

POLITICAL
ECONOMY OF
MODERN
CAPITALISM

MAPPING CONVERGENCE
& DIVERSITY

Edited by
Colin Crouch and Wolfgang Streeck

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Mapping Convergence and Diversity

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PREFACE

A full quarter century separates the publication of Andrew Shonfield's *Modern Capitalism* in 1965 and Michel Albert's *Capitalisme contre Capitalisme* in 1991, but in many respects the books are remarkably similar. Both are by men busily engaged in the world's affairs but capable of deep reflection on the wider implications of the changing economic environment. Both books rapidly had an impact on public debate in a number of countries. Both analysed and revealed the institutional underpinnings of government policy and social organization that are fundamental to the operation of economics but which are often ignored by academic economic science.

There is however a major difference in the economic climate within which these works appeared. When Shonfield was writing his immediate British public was keen to hear of new ways that economies might be managed other than through the stereotypical alternatives of free markets and state ownership – though the variety and subtlety of his discussion of national forms of capitalism tended to be temporarily lost in the general desire to concentrate on one form in particular: *planification à la française*. Ironically, the Frenchman, Albert, is less interested in his own country's specific approach than in the confrontation between institutional and free-market capitalism, captured largely in a comparison between German and US models. But the main difference in the climate of the 1990s compared with the 1960s is that there is less sympathy, at least among elites, for discussions of institutional arrangements. The prevailing orthodoxy emphasizes neo-liberal policies, deregulation and flexible labour markets, and treats most other forms of economic institution as sources of rigidity and inefficiency. At the precise time of publication of Albert's book the mood was different, which was one reason why it attracted so much attention. Since 1992 however, in the wave of disillusion with the scope for constructive public policy-making that seemed to follow the Treaty of Maastricht, an uncritical neo-liberalism has come to dominate thinking in many national governments as well as in international organizations.

Why is this so? Is this convergence on a preference for free markets a well-founded or a panic response to intensified global competition? What are its likely implications for the institutional diversity of the advanced economies? Will they all converge on an imitation of the USA? How do the very different arguments that have led to attempts to imitate Japanese economic institutions relate to this?

It is to answer questions of this kind that this book has been prepared. Its origins lie in the different activities of two other thinking men active in

public life, and again an Englishman and a Frenchman. Sir Arthur Knight, with some associates, founded the Andrew Shonfield Association in the mid-1980s to try to bring together business people, people active in public life, journalists and academics to continue the kind of work that Shonfield had started in his several books: the practical but intellectually informed analysis of the public policy issues facing business in western Europe and elsewhere at a time of rapid change in the global economy. It was within the framework of debates within the Association that the ideas in the present volume took shape. René Monory, past president of the Senate of France, chairman of the Conseil Régional de la Vienne, founded some years ago at Poitiers the Observatoire du Changement Social en Europe Occidentale, with similar objectives of bringing together academics and *hommes des affaires* to consider the future challenges confronting Western Europe. A joint initiative by the Association and the Observatoire enabled the editors to organize in October 1994 a seminar at the Observatoire in Poitiers and a larger conference in Paris, from which the chapters in this volume developed. We are indebted to all involved in both organizations, and to all who attended the two meetings, for having made our venture possible. The editors and individual contributors are of course solely responsible for the contents of the chapters, which do not necessarily reflect the views of others associated with either the Association or the Observatoire.

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INTRODUCTION: THE FUTURE OF CAPITALIST DIVERSITY

Colin Crouch and Wolfgang Streeck

Institutional capitalism: diversity and performance

Interest in the diversity of modern capitalist economies became widespread as far back as the late 1960s, when a new generation of social scientists began to challenge the then ruling 'convergence theory' of 'pluralist industrialism'.¹ The scholars associated with this emerging tradition were sociologists and political scientists at least as much as economists, and the diversity in which they were interested was seen as resulting from differences in the institutional structures of societies, not only purely economic institutions but also political and wider social ones. This is why what has by now become a broad stream of theory and research is often referred to as 'new institutionalism' (for a selection of recent studies see Berggren, 1991; Dore, 1986; Jürgens et al., 1989; Maurice and Sorge, 1989; Best, 1990; Sako, 1992; Kogut, 1993; Hollingsworth et al., 1994).

For the new institutionalists, the differences they found in the social organization and the *modus operandi* of modern capitalist economies were of more than merely aesthetic interest. Describing and analysing them served to make a fundamental political point: that, contrary to the demoralizing message sent by Kerr et al. (1960), technologies and markets were far from fully determinative of social life under capitalism, and that societies had non-trivial alternatives with respect to how they wanted to run their respective capitalisms and, by implication, what kind of society they wanted to be. It was true that sometimes these choices had been made long ago and were now deeply entrenched in an established 'culture' that was, at least in the short term, beyond the reach of contemporary actors. Nevertheless, the very idea of alternatives and choice implied that, to some extent at least, purposeful collective action – in one word: politics – could make a difference even and precisely for the nature of advanced capitalism. Observed and relentlessly documented capitalist diversity stood for the promise that, provided one could create the 'right' political conditions,² people in twentieth-century societies did have a capacity to reorganize their capitalist economic systems in line with collective preferences, within a broad band of meaningful alternatives.

Very importantly, the politics that was supposed to generate capitalist diversity was national. This was not because of any inherent affinity of institutional analysis to the nation-state, nor because of normative preferences on the part of theorists for markets to be interfered with only by national and not by other agents of collective intervention. Instead it reflected the historical fact that it happened to be mainly through and within nation-states that twentieth-century capitalism was organized and regulated by twentieth-century society,³ and that in particular it was only at national level that societies were able through democratic politics to 'talk back' to their economies. For popular-democratic intervention in the economy, the nation-state simply was the only game in town, like it or not – and indeed many of the post-1968 generation did not like it at all and remained profoundly uncomfortable with it.

Mapping capitalist diversity

In the 1980s a welter of studies showed advanced capitalist societies to vary profoundly in the way they dealt with the two core institutions of capitalism: competitive markets and property rights based organizational hierarchies. Markets and hierarchies were found to differ between countries, not just in their scope or reach, but also in their mode of operation. Just as in some societies markets tended to be more flexible and 'liquid' than in others, managerial hierarchies, rather than always being operated unilaterally, had to differing degrees to be negotiated between their participants.

Moreover, research into Japanese firms in particular suggested an important refinement to the concept of hierarchy. Any large firm is likely to have a structured set of relationships through which orders are transmitted, making companies into social institutions and not just clusters of individual exchanges. Some firms, however, go considerably further than this and generate entire cultures and communities within themselves. A company culture embodies certain values about specific ways in which work is considered to be conducted in that firm, and becomes the basis for appeals to loyalty. Companies of this kind usually develop internal labour markets and encourage long service among their employees, to the extent of developing a company level of social policy. While these firms can exist within highly competitive product markets, they do suspend the operation of market rules in their labour relations. They can be identified as institutional companies to distinguish them from mainstream hierarchical firms.

Institutionalist analysis also urged recognition of at least three other, equally important, mechanisms of economic governance. Not only did these differ even more strongly between countries, but they also formed a wide variety of configurations with markets and firms, embedding the latter to different degrees and in different ways in broader social contexts and thereby further defining their jurisdiction and operation. First, far

from being limited to the maintenance of public order and the enforcement of contracts, states were found to be deeply and variously involved in the management of capitalist economies, so much so that different 'state traditions' made for quite different rules and outcomes of economic action. Second, formal associations, such as *Kammern* and trade unions, organized cooperation between competitors and negotiated collective rules of exchange between groups with opposing interests, thereby both modifying the functioning of markets and firms and adding to the variety among states. Third, informal communities and networks apparently controlled a significant share of certain economies' transactions, and in varying degrees helped to sustain as well as transform the other mechanisms of governance.

Capitalist diversity was found to affect wide areas of economic activity. More importantly, some national economies were found to be more 'institutional' than others, in that they tended to subject a wider range of economic activities to governance mechanisms other than and in addition to market exchange and managerial prerogative, while typically also modifying the two through various forms of social intervention. It was the presence of these 'institutional economies' that most strongly supported the claim that capitalism was more than one system, and that modern capitalist economies were open to, and indeed required, defining influences of a social as well as an economic kind.

Performance and competitiveness

From the beginning, the new institutionalists took a strong interest in how different institutionalizations of capitalism related to different economic performance patterns. Increasingly during the 1970s and 1980s, and with rising confidence derived from a growing stock of evidence, claims were made that the typical performance pattern of institutional economies gave them a competitive advantage over economies operated by free markets and unfettered hierarchies. Apparently this was because institutional economies could combine keen competitive behaviour with the pursuit of collective goods, from which they derived advantage over economies that were locked into short-term market maximization. For example, it has been argued that during the 1980s the greater capacity of the German economy for producing the collective good of a skilled workforce enabled that country's motor industry to produce high-quality vehicles of a type that eluded its British competition. In analyses like these, diversity residing in social-institutional differences was understood as constituting factor advantage or disadvantage, in the same way as natural resources. Conventional economics was more reluctant to recognize this, because institutions often operate on economic behaviour in a way that neo-classical theory has to regard as a distortion. However, more flexible forms of economic analysis have demonstrated a capacity to adapt and take account of institutions in theory (see Soskice, 1990; Crafts, 1992).

The 1980s were the decade in which the competitive advantage of institutional capitalism was celebrated in the academic literature. Obviously this was a period when various continental European economies as well as Japan were outperforming the two countries that seemed to correspond most fully to a 'pure' free market model: the UK during the 'de-institutionalizing' Thatcher period, and the USA. Work done at the time showed, for example, the importance for competitive economic performance of formal and informal links between competing firms in the German, Italian and Japanese economies, although such links operate in very different ways in each of these countries (Bagnasco, 1977; Dore, 1986; Sabel et al., 1989). 'Networks' of this kind enable profit-seeking companies to cooperate with one another in the pursuit of collective goods despite their competition, with cooperation requiring only limited recourse to the sort of state action that is often considered indispensable for collective goods production. Differences in the model of cooperation between institutional economies were, again, regarded as functionally equivalent means for securing identical ends: like, for example, the differences between the formal associational structures of German business on the one hand, and the informal community links that bind central Italian firms on the other; or between either of these and the coordinative role of the French state. The notion of functionally equivalent institutions opened up an even richer landscape of possibilities of how to make an internally and externally competitive market economy compatible with a desirable society, and by implication once more underlined the economic significance of 'culture' and, embedded in it, politics.

Over time, several 'models' of institutional economies had their theoretical and political conjunctures, depending in part on their economic fortunes, but also on changing perceptions of their operation and on shifting political values. For a while, Sweden was widely regarded as the foremost example for the national-political malleability of capitalism. Later it was increasingly joined by (West) Germany, whose prestige with the left rose inexorably in the 1980s, in spite of the Kohl government, while it declined somewhat among the right, which was compelled to recognize that the 'social market economy' was a good deal more social than many of its admirers had believed. Japan came to be embraced by conservatives for its 'work ethic' and the apparently unlimited willingness of its workers to accept managerial authority – social contributions that even the freest of the free marketeers would rather not want to miss. More seriously, Japanese economic success provided others, like Ronald Dore (see this volume), with evidence that, *pace* Adam Smith, it is not just the self-interest of the butcher but also his benevolence – his commitment to ethical values restraining that self-interest – on which the performance of a modern capitalist economy depends.

The message all this was to convey was that attempts to impose social control on capitalism were not at all doomed to failure by the 'economic realities' that were so confidently invoked against them by mainstream

free market economists. Quite to the contrary, the superior performance of countries like Japan and Germany, but also very much northern and central Italy, seemed to indicate that economies which refused to be talked back to, and insisted on extricating themselves from political and social regulation, were *ipso facto* and on their own terms deficient – ultimately reflecting the fundamental fact that economic action is always and inevitably social action, and for this reason depends for its successful conduct on a supportive social context.

The study of capitalist diversity and its implications for competitiveness supported a common, generalizable conclusion, one that went far beyond the technicalities of macro-economic management and the apparently technocratic details reported in Shonfield's book. While Shonfield had made visible the diversity of national economic regimes, what he really meant to demonstrate was a general need for all countries, albeit each according to its traditions and politics, to build strong non-market institutions for governing their economies. In this respect, his work was not just about diversity, but also about 'convergence' – convergence of the variety of democratic ('modern') capitalist nations on and under the 'embedded liberalism' (Ruggie, 1983) of the post-war period, that is, on a common practice of internationally protected and socially protective institutional regulation of capitalist economies by and within sovereign but similar and cooperating nation-states.

The crisis of institutional capitalism: back to convergence?

The deep recession of the German and Japanese economies in the early 1990s caused a change in the perception, and perhaps indicated a change in the reality, of the economics of capitalist diversity. With the USA and the UK beginning to expand at a time when in Japan and many of the continental European economies unemployment was still rising, old claims about an inherent lack of competitiveness on the part of institutional economies were again heard, and were more confidently made than ever before. At the time of writing it is not possible to decide whether this was based on purely temporary, conjunctural phenomena associated with the timing of national economic cycles. Something rather similar had, after all, happened for a brief period in the mid-1980s with respect to the continental versus British economies, and it is quite compatible with the notion of short-termist economies that their initial recoveries may be more rapid than those of countries locked into longer term behaviour.

The new competition

Still, there is no doubt that institutional economies, and most of all German-style, high-wage, high-cost and high-quality regimes that allow for only limited wage differentiation (see the chapters by Pontusson and Streeck, this volume), have come under pressures for change that would

have been hard to foresee only a few years ago. In part this seems to reflect a declining capacity of such economies to avoid price competition by specializing on less price sensitive quality markets. Technological developments and improved managerial and accounting systems seem to widen the price differentials between advanced industrial nations and low-cost producers in the Far East and, increasingly, Eastern Europe, to a point where many consumers' trade-off between price and quality has become affected. Moreover, in some areas of production it is not even clear that there is still a quality difference. While new production technologies may originate among the institution-rich economies of the West and Japan, they seem to be increasingly amenable to being applied by poorly skilled workers in poorly equipped infrastructures, to turn out products that are not only cheap but also of high quality.

In addition, accelerated technological change, renewed price competition and the globalization of financial markets have combined to produce a world economy in which a premium seems to be placed on speed of reaction: on rapid product change and an ability to cut costs fast. To the extent that this favours decision-makers who can act without having to seek agreement within their organizations, it challenges the viability of institutional economies which, depending as they do on 'voice' mechanisms for change and improvement, assume committed resources and make change dependent on broad consensus. On the other hand, the force of this argument is reduced by at least two important considerations: first, unilateral fast decisions by non-responsive leaderships may generate mistrust and thus necessitate cost-intensive legal-contractual regulation; second, they may also be less than constructive where organizations depend on widespread employee commitment (Sako, 1992).

Certainly the last word on the social conditions of competitiveness is far from spoken. Today the socio-economic model of a high-wage economy with relatively egalitarian wage dispersion and effective democratic participation, in the political system and the workplace, appears on the defensive. If advantages lie overwhelmingly with fast moving, low-cost, unregulated market behaviour, then economies of the institutional type that refuse to admit increased inequality, stepped-up pressure on individuals, families and communities, and greater discretion in decision-making by managers and investors may be doomed, and only deregulated, finance-driven capitalisms of an Anglo-American kind may stand a chance of meeting the Far Eastern and Eastern European competition. But this argument is itself not without problems. At some point it will need to clarify whether it is really expected that British and American wages and social and infrastructural costs can be forced down to a point where they can compete on straight cost terms with the Far East and Eastern Europe, or, alternatively, whether it is assumed that inheritance of certain institutional and infrastructural features will provide advantages that compensate for higher costs. Answering the former in the affirmative creates a real credibility problem, while the latter does not differ very

much from arguments in defence of institutional economies: it simply asserts that effective competition will take place at a point of lower cost and quality trade-off.

The economic capacity of institutions

Generally, there is a need to proceed beyond crude distinctions between institutional and pure market economies, and between strategies likely to succeed and to fail. More differentiated typologies of governance mechanisms – like markets, firms, states, associations and communities – make one less likely to run to easy conclusions concerning the general or overwhelming superiority of any particular kind of economy. For example, formal associations are likely to be more associated with a strong collective goods potential than market systems, but less with adaptability. However, one must again be cautious of asserting too many a priori rules. Associations might be prone to rigidity because there must usually be widespread consultation before they can act. But the high trust that can be established through associational networks may also increase the speed of decision-making, by reducing the need for formal transactions, avoiding costly trial and error, and accelerating the diffusion of best practice. Alternatively, while pure markets are usually associated with short-term actions and exchange rather than long-term enhancement, there are niches within pure market systems for firms specializing in research-based technologies.

Undoubtedly institutions may sometimes have a negative effect on economic performance, or they may outlive an earlier usefulness; but discovery of this will have to be the result of detailed theoretical and empirical investigation, not a conclusion to be derived axiomatically. At the same time, failure to recognize the role of institutions in, for example, sustaining creative entrepreneurial behaviour may lead, and indeed is currently leading, to the false conclusion that markets alone can sustain economic dynamism. This is particularly observable in the former Soviet bloc countries. The communist system allowed no true markets, and eventually produced economic stagnation; therefore it may seem that all that is needed for economic dynamism is free markets.

The point is, however, that communism destroyed not only markets, it also destroyed – or in many parts of Eastern Europe, took advantage of the absence and prevented the formation of – the very associational and community networks that are central to the Western concept of civil society. It is often accepted in the West that civil society is important for things that the economy cannot provide: for example, welfare, a sense of collective identity, and control of deviant behaviour. But civil society also produced such institutions as the Japanese employment system, the small-firm communities of central Italy, or indeed the dense web of relations that bind the firms of the British financial sector – the ‘City of London’ – into something far more than just a multitude of competing companies. Indeed, in some

respects the move from state socialism to pure capitalism that seems to be the current fate of much of Eastern Europe is among the easier transitions for that part of the world to make. While in the past people in these societies were told that economic success came from the state, all that has changed now is that the state has been replaced in the message with the market – again leaving out the crucial role played by social institutions.

Competitiveness re-examined

A useful starting point for re-examining the problem of performance and competitiveness is the insight that economic success often depends on finding niches of some kind that provide temporary relief from immediate competitive pressure. After all, what the individual entrepreneur requires is not maximal competition, but sufficient security and confidence to risk investment in major projects. Schumpeter recognized this in his argument on the paradox of monopoly, but a more flexible and more generally applicable argument has recently been developed by Kay (1993) in his analysis of successful competitive strategies. The aim of really successful firms, he argues, is to find niches where there is a temporary distinctiveness of some kind – not to find the anonymous, purely competitive position of ‘average’ firms around which economic theory is axiomatically built. Of course, if such a situation persists without challenge for a prolonged period, the lethargic symptoms of uncompetitiveness will set in; but where there is nothing but relentless competitive pressure, it is likely that only the most short-term forms of trading or petty production will become established. If Soviet Eastern Europe provided abundant cases of the former weakness, in the new Eastern Europe there are many instances of the latter.

As Kay himself argues, this reasoning can be extended to countries. German apprenticeships, Japanese consumers’ resistance to imported products and the ability of the French state to regulate competition constitute distinctive features of national societies that help domestic producers to gain a competitive edge. But Kay’s theory also allows us to deal with the case of the USA. While the USA is often seen as the purest example of a market economy among developed nations, it is also the world’s dominant political and military power, with a unique investment of state resources in defence and aerospace technology; it has a distinctive commitment to expenditure, private and public, on higher education; and it has exceptionally high rates of immigration, and consequently a higher birth rate and a more multi-ethnic population, than almost all other industrial nations. None of these attributes can be derived from the pure concept of the free market, but all in their way constitute distinctive resources at the disposal of US companies.

For example, it is true that the US economy lacks traditional community ties and widely accepted customs of the kind that bind, say, Japanese businesses, with each other and with their employees. However, precisely because of the ethnic diversity that is a major cause of this, distinctive

sub-cultures and ethnic communities have often been the base for economic organization and the establishment of trust networks. One may go even further and argue that the very lack of collective identity that underlies much of the individualism of American life, has made it possible for some of the large corporations to manufacture a sense of company identity and loyalty among their employees that transcends the simple wage-effort bargain. This may be very different from the kind of loyalty on which Japanese employers are able to draw, but it sometimes seems to have similar results. Both defenders of the 'American way' as the way of pure markets and individualism, and critics of its anomie and lack of relationships other than contract and short-term obligation, miss this important characteristic of many of its most dynamic firms.

In addition and even more importantly, the present resurgence of the American economy indicates that certain assumptions underlying some of the work of the 'new institutionalists' were, from their perspective, excessively optimistic. Claims, however implicit and qualified, that an economy can be competitive only with a benevolent politics and a cohesive society were clearly premature. While for a time it seemed evident that a socially cohesive society was capable of being economically competitive, Hollingsworth shows in his contribution to this volume how the American example today indicates that in turn competitiveness may well be compatible with social decay, at least in certain conditions and for a considerable length of time. Large US firms, rather than having to wait for a political restoration of American society, made their comeback in the 1990s in an environment of progressive infrastructural decline, growing social inequality, and accelerating destruction of the social fabric at the lower end. To the extent that their recovery required social relations other than pure markets and hierarchies, they were apparently able to generate these in-house, applying social engineering technologies like human resource management and corporate culture building.

Far from needing an institutional economy to surround them, institutional firms of this sort seem to be able to achieve a remarkable degree of autarky from their social and political environment,⁴ which among other things enables them to cross national borders with great and growing ease. The formation of such firms, which increasingly seem to occupy the place of more traditional communities and social identifications, is one of the most consequential developments in the recent history of capitalism, one that must be seen in the context of another fundamental transformation, the globalization of markets and the resultant attrition of the governing capacity of nation-states.

The future of capitalist diversity

The full extent of the challenge of globalization to capitalist diversity, and in particular the impact of international financial markets, are pursued in