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A state-of-art literature report on Varieties of Capitalism approach

- work in progress -

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Introduction

Seeing that the concept of command economy failed as an alternative to the concept of market economy the last remaining one has come into a sharper scientific focus. Some strong distinctions of institutional shape of market economies in countries like Germany and the USA has been made out soon, as described by Gøsta Esping-Andersen in “The Three Worlds of Welfare Capitalism” (Esping-Andersen 1990), Guliano Bonoli in “Classyfying Welfare States: A Two-dimension Approach” (Bonoli 1997), Torben Iversen in “Contested Economic Institutions. The Politics of Macroeconomics and Wage Bargaining in Advanced Democracies“ (Iversen 1999) Colin Crouch and Wolfgang Streeck in “Political Economy of Modern Capitalism: Mapping Convergence and Diversity” (Crouch/Streeck 1997), Bernhard Ebbinghaus and Philip Manow in “Comparing Welfare Capitalism: Social Policy and Political Economy in Europe, Japan and the USA” (Ebbinghaus/Manow 2001) et al. However, the publication of the “Varieties of Capitalism. The Institutional Foundations of Comparative Advantage” edited by Peter A. Hall and David Soskice (Hall/Soskice 2001) with the contributions of other authors seems to have touched the core of the discussion at the best and has given a fresh impetus into the science of comparative political economy by devising the varieties of capitalism approach. Since then a lively debate has emerged about the question which is the ‘best-practice’ of capitalism in the face of increasing competition not only in the realm of firms but also of institutional fitness of national economies in the face of the globalization process.

The discussion is also relevant to the EU-Commission’s idea of a common EU welfare model. Within the EU the variety of capitalism and of welfare models is widely diversified – some different types of national market economies with different shaped welfare systems and labor markets compete with each other. This context raises the question weather the EU prefers one of the models and weather its policy influences their institutional adjustment. At least, there is a need to research the question of the relevance of the varieties of capitalism literature for the East European cases, especially for those economies within the EU. What kind of capitalism has emerged since the political and economic transition there? Must the new EU members develop into liberal market economies with minimised welfare systems in order to become internationally competitive economies? And even if there is a need for such transition, are they able to radical institutional changes, an ability which Hall and Soskice would deny according to the varieties of capitalism approach?

In the report you will find abstracts of the core essays and monographs on the issue published since the work of Hall and Soskice. The report is meant to gain a state-of-the-art overview of the varieties of capitalism literature by systemize it into four cluster regarding subjects as following: The abstracts of the approach of Hall and Soskice and of some critical essays are compiled in the first chapter as well as Hall's and Soskice's response to the critics. In the second chapter you will find the abstracts of texts in which the authors raise the question, how many different types of capitalisms can be identified anyway. The third chapter delivers an overview over the literature of authors developing further the varieties of capitalism approach. And the last chapter includes the abstracts of literature connecting the varieties of capitalism to the issues of the EU and those of its new member states.

1. Debate on the Varieties of capitalism approach

Hall, Peter A. and David Soskice (2001): An Introduction to the Varieties of Capitalism, Peter A. Hall and David Soskice (eds.): Varieties of Capitalism: The Institutional Foundations of Comparative Advantage. Oxford/New York: Oxford University Press: 1-68.

Facing the globalization process national economies and their institutional arrangements are confronted with the increasing competition to each other in order to generate the best economical results as national wealth growth, high employment etc. The liberal argumentation in this issue supports therefore institutional deregulation and the welfare-state retrenchment as the adequate responses to the challenge and names the economies of the USA and of the UK as the successful models of capitalism. In their opinion, the less liberal market economies as f. ex. Germany, Sweden, France or Japan should change their institutional arrangements into liberal ones to keep competitive on the global markets. Peter Hall and David Soskice contradict to this argumentation. Distinguishing themselves from the neoclassical approach and its assumption of convergencing systems into a uniform, deregulated global market Hall and Soskice add to the model of homo oeconomicus, the subject acting according to its cost benefit analyse, the aspect of the influence of social institutions. These are the framework and enable the actors to the economical acting by supplying stability and expectations security. The institutions have developed in a long-term evolution to stabile structures connecting the constitutional parts of market economy and the social connection between the parts means much more then the addition of all the parts only, so the system tends to keep stabile structures. The market actors have a strong interest in adjusting their acting to these arrangements because they associate a radical change of the institutional structure with high costs of insecurity. An institutional change would threaten the institutional equilibrium of rules, norms and forms of market dependencies. Following Hall's and Soskice's argumentation a convergence of economical systems would be an illusion.

Applying the new economics of organization to the macroeconomy, the authors distinguish between two models of production systems at the poles of a spectrum along which many countries can be arrayed. They point out clear distinctions between the both ideal types in the spheres of corporate governance, education and training system, system of intercompany relations and industrial relations. Analyzing these distinctions Hall and Soskice name the economies in the USA and the UK as the Liberal Market Economies (LMEs) where the coordination between the actors is organized by the competitive market forces. While the other economies are added to the ideal model of Coordinated Market Economies (CMEs) where the coordination is centred on networks more then market and the competitiveness is embedded in strategic cooperation. Concerning globalization, both types feature advantages and disadvantages. Focusing on their strengths the LMEs and the CMEs develop different strategies and specialize under the pressure of globalization in order to generate their own specific advantages. Hall and Soskice find therefore no evidence for general deregulation tendencies. On the contrary, as response to the globalization processes, the decentralization of production regimes in the CMEs occurs in coordination of the firms with the trade unions.

As conclusion, Hall and Soskice expound the problem of changing a CME into a LME. In their opinion, a radical change is impracticable without paying attention to the distinct institutional structures, which complementarily act in concert shaping a variety of capitalism.

Hall, Peter A. and Daniel W. Gingerich, (2003): Varieties of Capitalism an the Institutional Complementarities in the Macroeconomy: An Empirical Analysis

As the varieties of capitalism approach (Hall/Soskice 2001) has become issue of a lively debate Hall and Gingerich subject its core postulates to empirical tests based on aggregate analysis of a large number of cases.

Establishing Coordination as a Crucial Dimension

Since, according to the varieties of capitalism approach, coordination represents a crucial dimension in order to distinguish the varieties of capitalism Hall and Gingerich aim to identify it as principal component loading on the relevant variables across spheres of the political economy. Using the principal factors method to perform a factor analysis, a structure detection technique, they obtain a factor assessing the balance of strategic relative to market coordination in the political economy that they label as a “coordination index”. As its application on the cases of national economies affirms the basic distinction between strategic and market coordination Hall and Gingerich propose to use the index as a broad measure for the diverse types of coordination.

Institutional Complementarities in the Macroeconomy

As next core postulate of the varieties of capitalism approach the economists assess institutional complementarities in the macroeconomy considering as examples the three most important ones by empirical testing: the complementarities between labor relations and corporate governance, these between labor relations and training systems and the ones between corporate governance and inter-firm-relations. Again, using the principal factors method they performed a factor analysis on the variables among the spheres of the macroeconomy and compared the results across the national cases. The results of the analysis illustrated by figure 2 in attachment of the essay (Hall/Gingerich 2003: 35) provide the evidence of significant complementarities between the above-mentioned spheres of macroeconomy. Moreover, it suggests that firm strategy varies systematically across nations to exploit the complementarities available with the different institutional context.

The effect of complementarities on Economic Growth

As next step, Hall and Gingerich examine the claim of the varieties of capitalism approach that rates of growth should be higher in countries with the pure types of coordination, either market or strategic, than in those where coordination is mixed or is secured at lower levels. Using three different econometric approaches, they estimate the effect of coordination on annual rates of per capita economic growth for OECD nations from 1971 to 1997. As the tables 4, 5 and 6 and the figure 3 illustrate (Hall/Gingerich 2003: 37-38) the results affirm the estimated relationship between coordination and growth. The higher levels of market or strategic coordination allowed by the institutional structure of the political economy the higher estimated growth rates. The scientists point out that “these findings have important implications for many of the institutional reform proposals” (Hall/Gingerich 2003: 18) such as deregulation of labor markets. As there are relevant effects of complementarities on growth institutional changes in just one sphere are likely to have only small effects on growth or even deleterious ones and should be considered in relation to the institutional changes in other spheres.

Political and Economic Adjustment Paths

Finally, Hall and Gingerich turn to issues of institutional change and raise the question whether the different patterns of coordination will persist or are they likely to convergence in face of international pressures for changes. Firstly, they examine the effect of economic dynamics, such as the shift from manufacturing to services, technological change, and international liberalization, on the efficiency of the institutional complementarities between labor relations and corporate governance. The results of their analysis presented in Table 7 (Hall/Gingerich 2003: 41) may be interpreted that such economic changes may be altering the effectiveness of existing institutions in the last decades indeed. Thus, the pressures to change existing institutions should increase. The political response to contemporary economic challenges becomes, therefore, especially important. According to the varieties of capitalism literature the response will vary across liberal and coordinated market economies. While there will be political support for more deregulation in liberal market economies, cross-class coalitions arise to support existing regulatory regimes in the coordinated market economies. Hall and Gingerich go further into that question by examining a number of indicators, such as levels of income inequality, levels of conflict in industrial relations and others from the spheres of labor relations, social protection, firm strategy and finance. On balance, they conclude from the obtained results that “institutional practices have not converged dramatically across political economies in recent years” (Hall/Gingerich 2003: 22). Although the coordinated market economies have made efforts in some spheres to improve flexibility, one can not identify a pattern of “widespread convergence in the face of substantial economic pressures during the recent period” (Hall/Gingerich 2003:22).

Hall, Peter A. and David Sockice: Varieties of Capitalism and Institutional Change: A Response to Three Critics, in: Comparative European Politics (2003) 1, p. 241-250

The scientific debate over the issue of the varieties of capitalism (shortly VofC) assumes the shape of a dialog after the founders of the theory Hall and Soskice have given responses in this essay to some critics on some aspects of their construct. Animated by essays of Robert Goodin, Mark Blyth and Michael Watson they felt obliged to clarify their claims and to extend their analysis of matters such as unemployment and the service economy, comparative institutional change and comparative institutional advantage.

According to the issue of unemployment and the service economy Blyth doubts that the countries with coordinated market economies (CMEs) are able to match the employment performance of countries with liberal market economies (LMEs) as claimed by Hall and Soskice (Blyth 2003, p.43-45 and Hall/Soskice 2001, p.21-22). Halls and Soskice response to this by emphasizing their principal claim of VofC that “many of the regulations or policies that others see exclusively as the source of rents or rigidities [according to the labour-markets in CMEs (*authors note)*] actually enhance the operation of coordinated market economies and their employment performance.” (Hall/Soskice 2003, p.242). They also go further in Blyth’s question whether the CMEs can continue to generate employment in future as the sectoral composition of economy shifts toward services, a sector which seems to be successful within the LMEs-structures. The evidence for such pessimistic view is, in their opinion, ambiguous. Firstly Germany generated the same rate of employment in services from 1980 to 1995, by 15%, as the UK, a classic liberal market economy with strong reputation in services. Secondly there are low unemployment rates in many of the CMEs for 2001 as in the Netherlands (2,1%) Austria (3,6%) and Sweden (4,6%). However, they see a need for further work on how nations adjust to the rise of the post-industrial economy as the problem of unemployment mainly affects the CMEs countries.

With regard to the issue of the comparative institutional change Goodin raises the questions whether countries whose institutional structures of political economies are not the purest types of coordinated or liberal market economy will survive the raising international competition and where institutional change is likely to take such hybrids with imperfectly developed market or strategic coordination. Refering to Gingerich's and Hall's essay *Varieties of capitalism and institutional complementarities in the political economy: an empirical analysis* (Gingerich/Hall 2002) and to their basis essay about the VofC Hall and Soskice indeed consider economies lying between the "pure" poles of CMEs and LMEs as less efficient than those pure types (Hall/Soskice 2003, p. 244-245). Although efficiency considerations of labor relations and corporate governance, two crucial dimensions of difference consequential for national policy and economic performance, are relevant to institutional change, Hall and Soskice want them to be seen as a political process driven by many factors. As result of this view economies which are mixed types of CMEs and LMEs don't have to move inexorably toward the both ideal types by changing their institutions. They doubt as well the ability of CMEs to converge toward a liberal economic model. Although there are tendencies in CMEs to liberalization of markets and institutional forms in order to intensify international competition, CMEs are not seen as fragile by Hall and Soskice. Refering to Gingerichs and Halls data on patterns of institutional adjustment in the developed political economies (Gingerich/Hall 2002, p…..) they point out that during the 1980s and 1990s the LMEs also moved in a 'liberal' direction deregulating institutions in some sectors as labor market and industrial relations even more than CMEs. That's why they want to see "the overall pattern as one of change but not institutional convergence" (Hall/Soskice 2003, p. 246).

To Watson's critic on the analysis of comparative institutional advantage, Hall and Soskice response clarifying that their analysis associates the level of institutional support for market and (non-marked) coordination in a nation with the type of innovation likely to be found there. In contrast to Ricardo's theory of comparative advantage their analysis covers international flows and predicts flows of investment in specific types of endeavours: in firms within LMEs to create radical innovation and in firms within CMEs to create incremental innovation. While companies with international reach should shift act across national borders to benefit from both comparative institutional advantages. As for the explanation of the origins and sustaining of institutions Hall and Soskice agree with Watson that the institutional variety of capitalist economies is not likely to be explained best by reference to the comparative economic advantages those institutions support. Although they link the persistence of some institutions in countries as UK or Germany to the comparative institutional advantages to the national economy or to the competitive advantages to firms, they have not meant to supply a full explanation of the origins and sustaining of institutions by their analysis.

Encouraged by the criticism and responses to their VofC approach Hall and Soskice see the challenge in developing more complete models of the complex interplay between action in the economic and political arenas that underpins institutional stability and change (Hall/Soskice 2003, p. 249).

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