POLITICAL ECONOMY OF MODERN CAPITALISM

MAPPING CONVERGENCE & DIVERSITY

Edited by
Colin Crouch and Wolfgang Streeck

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To the memory of
Andrew Shonfield

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LIST OF CONTRIBUTORS

Robert Boyer is an economist, CNRS Director of Research, and Director of Studies at the Ecole des Hautes Etudes en Sciences Sociales in Paris. His present field of study is the performance and development of the labour market and the context of regulation. His publications include: *Labour Market Flexibility in Europe*, 1988; *The 'Regulation' School: A Critical Appraisal* 1990; (with Jean-Pierre Durand) *Post-Fordism*, 1997; and (co-edited with Yves Saillard) *Théorie de la régulation. L'état des savoirs*, 1995.

Philip G. Cerny is Professor of International Political Economy at the University of Leeds and has a special interest in the liberalization of global markets. He has published: *The Politics of Grandeur: Ideological Aspects of De Gaulle's Foreign Policy*, 1980; *Socialism, the State and Public Policy in France* (with Martin A. Schaia), 1985; *The Changing Architecture of Politics*, 1990; and *Finance and World Politics*, 1993.

Colin Crouch is Professor of Comparative Social Institutions at the European University Institute of Florence, Professor of Sociology at the University of Oxford and a Fellow of Trinity College, Oxford. His area of study covers trade union organizations, industrial relations, occupational training and the social structure of western European countries. He has published: *Class Conflict and the Industrial Relations Crisis*, 1977; *Trade Unions: the Logic of Collective Action*, 1981; and *Industrial Relations and European State Traditions*, 1993.

Philippe d'Iribarne, who is Director of Research at the CNRS (Gestion et Société), is concerned with the cultural milieu relating to systems of production characterizing different countries. He is the author of *La Logique de l'honneur. Gestion des enterprises et traditions nationales*, 1989; *Le Chômage paradoxal*, 1990 and *Vous serez tous les maîtres*, 1996.

Ronald Dore is Senior Research Fellow at the Centre for Economic Performance, London School of Economics and Political Science, at which he was some time Professor of Sociology. He is a member of the British Academy, the Japan Academy and the American Academy of Arts. His publications include: *British Factory: Japanese Factory*, 1973; *Flexible Rigidities*, 1986; *Taking Japan Seriously*, 1987; and *Will the Twenty-First Century be the Century of Individualism?*, 1990.

Jean-Paul Fitoussi is an economist and teaches at the Institut d'Etudes Politiques in Paris. His publications include: *Le Fondement micro-économique* *de la théorie Keynésienne*, 1974; and (with E.S. Phelps) *The Slump in Europe*, 1988.

Andrew Graham is Fellow and Tutor in Economics at Balliol College, Oxford. He was economic adviser to the British Prime Minister 1966–69 and 1974–76, and to the Leader of the Labour Party 1992–94. With A. Seldon, he is co-editor of *Governments and Economics in the Post-War World*, 1990 and with Garyn Davies he is the co-author of *Broadcasting, Society and Policy in the Multimedia Age*, 1997.

J. Rogers Hollingsworth is Professor of Sociology and History at the University of Wisconsin, Madison, and the author of a number of books and articles on comparative political economy. With J.L. Campbell and L.N. Lindberg, he has co-edited *The Governance of the American Economy*, 1991; with P. Schmitter and W. Streeck, *Governing Capitalist Economies*, 1994; and with Robert Boyer, *Contemporary Capitalism: The Embeddedness of Institutions*, 1997.

Jonas Pontusson is Associate Professor of Government at Cornell University and specializes in the problems of political economies of the Scandanavian social-democratic type. His publications include *The Limits of Social Democracy*, 1992 and (co-edited with Miriam Golden) *Bargaining for Change: Union Politics in Europe and North America*, 1992.

Marino Regini is Professor of Industrial Relations at the Università degli Studi, Milan, and has published numerous books and articles on industrial relations in Italy and other western European countries. These include: *I dilemmi del sindacato*, 1981; (with P. Lange) *State Market and Social Regulation*, 1989; and *Uncertain Boundaries: The Social and Political Constitution of European Economies*, 1995.

Susan Strange, Professor of International Political Economy at the University of Warwick. Formerly at the London School of Economics and European University Institute of Florence, she is one of the founders of the study of the international political economy. She has published several books, among them: *Sterling and British Policy*, 1977; *Casino Capitalism*, 1986; (with J.M. Stopford) *Rival States, Rival Firms*, 1991; *States and Markets*, 1988 and 1994; and *The Retreat of the State*, 1996.

Wolfgang Streeck is Co-Director of the Max-Planck Institut für Gesellschaftsforschung in Cologne and specializes in the sociology of economics and of labour. His publications include: (with P. Schmitter) *Private Interest Government*, 1985; (with R. Hyman) *New Technology and Industrial Relations*, 1988; *Social Institutions and Economic Performance*, 1992; (with J.R. Hollingsworth and P. Schmitter) *Governing Capitalist Economies*, 1994; (with J. Rogers) *Works Councils: Consultation, Representation and Co-operation in Industrial Relations*, 1995.

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 neoclassical 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 later chapters by Susan Strange and Philip Cerny. Jean-Paul Fitoussi and Philippe d'Iribarne take further some of the implications of the pursuit of pure free-market strategies for the distinctiveness of economies and societies in both Western and Eastern Europe. Our task in the rest of this introductory chapter is to consider the consequences for political and economic performance of one specific aspect of globalization: the decline of the governing capacity of the nation-state and its impact on capitalist diversity.

Globalization and political performance

The rapidly advancing attrition of national state capacity in relation to the economy does not mean the end of national politics, or of the assertion of national interests in the international arena. (1) While economic globalization places strong pressures on national economic policies for deregulation and privatization, formally ratifying the loss of national control over the economy, surrender to such pressures may well be offered in the name of national interest and national sovereignty. (2) Indeed the process may be accompanied by strong nationalist rhetoric and ideology. In part such symbolism may help conceal the loss of economic 'fate control' suffered by national political communities. But it also unwillingly sustains a potentially destabilizing 'democracy illusion' among citizens, to the extent that these continue to expect national politics to offer them protection against market forces. Finally and ironically, (3) defence of national democratic sovereignty constitutes a roadblock against the construction of supranational sovereignty, that is, the rebuilding of economic governance above the old nation-states, and in this way further advances the release of the globalized capitalist economy from public–political control. We shall consider these three points in turn.

1 National political systems embedded in competitive international product and capital markets and exposed to ungoverned external effects of competing systems are tempted to protect their formal sovereignty, or the appearance of substantive sovereignty, by devolving responsibility for the economy to 'the market' – using what little has remained of their public powers of economic intervention to limit once and for all the claims politics can make on the economy, and citizens on the polity. If citizens can be made to believe that economic outcomes are, and ought to be, the result of competitive markets, and that national governments are therefore no longer to be held responsible for them, national sovereignty and political legitimacy can be maintained even in conditions of tight economic interdependence.

In many countries today, the rapidly proceeding disengagement of politics from the economy through deregulation and privatization is defended with reference to international economic constraints that would frustrate any other policy. Deploying public power to liberate and accommodate market forces instead of trying to domesticate them may indeed have become the last national political programme that can be imposed on internationalized national economies without inevitably being frustrated by global economic forces that would expose to the citizens the obsolescence of the national state. Note that domestic deregulation tends to be presented by national governments as the only economically rational political response to internationalization, especially to international competition, and the only promising way of defending the national interest in competitiveness.

2 As nationally based democracy is increasingly preempted or constrained by the nation-state's loss of economic control, the political space provided for popular participation becomes available for symbolic performances of all sorts. Politicians have strong incentives to make their voters believe that they are in control, or in any case could and should be. The British example in particular shows that radical economic internationalism may easily be combined with nationalist rhetoric, and suggests that the latter may be fiercest where economic sovereignty is most energetically abandoned to the forces of the market. For a time, symbolic politics may help governments to neutralize citizen demands for economic protection that the nation-state can, and will, no longer satisfy. But as the gap between formal and effective sovereignty widens and the economic purchasing power of citizenship deteriorates, demagogically cultivated popular beliefs in the lasting efficacy of national democracy, running up against the realities of a global economy, are likely to have quite different consequences. Having kept alive illusions of national political capacity, politicians may find themselves in need of foreign scapegoats on which to blame their impotence, while citizens torn between their increasingly undeniable dependence on an internationalized economy and their desire to control their collective fate may begin to suspect that it was their 'sovereign' governments that had abandoned them to anonymous forces outside their comprehension and control.[5]

Political regression has many faces; in coming years nationally confined political democracy under international economic interdependence may offer ample opportunity to explore them in detail. Somewhat as in the world of the gold standard, as described by Karl Polanyi (1944), national governments must today simultaneously satisfy two constituencies: their national citizenry and the international capital market. Arguably, the much increased sensitivity of the latter (the small group of international bankers that embodied Polanyi's 'haute finance' has today been replaced by a faceless multitude of computer-linked bonds and securities traders), as well as the democratic character of today's polities have made this task even more difficult than it was in the nineteenth century. Hesitant to reveal to their voters the dirty secret that it is no longer they who determine their country's economic policies, national governments must somehow manage to extract from the democratic process policies that conform to the 'general will' of global capitalism: the will of 'the markets'. While these, at least for the time being, prefer democracy over dictatorship, and indeed place a premium on 'democratic stability', the democracy they reward is a strictly liberal one – one that keeps a country open to the world economy, bars itself constitutionally from using the tool kit of the nation-state for 'irrational' measures like capital controls or confiscation of private property, and keeps itself electorally vulnerable to middle-class concerns about the negative effects of a 'loss of confidence' among international investors. The difficult task of governments, then, is to ensure that their countries remain 'stable democracies' without generating policies that interfere with the free play of internationalized market forces.

3 How insistence on national sovereignty can help cement the liberalization of an increasingly global economy is exemplified by the politics of European integration. While European nation-states have progressively lost the capacity to impose a political will on the 'free play' of market forces on their territories, they have remained uniquely viable as political organizations and as foci of collective identification. Having lost their internal sovereignty over their economies, they have remained in control of international relations, including those within the European Union, enabling them to use an increasingly important political resource in a rapidly internationalizing world to protect their external sovereignty. In this, they continue to draw legitimacy from their historical association with democracy and 'cultural diversity'. Although the global market has grown far beyond the scope of democratically organized national political and cultural identities, defenders of the nation-state seem to find it easy to convince citizens that supranational governance would detract from democracy and replace citizen participation with bureaucratic rule.

Within the European Union, nationalism today takes the form of resistance against supranationalism and defence of inter-governmentalism. Rhetoric aside, and all their many disagreements notwithstanding, European nation-states have throughout the history of European integration carefully protected their status as the masters of their union. Nationalism thus ensured that the integrated European economy remained largely free from integrated public–political interference. Governance capacities that were lost at national level failed to be replaced at supranational level, due to the vigilance with which nation-states defended and defend their national sovereignty. This is not to say that the emerging international economy, in Europe and beyond, is or will be without any governance institutions at all; but whatever these may be like, they will probably lack the specific 'market distorting' capacities of the traditional European nation-state. The historical alliance of nationalism and neo-liberalism, as embodied most visibly but by no means exclusively by Margaret Thatcher, has many facets, domestic as well as international, and has for some time in both arenas clearly been the most powerful force in the European political economy.

Globalization and economic performance

The demise of national state capacity under globalization is likely (1) to destroy a range of governance mechanisms in institutional economies