

Mapping European Capitalisms and the Challenge of Social Context

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Introduction

The models (or varieties) of capitalism literature has come to dominate the study of comparative political economy and particularly the analysis of European economies. This perspective rejects the monolithic view of capitalist economies driven to convergent institutional arrangements by common market imperatives. Instead it is argued that there are multiple efficient ways to adapt to global markets, focusing on the ideal-typical liberal market economies (e.g., the US) and coordinated market economies (e.g., Germany). These traits create comparative institutional advantages that allow for divergent – but equally successful – economic strategies. Unfortunately, while the literature on the subject is substantial (representative texts include Berger and Dore, 1996; Hollingsworth and Boyer, 1997; Crouch and Streeck, 1997; Coates, 2000; and Hall and Soskice, 2000), most of it is based on detailed case studies with a good deal of variation in how different capitalisms are conceptualized (Coates, 2005). Considering the overall volume of studies in this area there have been relatively few attempts to quantify these concepts. As such it makes it difficult to either comprehensively explore the variations in forms of capitalism or effectively assess the connection between particular models and economic performance.

The purpose of this paper is thus threefold. The first is to reconceptualize the idea of the ‘models of capitalism’, extending the core concepts beyond the predominant institutional focus (dubbed here the economic context) to include the broader context of public policy and political-economic culture (the policy and social contexts, respectively). This framework can then be used to empirically map European and other capitalist economies in a manner that highlights both differences across countries and transformations of national economies over time. Based on this, a preliminary assessment of the comparative economic performance of different forms of capitalism can be made.

This analysis shows that there are measurable differences across capitalist economies that largely conform to a priori theoretical expectations and can be used to distinguish between coordinated, liberal, and ‘intermediate’ market economies. Examining the nature of these models across time shows the mode of capitalism practiced in some countries is largely unchanged while other states have transformed considerably. Surprisingly, however, the movement has not been uniformly towards greater liberalization, as analyses of globalization would imply; some states, most notably Ireland, have become more coordinated. Connecting types of capitalism to aggregate economic performance, the evidence first shows that there appears to be a statistically significant connection between different models and economic outcomes. All else being equal, the performance of more coordinated economies has declined in recent years while that of more liberal economies has improved, which

gives some support for those advocating for liberalization in the face of globalization. Ironically, however, it is those economies that are neither clearly liberal nor coordinated that have been most robust. This calls into question the so-called 'institutional coherence' thesis, discussed in more detail below.

Models of Capitalism and Their Measurement

The 'models of capitalism' school can trace its lineage back to the seminal work of Andrew Schonfield (1965), although it has antecedents in the work of Karl Polanyi (1945) and the analysis of comparative economic systems (then including socialist and communist economies). The basic message of this approach is that, contrary to mainstream economic theory, capitalist economies are not uniform and interchangeable. Rather, markets are embedded in specific institutional, regulatory and social structures that shape national development. Actors in capitalist economies may face common problems – managing industrial relations, gaining access to finance, securing a properly trained workforce, dealing with suppliers and clients (Hall and Soskice, 2001, p. 7) – but they have developed diverse institutional means to resolve them. The focus is on cross-national variations in the organization of business and corporate governance, the structure of corporate finance, the patterns of labor relationships, the prevalence of corporatist interest intermediation, the pattern of human capital and labor skills formation, the role of the state in regulating economic interaction, etc. The core principles of the models of capitalism paradigm are thus (a) a belief in capitalism as a socially embedded construction; (b) that different capitalisms can be distinguished by their underlying institutional configurations; and, perhaps most importantly, (c) that these organizational differences are crucial in determining relative levels of economic performance (Phillips, 2004).

This school has not, unfortunately, settled on a categorization scheme. The primary breakdown is between Anglo-American (or neoliberal) states; state-led or 'developmental' models, as found in Japan and East Asia, but sometimes also including France; and social welfare or coordinated models common to Western Europe. Sometimes the framework is narrowed: Coates (2000) distinguishes only between liberal and 'trust-based' models, while Hall and Soskice (2001) note only liberal market economies' (LMEs) and 'coordinated market economies' (CMEs), although the assumption is that all other states fall in between the two ends of this spectrum. Still others have also gone in the other direction, creating separate models for almost every national system, implying a distinct 'Swedish model', 'Japanese model', 'Rhineland model', etc. – and begging the question of whether systems so labeled can reasonably be described as 'models'. The approach adopted here is the Hall and Soskice

portrayal of liberal market and coordinated market economies representing two ends of the spectrum with other states scattered in between.

What is the purported influence of these different models in practice? The United States is the prime example of a liberal economy. Corporate finance focuses on the sale of equity shares, requiring managers to be attentive to current corporate earnings. Industrial relations are contractual and transient; managers can craft corporate strategy as they see fit. Education and training emphasize general, hence transferable, skills. Inter-firm networks are discouraged by the regulatory structure (i.e., antitrust). Innovations are treated as proprietary, allowing windfall profits to be reaped from new technologies, and putting a premium on being a 'first mover'. Germany, in contrast is the epitome of a CME. Firms have access to 'patient capital' through major banks or other corporations. Investments are monitored less through profit reports and more through insider information. Banks hold seats on the boards of directors and companies are linked through dense business networks. This allows the sharing of technological and organizational know-how. Corporate managers rarely have full freedom to shape corporate strategy as the structure of corporate governance and the dominant business ethos demands consensus decision-making, including labor. Industrial relations are governed by industry-wide coordinated bargaining, equalizing wages across skill-levels (generally at a high level), encouraging a committed and stable labor force. Training thus pushes industry or firm-specific skills.

A key point is that this is more than just a grab bag of policies. Rather it is an interconnected model that serves to produce *institutional complementarities*. A country's economic institutions offer certain opportunities and companies are likely to gravitate toward strategies that conform to the dominant modes of coordination within an economy, be they market or non-market. When cumulated across the entire economy these create *comparative institutional advantages* across these economies. CMEs thus excel in incremental innovations in existing products and processes, the markets for which are often driven more by quality than price (i.e., capital goods, machine tools, consumer durables). LMEs are stronger in radical innovations in fast-moving technology sectors where flexibility is crucial, not only in regards to labor, but also general management and investment decisions.¹ In short, different models of capitalism have different strengths and, by emphasizing those strengths, they can continue to prosper without fundamentally altering their core institutional framework.

¹ Hall and Soskice (pp. 41-44) use patent data to show that this is not just theoretical speculation; indeed, the pattern of technological innovations for Germany and the US is that predicted by the CME/LME dichotomy.

This is the crux of the issue. The intellectual *raison d'être* of this approach is not merely descriptive, it is explanatory, to connect variations in structure to economic performance. Mainstream economics contends after all that, especially in an increasingly globalized world economy, states must retreat from economic control and coordination in order to flourish (Friedman, 2005; Lindsey); that is, they must converge on the liberal model. Those who chronicle the diversity of capitalism suggest that both history and recent experience argue against such a deterministic conclusion. Corporatist economies dealt best with the inflationary disruptions of the 1970s. Coordinated economic development, whether practiced in its Japanese or German variety best addressed the rising competitive pressures of the 1980s. Even in the face of globalization there are multiple productive equilibria: "...both liberal and coordinated market economies seem capable of providing satisfactory levels of long-run economic performance..." (Hall and Soskice, 2001, p. 21). They differ in their social, not their economic costs, with the liberal model being seen as more corrosive of the social fabric – a politically useful argument to maintain social democratic structures in the face of liberal insistence that they serve as a barrier to growth in an integrated world economy (Goodin, 2003). Capitalist diversity, it is argued, will remain the norm, albeit with an implicit convergence of economic results.

While an exceptionally useful framework for analyzing the comparative performance of developed economies,² the models of capitalism suffers from shortcomings in its conceptualization, its empirical measurement, and in connecting the models to economic performance. First, the conceptualization of what distinguishes one model from another is too narrow. The Hall and Soskice LME-CME division has become the dominant framework. This puts the firm at the center of the analysis and focuses attention to those institutions that directly affect the coordination problems of the firm. Hence we are guided to explore issues of corporate governance, the nature of inter-firm relations, labor market and wage-setting structures, worker training, the organization of capital markets, etc. All of these are indeed pertinent to any understanding of varieties of capitalism and are included in this analysis below under the heading of 'economic context'. Yet this approach downplays the broader context in which economic interaction is occurring. After all, if one is not just picking institutional configurations a la carte, but portraying them as integrated systems – as *models* – then one cannot simply focus on part of the economic structure. Issues of public policy and political-economic culture also matter. Given that, the role of the state must take greater prominence (labeled here the 'policy context'), specifically in terms of taxation and spending as well as economic regulation. It would be unfair to suggest that the role of the state is ignored in this literature, but it is more that these policy

² One of the limitations of this approach is that it highlights variations across developed countries and thus offers little utility for the analysis of less-developed economies.

factors tend to be treated as secondary variables that only enter into the equation when they directly impinge upon those areas of economic coordination cited above (i.e., laws regarding corporate governance). The goal here is to include wider patterns of product and labor market regulation. Finally, what is completely absent in the models of capitalism is any consideration of the culture underlying different models. The dominant empirical and normative conceptions of economic interaction that individuals bring to the table shape how they interpret and respond to economic incentives. Formal institutions are often not sufficient in themselves to produce a particular outcome; this is often as much a function of a shared understanding of how those institutions are supposed to work.³ Hence the 'social context' in which economic institutions and policies operate is introduced into the analysis. All told, this paper is not only attempting a more inclusive conceptualization of what constitutes the distinguishing traits among different capitalisms, but also to take a first cut at the relative influence of these additional factors on economic outcomes.

A second set of problem stems from the fact that the models of capitalism literature has its roots in historical institutionalism. As a result, most studies rely on qualitative, descriptive analyses with an underlying assumption of path dependency. The core concepts of this approach further reinforce the presumption of stasis. The idea of comparative institutional advantage implies that changes in global markets do not inherently create imperatives to transform domestic economic structures. Institutional complementarities, in turn, suggest that firms within those economies have a rational incentive to continue to work within the dominant patterns of the model rather than trying to pursue alternative strategies. Indeed, the underlying assumption of the models of capitalism is that institutions change little, if at all. Activity then tends to focus on alternative categorizations and determining which countries fit in which category. It is all about cross-national variation, not variation over time.

The flip side of this problem is that comprehensive quantitative studies are relatively rare. Estevez-Abe, Iversen and Soskice (2001) documented variations in social (particularly employment) protections, wage-setting structures, and vocational training structures. Hall and Gingerich (2004) construct a 'coordination index' and use this to test the institutional complementarities hypothesis. While many of the measures used in these studies are appropriate to distinguishing across models (i.e., employment protection legislation), but the focus of both pieces is establishing empirically that there are differences across capitalisms. Changes over time are not the issue, so both rely on short-term data

³ Hall and Soskice indeed argue for just such an emphasis on culture as the foundation of different systems (Hall and Soskice, pp 12-14), but then promptly drop it from further consideration. This is a surprising omission given the intellectual debt owed by this school to studies of corporatism in the 1970s and 1980s and especially Katzenstein's (1985) recognition that successful corporatism was dependent on the inculcation of an ideology of social partnership.

or even single data points for some measures. Kenworthy (2004) examines the data going back to the 1970s, but his focus is on the relative coherence of institutional structures within states rather than gradations across capitalist economies. A more beneficial analysis is provided by Geffen and Kenyon (2005), who empirically tracks changes in varieties of capitalism over time⁴ and include measures of product market competition and social protection into their index. Still, this is a less inclusive index than that proposed here and, more importantly, they make no assessment of the connection between variations in these models and economic performance. The quantitative index constructed here is intended to be both conceptually more complete and able to track change over time.

Successfully connecting models to macroeconomic performance is the biggest chink in the models of capitalism armor. Again, the original rationale of this approach was to make the case that more social democratic, coordinated alternatives to free market capitalism were economically viable. As the literature progressed in the 1980s and into the early 1990s, the argument was put more forcefully -- coordinated systems actually performed better than liberal systems. Then, as the primary coordinated economies (Germany and Japan) misfired in the 1990s while liberal economies like the US and UK thrived, agnosticism reigned – a *variety* of capitalisms could deliver the goods, the point being most clearly articulated by Hall and Soskice. Hall (with Daniel Gingerich, 2004) took the point further to argue that it did not matter what type of capitalism was adopted, it was the institutional coherence of that model – whether or not all of the institutions in a system complemented either market or non-market coordination -- that was the key to economic growth, implying a U-shaped relationship between the level of economic coordination and growth. Or, as Goodin cleverly put it, “The productive advantage comes from being all fish or all fowl...intermediate cases should be expected to pay a hermaphrodite’s penalty” (2004, p. 206). While Hall and Gingerich found empirical evidence to support this conclusion, the follow up study by Kenworthy (2004) cited above found no significant relationship, U-shaped or otherwise, between models and economic performance. Definitive answers may be in short supply, but at least we are left with some clear testable hypotheses: Do LMEs outperform CMEs (or vice versa), or do different forms of capitalism perform equally well? Alternately, is institutional coherence the key to favorable performance, with more mixed economies suffering an economic penalty?

In sum, what is needed is an empirical construction of the models of capitalism that is comprehensive in its scope, can gauge variations in the models both cross-nationally and over time, and can be used

⁴ Geffen and Kenyon used cluster analysis to group countries. Rather than producing a set of stable categories, they found that countries moved around over time into groupings that did not neatly match the Hall and Soskice divisions.

to determine the connection between different capitalisms and economic performance. It is to the construction of such an index that we next turn. Before doing so it should be stated that this paper is not trying to argue that quantitative assessments should replace in-depth case studies in understanding the political economies of these states. Rather, the index constructed here is intended to complement and enhance further qualitative analysis.

Constructing the Models of Capitalism Index

Creating an improved index of the models of capitalism requires not only expanding the array of variables being considered, but also gathering data from as far back as possible. The specific variables chosen are explained below. In each case the target base year was 1970, which takes us back to the period of the Keynesian consensus in Europe. For about half of the variables at least some amount of reliable data⁵ was available back to the 1970s. In those cases where it was not, the earliest period available was included. Table 1 has a list of all variables used, the years covered, and their sources. The countries included in this study were the OECD economies, minus those in Eastern Europe, Turkey and Mexico.⁶ This includes eighteen West European economies plus Australia, Canada, Japan, Korea, New Zealand, and the United States.

The Economic Context – The economic context encompasses those variables that have been the primary focus of the models of capitalism literature -- the level of coordination within both labor and capital markets. The specific empirical indicators used here are, on the labor side, trade union density and the percentage of workers who are covered by collective bargaining agreements. While these two measures are congruent in some states (i.e., in Sweden both are high while in the US both are low), in others there is a good bit of difference between them. The most extreme is France, where only 10% of workers are members of unions but 90% are covered by some form of collective bargaining. Hence both are included separately. Equally central to the distinction of coordinated market economies is the centralization and coordination of wage-setting across the economy. This is measured using and OECD index of both the centralization of wage bargaining and the level of coordination among unions and management in crafting those agreements.⁷ As these two measures are closely correlated in all

⁵ Complete details regarding the data used in this study are available from the author upon request.

⁶ The Eastern European OECD states were excluded because of they cannot be meaningful examined prior to 1990. Turkey and Mexico were excluded as extreme outliers among the OECD on most economic indicators.

⁷ Centralization is determined by a subjective assessment of whether collective contracts are predominantly negotiated at the firm, sectoral, or national level. Coordination is a function of the degree to which pay negotiations are coordinated across the economy and able to take into account any consequences of settlements on the full economy. Details on both can be found in OECD (2004) *Employment Outlook*, Chapter 3.

instances, the average of the two is included. Finally, coordinated market economies are said to rely on 'patient capital', bank financing and cross-shareholding that allows firms to ride out downturns in profitability. Liberal economies are noted for equity based financial structures, with success dependent on maintaining a high stock value, forcing managers to focus intently on the bottom line. Different financial structures are thus produce different corporate strategies. Firms in CME focus on market share and avoid mass layoffs whereas managers in LMEs are more concerned with short-term profitability in order to maintain stock values and do not hesitate to 'downsize' workers (indeed, they are often reward with increased stock prices for doing so). A greater reliance on equity capital is, therefore, an indication of a more liberal economy. The measure used here is stock market capitalization as a percentage of GDP, a metric which varies a great deal across states. In 2002, for example, stock market capitalization was equivalent to 23.1% of the Austrian economy; for the UK it was 149.9%.

There is one factor given prominence in the models of capitalism literature that is not included in the economic context index: vocational education and training systems. Coordinated market economies are supposed to promote industry or firm-specific skills, reinforcing the tendency for encouraging highly skilled workers to focus on high value-added products and discouraging labor market volatility. More general and hence easily transferable skills are emphasized in liberal systems. Unfortunately, there is no reliable cross-national longitudinal data on vocational education. Data on general education levels across these states is available, but this would not make the crucial specific-skills/general-skills distinction. As such, while this should rightfully be included within this measure, the vagaries of data availability prevent it.

The Policy Context – The policy context relates to the overall role of the government in the economy, both in terms of fiscal policy and regulation of both product and labor markets. The size of government is measured using an index from the Fraser Institute's Economic Freedom of the World Report (Gwartney and Lawson, 2005). Data on government expenditure is, of course, readily available, but this has the advantages of encompassing both spending and taxation in one figure⁸ and being available for the countries under study going back to 1975. Similarly, one of the distinguishing features of European CMEs is a well developed system of social welfare. This is gauged by two measures: general social expenditure as a percentage of GDP and the generosity of unemployment benefits using

⁸ The Fraser index of 'Size of Government' is an amalgam of government consumption, transfers and subsidies, government enterprises and investment, and top marginal tax rates.

an OECD summary measure.⁹ This leaves issues of government regulation of the economy. This was measured first by the general level of business regulation, again relying on a Fraser Institute index. A more specific area of regulation, particularly as it directly affects elements of the economic context, is the level of employment protection legislation (EPL), the basic rules governing the hiring and firing of workers. Sticking with the idea of institutional complementarities, limitation on the ability of employers to hire and fire at will are intended to create exactly the sort of long-term labor-management relations epitomized in the CME construct. The indicator used is the OECD's (2004, Chapter 2) EPL index,¹⁰ which rates countries on a scale from 0-6, with zero being the least restrictive economies.

The Social Context – One of the shortcomings noted for the models of capitalism literature above is that it is narrowly focused on institutions with little regard for the wider social environment in which economic interaction occurs. The social context relates to the values and preconceptions individuals bring with them into economic interaction and how these might serve to alter behavior in response to economic incentives. To put the point more precisely, the issue here then is whether the economic culture of a country serves to encourage behaviors that are supportive of the dominant institutional and regulatory arrangements outlined in the economic context and policy context. Going back to studies on democratic corporatism, it has long been argued that successful coordination among economic actors requires a sense of social partnership (Katzenstein). To get at the idea of social partnership, data from a World Values Survey question on whether both labor and owners should have a say in the management of businesses were used.¹¹ The variations across states on this measure are consistent with theoretical expectations. Nearly twice as many Swedes on average (62.2%) express sentiments of social partnership as Americans (34.2%). Similarly, the main normative argument for coordinated systems is that they create more egalitarian outcomes. We would, therefore, expect to find greater support for egalitarian values in more coordinated systems, data for which were also drawn from the World Values Study.¹² Again, the data match theoretical expectations. Just under a quarter of Americans on average (24.6%) see equality as more important than freedom while just over half of

⁹ The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment.

¹⁰ The EPL index is a cumulative ranking of various regulations which cover the protection of regular employment and the regulation of temporary work.

¹¹ The WVS question was: "There is a lot of discussion about how business and industry should be managed. Which of the following statements comes closest to your view?" The statistic used here were the number of respondents who selected: "The owners and employees should participate in the selection of managers."

¹² The question here dealt with the trade-off between freedom and equality and the specific metric used was the percentage of people who responded: "Certainly both freedom and equality are important. But if I were to choose one or the other, I would consider equality more important, that is, that nobody is underprivileged and that social class differences are not so strong."

Portuguese (50.5%) feel the reverse. Lastly, the liberal model is premise on the idea of maximizing growth by allowing markets to function freely, but this assumes that people will undertake productive activity if given the opportunity or, in economic terms, that they be entrepreneurial. If consistent with the dominant model, we would expect people in more liberal systems to show a greater entrepreneurial propensity. The Global Entrepreneurship Monitor (GEM), an international research program directed by Babson College in the US and London Business School, measures the level of 'Total Entrepreneurial Activity', the percentage of the adult population engaged in entrepreneurial activity (GEM, 2005). New Zealand and the United States stand out as having the most entrepreneurial populaces; Japan and Belgium as having the least.

Part of the argument of this paper is that the social context must be included in the analysis to get a full understanding of different modes of capitalism. Regrettably, this is also the areas with the greatest limitations on data. The four 'waves' of the World Values Survey were 1981, 1990, 1995-97, and 1999-00, with nothing for the years in between. Moreover, not every country was covered in every wave, leaving substantial holes in this data and completely excluding one of the countries being studied here (Luxembourg). Similarly, the GEM surveys on entrepreneurship only go back to 2000.

While these are the best data available for these cultural traits, it means that only limited conclusions can be drawn regarding the connection between the underlying social context and the performance of various capitalisms.

Creating the Indices – The list of variables above presents a wide range of nominal values. In order to promote comparability across disparate information, the data were normalized using a panel normalization technique.¹³ This essentially compares the value on any given measure against all other values for that measure both across countries and over time, converting those values to a range between zero and one. The data was scaled so that the traits associated with more coordination were given higher normalized values and the traits associated with liberalized economies were scored lower. Once normalized, separate economic context, policy context, and social context indices were derived by averaging the normalized variables within each category.¹⁴ Given that the dataset was by necessity incomplete, the index values were calculated for five year periods, starting with 1970-74 and ending with 2000-2005. As the data is most limited in the seventies, the optimal starting point for

¹³ This method was adapted from that used by the University of Warwick's Centre for the Study of Globalisation and Regionalisation to construct a globalization index. See <http://www2.warwick.ac.uk/fac/soc/csgr/>.

¹⁴ As was ultimately done for the overall models of capitalism index, the ideal would be to use principle components analysis to weight the respective variables in each category. Viable variable weights were produced from this analysis, but the a good number of ad hoc corrections would have been required to account for holes in the data As this would largely nullify the benefit of a statistical weighting of variables, a simple average was used.

comparison with the present is the 1980-84 period. The three sub-indices were then combined into a single 'models of capitalism index' using principle components analysis to weight their values.¹⁵

The Results – In assessing the utility of the empirical index constructed here, the initial considerations are whether the index shows a clear distinctions across capitalisms, whether there is a coherent pattern of values that matches up with pre-existing categorizations, and whether the values for individual countries have changed over time. Figure 1 plots the value on the models of capitalism index for 1980-84 against the most recent period. The tan lines indicate the average score for each period. The most obvious result is that the bulk of European economies cluster at the upper end of the scale in both periods, indicating a substantial similarity in these states political economies. At the other end of the spectrum is a group of consistently liberal economies in the US, Canada, UK and Switzerland. The remaining states have fluctuated more over the decades, which is illustrated in Figure 2. Australia and New Zealand were more in the coordinated camp in the earlier period, but have liberalized substantially since. Japan, Korea, and Ireland have, if anything, become more coordinated, a finding which belies the idea of a consistent pattern of liberalization in the face of globalization across all economies. These latter findings concur with a similar assessment made by Geffen and Kenyon (2005).

In regards to European economies, what is most striking is how little movement there has been since 1980-84. Looking specifically at the major European economies in Figure 3, we see that, as one would expect, the UK has liberalized a great deal compared to her continental counterparts since the 1970s. This figure equally shows that the organization of the German, French, and Italian economies has been relatively stable over the same period.

In sum, the models of capitalism index constructed here appears to capture the core institutions and organization difference in capitalist economies as would be predicted in the literature. At the same time, there has been movement in this index over the years among some countries, which belies the idea of institutional complementarities always reinforcing the dominant model. Yet the index value for others, particularly the continental European states, have been relatively stable over the last three decades. Alternately, contrary to the purported liberalizing imperatives of globalization, not all of the movement has been toward greater liberalization. Most notably Ireland has become a more coordinated economy over the last twenty-five years.

¹⁵ The policy context was weighted as 0.44, the economic context and 0.37, and the social context as 0.19. Ironically, my initial inclination had been to subjectively weight these sub-indices as 0.4, 0.4, and 0.2, respectively. So the statistical calculation and my subjective sense of the relative importance of these factors were rather similar!

Converting this numeric index into categorical values, we can designate countries as CMEs, LMEs, or 'intermediate' market economies (IMEs) by taking the range of values for the index in any given period and dividing it into thirds, so that all countries that fall into the upper (numeric) third would be labeled CMEs, the bottom third LMEs, and the middle third IMEs. So, for example, for the 2000-05 time period, the index scores varied from 0.70 (Belgium) to 0.18 (United States) for a spread of 0.52. Dividing this range into thirds (0.17) means that those states with models of capitalism scores from 0.70 to 0.53 would be labeled CMEs, those from 0.18 to 0.35 would be labeled LMEs, with the remainder falling into the intermediate category. The results of this breakdown are shown in Table 2. Largely this conforms to a priori expectations of which countries should be so labeled, although some might be surprised that the 'Anglo-Saxon' economy of Australia was not labeled as liberal or that Japan, often portrayed as the epitome of organized capitalism, falls into the intermediate category. If we similarly categorized the countries for each time period, the countries on the coordinated and liberal ends of the spectrum largely hold their positions, with the major exception of New Zealand. There is, however, some movement in the middle of the range with, for example, Ireland moving from an LME in 1980-84 to an intermediate economy in 2000-05. Since there have been relatively few countries changing categories over the period of this study and in order to avoid confusion, the classification used in the economic analysis below will be based on the 2000-05 index scores as outlined in Table 2.

European Capitalisms and Economic Performance

If the study of diverse capitalisms is to be something more than a taxonomic exercise, then we need to be able to connect variations in capitalist structure to variations in economic performance in a systematic way. Given the sketch of the literature above, there are three primary and testable hypotheses regarding the relationship between capitalist models and economic performance:

- H1: Liberal market economies will outperform more coordinated economic systems as the world becomes more globalized.
- H2: Coordinated economies have outperformed liberal systems in the past and can continue to do so in the future despite globalization.

- H3: Both liberal and coordinated economies can prosper; the key to success is institutional coherence and/or complementarity within the models.¹⁶

In order to test these hypotheses, the scores on the models of capitalism index were compared against data on GDP growth (real annual percentage change), per capita GDP, productivity (GDP per hour worked),¹⁷ employment (employment/population ratio), unemployment, inflation, and inequality (Gini index) going back to 1970. For comparability, this data was indexed so that the average across the twenty-four countries studied equaled 100 with individual country values scaled against that. Index values for the individual economic indicators were also averaged to produce a single 'economic performance index' score for each country.

The first question is the basic correlation between the factors included in the models of capitalism index and countries' macroeconomic performance. Table 3 shows the bivariate correlations between the models index, including the component economic, policy, and social context scales, and the various measures of economic performance. At first glance, the relationships do not appear to be especially strong, although many are statistically significant. This is neither surprising nor discouraging, however. There more fundamental economic factors which go into explaining the broad patterns of macroeconomic performance; it should not be expected that the institutional, policy, and social factors identified here would explain the *majority* of the variance across countries on things like average annual GDP growth. As such, the levels of correlation here indicate that these are significant add-on factors to a nation's overall growth equation.¹⁸ In terms of the direction, since the models indices give higher value to more coordinated economies, negative correlations indicate comparatively poor performance by CMEs. Looking at statistically significant correlations within the component indices, a more coordinated economic context is negatively related to growth, but positively related to per capita GDP, productivity and equality. Coordinated policy contexts equally reduce growth and employment, yet enhance productivity and produce more equitable economies. A social context supportive of economic coordination hinders both average income and employment. It also appears to be strongly connected with high unemployment, although the relationship is not statistically significant. Overall, coordinated models of capitalism are correlated with lower growth, higher

¹⁶ Boyer (2005) makes the reasonable point that there is a distinction between coherence, implying mutual coexistence, and complementarity, implying mutual optimization. While this distinction might be relevant when undertaking more detailed econometric analysis, it is not important for our discussion here.

¹⁷ This measure is the most favorable to European economies in that it is the only one in which some European countries outperform the US. If any other of the common aggregate productivity measures were used (GDP per capita; GDP per person employed), the US would surpass all European economies.

¹⁸ Obviously, determining the relative influence and significance of varieties of capitalism on macroeconomic performance requires more extensive econometric analysis, which is the next phase of this research project.

productivity and greater equality. This chimes with impressionistic assessments of the current status of many of Europe's economies – highly skilled and highly paid employees, but too few of them employed to maintain high growth. A further point to note from this table is that there were statistically significant connections across all three of the sub-indices of the model. At first blush then the addition of policy context and social context indicators appears relevant to understanding economic performance.

Moving to a comparison across models, Table 4 shows economic performance by each category (CME, IME, and LME) for each of the five year time periods of the study. Looking at the coordinated economies, we see that their performance was generally above average in the 1970s and into the 1980s, but has deteriorated since then, particularly in regards to GDP growth and unemployment. The indicators that have held up over time for CMEs – not surprisingly – are productivity and comparatively lower level of inequality. Taken together, the average overall performance of these economies has declined since the 1970s. Liberal market economies, in contrast, have seen a significant improvement in their growth trajectories while reigning in the main weakness from earlier periods -- inflation. Employment levels have remained buoyant while unemployment has substantially improved. At the same time, GDP per capita has declined¹⁹ while inequality has risen. LMEs have either experienced stability or improvement on most measures during this period, which lends some credence to the idea that liberalization pays off in a globalizing world economy. Yet the most surprising results, as it completely confounds theoretical expectations, are for the intermediate economies. They were the worst performing group in the earlier periods, but now show much stronger performance on just about all measures, most especially on growth and unemployment. There are two key conclusions to be drawn from the data in Table 3: (a) the comparative economic performance of these different types of capitalism has changed over time; and (b) the intermediate market economies are those that have shown the most improved performance.

The relationship between the models and economic performance is shown graphically in Figure 4, which plots the average models index score against the average economic performance score from 1970-2005. Adding a polynomial trend line to the distribution shows something of the U-shaped relationship hypothesized by Hall and Gingerich, although the curve is tilted upward on the liberal side of the scale. However, as noted already, the performance of the models has varied over time.

¹⁹ This point requires qualification. Canada and New Zealand both saw a sharp decline in comparative per capita income during this period. The US figure also fell, but still remains well above the OCED average. Great Britain, on the other hand saw a substantial improvement. The index value in Table 3 is an average of all four states, so in this case it is the two much smaller economies dragging down the values for the two larger ones. If this were a weighted average, LMEs would show far superior performance.

Figures 5a-d plot the models index against the economic performance index in each of the decades since 1970. In the 1970s performance did not systematically vary across models. The 1980s, in contrast, most clearly manifested the U-shaped relationship implied by the institutional coherence hypothesis. Moving into the 1990s and since 2000, however, the relationship is turned on its head, producing more of an inverted U-shaped curve based on superior performance by intermediate economies -- the opposite of relationship from that predicted by the coherence hypothesis. In order to test this point further, a measure of coherence was calculated as the average deviation from the mean of the models of capitalism index. If being clearly one model of capitalism or another is the key to prosperity, then we would expect that those states with a higher average deviation would have stronger economies. The plot for the entire period is shown in Figure 6, illustrating a U-shaped curve, albeit a rather flat one. Again, however, if we plot just the most recent period (Figure 7), the curve inverts, drawn up by the strong performance of intermediate systems. All of this suggests that, while the institutional coherence hypothesis may have been valid at one time, it no longer appears to be so. It is economies characterized as mixed systems that have been the pacesetters of recent years.

There is one more puzzle to contemplate: the deviation of performance among the coordinated economies. Figure 8 repeats the scatter plot of Figure 5d in order to show which countries fall above and below the curve. The cluster of higher performing CMEs above the curve includes all of the Scandinavian countries plus the Netherlands and Austria. Lower performing CMEs include the Mediterranean states plus Germany and Belgium. Can these variations be explained by differences in the variables within the models of capitalism index? The average scores on the various components of the models index for both the higher performing and lower performing CMEs are broken down in Table 5. In terms of economic context, the higher performing CMEs are more coordinated, with higher trade union density and more centralized and coordinated wage-setting structures. The overall policy contexts scores are similar across these states, but with substantial variation on the individual measures. The higher performing CMEs have higher government spending and more generous welfare structures, but are less prone to regulate product and labor markets. The higher performing CMEs similarly lean toward the liberal end of the spectrum in terms of economic culture. Values of social partnership are slightly higher, but there is less emphasis on egalitarianism and a greater propensity to entrepreneurial activity (Note that, as higher levels of entrepreneurialism are associated with liberalized economies, this variable was scored such that a lower number implied a higher propensity toward entrepreneurialism.) Thus the key dimensions of difference separating successful from less successful coordinated economies does not appear to be the level of centralization or collaboration among private actors, or the level of government spending. The key seems to be a more market

friendly regulatory framework and a social context more favorably disposed to produce growth-enhancing activity within those markets. Or, to paraphrase the old line from Bill Clinton's first campaign, it's not about the welfare state, stupid, it's whether you let markets function.

Obviously, this is but a first assessment of the relationship between different capitalisms and economic performance. The next phase of this research project is to take the models of capitalism and insert them into a proper growth equation in order to assess the relative significance of these factors compared to inputs of capital and labor. Based on a previous study of the influence of social capital on economic performance in the American states (Casey and Christ, 2005), I am quite confident that this will yield robust results.

Conclusions

Empirically mapping European (and other) capitalisms and tracking these over time helps to clarify both theoretical problems with the models of capitalism literature, as well as practical issues of improving European economic performance. The concept of comparative institutional advantage suggests that all models have an equal shot at delivering the goods. The evidence above shows that liberal market economies are now outperforming their coordinated counterparts. Nor does the evidence support the idea of institutional coherence/complementarities as a causal factor. It was those very states where institutional coherence was lowest that outshone the others. In short, the causal connections between different modes of capitalism and economic outcomes must be reconsidered.

The policy implications are more mixed. Most liberal economies are prospering, supporting the argument for greater liberalization of markets and reduction of the state. Yet they are not the only ones that are prospering. Some coordinated economies, particularly in Scandinavia, are doing quite well while maintaining extensive welfare structures. Nor is it just a function of moving in a more liberal direction. Ireland has thrived while becoming even more coordinated. Underachievers are those states with substantial interference in product and labor markets. While one cannot draw a hard and fast conclusion from the above, the implication is that you can have coordination among economic actors and you can maintain a generous welfare state, but you have to allow markets to function relatively freely at the same time.

A further implication, admittedly tentative, relates to the social context. The examination of the higher performing-lower performing CMEs indicated that they differed both in their economic regulation and

in their social context. Public policy can change the former; this is the primary focus on the European Union's Lisbon Goals, after all, although the intense resistance to the passage of a meaningful directive liberalizing services calls into question the likelihood of these changes coming to fruition. The more troubling issue is what happens once the state gets out of the way? If there are underlying cultural traits that mitigate against individuals undertaking productive activity – and the data above gives some indication that there are -- once those barriers to enterprise are removed, will these economies improve? The more troubling challenge for Europe may be that the key to success resides in changing the culture, not the policy. This is a much more daunting task.

Table 1: Variables and Sources

Models of Capitalism Variables		
	Years Covered	Source
<i>ECONOMIC CONTEXT</i>		
Trade Union Density	1970-200	OECD
Coverage of Collective Bargaining	1980-200	OECD
Centralization/ Coordination of Wage-Setting	1970-2000	OECD
Corporate Finance (Stock Market Capitalization)	1975-2003	OECD; World Federation of Exchanges
<i>POLICY CONTEXT</i>		
Size of Government Spending	1975-2003	Fraser Institute Index
Social Expenditure as a Percentage of GDP	1980-2001	OECD
Unemployment Benefit Levels	1970-2001	OECD
Employment Protection Legislation	Late 1980s-2003	OECD
Economic Regulation	1975-2003	Fraser Institute Index
<i>SOCIAL CONTEXT</i>		
Values of Social Partnership	1981-2000	World Values Survey
Egalitarian Values	1981-2000	World Values Survey
Entrepreneurial Propensity	2000-04	Global Entrepreneurship Monitor
<i>Economic Performance Variables</i>		
GDP Growth	1970-2004	IMF
per capita GDP	1970-2005	IMF
Productivity (GDP per hour worked)	1970-2005	Groningen Growth and Development Centre (Total Economy Database)
Inflation	1970-2006	IMF
Employment/Population Ratio	1973, 1979, 1983, 1990, 1993-2004	OECD
Unemployment	1980-2005	IMF
Income Inequality (Gini Coefficient)	mid-1980s-2000	OECD
<p>MODELS OF CAPITALISM DATA: Nominal values normalized (scaled from 0-1) using panel normalization procedures. Formulas use minimum and maximum values within panel (all countries, all years for each variable). Traits attributed to coordinated market economies always receiving the highest values.</p> <p>Formulas:</p> <p>To give <i>highest</i> nominal value highest normalized value (X = nominal value): $y = (X-MIN)/(MAX-MIN)$</p> <p>To give <i>lowest</i> nominal value highest normalized value (X = nominal value): $y = (X-MAX)/(MIN-MAX)$</p> <p>ECONOMIC DATA: Indexed so that average across countries under study = 100</p>		

<i>Table 2: Categorizations of Capitalisms</i>	
<i>Coordinated Market Economies (CMEs)</i>	
Austria (0.60)	Iceland (0.66)
Belgium (0.70)	Italy (0.64)
Denmark (0.62)	Netherlands (0.60)
Finland (0.66)	Norway (0.65)
France (0.64)	Portugal (0.66)
Germany (0.59)	Spain (0.56)
Greece (0.57)	Sweden (0.64)
<i>'Intermediate' Market Economies (IMEs)</i>	
Australia (0.39)	Korea (0.46)
Ireland (0.51)	Luxembourg (0.52)
Japan (0.43)	Switzerland (0.36)
<i>Liberal Market Economies (LMEs)</i>	
Canada (0.25)	United Kingdom (0.33)
New Zealand (0.31)	United States (0.18)
Country placement based on 2000-05 models of capitalism index score (in parentheses).	

<i>Table 3: Correlations between Model Variables and Economic Performance</i>				
	<i>Economic Context</i>	<i>Policy Context</i>	<i>Social Context</i>	<i>Models of Capitalism Index</i>
GDP Growth	-0.165*	-0.262**	0.250	-0.202**
Per capita GDP	0.154*	-0.057	-0.227*	0.018
Inflation	-0.127	-0.045	-0.136	-0.086
Productivity	0.190*	0.185*	-0.036	0.178*
Employment	0.152	-0.182*	-0.250*	-0.044
Unemployment	0.021	-0.186*	-0.610	-0.083
Equity (Gini)	0.330**	0.329**	-0.076	0.320**
Economic Performance Index	0.039	-0.122	-0.173	-0.042
* Significant at the 0.05 level (2-tailed)				
** Significant at the 0.01 level (2-tailed)				

Table 4: Economic Performance across the Models of Capitalism

Coordinated Market Economies (CMEs: N=14)							
	1970-75	1975-80	1980-85	1985-90	1990-94	1995-00	2000-05
Growth	101.81	96.79	83.70	81.89	73.32	89.25	82.50
per capita GDP	96.93	101.73	98.01	97.90	98.76	96.70	94.78
Productivity (GDP per hour)	99.12	102.77	104.32	104.44	104.52	104.39	102.97
Employment	102.83	103.03	103.59	99.66	98.34	98.40	98.92
Unemployment			98.59	99.37	96.78	89.53	85.76
Inflation	100.11	103.43	103.93	103.66	97.72	97.26	95.72
Inequality (Gini Index)*		101.60		106.26		105.14	104.11
Overall Performance Index**	100.12	102.41	98.94	98.30	92.32	96.90	94.58
Intermediate Market Economies (IMEs: N=6)							
	1970-75	1975-80	1980-85	1985-90	1990-94	1995-00	2000-05
Growth	110.67	122.23	136.79	145.93	175.59	127.20	131.31
per capita GDP	92.87	96.56	98.13	102.20	109.45	114.12	115.34
Productivity (GDP per hour)	91.87	89.11	89.01	90.56	92.50	94.20	97.18
Employment	90.30	87.62	87.98	95.09	99.23	99.31	98.92
Unemployment			127.78	128.74	127.25	129.43	129.26
Inflation	95.59	116.64	124.65	142.73	118.73	112.52	106.46
Inequality (Gini Index)*		100.89		92.13		117.44	101.04
Overall Performance Index**	98.10	98.01	112.43	115.36	129.58	112.47	111.23
Liberal Market Economies (LMEs: N=4)							
	1970-75	1975-80	1980-85	1985-90	1990-94	1995-00	2000-05
Growth	77.65	77.91	101.86	94.49	80.00	96.84	114.26
per capita GDP	121.45	99.09	109.78	104.06	90.18	90.37	95.25
Productivity (GDP per hour)	115.30	106.66	101.37	98.63	95.44	93.33	93.85
Employment	104.65	107.97	105.46	108.57	106.96	106.64	105.40
Unemployment			74.84	92.05	85.06	108.50	105.95
Inflation	112.21	105.56	117.96	98.90	121.45	100.89	105.27
Inequality (Gini Index)*		97.27		90.65		87.78	87.38
Overall Performance Index**	104.79	102.32	100.28	98.19	89.35	97.76	101.05

Sources: OECD; IMF; Groningen Growth and Development Centre.

All values indexed so that average of 24 OECD countries studied equals 100. Categorization of economies from Table 2.

* Gini Index values are for the entire decade.

** Overall Performance Index equals average of other economic indicators.

Table 5: Difference in Model Variables within CMEs

	<i>Higher Performing CMEs</i>	<i>Lower Performing CMEs</i>	<i>Difference</i>
<i>ECONOMIC CONTEXT</i>	0.78	0.63	0.15
Trade Union Density	0.67	0.31	0.36
Coverage of Collective Bargaining	0.83	0.82	0.02
Centralization/Coordination of Wage-Setting	0.74	0.52	0.22
Corporate Finance (Stock Market Cap.)	0.85	0.92	-0.07
<i>POLICY CONTEXT</i>	0.60	0.60	0.00
Size of Government Spending	0.66	0.59	0.07
Social Expenditure as a Percentage of GDP	0.69	0.58	0.10
Unemployment Benefit Levels	0.52	0.39	0.14
Employment Protection Legislation	0.53	0.72	-0.19
Economic Regulation	0.64	0.78	-0.13
<i>SOCIAL CONTEXT</i>	0.46	0.61	-0.15
Values of Social Partnership	0.45	0.40	0.05
Egalitarian Values	0.48	0.65	-0.16
Entrepreneurial Propensity	0.66	0.77	-0.11
<p>Values are the normalized scores on respective models of capitalism variables Higher Performing CMEs = Austria, Denmark, Finland, Iceland, Netherlands, Sweden Lower Performing CMEs = Belgium, France, Germany, Greece, Italy, Portugal, Spain.</p>			

Figure 1: Models of Capitalism Index , 1980-84 and 2000-05

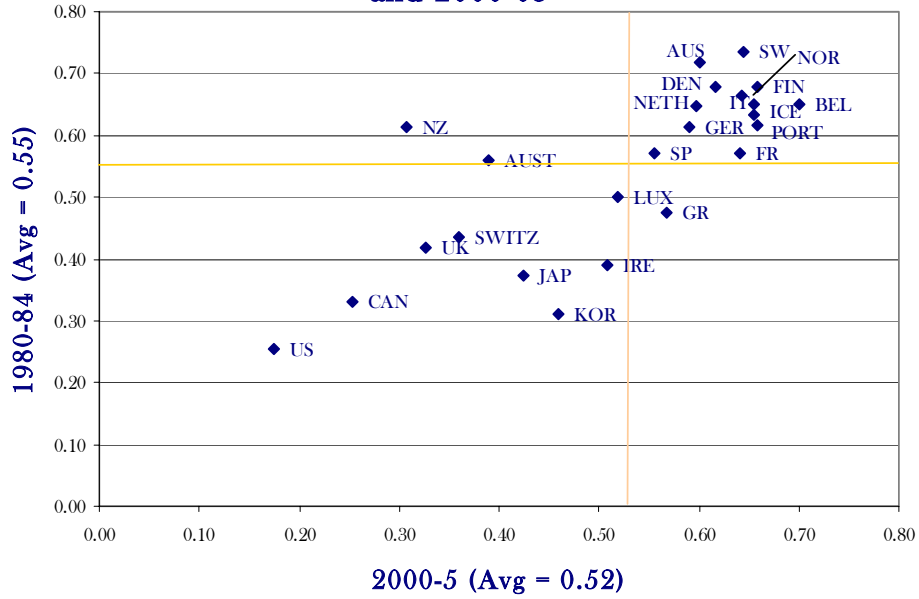


Figure 2: Change in Models of Capitalism Index, 1980-2005

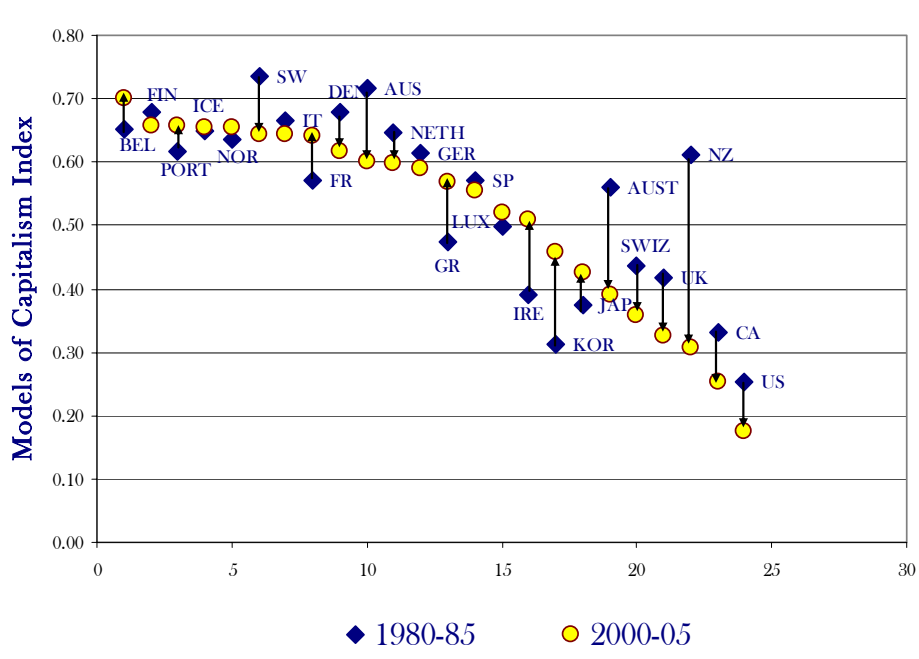


Figure 3: Movement in the Models of Capitalism among the Major European Economies

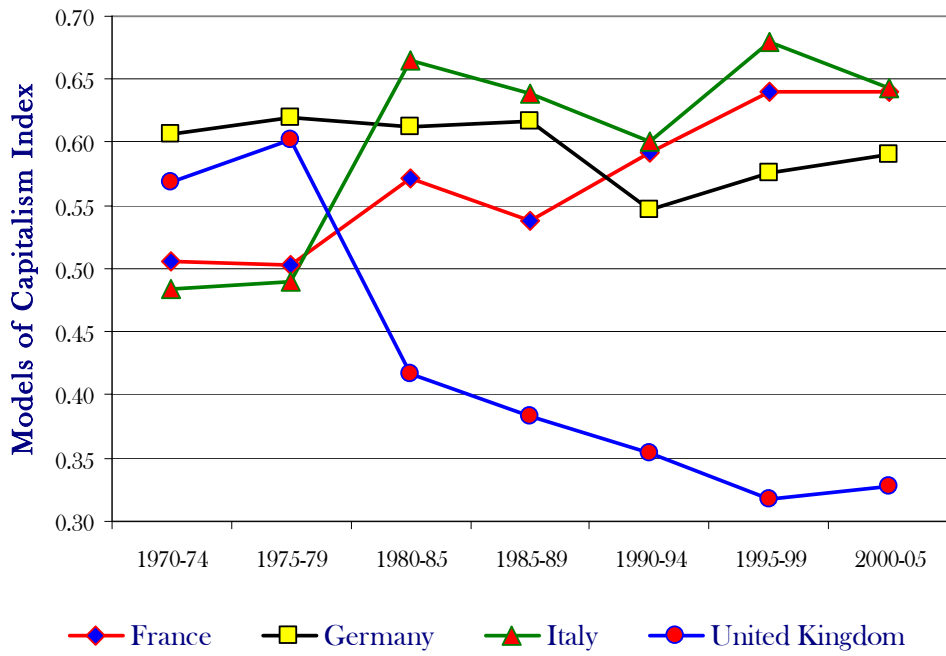


Figure 4: Models of Capitalism and Economic Performance, 1970-2005

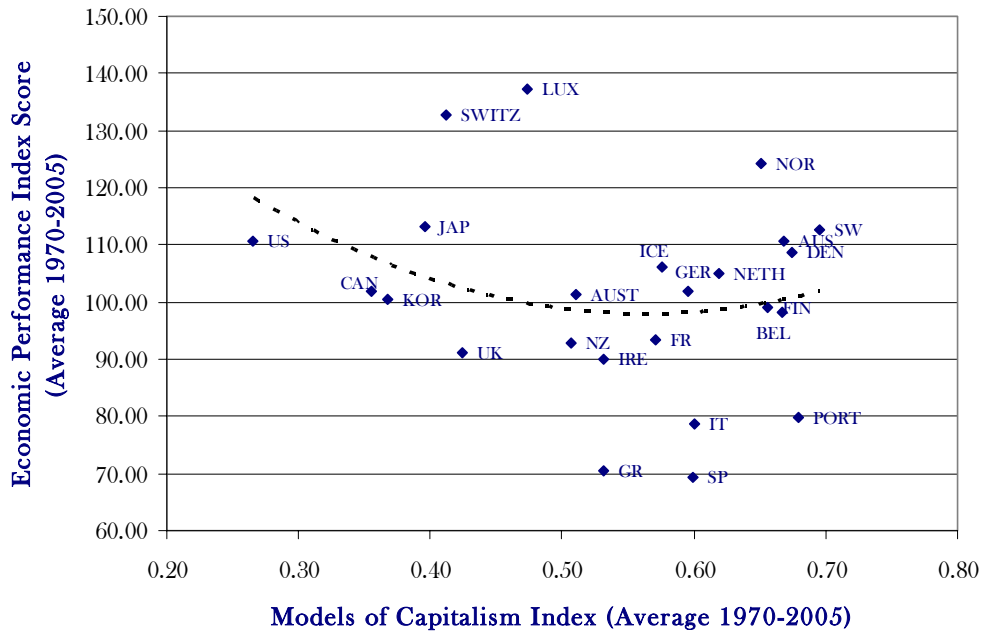


Figure 5: Models of Capitalism and Economic Performance in Over Time

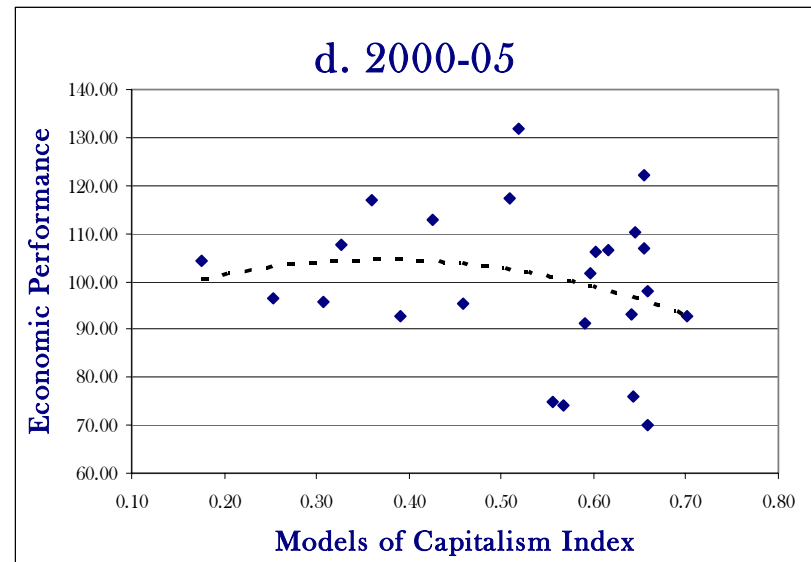
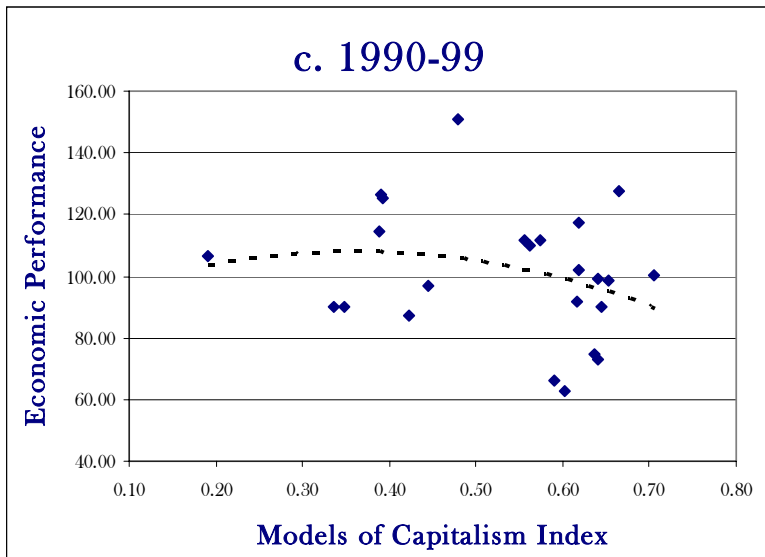
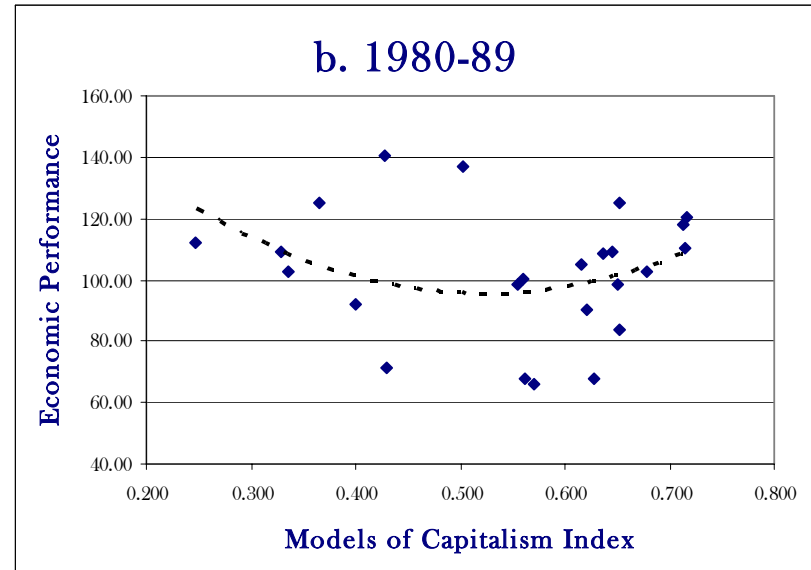
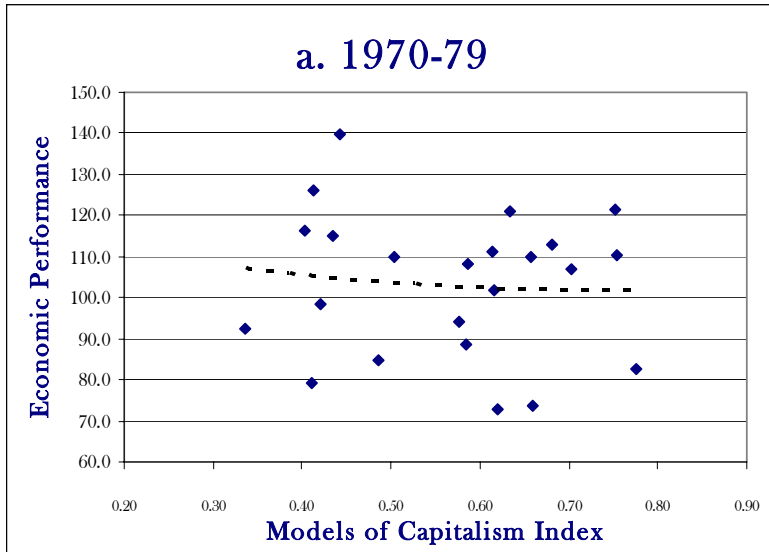


Figure 6: Coherence and Economic Performance, 1970-2005

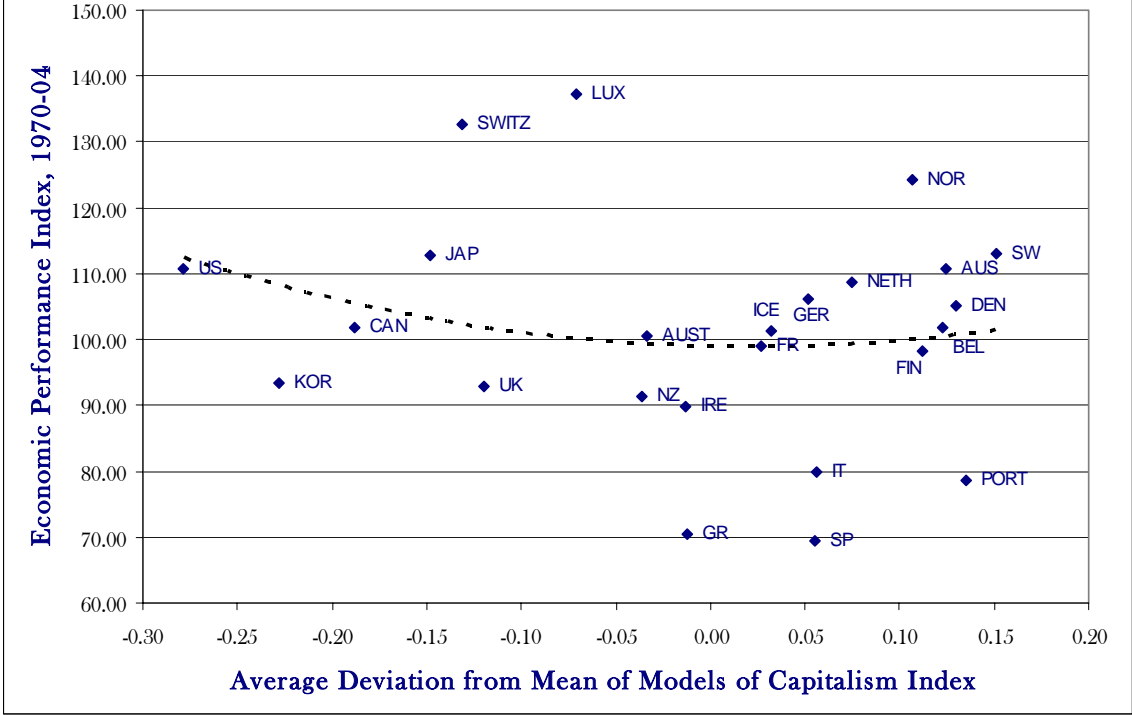


Figure 7: Coherence and Economic Performance, 2000-05

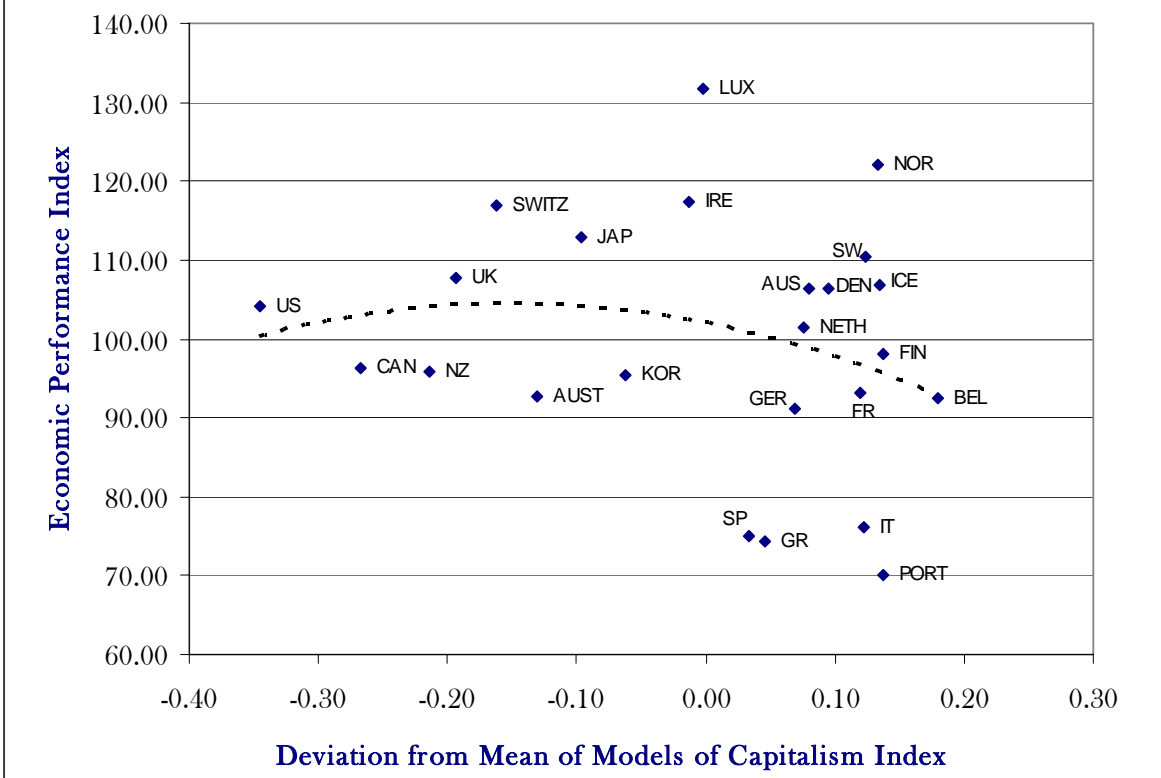
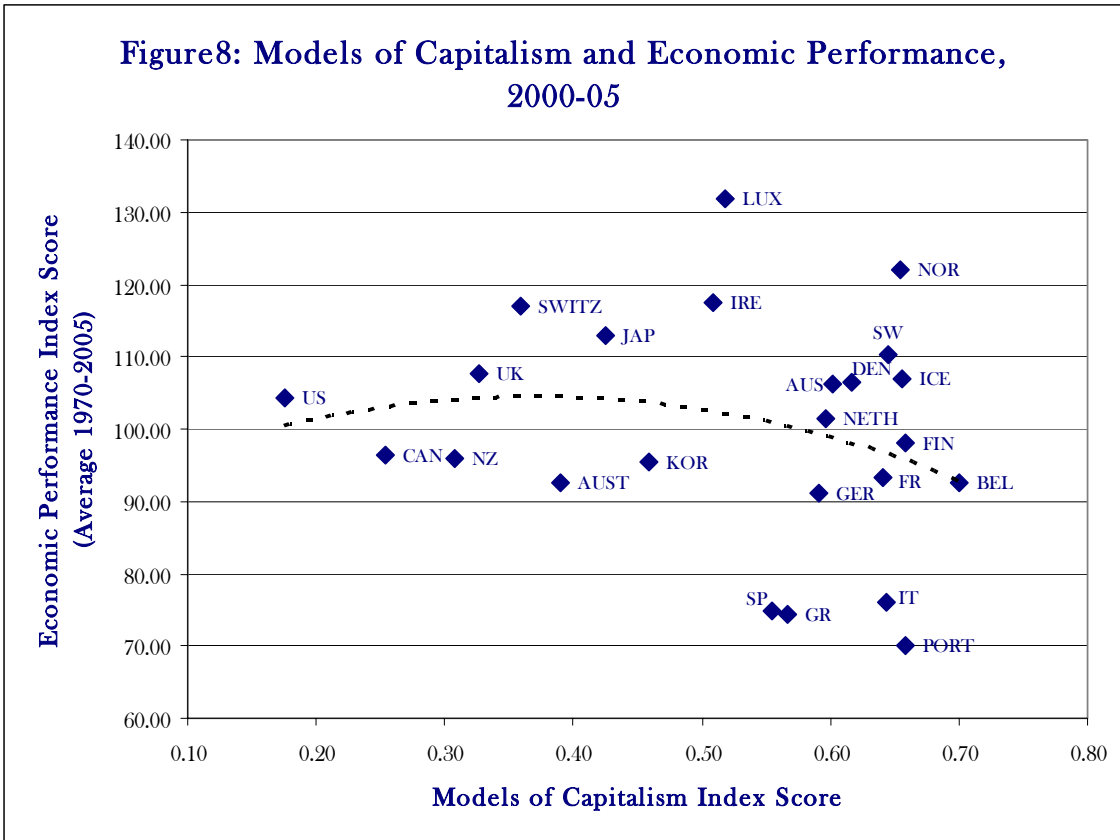


Figure8: Models of Capitalism and Economic Performance, 2000-05



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