; the claim of the equal if not superior “competitiveness” of non-standard capitalisms and, as a consequence, of their sustain-ability, even in a world of progressive globalization and increasing competitive pressures; the theme of a coincidence of moral and economic virtue in national economic systems, and of national political systems’ opportunity to choose a more humane alternative to Anglo-American standard capitalism; and a more or less explicit normative bias in favor of some sort of social-democratic or communitarian, welfare state-supported or otherwise solidaristic “embedding” of the capitalist economy.

The project of a comparative study of capitalism in this vein received further momentum from the breakdown of Soviet Communism and the final victory of capitalism over its historical opposition in 1989. While the events led an author such as Francis Fukuyama to declare the “end of history” (Fukuyama 1992), students of political economy in the institutionalist tradition felt encouraged to devote even more attention to the differences, if no longer between capitalism and Communism, then between different national varieties of capitalism after it had become “the only game in town.” In fact, it was in the 1990s, after the demise of Communism, that the concept of capitalism gained universal currency as a more or less value-free analytical description outside of the orthodox Left and the ultra-liberal Right.
There were also several adverse developments in the real world which, however, failed to derail the project. One was certainly the embarrassing fascination of the countries of the former Soviet Bloc with the “American model” and the enthrallment of their new elites with neoliberal prescriptions of “shock therapy.” Moreover, there had for some time been suspicions that the US was using its growing international power to bend the rules of global capitalist competition in favor of its own, “low-road” regime, so as to spare itself the effort of reform in the direction of a capitalism with a more human face. A frequently cited example was the so-called Structural Impediments Initiative launched in 1989 by the Bush I administration in relation to Japan, which was aimed at forcing the Japanese government to free up markets – including capital markets – based on the American model.\textsuperscript{24} In Europe, the fear of a less deserving, socially destructive capitalism on the brink of prevailing over its better alternative was forcefully articulated by the French author, Michel Albert. His \textit{Capitalism against Capitalism} (Albert [1991]1993), written for a popular audience and translated into all major languages, divided the world into two camps: the Rhineland, led by Germany and Japan, and Anglo-America, with France sitting on the fence.\textsuperscript{25} Anticipating and indeed defining some of the core themes of the “varieties of capitalism” literature, Albert arrived at the melancholy conclusion that the greater dynamism and cultural attraction of American-style neoliberal adventure capitalism – what he called the “neo-American model” – was about to crowd out the more solidaristic and ultimately more efficient capitalism of the combined Rhinelands.

Another inauspicious development – and easily the most important – was the retreat of the Clinton administration in the middle of its first term from its original pretense at social reform as a strategy of economic revitalization. The 1990s saw the astonishing success of the less demanding policy of deregulation and financialization that was chosen instead and that actually did usher in more than a decade of unprecedented if – as we now know, after the bubble has burst – artificial prosperity (Stiglitz 2003). Soon Britain under Blair was to follow the lead of Clinton and Bush II, reinforcing perceptions of Anglo-American parallelism. Simultaneously, the British and American “Euro-sclerosis” rhetoric, which had been around, if mostly in the form of wishful thinking, since the early 1980s, seemed finally to come into its own, with the mounting employment and fiscal crises of leading Continental-European welfare states and their desperate search for more “flexibility” in their labor markets and social security systems. There was also the rapid internationalization of the capitalist economy, popularly known as “globalization,” which potentially conflicted with the theoretical commitment of comparative capitalism research to the nation-state as its basic unit of comparison, pro-


\textsuperscript{25} Michel Albert was not a professional scholar but an insurance industry executive-cum-public intellectual who had worked in both worlds: Germany and Switzerland, as well as the US. He had several other books to his credit when he published \textit{Capitalism Against Capitalism}. Among the most interesting chapters of the latter work is the one comparing insurance practices in Switzerland (the “Alpine” model) and the UK (the “maritime” model, Chapter 5).
ducing mounting evidence of the obsolescence of a conceptual toolkit that disregards interdependence for the sake of comparability.

While the rise of neoliberalism in the 1990s did not stand in the way of the beginning “varieties of capitalism” debate, it did result in the optimistic beliefs of the previous decade in the economic superiority of the normatively favored alternative to standard capitalism being more or less silently abandoned. Increasingly it seemed unavoidable to concede to the Anglo-American “model” the same stability and sustainability that had been attributed to the more socially embedded capitalisms, perhaps in the hope that the opponents of the latter would reciprocate and in turn recognize the embattled European and Japanese “models” as coequal. As for the accelerating liberalization of the Continental and Asian “nonliberal” capitalism (Yamamura/Streeck 2003), this tended to be considered essentially as an opportunistic adjustment that was far from transformative (Vogel 2003). Concerning the United States and, to a lesser extent, Britain, questions such as how they would in the longer run service their rapidly growing private debt and pay for a level of consumption that had become increasingly detached from production and productivity were never asked. The same applies to the causes and consequences of the endemic US trade deficit that was soon to be complemented by, again, rapidly rising government deficits. It was only when financialized capitalism collapsed in the crisis of 2008 that the fundamental deficiencies and lack of sustainability of debt-financed neoliberal prosperity came into the view of comparative capitalism research and theory.

4 Varieties of capitalism, varieties of approaches26

Why should national “capitalisms” become and remain different, despite powerful pressures for cross-national convergence emanating from the diffusion of technologies, international competition, border-crossing markets, transnational firms, international organizations, an increasingly global culture, and the like? Four models of capitalist variety – in other words, accounts of what kinds of social forces result in it – can ideally be distinguished in the existing literature, although they sometimes overlap: (1) a social embeddedness model, (2) a power resource model, (3) a historical-institutionalist model, and (4) a rationalist-functionalist model (for a synopsis, see Table 1). While the first three are seen as superior to standard capitalism but vulnerable to its advance, the fourth is claimed to be equivalent to it and equally sustainable.

(1) The social embeddedness account of capitalist variety grounds the persistence of capitalist diversity in societies’ cultural traditions and formal and informal social structures or networks. It is the most sociological of the four models. Societies are distinguished by the extent to which traditional, pre-capitalist codes of social behavior and modes

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26 This is the title of a collection of essays edited by David Coates (2005b).
of social control continue even under capitalism to moderate the egoistic pursuit of economic interests.\footnote{The model is closely related to the “societal effect” theory of economic organization, where traditional status orders, or long-lasting meta-traditions of social organization, condition the organization of work and industry at the point of production (Maurice et al. 1980; Sorge 2005). The difference is that the societal effect literature treats each country as a historical individual and refrains from developing a typology.} In societies in which this is more the case than in others – where, in other words, the social and economic order is based on effective normative integration – economic transactions are to a lesser extent than in more “modern” societies exempt from the standards of appropriateness that govern social transactions generally. The dominant values, in economic life as well as in social life in general, are reciprocity, group solidarity, discipline, respect for traditional status, group identification, acceptance of paternalistic responsibility in return for deference to authority, and the like (Dore [1983]1992). Modern organizations in socially embedded capitalism are culturally styled in terms of extended families or villages, with prevailing role definitions emphasizing particularism, ascription, functional diffuseness, affectivity, and collectivity orientation.\footnote{These are, of course, the opposites of the “modern” end of Talcott Parsons’ five “pattern variables”: universalism, achievement, functional specificity, affective neutrality, and self-orientation (Parsons 1951: 67).} Economic performance is primarily the performance of social duties, and profit is not central but ensues as a result of faithful adherence to the normative order. Status counts more than class, honor more than income, and traditions – of workman-

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ship or social decency – matter more than material benefits. The model country for socially embedded capitalism is, of course, Japan.29

Despite their social traditionalism, and indeed because of it, capitalist systems based on social integration as opposed to economic incentives may perform very well economically, and at least sometimes better than more “modern” capitalisms. This is because cultural traditionalism happens to support long-term social relations that, as a welcome side-effect, sustain long-term economic relations, with the ensuing mutual trust being at least as economically beneficial as the individual incentives that come with high, market-generated inequality.30 Typically, accounts of the economic benefits of cultural traditionalism, or backwardness, carry with them a concern about their continued viability in the modern world. The question is whether the social and political elites that serve as guardians of inherited conventions will be able to defend traditionalist action orientations against the temptations of short-term satisfaction, consumerism, and individualism.31 As mentioned above, the notion of modernization undermining normative integration and thereby eroding the economic performance of alternative versions of capitalism is a central theme of Michel Albert ([1991]1993), but it is also present in more recent work of Ronald Dore (2000, Chapter 11) and others. That modern society may consume its normative foundations without being able to restore them is, of course, an old theme of social theory prominent in the works of writers as different as Daniel Bell (1976) and Jürgen Habermas (1973, 1975).

(2) The power resource model, of which the exemplary case is Sweden, as presented particularly in the work of Walter Korpi,32 is politically rather than culturally or social-structurally based. Non-capitalist social solidarity figures prominently in political-economic relations, but rather than being a residual of precapitalist traditions, it is constructed by collective political action and redistributive politics. In other words, traditional institutions, which were weakened in the course of capitalist market expansion, are replaced by social-democratic social policy. De-commodification, or protection from commodification in the first place, is achieved not through normatively in-

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29 But there are also culturalist-communitarian accounts of capitalism in Italy, the locus classicus being the work of Sebastiano Brusco (1982). Alternative interpretations of Italian industrial districts emphasize their dependence on a specific institutional “exoskeleton” (Piore/Sabel 1984; Trigilia/Burroni 2009). The story they tell is either historical-institutionalist or rationalist-functionalist, and sometimes both at the same time, depending on the degree to which institutions are described as inherited or rationally constructed for economic purposes.

30 Network-like social ties also figure prominently in the earlier literature on “social systems of production” (Hollingsworth/Boyer 1997), “national systems of innovation” (Lundvall 1992), and “business systems” (Whitley 1999), which both preceded and significantly informed the varieties of capitalism debate. The general idea in this literature is that different societies have different ways of establishing links between agents engaged in production, innovation, and business relations, resulting in different kinds and, perhaps, levels of economic performance.

31 It is the task of policy, then, to cultivate the social ties that keep the economy running. The more emphasis is placed on the need for political intervention to stabilize the social system underlying the capitalist economy, the closer one gets to the rationalist-functionalist model. See below.

egrated informal networks, but through the application of legislative state power as a functional alternative to and modern substitute for social traditionalism. The main agent of social-democratic “politics against markets” (Esping-Andersen 1985) is the labor movement with its two wings, a unified socialist party and an encompassing trade union confederation, working together – also in coalition with other social forces – to acquire and maintain control of the democratic state as the modern “power resource” of the broad mass of the people. Capitalist firms are used, and the laws of the market are judiciously observed, in order to generate general prosperity. Simultaneously, social policy, especially labor market policy, is deployed to distribute the results of the collective effort in as egalitarian a manner as possible and to contain the uncertainties that would emerge from an unfettered free market economy.

Socially controlled capitalism, or democratic socialism, as envisaged by the power resource model of capitalist diversity probably comes closest to what Karl Polanyi meant by the “great transformation” he expected to take place after World War II and the catastrophe of liberalism in the first half of the twentieth century (Polanyi [1944]1957). The principal condition of its persistence in the face of pressures for convergence on a market-driven and de-politicized standard capitalism is that the collective organizations of the working class succeed in keeping their constituents mobilized, in principle indefinitely. In particular, they must manage to secure broad popular adherence to the political goals of an egalitarian distribution of life chances and of public protection for all members of the community from the vagaries of capitalist markets, especially markets for labor and capital. As recent Swedish experience shows, disorganization of the Left, or of the political system generally, disperses the power resources of those whose interests depend on effective containment and control of markets, eventually moving the political economy closer to the capitalist mainstream.

(3) The historical-institutionalist model, by comparison, emphasizes the role of inherited institutions as both constraints and opportunities for economic action. Institutions are conceived, not primarily as normative scripts or tacit cultural understandings, but as collectively sanctioned, mostly formalized building blocks of social order, including economic order. Rather than the result of rational calculation or voluntary agreement, institutions are seen in principle as historical legacies that are sticky, i.e., not easy to change, or likely to change mostly along an established path (Thelen 1999; Pierson/Skocpol 2002). Moreover, they entail obligations, not just rights, and while they may serve rational-economic objectives, they also serve a wide range of further purposes. Economic institutions therefore also have to satisfy expectations beyond economic ones, and economic action is governed not just by economic institutions in a narrow sense but also by social institutions.

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33 On different concepts of institution, and the respective variants of institutional theory, see Hall and Taylor (1996).
In historical-institutionalist work, institutions that regulate and accommodate collective interests and collective organization at the intermediate level of society between the market and the state are especially important for capitalist variety. Intermediate institutions of this kind were at the center of theories of corporatism (Schmitter 1974) which contributed significantly to the emerging research program of historical institutionalism (see Streeck 2006). In this perspective, capitalist variety is vested in the way in which the interests of social groups and the organizations that represent them are included in political and economic decision-making, at both the micro and the macro level. What is particularly important is the extent to which intermediary institutions are labor-inclusive, allowing non-capitalist interests to insert themselves in the governance of the capitalist political economy, for example through tripartite negotiations with the state and capital. Obviously, the principal example for the model is Germany (Streeck 1997).

In historical-institutionalist accounts, capitalist diversity is brought about and sustained not just by political democracy and redistributive government intervention, but also by the way in which labor is institutionalized as a countervailing power in the organization of production. The underlying assumption is that productive cooperation between capital and labor takes different forms and produces different results depending on how labor is organized and included. Whether or not negotiated production systems prove “competitive” in the market depends on conjunctural circumstances – that is, on good luck – as well as on whether capitalists and their managements learn to live with the obligations they have to accept as the price of labor’s cooperation. Capitalist “economizing” takes place only against the background of institutionalized restrictions imposed on it in the name of objectives other than the maximization of profit. Leading assumptions are that there are different ways for capitalist firms to make a profit; that some ways, like diversified quality production (Streeck 1991), are more demanding although not necessarily less profitable for capital than others; that labor and society at large may have a preference for the more difficult production strategies (“the high road”) being adopted by firms; that which strategy is in fact adopted is affected in part by the institutionalized power of labor as well as the willingness of firms to live with what may for them be a second-best alternative; and that the ultimate arbiter for the path taken by a social system of production under capitalism is whether it can find a market for its products. Moreover, whether or not capital is willing to “learn” and explore alternative, more labor-accommodating production and marketing strategies is significantly affected by available opportunities to exit from a regime under which labor has the capacity to impose obligations on capital (Streeck 2009, Chapter 13). The main source of convergence in the historical-institutionalist model, therefore, is economic liberalization and the opportunities for international mobility it offers (Streeck 2004a).

(4) Finally, the rationalist-functionalist model explains capitalist variety as the outcome of a search for economic advantage. Its background is the shift of the convergence discourse in the neoliberal 1980s and 1990s from technological to economic determinism: that is, to the idea that increased international competition as brought about by “globalization” will force national economic systems to converge on a unified “best practice.”
While sharing the neoliberal – or economistic – view of *the social order as an economic order*, rather than the other way around, the rationalist-functionalist model arrives at the opposite conclusion: it suggests that, in an integrated world economy, institutional differences may not only be not obsolete but in fact desirable as they may enable national or local economies to specialize in particular products and processes and thereby establish a comparative advantage. Far from generating identical institutions, in other words, competition is seen as giving rise to institutional diversity by exerting pressures for specialization.35

The rationalist-functionalist model differs from the social embeddedness and the historical-institutionalist models in that it treats the economic benefits of institutional non-conformity not as its more or less unintended effects but as its cause, or *raison d’être*. Institutions do not just enable successful economic performance, but they are built for the purpose and would be re-built if they ceased doing so. In the social embeddedness model, competitiveness comes about as a side-effect of adherence to community norms, while in the historical-institutionalist model it results from capitalists learning to live with and make the best of a firmly institutionalized labor constraint. The rationalist-functionalist model, by comparison, considers competitive efficiency as the intended goal of a cooperative economizing community of transaction cost-conscious actors consensually seeking the most efficient ways of organizing their mutual relations;36 in particular, cooperation is not seen as conditional on capitalists meeting non-economic social obligations.

In the rationalist-functionalist model, to sum up, capitalist variety in institutional structures and public policies is causally explained and normatively evaluated by its functions for economic efficiency. That a country’s institutions and policies enhance economic performance is assured by hegemonic political-economic actors conceived as rational economizers concerned with minimizing transaction costs. Economic institutions have

34 The social embeddedness model views the economic order as a social order, while the power resource and historical-institutionalist models describe it as social-political order.

35 This is a theme well known to sociologists (Durkheim [1893]1964). It is taken up by Hall and Soskice with reference to economic theories of comparative advantage (Hall/Soskice 2001a: 36 f.), as originating with David Ricardo and further developed by Paul Krugman (1991). Their point is that trade theory has increasingly recognized the importance of institutions (as distinguished from factor endowments) as sources of comparative advantage, but has as yet been unable to find a systematic link between the nature of national institutions and the kinds of products in which national economies excel. Still, there is much similarity between their argument and that of an author such as Michael Porter, in his *Competitive Advantage of Nations* (1990).

36 In other words, it explains community norms in a reductionist manner, by conceiving of them as rationally designed to be economically efficient, or selected by an efficient market for institutions. The boundary between economistic-reductionist and cultural or historical-institutionalist accounts is, however, sometimes blurred. See the famous article by Williamson and Ouchi (1981), which wavers between rationalist and culturalist perspectives on transaction cost-minimizing social norms. Rational choice reconstructions of cultural integration in capitalism are frequent, both in the German and the Japanese case.
only one function, to increase efficiency, which makes them easy to design and redesign, and enables the theory of capitalist variety to be functionalist and voluntaristic-rationalist at the same time. Institution-builders are modeled as rationally interested in preserving the distinctiveness of their country’s institutional arrangements, unless they make the mistake of listening to the advice of neoliberal prophets of the “one best way.” The rational design capacities of economic and political actors are complemented by effective selection in competitive markets for institutions, where institutions survive to the extent that they enjoy comparative advantage. The functionalist nature of the model is also reflected in its relegation of distributional concerns to secondary status.

5 Institutional complementarity and comparative advantage

By the late 1990s, capitalist diversity had become the subject of a broad literature, culminating in a number of widely read books (for example, Stallings 1995; Berger/Dore 1996; Crouch/Streeck 1997b; Kitschelt et al. 1999; Coates 2000). However, the most influential formulation of the theme was presented in a collective volume edited by Peter Hall and David Soskice in 2001, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (2001b). While individual chapters differed somewhat in their approach, the book’s introduction (Hall/Soskice 2001a) developed a conceptual model of capitalist variety that was straightforwardly rationalist-functionalist. Although the model was not consistently applied, not even at the point of its invention, and was later occasionally fudged to accommodate historical-institutionalist critiques, it became the founding document for a veritable growth industry in political science and political economy in particular (Figure 1).

Both the model and its reception are, again, best understood in a sociology-of-knowledge perspective. While politically the model reflects the ascendancy at the time of its inception of Anglo-American finance-led capitalism – whose fundamental unsustainability had yet to be revealed – academically it spoke the language of the rational choice institutionalism that was then rising to dominance almost everywhere: a language that lent itself to being presented and received as so much more “rigorous” and “theoretical” than that of competing models of capitalist diversity. Couched in those terms, and

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37 To the extent that cost-saving social ties are described as only partly constructed and ultimately culture-based, the rationalist-functionalist model shades into the social embeddedness one.

38 See Hall and Thelen (2009) or Hall (2007). Concessions to critics of efficiency-theoretical accounts of socioeconomic institutions went, however, mostly unnoticed by subsequent users, probably because they were never integrated by the authors of the model into its core conceptual structure.

39 Hall and Soskice draw extensively on the conceptual apparatus of transaction cost economics, referred to as the “new micro-economics” or the “new economics of organization” (Hall/Soskice 2001a: 5; 14).
against the background of the apparent turnaround of the Anglo-American economy, Hall and Soskice delivered their message that alternative, “European” versions of capitalism were not doomed to converge on the neoliberal, American model, and that this could be demonstrated even in the much-admired language spoken at leading economics departments, thereby making that language finally available even to those unwilling to buy into the “best practice” universalism of neoliberal economics. What further endeared their approach to a wide readership seems to have been its dichotomous and perhaps Manichaean division of the world into two warring camps, like the one that had already boosted Michel Albert’s book ([1991]1993).

Given the enormous impact of the 2001 essay, it seems appropriate to take a closer look at some of its main tenets, including the conceptual weaknesses associated with its rationalist-functionalist orientation:

(1) National capitalist systems, referred to as “market economies,” are said to come in two types, “liberal” and “coordinated,” the former (abbreviated “LMEs”) comprising six countries from the Anglo-American family of nations, the latter (the “CMEs”) including Germany and its smaller neighbors (the Netherlands, Belgium, Switzerland, and Austria), Scandinavia and Japan. Occasionally, France, Italy, Spain, Portugal, Greece, and Turkey are classified as “ambiguous” or, alternatively, as constituting a third, “Mediterranean,” type; for the conceptual framework this remains however largely irrelevant. Germany is the paradigmatic case of a “CME.” In the Introduction, its contrasting case is the United States. Of the 13 empirical chapters, however, the US appears only in four. In six chapters, LMEs are represented by the UK, in three of them in a direct two-
country comparison with Germany, which in turn features in no less than 10 of the 11 chapters that consider individual cases.

(2) LMEs and CMEs are alleged to differ in the way the firms that operate in them secure the “cooperation” they need for efficient production. Partners with which firms have to “coordinate” include suppliers, workers, creditors, shareholders, customers, trade unions, governments, and others (Hall/Soskice 2001a: 6). The authors describe their approach as “firm-centered” (ibid.: 5) and “relational” (ibid.: 6), which they consider to be its distinguishing characteristics. Relations of production are described as either “arm’s-length,” as in the so-called LMEs where they are arranged through formal contracts and competitive markets, or “relational,” as in the CMEs, where they are established through strategic interaction and coordination.40

(3) National models of capitalism are controlled by firms in search of efficient relations of production. The problems firms must solve are conceived as those identified by transaction cost economics and rational choice institutionalism: avoiding hold-ups and moral hazard, containing opportunism, eliminating uncertainty, cultivating trust, preventing shirking and adverse selection, and generally minimizing transaction costs. Institutional structures in either system are solutions, established by firms or, on their behalf, by national states, to problems of efficient governance of economic transactions. Political intervention serves to optimize the institutional framework within which firms pursue their respective competitive strategies. This includes institutions such as labor market regulation or the welfare state. With firms as the main agents of institution-building and institutional change, the theory is revisionist with regard to the role of trade unions and labor parties: rather than as countervailing powers, as in the power resource model, they appear as cross-class coalition partners of strategically competent firms with which they share a general interest in competitive efficiency.41

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40 Conceptual confusion is rampant here. “Coordination” sometimes refers to the establishment of productive relations in general, regardless of whether through markets or – other? – institutions. Mostly, however, the term is used synonymous with “non-market coordination”; hence the distinction between “coordinated” and “liberal” market economies. Also, while markets are sometimes included in institutions, mostly institutions mean only non-market institutions. And while in some places all interaction between economic actors seems to be “strategic,” when it comes to distinguishing the two main types, strategic interaction is confined to CMEs (Hall/Soskice 2001a: 8). Similarly, the authors designate their approach as “relational” on the grounds that it models political economy in game-theoretical terms, only to limit the concept later to the coordinated type of market economy. Moreover, although game theory is prominently invoked in the conceptual part of the chapter, and is claimed to be distinctive of the approach (ibid.: 5), it plays no role in the substantive sections.

41 For empirical reference the argument draws on the work of Swenson, Mares, and others who in the 1990s redefined welfare state development as an outgrowth of a strategic search by capital for higher returns on investment, rather than the result of pressure from labor for redistribution and protection from market forces (Swenson 1991, 1997; Estevez-Abe et al. 2001; Mares 2001, 2003; Swenson 2001).
(4) LMEs and CMEs differ in their economic capabilities as vested in their differing endowments with institutions and resources. While different, however, the capabilities of liberal and coordinated market economies are also equal, in the sense of equally competitive and sustainable. This is because each of the two types comes with a different “comparative advantage.” LMEs and CMEs show similar levels of economic growth, per capita income, and unemployment which, however, they achieve in different ways. Whereas German-type economies excel at “incremental” innovation resulting in “diversified quality production,” Anglo-American economies are alleged to be better at “radical” innovation, with the respective innovation patterns related to different patterns of “coordination” between economic actors (Hall/Soskice 2001a: 21–44).

(5) National political economies are composed of institutional spheres that function better the more they “complement” one another. Five such spheres are envisaged: industrial relations, vocational training and education, corporate governance, inter-firm relations, and the relationship between workers and management (Hall/Soskice 2001a: 6f.), although the list keeps changing. Institutions are considered complementary “if the presence (or efficiency) of one increases the returns from (or efficiency of) the other” (2001a: 17). The claim is “that nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well” (ibid.: 18). Although the meaning is not entirely clear, it seems that complementarity is defined as structural homogeneity (or isomorphism): coordination via institutions other than markets – that is, through strategic interaction in the narrower sense – is to be more efficient in one sphere if the same sort of coordination is also practiced in other spheres. National institutional configurations are likely to be structurally homogeneous, and in this sense complementary, because of their governors’ desire to increase their efficiency.

(6) Together, the equal competitiveness of LMEs and CMEs and the economic benefits of complementarity stand in the way of convergence on a single “best practice” of national capitalisms. Both types are capable of survival, their chances being greater the purer their adherence to their respective method of “coordination” across institutional spheres. This makes radical institutional change rare. While a deviant development in

42 “Although each type of capitalism has its partisans, we are not arguing here that one is superior to another” (Hall/Soskice 2001a: 21).
43 “Performance” does not include distribution, which is treated as a separate matter (Hall/Soskice 2001a: 21). The typical patterns of distribution associated with the two capitalisms are not included among their typological characteristics. Institutional analysis is only about efficiency defined as “the net return to the use of an institution given its costs” (ibid.: 17). A typical claim is that since economic actors in CMEs “rely more heavily on forms of coordination secured through strategic interaction…, the relevant institutions will be those that allow them to coordinate on equilibrium strategies that offer higher returns to all concerned” (ibid.: 9f.; italics added).
44 “We refer to total returns, leaving aside the question of to whom they accrue,” which is “a matter of property rights” (Hall/Soskice 2001a: 17, FN 17). The latter are obviously considered to be irrelevant for capitalist institutional variety as different patterns of distribution.
one sphere is likely to be reined in by economic pressures for efficiency-through-complementarity, simultaneous change in all sectors in the same direction is difficult if not impossible to bring about.\(^{45}\) (Note that this deals a poor hand to oppositional forces in either system that would like their country to switch to the alternative system — to neoliberals in Germany-at-large, just as to social reformers in Greater Anglo-America.) Rather than convergence, the tendency is for polarization: for countries with impure combinations of institutions to move from their position somewhere between the two “ideal” types to either of its two endpoints where institutional arrangements are homogeneous and, therefore, more efficient.

Ultimately, the functionalist make-up of the Hall and Soskice conceptual schema would seem to be most apparent in, and perhaps to derive from, the way it equates its main concept, “capitalism,” with that of “market economy.” The very problems of distribution and exploitation that are centrally emphasized when a socioeconomic formation is referred to as capitalist are thereby submerged in, or redefined as, problems of efficient production. As a consequence, the fundamental ambivalence inherent in the concept of capitalism as a system of both economic progress and private appropriation is eliminated. Similarly, conflict and power are thrown out as sources of socioeconomic order in favor of coordination and cooperation. Reconceived as a market economy, capitalism becomes a political technology for cooperative wealth creation, where the pursuit of efficiency is identical with the pursuit of profit and where political conflict results, if at all, from misunderstandings and insufficient knowledge of economic “laws.” Thus the notion of capitalism, originally inseparably associated with conflict and crisis, becomes not just technocratically sterilized but also de-historicized, as the conceptual schema of capitalism-as-market-economy has no systematic place for the possibility of capitalism-as-political-economy reaching historical limits to its sustainability.

6  Not enough variety, too little history? The “VoC Debate”

In the following I will review central aspects of the extensive debate on the Hall and Soskice model of capitalist variety, referred to from here on as “VoC.” My review will focus on four critical issues:\(^{46}\) the methodological nationalism behind VoC’s definition of cases as countries, and the assignment of countries as whole units to positions in a typological classification of “capitalisms”; the functionalism behind the conceptualization of countries as tightly coupled interactive systems of “complementary” institutions; the

\(^{45}\) For a brief discussion of the relationship between complementarity and change, see Hall and Soskice (2001a: 63f.).

\(^{46}\) For an excellent overview that appeared when the present paper was being written, see Bohle and Greskovits (2009). See also three collective volumes that reflect the breadth of the debate: Morgan/Whitley/Moen (2005), Hancké/Rhodes/Thatcher (2007a), and Hancké (2009).
emonomism underlying accounts of social order as a result of adaptation to pressures for efficiency; and the static comparativism of an approach to capitalism that assigns only secondary significance to origin, history, agency, conflict, and change.

First, critics objected early on to the dualism, or bipolarity, of the Hall and Soskice typology, and to the way the two main types, “LMEs” and “CMEs,” were defined as opposite ends of a one-dimensional property space (Goodin 2003). As noted, Hall and Soskice mention in passing but fail to theorize a third category of capitalism, which they label “ambiguous” or “Mediterranean.” This leaves open the question of whether cases that do not fit either of the two principal types are located somewhere between them, with the prospect of evolving with time into one of the two (“dual convergence”), or whether they are something else, requiring a more complex typology, like the one suggested by Boyer (2001), who distinguishes between market-led, corporate, social-democratic, and state-led capitalisms. Amable (2003), using factor-analytical econometric techniques on a large set of macroeconomic variables, establishes five types, which he calls market-based, Asian, Continental-European, Social-Democratic, and Mediterranean. In contrast, Coates distinguishes between market-led, negotiated-consensual, and developmental state-led capitalism (1999), or between liberal and trust-based capitalism (2000). Still other classifications are offered by Schmidt, who in order to accommodate the peculiarities of the French political economy proposes three types, market capitalism, managed capitalism, and state capitalism (2003), and by Hancké, Rhodes and Thatcher (2007b: 25).48

Another, more specific objection to the bipolar typology of Hall and Soskice relates to the way it lumps together the United States and the United Kingdom as the two paradigmatic “LMEs.” For a major difference between the two, with high typological relevance, several authors point to the strong role of the American state in technological innovation, especially through military spending, without which Silicon Valley or the internet would never have come into being (see, among many others, Crouch 2005a: 134f.; Taylor 2009). Moreover, and more fundamentally, Crouch (2005a) argues that Hall and Soskice confuse cases and types, a mistake of which Max Weber had already warned (ibid.: 57).

Empirical cases must be studied, not to determine to which (singular) of a number of theoretical types they should each be allocated, but to determine which (plural) of these types are to be found within them, in roughly what proportions, and with what change over time.

(Crouch 2005a: 26)

47 Schneider and Soskice (2009), in order to accommodate Latin America, add “hierarchical” to “coordinated” and “liberal” market economies.

48 There is also a broad literature trying to fit the political economies of Eastern Europe after the transition into a, usually expanded, typology of national capitalisms (see, for example, David Lane 2005; Feldman 2007; King 2007; Lane/Myant 2007; Mykhnenko 2007; Bohle/Greskovits 2009; Nölke/Vliegenthart 2009). If anything, the apparently unending number of alternative typologies serves to reinforce skepticism about the validity of any general typology of different “capitalisms.”
Ultimately, this raises the issue of the nature of the cases compared. As noted, in standard comparative capitalism cases are countries, or societies organized as nation-states. But if what is compared are really types of coordination, or modes of governance, sub-national regions (Trigilia/Burroni 2009) and sectors (Hollingsworth et al. 1994) might also qualify as cases, while countries would better be conceived as combinations of more or less heterogeneous institutions (Crouch et al. 2009). In general, as the number of types of capitalism grows, and that of countries within types consequently declines, countries begin to appear increasingly as “historical individuals” in a Weberian sense. Paradoxically, this makes their commonality as capitalist political economies and their mutual interrelations more salient.

The status of countries as principal units of comparison is also called into question by research on the behavior of firms. That firms are not the prisoners of nation-states, and today less so than ever, entails the possibility of institutional arbitrage, with firms moving their operations, or parts of them, to the environment that best fits their needs. While Hall and Soskice expect this to reinforce diversity between countries (2001a: 57), porous national borders seem to enable firms also to acquire needed resources from abroad, which would allow them to pursue deviant or atypical competitive strategies at their original location. As a consequence, diversity between firms within national systems may increase, causing in turn growing convergence among the latter. On the basis of research on the German, Italian, and British pharmaceutical industries, Herrmann (2008a) argues for the possibility of radical innovation in a “coordinated market economy” such as Germany, as firms can procure from abroad production inputs not supplied under domestic institutional regimes. More generally, several authors doubt the capacity of national institutional contexts to control the strategic behavior of firms as tightly as implied by VoC (Hancké/Goyer 2005; Batt, Nohara/Kwon 2010; Doellgast 2010). Thus Wood et al. (2009) show important differences in firm-level labor relations practices within and not just between countries. Similarly, Morgan (Morgan 2005, 2009) emphasizes an – apparently growing – strategic capacity of firms to make individual choices independent of national institutional constraints, thereby bringing about systemic change by increasing diversity within systems and simultaneously blurring the differences between them.

More questions regarding the power of national institutions to shape the behavior of firms are raised by an inspection of trade patterns. According to Watson, who warns of the danger of “reification” of “the national” in Ricardian theories of comparative advantage, there is no indication that, as the Hall and Soskice typology implies, “the greater the institutional difference between two countries the more distinct their pat-

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49 See the extended debate between Herrmann (2008b, 2009, 2010), Lange (2009), and Casper (2009) in several issues of Socio-Economic Review on the competitive strategies and success of German firms in biotechnology, which goes back to Casper's contribution to the Hall and Sosskice volume (Casper 2001).

50 See also, earlier, Katz and Darbishire (2000).
terns of economic specialization will be” (Watson 2003: 234). Nor does there seem to be evidence of an “obvious concentration of trade between countries whose economies are most institutionally dissimilar” (ibid.: 236).

Second, the fact that mainstream VoC reasoning explains national institutional configurations in terms of the economic benefits of “complementarity” raises well-known general questions on the merits and demerits of functionalism in the social sciences (on the following see Crouch et al. 2005). Defining complementarity as structural homogeneity of institutional practices, in particular in industrial relations and corporate governance, Hall and Gingerich (2004) claim to have found that countries with homogeneous institutions, supporting either markets or “strategic coordination,” perform better economically than countries with heterogeneous institutions. Höpner (2005: 340), however, notes that the “clustering” of homogeneous institutions “is an indication for compatibility, but no proof of complementarity.” Moreover, in the German case which Höpner has studied, more market-driven corporate governance has served to tighten cooperation and coordination between management and labor at the enterprise level. Höpner also argues that structural homogeneity may be due not to higher efficiency, but “simply (to) the existence of culturally related ‘families of nations’ in the OECD world” (2005: 334). Furthermore, several studies find no empirical support for the claim of the economic superiority of “pure” cases (see, for example, Kenworthy 2006).

A related theme is whether functional complementarity requires structural homogeneity or whether performance, for example with respect to innovation, might not, to the contrary, be enhanced by a mix of different types of institutions inside a national economy (Crouch 2005b). Campbell and Pedersen (2007) point to the frequency and apparently high economic viability of “hybrid” national systems that combine coordination by institutions with “coordination” by markets, arguing that the functional advantages of structural homogeneity, if they exist at all, may be weaker than assumed by VoC theory. Outside of functionalist concerns with economic performance, the existence of hybrid systems (Boyer in Crouch et al. 2005; Höpner 2005; Deeg 2009) can be taken as an indication that national institutions are not as tightly coupled as suggested, and are tolerant of a good deal of internal diversity and, perhaps, friction (Lane/Wood 2009). This would appear to allow not just for change and experimentation but also, by implication, for the pursuit of non-economic objectives in addition to or in competition with economic ones.

Even more fundamentally, any theory that explains the elements of a social system, whatever their structural make-up, by their – “complementary” – contribution to a common purpose must specify a mechanism that causes and safeguards their functional fit. In political economy, this could either be intelligent institutional design by an agent willing and able to take responsibility for optimizing economic performance – for example, the government or organized business – or competitive selection in something like an efficient market for national institutions. However, neither an all-powerful and theoretically competent system designer (Streeck 2004b) nor a market selecting institutional
configurations on their complementarity can be identified for contemporary capitalist countries (for an extensive discussion of the German case see Streeck 2009, Chapter 13). In both respects, Paul Krugman’s dictum applies that “a country is not a company” (Krugman 1996): not only can it not be structured and restructured from the top for the purposes of efficiency and competitiveness, but it comprises a broad variety of sometimes conflicting objectives that cannot be authoritatively reduced to a single common goal, even that of economic efficiency or prosperity.

A third issue, which is closely related to that of functionalism, is the inherent economism of the VoC paradigm, as evident in its self-professed “firm-centeredness” and its marginalization of politics in favor of policy and of culture in favor of efficiency (Dore 2003). While traditional theories of capitalism have conceived of their subject as a society contingently and unfortunately driven by its economy, in VoC capitalist society tends to be treated as an economy, and society and economy as happily unified in a joint search for economic efficiency. This is close to the rational choice institutionalism of the early Douglass North (North/Thomas 1973). Commentators have pointed to the virtual absence in the VoC paradigm of labor as an actor with interests different from those of capital (see, among others, Howell 2003). They have also pointed to the theory’s neglect of the political as distinguished from the economic conditions of social stability and change (Amable/Palombarini 2009). Others have emphasized the absence of cultural motives as opposed to economic ones in VoC accounts of stability and change in capitalist political economies (for example, Bruff 2008). Drawing on the case of Germany since the 1970s, Streeck (2009) has argued that, empirically, capitalist development cannot be explained as a result of rational economizing but must be accounted for as shaped by a conflict between profit-seeking and the social countermovements contesting the dominance of capitalist market relations over social life.

An important aspect of the underlying economism of mainstream VoC theory is its firm- or employer-centered account of the origin and function of the welfare state as

51 As Amable has argued, complementarity in the sense of a good functional fit between institutions often comes about by accident (Amable 2003), or it may be the combined result of improvisation and conjunctural good luck, and is likely therefore to be only temporary (Streeck 2009).

52 Compare Pontusson (2005: 164): “The VoC approach theoretically privileges considerations pertaining to efficiency and coordination at the expense of considerations pertaining to conflicts of interest and the exercise of power.”

53 Marxian materialism considers the rule of the economy over society under capitalism as an historical anomaly that must be overcome by revolutionary politics if civilization is not to perish. By contrast, “vulgar materialism,” the rise of which in the nineteenth century made the late Marx insist that he was “not a Marxist,” sees the dominance of the economy over society as normal, and undertakes as a theoretical strategy to explain the social by reducing it to the economic. Much of today’s political economy literature is in this sense vulgar-materialistic.

54 While Hall and Soskice mention culture, albeit only as a lubricant for effective coordination of economic transactions (ibid.: 12–14; see also Dore 2003), Bruff (2008) insists on a Gramscian concept of cultural hegemony shaping and stabilizing historical social formations.
an institutional device designed to enhance the efficiency of economic transactions. Several chapters in the 2001 volume, very much in the “Third Way” spirit of the time, suggest an economic-productivist explanation (a “welfare production regime theory”) of the rise of social protection (Estevez-Abe et al. 2001; Mares 2001), contradicting the power resource model of capitalist variety. The difference is nicely detailed, and the difficulties of the economistic position are spelled out at length, in a pointed rejoinder by Korpi (2006).

The key concept in the economistic reinterpretation of the welfare state is asset specificity (Iversen/Soskice 2001), and the substantive area in which it came to be primarily applied is skills and skill formation (Culpepper 2002; Iversen/Stephens 2008). As Korpi (2006) has pointed out, these take the place in welfare production regime theory of class and class politics in traditional theories of capitalism. According to Williamsonian institutional economics, transactions involving specialized assets are more vulnerable and therefore less likely to come to pass. For them to be possible, more sophisticated coordinating institutions are required offering reassurance to actors that would have to invest in transaction-specific assets. Asset theories of capitalist variety explain political-economic institutions, in economic-reductionist fashion, by the kind of assets traded in economic transactions. Thus differences between capitalist political economies with respect to labor market and welfare state institutions are explained as voluntary differences in typical skill endowments giving rise to different preferences of the median voter. In particular, the presence and absence, respectively, of employment protection and unemployment insurance in “CMEs” and “LMEs” is accounted for by the fact that skills in the former are presumably more specific and in the latter more general, in the sense of more widely and easily transferable (Estevez-Abe et al. 2001). The argument – which explains low social protection in the US by economically rational low demand for it on the part of workers – has triggered extensive debate, both empirical, in particular with regard to how “skill specificity” may be measured, and theoretical (Korpi 2006). Reviewing that debate, Gallice (2007) concludes that power resource theory trumps VoC in accounting for different patterns of labor market regulation and, in particular, of constraints on employers. Most recently, it has been argued that the transferability or non-transferability of skills is less an intrinsic quality of the latter – and thus exogenous to a country’s regulatory institutions – than something determined by institutional arrangements (Busemeyer 2009).55

The fourth major issue in debates on capitalist variety is change (on the following, see Deeg/Jackson 2007). Little is said in standard VoC theory about the historical development of the two polar types, “liberal” and “coordinated.”56 As to “LMEs,” there is no indication of how the New Deal in the United States or the postwar welfare state in Brit-

55 In particular, low transferability of Japanese skills is due not to narrow specialization, or skills being too firm-specific to be transferable, but to Japanese employers not allowing workers to enter internal labor markets except at the bottom, to deter them from moving and make them dependent on their present place of employment.

56 But see Hall (2007).
ain – as associated, for example, with the Beveridge Report or T.H. Marshall’s celebration of a politics of social rights (Marshall [1949]1965) – might fit in the conceptual framework. That both countries had been much less market-liberal in the past than they were in the 1990s, and that this remains unaccounted for in the Hall and Soskice approach, has been noted by critics such as Goodin (2003). As to “CMEs,” they are styled essentially as frozen in the shape they may have had in the 1980s, their subsequent “liberalization” being treated as typologically insignificant. In critical response, several authors emphasize what they describe as a parallel, equidirectional movement in advanced political economies, regardless of type, towards more market-conforming modes of governance (Schmidt 2003; Thatcher 2004; Hay 2005). While parallel change in the same direction need not lead to convergence (Schmidt 2003), it indicates a systemic dynamism not envisaged by the paradigm leading, among others, the editors and authors of a voluminous collection of critical essays on the subject (Morgan et al. 2005) to urge a shift of focus from static comparativism to a generally more dynamic perspective on firms and institutions.58

Generally, the emphasis of VoC theory on complementarity as the force organizing national institutional configurations limits the possibilities of institutional change (Deeg 2005). Still, as Goodin reminds us (2003), the bipolar LME/CME schema does allow for two modes of change, both of which are seen as occurring at the “coordinated” end of the typological continuum. One is erosion of trust which, as Hall and Soskice note, is easier to start than to stop (2001a: 63); the other is financial deregulation, which, according to them, could be “the string that unravels coordinated market economies” (ibid.: 64). While this might be read as a reference to the process of systemic liberalization observable in the 1990s throughout the capitalist world, conceptually, both erosion of trust and financial deregulation appear, rather than as historical trends, as contingent events that could in principle be reversed. In particular, there is no indication that they might be linked to specific socioeconomic interests in or conflicts over systemic change. The same applies to international pressures, which appear as reinforcing instead of undermining the – static – differences between the two main types (ibid.: 54f.). Referring to the treatment of institutional change in VoC, Hay writes of “a rather agentless and apolitical conception of institutional adaptation to largely exogenous challenges and imperatives and an overly mechanistic understanding of ‘bifurcation’ or ‘dual convergence’ amongst models of capitalism in response to globalization” (Hay 2005: 120).59

57 The fact that liberalization and deregulation in the United States in the 1970s had to be aggressively advocated and fought for by economists such as George Stigler and social movement leaders such as Ralph Nader (with regard to corporate governance; Canedo 2009) has no place in the static typology of the mainstream varieties-of-capitalism paradigm.

58 See also Jackson and Deeg (2006: 3), who on the basis of a critical inspection of VoC and similar approaches agree that the way forward for a comparative study of capitalism “lies in developing a more dynamic view of individual institutions, the linkages between domains, and the role of politics and power.”

59 The extent to which “globalization” affects national institutional arrangements is of course an old theme. Recently, the VoC debate has been tilting towards the view that economic interna-
This seems to hold also for Hall and Soskice’s admission that tight inter-institutional coupling for complementarity might not just prevent institutional change, but could also facilitate it (ibid.: 63f.). Here, too, no room is reserved for political contestation of the socioeconomic order, whether “LME” or “CME,” or for historical periodicity and the possibility of a limited lifespan for one or both of the two main types.

As indicated, much of the VoC discussion after 2001 was of how to identify and account for institutional change, especially change in the direction of liberalization (Streeck/Thelen 2005). In fact, critical debates on VoC contributed importantly to the emergence of institutional change as a central issue in historical institutionalist theory (Mahoney/Thelen 2010; Thelen 2010). Within the VoC mainstream, efforts were undertaken to make the original formulation more dynamic by softening its static-functionalist edge (Hall/Soskice 2003; Hall/Thelen 2009). Whether or not the static functionalism of the 2001 essay was just read into it by its critics, as its defenders sometimes but not always suggest, need not be decided here; if it was a misreading, however, it was certainly a widespread one.

Related to the discussion of change in VoC are recent attempts to ground the LME/CME distinction in the long-term political history of nations. In a widely read article, Cusack, Iversen, and Soskice (2007) try to establish a link, going back well into the nineteenth century, between types of capitalism and electoral systems. The claim is that early liberal economies gave rise to majority voting systems, whereas economies with traditionally high coordination favored proportional representation. Again, the suggestion is that the connection lies in the predominant nature of economic resources.

While proportional representation is said to support regulatory regimes that protect “co-specific investments,” majoritarian systems allegedly suit the political-economic interests of capitalists employing more mobile, general assets. Subsequent discussion will have to explore whether the correlations on which the theory is based are more than spurious and in what direction, if any, the historical lines of causation run.

7 From static variety to dynamic commonalities

The worldwide economic crisis that began in 2007 has revived interest in what different national capitalisms have in common and how they are connected, as opposed to where they differ. In particular, as the sudden outbreak of the crisis has drawn attention to the

tionalization does erode national “models” (Cerny et al. 2006), especially in Europe, where it takes the form of European integration (Menz 2005), and that it changes, in particular, “social” forms of capitalism in the direction of a more market-driven economic order (Perraton 2009).

60 For another, less functionalist and more qualitative account of the history of capitalist variety see Hall (2007).
dynamic nature – the Eigendynamik – of capitalism, the VoC typology is found wanting with regard to the nature of the beast whose diverse appearances it pretends to explore.\textsuperscript{61} The crisis has also brought back the memory, still vivid until only a few decades ago, of the self-destructive potential of capitalism – a topic that was at the center of traditional theories, from Marx to Schumpeter, but had been lost in rationalist-functionalist accounts of capitalist diversity, as constructed in the “end of history” decade of the 1990s. Moreover, the crisis has thrown into high relief the international interdependence of national capitalist economies and societies, which causes developments in one country to have potentially far-reaching consequences in others, regardless of whether they are of the same “variety” or not.

In the following, I will single out four themes that future research on capitalism will likely have to address, themes that as far as I can see call for a paradigm shift from a focus on static varieties of capitalism as a socioeconomic formation to a focus on its dynamic commonalities:

(1) Older theories describe capitalism as a uniquely dynamic and thus fundamentally modern economy-cum-society that is constantly evolving, driven by endogenous pressures for continuous expansion. Static “models” of capitalism have failed to capture the genuinely historical nature of a nontraditional political economy evolving into an open future (Keynes 1937). Capitalist development, of whatever “variety,” has been described as a self-driven expansion of market relations, extensive with regard to their territorial reach and intensive in terms of a progressive commodification of social relations (McMurtry 1999). It is this process for which Rosa Luxemburg, a much underestimated theorist of political economy, coined the metaphor of \textit{Landnahme}, or land-grabbing (Luxemburg 1913). The idea behind it is reflected in the inability of modern economics and political economy to imagine a “variety” of capitalism that is not growing, that is, not commodifying and monetarizing more and more social transactions so that their “value” can be measured and a surplus can be extracted from them.\textsuperscript{62}

Capitalist development has often been conceived as subject to historical periodicity. Periods, or stages, of capitalist development have always been central to the approach of the French \textit{régulation} school (Boyer 2001, 2005; Boyer/Saillard 2002). While the \textit{régulation} approach does recognize differences between national capitalisms and tries to interpret them systemically, it is also and perhaps primarily concerned with the evolution of capitalism over different historical periods. Central to it is a notion of endogenous

\textsuperscript{61} As Pontusson laconically puts it (2005: 164), “the VoC literature has a great deal to say about ‘varieties,’ but surprisingly little to say about ‘capitalism.’”

\textsuperscript{62} All notions of capitalist development go back, in one way or another, to Marx’s concept of extended capitalist reproduction, as summarized in his famous $M\rightarrow C\rightarrow M’$ formula. The formula represents the process of capital accumulation through the extraction of surplus value. Another way of understanding the specific dynamic of capitalism is to emphasize its intimate relationship with a credit system that requires growth as a condition of future repayment of current debt (Ingham 2004).
crisis of each capitalist “growth regime,” leading to a search for a new institutional equilibrium which, however, will also serve only for a limited time span. A post-VoC theory of capitalism can borrow from the régulation approach the notion of periodicity, without necessarily buying into the idea of political-economic equilibrium. In contrast to VoC, its central message might be, not that different capitalism can be equally “successful,” but that there was a period in the history of capitalism when capitalism as such was successful, followed by an extended crisis and a historical effort, with open event, to establish an effective post-Fordist accumulation process.

In any case, bringing historical dynamics back into the study of capitalism allows for recognition of the parallelism and interdependence of the tendencies toward liberalization that have been dominant in Western capitalist societies since the 1980s. In this vein, Albo (2005) suggests that VoC has not captured the variety of capitalism as such, but rather that of the neoliberalism of the late twentieth century, or what he calls the “new capitalism.” From a dynamic perspective, late-twentieth century liberalization can be thought of as an interconnected common response of national capitals after they had become stagnant in the 1970s, in particular as an attempt to escape from the political constraints imposed on capitalist accumulation in the New Deal and the post-war settlement after 1945 (Glyn 2006). Again, traditional theories of capitalism, here the notion of capital accumulation proceeding by way of market pressures breaking through their institutional containment, seem to offer a more realistic account of the working of the capitalist political economy than concepts of bifurcated convergence on two alternative, equally transaction cost-efficient “models” of a “market economy” conceived of as an equilibrated machine for the production of prosperity.

(2) Growing inequality in all variants of capitalism (Pontusson 2005) and the bailout under duress of the global financial sector by governments at the expense of citizens have made efficiency-theoretical accounts of capitalism and its “varieties” even less convincing. As a consequence, the monistic image of a capitalist political economy as a joint enterprise of firms and governments working together to increase “efficiency” may be expected increasingly to give way to a more pluralist model of capitalism-as-capitalism, instead of capitalism-as-market economy – a model that assigns a prominent place to conflict and contradiction, in addition to and probably prior to cooperation and coordination. Concepts such as power, as in the power resource model, and constraint, as in historical institutionalism, will need to be brought back if the dynamic of capitalist development is to be understood. This includes the notion that conflicts under capitalism, fought out with political power and constrained by institutions, are conceived as more than just struggles over the distribution of the results of joint production: importantly, they are also about which spheres of life should legitimately be subject to commodification, and which should remain protected from the expansion of market relations.

63 For a recent attempt to revive convergence theory to account for the parallel neoliberal evolution since the 1990s of industrial relations in European countries, see a brilliant, empirically based paper by Baccaro and Howell (2010). See also Christel Lane (2005) with regard to corporate governance.
Capitalist societies, this implies, and indeed all societies, should not be modeled as dedicated to just one objective, even if that was to be their “survival” in economic or political “competition.” This is the fundamental idea behind Polanyi’s image of capitalist development proceeding through a “double movement”: a struggle between the forces or tendencies of commodification and of the “disembedding” of market exchange on the one hand, and those of containment of commodification, or “re-embedding” and social reconstruction, on the other. The same idea underlies Habermas’ notion of a conflict between capitalist rationalization and the “life world” (Habermas 1987). A theory of capitalism that recognizes the pluralist, multi-dimensional and internally conflicted nature of social systems restores politics to the central place it deserves, in contrast to efficiency theories in which politics is about no more than the instrumental problem of defining and implementing the most efficient institutions for the essentially technocratic task of “coordination.” Moreover, a theory like Polanyi’s that conceives of politics as an open struggle between values and interests that are not easily reconciled, if at all, ceases to be deterministic, just as the dynamic of social development that it describes no longer needs to appear to be one-dimensional or linear. Among other things, this makes it possible to allow for capitalist expansion to be halted for historical periods, or to have to move one step back for every two steps forward, or even to be reversed if a resisting society defending its cohesion and seeking security from the vagaries of markets manages to build up enough political muscle for the purpose.

An elegant way of restoring politics, conflict and power to the study of capitalism without abandoning production, cooperation and coordination – the principal concerns, in other words, of VoC – has been suggested by Martin Höpner (2007). Höpner argues that “nonliberal” capitalism was not just coordinated but also organized, with institutions providing not only for the efficiency of markets but also for their social containment and control. The implication is that nonliberal capitalism can become less organized, and in this sense liberalized, without necessarily becoming less coordinated. While the differences in production regimes that are central to VoC may remain, political regimes may become more similar as the social obligations imposed on firms under organized but not under coordinated capitalism wither away.65

64 This reading of Polanyi is, of course, in sharp distinction from the “always embedded,” functionalist tradition of the, mostly American, Polanyi reception (Streeck 2009, Chapter 13). That ultimately no economy can work without social integration is no reason why “disembedding” should not be tried by capitalist actors seeking individual advantage and freedom from collective constraint. Nor is there any guarantee that societies will always be able to invent and build the institutions required for embedding or re-embedding a self-driven, expanding system like modern capitalism. The hard core of Polanyian theory is that the institutions that capitalists may be able to construct voluntarily for their own benefit – that is, in their search for profitable efficiency – are not enough to secure the social integration and cohesion ultimately required for a functioning economy and, thus, for their search for profit to be sustainable. See Beckert (2009).

65 While strongly emphasizing the role of politics in the “coordination” of capitalist political economies, Martin and Thelen (2007) do not distinguish between state intervention facilitating productive cooperation and state intervention constraining the more powerful participants in market exchange. The critical distinction in comparative theories of capitalism today seems to
Arguing against neoliberal theories of and demands for convergence on a single, market-driven “best practice” model of capitalism, theories of capitalist variety have tended, not only to neglect the commonalities of national capitalisms, but also to downplay their interdependence. The dramatic events after 2007, with a bubble in the US subprime mortgage market resulting, among other things, in millions of people around the world having to spend years of their lives unemployed, not to mention the possible bankruptcy of sovereign states, are beginning to revive memories of the Great Depression and the tight coupling of national capitalisms in an encompassing world system. Theories of capitalist variety in the 1990s emphasized the limits imposed by pressures for complementarity or, in the historical-institutionalist model, by path dependence on the diffusion of institutionalized practices from one country to another, and in this sense on cross-national convergence. That boundary-crossing transactions, in markets as well as inside multinational corporations, had increased in significance in recent decades was sometimes recognized, although it was typically claimed that internationalization had not advanced much beyond what it was before the First World War. Even where “globalization” was considered important, however, the argument was basically that its impact on national political economies was sufficiently moderated by national institutions to keep the identity and autonomy of national variants of capitalism intact (Hall/Soskice 2001a: 54f.).

It is hard to see how a view as sanguine as this could survive the experience of the global crisis and its proliferation along the transnational linkages created by dynamically expanding international markets, in particular for finance. What might have to be overcome in future theory and research is not just a lack of systematic attention to international interdependence and the possibilities it creates for institutional diffusion. Even more importantly, the very notion of sectorally and institutionally complete, symmetrical and therefore comparable national capitalist systems may have to be given up. If it is true that national financial sectors have long been effectively integrated into a global financial industry headquartered in the United States, this must cast doubt on the continued applicability of the rationalist-functionalist core concept of complementarity. At the time of writing, it seems more than possible that the effort of capitalist states to re-regulate the financial industry, jointly or individually, will end with the realization that the only country that is still institutionally complete – that is, which has a financial sector of its own that it can decide to regulate or not to regulate – is the United States. All others may have no choice but to follow and live with what the United States is willing or able to do.

Ultimately, political economy might have to abandon entirely the idea of national varieties of capitalism and advance towards a concept of an internationally variegated capitalist world system. There is no need for a theory of global capitalism to deny the
possibility of diversity, along national or regional lines, just as current theories of national capitalism sometimes allow for internal variation between regimes and practices by subnational territories or economic sectors. In recent years, the concept of “variegated capitalism” (Peck/Theodore 2007) has been put forward in explicit criticism of the VoC approach, not in an attempt to deny differences, but in order to place them in a context of economic and political interdependence.

Conceiving of capitalism as a more or less integrated global system must not, of course, be taken to imply an equally integrated global regime of economic governance, let alone of political government. This would amount to another functionalist fallacy, as there is no reason to believe that, where market relations spread, they are automatically followed by institutions regulating them, even though their long-term stability would depend on this. To the contrary, it seems to be characteristic of capitalism that market expansion tends to outpace institution-building, even where regulation may be desirable and in fact desired by market participants themselves. For regulation to follow market expansion, a political capacity is needed that is capable of disciplining the potentially self-destructive actions of self-interested, essentially anarchic profit-seekers. The existence of such a capacity cannot be taken for granted, and where it exists it may become obsolete or fall apart in the course of social or economic change. The crisis has restored the memory – and may increasingly do so – of the fact that, unlike the neoclassical model, a real-world capitalist political economy-cum-society has no equilibrium that it could and would attain and maintain without political intervention. If this holds for national capitalisms, as it clearly does, it should hold all the more for capitalism as a global system.

Towards a new paradigm: A tentative summary

Current tendencies in the study of the capitalist political economy, as inspired by a decade-long debate on VoC as well as by contemporary events, are summarized in Table 2. Increasingly, equilibrium theories of national institutions are giving way to theories emphasizing institutional change, both endogenous and driven by globally expanding markets. Theoretical interest is focusing less on the self-stabilization of complementary institutions at national level and more on the international dependence and interdependence of national institutional configurations embedded in global markets, as distinguished from embedding national markets. Markets are studied as potentially destabilizing their institutional context, rather than as being always and necessarily stabilized and contained by it, and as expanding faster than the institutions by which they are supposed to be regulated. In the emerging new paradigm for the study of capitalism – which has much similarity with older paradigms – maximization of profit takes the

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67 As suggested by, among others, Panitch and Gindin (2005).
place of maximization of efficiency, and economic outcomes are attributed as much to agents interested in private gain as to public institutions designed to ensure an efficient use of scarce resources. Empirical research is increasingly looking at crises and contradictions instead of stability and coherence, conflict is considered the rule rather than the exception, and compromise is expected to precede cooperation. Differences over time between periods of capitalist development trump differences between places, or countries (Coates 2005a). Instead of competition between countries and coordination within them, political economy is again giving primacy to conflicts between actors inside and outside of markets over where the laws of the market should apply and where not. The political may finally be put back into political economy as it ceases to consider countries as firms and polities as “firm-centered.” Instead, it may rediscover them as republics housing a variety of conflicting economic and non-economic concerns, all of which in one way or other related to the inherent dynamism of the capitalist mode of production and in need of adjudication through national and international politics.

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Varieties of Liberalization and the New Politics of Social Solidarity

For the past few decades, much of the scholarship on the political economy of the rich democracies has been organized around a broad distinction between an inegalitarian “liberal” model of capitalism that prevails in much of the Anglo-Saxon world and a more egalitarian “social” model found in many European countries (e.g., Pontusson 1997; Acemoglu et al. 2012). While both models seemed equally viable in the Golden Era of postwar development, many contemporary trends seem to spell trouble for the European social model. The litany of pressures on these systems is long and includes heightened competition in international markets, footloose finance, deindustrialization, declining union power, fiscal distress, and ascendant neoliberal ideology, among others. In light of these trends, some observers have suggested that the Golden Era of egalitarian capitalism may be over and that in the end, there is just one model of capitalism after all – the harsher one in which the market prevails over social solidarity (e.g., Howell 2003; Glyn 2006).

While sharing many of the concerns that animate these analyses, I argue here against the idea of a uniform slide toward Anglo-Saxon-style liberalization. I propose a new, more differentiated way of thinking about contemporary changes in the political economies of the rich democracies. The framework offered here breaks with the continuum models on which much of the traditional literature has been based, in which countries are arrayed along a single dimension according to their degree of corporatism or, more recently, of coordination. In doing so, it reveals combinations – declining solidarity in the context of continued coordination, and continued high levels of equality with significant liberalization – that other frameworks rule out by definition. Moreover, and against the dominant view of institutional stability as grounded in vested interests and straightforward feedback effects, I suggest that the institutions of egalitarian capitalism survive best not when they stably reproduce the politics and patterns of the Golden Era, but rather when they are reconfigured – in
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both form and function – on the basis of significantly new political support coalitions.

A vast, rich literature on the welfare state has taught us a great deal about recent changes in welfare regimes and social policy. This study therefore does not rehash developments in this area, but instead concentrates on three other institutional arenas that welfare-state scholars tend not to examine, but that figure centrally in a different, though related, literature on varieties of capitalism (VoC). Specifically, I examine recent trajectories of change in three political-economic institutions – collective bargaining institutions, institutions of vocational education and training (VET), and labor market institutions – that have also been linked directly to the distributional outcomes of ultimate concern in this study. The differences that have traditionally distinguished liberal market economies (LMEs) from coordinated market economies (CMEs) in these areas are well known and can be summarized succinctly. Whereas industrial relations systems in LMEs are characterized by decentralized, uncoordinated collective bargaining and adversarial relations between unions and employers, CMEs feature highly coordinated bargaining and social partnership between unions and strong, centralized employer associations. Whereas LMEs are associated with highly stratified systems of education and training organized around the production of general (widely portable) skills, CMEs feature stronger systems of VET organized around firm- or industry-specific skills. Finally, whereas LMEs are characterized by fluid labor market regimes and weak employment protections, CMEs feature stronger employment protection and associated longer job tenures.

From the beginning, VoC theory challenged the idea that contemporary market pressures would drive a convergence on a single best or most efficient model of capitalism. The core argument holds that these two broad models represent different ways to organize capitalism. Each type operates on a wholly different logic and each does different things well, but both are durable even in the face of new strains. In contrast to earlier corporatism theories that explained the origins and reproduction of key coordinating institutions (such as centralized bargaining) with reference to labor strength, VoC scholars explain this resilience with reference to differences in employer organization and interests in LMEs and CMEs (Hall and Soskice 2001). They suggest that in CMEs employers themselves have a stake in the survival of the institutions that distinguish these political economies from the liberal model; having organized their production strategies around these institutions, firms now rely on them for their success in the market. This logic offered a reassuring picture for those who might otherwise worry about breakdown of the institutions characteristic of CMEs, which are also widely seen as supporting what some observers have called a "gentler" form of capitalism than that which prevails in the alternative "cutthroat-capitalist" LMEs (e.g., Bohle and Greskovits 2009: 355; Acemoglu et al. 2013).

These predictions have not gone unchallenged. Economic turmoil of the last two decades has set in motion a vigorous debate in the political economy literature. On one side of the debate stand representatives of a powerful liberalization thesis (see especially Streeck 2009; also Howell 2003; Glyw 2006). These authors perceive in contemporary developments an erosion of the arrangements that have distinguished coordinated political economies in the past. As evidence, they point to the massive changes in global finance that have in many cases released banks from the systems of "patient capital" that were once seen as foundational to the CME model (Höpner 2000; Höpner and Krempl 2005). They note that employer pressures for greater flexibility in other arenas, notably collective bargaining, have had a corrosive effect on coordination and social solidarity (Hassel 1999; Baccaro and Howell 2011). They cite ongoing fiscal strain and relentless pressure on governments to cut costs and relax "restrictive" labor market arrangements that have long offered protection to the weaker segments of the workforce (Trampusch 2009; Streeck 2010; Streeck and Mertens 2010).

These scholars emphasize the commonalities rather than the differences across capitalist countries, particularly with respect to the overall direction of change in LMEs and CMEs alike. Behind this diagnosis is a very different, less benign view of employer interests. In this perspective, employers everywhere seek to extend the reach of the market. The only thing that distinguished the CMEs in the past was that – for various historically contingent reasons – society had been able to resist efforts on the part of capitalists to break free from the political constraints imposed on them. For these authors, globalization and the attendant decline in organized labor's power, as well as the resurgence of neoliberal ideology, bode very ill for the future of coordinated, egalitarian capitalism.

By contrast, defenders of the classic VoC perspective see the divergent institutional arrangements characteristic of LMEs and CMEs as relatively robust and resilient. They point out that the institutional differences between the two models of capitalism have deep historical roots (e.g., Iversen and Soskice 2001; Martin and Swank 2012). As such, these systems have survived all manner of crises (economic and political) over the past century, which were every bit as daunting as today's challenges. Scholars in this camp do not see the institutions of coordinated capitalism as a straightforward product of labor strength against capital; they refer instead to historical research that suggests that many of these arrangements were forged out of cross-class coalitions in which employers were key co-architects (Swenson 1989; Mares 2000; Martin 2000). Clearly, scholars in this camp acknowledge current, ongoing changes in these political economies. However, true to the original anti-convergence theme

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1 On collective bargaining, see, for example, Michael Wallerstein's (1999) classic analysis of centralization and wage equality. On skills and training, see Streeck (1992) and Acemoglu (e.g., Acemoglu 1998); and on labor market policy and inequality, see the recent OECD reports (e.g., OECD 2008, 2013).
at the heart of the theory, VoSC scholars also tend to insist that most of these developments do not undermine the core logic that separates CMEs from LMEs (Hall and Gingerich 2009). VoSC scholars are thus more likely to code observed changes as modifications or adjustments that do not undermine coordination and may in fact be necessary to stabilize it under new prevailing conditions. At some point, the debate typically devolves into a disagreement on whether the glass is half empty or half full, or sometimes simply into a dialogue of the deaf. As useful as the broad categories of LME and CME have been for other purposes, they present some impediments to exploring the dynamics of contemporary institutional changes as they are unfolding, especially – although by no means exclusively – in the CMEs. A core problem is that the debate as it is currently structured is not equipped with analytic categories that can capture relevant changes that, while not necessarily signaling a breakdown of coordination, do indeed involve some rather consequential shifts from more solidaristic to distinctly less egalitarian forms of coordination (Thelen and Kune 2006; Thelen 2009). To the extent that the changes taking place in many advanced industrial countries involve a combination of relatively stable coordination and declining solidarism, we must confront head on the possibility that a high level of employer organization – while quite possibly still a necessary condition for continued social solidarity within CMEs – is by no means sufficient to guarantee its perpetuation. In this case, models of change built up around a one-dimensional continuum that runs from coordinated to liberal are going to miss the most important changes in the current period.

Moreover, for all their differences, defenders of the VoSC perspective and their critics tend to agree on one central point: the best way to preserve egalitarian capitalism is through a vigorous defense of the institutions that have traditionally anchored coordinated capitalism. The empirical analysis presented in this book calls this bedrock conventional wisdom into question. An analysis of developments in the three political-economic institutions under examination here reveals that the successful defense of traditional arrangements has often been a recipe for institutional erosion and dualization, associated with dramatic increases in inequality. Conversely, it turns out that in these areas some varieties of liberalization are quite compatible with continued strong social solidarity and high levels of equality. In short, for the institutions under analysis in this volume, not every coordination-preserving move has solidarity-enhancing effects; and perhaps more counterintuitively still in the context of current debates, not every liberalizing move compromises social solidarity.

This book thus attempts to understand the types of political-economic institutions that support broadly egalitarian outcomes in the sense of a relatively equitable distribution of jobs and income and relatively high levels of economic security for the most vulnerable groups. While building on insights from the VoSC literature, I demonstrate what can be gained through two innovations that can advance our understanding of current trajectories of change and their likely implications. First, I argue that recent developments call for greater conceptual clarity to disentangle two phenomena that have come to be usefully conflated in contemporary debates, namely coordinated capitalism and egalitarian capitalism. Second, and based on the conceptual discussion, I propose a new framework that can take us beyond the usual dichotomy between coordinated and liberal market economies and allow us to distinguish among divergent trajectories of liberalization driven by very different political dynamics and associated with different distributional outcomes. Both these analytic moves flow from an understanding of institutional resilience and change that is explicitly linked to an analysis of the political coalitions on which economic institutions rest. Elsewhere I have argued that institutions do not survive long stretches of time by standing still or even through the faithful reproduction of the founding coalition on which they were originally premised (Thelen 2004). As the world around these institutions shifts, their survival depends on their active ongoing adaptation to the social, political, and market context in which they are embedded. Viewing contemporary developments through a political-coalitional lens, my analysis also explains why it is that the institutions of coordination that most faithfully reproduce the politics of the Golden Era of postwar capitalism of the 1950s and 1960s are sometimes the ones most vulnerable to institutional erosion and decay, while those that remain most robust are those whose forms and functions have been reconfigured under the auspices of support coalitions that are in some respects quite different from those of the past. The next sections lay out each of these points one by one.

VARIETIES OF CAPITALISM AND ITS CRITICS

Virtually all political economists agree that industrial relations, VET, and labor market policy are centrally important to defining distinct models of capitalism. However, there are huge disagreements over how to interpret the trends we observe in these three areas. In some cases, the dispute is mostly empirical, rooted in an emphasis on different variables or measures (for an extended discussion, see Thelen 2012). From some perspectives and by some measures, the traditional institutions of coordinated capitalism appear quite stable, whereas from other angles and by other measures, they are undergoing dramatic change. Take industrial relations institutions. Centralized bargaining arrangements in most CMEs have exhibited considerable durability in the face of new pressures over the past three decades, defying previous predictions that they would collapse in the face of an employer offensive (Kapstein 1996; Katz and Darbishire 1999; Martin and Ross 1999). Formal bargaining structures, and industry-level bargaining in particular, have instead proved remarkably resilient. However, collective bargaining coverage (i.e., the number of workers whose employment relations are governed by collective contracts negotiated at the industry level) has shrunk in many countries, and the contents of central contracts almost everywhere have become more flexible than before. In such cases,
formal-institutional stability in the level at which bargaining occurs may be masking significant change (Thelen 2009, 2010).

Disagreements between VoC proponents and their critics cannot necessarily be settled with more data or better measures, for it turns out that scholars on different sides of this debate are in fact often looking for change on wholly different dimensions (Höpner 2007). As mentioned earlier, the VoC literature usefully directed our attention to the importance of employer coordination as a core underlying feature distinguishing liberal from coordinated market economies. The key difference is whether employers are capable of strategic coordination among themselves and with labor in order to achieve joint gains through cooperation (CMEs) or not (LMEs) (Hall and Soskice 2001: 8). Following this lead, a good deal of the literature on stability and change has been organized around evaluating how well employers’ coordinating capacities are holding up. For example, based on a comprehensive statistical analysis of various aspects of coordination across the full range of advanced industrial democracies, Hall and Gingerich (2009) find that despite some changes, there remains a very pronounced gap between LMEs and CMEs.

VoC critics are unlikely to be impressed by this, not necessarily because they dispute the empirics but because they are not interested in employer coordination at all, but rather in distributional outcomes like income inequality and other measures of social solidarity. Liberalization theorists point to what they see as an all-out employer offensive against organized labor, expressed in a relentless, across-the-board drive for more flexibility, while a related critique mounted by dualization theorists locates the source of new inequalities in a hardening of the line between labor market insiders and outsiders – employed versus unemployed, or those in “standard” full-time jobs with benefits and those in various “atypical” employment relationships.

These differences in vantage point are obviously rooted in wholly different intellectual and disciplinary traditions. The VoC framework comes out of an economic perspective that is concerned primarily with the effects of institutions on economic efficiency, hence the focus on what (following Streeck) we can think of as the “Williamsonian” functions of institutions (i.e., institutions as mechanisms through which firms can achieve joint gains through cooperation). Skeptics often come out of a more sociological or political frame of reference, and are thus really assessing something else entirely – namely, the solidarity-enhancing effects of institutions, or their “Durkheimian” or “Polanyian” functions (i.e., institutions as mechanisms that promote social cohesion). Such differences can contribute to “glass half-empty, glass half-full” dis-encounters because it is possible for firms to benefit from continued coordination with each other over some issues and for some employees, even while the number of workers encompassed by these arrangements declines. In such cases, VoC

scholars will see continued relatively robust employer coordination while skeptics will stress the inequalities that result from declining coverage.

Figure 2.1. Trajectories of Change, Selected Countries, 1980s to Mid-Late 2000s

This is not to say that the data are uninformative. To the contrary, many of the main trends identified by VoC scholars are consistent with the patterns described in Figure 2.1. In particular, the main divergence in trajectories over the period is between the US and the UK (as well as Japan, which is included in the figure). These are essentially the two cases where the respective liberal and social democratic trajectories are most pronounced, and where the political tendency toward dualization is least visible.

1 I am indebted to Wolfgang Streeck (2009) for this distinction.

3 I am indebted to Martin Höpner (2007) for this depiction of the issue. In his own work, Höpner draws a different, though related, distinction between "distributive" and "regulatory" liberalization.

4 All data are courtesy of Duane Swank. Power of peak employer associations is based on the Golden-Wallerstein-Lange index (scores range from 0-4); labor-management coordination is based on an index devised by Kenworthy and Hicks; and wage coordination is based on Kenworthy’s five-point index that ranges from plant-level bargaining (1) to binding confederal-level bargaining (5).

5 All based on OECD data. See the appendix for specifics of the index.
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employer coordination, the y-axis captures issues of interest to VoC skeptics with respect to the encompassingness of these arrangements.

This picture – admittedly crude – makes it easier to see why VoC scholars and their detractors have such different views of stability and change. While Germany and Japan remain stable on the VoC dimension, this has not prevented them from moving strongly toward higher levels of dualization. By contrast, Sweden and Denmark managed to maintain high – even slightly increasing – levels of social solidarity (conceived in terms of coverage/compassion), despite some formal-institutional liberalization. For reasons to be explored in detail in chapter 5, the Dutch case stands out as moving against the grain and toward higher levels of social solidarity, at least for this period and by these measures.6

DISENTANGLING THE RELATIONSHIP BETWEEN COORDINATED AND EQUITARIAN CAPITALISM

The observations in the preceding section call into question conventional understandings of the relationship between coordinated capitalism and egalitarian capitalism. In fairness, the original VoC volume by Hall and Soskice (2001) was not designed to explain equality; instead, it sought to explain different patterns of economic specialization and associated institutional choices or complementarities. However, a good deal of subsequent work has conflated the phenomena of coordination in the VoC sense with egalitarian outcomes, a convention well captured in recent work that distinguishes between “corporate” (liberal) and “rudimentary” (coordinated) capitalism (Acemoglu et al. 2012). Empirically, these two phenomena – coordinated capitalism and egalitarian capitalism – seemed to coincide in what might in retrospect be thought of as the Golden Era of postwar capitalist development beginning in the 1950s. However, they are analytically distinct, and historically by no means accompanied one another. By most definitions, the German political economy could be seen as strongly coordinated beginning in the late nineteenth century, but as Hillerding (1910) and others clearly understood, this variety of capitalism could be associated with either progressive or deeply reactionary politics.

The debate as it has evolved, however, has mostly overlooked these issues and has therefore been played out in disagreements over how far liberalization has taken CMEs toward LME-type arrangements – thus effectively situating countries on a single continuum and reducing the question of change to movement along that continuum.7 For example, the landmark volume by Kitschelt et al. (1999a) distinguished three broad political-economic types in which coordination and equality seemed to be tightly connected. CMEs featuring institutions that provided for national-level coordination (what they called “national CMEs”) were associated with high scores on most measures of equality, while liberal countries scored the lowest. Cases of “sector-coordinated CMEs” (coordinated but not at an industry level) like Germany came out in between – not as egalitarian as Scandinavia but still more solidaristic than the Anglo-Saxon countries (see also Pontusson 2009a; Martin and Swank 2011).8

The template that scholars developed to sort and classify country cases in many ways resembled the old corporatism literature, which arrayed countries along a continuum based on their degree of corporatism – with the important difference that new employer coordination replaced labor organization and strength as the master variable (see Figure 1.2).

The dominant models of change in the literature then followed the logic implied by these conventional understandings. So when countries such as Denmark and Sweden experienced strains in peak-level collective bargaining and underwent a shift to industry-level bargaining in the 1980s, many observers coded this as signaling the convergence of the national CMEs on the industry coordination model. A synthetic concluding essay in the Kitschelt et al. (1999a) volume offered three “firm conclusions,” one of which was that “national and sectoral coordinated market economies are becoming more alike,” with “national CMEs” becoming more like “sectoral CMEs,” even if neither was converging on the liberal model (444, 451, 459, see also Pontusson 1997; Taussig 2001). This line of argument is represented in Figure 1.3.

More recently, the Nordic countries have regained their luster and, with that, their status as distinctly successful models of social solidarity and economic efficiency (Pontusson 2009; Martin and Swank 2012), now it is the industry-coordinated systems such as Germany that are often seen as fragile

4 As discussed in Chapter 5, many of the previous gains in the Netherlands have suffered serious erosion since the mid-2000s as a result of the austerity policies of the center-right government.

5 This continuum-based conceptualization of change is no doubt partly a function of the dichotomanous categories around which the VoC framework was organized. However, it is also a function

6 However, I hasten to add that in much of his other work Pontusson draws a stronger distinction [in kind, not in degree] between Continental and Scandinavian CMEs. He bases this distinction in part on persistent differences in long-term unemployment, a dimension on which Christian Democratic CMEs always performed worse than both the Scandinavian CMEs and liberal economies (Pontusson 2009a).
and changing in ways that take them toward the less egalitarian Anglo-Saxon model. This line of argument is depicted in Figure 1.4.

However, as closely connected as the notions of coordinated capitalism and egalitarian capitalism came to be in the Golden Era of postwar development (and by extension in the minds of many scholars), nothing in the broader historical record suggests that the two necessarily go together. The origins of many of the institutions that define the CMEs can be traced back to the early industrial period (Crouch 1995; Streck and Yamamura 2001; Thelen 2004; Iverson and Soskice 2009; Martin and Swank 2012), but clearly these institutions were not designed to promote equality. Their effects on social solidarity had, rather, to do with variation over time in the scope of employer coordination and the purposes to which these coordinating capacities were put.

Neither of these variables is solely a matter of institutions per se, but instead of the political coalitions on which these institutions rest—and this is something that can and does change over time. To give an example, coordinating capacities with respect to worker training in Germany were first established in the artisanal sector. What we could call their solidarity-enhancing side effects grew as the system expanded in scope, first to encompass the machine industry and later to be imposed as a national model to which virtually all youth had access. Conversely, as the reach of the coordinated training system in Germany began to shrink in the 1990s, the result was a rationing of apprenticeships within the still-coordinated system. Previously broad access to training had many solidarity-enhancing effects—above all, providing an avenue through which working-class youth could move into secure and well-paid jobs, especially in manufacturing. In the 2000s, however, increased rationing of access to training fueled new kinds of inequality because those who failed to land an apprenticeship were doubly disadvantaged in the labor market—shunted into distinctly second-class training and stigmatized as second-rate prospects for later employment (A. Kuper 2010; Thelen 2011; Busemeyer and Iversen 2012). The general point is that the extent to which the institutions that support employer coordination will have egalitarian side effects is partly a question of the scope or encompassingness of these institutions. This is an issue to which I have tried to draw attention with reference to what I call more segmentalist versus more solidaristic forms of coordination (Thelen 2004).

Beyond this, high capacity for coordination among employers has different consequences with respect to social solidarity depending on the functions to which this capacity is directed. Historically, employers in some of today’s most solidaristic countries originally organized not to cooperate with unions but to crush them (Kuo 2009; Paster 2009; Martin and Swank 2012). Too often, scholarship on the political economy of the rich democracies conflates employers’ capacity to coordinate among themselves with a willingness to cooperate with labor. However, cooperation does not flow naturally or automatically from the capacity for coordination, even if— as Hilferding (1910) again reminds us—a high level of employer organization can be extremely useful (maybe indispensable) for the political management of capitalism. The more general point is that the institutions for coordinated capitalism do not themselves dictate the uses to which they will be put; the latter is a question of politics and not institutions.

Opening up the analytic space to disentangle the complex (and non-linear) co-evolution of egalitarian capitalism and coordinated capitalism allows us to move beyond the current terms of the debate, which is mostly organized around the questions of whether employers will abandon the institutions of coordination and/or whether labor is sufficiently strong to resist liberalization—or alternatively, whether employer coordination is overall “good” or “bad” for social solidarity. It forces us to think harder about the coalitions and interests—who exactly is coordinating with whom, and to do what—and how differences in the answers to these questions drive variation in the trajectories of change in the rich democracies (see also Iverson and Soskice 2010).

**Varieties of Liberalization**

Together with Peter Hall, I have elsewhere argued that the term “liberalization” that is typically invoked in the literature may be too encompassing to be useful in assessing the meaning and significance of the myriad developments this term subsumes (Hall and Thelen 2009: 23–24). There is certainly a family resemblance between some aspects of the reforms associated with Danish flexicurity and some of the measures introduced by Prime Minister Margaret Thatcher in the UK in the 1980s, and both can reasonably be treated as cases of liberalization, broadly defined. However, it is not clear that the term then provides us with the kind of precise and discriminating analytic tool we need to grasp the rather different implications of different liberalizing moves.
Especially important for an analysis of political dynamics are the vast differences in the political-coalitional alignments that lie behind what many scholars subsume under the broad liberalization rubric. In some cases (e.g., the UK under Prime Minister Thatcher), liberalization is the result of battles in which interests cleaved largely along class lines (i.e., the familiar story of a neoliberal offensive that pits representatives of organized labor against employers). In other cases, (e.g., Germany) it can be the result of a cross-class coalition that unites rather than separates segments of labor and capital (Thelen and van Winthagen 2003; Thelen and Kune 2006). In still other cases, it rests on a coalition that includes both low- and high-skilled workers – including, crucially, white-collar salaried employees – albeit one that presides over the implementation of policies that are distinctly market-promoting (e.g., flexicurity). The broad headline of liberalization conflates these very different political dynamics.

The discussion above suggests a need to distinguish more carefully between different dimensions or aspects of liberalization. In this book, I evaluate developments in industrial relations, VET, and labor market policy in terms of trends in “coordination,” using the meaning attached to that term by VoC scholars (i.e., capturing the extent to which employers engage in strategic coordination) (Hall and Soskice 2001). Defined in VoC terms, “high” coordination is associated (in industrial relations) with centralized wage bargaining and associated wage compression, which (in education and training) encourages investments in industry- or firm-specific skills, which in turn supports and underwrites (in labor market policy) long job tenures and associated strong employment protection.

However, if we are interested in the distributive outcomes associated with these institutions, then we must of course also attend to issues of coverage, namely how encompassing are these arrangements? Do they cover a small core workforce, or are unions and/or the state able to impose similar obligations and conditions on firms that would otherwise choose not to participate? The latter are issues to which the critics of VoC have usefully drawn our attention, and the discussion in this book also attends to trends with respect to coverage as a separate dimension of variation.

Employers’ coordinating capacities and coverage do not necessarily co-vary. By distinguishing the two, we can identify three distinct ideal-typical trajectories of liberalization. These are depicted in Figure 1.5 and they correspond to (1) deregulatory liberalization, associated especially with LMEs like the United States; (2) dualizing liberalization, associated with conservative Christian Democratic countries such as Germany; and (3) embedded flexibilization, associated with Scandinavian Social Democratic countries such as Denmark.

By identifying the three different trajectories of change we recognize that liberalization can take many forms and occur under the auspices of different kinds of social coalitions – with important implications for distributive and other outcomes. Moreover, and as I will argue in more detail, these three trajectories of liberalization frequently proceed (again, ideal-typically) through different processes of institutional change: deregulation often through institutional displacement; dualization through institutional drift; and embedded flexibilization through institutional constriction (Streeck and Thelen 2005; Mahoney and Thelen 2009).

Deregulatory liberalization as I am using it here involves the active political dismantling of coordinating capacities (on one or both sides of the class divide) and declining coverage – and with that a marked individualization of risk (Hacker 2006). Deregulation is associated with change through displacement because in these cases institutions and mechanisms for collective labor regulation are explicitly set aside in favor of arrangements that re-impose the discipline of the market. Examples would include the demolition of systems of compulsory arbitration and court-based coordination in Australia and New Zealand (Kitschelt et al. 1999: 431–432) or, more recently, the rollback in collective bargaining rights of public-sector unions in Wisconsin. This kind of direct frontal assault on institutions supporting the collective regulation of labor relations is perhaps most often on display in LMEs, an association that is not wholly surprising since history suggests that where employers do not themselves possess stable coordinating capacities, they will press vigorously to weaken unions as well.11

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8 Largely but not entirely because some segments of business did not support Prime Minister Thatcher’s early moves against the unions, fearing the shop floor unrest this would generate.

9 I am grateful to colleagues at the Max Planck Institute in Cologne, and in particular Martin Höpner and Wolfgang Streeck, for emphasizing to me the importance of distinguishing different varieties of liberalization.

11 Examples include the open-shop movement in the United States or the campaign against shop steward controls in Britain (see Thelen 2004).
Dualization, by contrast, involves continued strong coordination on the employer side but in the context of a distinct narrowing in the number of firms and workers covered under the resulting arrangements. Unlike deregulatory liberalization, dualization does not involve a direct attack on traditional institutions. Indeed, these institutions often exhibit remarkable resiliency, even as an unorganized and unregulated periphery is allowed to grow outside their ambit, one that is characterized by inferior status and protections for firms and workers outside the core (see also Emmenegger et al. 2011). Dualization takes many forms—for example, maintaining strong employment protections for regular workers while the number of atypical or irregular workers grows, or defending traditional institutions for firms-based training even as the number of opportunities for landing an apprenticeship shrinks, or continued centralization of bargaining but covering fewer sectors and workers (to name a few manifestations).

Whereas deregulation involves a neoliberal offensive in which class cleavages dominate, dualization is often fueled by an intensification of cooperation between labor and management in core firms and industries to the extent that developments in the core leave other firms and workers behind or outside (Thelen and van Wijnbergen 2003; Rueda 2007). For example, such intensification of cooperation in some sectors has contributed to collective bargaining erosion and labor market dualization in Germany and France (Thelen and Kune 2006; Palier and Thelen 2010). The mode of change associated with this trajectory of change is also distinct. Unlike deregulation, which proceeds through outright institutional displacement, dualization often proceeds through a process of institutional "drift." In the current period, this is often seen as a process of so-called "flexibilization," in which institutions and practices that were developed for manufacturing fail to take hold outside the industrial core. For example, where membership in unions and employer associations is heavily concentrated in industry, collective bargaining institutions will erode "by themselves" as employment shifts to the service sector.

Embedded flexibilization, finally, involves the introduction of new forms of flexibility within the context of a continued strong and encompassing framework that collectivizes risk. The institutions and policies associated with this trajectory depart from the kind of market-suspending institutions long associated with strategic coordination à la VoC (e.g., the institutions that encourage long-term relations between firms and employees, or underwrite employees' investments in specific skills), and are instead often specifically organized around making workers more—not less—mobile. However, what distinguishes embedded flexibilization from sheer deregulation is that these moves are embedded in policies that promote what Baccaro and Locke (1998) once called

"supply side solidarity," collectivizing risk by focusing resources on enabling society's most vulnerable to get and keep a good job. Implementing such policies frequently involves a functional conversion of existing institutions—whether collective bargaining institutions or labor market institutions—to new goals, and one that is based on a significantly reconfigured social coalition (see also Levy 1999; Bonoli 2005).

Even the most casual reader will not have missed that the broad trajectories of liberalization I just mapped out correspond to Gosta Esping-Andersen's (1990) famous "three worlds" of welfare. A later section will address the connections behind the political-economic institutions featured in this study and the welfare arrangements so brilliantly analyzed by Esping-Andersen. At this point, however, it is appropriate to ask: What has the literature on VoC had to say about the relationship between these realms? With few exceptions, it sees political-economic and welfare-state arrangements as parallel and complementary. Most VoC scholars see social policy as part of the same set of mutually supportive institutions that define CMEs and that distinguish them from LMEs. To give one example, generous unemployment insurance in CMEs is seen as supporting investment in specific rather than general skills, whereas means-tested social policies in LMEs complement fluid labor markets (low employment protection) and promote investment in general rather than specific skills. In fact, exactly these connections explain why the conventional wisdom so clearly holds that maintaining high levels of equality requires protecting traditional political-economic (and not just welfare-state) institutions and why VoC scholars and their detractors alike view all liberalizing moves as compromising social solidarity.

I must emphasize this point where the framework I am proposing deviates most sharply from the conventional wisdom. Disentangling the question of employers' capacity for coordination lying at the heart of VoC scholarship on one hand from the issues of equality that are so central to the agenda of Esping-Andersen and other welfare-state scholars on the other allows us to see combinations that are difficult to analyze (even hard to conceive) within the context of traditional one-dimensional models of change in which coordination and social solidarity are tightly coupled, either implicitly or explicitly. Dualization, for example, involves declining equality but in the context of continued significant coordination for core firms and sectors in all three of the political-economic realms I examine—industrial relations, VET, and labor market policy. Embedded flexibilization, conversely, involves continued high levels of equality but in the context of developments across all three institutional arenas that can only be characterized as liberal in the sense of market-promoting—sometimes even radically so, since they are precisely not premised on protecting workers from
the market, but instead on actively adapting their skills to changing market conditions.

Generous social policy – and thus a strong welfare state – remains central to the new politics of social solidarity in the context of these changes. But the logic and the functions of social policy are quite different from the traditional model. Rather than serving the complementary (social-insurance) role the literature has traditionally assigned to them, the role of welfare policies increasingly revolves around re-embedding these liberalizing moves in measures that collectivize the resulting risks. I will have more to say about this in the conclusion.

In the meantime, Figure 1.6 provides an overview of cross-national variation (and change over time) on two dimensions that are particularly central to debates on contemporary changes in the political-economic institutions around which my study is organized: long-term unemployment (the most severe form of labor market exclusion) and involuntary part-time employment (as an indicator of the prevalence of “bad jobs”). The countries are clustered into three groups – LMEs, Nordic CMEs and Continental CMEs – plus Japan. The arrows display the average change in the specified indicator from the late 1970s to the late 2000s, and the vertical lines indicate the average value for the cluster in the most recent period.

What we see conforms broadly to the three trajectories of change sketched out above. Long-term unemployment in the Continental CMEs – though declining in the past decades – remains on average a good bit higher than in both the liberal and the Nordic countries. Moreover, the declines in long-term unemployment in Continental CMEs have been accompanied by increases – sometimes dramatic – in the number of “bad jobs” as measured by involuntary part-time employment. Figure 1.6 also adds nuance by revealing some interesting differences even within the usual country clusters. For example, among the Nordic CMEs, long-term unemployment is sharply down in Denmark (from very high levels) since the early 1980s, but it has grown slightly in Sweden to a level that is now above the Nordic average. Meanwhile, among the Christian Democratic CMEs, the Netherlands sharply reduced long-term unemployment, while the level in Germany (already above the Continental average) continued to increase. Finally, involuntary part-time employment in Germany and Italy has increased significantly while remaining more stable (and lower) in the Netherlands. Among the Nordic countries, involuntary part-time employment has declined somewhat in both Denmark and Sweden, though the level in Sweden is higher than in Denmark.

Much of the analysis in this book is devoted to examining trends in three countries that exemplify the broad and diverging patterns of change associated with each of the “families” of countries as identified by Esping-Andersen: the United States as an example of an LME, Germany as a classic Christian Democratic country, and Denmark as a Social Democratic political economy. However, complementary treatments of the Netherlands and Sweden provide additional insights into the political dynamics as they unfold in different countries within the same family. My analysis thus highlights core and enduring parallels between most similar cases such as Sweden and Denmark (and Germany and the Netherlands), but it also identifies important differences within
each pair in order to provide finer resolution on the interests and political alignments that are behind the broader cross-national patterns. The analysis sheds light, for example, on why a broad national bargain remains elusive in Swedish industrial relations, while Denmark has settled into a new and apparently quite stable pattern, or why the Netherlands departed in some ways from core features of the classic Christian Democratic mold while Germany’s manufacturing model thrives even as inequality grows. This leads me to a discussion of the politics of change.

EXPLAINING TRAJECTORIES OF CHANGE

How do we account for differences in the trajectories of change in the rich democracies? Elsewhere I have reviewed the literature on the advanced political economies in some detail (Thelen 2011), but a cursory look at existing scholarship reveals both penetrating insights and glaring gaps. In the following sections, I briefly reprise what I see as the core strengths and weaknesses of the most important perspectives in the literature — power resource theory, dualism theories, and theories of employer organization and macro-corporatism — before sketching out my own alternative explanation emphasizing producer group politics and the role of the state.

Power Resource Theory

One of the most prominent and powerful arguments attributes different trajectories of change to the strength of the organized labor movement. In the Golden Era of postwar growth, employers may have valued institutions like coordinated wage bargaining as an avenue for securing wage moderation in the context of full employment. However, higher unemployment since the 1970s makes these arrangements superfluous because firms can now rely on the discipline of the market to secure this outcome. As employers press against institutions they now perceive as rigid and confining, power resource theory holds that cross-national differences can be explained by labor’s capacity to resist.

In most versions of the argument, there are two facets to labor’s power resources — one is the organizational structure of labor unions (typically measured in union density), and the other is the relative power of labor’s political allies (typically measured in terms of the electoral strength of the Social Democratic Party and/or Left participation in cabinet government). Power resource theory provides a very compelling first cut explanation of significant and enduring cross-national differences, and yet it leaves many intriguing puzzles unanswered. For example, the Netherlands and Germany have moved on rather different paths since the 1980s, with the Netherlands embracing a variation of flexicurity and achieving significant employment growth, while Germany moved strongly in the direction of dualization in the context of higher unemployment and, increasingly, low-wage employment without social benefits. This is not a difference that is linked in any obvious way to labor’s power resources since both countries feature medium (and declining) unionization rates and dominant Christian Democratic parties. Moreover, as elaborated in Chapter 5, Sweden has struggled more with tendencies toward dualism (e.g., especially Davidson 2010) than Denmark despite stronger “power resources,” whether measured by unionization rates or left-wing dominance.

Secondly, power resource theories frequently involve the claim that globalization is what gives the employer offensive impetus, by empowering (mobile) capital against (nationally anchored) unions. But closer empirical scrutiny reveals a more complex picture. As mentioned, manufacturing employers — though most clearly impacted by globalization — are not always the ones most urgently calling for institutional reconfiguration. Consistent with VoC logic, these firms are often rather heavily invested in competitive strategies that rely on high-quality production, high skills, and peaceful labor relations, and they continue to be more invested in traditional institutions than, say, employers in lower-wage, lower-skill service sectors. The counter-hypothesis (explored in this book) is therefore that where traditional manufacturing interests dominate the interest associations, the trend is likely toward dualization rather than across-the-board deregulation (see also Palier and Thelen 2010).

Dualism Theories

The idea that employer preferences may be less obvious (and less uniform) than commonly assumed finds a corollary on the labor side in an alternative explanation of the trends documented in the previous section. David Rueda (2007) flips the power resource theory on its head by suggesting that powerful Social Democratic parties allied with strong labor movements may well promote rather than inhibit inequality. Drawing on early labor market segmentation theories, Rueda argues that contemporary market trends have heightened conflicts between labor market “insiders” (i.e., core workers who have jobs and who are intent on preserving their relatively privileged position within the labor market) and labor market “outsiders” (i.e., those who either do not have jobs or are in more precarious forms of employment and thus do not enjoy the same package of wages and benefits as insiders).34 As egalitarian as their

34 Rueda’s claims in some ways reprise arguments made by mainstream economists in the 1980s to explain pervasive involuntary unemployment in some countries with reference to the effects of unions in increasing turnover costs — for instance, costs associated with hiring (searching, advertising, etc.), firing (including severance pay and costs of legally mandated protections), and training — in ways that benefit the currently employed labor market insiders but render the labor market less permeable to outsiders (e.g., especially Lindbeck and Snower 1988). But in other ways, his arguments also bear a family resemblance to the segmentation theories of...
Varieties of Liberalization and the New Politics of Social Solidarity

and Swank (2004, 2012) suggest that centralized business associations and national-level tripartite bargaining produce higher levels of social solidarity by facilitating compromise among groups with divergent economic interests, among other things by "transform[ing] employers' preferences" in ways that inspire "greater attention and commitment to collective goals than are found among less organized employers" (2004: 592–593). Emphasizing the political construction of preferences, they note that employers "develop their policy interests in packs" and that national-level employer associations can "facilitate regular meetings with government and labor leaders and expose members to ideas about the benefits of social policies for productivity growth and labor market stability" (2012: 1–2). Through such associations, employers not only come to prefer, but also to act collectively in support of broad social goals.¹⁷

Cooperation theorists past and present can point to compelling evidence of a strong association between tripartitism and social solidarity, so something is clearly going on here. It is a measure of the staying power of corporatism theory that an entire generation of political economists has committed to memory the names of obscure villages in small European countries where important pacts were concluded. However, there seems to be significant variation over time in how and how well tripartitism works. Denmark and Sweden have both experienced spells of serious economic distress and intense distributional conflict, and the 1970s and 1980s were particularly tumultuous.¹⁸ Both countries experienced very significant neoliberal interludes in which "bourgeois" governments (or in some cases Social Democrat finance ministers with neoliberal leanings) introduced policies that represented a sharp break with the traditional model. Now that the policies have re-stabilized and the economies have rebounded, it is easy to forget that twenty years ago some very astute observers were depicting Scandinavian Social Democracy as being "in disarray," and warning their colleagues at the observation that "the major social democratic parties are rapidly...embracing market liberalism" (Moene and Wallerstein 1993: 385, 388).

Similar observations could be made for other (non-Scandinavian) countries that feature strong tripartitism. Some have been quick to attribute the Dutch

Theories of Employer Organization and Macro-Corporatism

Another body of work calls attention to the organization of business and the presence or absence of corporatist channels of interest intermediation. Martin


¹⁵ Rueda cites two conditions that could prompt Social Democrats to promote outsider-friendly policies. One is when insiders are themselves threatened with outsider status (e.g., through unemployment). The other has to do with the existence of corporatist channels of interest intermediation, which could soften union defense of insiders and force them — and, by extension, Social Democrats — to take the interests of outsiders into account. On the latter, however, Rueda's evidence is ambiguous.

¹⁶ Rueda reports an observed difference in preferences on active labor market policies between insider and outsider voters of only about two percentage points — 42% of insiders and 44% of outsiders express willingness to pay more taxes to stimulate employment. The difference between the two groups is smaller still (about one percentage point) when it comes to passive labor market policies, with just over 30% of insiders and just over 31% of outsiders disagreeing that the welfare state costs too much. Among the three measures that Rueda offers, the biggest difference is in employment projections, but here too we are talking about a gap of only 5 percentage points (58% vs. 63%) agreeing with the statement that job security is very important.

¹⁷ There is some ambiguity in Martin and Swank's (2012) account about whether it is the business organization or tripartite corporatist bargaining that is more important for the outcomes they seek to explain — and in practice, of course, the two are almost impossible to disentangle because strong business organizations is a prerequisite for tripartite bargaining. Thus, while the first part of the book explores the origins of business associations, the second part tends to emphasize corporatist bargaining in explaining contemporary outcomes.

¹⁸ Lindberg and Petersen (2012) note that Denmark in the 1960s and 1970s was characterized by severe conflicts — not just between employers and unions and between the center-right government and the labor movement, but also within the Social Democratic Party itself (§5). In Sweden, the reforms of the 1990s also generated tremendous conflict between organized labor and employers, as well as "great internal convulsions" in the Social Democratic Party (2012: 9).
employee "miracle" (sharply reduced unemployment and even significant employment growth) to the famous Wassenaar Accord of 1982. However, such accounts tend to downplay the fact that many of the problems that plagued the Netherlands in the 1970s (debilitating inflation through wage indexation) and 1980s (skyrocketing labor costs through promiscuous use of disability pay to ease downsizing) can also be traced to the impact of policies coming out of corporatist bargaining processes.

The strong emphasis on employer organization and bargaining structure in the macro-corporatism literature tends to obscure the political maneuvering and conflicts that animate, complicate, and sometimes derail peak bargaining even in the most corporatist countries. In so doing, these accounts sometimes gloss over the political conflicts that have been played out inside these associations and negotiating structures, and thus miss the massive changes that have transpired in the form and content of corporatist bargaining. In 1993, Swedish employers abruptly withdrew from centralized bargaining and dismantled their peak association's wage bargaining unit in a move that was precisely designed to render continued corporatist bargaining impossible (Kjellberg 1998: 93). Organized employers in Sweden are currently doing everything in their power to marginalize the peak labor confederation Landsorganisationen (LO) and prevent any national-level centralization. Such observations seem to be at odds with the logic of corporatism theories that emphasize capitalists' willingness and capacity to learn through negotiation and consultation, and to embrace tripartism and the policies it generates to serve broader societal interests. The fact is that many of the most famous (and famously successful) corporatist bargains were shotgun weddings forged in the shadow of hierarchy (Scharpf 1997; van Winbergen 2002; see also Baccaro and Howell 2011: 39).

Producer Group Coalitions and the Role of the State

This point has not been lost on second-generation corporatism theorists, and some authors—including myself in joint work with Cathie Jo Martin—therefore embrace a somewhat different though complementary argument about state capacity in the tradition of Skocpol (1985) (see, e.g., Martin and Thelen 2007). What is foregrounded now is the capacity of the state to cajole and coerce private-sector actors into agreement (or at least compliance) at key junctures. In these versions, the idea that capitalists can be persuaded to act in their enlightened (long-term) self-interest is supplemented or even replaced with the idea that solidarism has to be imposed on resistant employers by powerful state actors.

State capacity and state power clearly matter. What we know from the historical record is that state power was frequently crucial in explaining the origins of many of the institutions of coordinated capitalism, not least in the way that interventions by state actors facilitated employers overcoming their own collective action problems (Crouch 1993; Thelen 2004; Martin and Swank 2011). State capacity also matters today. To continue with the examples in the previous sections, as in some Scandinavian countries (and unlike in Germany), the Dutch state possessed some very strong tools with which to elicit compliance from reluctant employers and for that matter reluctant unions as well. The most important tool in the arsenal was the ability of the government to intervene directly in wage bargaining and impose settlements if the social partners could not come to agreement. This was a power that was repeatedly invoked throughout the 1970s, and it continued to play a decisive role in crucial peak-level bargains well into the 1980s. It is a tool that is utterly lacking in Germany, where collective bargaining autonomy is officially enshrined in the constitution, and this clearly contributed to the failure of tripartite bargaining in that country (Streeck 2005).

Of course, strength is an inherently relational concept so in order to make sense of divergent trajectories of change in the three political-economic arenas of concern here, what we really need to know is: Strong in relation to whom? My short answer to that—and this is really the blunt core of the alternative political-coalitional argument to be laid out in more detail—is "strong relative to manufacturing interests" (see also Palier and Thelen 2010). In a context in which employment in manufacturing is now below 20 percent in all the rich countries, the strong and resilient cross-class coalition in manufacturing that was so central to the politics of coordination in the Golden Era is no longer able (labor) or willing (employers) to defend traditional institutions—in industrial relations, in VET, and in many aspects of labor market policy—on an economy-wide basis (Martin and Thelen 2007). Where such coalitions continue to dominate the relevant interest associations, they have certainly proved capable of heading off full liberalization and of defending—for themselves—the arrangements long associated with coordinated capitalism. In the process, though, they often indirectly or even directly promote dualism (Palier and Thelen 2010). Alternatively, where manufacturing interests are tightly imbricated in more encompassing organizations, liberalization may in fact proceed further in these three political-economic realms, but under the auspices of a broad alliance of interests organized around socializing the accompanying risks.

My analysis of trends in industrial relations, vocational training, and labor market policy points to the importance of two variables in particular that affect the way manufacturing interests are connected to the interests of firms and workers in other parts of the economy. The first of these variables concerns the level of inclusiveness of interest associations. In the Scandinavian countries, union presence and employer organization are broad and encompassing, so that association membership on both sides of the class divide includes a very diverse set of actors. In many Continental political economies, by contrast, membership in organized interest associations is heavily concentrated in manufacturing. The second of these variables concerns variation in state capacity. As the discussion in the previous section showed, what often distinguishes cases
Varieties of Liberalization and the New Politics of Social Solidarity

TABLE 1.1. Factors Influencing Divergent Trajectories of Change

<table>
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<th>State Capacity</th>
<th>More Encompassing</th>
<th>Less Encompassing</th>
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<tr>
<td>stronger</td>
<td>Denmark</td>
<td>Netherlands</td>
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<td>weaker</td>
<td>Sweden</td>
<td>Germany</td>
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of "successful" from "failed" tripartite bargaining is the power of the state to actively broker — with carrots and where necessary sticks — encompassing deals that overcome both internal divisions within the relevant interest associations (unions and employer associations alike) as well as between the two. These two factors — the scope of interest associations and state power — vary independently of one another. For example, despite higher organization among labor and employers in Sweden, the Danish state actually has far more tools at its disposal than the Swedish state does to broker encompassing deals. And while the Netherlands and Germany both share much lower levels of encompassingness, the Dutch state commands more power to force the hand of the social partners than the German state, where employer coordination rests more squarely on voluntarism (Streeck 2005).

Putting the two factors together produces four broad scenarios, captured in Table 1.1. The best case scenario is that in which organized interests are broad and encompassing and the state possesses strong tools to broker and underwrite agreements that reconcile the interests of diverse constituencies within and between these associations (upper left). The worst case scenario — leading to dualism — is that in which manufacturing interests dominate the relevant interest associations and where the state has limited capacity to force more encompassing deals (lower right). One intermediate scenario features broad and encompassing interest associations, but a state with limited capacity to broker deals (lower left). In such instances (e.g., Sweden), manufacturing interests are often still powerful veto players even if they cannot dictate outcomes in other sectors. A second intermediate case is one in which traditional (blue-collar, male) industrial interests continue to dominate interest associations, but the state possesses tools to force the hand of the social partners (upper right). In such instances (e.g., the Netherlands) significant redistributive change is possible, but this outcome rests very heavily on the willingness of the state to sponsor and underwrite the policies needed to re-embed markets after liberalization.

THE NEW POLITICS OF SOCIAL SOLIDARITY

The following sections unpack the logic of the stylized argument as presented in the previous sections. I organize the discussion into two parts, first, addressing changes in interests, and second, in the resulting political and coalitional dynamics.

Beyond Varieties of Capitalism I: The Question of Interests

The question of interests lies at the core of any political explanation. As noted above, the Veblen framework posited that coordinated capitalism was held together by a confluence of interests between labor and capital with respect to key institutions and practices. Of particular importance to the outcomes of interest here, organized employers and unions were seen to be jointly invested in (1) centralized and highly coordinated rather than decentralized, uncoordinated collective bargaining; (2) education and training systems promoting specific rather than general skills; and (3) strong employment protections rather than fluid labor markets. It may seem obvious why unions support these arrangements, but recall the key claim that they are stable because employers also support them, albeit for their own, possibly quite different reasons.

The evidence presented in the following chapters provides significant support for these claims — but only for a subset of actors and organized interests centering primarily, though not exclusively, on manufacturing. Understanding the new politics of social solidarity requires as a first step acknowledging the profound shift in the political-economic landscape over the past three decades. Manufacturing lay at the heart of the political economies of all the rich democracies in the 1950s and 1960s. This was the engine of growth and jobs in industry accounted for between a third and half of total employment for the period between 1960 and 1973 (OECD 1999). The dominance of industry was shaken in the oil shocks of the 1970s, and while manufacturing rebounded subsequently in many (though not all) of these countries, employment in the sector never bounced back. It is not that manufacturing did not remain important for many of these economies; it clearly did, although the extent to which this is true varies. But what matters for the politics is that everywhere employment in industry has dropped steadily over time to currently between 10 and 20 percent.48

The shift in employment to services — including, of course, services to industry itself — has upset previous political dynamics because both firms and workers in these emerging sectors have interests that are very different from their counterparts in traditional manufacturing. On the employer side, I find that service sector firms do not support traditional arrangements and have in fact pushed

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48 The exceptions are countries that continued to employ very large numbers (greater than 50%) in agriculture — namely Greece, Ireland, and Turkey (with Spain and Portugal not far behind). Japan and the United States were on the low end for industrial employment, at 34.4% and 34.7% respectively. Germany, Luxembourg, Belgium, and Austria were at the high end, all with over 40% employed in industry (Germany at 47.8%).

49 In the UK, the decline in manufacturing employment set in earlier, in 1961 (see the figures in Rodderyy 1993: 790).
relentlessly in most countries for more wage differentiation and more flexible labor markets. Clearly a part of this is simply an effort to reduce costs, but beyond this, labor mobility and wage differentiation play a more prominent and sometimes positive role in emerging service sectors. Whereas traditional manufacturing thrives on high employment stability (allowing firms and workers to amortize their co-investment in firm- or industry-specific skills), in high-end services labor mobility promotes skill acquisition by providing incentive and opportunity for workers to enhance their human capital (Becker 1993: 34). This observation is consistent with the original VoC logic (Hall and Soskice 2001), and it explains why many CMEs in the past have experienced skill shortages at the high end (e.g., Smith 2000; Thelen 2004; chapter 13; Daley and Kalish 2012).

Related to this, service-sector firms thrive on general rather than specific skills. This is particularly true at the high end for occupations like software engineering that involve very portable skills. But in low-skill sectors like the retail and hospitality industries as well, a high-quality public school system providing foundational general education and training may in some ways be better equipped than traditional apprenticeship to generate the kind of social and communication skills that employers seek (see especially Iversen and Stephens 2008a). In light of such differences, it is no surprise that the most pressing calls for a reconfiguration of traditional political-economic institutions—industrial relations institutions, educational institutions, and labor market institutions—have emanated from organized employers in the service sectors.

On the labor side, the shift to services has also brought new interests to the fore, including constituencies that we know were never well served by arrangements suited to male blue-collar workers in the era of manufacturing dominance (Klausen 1990: 261). The growing number of working women, for example, may benefit from some forms of liberalization, since existing evidence suggests that they do not do well under many of the arrangements traditionally associated with coordinated capitalism. Iversen and Rosenbluth (2012), among others, have noted the great paradox that “labor market protections and solidaristic wage policies, although designed to safeguard society’s weak, can have the effect of disadvantaging women” (507). Recent work by Nelson and Stephens (2012) demonstrates that strong employment protections and generous long-term unemployment replacement rates suppress women’s employment (161). Such arrangements—traditionally so central to supporting investment in specific skills in manufacturing—put women at a disadvantage because employers anticipate having to bear the costs associated with interruptions for maternity leaves (Estevez-Abe 2006). As long as social protections are strong, more fluid labor markets may in some respects be more congenial for women, whose employment records are more likely to be interrupted for family reasons.

With respect to skill regimes as well, research has shown that women are distinctly disadvantaged in countries featuring traditional firm-based apprenticeship and do better in school-based training emphasizing general skills

Varieties of Liberalization and the New Politics of Social Solidarity (J. Martin 1998: 16; Estevez-Abe et al. 2001; Estevez-Abe 2006). Here again, the possibility of career interruption due to motherhood makes employers reluctant to invest in training women in firm- or industry-specific skills (Iversen and Rosenbluth 2012: 368). Moreover, beyond the question of access to training, more general skills afford women greater flexibility and penalize career interruptions less (Estevez-Abe et al. 2001: 150–151, 155; Estevez-Abe 2006). Women thus stand to benefit disproportionally from institutional reforms that support school-based education and training in more general (portable) skills (Estevez-Abe 2006), and in fact they often outperform men in such settings (Baetge et al. 2007).

Many of these arguments apply equally well to the growing number of salaried employees, professionals, and semi-professionals who see themselves as benefitting from at least some aspects of liberalization. For example, care in Scandinavia eagerly embraced liberalization in collective bargaining because centralization and wage compression had been holding their increases back. Moreover, salaried employees will often welcome forms of liberalization that enhance consumer choice. Esping-Andersen (1985) pointed out nearly thirty years ago that as the composition of employment in the economy as a whole shifts in response to economic trends, white-collar groups may prove crucial to the survival of egalitarian capitalism. My analysis affirms Esping-Andersen’s original insight about the importance of white-collar constituencies, while also showing that these groups are often not particularly invested in some of the institutions traditionally associated with coordinated capitalism. It is not that they face no risks in the labor market; it is just that existing arrangements fail to cover the very different risks those groups face, which may include isolation such as insufficient social security coverage as a result of less continuous career paths, or the need to reconcile work and family (Bonoli 2006). As Silja Häusermann’s work in particular has emphasized, well-educated socio-cultural elites (professionals, semi-professionals, and high-skill employees in services) are in many cases core constituencies of Social Democracy and defend a universal welfare state even if they embrace a different variety of universalism in the labor market—one that emphasizes individual development, integration, meritocracy, and gender equality (e.g., Häusermann and Kriesi forthcoming: esp. 28–29).

Finally, less-skilled workers generally also face a host of new risks that are not necessarily well addressed by traditional institutions. Such workers clearly benefited in the past from arrangements such as centralized collective bargaining and associated wage compression. However, skill-biased technological change and the transition to services create new trade-offs that pit wage equalization against full employment (Iversen and Wren 1998). Less-skilled workers are the ones most likely to bear the brunt of such trade-offs—either through

62 Unless, of course, reforms introduced under the consumer choice banner aim to inject forms of market competition that threaten a profession’s organizational monopoly or integrity, in which case professionals will oppose it (Saloner 2012).
unemployment or through low-wage work in dead-end jobs. Given that these groups are the ones most exposed to rapid shifts in labor market conditions, they may not be well served by traditional arrangements organized around the assumption of stable career trajectories, such as training systems that involve heavy upfront investments in particular (industry or occupational) skills. For them, training regimes that are organized around more general (especially basic cognitive) skills, and especially those that provide multiple entry points to allow individuals to acquire new skills flexibly and over the life course may be more suited to helping them manage the uncertainties they face in the labor market.

In short, the transition to a post-industrial employment structure brings to the fore new constellations that face different risks. How these new risks are articulated and addressed – also in relation to those of other groups – is crucial to the new politics of solidarity. Clearly the old sources of insecurity (unemployment, loss of benefits) remain important, but alongside these there are a host of new issues as well, including single parenthood, skill obsolescence in a period of rapid technological change, less continuous career paths, and the need to reconcile work and family in a context in which women no longer stay at home (see especially Bonoli 2005; Morel et al. 2011). Institutions that protected well against the risks of the 1950s do not unproblematically continue to cover risks that have shifted considerably since that time (Hacker 2006).

The crux of the debate between VoC and its critics discussed in the preceding sections really boils down to the issue of interests. VoC scholars operate on the (often unspoken) assumption that the interests of traditional manufacturing are shared by all employers, and they are therefore forced to ignore a great deal of evidence that in fact employers in CMEs (especially but not exclusively outside manufacturing) have notably not defended traditional institutions, but indeed vigorously promoted changes in them. For their part, however, VoC critics sometimes overlook evidence of continued support for these arrangements within the (still important) manufacturing core, and operate on the equally shaky assumption that traditional institutions meet the interests of (and cover the relevant risks faced by) all workers. In the end, both perspectives are deeply infused with a map of interests that reflects a distinctly industrial logic. And this is why, even though they disagree on so many other things, scholars in these two camps often converge on the idea that the interests of social solidarity are best served through a spirited defense of traditional institutions.

This is the received wisdom that the present analysis challenges. It shows on the one hand that the faithful reproduction of traditional arrangements can in fact promote institutional erosion and increased inequality through dualization, and it demonstrates on the other hand that some forms of liberalization can actually shore up social solidarity by addressing the interests of emerging constellations that were under-represented in the era of manufacturing dominance. This leads me to a discussion of the political dynamics.

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Beyond Varieties of Capitalism II: Political Dynamics and Coalitions

Many of the political choices in the 1950s and 1960s that were so important in shaping welfare regimes (Esping-Andersen 1999) have also had downstream implications for the politics surrounding current changes in the political-economic institutions at the center of the present study. Above all, developments at that time powerfully influenced the political and organizational resources that all of the relevant actors – organized labor, business, and the state itself – can bring to bear in the current period. For example, and as is widely known, in Social Democratic countries, the modal response to labor market shortages in the 1960s was to mobilize women, whose entry into the labor market in turn fueled demand for an expansion of public services to support female employment. The shift away from household-based (unpaid) caregiving created demand for a wide range of services, thus drawing even more women into the labor market and in particular into the rapidly growing public sector (Huber and Stephens 2000: 327; see also Ponsot 2000). As a result of these developments, a large and well-organized public sector came to form a very important second pillar within the union movement, producing a significant counterweight to manufacturing.38 Women now constitute a majority of the organized labor movement in most of these countries.39

In Christian Democratic countries, by contrast, the response to labor market shortages in the 1960s was very different. These countries frequently turned to state-sponsored guest worker programs to cover labor market shortages. Women, meanwhile, stayed home in large numbers and continued to support a traditional male breadwinner model through their role as crucial providers of unpaid caregiving services (Orloff 1993). That meant that the public and service sectors remained smaller, which in turn allowed manufacturing interests to continue to dominate producer group politics. In these countries, the structure of union membership often continues to reflect the employment patterns of the 1950s and 1960s – heavily concentrated among male blue-collar workers in manufacturing and weak in services (Hassel 2011). When women did enter the labor force in larger numbers, typically in the 1980s and 1990s, the context had shifted completely to one of high unemployment rather than labor

38 In previous work with Cathie Jo Martin (Martin and Thelen 2007), we observed a strong correlation between the size of the public sector and solidaristic outcomes (a finding that is elaborated in more detail in Martin and Swank 2010).

39 On the electoral impact of the different patterns sketched out here, see especially Huber and Stephens (2000).

40 Despite the presumption that these would be limited to women, foreign workers often stayed on. In many cases, manufacturing unions went to great lengths to incorporate them into the organized labor movement in an effort to forestall downward pressure on wages once markets tightened up. Where this succeeded, first- and even second-generation immigrants often came to be either well integrated into industry (as reflected, for example, in unionization rates) even if they usually remained poorly integrated in society (Fahelp, n.d.; Lacry 2008; Altrock 2001: 138).
shortages. Women in Christian Democratic countries were therefore more likely to enter as secondary earners looking to supplement family income in a period of heightened economic insecurity.65

Drawing together the ways in which previous political settlements interact with changing interests today, we can make out three broad political-coalitional patterns that correspond to the three trajectories of liberalization laid out above.

In the case of liberal economies like the United States, no stable accommodation had been reached within manufacturing between employers and organized labor even in the Golden Era of postwar growth. Here the decline of manufacturing set in motion a pattern of deregulation. Organized labor's strength—initially formidable in the industrial core—rested on tight labor markets and sometimes state support. But absent complementary institutional arrangements to sustain the kind of high skill, high-value-added manufacturing that could survive in the more turbulent markets of the 1970s, economic downturn sparked ferocious conflict within manufacturing. This is consistent with the original VoC logic (Hall and Soskice 2001; Thelen 2001). The transition to services then took place under the auspices of a coalition between employers in declining and emerging sectors based on a broad neoliberal project, and was accompanied by a marked turn toward the individualization of risk. In these cases, deregulation in the three institutional arenas examined here contributed to striking increases in levels of inequality.

A second pattern—dualization—has prevailed in those CMEs where organized interests and producer group politics continue to be dominated by a strong and often still-competitive manufacturing sector. The paradigmatic cases here are Germany and Japan. The VoC logic substitutes active engagement for passive state "repair, not repair" in the language of its advocates (Moore et al. 2011: 554). While a high degree of employer organization is helpful for the reasons that Hillerding identified, it is by no means sufficient. Instead, as power resource theory suggests, what is crucial is unity and coordination on the labor side, along with the active support of the state to underwrite policies that collectivize risk (Huber and Stephens 2005; Rehm et al. 2012; Hacker 2013). Moreover, and as Chapter 5 on the Netherlands and Sweden demonstrates in particular, because the arrangements associated with embedded flexibilization often rest on "ambiguous agreements" among actors with different and sometimes contradictory interests (Palier 2005: 127, 128), embarking on this

65 Standard and Rosecrans (2010) show that where traditional family structures persisted longer, women are politically conservative and oppose policies that are likely to raise taxes on male insiders (142; see also Barrows 2012).

66 Thanks to Martin Hopper for emphasizing this to me.
path requires a rather significant reconfiguration of institutions and policies to "upset inherited coalitional patterns and stimulate the emergence of new vested interests and political alliances" (Parashnik 2008: 3-4). Where they are durable, the resulting arrangements institutionalize what Alquist and Levi (2013) call a "community of fate" that reconciles the interests of Social Democracy's traditional blue-collar core with the interests of new constituencies including, notably, women and service employees (Huber and Stephens 2005; Pontusson 2009; Iversen and Rosenbluth 2010; Martin and Swank 2012).

OUTLINE OF THE CHAPTERS TO FOLLOW

The next three chapters explore the propositions laid out above through an analysis of the politics of institutional stability and change in three of the central institutional arenas to which the VoC literature has drawn our attention, namely industrial relations (Chapter 2), vocational education and training (Chapter 3), and labor market policy (Chapter 4). In each area, I compare developments in a classic LME (the United States) and two important CMEs that have traversed rather different paths since the 1980s (Germany and Denmark). These chapters examine the political dynamics and political outcomes that distinguish the three trajectories of change identified in this chapter. Chapter 5 extends and elaborates the argument through an examination of two further cases, the Netherlands and Sweden. The Dutch case gives us an illuminating contrast to Germany, as the Netherlands is a Christian Democratic country that deviated somewhat from the usual Continental pattern to embrace a version of flexicurity sharing some broad similarities with Scandinavia. Sweden provides a useful foil for Denmark, because it gives us an instance of macro-corporatism (including powerful and encompassing unions and well-organized employers) that has been plagued with dualist tendencies that bear some resemblance to the dominant pattern in the Continental cases. Chapter 6 concludes and draws out the implications of my analysis for the study of advanced capitalism and for the politics of social solidarity in the contemporary period more generally.

2

Industrial Relations Institutions

We can begin the analysis of divergent trajectories of change with an examination of developments over the past two decades in industrial relations. This is an area in which scholars who are focusing on different measures often reach wildly different conclusions concerning the relative stability of traditional arrangements (see Thelen 2012). VoC scholars expect stability, at least in CMEs. They argue that even though employers in liberal market economies may well seek deregulation, those in CMEs will continue to support traditional arrangements because their competitive strategies rely on a high degree of labor cooperation, wage moderation, and peaceful plant relations— all elements that the institutions and practices associated with coordinated bargaining safeguard and protect.

VoC critics, by contrast, maintain that employers in CMEs are no more supportive of these arrangements — or for that matter of unions — than their counterparts in the Anglo-Saxon world, and in fact seek at all turns to escape from the regulatory constraints imposed on them by organized labor and the state. VoC critics maintain that globalization has tilted the balance of power against labor, emboldening and empowering firms to increase flexibility and lower costs (Kapstein 1996; Katz and Darbishire 1999; Martin and Ross 1999). The direction of change is the same cross-nationally—neoliberalism — and any observed variation in the pace of institutional change is for them a matter of successful labor defense, not divergent employer preferences.

We can begin to assess these arguments in light of several key indicators of stability and change in industrial relations. Tables 2.1 and 2.2 record change within countries in the period from 1970 to 2010 with reference to two common indicators, the level of collective bargaining and the degree of bargaining coordination.1 What we see by either measure is evidence of significant formal

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1 All four of the tables below are based on data assembled by Jelle Visser. I exclude Ireland and New Zealand, for which Visser does not have data on all four of the measures considered.