Changes in Developed Countries' Economic Systems since the 1980s - Implications for Developing Countries*

Jonathan Perraton

Department of Economics and Political Economy Research Centre, University of Sheffield, UK

Contact
Jonathan Perraton
Department of Economics
University of Sheffield
9 Mappin Street
Sheffield S1 4DT
United Kingdom
Tel: ++ 44 (0) 114 222 3408
Fax: ++ 44 (0) 114 222 3458
Email: j.perraton@sheffield.ac.uk

Abstract

This paper reviews changes in institutional arrangements amongst developed countries over the past 25 years, and assesses how far these can be explained in terms of recent theories of different models of capitalism. It argues that globalization has acted to undermine central features of the key models and weaken the position of labour. The account in this paper points to limitations in the current varieties of capitalism approaches in explaining recent patterns of institutional changes and sketches possible bases for enhancing the approach. Comparisons are made with economic systems in developing countries, particularly in Latin America.

Key Words: Varieties of capitalism; globalization; international comparisons; economic development

* This paper also draws upon work in Perraton and Clift (2004) and Perraton (2007).

1. Introduction

It is now widely accepted that countries differ significantly in their national economic institutions. Countries differ not just in their component parts; these also need to be understood as an ensemble of relations that have evolved and coalesced together so that their operation and effects often act to reinforce each other. Different countries faced by common exogenous changes will tend to evolve along different lines rather than converge; path dependence and institutional lock-in provide powerful tendencies towards persistence.

Amongst industrialized countries at least, which have been the focus of much of this work, different institutional arrangements are compatible with sustained prosperity. The Varieties of Capitalism (VoC) approach's binary distinction between coordinated and liberal market economies (CMEs and LMEs) emphasizes that both types have complementary institutional arrangements that underpin their comparative advantage (Schneider and Soskice THIS ISSUE). Crucially, therefore, globalization trends – increased trade openness, but also capital mobility – are as likely to act to reinforce and preserve existing arrangements as they are too undermine them so long as they remain key sources of firms' competitive advantage. Approaches that insist that the binary distinction is too limited and that there exist several variants of advanced capitalism with distinct patterns and internal logic nevertheless still share the perspective that these arrangements will be persistent and underpin performance in open economies (Amable 2003; Boyer 2005). National institutions operate as coordinating mechanisms between agents and arrangements through which distributional conflict can be ordered and ameliorated. Recent extensions of the VoC approach have related this to political systems and the different ways in which majoritarian and consensual PR systems underpin distributional arrangements, particularly forms of the welfare state.

In important ways the significance of institutional approaches for developing and transition economies can hardly be over-emphasized. The variegated performance of transition economies has highlighted that market economies require not just price reform and private property rights, but a range of institutions underpinning their effective operation. Similarly, the 'lost decade' of the 1980s in Latin America and subsequent disappointing performance have demonstrated that Washington consensus policies designed to 'get prices right' are at least insufficient to generate sustained development. This generic institutionalist approach has profound implications for development: a range of institutional arrangements are compatible with prosperity and there is no one right model for countries to emulate. In particular, Anglo-Saxon arrangements are not the only route to development – something that even the codifier of the Washington consensus is at pains to acknowledge.[1] There are no simple lessons for picking institutional arrangements off the shelf and, in particular, it cannot be assumed that the positive impact of any one institution will transfer over when emulated in another national setting. Although institutions do appear to affect growth in developing economies, there is no simple link between specific institutions and performance with their effects depending on the national context and interaction with other institutions (cf. Engerman and Sokoloff 2003; Rodrik 2007).

In extending the VoC approach to developing economies, similar mechanisms promoting persistence in institutional arrangements are expected to operate but without the expected positive impact on economic performance. In proposing their account of Latin American capitalism Schneider and Soskice (THIS ISSUE) advance an explanation centred on the political system both of why these countries have persistent high levels of inequality and also why they have been unable to sustain consistent accumulation of physical and, especially, human capital. Notoriously these countries have been unable to sustain performance comparable with industrialized countries; nor have they been able to emulate the East Asian developmental states which were able (at least until 1997[2]) to sustain accumulation with much lower levels of inequality. Although Schrank (THIS ISSUE) notes any institutional biases in the Latin American polity to the centre-right have not prevented the recent emergence of left governments across the continent it is notable that not only have these governments eschewed radical redistribution programmes they have also followed broadly orthodox macroeconomic policies which tend to reinforce existing patterns of inequality (cf. Arestis and Sawyer 2007).

The key limitation of analyses of different models of capitalism is that they emphasize continuity over change, national differences over common trends. A particular danger here is that the analysis becomes a form of institutional determinism.[3] This paper argues that over the past 25 years institutional arrangements amongst developed economies have changed significantly in response to globalization trends. In particular this has had a key impact on the fortunes of labour – a pronounced income shift from capital to labour but largely without a commensurate rise in investment. Associated with this have been trends towards financialization.

These changes have occurred across political systems – institutional political arrangements may have changed little but political processes in previously consensual cases have become more majoritarian in character with elites less willing to pursue consensus and more able to initiate decisive change (cf. Jones 2008). Much of this literature examines globalization by refuting claims that it is leading to convergence on LME institutional arrangements (or, perhaps more accurately, an idealized version of them); however, although frequently clamed to be an orthodoxy, the hyper-globalization convergence arguments has few academic proponents and focusing on it downplays the effects of globalization has had (cf. Perraton 2001).

Central institutional features of these economies have been eroded and the coherence of the institutional arrangements is now less apparent. The implications of these trends for developing economies in Latin America and elsewhere are not straight-forward: in the absence of a simple convergence story, the character of a hybrid model is hard to predict. Hybridization may not matter much for developed countries – the evidence that institutional coherence affects industrialized countries is not clear – but the emergence of hybridized forms of capitalism in developing and transition economies may lead to incoherence and undermine performance.

This paper proceeds as follow. Section 2 examines the different varieties of capitalism proposed in the literature. Section 3 examines the effects of these arrangements on economic performance. Section 4 examines the evolution of these arrangements amongst developed countries over the past 25 years. Section 5 draws out the implications of this for developing economies, particularly in Latin America. Section 6 concludes.

2. How Many Capitalisms?

At the most parsimonious level, the VoC approach proposes the CME and LME binary classification according to countries' organization of production and market institutions (Schneider and Soskice THIS ISSUE; Soskice 1999; Hall and Soskice 2001; 2003). Strategic interaction between firms determines, in particular, the institutional solutions to the coordination problems of bargaining with labour, the supply of skills, access to finance, corporate governance and the operation of inter-firm relations. Whereas LMEs have largely evolved market-based solutions to these coordination problems, CMEs have evolved complementary cooperative solutions to these problems primarily through inter-firm coordination networks. The broad logic of CME arrangements is well-known: relational finance through a bank-based system allows the development of long-term relations, particularly with the labour force encouraging their acquisition of firm- and industry-specific skills. Collective organization by employers underpins training and education systems promoting such skill acquisition. Collective wage bargaining varies in its degrees of centralization and formality, but coordination typically based around the internationally competitive manufacturing sector can produce orderly adjustment and low inflation. Further, Soskice (1999: 109) argues that 'there are strong interlocking complementarities between different parts of the institutional framework. Each system depends on the other systems to function effectively.'

This creates powerful incentives for reproduction of these arrangements so that although globalization could exert exogenous pressure for change, there are strong mechanisms for continuity in these arrangements. Indeed, since this approach emphasizes that institutional differences are key sources of comparative advantage, determining patterns of industrial specialization, globalization is as likely to preserve national differences as it is to provide pressures for change and can act to create incentives for firms to maintain institutional arrangements as key sources of their competitiveness (Hall and Soskice 2001). This point is of particular relevant to developing economies: their export specialization depends not simply on textbook factor proportions, but also their historical evolution and institutional arrangements. They can find niches and achieve relatively sophisticated product development and dynamic upgrading through supporting institutions and industrial policies which can promote growth and development more generally (Lall 2000; Rodrik 2007).

Recent extensions of the VoC approach have emphasized the degree to which varieties are embedded in the political systems: LMEs are strikingly more likely to have majoritarian political systems than CMEs (Schneider and Soskice THIS ISSUE; King and Wood 1999). These predictions survive finer group classifications of capitalist systems – market-based systems tend to be characterized by majoritarian

systems, party concentration and a lower percentage of votes for parties of the left (Amable 2003: ch. 5). Similarly Schneider and Soskice (THIS ISSUE) point to features of the Latin American polity that act to sustain their models, although Schrank (THIS ISSUE) provides a critique of this.

Welfare state differences between LMEs and CMEs are seen to follow from this, with the importance of sector-specific skills giving rise to much broader support for welfare provision in CMEs than LMEs, reinforced by the nature of political systems. The evolution of welfare states and labour market regimes reflects historical traditions, political developments and the accommodation of organized labour. Nevertheless, whilst labour market regimes and welfare policies may not be strictly functional for business, 'one of the principal claims of the varieties-of-capitalism literature is that many of the regulations or policies that others see exclusively as the source of rents or rigidities actually enhance the operation of coordinated market economies and their employment performance' (Hall and Soskice 2003: 242).

However, as the Esping-Anderson analysis discussed in more detail elsewhere in this issue indicates, there are differences within the CME group at the very least between conservative and social democratic welfare states. Further, whilst it is a useful corrective to earlier approaches to analyse the emergence and sustaining of institutional arrangements in terms of employer strategies the role of the state remains important in forming and underpinning institutional arrangements particularly in countries where employer organisation is less cohesive and developed than in exemplar CMEs (cf. Levy 2006). Analysis points to a southern European grouping where state coordination has traditionally played a greater role; although southern European welfare states have some similarities with conservative grouping, they also have distinctive features with variegated coverage, considerable involvement of agencies besides the state but areas of generous provision within this (Ferrara 1996).

Inevitably there is a trade-off between the parsimony of the binary classification scheme and the danger of obscuring differences between these economies. Approaches from the regulation school not only claim that the binary classification obscures important differences, but also that alternative conceptions can help explain the endogenous features of models of capitalism that lead to crisis and change where the VoC approach tends to emphasize institutional equilibrium (Amable 2003; Boyer 2005). Thus, this is not simply an insistence that many countries do not fit neatly into the LME-CME dichotomy, but a delineation of clear differences in the logics and institutional complementarities of different models of capitalism. Boyer (2005) argues that although exogenous shocks may lead to the continuation or even reinforcement of institutional equilibrium this can also lead upheaval where aspects of the institutional forms become increasingly incompatible with a country's development and reconfiguration of the arrangements emerges. In extreme cases a structural crisis occurs from which a structural transformation is required – here Boyer notes not just the collapse of state socialism but also the fate of Latin American economies in the 1980s and 1990s.

Recent cluster analysis add credence to further sub-division of developed capitalist models into social democratic, continental European, southern European and East Asian groups as well as an LME group of Anglo-Saxon countries (Amable 2003: ch. 5; Pryor 2005; cf. Boyer 2005). Just as Hall and Gingerich (2004) found evidence of continued differences between LMEs and CMEs, Amable (2003) found evidence of continuity over the 1980s and 1990s in these group patterns and thus little evidence of institutional convergence. Interestingly several variables often assumed to be central to differentiating economic systems failed to play a significant role in cluster analysis, including various measures of government activity, business clusters, labour organization; creditor rights and restrictions on bank activities (Pryor 2005: 36). Pryor acknowledges that his analysis is static and only goes up to 1990; missing data limits the possibilities for tracking changes over time, noting that 'many of the institutional characteristics defining types of economic systems have been changing over time.'

Whilst these analyses have been based on data from developed economies, Boyer (2005) notes continued differentiation within capitalism amongst emerging market economies with the likelihood of continued diversity with their development. He reports characterizations of the five leading Latin American countries, but noting that their arrangements were unable to prevent crisis; past institutional arrangements did not coalesce into an effective production regime capable of sustaining development. Data on institutional arrangements in developing and transitional economies is relatively scarce, but Pryor (2005) found they tended to most closely resemble the southern European group; the similarities between southern European welfare state regimes and those in some Latin American countries are evident from the case studies elsewhere in this issue. Elsewhere, Pryor (2006) finds evidence of clusters within developing economies; ignoring the 'traditional' group of the poorest economies most of the Latin American countries fitted into a 'labour-oriented' group with relatively high employment protection legislation and limited financial development although with relatively high openness to FDI and relatively low government consumption. Indeed, Latin American countries formed the core of this group. Not surprisingly Chile fitted into the business-oriented group with relatively developed financial systems and high levels of investor protection, greater product market development and correspondingly lower employment protection and labour bargaining institutions. Brazil and Costa Rica were (statistically) marginal members of a statist group with relatively high government expenditure but also relatively high human capital development. Overall, though, there appears to be greater fragility in Latin American models of capitalism with recent decline of the statist and populist models; nevertheless, there are some signs of trends towards combining social policies and/or forms of interventionism within broadly liberal economic structures (Sheahan 2002). These issues are considered further in section 5 below.

3. Institutions and Economic Performance

Although studies indicate that institutions can have a profound impact on development (cf. Rodrik *et al*. 2004), beyond fairly broad indicators of the rule of law and protection of property rights there are few concrete, robust results linking specific institutional arrangements to economic performance. Nor is that surprising: the whole thrust of this literature is that various institutional arrangements are consistent with prosperity and so no clear relationship between specific institutions and economic

performance would be expected. Further, in the non neo-classical institutionalist approaches at least there would be methodological scepticism that countries can in effect be fitted on a global production function and the impact of institutions simply read off from this. Amongst developed countries recent studies find that the impact of institutions on economic performance amongst developed countries is secondary; their chief impact is on income distribution (Freeman 2001; Pryor 2005). This conclusion appears robust to controls and variables used to determine institutional type.

Nevertheless, some of the more specific predictions made here have less empirical support than has been claimed. There is a clear expectation of a dichotomy between LMEs and CMEs in their patterns of innovation and comparative advantage: 'we expect firms in liberal market economies to be relatively better at radical innovation and firms in coordinated market economies to be better at incremental innovation, and companies with international reach should shift some of their activities across national borders in order to benefit from these comparative institutional advantages' (Hall and Soskice 2003: 248). Thus, not only would increased trade integration be more likely to strengthen differences between CMEs and LMEs than promote convergence, even capital mobility is not necessarily a threat to the coherence of CME models: inward investment may be attracted to the skills and technological advantages of CMEs with rates of return not a simple function of low wage costs and/or taxes, whilst outward investment by CME multinationals may lead to some domestic restructuring but can still strengthen activity to the extent that firms' competitive continues to be based on national arrangements and thus core activity largely remains in the home country. Although there is some evidence that patterns of innovation and trade specialization conform to these priors (Amable 2003: chs 3 & 5; Hall and Soskice 2001), more detailed investigation provides little support for any clear link between institutional differences and patterns of specialization in either trade or innovation (Allen 2006; Taylor 2004). Further, the links between national innovation systems and economic performance may be weakening anyway; Frantzen (2000), for example, finds that outside the largest G5 economies foreign R&D expenditure has a stronger impact on productivity growth than domestic R&D expenditure.

Although specific institutions would not necessarily be expected to have a clear impact on economic performance, a coherent ensemble of mutually reinforcing institutions would be expected to lead to superior outcomes. Again there is some evidence that indicators of institutional coherence are related to faster growth rates and lower unemployment amongst developed countries (Amable 2003: ch. 5; Hall and Gingerich 2004). However, Kenworthy (2006) reworks various measures of institutional coherence for developed economies and finds that they fail to have any significant impact on either growth or employment over the post-1973 period; the efficiency claims about complementary ensembles of institutions are not clearly borne out by the evidence either.

For developing and transition economies, Pryor (2006) finds that the 'business-oriented' group grew faster than the others although, as noted, many institutional variables failed to display the expected relationship to growth. There has been little

consideration of whether institutional coherence rather than particular institutions affects development. Cernat (2006) found that for the East European transition countries the combination of globalization pressures with EU harmonization measures and domestic traditions have produced, to varying degrees, a 'cocktail' capitalism of contradictory elements that have inhibited growth in these countries and the emergence of a coherent national model. Less directly, Pryor (2006: 83) notes that 'the percentage of countries close to the boundaries of the clusters among the developing nations is much larger than in a similar analysis of industrialised nations'; developing economies do appear to have less coherent arrangements than richer ones. However, the Latin American countries classified as labour-oriented formed the core of this group. These issues are considered further in section 5 after examining changes in institutional arrangements amongst developed countries.

4. Change in Developed Country Institutional Arrangements

This section considers the evolution of different types of developed capitalism over the past 25 years as ensembles of institutional arrangements. A necessarily selective overview of changes in labour relations, financial systems and the role of the state in the context of globalization then leads to consideration of the development of the key variants of developed capitalism as systems. During this period trade integration has grown and international competition has thereby been strengthened, reinforced by free trade agreements at regional and global levels that increasingly go beyond removal of tariff barriers to deeper processes of harmonization. Cross-border investment and multinational activity grew faster still over most of this period. Cross-border financial activity has grown exponentially as previously separate national capital markets have become increasingly integrated. Associated with this have been processes of financialization, the relative growth of the financial sector and the increased importance of financial sector criteria, particularly shareholder value maximization, for the operation of the corporate sector (e.g. Epstein 2005; Palley 2007; Stockhammer 2004). These trends are well-attested, but their effects remain controversial. VoC analysts and others have documented that these trends have not induced identical responses or led to convergence on one model, nor have they rendered alternatives to Anglo-Saxon arrangements untenable or even necessarily inefficient. Nevertheless, beyond refuting simple convergence stories, these accounts tend to downplay the common trends and the degree to which these trends have led to changes in national arrangements, although Boyer (2005) does note that the potential threat of financialization to the viability of different models. Whilst the clearest shift towards more market-based institutions over this period can be seen amongst the LMEs, the argument here is that much of this can also be seen amongst other CMEs. What emerges is a shift towards more market-based arrangements and a process of hybridization of models that is neither a straight-forward continuation of past arrangements nor a simple convergence onto a supposed Anglo-Saxon norm.

Along with general globalization trends, the key development for continental European countries has been the Single European Market (SEM) programme. This has not only intensified product market competition but was integral to promoting financial integration, a process deepened with monetary union. Indeed, Abdelal (2007) has shown that the promotion of liberal rules for the international financial architecture has been very much the work not of US institutions and policy-makers –

who, following legal traditions, have often been content for an international framework to emerge – but of EU policy-makers, not least in the context of framing SEM rules, instituting an international legal regime.

In the VoC literature (and elsewhere) the effects of the SEM are downplayed, but this is often to conflate the degree of integration with the failure (thus far) of the SEM to yield the income gains optimistically predicted for it by the European Commission. Furthermore, the SEM was explicitly constructed to promote the emergence of a more market-based European capitalism. Following the 2004 Sapir Report (Sapir *et al*. 2004), the EU Lisbon Agenda explicitly aims to strengthen SEM measures, promoting the development of financial market integration and using integration to drive further liberalisation of product, labour and capital markets. The report explicitly aims to use deeper integration, particularly applying SEM rules to integrate services activity in order to construct a more market-based economy as the only route for the EU to achieve US levels of employment and productivity. Elsewhere, Sapir (2006) argues that both the Anglo-Saxon and the Nordic (social democratic) models are efficient and the latter also equitable, but neither the main continental European model nor the southern/Mediterranean models are efficient or even sustainable in the face of global competition. This is not necessarily to endorse the analysis: Watson (2001), amongst others, argues that simply removing market regulations will be insufficient to transform the EU economy towards the 1990s new economy performance of the US in the absence of other supporting institutional arrangements. Nor is it clear how Sapir (2006) conceives these measures might help to promote Nordic arrangements. Kitson (2005) criticises the short run comparisons here: core continental European countries, but not the UK, Australia or New Zealand, have similar productivity levels to the US and recent employment trends are less favourable to the US. Moreover, he highlights that US firms' innovation effort reflects not just market-based arrangements but also longstanding relations with publicly funded institutions. However, Amable's (2003: ch. 6) argument that a shift towards market-based institutions amongst EU countries lacks policy support no longer appears tenable – there is an explicit attempt to use integration of goods and services markets, and to promote a more Anglo-Saxon capital market at the European level to create more LME-type arrangements.

VoC theorists in particular argue that globalization is likely to increase the divergence between national capitalisms in wage-labour relations; whereas LMEs are likely to see an increase in pressure for reducing the power of organized labour, by contrast in CMEs employers' need for stability and cooperation at the enterprise level shores up at least some aspects of their cooperative relations with the workforce. Thus, in the paradigm German case employers are seen as reluctant to dismantle the post-war industrial relations system and clearly move towards CME flexibility (Thelen 2000; 2001). The problem here is that this overstates the degree to which national employers have followed a common response to intensified competition. Rather than integration strengthening particular systems as a source of competitive advantage, national systems are becoming more variegated as firms adopt strategies which vary across firms and industries undermining unitary national employment systems (Katz 2005; Katz and Darbishire 2000). Formal involvement of employees in company boards is not universal amongst Continental European countries and has seen some decline even in those countries where it has been strongest (Gill and Krieger 2000; Hassel

1999). Though *some* German employers see the post-war industrial relations system as an enduring source of competitive advantage; others, though, emphatically do not and have used globalization – particularly the threat of shifting production overseas (notably to Eastern Europe) – to undermine union bargaining strength and to lobby for increased labour market flexibility and to decentralize wage bargaining (Ochel 2005; Raess 2006). Hassel (2007) points to the ambiguities here with dualist arrangements emerging so that although there is continuation of historic arrangements with core manufacturing workers, but erosion of these for other manufacturing and services workers. This may act to undermine CME wage compression relative to LME norms (Hassel 2007).

More formal arrangements have shifted towards labour market flexibility so that although differences remain the trend towards labour market deregulation is clear (OECD 2004: ch. 2); Germany in particular has undertaken some of the strongest deregulation measures, although without the expected benefit in terms of employment (Hein *et al*. 2006). Excepting the social democratic economies, union density has declined or been static amongst CMEs (OECD 2004: 145); Germany has seen one of the sharpest declines in union membership amongst European countries (Hassel 2007: 275). Although there was no clear trend in bargaining arrangements, movements were typically towards greater decentralization of bargaining and an increased role for plant-level negotiation (OECD 2004: ch. 3). This would tend to weaken labour's position and lead to greater wage dispersion; during the current decade actual German wage increases have tended to run *below* collectively agreed increases (Hein *et al*. 2006). Amongst the social democratic economies with traditionally centralized wage bargaining systems, Iversen (1999) shows that such systems contain incentives for both employers and skilled workers to defect from such arrangements. Further, if central banks' pursue policies of non-accommodation of inflation, this would tend to undermine the effectiveness of centralized wage bargaining in achieving low unemployment. Although Sweden has seen a clear trend to decentralization under pressure from employers to dismantle aspects of post-war employment relations and increase flexibility, nevertheless relatively centralized and coordinated wage bargaining systems have been maintained in Finland and Norway, with considerable – if not universal – employer support (OECD 2004: ch. 3).

Intensification of product market competition implies employment flexibility, or at least it would tend to increase the elasticity of demand for labour and thereby tend to make employment more variable and increase wage inequality (Rodrik 1997). The evidence is consistent with this. In general increases in wage inequality over the 1980s and 1990s have been more pronounced in LMEs than CMEs in line with expectations, although even here social democratic Sweden saw similar rises to Australia and Britain whilst wage inequality in the Netherlands rose almost as much as in the US and New Zealand (OECD 2004: 141). Nevertheless, the fall in labour's share of national income since the 1980s has been more pronounced amongst continental European economies than amongst LMEs (Guscina 2006). This, in part at least, is due to differences in corporate governance systems so that CEOs (and other managerial staff) in LMEs can appropriate returns that would accrue to capital in CMEs (Dew-Becker and Gordon 2005; Mohun 2006). The falling labour share points tointensified competition disrupting stable employment relationships; further, declines

in labour's share appear to be significantly related to globalization indicators of rising trade and FDI. The 1990s saw generalized wage moderation amongst continental European countries with consequently declining wage shares. The employment response to this moderation has varied, however, with no clear relationship between wage moderation and employment levels (e.g. OECD 2004: ch. 3; Varghese 2001). In general there were no strong relationships between bargaining institutions and wage moderation over the 1990s (OECD 2004: ch. 3) – these various arrangements were all, to varying degrees, able to deliver wage flexibility in response to shocks. Although OECD (2004: ch. 3) finds no clear between bargaining arrangements and employment, other evidence points to coordinated wage bargaining systems still appearing to lead to lower unemployment; further, evidence that differences in labour market deregulation explain unemployment performance across the OECD, and thus relatively low unemployment rates amongst LMEs, is not robust (Baker *et al*. 2005).

[FIGURES 1 & 2 HERE?]

Although organized labour faced exclusion from policy processes in some LMEs, this was not universal with Australia and Ireland as important exceptions. Amongst CMEs unions did not face exclusion, indeed a notable development here was the emergence of corporatist arrangements in southern European countries in conditions where fragmentation of both unions and employers had traditionally been held to work against establishing such relationships. These arrangements effectively provided unions with some voice over moves to reform labour markets and social expenditures and led to outcomes that differed from LME labour market deregulation; they were thus in part a defensive measure, a view that bargaining with government over reform, as well as with employers, would be more effective than simple opposition. These forms of corporatism can therefore be seen as a defensive response to neo-liberal policies as much as an alternative to them. In the key Dutch case unions negotiated wage and employment flexibility to restore competitiveness, with variable employment outcomes, sharply increased wage inequality, a shift in the burden of adjustment expenditure from employer contributions to general taxation and a restoration of profitability that has not led to a commensurate rise in investment (Becker 2001; Jones 1999). During this period the southern European countries faced particular pressures as they moved from relatively protected economies to ones exposed to regional and global competition. Governments, often of the left, managed this restructuring in broadly similar fashion to other European countries but sought to cushion the impact on affected groups (Smith 1998). Emergent corporatist relations were an attempt to incorporate organized labour into trading cooperation in this restructuring for social goods, with varying degrees of success (Royo 2002). Overall the coherence of national employment systems has been undermined as firms employ various strategies in response to intensified competition. Wage bargaining systems have typically become more decentralized as labour's power has weakened.

Shifts towards market-based financial systems have been variable across developed economies. It should first be noted that the rise in shareholder activism amongst LMEs represented a break from post-war arrangements (Holmstrom and Kaplan 2001; Goergen and Renneboog 2001). Previously managerialist theories held sway with widespread claims that managers enjoyed considerable autonomy and that *de facto* shareholders had limited powers. The shift towards shareholder value maximization and the market for corporate control as the key corporate governance mechanism

partly reflected innovations – particularly new financial instruments that enabled easier fund-raising for hostile takeovers and increased use of share option packages for executives. Crucially, too, policy reform, notably the 1986 'Big Bang' UK financial deregulation programme, represented a decisive shift from post-war arrangements and provided the institutional underpinning for shareholder activism (Moran 2006).

Several CMEs have seen dramatic transformations in their financial systems. The French experience is notable for a rapid transition from a bank-based financial system with state direction of credit to one where sources and uses of funds by companies resemble those of Anglo-Saxon economies (Scharberg 1999; Schmidt *et al.* 1999). Ownership of the largest companies was typically highly concentrated with dense inter-locking corporate networks through inter-locking share ownership networks around major banks and interconnected directorships amongst the cohesive French business elite (Morin 2000). The privatizations of the 1980s and 1990s saw attempts to keep major concerns within the *noyaux durs*, hardcore networks of inter-linked industrial and financial interests and thereby limit the emergence of any effective market for corporate control. Nevertheless, these networks have unravelled with both the entry of foreign investors and the development of international networks by French companies. This has also lead to greater orientation towards shareholder value amongst publicly quoted French companies, but it is not a simple case of either convergence to LME arrangements or persistence of old ones. Elsewhere southern European countries saw decisive declines in state banking. The social democratic economies saw shifts from closed, regulated financial systems to internationally integrated ones with an Anglo-Saxon character.

Elsewhere the evidence of emergence of more capital market based finance is less pronounced than the French case (Beyer and Hassel 2002; Deeg and Perez 2000; Lane 2003). Nevertheless, financial globalization in general and the active attempts to promote an integrated EU capital market in particular may undermine bank-based systems (Gibson and Tsakalotos 2003). Allen and Gale (2000) point out that banks, as financial intermediaries, provide smoothing of returns over time and thus reduce risk to investors; however, competition from financial markets means that investors would have to accept lower returns in some periods to smooth returns over time. The effective processes of cross-subsidization that operate within bank-based systems are undermined by financial globalization. Financial markets may then grow relative to intermediaries even where it may be socially optimal to retain the insurance function provided by the latter. It is not simply the rise in cross-border flows and convergence in returns on financial assets – important as these are – it is that access to international markets for borrowers and savers increasingly set the terms for both savers and borrowers (Grahl 2001). EU countries show no evidence of convergence in the use of bank loans for investment funds, but some evidence of a shift towards use of funds that is more characteristic of a capital market system with levels of stock market capitalization rising, often sharply (Rajan and Zingales 2003a; 2003b). Elsewhere the collapse of the 1990s Japanese bubble economy has led to a transformation in its financial system with a decline in bank borrowing by larger firms so that their financing patterns now resemble those of firms in Anglo-Saxon countries (Nabeshima

2000). This has in part led to a marked decline in the 'main bank' relations between firms and their principal creditors.

To pull the threads together here, post-war arrangements in employment relations and financial systems have been undermined by globalization leading to transformations in the major models. There has been a clear shift in income shares from labour to capital, in contrast to much of the post-war period when wages rose roughly in line with productivity and income shares remained constant; that this shift has been less pronounced in LMEs than in European CMEs is in part due to the ability of managerial staff, CEOs in particular, to appropriate gains. Wage inequality has tended to rise more sharply in LMEs than CMEs, as expected, but the patterns here are not a simple contrast between the two. The general shift to profit shares and rates comparable to or higher than the post-war golden age has not, though, for the most part led to the restoration of earlier investment levels.

In terms of particular models, the shift towards more market-based institutions amongst LMEs was considerably more than a continuation of previous trends and represented a decisive shift away from post-war arrangements – the New Deal in the US, the pre-Thatcher British policy consensus and the Antipodean policy framework. Moreover, although retrospectively trends since the 1980s may seen as a strengthening of the key characteristics of the LME model in response to intensified integration, as Howard and King (2004) note, for the most part earlier commentators on institutional arrangements far from predicting a shift towards *laissez-faire* policies and arrangements frequently emphasized the limitations of markets for solving social problems and argued that LME arrangements would undermine their long term competitiveness leading to predictions of the lessening of the role of markets. Within the LME group, though, important diversity of response remains. Canada's welfare state remains considerably more developed than the United States'. The Irish economic success over this period cannot simply be reduced to or explained by neo-liberal features and indeed the Irish economy diverges from classic LME characteristics in key respects, notably in the role of social compacts (Kirby THIS ISSUE). New Zealand's neo-liberal reform programme was considerably more thorough-going than Australia's, which retained coordinated wage bargaining institutions through the 1980s; indeed, Dalziel (2002) attributes New Zealand's poorer relative performance over this period to the nature of these reforms.

The evolution of the East Asian model outside Japan remains unclear as the working out of the 1997 financial crisis continues; there are attempts to impose LME-type arrangements on Korea without adequate adaptation to a very different institutional inheritance (Shin and Chang 2005). Within Japan the post-war model has undergone radical change with the collapse of the bubble economy in the 1990s, without a clear set of institutional arrangements emerging. Matsuura *et al* (2003) summarize the key features of the Japanese post-war system and then show how far these have been eroded:

> The chief features of this system are: a financial intermediation system centered around 'main' banks and lead underwriters; seniority-based pay and long-term employment; inter-corporate relationships, involving a closely linked group of

firms, known as ‘Keiretsu’; and minute government regulation covering a wide range of economic sectors.

Although for many Japanese firms the main bank continued to play a key governance role, during the 1980s the nature of the governance relationship operated in ways that differed significantly from that claimed for the Japanese main bank system. Although the theory of the Japanese main bank system predicts the main bank tends to increase its exposure to firms with falling profits, the reverse happened in the 1990s (Matsuura *et al.* 2003). Thus, overall relationships between major Japanese firms and their main banks have declined and the banks have been unable to maintain the relations characteristic of the earlier post-war period. The proportion of the economy under MITI measures has fallen with structural change in the Japanese economy and MITI’s power within the government apparatus appears to be diminishing as its budget and personnel fall relative to the rival competition agency, the Japanese Fair Trade Commission. This is hardly surprising given the pressure for external liberalization from global and regional agreements and bilateral pressure from the USA. Cross-shareholding in Japan has been falling since the 1980s; much of this is accounted for by non-financial enterprises selling their shares in banks, not least because of the poor performance of those banks. Internationalization of Japanese enterprises and the 1990s crisis have undermined all of these features. Large firms have become less reliant on main banks and the banks themselves have ceased to play their traditional role in the 1990s crisis. So far there has been limited erosion of long-term employment relations amongst those sections of the work force to which this applies; nevertheless, employers wish to change these relations and pay relations do appear to have changed. Matsuura *et al*. (2003) found that inter-corporate relationships have tended to decline, partly with increased production overseas and increased competitive pressure to switch suppliers as enterprises have more become profitability focused. Under internal and external pressure Japan has liberalized much of its post-war interventionist regime. A key aspect of this has been the operation of Japanese multinationals, hollowing out parts of domestic production with increasingly global production and thereby restructuring post-war relations (Cowling and Tomlinson 2002).

As noted earlier, in the classic VoC conception institutional arrangements are based around interaction between firms but this tends to underplay CMEs where for much of the post-war period the state has played a more central coordinating role in the absence of cohesive employer organization. This is particularly notable in the French case, arrangements which had put the French case on the cusp of the continental European and southern European groupings. New arrangements have emerged of a hybrid character so that as firms grew less dependent upon the state they forged new relationships with (in particular) their workforce and financiers; in other words, they actively reshaped French institutional arrangements producing arrangements that contained elements of LME and continental European capitalism but did not form an ensemble of relations that clearly resembled either (Hancké 2002; Clift 2007). The distinctiveness of the southern European governments has been eroded with global and regional integration. Far-reaching privatization and deregulation programmes often by left parties in coalition governments have undermined earlier state-based systems. This is not just on the left, but also amongst European Christian democrats so that southern European governments of the right are pursuing more clearly *laissez-faire* policies than they did for much of the post-war period. Again, integration has

tended to undermine employment stability and associated employment protection leading to considerable reform; although these countries still have relatively high employment protection, differences have narrowed (OECD 2004: ch. 2). As noted above, there have been attempts to negotiate co-operative arrangements with unions to manage this restructuring, whilst persistent high levels of unemployment have strained welfare systems. Nevertheless, changes in the coordinating role of the state have been portrayed as less a case of a decline in the state's role as a change in its character, a shift in its focus (Levy 2006). Apparently paradoxically, deregulation has been a major project of the state itself with wholesale rewriting of rules rather than simply repeal of earlier regulations. This in part reflects differences in legal traditions between CMEs and LMEs. The argument is, in any case, over-stated; states virtually by definition pass laws whilst raising and spending sums of macroeconomic significance. New regulatory frameworks, themselves strongly influenced by EU and global regulations, are unambiguously more market-oriented and their design does not necessarily ensure the outcome governments intended – this can be seen with financial deregulation, but also with utilities.[4] If states were innovating new missions then an obvious area would be for major public capital projects, widely expected to enhance private sector productivity and economic performance, but expenditure here remains low.

The post-war social democratic economies' performance rested on several institutional conditions, notably restrictive fiscal policy combined with active labour market policies; openness to trade but a regulated financial system that ensured cheap investment funds; wage moderation in the context of centralized bargaining that was effectively traded for high levels of investment (e.g. Stephens 2002). Much of the recent critical literature has focused on the viability and effectiveness of social democratic countries' post-war centralized wage bargaining systems (e.g. Iveresen 1999). Indeed, at high levels of labour organization, if unions use their power to pursue wage bargaining in support of equality objectives this is likely to lead to wage inflation pressures and egalitarian wage bargaining may have a greater adverse impact on employment by inhibiting the growth of relatively low productivity private services jobs. It is not clear how far this actually explains both the decline of centralized wage bargaining systems and the decline in relative unemployment performance of social democratic economies. There is no clear evidence of rising trend unemployment rates amongst social democratic economies as opposed to adjustment to major downturns in the early 1990s (Vartiainen 2004); nor do equality-employment trade-offs appear as strong as this account proposes (cf. Glyn 2001; Kenworthy 2003). The more fundamental problem with such accounts is that social democratic strategies were not designed simply to achieve high levels of employment, but to elicit a private investment response that ensured high productivity-high wage employment as part of an egalitarian project; in the post-war period social democratic economies were able to maintain high investment activity relative to rates of return (Landesmann and Vartiainen 1992; Varghese 2001). With wage moderation since the 1980s profit rates have largely recovered, but investment efforts have not and the effects on unemployment have been ambiguous. Since the 1980s social democratic economies have shifted from relatively unsophisticated financial systems characteristic of CMEs to open, deregulated financial systems. In Finland and Sweden particularly the financial boom and subsequent banking crisis following 1980s deregulation was a major cause of the subsequent recession. Globalization, and

financial openness in particular, has undermined the social democratic project of tying national capital into relations supporting the investment effort underpinning prosperous egalitarianism.

Overall institutional arrangements amongst developed economies have evolved over the past 25 years in response to globalization pressures. This has acted in particular to weaken organized labour relative to capital. It has not clearly led to a strengthening of systems as LMEs and CMEs become more clearly bifurcated. New institutional arrangements have emerged and combinations of these show tendencies towards hybridization. Labour relations systems have become more fragmented within countries and less clearly constitute a coherent national systems; co-ordinated systems of wage bargaining have been undermined and labour markets have become more flexible; traditional banking relations have been undermined and post-war tools of state intervention have become increasingly ineffective. In their place new hybridized relations have emerged. How stable these new ensembles are, whether globalization in general and financial integration will lead to an internal logic towards more market-based arrangements, remains to be seen (cf. Lane 2003). Financialization has not developed in identical fashion across countries, but it has had had macroeconomic consequences. The financial sector's income share has risen over this period, a trend that appears to be positively related to capital mobility and negatively related to the strength of domestic labour movements (Epstein 2005). By raising required rates of return on capital investment, changing incentives facing corporations and providing alternative opportunities for funds it appears to be significantly related to lower rates of investment and from this lower employment growth amongst leading OECD economies (Schaberg 1999; Stockhammer 2004) as well as greater financial insecurity (Palley 2007). Moreover, these trends have been common across political systems. Although political institutions have changed little in character, political processes in previously consensual countries have become more majoritarian in character as political processes have become more conflictual and key elites have sought to extricate themselves from restrictions imposed by consensual practices: Jones (2008) documents this for the low countries but it could also be seen in southern European countries where governments, often with parties of the left in coalition, have pursued decisive breaks with post-war arrangements.

None of these trends led to simple trends of decline of the welfare state. It is now well-attested that developed economies at least have experienced welfare state retrenchment in response to globalization; trends in developing economies are considered in the next section. Globalization does not lead to a race to the bottom in welfare provision or a simple convergence onto LME arrangements – popular support for welfare state provisions remains high in Europe notwithstanding attempts by various commentators to insist it needs shrinking in the interests of efficiency. Amongst developed countries government expenditures appear to have stabilized as shares of national income at different levels and this may reflect national social equilibria in terms of relative demands for social goods and their costs of supply (Vartiainen 2004). Further, national differences are less pronounced in terms of net social expenditure than headline figures suggest (Adema and Ladaique 2005); more broadly, differences between the contemporary social democratic welfare states and those in leading north European CMEs may be less pronounced than earlier accounts

indicated (Stephens 2002). Any balance here, though, may be fragile as governments face trying to balance growth in demand for public services with increased difficulties in raising tax revenues. Globalization has acted to reduce effective corporate tax rates (including amongst the Scandinavian countries) and reduce cross-country variance amongst developed economies, shifting the burden towards labour and indirect taxation. To the extent that globalization constrains governments' ability to raise revenues to levels they desire this has restricted their ability to cut income taxes at levels where they harmed employment and shifted them towards less mobile factors (Genschel 2002). In particular, the shift towards greater use of indirect taxes makes the financing of the welfare state regressive to varying degrees across countries (Kato 2003). It is not simply that the tax share has shifted towards labour and indirect taxation; globalization would be expected to raise the elasticity of demand for labour so that the incidence of taxes (the real economic burden) would increasingly fall on labour and this would worsen the adverse employment impact of taxation (Rodrik 1997). Although Rodrik (1997) found that across countries more open developed economies have larger welfare states, he also found that over time increased openness to trade and capital movements was associated with lower expenditure; Liberati (2007) finds further evidence for this. These notions are given further support by Skidmore *et al.* (2004) who find evidence of convergence – robust to the inclusion of various control variables – for government expenditure per capita both globally and within the OECD countries. Similarly Sanz and Velázquez (2006) found evidence that European economic integration is leading to some convergence in the composition of government expenditures. The fiscal pressures may also have led to some qualitative convergence between welfare states. The diffusion of new public management techniques has led to some similarities in strategies. Schwartz (1994) found that in Denmark, Sweden, Australia and New Zealand countries reorganization of welfare state provision saw operational responsibility increasingly devolved to local levels whilst control over spending became increasingly centralized and strict. Increased use of markets and quasi-markets for provision of welfare services meant that local level managers had more devolved power, mirroring developments in private corporations. Competition and comparisons was encouraged between agencies and sometimes with private sector providers. These processes have the effect of diffusing pressures on the welfare state by limiting the power of interest groups whilst strengthening the power of fiscal bureaucrats. Similar tendencies trends towards such decentralization and increased public-private arrangements can be observed in Latin American countries (Filgueira THIS ISSUE). Whilst globalization may increase demand for welfare services by exposing citizens to greater risks, it may also reduce governments' ability to sustain levels of provision.

5. Implications for Developing Countries

With limited evidence classifying developing countries' institutional arrangements and discerning the logic of their development is harder. As noted above, it is often harder to group countries statistically (Pryor 2006) and emergent arrangements may have contradictory elements so that arrangements are not mutually-reinforcing (Cernat 2006). In the contemporary period Latin American governments have pursued broadly orthodox macroeconomic policies and limited redistribution (Weyland 2004); this holds for the recently elected governments of the left (e.g. Arestis and Sawyer 2007). As Boyer (2005) noted, earlier institutional arrangements in these economies collapsed in the 1980s, whilst the more-or-less thorough going neo-liberal policies of

the 1980s and 1990s have produced disappointing results in terms of growth, employment and wider social indicators examined in more detail elsewhere in this issue.

These trends do not, though, indicate that Latin American countries have converged to an LME model, either as idealized type or as actually existing Anglo-Saxon capitalism. As noted above the clearest parallels are with the southern European grouping in terms of more limited financial development and relatively high labour market protection under conditions of moderate competition. Moreover, there are also parallels in terms of democratic transitions. Democratic transitions under globalization and relatively orthodox policies with limited redistribution may be inter-related: elites may accede to transition to the extent that globalization is perceived to constrain democratic governments' ability to engage in radical redistribution (Weyland 2004). Further, in the process of democratic transition elites may well placed to embed institutional measures that limit the power of labour and/or opportunities for redistributive measures (Boylan 2001

Increased openness posed key challenges for democratic governments, particularly of the left. It can no longer be assumed with low wage competitors like China that trade integration will lead to disproportionate benefits for ordinary workers and the narrowing of wage differentials; on the contrary, the combination of general globalization trends and the specific impact of structural adjustment has seen rising inequality in Latin American countries, often to a greater degree than in developed economies outside of the LMEs (Singh and Dhumale 2005). As in southern European, governments attempted to manage this restructuring; again there were attempts to negotiate cooperative arrangements with fragmented, but sometimes sectorally-powerful, unions with mixed results (Murrio 2000).

The simple story here would be that welfare state provision in developing countries generally, and Latin America particularly, has been hampered by internal and external pressures. The pressures in terms of both demands placed upon the welfare state in developing countries and globalization trends undermining its resources have been more acute in developing countries and have undermined attempts to sustain these in Latin America. Opportunities for capital exit have for some time provided important constraints on policy autonomy in Latin American countries (Mahon 1996). There is considerable evidence for this simple story in developing countries, particularly Latin American ones - social expenditures have proved to be more vulnerable to globalization trends amongst these economies than amongst developed countries (Kaufman and Segura-Ubiergo 2001; Rudra 2002). Nevertheless the picture is more nuanced here an there are grounds for believing useful policy space remains for constructing welfare regimes in these economies consistent with open developing economies. There is little doubt about demands – Latin American liberalization policies have been disappointing in terms of employment generation, poverty and inequality. Rudra (2002) shows that domestically one key difference from developed economies is the strength of organized labour – surplus unskilled labour is hard to organize and in the absence of labour movement strength globalization pressures are likely to worsen welfare provision. Further the strength of organized labour has been weakened by developments since the 1980s (Arestis and Sawyer 2007: ch. 1). Nevertheless, democracy does appear to act to increase welfare expenditure whilst

development, and particularly human capital development, by increasing relative supplies of skilled labour also tends to raise expenditure. Further, Kaufman and Segura-Ubiergo (2001) finds that it is transfer expenditure (particularly pensions) that is particularly vulnerable to globalization pressures, with human capital expenditure on education and health much less vulnerable. This is particularly significant since Rudra (2004) finds that whereas public social expenditures are generally related to progressive outcomes amongst developed countries, amongst developing economies this is typically only true for education expenditure – transfers and even health expenditure are not systematically related to more egalitarian outcomes in developing economies. Further, with some parallels of developments in industrialized countries, welfare state expenditure relies upon regressive taxation (Sandbrook *et al*. 2007: ch. 8). Thus, and with some similarities to welfare state reform in southern European countries, whilst globalization does act to increase welfare states' vulnerability it may also offer some opportunities to recast welfare states in the face of increasing demands for more effective outcomes. . Welfare states can promote social cohesion and human capital accumulation and may thereby lead to the cross-class and interest group support that has helped sustain them in developed countries, including LMEs.

More generally, the fate of developed country models has key implications for the construction of welfare regimes in developing countries. On several grounds the East Asian post-war model is not a feasible or even desirable model for Latin American countries, not least as the model was predicated upon exclusion of organized labour and low public welfare provision (cf. Pempel 2002). Nevertheless, its fate is instructive. The growth of East Asian economies prior to the 1997 crises has been characterized in terms of a profits-investment-growth nexus (Akyuz *et al*., 1998; Singh, 1998). Profit shares were sustained, in part through selective measures. Alongside this developmental states were able to maintain the animal spirits of capitalists and ensure that savings out of business incomes were high with sustained capital accumulation. This was buttressed in particular by bank-based financial systems and state industrial policy that was capable of providing selective incentives and directing rents to underpin the capital accumulation effort. Productivity growth from capital accumulation largely ensured economies avoided pronounced fluctuations in functional income shares and associated investment cycles. This is in contrast to the Latin American experience where states were unable to create such social bargains and to achieve sustained capital investment efforts out of business incomes and so investment cycles were pronounced (e.g. Huber 2002). The social bargain between capitalists and the state that underpins this is hard to construct and inherently unstable with development (Chibber 2003). Since the 1997 East Asian crisis these relations have been undermined; more generally globalization has undermined the traditional policy tools of the developmental state making the post-war selective protection and industrial promotion policies increasingly inoperable (Perraton 2005).

This is certainly not to dismiss industrial policy tools, although it is to argue that they are much more circumscribed. All industrialized countries rely on production of high end tradable goods and have done for their development – LMEs rely on strategies for skill development amongst leading sector employees, wage flexibility as a route for employment expansion was concentrated on the non-tradable services sector and was

not pursued as a strategy of primarily competing on the basis of low wages. The limitations of neo-liberal policies amongst Latin American economies has led not to a reversal towards protection or traditional developmental state strategies, but more subtle industrial policies, similar to those proposed by Rodrik (2007: ch.), that appear to be having some success at industrial restructuring and upgrading in Latin American economies (Peres 2002; Wise 2003). Countries' export development depends not simply on their factor proportions, including human capital, but can be incubated through various industrial policy tools that promote up-grading leading to wider development.

Post-war social democratic strategies in small open European economies also rested upon organizing high rates of investment, particularly in tradable industries, through various mechanisms including historically similar forms of industrial policy to those used more recently in developing countries (Landesmann and Vartiainen 1992; Vartiainen 1999). Alongside economy-wide organization of labour and employers the state played a key role in promoting structural change and making side-payments to ensure co-operation. These economies have faced difficulties in sustaining such arrangements, particularly as a result of capital mobility, and no longer boast the investment performance on which their post-war success rested. Straight-forward replication of advanced social democratic models is unlikely in the developing world, although it should be noted that these models grew out of up-grading of industrial structures from a primary export and processing base. Latin American countries would have difficultly in maintaining fiscal conservatism combined with high levels of taxation alongside measures to promote structural change including strong active labour policies (cf. Stephens 2002). Nevertheless, in general terms, social democratic economies achieved orderly adjustment to post-1973 shocks through cohesive national arrangements; Rodrik (2007), amongst others, stresses the importance of various national institutional arrangements that preserved social cohesion and limited conflict over adjustment in developing countries. More specifically social democratic strategies have emerged amongst developing countries - policies in Costa Rica and Chile in particular point to possibilities for constructing effective welfare systems consistent with functioning market systems in these economies (Sandbrook *et al*. 2007; Sheahan 2002), albeit less systematically than with classic developed country social democracy. Constructing such arrangements in developing countries remains problematic since 'what they lack is the kind of dynamic coordination on the economic side, guided by wide consensus on goals and methods, that characterized European social democracy at its best' (Sheahan 2002: 34).

This leads to a more general point. The fragmentation of developing country labour movements and their limited representation of the unskilled and/or informal sector workers have already been noted. Employer organization has also tended to be weak; employer groups have organized to lobby for policy changes in Latin America but have not typically formed the cohesive groups characteristic of CMEs (Durand and Silva 1998). This hampers the emergence of CME relationships generally, not just social democratic ones, and has tended to lead to more state involvement in constructing institutional relations (cf. Sheahan 2002). Nevertheless reform offers some potential opportunities. Comparative political economy literature has seen the co-evolution of employment protection legislation and restrictions on openness and

capital labour market development; Schrank (THIS ISSUE) shows an expected negative relationship between openness and employment protection for Latin American countries. However, Palley (2005) finds that democracies tend to institute legal rights and standards for labour which help promote independent labour organization and bargaining, but these are also associated with greater security in economic transactions, lower corruption and generally better governance. It is not a simple case, as Rodrik (1998) claims, that democracy leads to higher wages than that it leads to conditions for labour organization and bargaining that lead to higher wages in the context of more effective governance.

Both southern European arrangements and models of capitalism in Latin American countries have been characterized as combining restrictions on labour and capital markets. In both cases labour markets have been at least partially deregulated. Financial market integration has grown but this is not readily explained by either the historic legacy of legal traditions or alternative explanations in terms of political choices (Rajan and Zingales 2003a). Armour *et al*. (2007) find no evidence that different legal traditions affect the long run development of stock markets or, through this, economic development more generally. There are several grounds for doubting that a shift towards a capital-market based system would aid development in the light of widespread and irreducible market failures associated with information asymmetries and imperfections (e.g. Singh *et al*. 2005; Grabel 1995). Recent research points to developing countries not clearly conforming to either a bank or capital-market based system, but developing country firms making more use of external funds partly in response to recent policy measures to promote stock markets (Sartiz 2007). There is some evidence of similar trends towards financialization in emerging market economies, with attendant income inequality effects, although data is limited (Epstein 2005). Globalization trends and neo-liberal policies do not necessarily imply that developing countries will converge on LME models, but just as southern European countries are faced with external pressures to change contemporary arrangements in developing economies may not be sustainable.

6. Conclusions

Conceptions of variants of capitalism have recently gained widespread assent. They have the key implication for development that a range of institutional arrangements are compatible with prosperity. What matters is less the particular institutions than an effective ensemble where inter-relations act to reinforce the operation of different mechanism. How far this institutional coherence matters amongst developed countries is not clear, although there is some evidence that ‘cocktail’ arrangements mixing domestic traditions with arrangements imposed by international agencies may lead to sub-optimal outcomes amongst developing and transition economies.

The argument here is that globalization trends have undermined core features of national institutional arrangements amongst developed economies and made it harder to sustain social bargains and welfare provision. This applies not just in CMEs but also LMEs where arrangements since the 1980s marked an important departure from earlier post-war social bargains. Traditional national employment relations have been undermined and become more fragmented; finacialization has undermined earlier

arrangements that tied national capital into domestic relations. Variants of continental European capitalism have faced strong pressures to shift to more market-based arrangements, although there is no guarantee that this would lead to a performance comparable to the 1990s 'new economy' US and risks undermining longer term sources of relative advantage (Kitson 2005; Watson 2001). Versions of the East Asian model have been in crisis since the 1990s. It is easy to refute hyper-globalization versions of these claims, and naïve predictions of convergence to LME models and/or a race to the bottom in welfare provision. This though is to ignore the ways in which globalization and, within the EU, European integration has shifted the character of developed economies to more market-based arrangements with a key impact on the fortunes of labour. Latin American economies emerged from the neo-liberal 'lost decade' of the 1980s with economies that were more market-based in character – increases in poverty and inequality even with the resumption of growth. These forces may undermine patterns of state intervention and the emergence of an effective welfare state. But developments in both groups point to possibilities for emergent new relations. The argument here is not that globalization makes construction of alternative arrangements to Anglo-Saxon capitalism impossible but that it does make them more difficult to achieve.

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[1] Amongst the 'issues on which the Washington consensus does *not* imply a particular view is… the model of the market economy to be sought (Anglo-Saxon *laissez-faire*, the European social market economy or Japanese-style responsibility of the corporation to multiple stakeholders).' (Williamson 1993: 1334).

[2] East Asian countries' performance and institutional arrangements since the 1997 remain unclear; this is touched on below.

[3] As an extreme example, but one that exemplifies how far institutional analysis is now accepted by mainstream economics, a recent World Bank analysis of slow-growing mineral exporters (and no doubt in the shadow of attempts to impose new institutional arrangements in Iraq) effectively concludes that, given their institutional inheritance, there is little that could be done to improve their performance significantly (Isham *et al.* 2005).

[4] In European telecommunications and electricity deregulation national institutional differences appear ultimately to have made little difference to the outcome of deregulation (Bartle 2002; Serot 2002).