Changes in Developed Countries' Economic Systems Since the 1980s and Implications for Developing Countries

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Abstract

This paper reviews recent changes in institutional arrangements amongst developed countries, and assesses how far these can be explained in terms of recent theories of varieties of capitalism. It draws upon the author's recent work which tracks changes over the past 25 years in key institutional arrangements amongst developed economies. The account in this paper points to limitations in the current varieties of capitalism approaches in explaining recent patterns of institutional changes and sketches possible bases for enhancing the approach. Comparisons are made with economic systems in developing countries, particularly in Latin America.

Keywords: Varieties of capitalism, institutional change, globalization

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1. Introduction[1]

Institutions underpin the operation of national economies. These differ significantly between countries reflecting varying historical paths, policy choices and national cultures. Moreover, they need to be understood systemically as an ensemble of relations between their component parts: financial systems, corporate governance, industrial relations, patterns of state intervention, etc have evolved together so that their operation and effects tend to reinforce each other. Different countries faced by common exogenous changes will tend to evolve along different lines rather than converge; path dependence and institutional lock-in provide powerful tendencies towards persistence. National institutions matter: they significantly affect economic performance and distribution.

Until relatively recently such propositions would probably have marked their proponents out as avowedly institutionalist; indeed Hodgson (1999: esp. ch. 6) explicitly contrasts this approach with the universalism of other, particularly neo-classical economics and Marxist, approaches. Whilst there were clear differences between 'new' and 'old' institutionalist schools these can be over-stated and empirical examinations of longer term economic performance by scholars from both traditions typically invoke a similar set of variables with similar predicted impact (e.g., Hodgson 1996; Rutherford 1994). From either a 'new' or 'old' perspective, institutional arrangements are expected to be enduring. We would expect to see a diversity of institutional arrangements across national economies and would not necessarily predict convergence either in response to common exogenous developments or differences in performance. More recently, though, mainstream economics appears to have undergone a rapid transformation in its approach to institutions, having shifted from ignoring them to incorporating them once suitable proxies can be found for empirical testing and now moving towards a position of institutional determinism. Some of this work amounts to an application of the Coase theorem – usually downplaying consideration of whether the necessary conditions hold in practice – viewing institutions as more-or-less efficient adaptations to local conditions and traditions. Thus, institutions – or some institutions at least - are now regarded as necessary complements to the efficient operation of markets (e.g. World Bank 2002). In recent work, though, institutional structures are not merely asserted to have a decisive impact on economic performance but are determined by factors lying long in a country's past leading to very strong persistence. A recent analysis by World Bank associated economists of the admittedly extreme case of mineral exporters (and no doubt in the shadow of attempts to impose new institutional structures in Iraq) ends up not with the customary policy advice but effectively concluding that, given the institutional inheritance of many of these economies, that there is little that could be done at least in the short term to affect their performance significantly (Isham *et al.* 2005). As mainstream economics appears to have rapidly made a transition from institutional blindness to institutional determinism this highlights the more general point that our tools for understanding institutional differentiation and persistence are more developed than those for explaining institutional change.

This paper follows from earlier collaborative work tracking institutional change amongst developed economies since the 1980s (Perraton and Clift 2004) and work on a transformationalist approach to the impact of globalisation (Held *et al*. 1999). It is regularly claimed that the orthodoxy here is that globalisation is leading to convergence on to an Anglo-Saxon norm and that analysis in the national capitalisms literature decisively refutes this. Set in these terms this literature does point to continued institutional diversity amongst the developed countries and the absence of clear evidence of convergence onto one set of institutional arrangements. Nevertheless, the focus on refuting hyper-globalisation claims which have few academic proponents risks downplaying the effects of globalisation more generally (Perraton 2001). The transformationalist account by contrast views globalisation as a process rather than an end-state (cf. Held *et al*. 1999; Perraton 2003 from which this paragraph draws). Globalisation can be conceived of as a process, or set of processes, which embodies a transformation in the spatial organization of social relations and engenders a shift in the spatial reach of networks and systems of social relations to transcontinental patterns of human organization, activity and the exercise of social power. More specifically here we focus on the effects of the emergence of global product and financial markets and the international organization of business. This entails a stretching of economic activity across frontiers, regions and continents. The growing extensity of economic activity is combined with an intensification, or the growing magnitude, of interconnectedness and flows of trade, investment, finance, etc so that domestic economic activity is increasingly enmeshed with activity elsewhere. In this sense, the boundaries between domestic matters and global affairs become increasingly fluid. Networks and infrastructures have emerged to facilitate these interactions and institutions have emerged to regulate them. Such developments are rarely uniform and typically display clear patterns of hierarchy and unevenness. Globalisation is not a singular condition, a linear process or a final end-point of social change. Although the impact of globalisation processes is affected by the extensity and intensity of the processes, it cannot simply be read off from them and it should not be seen as a substitute for established social science approaches to assessing the impact of social relations, but instead it complements them by illuminating the specific role played by the intercontinental dimension of social relations and indicating how established tools should be modified and applied to understanding these relations. Globalisation does not simply denote a shift in the extensity or scale of social relations and activity. Fundamentally, transformationalists argue, it also involves the spatial reorganization of the exercise of power. Globalisation can thus be understood as involving a shift or transformation in the scale of human social organization that extends the reach of power relations across the world's major regions and continents. Although evidence does point to higher levels of international economic activity, the primary issue here is not quantitative changes but qualitative transformations as previously nationally-based organization of economic activity now faces global product and asset markets and international networks of production.

This paper proceeds as follow. Section 2 examines attempts to delimit contemporary varieties of capitalism. Section 3 examines whether there are systematic relations between institution arrangements and differences in economic performance. Section 4 examines trends in state intervention amongst contemporary developed economies. Sections 5, 6 and 7 examine differences in wage-labour relations, financial systems

and welfare protection respectively. Section 8 examines changes in national ensembles of institutional relations in countries as a whole and section 9 concludes.

2. How Many Capitalisms?

Authors vary in their classifications of types of (developed) capitalism; rather than review the various proposed schemes and labour over inconsistencies and ambiguities, this paper focuses on two main intellectual traditions here. The 'Varieties of Capitalism' (VoC) approach proposes a binary classification between coordinated and liberal market economies (CMEs and LMEs) according to their organization of production and market institutions (Soskice 1999; Hall and Soskice 2001; cf. Freeman 2001): this determines, in particular, primary variations in the structures of industrial relations and wage bargaining systems; education and training; company financing; and inter-firm relations. Whilst globalisation can exert exogenous pressure for change, the VoC approach in particular emphasizes that institutional differences are key sources of comparative advantage which in itself provides a mechanism whereby integration would tend to lead to the preservation of national differences as much as providing pressure for change (Hall and Soskice 2001). Institutional relations in each country are typically claimed to have evolved to form a mutually reinforcing ensemble; Soskice (1999: 109), for example, argues that 'there are strong interlocking complementarities between different parts of the institutional framework. Each system depends on the other systems to function effectively.' These ensembles can then produce efficient outcomes even where a particular component transplanted into another system might be inefficient. There are different levels of claims about performance here. Some versions specifically argue for superior performance of particular systems, others simply predict that coherent models will produce broadly efficient outcomes.

This binary approach has been criticized on a variety of theoretical and empirical grounds and various attempts at further sub-division have been proposed. The key alternative approach derives from regulation theory (Amable 2003; Boyer 2005). Boyer (2005) proposes that the VoC approach's classification of co-ordinated market economies can be more usefully be subdivided into (at least) three ideal types: meso-corporatist, social democratic and state-led as well as a market-led group that effectively corresponds to the liberal market economies. Boyer argues that drawing out these ideal types enables an analysis of the internal logic and dynamics of different systems as ensembles of relations. Boyer (2005) argues that these conceptions that can help explain the endogenous features of models of capitalism leading to crisis and change. As Coates (2000: ch. 8) argues from a somewhat different perspective, the search for a persistently superior model has been chimerical in the past and is likely to continue to be – not only did the main models exhibit limitations, but more fundamentally capitalist growth processes tend to be uneven both over time and in their distributional consequences; the impact of institutional arrangements on economic performance is considered in the next section.

Mapping ideal types onto evidence from contemporary economies is inevitably somewhat imprecise and ambiguous. Recent analyses, whilst they are based on theoretical priors, allow the data to 'speak for themselves' through cluster analysis of

relevant variables producing broadly similar patterns (Amable 2003; Pryor 2005). Amable (2003: ch. 5) finds - based upon analysis of levels of product market competition, the wage-labour nexus, the financial sector, social protection systems and the education and training system - that developed economies broadly cluster around five groups: the market-based or LMEs; social democratic countries; Asian capitalism; continental European capitalism and a Southern European or Mediterranean group. There is evidence of further fragmentation within this basic classification with a 'European integration' group that already had France, Germany and the Netherlands in and now includes Belgium and Ireland; an 'Alpine' variant of this group comprising Austria and Switzerland and a Mediterranean variant comprising Greece, Italy, Portugal and Spain. A five-fold classification appears to be appropriate; there do appear to be distinctive arrangements in terms of welfare systems and corporate governance amongst Southern Europe countries, although the position of France between this and the continental European group remains ambiguous.

Basic patterns of difference and institutional coherence can be discerned. The characteristics and logic of the market-based system, Asian capitalism and social democratic economies are well known. The interesting cases here the European capitalism groups: this includes both countries like Germany which operated somewhat meso-corporatist relations based around industry level organization and bargaining, but with less state co-ordination than Asian capitalism, and countries like France and the Southern European economies where the state played a central coordinating role. It is therefore not surprising that this group has attracted considerable debate over whether – in the face of pressures to increase product and labour market flexibility and shifts away from traditional financial arrangements – institutional arrangements are cohering into an effective ensemble (Amable 2003: ch. 6; Schmidt 2002).

Amable took evidence that differences in these categories appeared to have persisted since the 1980s as evidence against a convergence-through-globalisation hypothesis:

> The broad categories found for economies at the end of the 1980s still existed at the end of the 1990s. This is a weak confirmation of the non-convergence towards the market-based system. Only Norway seems to have made a significant move in that direction. Otherwise, the SSIPs [Social Systems of Innovation and Production] have kept their distinctive features. However, subsystem analysis does not show that the SSIPs have remained unchanged. Quite the contrary, it provides glimpses of a deeper infiltration of certain market-based mechanisms in most economies. This advance of market-based mechanisms is localized in a finite number of subsystems, namely the financial sector and the labour-relations subsystem, and is epitomized by the progressive transformation of the SSIPs rather than by any radical transformation. (Amable 2003: 92).

This raises key issues here. The assumption of institutional fitness amongst the ensemble of relations does not imply either that any substantive change in one institutional arrangement would lead to the unravelling of the whole ensemble or, alternatively, that any form of institutional change in one area is compatible with the persistence of the general ensemble of relations (e.g. Amable 2003: ch. 2).

Nevertheless, there are questions over the degree to which institutional arrangements can differ in their internal logic within one national ensemble (Lane 2003).

Pryor (2005) also uses cluster analysis on data from the early 1990s on differences in product market regulation, labour market institutions and business ownership and organization patterns. Even here there are problems as some of the classifications are based upon subjective assessment surveys. The number of clusters here depends on the procedures chosen, but comparing a five-fold classification provides similar results: an Anglo-Saxon group; a social democratic group; a central European group and a Southern European group, with France in the latter group; with Japan as the only Asian country included here it ends up in a group of its own (Amable also includes Korea).[2] Interestingly a whole series of variables often assumed to be central to differentiating economic systems fail to play a significant role in this cluster analysis, including: various measures of government activity; business clusters; centralization of labour organization; creditor rights; restrictions on bank activities (Pryor 2005: 36). Pryor acknowledges that this analysis is static and only goes up to 1990; missing data limits the possibilities for tracking changes over time, noting that 'many of the institutional characteristics defining types of economic systems have been changing over time.' Moreover, many of the indicators used here are inherently relative not absolute and as such would limit any attempt to test for convergence.

Whilst these analyses have been based on data from developed economies, Boyer (2005) notes possible continued differentiation within capitalism amongst emerging market economies with the likelihood of continued diversity with their development. Data on institutional arrangements in developing and transitional economies is relatively scarce but Pryor (2005) found they tended to most closely resemble the Southern European group. Elsewhere, Pryor (2006) finds evidence of distinct clusters within developing economies; ignoring the 'traditional' group of the poorest economies most of the Latin American countries fitted into a 'labour-oriented' group with relatively high employment protection legislation and correspondingly limited financial development although with relatively high openness to foreign investment and relatively low government consumption. Not surprisingly Chile fitted into the business-oriented group of relatively developed financial systems and investor protection, greater product market development and correspondingly lower employment protection and labour bargaining institutions. Brazil and Costa Rica were (statistically) marginal members of a statist group with relatively high government expenditure but also relatively high human capital development. Overall, though, there appears to be greater fragility in Latin American models of capitalism with recent decline of statist and populist models; nevertheless, there are some signs of trends towards combining social policies and/or forms of interventionism within broadly liberal economic structures (Sheahan 2002).

3. Institutions and Economic Performance

Globally it is hard to account for the range of levels of income per head and productivity observed between countries simply in terms of human and physical capital stocks and available technology – institutional differences appear to be important to explaining this. Institutional differences amongst developed economies

might be expected to impact on the key determinants of growth: financial systems have a key role in channelling investment funds, but national institutions are also expected to affect the nature of human capital formation and technical progress in different countries.

Recent studies using various classifications find that the impact of institutions on economic performance amongst developed countries is secondary; their chief impact is on income distribution (Freeman 2001; Pryor 2005; cf. Coates 2000). This conclusion appears robust to controls and variables used to determine institutional type. Levels of income per head have tended to converge amongst developed countries in the post-war period, although this needs to be qualified particularly in relation to hours worked (Gordon 2004). Income convergence processes amongst developed countries are now fairly well understood. The performance on other indicators, such as unemployment or inflation, typically depends on the period of comparison chosen. The evidence on inflation shows clearly that rates were both generally lower and converged in the 1990s compared with the 1980s. The evidence on unemployment shows no clear pattern since the end of the post-war Golden Age. The question of institutional impact on unemployment is considered further below, but the evidence that labour market regulations, trade union activity and minimum wages significantly affect unemployment levels is weaker than often claimed (Baker *et al*. 2005; cf. OECD 2004: ch. 3).

Much of the literature could be seen as talking past this. Institutional differences could affect technical progress and human capital accumulation, but typically contributions argue institutional differences affect the nature rather than necessarily the rate of technical progress. In the binary approach, liberal market economies are more geared towards radical, discontinuous innovation: their capital markets are more geared towards venture capital and other mechanisms for raising finance for radically new projects, their employment systems allow for radical changes in work practices (Hall and Soskice 2001; cf. Allen and Gale 2000; Houben and Kakes 2002). Conversely, these same characteristics give LMEs a relative disadvantage for incremental investment: emphasis on current profits and flexible labour markets tends to limit long term investment in incremental innovation and associated firm and industry specific skills formation. Approaches that stress greater differentiation amongst varieties of capitalism nevertheless makes broadly similar predictions about innovation patterns (Amable 2003: ch. 3). Hall and Soskice (2001) find evidence – from a limited period – that patterns of innovation between developed economies accord with these prior expectations. There is a ‘hare and tortoise’ quality to expectations here: besides static gains from specialization, studies are inconclusive on whether specialization in particular products affects long term growth prospects and the relative rates of technical progress between liberal and coordinated market economies over any period would depend on whether the period was characterized by break-though technologies or relative stability.

There is some evidence that patterns of trade specialization conform to expectations, although with inevitable ambiguities in terms of particular sectors and the classification of certain countries (Allen *et al*. 2006). Moreover, this is of considerable

relevance to developing economies. At first cut developing country trade patterns are more readily explicable in terms of standard factor proportions; however, patterns of developing country exports – and particularly dynamic of upgrading – are also strongly influenced by government policies and institutional milieu (Lall 2000).

However, Taylor (2004) shows that the empirical support for propositions regarding technological progress is weak and critically dependant upon the inclusion of the exceptional case of the US. Taylor finds that the classifications in terms of whether industries tend to be characterized by incremental or radical technological change largely fits with Hall and Soskice's classifications in terms of patent data. However, significant differences in terms of patent patterns between the two groups of economies do not appear to be found, including use of forward citation patents as an indicator of radical innovation. Japan, somewhat contrary to expectations, appears to have the characteristics of a radical innovator based on this patent data. Alternatively, surveying the output of scientific papers in these countries – an innovation process subject to different incentives from patenting but often assumed to reflect the country's institutional milieu – produces similar results that there is no clear pattern between the nature of the economies and the research undertaken. Neither of these is necessarily directly related to national economic performance and productivity growth, although the national systems of innovation approach presumes that the connections are likely be close. However, Frantzen (2000), for example, finds that outside the largest G5 economies foreign R&D expenditure has a stronger impact on productivity growth than domestic R&D expenditure; globalisation may thus be eroding national systems of innovation (at least amongst smaller economies) in any case.

The thrust of the both major approaches here is not that one particular model is superior but that coherence amongst the core institutional arrangements will lead to superior performance as they reinforce each other in the manner outlined above: complementary institutions act to raise the positive impact of others (e.g. Amable 2003: ch. 3). Thus, Amable (2003: ch. 5) found that over 1989-2001 institutional variables were only weakly related to growth and unemployment performance; using interaction terms, though, considerably strengthened the estimates. It is not that particular institutions are expected to have an unambiguous impact on performance, rather that particular combinations of mutually-reinforcing institutions can produce efficient results. However, Kenworthy (2006) finds that various measures of institutional coherence here fail to have any significant impact on either GDP or employment growth over the post-1973 period; the efficiency claims about complementary ensembles of institutions do not appear to be borne out by the evidence.

The lack of a clear relationship between institutions and economic outcomes should hardly be unexpected to economists in the institutionalist tradition or necessarily seen as undermining this approach. Those in the 'old' institutionalist tradition at least would be sceptical of the effective assumption that there exists a cross-country production function in which institutional variables enter with a simple linear impact on performance. It is unlikely that relatively short term performance could be

explained in terms of enduring institutions. It is quite consistent with different approaches in this literature that societies will be able to evolve more-or-less efficient solutions to different institutional configurations rather than one arrangement (or a very limited number of them) being sustainable. Such differences though are highly likely to affect the fortunes of different groups; indeed, the emphasis of institutions as the outcome of political equilibria in the regulation approach acknowledges the importance of these effects. The impact of the financial system of capital accumulation is unclear: both bank and equity based systems have strengths and weaknesses in principle and overall the evidence on financial systems and performance is mixed and does not clearly indicate the superiority of any particular system for developed economies (Allen and Gale 2000; Beck and Levine 2002). Particularly with increased international technology flows, the link between domestic institutions and productivity growth becomes weaker. Thus, considered either via the impact of specific institutions or as the whole ensemble, institutions do not appear to be primary determinants of economic performance.

Such conclusions stand in apparent contrast with much of the literature on institutions and economic performance in developing economies. One interpretation would be that countries that have achieved development have already sufficient levels of market-friendly institutions as to allow sustained development; Pryor (2006) raises this possibility. However, such an explanation is unlikely to be sufficient. Developed countries frequently used policies and possessed institutions regarded as sub-optimal in these terms during their industrialisation (e.g. Chang 2002). Further, differential institutional arrangements in terms of corporate governance, financial regulation and labour markets persist amongst developed countries (Botero 2004; La Porta *et al.* 1999; 2000). Fundamentally, whilst there is clear evidence of institutional arrangements significantly affecting economic performance in the developing world, it is much less clear that there is any clear pattern of the impact of particular institutions over time and place (e.g. Engerman and Sokoloff 2003). This is hardly surprising in terms of recent growth performance; whereas convergence trends may be observed amongst OECD countries, they are far less evident elsewhere. Periodic economic crises – such as the 1980s ‘lost decade’ of Latin American development – have level effects on income per head and sometimes trend growth effects too (Cerra and Saxena 2005). Downward mobility is more prevalent than upward: Milanovic (2005, ch. 7) found that ten Latin American and Caribbean countries could be classed as rich in 1960, but this fell to four in 1978 and none by 2000; in the latter period on Chile clearly improved its relative position whilst others fell further back.

4. State Intervention

State intervention entails the setting the rules and framework for market activity and, as such, is necessary for the governance of markets; this notion is a useful corrective to the notion that even the market-led economies are, have been or even could be reduced to night watchman states and that deregulation processes are simply a case of removing regulations. On the contrary, for both the US and UK state support has played a key role in developing particular sectors. This argument has antecedents at least as far back as Polyani’s emphasis that a pure market economy could not exist and must be embedded in non-market institutions. Nevertheless, as an insight it only gets us so far: recognizing the ubiquity of state intervention does not preclude

examining changes in its level over time and differences between countries. Moreover, as Pryor (2005) notes, the diversity of capitalism cannot simply be read off from state intervention variables.

Product market competition plays a key role here since in the limit the types of institutions that generate rents and allow them to be distributed within firms are undermined by intensified competition. Although cluster analysis product market competition indicators from does indicate patterns broadly consistent with expectations amongst developed countries (Amable (2003: ch. 4), overall competition has intensified through global and regional integration and associated reduction in internal and external barriers. Unfortunately, the snap shot measures used provide little indication of trends over time; moreover, these measures are partly based on subjective assessments. Nicoletti and Scarpetta (2003) note that the evidence points to a general decline in product market restrictions but they claim that because of varying starting points and rates of reform differentiation amongst countries has increased. However, the nature of either the variable measures used in this analysis (including relative scoring by analysts) and the limited information available on the economic significance of each one means that such judgements cannot clearly be made. The limited information available on wider groups of countries indicates that, possibly with the exception of the Southern European countries, product market restrictions amongst developed countries are low and the differences between them are relatively small. Recent OECD work has emphasized product market restrictions, in part as a proposed explanation for why widespread wage moderation over the 1990s has not led to the expected expansion in employment; the thrust of this approach has been to emphasize levels and differences in these regulations (OECD 2001: ch. 6). It is often overlooked, or at least downplayed, that the EU countries are subject to stringent pro-competitive rules through the Single European Market that enforce essentially the same regime throughout; the downplaying of this by the OECD and others can be seen as an attempt to account for why the actual gains from this project have failed to live up to expectations. That the SEM has failed to produce the income gains predicted for it should not be taken as indicating that international competition has not increased substantially within the EU when it may well simply reflect models that over-estimated the gains from liberalization. Furthermore, the nature of the SEM regime does point to the emergence of a more market-based European capitalism. Broadly speaking the negotiations over the formation of the SEM pitted a neo-liberal open markets vision against a ‘fortress Europe’ conception within which at least some EU-wide Keynesian and social protection structures could be constructed and in which post-war French policies of promoting national champions could be operated at the regional level; the neo-liberal vision clearly won out. These developments have key implications for the continental European capitalism group. Amable (2003: ch. 5) points out that product market competition above some levels of intensity implies employment flexibility, or at least it would tend to increase the elasticity of demand for labour and thereby make employment more variable and increase wage inequality.

A key qualification commonly offered to notions that widespread deregulation points to a generalized shift towards a more Anglo-Saxon capitalism is to argue that the processes differ between countries because they entail not simply removing restrictions but active *re*regulation, with important national variations in the new

regulatory frameworks (cf. Vogel 1996); Soskice (1999: 134), for example, argues that amongst CMEs 'organized business has sought not deregulation but reregulation in order to face up most effectively to global markets' in order to preserve domestic institutional arrangements that remain a source of competitive advantage. There are three main limitations of this line of argument. First, there is evidence of convergence in business regulation; Braithwaite and Drahos (2000) in their exhaustive study of business regulation find significant similarities between national regimes, attributing this in part to the emergence of an international epistemic community of business regulators leading to global regimes of regulation. As noted, within the EU large firms were lobbying for deregulation through an open borders SEM. Second, formal international integration, both regionally and globally through the WTO, reduces the scope for state intervention. The WTO effectively prohibits many of the instruments traditionally used for industrial policy and makes challenges to market restrictions easier; within Europe the SEM has produced a more Anglo-Saxon competition policy regime. Finally, it is one thing for states to design deregulation programmes in order to retain certain powers and in an attempt to secure particular outcomes, it is quite another for them to succeed. The case of financial regulation shows that government regulation is frequently playing catch-up with developments in the industry with regulations leading to outcomes not foreseen by the authorities. In European telecommunications and electricity deregulation, key examples in Vogel (1996), national institutional differences appear ultimately to have made little difference to the outcome of deregulation (Bartle 2002; Serot 2002).

In initial interpretations decisive deregulation was interpreted within a bifurcation framework: it was achievable within liberal market economies, and even then only amongst those with majoritarian political systems, in the face of interest group opposition (King and Wood 1999). This is consistent with notions on path dependence in policy change but such a judgment no longer looks tenable. Across Europe governments undertook far-reaching privatization and deregulation programmes often, as in France and Spain, by left parties in coalition governments (Smith 1998). Jospin's French Socialist government, for example, privatized more state-owned concerns than the previous six governments combined. The Southern European economies have seen a decisive shift away from their traditional post-war interventionist policy tools. This is not just on the left, but also amongst European Christian democracy so that Southern European governments of the right are pursuing more clearly *laissez-faire* policies than they did for much of the post-war period. State intervention in East Asian capitalism is examined in more detail below, but traditional tools of the developmental state as practiced in first Japan and later Korea and Taiwan in the post-war period have also been strongly undermined by these processes (Perraton 2005); these cases are considered in more detail below. It is not simply that the shift away from state intervention represents a common move and one driven in large measure by global and regional integration; rather than leading to bifurcation or accentuated differences, this is largely a case of common trends. There remain differences between countries and these owe much to policy packages between countries, but these differences do appear to be diminishing. But, as Howard and King (2004) note, for the most part theorists within the institutionalist tradition often did not predict a shift towards *laissez-faire* policies or only amongst (some) Anglo-Saxon economies; on the contrary almost invariably the emphasis within earlier literature

was on the limitations of markets for solving social problems leading to predictions of the *lessening* of the role of markets.

5. The Wage-Labour Nexus

Wage-labour relations apparently present a clear case where integration does not lead to convergence; whereas liberal market economies are likely to see an increase in pressure for reducing the power of organized labour, by contrast in coordinated market economies employers' need for stability and co-operation at the enterprise level shores up their co-operative relations with the workforce, including unions (Thelen 2001); if anything globalisation is likely to increase the divergence between national capitalisms in this sphere (cf. Marsden 1999; Whitley 1999).

Amable (2003: ch. 4) examines the wage-labour nexus in terms of employment protection legislation, industrial relations systems and wage bargaining arrangements. With employment protection legislation similar points apply as with product market regulations – evidence points to continued diversity but a pronounced general trend towards lighter regulation (OECD 2004: ch. 2); again the nature of the measures used does not readily allow assessment of scales and the extent to which these trends constitute convergence. More interesting is the evidence on industrial relations systems and wage bargaining arrangements.

Trade union density data provide some support for a bifurcation argument of the emergence of a low union density group of liberal market economies and high union density group of coordinated market economies (OECD 2004: ch. 3). The claim that where unions were initially strong that strength has been maintained largely holds for the Scandinavian countries, where the Ghent system of unions providing unemployment insurance operates; elsewhere union density has either shown no trend over the past forty years or density has fallen. Although formal employee representation is hypothesized as one distinguishing feature of coordinated market capitalism, mandatory systems of co-determination are essentially a German-Dutch-Austrian system. As Gill and Krieger (2000) show, although some form of formal employee workplace representation is common in Western Europe, the German Works Council system is hardly universal amongst these economies. Further, the proportion of German workplaces operating works councils is falling (Hassel 1999). Overall formal involvement of employees in company boards is not universal amongst Continental European countries and has seen some decline even in those countries where it has been strongest.

The notion of a unitary national industrial relations system is hard to sustain. This is not to deny evident inter-country differences, but rather to question whether common norms within countries can clearly be discerned. Evidence is inherently problematic when it is typically collected through impressionistic surveys whose comparability across nations is questionable and may not be fully representative of national workforces. Evidence from a major survey of new work practices indicates few clear national patterns (OECD 1999: ch. 4). The prevalence of practices such as job rotation, team working and delegation to groups or individuals varies considerably

between firms within a country and between countries. Overall, differences between national economies had limited explanatory power in accounting for the differences in the prevalence of these new work practices. Further, there are often considerable differences between countries with ostensibly similar industrial relations systems. Rather than integration strengthening particular systems as a source of competitive advantage, national systems are becoming more variegated with trends differing by company and industry as well as between countries (Katz 2005; Katz and Darbishire 2000). Attempting to produce generalizations about industrial relations systems in particular countries, let alone groups of countries that otherwise share key features, is perilous. The argument here is not that countries' industrial relations are the same or that they are converging; there is evidence that different initial traditions do affect the nature of change (notably over the degree of union involvement in changing practices). The argument here instead is that it is increasingly difficult to maintain that there is a common, coherent system of industrial relations within each nation or economic group of nations. The limits of a bifurcation argument here are illustrated by the paradigm cases for the VoC approach, Germany and the US. The argument made here for Germany is that employers do not wish to dismantle the post-war industrial relations system and move towards Anglo-Saxon flexibility (Thelen 2000). There is evidence of a post-war co-operative system of German industrial relations helping to introduce and initiate incremental innovation, with a danger that liberalization would undermine the virtuous circle this model created (Annesley *et al.* 2004; cf. Allen *et al.* 2006). Undoubtedly, as Thelen shows, *some* German employers see the post-war industrial relations system as an enduring source of competitive advantage; others, though, emphatically do not and have used globalisation – particularly the threat of shifting production overseas (notably to Eastern Europe) – to undermine union bargaining strength and to lobby for increased labour market flexibility (Raess 2006). With the US, although the picture of low trust/low wage employment relations finds ready support this is far from the whole picture. For some groups of workers US firms have used various mixed strategies between firms and for different groups of workers with attempts to induce co-operation through human resource management policies that by-pass unions (Katz and Darbishire 2000); there is also evidence of their successful implementation – sometimes with union co-operation – in British firms (Guest *et al*. 2003). The logic of theories of national labour relations systems is that such strategies would be hard to implement without being embedded in wider social relations that promoted workplace trust but the evidence here is more consistent with scepticism that national labour relations are usefully characterized in this way. Faced with new technologies and intensified international competition firms have adopted a variety of strategies which have led to fragmentation of national industrial relations systems.

National systems of wage bargaining may be distinguished from industrial relations systems. Since Calmfors and Driffill (1988) advanced the hypothesis of a hump-shaped relation between the degree of coordination of wage bargaining and inflation/unemployment performance, a large literature has developed exploring the theoretical and empirical basis of this analysis. Those in the VoC in particular insists on focusing on the degree of co-ordination rather than centralization in wage bargaining systems; whereas social democratic countries have been associated with centralized bargaining systems with national level bargaining between large scale union and employer organizations, amongst the meso-corporatist group although

bargaining is more at the industry level there is in effect communication and co-ordination (of varying degrees of formality) between major bargainers. Effective co-ordination of bargaining in the meso-corporatist groups may thereby avoid the problem Calmfors and Driffill (1988) identified for intermediate level bargaining systems where organized insider groups are able to partially externalize the costs of inflationary wage claims and its effects on raising the NAIRU. Coordinated systems may also have certain other advantages: cohesive employer organization, particularly in the meso-corporatist group, can aid the provision of collective goods, particularly training systems and these arrangements may promote trust and thus help the industrial relations strategies noted above.

From the 1990s the apparent superiority of coordinated, or at least centralized, wage bargaining systems has diminished and several countries have shifted to more decentralized systems. Particularly with the worsening relative employment performance of social democratic economies in the 1990s, recent tests often find only weak evidence for the standard Calmfors-Driffill relationship and generally find relations between bargaining systems and macroeconomic outcomes are not robust (OECD 2004: ch. 3; Traxler *et al.* 2001: ch. 6); this can be over-stated, Baker *et al.* (2005) found that coordinated wage bargaining systems continued to be associated with lower unemployment levels throughout the 1990s, although they caution that the implied effects from their regression analysis are implausibly large and are probably picking up other country-specific effects.

For all the emphasis, particularly in the VoC literature, on coherence and coordination within national bargaining systems there appear to be only weak relationships between component parts of wage bargaining systems and particularly between degrees of employer and union organization (Traxler *et al*. 2001: 95). Trends in bargaining systems present problems of interpretation with mixed trends (OECD 2004: ch. 3). Amongst the social democratic economies initially characterized by the most centralized bargaining systems, Sweden has seen a clear trend to decentralization from previously highly centralized bargaining under pressure from employers to dismantle aspects of post-war employment relations and increase flexibility; Denmark has seen a more negotiated move towards ‘flexicurity’ with more decentralized bargaining arrangements but still some inter-industry co-ordination. Relatively centralized and coordinated wage bargaining systems have been maintained in Finland and Norway, with considerable – if not universal – employer support.

At the decentralized LME pole the core countries – UK, US and Canada – have maintained strongly decentralized bargaining systems with relatively high degrees of wage flexibility; the lack of real wage growth for significant sections of the US workforce is well known and in the UK downward flexibility of *nominal* wages appears to be common. Australia and New Zealand have had a somewhat different evolution with previously relatively coordinated wage bargaining systems being strongly eroded in the 1990s.

Apart from the Anglo-Saxon countries, corporatist relations tended to develop rather than diminish over the 1990s amongst both those meso-corporatist countries where coordination between industry bargainers had been established and those of the poorly performing middle in the Calmfors-Driffill typology. Particularly in the latter group this appears surprising in view of theories of how and why corporatist relations emerge positing that they require historically embedded levels of trust and an ability of union hierarchies to deliver compliance at the local level. Without surveying all developments, particularly amongst continental European countries some common trends can be discerned (Perraton and Clift 2004). The arrangements arose following a widespread perception of economic crisis within the country even if there was not a consensus over the appropriate reforms. The emergence of corporatist relations in these countries was in part a defensive measure, a view that bargaining with government over reform, as well as with employers, would be more effective than simple opposition. Unions typically abandoned any commitment to indexing wages to inflation and their opposition to expanding part-time work. This form of corporatism can therefore be seen as a response to neo-liberal policies as much as an alternative to them. In the Southern European countries particularly the role of political processes has been crucial: organized labour has attempted to trade cooperation in these areas for various concessions, particularly from governments of the left. How successful trade unions have been in extracting such concession is questionable. The Dutch and German cases are worthy of note here. The conclusion of the 1982 Wassenaar Agreement can be seen as marking the end of a period in which the Netherlands displayed the characteristics of the negative consequences of uncoordinated bargaining, although earlier post-war Dutch relations were more consensual. Faced with a crisis of adjustment Dutch unions effectively negotiated wage flexibility to restore competitiveness and employment. Whilst in broad terms this has been successful, much of the burden of adjustment fell on vulnerable groups who have experienced variable increases in employment and the restoration of profitability has not led to a commensurate rise in investment (Becker 2001; Jones 1999). In Germany there have been some attempts to decentralize wage bargaining (Ochel 2005), again indicative of the desire of at least some employers to dismantle post-war arrangements; interestingly in the current decade actual German wage increases have tended to run *below* collectively agreed increases (Hein *et al*. 2006). Overall, though, the evidence here is that even where the union movement had traditionally been fragmented and/or had limited representation it can play a role in reform processes which end in neither a neo-liberal destruction of union power nor a preservation of measures that benefit insiders at the expense of those in secondary labour markets.

Globalisation could act to undermine wage bargaining system in several ways. Increased elasticity of demand for labour from globalisation would undermine labour's ability to extract production rents and tend to make wages more unequal (Rodrik 1997). Economic integration would be expected to generate convergence pressures on wages and there is evidence that this has already happened in the EU (Andersen *et al.* 2000). Overall the evidence from developed countries is strikingly consistent with falls in labour's share of national income even in an era of low inflation and intensified international competition and these trends appears to be significantly related to some globalisation indicators (Guscina 2006; IMF 2007: ch. 5). The effects of these systems on wage inequality remain largely in line with prior expectations. Consistent evidence over time and across countries is patchy (OECD

2004: 141), but evidence indicates that although there while has been some there has been some increase in Swedish wage inequality in general the social democratic economies still exhibit low wage inequality. In general wage distribution in the Anglo-Saxon economies remains clearly the most unequal, with trends towards greater inequality most clearly operating in this group. The US case deserves particular comment. Thompson (2004) points to the undermining of the post-New Deal settlement in explaining the growth of US inequality from the 1980s and how average and below average income households saw low rises in real incomes even during the 1990s US boom; Dew-Becker and Gordon (2005) explore this further: over 1966-2001 only the top 10 per cent of tax payers saw rises in real income equal to or above the economy's productivity growth rate – and this holds over the 1997-2001 boom period – so that inequality increased over this period despite a roughly constant labour share of income. This also raises questions over the conventional wisdom that rising inequality is essentially due to a combination of skill-biased technical change; in the US this appears to owe much to the richest group's increasing ability to appropriate rents and more generally the decline of trade unions and other institutional measures that tended to reduce such inequality. The 1990s saw generalized wage moderation amongst OECD countries with consequently stable or declining wage shares. In general there were no strong relationships between bargaining institutions and wage moderation over the 1990s (OECD 2004: ch. 3) – these various arrangements were all, to varying degrees, able to deliver wage flexibility in response to shocks. The employment response to this flexibility has varied, however. There is no clear relationship between wage moderation and employment levels (e.g. OECD 2004: ch. 3). Standard accounts invoke various auxiliary hypotheses, particularly the effects of product and labour market regulations, to explain these differences although evidence above provides grounds for scepticism over this (OECD: 2001 ch. 6).

With typically weaker wage bargaining systems, globalisation trends are likely to undermine labour's position in developing economies. Some counter balance to this may be provided by democratisation processes in the light of evidence that, *ceteris paribus*, wage levels are higher in democratic regimes (Rodrik 1999). However, besides the effects of globalisation trends, further investigation indicates that such democratisation effects are conditional upon instituting measures designed to defend labour's position (Palley, 2005). In the process of democratisation elites may embed institutional measures that limit the power of labour and/or opportunities for redistributive measures (Boylan 2001).

Some attempt has been made to explain the decline of centralized bargaining in terms of trends in central bank behaviour and deindustrialization. Iversen (1999) attempts to explain reversals in the relative employment performance of economies with centralized wage bargaining systems. The key shifts in his analysis are central banks' policy stance of towards non-accommodation of inflation and changes in economic structure which in this analysis would reverse the Calmfors-Driffill (1988) results. Rational wage and price setters will incorporate the central bank's non-accommodating stance into their behaviour. Ignoring the completely flexible extreme, initially higher levels of bargaining lead to superior outcomes through co-ordination effects but these now peak at intermediate bargaining levels where labour would not rationally push for inflationary wage increases because of non-accommodation.

However, at very high levels of labour organization, if unions use their power to pursue wage bargaining in support of equality objectives this is likely to lead to wage inflation pressures. This will particularly be the case if there is wage drift amongst the most productive workers which is anticipated and incorporated into wage claims by low productivity workers; similar arguments are also made in some recent OECD literature (OECD 2004: ch. 3). Further, such wage bargaining provides incentives for the most skilled workers to defect from coordinated arrangements to the extent that such arrangements hold back their wage rises by reducing firms' discretion to offer higher wages. Both employers and skilled employees therefore have a common interest in undermining centralized bargaining systems. Thus, this analysis appears to explain both the worsening of social democratic countries' unemployment record in the 1990s and the shifts away from centralized wage bargaining in these countries. Iversen (1999) offers a coherent account of why social democratic economies have become less successful at delivering low unemployment together with an explanation for shifts away from centralized bargaining systems. Non-accommodation would be expected to leader to lower inflation and unemployment with less variation across economies, as we have observed amongst virtually all developed economies in the 1990s. Iversen (1999) predicts that egalitarian wage bargaining will now have a greater adverse impact on employment since it will inhibit the growth of relatively low productivity private services jobs, with evidence that limits to increasing employment through public sector service job creation have been reached and that lower wage differentials are associated with lower private sector service employment and lower employment growth in the 1990s. However, whilst this analysis represents a detailed attempt to explain changes in the performance of coordinated economies, it turns on several key assumptions. Varghese (2001) criticizes this and similar studies for their exclusive on supply side explanations of unemployment and their neglect of the capital side of these relationships in terms of the investment response. Kenworthy (2003) found that although there was some evidence of a negative impact of egalitarian wage policies on employment growth it was relatively small. We noted above the absence of a clear relationship between wage moderation and unemployment; Baker *et al.* (2005) review key studies of the determinants of unemployment levels amongst OECD countries, finding that results for the conventional supply side explanatory factors are not robust and do not support the strong policy conclusions drawn from them. This is particularly important amongst the social democratic economies; in both Finland and Sweden the financial boom following 1980s deregulation collapsed into a banking crisis, with the amplitude of the financial boom and crash aggravated by the effects of the hard currency policy pursued at the time. Both countries are estimated to have experienced greater proportional output losses than either suffered during the Great Depression. Vartiainen (2004) carefully evaluates analysis of unemployment trends amongst the Scandinavian countries in the 1990s and finds no clear evidence of rising equilibrium unemployment rates as well as evidence for the importance of demand side factors in explaining their unemployment levels over time (cf. Holden and Nymoen 2002; Nymoen and Rødseth 2003). As Glyn (2001) points out, the contrast between the supposed greater ability of the US and similar economies to generate employment amongst the least skilled due to wage flexibility at the bottom end is overstated. Employment rates and unemployment rates for the least educated group in social democratic economies are comparable with or better than the OECD average. Since the mid-1990s these economies have seen comparable growth in private sector service employment to that experienced of the US and UK.

The investment response is central here, particularly for the social democratic group. Corporatist bargaining in response to earlier shocks was successful, at least according to its proponents, because unions were prepared to accept wage moderation in return for an expectation that this would result in higher investment and thence higher income and employment. The coordinated wage bargaining systems in these countries were not, from the point of view of labour at least, simply designed to achieve high levels of employment wage restraint – decentralized wage flexibility in principle can achieve that. Nor is it simply a device to ensure wage restraint and adjustment without major increases in wage inequality. For organized labour corporatist strategies in particular the aim here was to achieve full employment through high productivity-high wage employment in the tradables sector (e.g. Landesmann and Vartiainen 1992). As Varghese (2001: 720) argues re. Iversen and others: 'What mars… and what also distinguishes them from earlier treatments of social democracy is their complete silence on how the supply and content of private capital and investment can be channeled in such a way as to further an egalitarian project.' By contrast earlier analyses of corporatism stressed its ability to achieve negotiated adjustment preventing a profits squeeze and thereby preserving employment and investment over the medium term (Henley and Tsakalotos 1991; Landesmann and Vartiainen 1992). Earlier contributions to the literature on corporatism recognized that the post-war success of European small open economies rested on high rates of investment, particularly in tradable industries; if labour can credibly pre-commit to wage moderation then higher levels of investment and thus income can be achieved. In some models this is essentially an investment co-ordination problem; in others though it has the character of a non-cooperative game where both sides have incentives to defect and so the socially optimal solution cannot be assumed to arise for repeated bargaining. A co-operative solution would thus require organized labour to accept greater wage moderation than they would otherwise choose in return for capital delivering higher levels of investment relative to profits than capitalists would otherwise choose; even in the absence of organized labour there are several standard grounds for expecting private capital accumulation to be socially sub-optimal. Landesmann and Vartiainen (1992: 234) note that for the 1960-85 period 'these [social democratic] economies seem to be able to maintain comparable or even higher investment activity compared to other OECD economies while showing significantly lower rates of return or profit shares in national income.' Other conditions, particularly through economic policy, may buttress this and help maintain investment levels. Side payments by the state to induce co-operation may be made to labour in the form of provision of a social wage and to capital in the form of support for investment and other industrial policy measures. Since the 1980s although profit rates have largely recovered investment efforts have not; this is important not just for the generation of high incomes but – if standard economic modelling assumptions are relaxed – for total employment levels.

To recap, increased wage flexibility has been common to developed countries with increased pressure on wage costs. Where union density was high this has typically remained so, but unions' ability to bargain with the state over social goods and political goals has, in general, declined. Although union power has tended to diminish in the Anglo-Saxon countries, where unions had medium strength corporatist relations have tended to emerge despite the absence of conditions typically thought conducive

to this. Unions were powerful enough for employers and governments to seek accommodation with them, but this also had advantages in terms of delivering cooperation. Overall whilst there clearly are differences between employment practices and wage bargaining systems, it is far from clear that these constitute a coherent national ensemble of relations with developed countries.

6. Financial Systems

Differences in financial systems are invariably central to the national capitalisms literature. The financial system is not only key to channelling funds for investment; the patterns of ownership and control of firms – corporate governance – are seen as determining social outcomes. Systems of corporate governance not predicated upon maximizing shareholder value are said to permit 'voice' to other stakeholders. Authors in this debate often claimed the benefits of 'patient' finance in Continental European and East Asian systems, with banks' close ties to creditor firms, over the 'arms-length' Anglo-Saxon models (e.g. Grabel 1997; Nell and Smith 2003). The 'voice' character of bank-based systems permits the development of long term relations with other stakeholders, particularly training workers, credible commitment to investment in return for wage restraint and not resorting to hire-and-fire policies over the business cycle. Whilst this was hypothesized in particular to secure investment in firm-specific human capital and commitment to this, within the VoC view this leads to patterns of specialization with bank-based systems having relative advantage in industries characterized by incremental innovation whereas capital market based systems have a relative advantage in industries characterized by radical change where firm-specific human capital investments are likely to be less important. Recent crises among European and Japanese banks, and the alleged failure of these systems to support new firms, have led to praise for the Anglo-Saxon system; in particular, for the ability of capital market-based systems to mobilize funds for the 'new economy' industries in the US and elsewhere during the 1990s (Houben and Kakes 2002). Moreover, trends towards financial globalisation are often believed to undermine the basis for alternative systems to Anglo-Saxon finance. Although we may not necessarily expect convergence on efficiency grounds, financial globalisation might be expected to lead to convergence towards the capital market system. Financial globalisation has the increased possibilities for large firms at least to raise funds on international capital markets as global financial markets have grown exponentially since the 1970s and cross-border barriers have been liberalized (Held *et al.* 1999: ch. 4).

The clearest transformations can be seen in the Southern European group that have shifted from state-owned bank ownership patterns directing finance according to industrial policy to privatization of these banks. State-owned banking was also prevalent in the East Asian economies of Korea and Taiwan; the working out of post-crisis reforms in Korea, with some attempts to create an Anglo-Saxon financial system, remains incomplete (Haggard *et al*. 2003). Amongst the Southern European group there was no common pattern to the outcome of this liberalization process. The French experience is notable for a rapid transition from a bank-based financial system with state direction of credit. Since the 1980s liberalization and opening of financial markets have transformed the French financial system towards a market-based system as a deliberate act of government design. Bank loans have become proportionately

less important and internal finance and other instruments more important in firms' finance since liberalization with a clear trend towards disintermediated forms of finance to the extent that the relative proportions now resemble those of Anglo-Saxon economies (Scharberg 1999; Schmidt *et al.* 1999). Whilst there has been a general decline in loans as a proportion of firms' liabilities across the G7 countries this has been particularly marked in France with a sustained rise in equity as a proportion of corporate liabilities and a sharp rise in foreign assets and liabilities (Byrne and Davis 2003: chs 4 & 7). The behavioural implications of these trends are harder to determine. Ownership of the largest companies was typically highly concentrated with dense inter-locking corporate networks through inter-locking share ownership networks around major banks and interconnected directorships amongst the cohesive French business elite (Morin 2000; Windolf 2002: ch. 4). The privatizations of the 1980s and 1990s saw attempts keep major concerns remain within the *noyaux durs*, hardcore networks of inter-linked industrial and financial interests and thereby limit the emergence of any effective market for corporate control. Nevertheless, there is evidence that these networks are partially unravelling with both the entry of foreign investors and the development of international networks by French companies. Whilst the degree of short-termism amongst foreign investors may have been exaggerated, rising equity ownership has still led to greater orientation towards shareholder value amongst publicly quoted French companies (Morin 2000; Clift 2004).

Elsewhere in Southern Europe transformations have been less dramatic with continued concentrated ownership and limited markets for corporate control so that neither a capital market based system or a meso-corporatist bank-based system of governance is clearly emerging (Deeg and Perez 2000; Rajan and Zingales 2003b). Even here, though, levels of stock market capitalization have risen sharply (Rajan and Zingales 2003a). In general, evidence for EU countries shows no evidence of convergence in the use of bank loans for investment funds but some evidence of a shift towards use of funds that is more characteristic of an Anglo-Saxon system (Murinde *et al.* 1999; Rajan and Zingales 2003b). Relative to the 1980s differences in sources of funds, financial market activity and regulations have narrowed between continental Europe and the US/UK systems. The social democratic economies had been characterized as having bank-based systems with significant state direction of credit towards social goals and 'no sophistication of financial services' (Amable 2003: 88). Since then these economies have seen a thorough-going programme of financial liberalization.

The collapse of the 1990s bubble economy has led to a transformation in the Japanese financial system with a decline in bank borrowing by larger firms so that their financing patterns now resemble those of firms in Anglo-Saxon countries (Nabeshima 2000). Although for many Japanese firms the main bank continued to play a key governance role, during the 1980s the nature of the governance relationship operated in ways that differed significantly from that claimed for the Japanese main bank system. Although the theory of the Japanese main bank system predicts the main bank tends to increase its exposure to firms with falling profits, the reverse happened in the 1990s (Matsuura *et al.* 2003). Whereas earlier studies had attempted to test whether main bank relationships increased investment, even after controlling for other factors, Japanese firms whose debt had a higher fraction of bank loans in 1989 performed

worse and invested less in the 1990s than other firms did (Kang and Stulz 2000); close firm-bank ties tended to raise the cost of capital, so that most of the benefits from these relationships were appropriated by the banks (Weinstein and Yafeh 1998). Thus, overall relationships between major Japanese firms and their main banks have declined and the banks have been unable to maintain the relations (said to be) characteristic of the earlier post-war period.

These shifts towards financial liberalization has affected income distribution with the rise of rentier income as a share of national income, defined as the profits of financial firms plus interest income accruing to non-financial, non-government residents (Epstein and Jayadev 2005). Although only limited data is available, the largest increases appear to have occurred in the Anglo-Saxon economies of Australia, the UK and US although Belgium and the Netherlands also saw relatively large rises. This financialization may have had macroeconomic consequences by raising required rates of return on capital investment and providing alternative opportunities for funds it appears to be significantly related to lower rates of investment and from this lower employment growth amongst leading OECD economies (Schaberg 1999; Stockhammer 2004). There is some evidence of similar trends in emerging market economies, although data is limited.

In some interpretations functional convergence in response to financial liberalization can stop short of systemic convergence – legal changes and a greater focus on shareholder value remain compatible with arrangements other than capital-market based systems. Lane (2003) argues that such hybrid arrangements are inherently unstable in that they entail different logics operating in different parts of an institutional system, in contrast to principles of institutional coherence. Allen and Gale (2000) point out that banks as financial intermediaries provide smoothing of returns over time and thus reduce risk to investors; however, competition from financial markets means that investors would have to accept lower returns in some periods to smooth returns over time. Financial markets may then grow relative to intermediaries even where it may be socially optimal to retain the insurance function provided by the latter. Grahl (2001) argues that it is not simply the rise in cross-border flows and convergence in returns on financial assets – important as these are – it is that access to international markets for borrowers and savers increasingly set the terms for both savers and borrowers. The depth and breadth of international financial markets makes them attractive to both savers and borrowers, particularly as it tends to raise returns to the former whilst offering keener terms to the latter. The effective processes of cross-subsidization that often operated within bank-based systems – between firms and from savers to borrowers – are undermined by financial globalisation. Globalisation can undermine these relations in other ways. Product market integration through trade will tend to increase the pressure on companies to maximize profits. This will act to reduce rents available to insiders, particularly labour.

It is far from clear that capital-market based financial systems are most appropriate for development (e.g. Singh *et al*. 2005), particularly in the light of widespread and irreducible market failures associated with information asymmetries and

imperfections (e.g. Stiglitz and Charlton 2005). Although the contrast is often drawn between historic trade openness in East Asia relative to Latin America, the latter have longer standing financial openness (e.g. Mahon 1996). It has become commonplace in some political economy literature to see a co-evolution of excessive employment protection legislation and restrictions on financial development providing rents to insiders but at the expense of wider development (e.g. Fehn and Meier 2001). However, Palley (2005) provides counter-evidence to these assertions finding evidence the legal protection measures for labour introduced in democracies are also associated with greater security in economic transactions, lower corruption and generally better governance.

7. Social Protection

There have been numerous studies of transitions in national welfare states and space precludes a detailed analysis. Consensus analysis in the literature focuses on explaining the ways in which different institutional arrangements have led to varying responses to the challenges for social welfare provision from ageing populations and (frequently) persistent economic inactivity amongst working age people. Government expenditures appear to have stabilized as shares of national income (at different rates) and this may reflect national social equilibria in terms of relative demands for social goods and their costs of supply (Vartiainen 2004). Rather than exploring changes in welfare systems in detail, the purpose of this section is to point to certain common trends that analysis of differentiation between systems tends to downplay. Any equilibrium may be fragile as governments face trying to balance growth in demand for public services with increased difficulties in raising tax revenues. In Europe at least the welfare state continues to command widespread legitimacy and the European public largely continues to demand its services notwithstanding attempts by various commentators to insist it needs shrinking in the interests of efficiency (Boeri *et al.* 2001). Nevertheless, the expansion of the welfare state appears to have come to an end and in the Scandinavian economies processes of decommodification (at least as interpreted by Glyn 1992) have reached their limits (Perraton and Clift 2004).

Whilst globalisation may increase demand for welfare services by exposing citizens to greater risks it may also reduce governments' ability to sustain levels of provision. There is evidence that globalisation has reduced effective corporate tax rates (including amongst the Scandinavian countries) and reduced cross-country variance amongst developed economies and shifted the burden towards labour and indirect taxation (Bretschger and Hettich 2002; Gropp and Kostial 2000). In part governments have responded by broadening the corporate tax base but cutting rates on the most mobile capital (Devereux *et al.* 2002; Ganghof 2000). One common response is to downplay the significance of this since corporate tax only ever raised a minority of total revenues. Nevertheless, to the extent that globalisation constrains governments' ability to raise revenues to levels they desire this has restricted their ability to cut income taxes where they harmed employment and shifted them towards less mobile factors (Genschel 2002). In particular, the shift towards greater use of indirect taxes makes the financing of the welfare state regressive to varying degrees across countries (Kato 2003). Although downward pressure on corporate tax rates has not led to a race to the bottom as such, it remains a key constraint on expanding welfare provision in line with rising demand. It is not simply that the tax burden has shifted towards labour

and indirect taxation; globalisation would be expected to raise the elasticity of demand for labour so that the incidence of taxes (the real economic burden) would increasingly fall on labour and this would worsen the adverse employment impact of taxation (Rodrik 1997). Although Rodrik (1997) found that across countries more open developed economies have larger welfare states, he also found that over time increased openness was associated with lower expenditure. These notions are given further support by Skidmore *et al.* (2004) who find evidence of convergence – robust to the inclusion of various control variables – for government expenditure per capita both globally and within the OECD countries. Although they explain this in terms of a new growth theory convergence model rather than a globalisation hypothesis, evidence on openness proxies is also consistent with this explanation. Similarly Sanz and Velázquez (2006) found evidence that European economic integration is leading to some convergence in the composition of government expenditures. More detailed analysis of net social expenditure indicates that expenditure differentials between developed countries are less pronounced than headline figures suggest (Adema and Ladaique 2005)

The fiscal pressures may have led to some qualitative convergence between welfare states. The diffusion of new public management techniques has led to some similarities in strategies. Schwartz (1994) found that in Denmark, Sweden, Australia and New Zealand countries reorganization within the state – particularly of welfare state provision – saw operational responsibility increasingly devolved to local levels whilst control over spending became increasingly centralized and strict. Increased use of markets and quasi-markets for provision of welfare services meant that local level managers had more devolved power, mirroring developments in private corporations. Competition and comparisons was encouraged between agencies and sometimes with private sector providers. These processes have the effect of diffusing pressures on the welfare state by limiting the power of interest groups whilst strengthening the power of fiscal bureaucrats.

The pressures in terms of both demands placed upon the welfare state in developing countries and globalisation trends undermining its resources have been more acute in developing countries and have undermined attempts to sustain these in Latin America (Rundra 2002). Opportunities for capital exit have for some time provided important constraints on policy autonomy in Latin American countries (Mahon 1996). Nevertheless there are grounds for believing useful policy space remains for constructing welfare regimes in these economies consistent with open, market-oriented economic policies. There is little doubt about demands – Latin American liberalisation policies have been disappointing in terms of employment generation and inequality (Taylor 2001; Tokman 2002). Just as open European economies developed welfare systems to maintain social cohesion, cushion adjustment and encourage retraining and labour transfer in the post-war period, there is a case for this amongst contemporary developing economies; without complementary policies liberalisation may engender decline in uncompetitive sectors without supporting resource transfer to sectors with potential for expansion (Stiglitz and Charlton 2005). Nevertheless, recent policies in Costa Rica and Chile in particular point to possibilities for constructing effective welfare systems consistent with functioning market systems in these economies (Sandbrook *et al*. 2007; Sheahan 2002).

8. Where Are Different Capitalisms Now?

This section draws together material to examine how far the ensemble of relations identified for the main types of developed capitalism have persisted; given their limited relevance for Latin American countries developments in Anglo-Saxon and social democratic economies are over-looked here.[3] As this focuses on particular countries as exemplars of each type it is inevitably somewhat selective.

Continental European Capitalism

Here the French case offers one of the most intriguing cases of institutional change. For much of the post-war period at least the key defining feature of French capitalism has been its *etatiste* character: the centrality of the state to organizing state-led industrialization, mobilizing finance and providing an extensive legal framework for the conduct of industrial relations. The interpenetration of the state and business elites acted to reinforce the coherence of this model. Since the abandonment of Mitterand's radical policy programme in the early 1980s, key aspects of the post-war state-centred system have been dismantled, often under governments of the left, although France still has the largest share of government expenditure in GDP of industrialised countries outside of Scandinavia. Recently France has often been viewed in unfavourable terms, with particular attention focussed on high unemployment rates since the 1980s and the limited impact of 'new economy' technologies in the 1990s. It is charged with operating out-dated policies that inhibit job creation and the up-take of new technology or, in more nuanced accounts, having only achieved partial liberalization sometimes with unexpected (even perverse) effects. Whilst the French economy has achieved productivity levels and growth rates comparable with leading economies, levels of investment in and productivity growth from new technologies remain relatively low.

Since the mid-1980s the role of the state within French political economy has been transformed. Internal pressures for liberalization and the effects of regional and global integration have undermined the policy tools of post-war intervention, not least directed credit; much of this effectively received cross-party support. The financial liberalization, discussed above, transformed the financial system towards a strikingly Anglo-Saxon character and eventually led to the unravelling of corporate networks. This is in the context of increased international integration of the French economy (Held *et al.* 1999: esp. chs 3-5): cross border capital flows have grown rapidly and both inward investment in France and outward investment by French companies have risen sharply as French multinationals are increasingly establishing international production networks but foreign ownership of French companies is also rising (Morin 2000). From the 1970s France saw rising trade and international investment flows as French industry became increasingly exposed to external competition and increasingly oriented towards European markets away from the more sheltered markets of former colonies. Growing integration and multinationalisation of French industry has undermined the traditional promotion of the French national innovation system (Mustar and Laredo 2002). As firms grew less dependent upon the state they forged new relationships with (in particular) their workforce and financiers; in other words, they actively reshaped French institutional arrangements (Hancké 2002). Liberalization in the 1980s and global and regional integration acted to sharply reduce

the scope for state intervention. As in several other countries, France has shifted away from promoting large firms as 'national champions' towards broader-based support for SMEs but with ambiguous results (Parker 1999). Clift (2004) points out that the French state remains attached to major policy initiatives, such as the 35-hour week, and defence of the public realm within the remaining space for policy activism, but its scope has been curtailed.

In terms of the institutional complementarities the French case illustrates the possibilities of rapid change. As noted above, liberalization has led to a rapid transition to a market-based financial system. France has grown relatively rapidly and achieved world frontier levels of technology; it has reversed its tendency towards relatively high inflation and reliance on devaluation to ensure external competitiveness. Despite the success of competitive deflation policies in securing productivity growth and low inflation unemployment has persisted and strained the high social insurance model. This is despite greater formal and informal labour market flexibility (Clift 2004); restrictive macroeconomic policy, human capital accumulation and physical capital investment may all have played key roles in determining French unemployment. With deeper integration and Eastern enlargement of the EU the space for a distinctive model appears squeezed.

East Asian Capitalism

The evolution of the East Asian model outside Japan remains unclear as the working out of the 1997 financial crisis continues. Within Japan the post-war model has undergone radical change with the collapse of the bubble economy in the 1990s, without a clear set of institutional arrangements emerging. The political responses to the crisis illustrate the limits of the post-war Japanese political system in undertaking effective reform and transformation.

A summary of the Japanese model that would gain reasonable assent is given by Matsuura *et al* (2003):

> The chief features of this system are: a financial intermediation system centered around 'main' banks and lead underwriters; seniority-based pay and long-term employment; inter-corporate relationships, involving a closely linked group of firms, known as 'Keiretsu'; and minute government regulation covering a wide range of economic sectors.

All these key features have been sharply eroded. The proportion of the economy under MITI measures has fallen with structural change in the Japanese economy and MITI's power within the government apparatus appears to be diminishing as its budget and personnel fall relative to the rival competition agency, the Japanese Fair Trade Commission (Matsuura *et al.* 2003). This is hardly surprising given the pressure for external liberalization from global and regional agreements and bilateral pressure from the USA. Cross-shareholding in Japan has been falling since the 1980s; much of this is accounted for by non-financial enterprises selling their shares in banks, not least because of the poor performance of those banks. As noted above, the organization of financial system around 'main' banks has diminished for large firms with the 1990s crisis.

Internationalization of Japanese enterprises and the 1990s crisis have undermined all of these features. Large firms have become less reliant on main banks and the banks themselves have ceased to play their traditional role in the 1990s crisis. So far there has been limited erosion of long-term employment relations amongst those sections of the work force to which this applies; nevertheless, employers wish to change these relations and pay relations do appear to have changed. Matsuura *et al*. (2003) found that inter-corporate relationships have tended to decline, partly with increased production overseas and increased competitive pressure to switch suppliers as enterprises have more become profitability focused. Under internal and external pressure Japan has liberalized much of its post-war interventionist regime. Increased multinational operations by Japanese corporations have hollowed out production so that their production has become increasingly dissociated from Japanese economic development in general (Cowling and Tomlinson 2000; 2002)

9. Conclusions and Implications

The focus of varieties of capitalism work is almost bound to be on national differences rather than common trends, on institutional persistence rather than change. Discussions tend to emphasize long-term continuity in institutional structures, often back decades or even centuries. The logic of conceiving of countries as having an ensemble of mutually reinforcing institutions is that change in just one would undermine the whole system. Sometimes analysts of national capitalisms do trace through the unravelling of systems in response to changes in just parts of them; more commonly there is a tendency to downplay the extent and significance of any changes and assert that each national model persists and remains viable. Further, the analytical tools we have to analyze institutional change are much weaker than those to analyze the effects of institutions. Measuring the degree of institutional change and accounting for it pose methodological challenges. . Lane (2003) makes the important point that such accounts provide limited guidance for determining whether observed transformations conform to established paths or constitute deviations from them.

Nevertheless, it is one thing to argue that there is no simple logic that globalisation will lead to convergence to an Anglo-Saxon model; it is quite another to suppose that greater international integration will have little significant impact on domestic institutional arrangements. In the past national stakeholders were compelled to achieve socially beneficial bargains they would not voluntarily have chosen; globalisation processes may weaken the basis of such bargains, and the commitment of business to them in particular. The key argument here is that significant institutional change can and does occur, in part in response to globalisation forces.

More specific claims advanced here may be summarized thus. First, here is no clear relationship between institution arrangements and economic performance; in many ways this is readily explicable within an institutionalist approach; perhaps more surprisingly the result also appears to hold for indicators of the degree of congruence of institutions. Second, state intervention has diminished with internationalization. The evidence on France and Japan is that even the traditionally most interventionist states have seen significant declines in their industrial policy. Third, attempts to posit

a common system of labour relations within nations or groups of them obscure as much as they reveal; under globalisation firms are experimenting with a variety of industrial relations strategies. Fourth, whilst differences in financial systems persist, there are grounds for expecting a shift towards market-based systems and some evidence this is occurring. Fifth, there is no simple convergence in welfare systems, but countries face broadly similar challenges and some commonalities in their responses can be delineated.

The key implications for Latin American economies here are in terms of the role of the state. The more-or-less thorough going neo-liberal policies of the 1980s and 1990s, following the crisis of earlier statist policies, have produced disappointing results in terms of growth, employment and wider social indicators. The trend is not to a reversal towards protection or traditional developmental state strategies, but more subtle industrial policies and some supporting welfare measures. Whilst the decline of developmental states under globalisation limits the operability of traditional policy tools, there are a series of imaginative policy interventions that appear to be meeting with some success at industrial restructuring and upgrading and a deserving of further research (Peres 2002; Wise 2003).

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[1] This paper draws heavily on joint work in Perraton and Clift (2004) and on Perraton (2007).

[2] There are similarities between the institutional arrangements between Korea and Taiwan, but interesting differences in their financial systems in particular (Perraton and Clift 2004: 229).

[3] For further details see: Perraton and Clift (2004) and Perraton (2007).