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The theory of comparative capitalisms and the possibilities for local variation

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Globalization is placing European societies under pressure to change. In the 1990s, researchers identified particular national models of capitalism. These were argued to consist of integrated and reinforcing institutions that created specific rules of the game for economic actors. These rules favoured the development of globally competitive firms in particular sectors where the institutional characteristics of the home society facilitated the building of distinctive types of capabilities. In this view, a global division of labour was developing based on institutional differences. Thus, national policy makers needed to reinforce institutional advantage and institutional specialisation by incremental adaptations to globalization. Reforms needed to be consistent with the underlying model of capitalism. This paper challenges such a view. It argues that firms are highly innovative and use institutions not as constraints but as resources that enable them to build new capabilities. It further argues that institutions are more diverse, malleable and multi-levelled than the national models perspective recognizes. Thus, options for change are much broader than predicted by the path-dependent national models framework. Indeed, the main issue for European societies in response to globalization is to ensure diversity and experimentation rather than simply seeking to reproduce a dominant logic.

Introduction

European societies are engaged in a process of economic restructuring as global competition becomes more intense. Globalization, characterized in economic terms by the opening of national markets, the deregulation of business activities, the construction of new technologically enabled global supply chains and the intensification of competition between firms has challenged existing institutional arrangements across Europe. Firms are now able to identify new locations outside Europe where goods and services can be produced more cheaply at increased

levels of quality. They can move to locations where they pay much lower wages and benefits, receive generous tax breaks and subsidised infrastructure, and are subjected to fewer regulatory demands. Nor is this simply an issue for manufacturing industry. Knowledge-based activities can be reorganized and many elements, including high level research and development, can now be transferred and outsourced away from Europe into Asia, most obviously China and India. For example, Novartis, the Swiss Pharmaceutical company, has recently announced it that it intends to make Shanghai one of its three big research hubs alongside Cambridge, USA and Basle, Switzerland. In these circumstances, what is left for the countries of 'old Europe', the heartland of the EU project? Will employers force potential employees into more flexible labour market arrangements in a 'race to the bottom' in terms of employment rights and welfare systems? Will Europe lose its comparative advantages in terms of skills, knowledge and learning and find its economic position weakening as the new economies of Asia and the Americas grow and develop?

A range of options arise in academic and policy considerations. The first, which is traditionally represented with the European Union by the British government, is that Europe needs to open itself further to market competition in order to get rid of underperforming firms and to grow firms in new expanding sectors. The implication of this model, which has been expressed frequently by Tony Blair and his chancellor, Gordon Brown (and supported implicitly and sometimes explicitly by the US), is that the continental European economies need to dismantle their regulated and 'ossifying' economies and undergo rapid institutional change to turn them into open liberal market systems where national protection for firms and for employees has been removed.

A contrasting perspective to this argument is to emphasize that there is a path dependency to processes of economic change and European societies will not lightly give up their distinctive social and political systems. Instead, there is likely to be a complex amalgam of processes of adaptation and change. Societies are likely to respond to challenges in ways that reflect their history and their particular social structure and institutions. Therefore, the opening of markets and the development of capital and labour flexibility will be adapted and shaped by particular national circumstances. In this paper, I pursue this issue in greater depth. In particular, I distinguish between two types of analyses of these pressures, both of which emphasize path dependency and the role of institutions. However, they differ in certain important respects. The first type emphasizes that European societies should become more focused on their particular historically developed institutional strengths. Policy should, therefore, aim to strengthen existing institutions and the complementarities between them. Institutional change should be incremental and carefully calibrated to ensure that the system as a whole retains its distinctive strengths. The second approach suggests that, as a result of

processes associated with globalization, European societies are becoming more internally diverse in terms of their economic organization. Further, this diversity can be seen as a source of strength because it enables new combinations and innovations to emerge. Crouch¹ has labelled this as the difference between the 'pedigree' and the 'mongrel'. The pedigree in animal husbandry is bred to do one thing extremely well; but it is only one thing and if this is not required the pedigree is superfluous. The mongrel, by contrast, has attributes from different sources that may come in useful in different conditions. In the first part of this paper, I critically examine the 'pedigree' model, arguing basically that it is an inadequate representation of the empirical reality of societies and their processes of change. In the second part of the paper, I examine the 'mongrel' model. I suggest that this is a more appropriate perspective for understanding societies and how they change in response to internal and external pressures. In the final section of the paper, I consider the policy implications of these arguments, suggesting that from both a political and economic point of view, the central goal of policy should be concerned with supporting and stimulating diversity within a framework of broad social consensus on legitimate forms of economic activity.

Pedigree models of national capitalisms

The 1990s saw a revival of interest in the comparative study of capitalisms. With a number of honourable exceptions (e.g. Shonfield²) in the Cold War period, the clash between the communist states and the West tended to conceal the extent of difference between capitalist economies. Almost as soon as the communist system collapsed, authors began to explore differences between capitalist societies in much more detail.³⁻⁶ These authors suggested that different forms of capitalism institutionalized particular economic rules of the game that shaped the strategies, structures and competitiveness of firms. Thus, societies developed institutions that reflected their own particular way of organizing economic relations (from systems of ownership through to patterns of industrial relations). These, in turn, derived from the social compromise between, in particular, labour and capital that had been constructed most noticeably in the post-war period but had deeper roots in the mode of transition from an agrarian, pre-industrial economy. Competition in open global markets brought firms from different institutional contexts and with consequently different capabilities into a level playing field. In those industries (mostly manufacturing, e.g. autos, electrical, chemical and other forms of engineering) where such a level international playing field more or less existed in the 1960s through to the 1980s, firms from certain countries out-competed those from others with a consequent impact on internal patterns of wealth, inequality, welfare and social order more generally in the different societies. The result was a growing international division of labour with firms from particular societies

specialising in distinct sectors where the national institutional conditions gave them a particular advantage.

Hall and Soskice⁷ made the clearest theoretical statement of this position in their distinction between liberal market economies (LME) and coordinated market economies (CME). Liberal market economies, driven by market relations in the provision of capital and labour and in the construction of inter-firm relations and based on a short-term logic, encourage firms to prosper in sectors where rapid and recurrent restructurings of assets is likely – low end manufacturing, industries undergoing major technological restructuring (such as telecoms and the internet) and high end services (consulting, accounting, financial markets). By contrast, coordinated market economies are characterized by negotiation between the main actors, i.e. between owners and managers, between managers and employees and between firms. Coordination brings gains in terms of collective incremental upgrading and improvement, although the process is likely to be slow. Sectors of manufacturing (e.g. cars, engineering) which are characterized by the competitive need for continuous improvement are supported by these processes of coordination. Thus, CMEs could be expected to grow globally competitive firms in these sectors. CMEs and LMEs would specialize in different industrial sectors and this would be reflected in the sorts of firms that were globally competitive in those countries.

In this view, both LMEs and CMEs are structurally integrated forms of social organization that create strong path dependencies that generate advantages for actors in those systems. Actors in these systems, according to Hall and Soskice⁷, are incentivized to follow the rules for two reasons. Following the rules reduces search costs and enables actors to assume a common framework of understanding, thus facilitating economic interaction. Failure to follow rules leads to sanctioning that has an economic impact. Sanctioning may be informal, e.g. in terms of loss of reputation or it may be formal, e.g. expulsion from an employers' federation. Actors are locked in to a certain model of economic coordination that creates a path dependency. Institutions reinforce each other, creating institutional complementarities that also generate economic efficiency gains for those who continue to abide by the rules. External changes are therefore unlikely to lead to major internal changes, and more likely to be absorbed into the existing model (for similar perspectives, see Amable⁸ and Whitley⁹).

In general, these authors share a similar focus on the 'system' nature of institutional arrangements and their impact on firms, focusing on how different institutions (the financial system, the labour system, the contracting system) reinforce each other and lead to a particular way of doing things in particular societies. This process of reinforcement (although relatively under-examined) is seen as having economic and political benefits for social actors who therefore continue to reproduce the institutions, thus creating a path dependency. Hall and

Soskice, for example, state that; ‘The firms located within any political economy face a set of coordinating institutions whose character is not fully under their control. These institutions offer firms a particular set of opportunities; and companies can be expected to gravitate towards strategies that take advantage of these opportunities. ... Our approach predicts systematic differences in corporate strategy across nations, and differences that parallel the overarching structures of the political economy.’⁷

In more recent empirical work, Hall and Gingerich¹⁰ have elaborated on the implications of this for institutions. They examine first of all the degree to which institutions in particular societies cohere around either market coordination or, what they term in the paper, ‘strategic coordination’. They find strong correlations across different spheres indicating that societies tend to lie closer to one of the two ends of the market-strategic coordination dimension. They then test whether those societies lying closest to the ‘pure’ type of either market or strategic coordination perform better in economic terms than do societies nearer the middle (i.e. mixing the two different modes of coordination). Their overall conclusion is that the greater the degree of institutional coherence and complementarity (at either end of the dimension) the higher the growth rate. The lower the degree of institutional complementarity the lower the growth rate. The message for analysts and policy makers is clear. Change should be ‘path dependent’ and based on a recognition of the importance of complementarities. Changes to single institutions are likely to undermine these complementarities and therefore do more harm than good. Reform and institutional change is likely to be more effective if it is incremental as any attempt to institute ‘path breaking’ change is likely to lead to loss of performance. In this model, institutions are ‘strong’; they provide unambiguous messages to actors about the rules of the game and, if these are transgressed, strong sanctions (economic, reputational) come into play that pull actors back from their deviance. Conformity is rewarded and experimentation punished. Firms in this model are the passive recipients of institutional constraints. If they fail to play by the rules of the game, they will perish.

However, this approach is challenged by globalization, which complicates the picture. Both LME and CME economies are put into crisis by globalization. CMEs find themselves out-competed by firms from Asia where costs are cheaper and quality is nearly as high. Thus, some manufacturing tends to move out of the core CME economies into Eastern and Central Europe, Latin America and China. CMEs face the problem of continually speeding up incremental innovation at the same time as holding labour costs down, increasing flexibility where possible and continuing to improve skill levels. The state, in particular, becomes the site of these problems, both in terms of legislative reform and in terms of balancing the budget for welfare and pensions in contexts where tax returns are increasingly politicised and subject to criticism.^{11–13} LMEs find that low end manufacturing

production cannot be sustained given the competition from Asian economies and increasingly the potential for relocation has moved up the value chain – into banking activities, software production, document production and now research and development. This is where the policy issues become acute. Should societies respond by trying to strengthen their already existing core assets or should they open themselves up to new experimental forms of organization? In the next section, I explore the theoretical underpinnings of this second ‘mongrel’ model before returning to the policy issues in the final section of the paper.

Beyond the pedigree model

Rethinking firms

In terms of actors, I emphasize the idea of the firm as an actor drawing particularly on recent Penrosian inspired theories of the firm.¹⁶ To begin with, let us note that firms exist in relatively strong selection environments – i.e. markets, both financial and product markets. Failure to perform successfully in these markets threatens the existence of the firm. Economists and others have sought to understand how firms survive in such contexts. One tradition represented in the work of Michael Porter is that firms find ways to create a singular position in the market often by setting barriers to entry to other firms. As it has become increasingly difficult to maintain entry barriers in an era of globalization, deregulation and free markets, there has been a shift from an interest in mechanisms of market protection to an interest in how the firm develops unique assets that provide it with the capability to produce new products and services in ways required by consumers. This approach emphasizes that the firm has to use its existing assets in new ways in order continually to stay ahead of competition. The firm is always moving forward and developing, rather than protecting, markets. The result is a focus on firm innovation and experimentation. Increasingly, researchers have linked this to the idea of networks, i.e. dense connections with other firms that provide the possibility of cooperation and thereby the leveraging of existing assets into new capabilities.^{17–21} This strand of research, therefore, emphasizes that the firm is not a passive recipient of institutional constraints but, on the contrary, is in a dynamic relationship with its broad environment in the search to survive and grow by developing new assets and capabilities. So how does the firm relate to institutions and institutional constraints?

In its search for new resources, the firm does not simply accept institutional constraints. Rather, it looks to find new ways to develop its capacities and by implication this may lead away from the existing dominant rules of the game. This can occur in a number of ways. First, the firm may look to what institutional advantages it might accrue from locating parts of its business overseas in other

settings where different combinations of institutions become relevant, e.g. a European firm accessing US capital markets or a US firm accessing techniques of 'diversified quality production' by entering Germany. Two main effects emerge from this. First, firms learn new practices in other institutional contexts, which they may bring back to their home base – a process labelled 'reverse diffusion'.^{22–24} This potentially changes the relationship the firm has with other actors in its national context and may give rise to new practices in the home context. Secondly, when multinationals enter into new contexts, they may bring new practices that affect both their own subsidiary and also their local context, e.g. through their impact on local suppliers, on local training systems, on local industrial relations etc. Thus, firms are not locked into a single institutional context.²⁵ On the contrary, they look for new advantages that can be gained from going elsewhere. In doing so, they increase variety both in the host and the home context. It is likely that the more multinationals there are based in an economy and the more multinational subsidiaries there are located there, the greater the diversity of firm practices will become. This diversity acts as a lesson or a guide for other firms, further decreasing the homogeneity of firm practices and the dominance of the home institutional context (see for example the impact of the entry of Japanese firms on supply chains in the UK in the 1980s and 1990s).²⁶

However, firms do not just learn new ways of doing things from international experience. They may also identify different tracks within their home context. This is most obviously the case with the diversity of different regional experiences that may exist in particular contexts. Regions also can vary in terms of the nature and degree of their coordination mechanisms and how this is supported by broader political and social identities.^{27–29} Finally, firms can develop new ways of working by picking up on discarded institutional legacies that yet retain some legitimacy and power in the contemporary context. Crouch¹ offers an example in an explanation of the shift in the UK from a form of mild corporatism during the 1970s to a free market model under Thatcherism. He points out that free market liberalism had a long tradition in the UK and, although it had declined as a political force in the 1960s and 1970s, there were important political actors seeking to revive it from the 1970s. Thus, Thatcher was able to build on a renewed and revived legacy of market economies in the 1980s. Similarly, Djelic and Quack have identified the coexistence of *ordo-liberalism* (with its emphasis on the market) and *coordinated capitalism* in Germany since the 1800s. They argue that there has been a consequent fluctuation historically and institutionally in terms of the dominance of either of these approaches.³⁰

What we can observe from these processes is that firms have the opportunity to pursue a diversity of approaches in their fight against the strong selection environment and this diversity has increased as a result of globalization and the ability of MNCs to move across national boundaries. The result is likely to be a

growing divergence within national contexts. On the one hand, there will be those firms that have developed in ways that loosen their connection with the dominant institutions and make them more a complex amalgam of various skills and capabilities drawn from a number of settings. They will be linked in particular local, regional and global networks of cooperation and supply that go beyond any one national system, a necessary change in order to build a globally competitive advantage in particular sectors. On the other hand, there will be those firms that have remained locked within a particular institutional setting with very little involvement in global flows of knowledge, people and capital. In other words, what we can predict is a growing diversity of firm structures and strategies within national systems and therefore a growing tension over the degree to which national institutions can and should constrain action.

Rethinking institutions

As can be seen from this discussion, a key problem is how we conceive of institutions. Here there are a number of arguments that need to be made in contrast to the 'pedigree' approach. The first is that institutions are not to be analysed in functional, teleological terms. It is important to ask where they come from and this leads into an analysis of politics and contingent 'events' (wars and revolutions, most spectacularly but also the confluence and connection of different strands of causality.^{31,32}) In this view, institutions represent a compromise between social actors that has become an established way of doing things.³³ Within this compromise, some actors gain at the expense of others. Therefore, the compromise may be subjected to pressure when circumstances change and, for example, one group perceives itself becoming stronger and therefore capable of challenging the compromise. This perspective can enlighten the current arguments in Germany about the nature of the social compromise. Where owners and managers feel stronger due to their ability to relocate outside the German system or gain funds from capital markets in new ways, then they become less ready to accept old agreements about how jobs, rewards and representation rights should be organized. They become more likely to challenge this and look for their own company solution rather than adhering to corporatist norms (Lane³⁴). In turn, employees look for ways to resist this and use their existing institutional position to rebuild their eroding power (see Yamamura and Streeck³⁵). Thus, institutional reform is a political battle, not simply a technical and neutral mode of restructuring firm relations, nor a predetermined path-dependent response to external change.

This point can be reinforced if we secondly turn to the issue of institutions themselves and more particularly the question of institutional complementarity. The 'pedigree' approach has a strong view on institutions and institutional complementarity. As described in the previous discussion, it is less interested in

issues of historical formation and political action and more in the idea that societies evolve a functionally useful set of complementary institutions that drive increasing returns. Here the basic problem is that the model overestimates the degree to which societies develop complementary institutions to the exclusion of any other type of institutions. One reason for being sceptical about this argument is that institutions tend to exist in weak selection environments. There is no ultimate arbiter of whether an institution should cease to exist. Institutions accrue actors who become committed to their continuance by virtue of what the institutions actually deliver to them. Such actors may need strong persuasion if they are asked to reform or get rid of the institution for some postulated greater good. This is why institutional change is primarily a matter of politics (and the political balance of forces), and not a matter of economics (and efficiency). As a result, institutions tend to linger rather than disappear, thus making them possible resources in future developments. Thus, institutional change is less likely to occur through wholesale reform and more likely to appear through often unconscious and for a time, invisible, processes. Streeck and Thelen¹² refer to this processes in terms of layering, drift, conversion, displacement and exhaustion. In Amable's terms,⁸ particular institutions may no longer be part of the dominant institutional hierarchy in a society but they still survive in a truncated or changed form. Thus, the more interesting question is to consider how, over time, institutions tend to move out of this dominant hierarchy and become peripheral or even expendable as far as most actors are concerned (see the studies in Streeck and Thelen.¹²) Thus, societies are likely to be characterised by a long tail of partially embedded institutions, some of which have moved from the institutional centre to the periphery, others of which never became fully established but were given enough of a life to keep ticking over after the initial flush of enthusiasm for their establishment has long passed. These partially embedded institutions may be picked up and developed by actors looking for new ways of doing things. This reinforces the idea that societies are much more complex in institutional terms than can be understood using a strong model of institutional complementarities (which assumes that other institutions are 'selected out' and disappear because they are not 'functional' to the economic system).

If we allow for the fact that there may be institutions in a society that are not particularly complementary to the core set then we raise a number of questions. First, we historicise the question of institutional complementarities; i.e. we can ask how did these particular complementarities come about? Were they purposively created or were they the outcome of unexpected linkages and reinforcement processes? What happened to institutions that did not end up being complementary? Were they destroyed or did they remain present on the periphery? Secondly, we can conceive of societies that vary in structure from tightly complementary to loosely complementary. An interesting example here is

Japan. Japan is frequently characterized as a system with high levels of complementarities between its institutions, leading to the creation of the Japanese mode of the firm identified with high levels of employee commitment, strong network linkages and long-term planning and investment. And yet this does not describe Japan *per se*. Even within the manufacturing sector, there are many small firms where employment is unstable, rewards are low and the use of skills limited (see the discussion in Whitley³⁶). This, in fact, raises a different meaning for complementarity. The small firm sector, organized on much more short-term principles, actually enables the large firm sector to work because when there are downturns the big firms pass the consequences on to the small firms who bear the brunt of the contraction and have to lay off workers. The big firms on the other hand are able to retain their employees and reinforce the lifetime employment system. The two areas are complementary not in that they are similar but rather that they are different (see Crouch^{1,14}). That is why the system works. The Danish model of 'flexicurity', combining a liberal market principle of high employment flexibility with a coordinated market principle of high welfare security, also reflects this linking of two different principles in a new way (see Campbell *et al.*¹³).

Japan also illustrates other problems with the assumption of a tight national integration of institutions. It is frequently remarked that the Japanese service and retail sectors are very poorly performing as is their agriculture and the public sector. Agriculture, for example, as in many countries, remains a protected sphere due to political interests in the preservation of the distinct role of the land in Japanese culture. It has not been rationalized or made complementary to the big firm sector (see Pempel³⁷ for an excellent analysis of the complexities and contradictions of the so-called 'Japanese system'). In comparison, this has been the case in the UK and the US though not in many European countries as debates over the Common Agricultural Policy within the EU continuously reveal. In other words, we have to be very careful about imputing a single logic to a system.

Indeed, we could expect that as societies seek to increase their degree of integration and complementarity, there would, for at least a transitional period, be an increase in actors resisting this process and struggling to retain their particular autonomy from the wider context. An example of this might be education (see for example the discussion in Brown *et al.*³⁸). In European countries, school and university education has been closely associated with the development of citizens in nation-states. In some countries, this also became closely tied to the development of skilled workers, but in other contexts, most obviously the UK, this link was of limited significance. From the 1960s, the school teaching profession embraced various philosophies of education that were much more concerned with the 'development of the whole child' than with issues of production. From the 1970s, when the British Prime Minister, Jim Callaghan, launched what he described as the Great Education Debate, there has been

continuous reform of the school system aimed at creating a new generation of productive workers rather than informed citizens. This has been a protracted struggle between actors at various levels of the education system. The point is that, in the UK, this system had, in a sense, become increasingly autonomous and separate from the economic sector. Governments have tried to bring this institutional set-up more closely into a positive relationship with firms and skill development but this has been a complex process.

These considerations suggest that we are likely to find, once we move from abstraction to empirical research, that there is no single logic in a society but a series of different logics sustained by local and regional conditions, by sectoral differentiation, and by social and political factors (e.g. the degree of cohesion in particular societies). Sometimes these different logics become complementary in the sense of being different but reinforcing. Sometimes these logics may be similar. Sometimes these logics may become relatively autonomous and deemed irrelevant to economic issues. This is a matter of empirical research rather than a necessary assumption.

In conclusion, institutions are not capable of strongly binding actors to single logics of action. They are, in themselves, contested and liable to be undermined or reconstructed from the inside. The stability of an institution may be an indication of its strength to bind but deeper analysis is required to understand how this stability is constructed and what factors might be capable of undermining it. Even complementarity can suggest difference rather than similarity. It can be argued that societies derive much of their capacity for renewal and change from the fact that they have institutions and logics that pull in different ways and can therefore be recombined in new ways in response to external and internal change processes. In such a context, actors face different principles and can use this to give themselves more flexibility in particular contexts. Societies consist of an array of institutions that reflect historical processes of development and change. Although in terms of power such institutions may vary greatly, they still provide the possibility for diversity, change and experimentation. In sum, institutions are diverse and multi-levelled and actors can use this to develop their own distinctive trajectories.

Striving for prosperity: beyond national models

The pedigree model suggests the importance to policymakers of ensuring coherence and consistency in institutional change. From this perspective, reforms that do not reflect the dominant logic of the model will fail and lead to confusion and decline. However, when we dig deeper it becomes clear that societies are not so coherent, actors are not so passive and institutions are not so strong. Societies represent, to varying degrees, mongrel patterns of institutional development. From

a historical perspective, it is clear that the nation-state building process that characterized the European economies (plus the US and Japan) in the 19th century was, to a significant degree, concerned to create 'pedigrees' (see Mann³⁹). These were to be national systems that fitted together and where 'deviant' patterns were dispelled. A common approach across a wide range of institutions was to be established mainly by the coordinated action of governments and the ruling elites. As history shows, in many European countries, this gave rise in the inter-war years to fascist movements intent on the compulsory destruction of deviant groups in order to purify the nation in this search for unity of purpose. The Second World War and its Cold War aftermath effectively purged European nation-states of the more extreme features of these 'system' like qualities, although earlier patterns continued to have an influence in the organization of economic affairs (see for example Bendix⁴⁰). Thus, most of the advanced industrial countries entered the post-war era with an underlying logic of social organization, reorganized in the defeated Axis powers but nevertheless showing remarkable continuity with the previous period of nation building. Post 1945, what Ruggie⁴¹ describes as 'embedded liberalism', which restricted the movement of capital whilst allowing open trade in most manufacturing products, enabled national policy makers to continue to think in terms of 'national models', even if the reality in most countries was much greater diversity and uncertainty. From the 1980s, onwards, however, the speed and nature of the flows of capital, technology, people and knowledge through open borders has prompted a huge debate on what this means for the nation-state.⁴²⁻⁴⁵

Where does this leave our concern with striving for prosperity in Europe and policymaking? As an empirical question, we need to understand whether European societies are becoming more diverse in terms of models of economic organization, types of firms and institutional structures or are they becoming more homogeneous? I suspect that any detailed empirical examination will reveal the former rather than the latter. The point, however, is not that dominant models are disappearing but that they are surrounded by more diverse possibilities than previously and this changes the calculation of governments, individual actors and firms when they face new challenges. The result is that where there have been very dominant and distinctive models, we are likely to see them engaged in complex and conflictual relations with new and emerging actors. Part of this conflict may occur because certain actors want to go back to the 'pedigree' model and squeeze diversity out of the system by top down control. However, their ability to achieve this in contexts of open borders that allow actors to move around and engage in 'regime shopping' makes it unlikely that this model could ever succeed again.

Does this mean that the 'market' has won and that coordinating institutions with their emphasis on corporatist negotiation will decline in order that flexible markets in labour and capital can emerge? This is not the lesson at all. The lesson is, on

the contrary, the need to sustain the institutions that have served European economies well in the past but sustain them in ways which allow change, diversity and recombination by individual actors and firms. Indeed there are some reasons for being cautiously optimistic about the European response to globalization and about the underlying ability to continue to out-compete other countries precisely because of the deep embedding of social institutions. Of course, there is an element of lock in and sunken assets that makes wholesale change difficult. But this is not really how change is occurring. It is not that societies are remodelling themselves from the top but rather that economic actors are taking new opportunities and in the process reshaping their local institutional environments. This process is most clearly seen in small societies in particular, which seem to have built the cooperative institutions that enable actors to reflect and reach new agreements about the sorts of reforms required (see Katzenstein's original small states theory⁴⁶ and subsequent discussions in Campbell *et al.*¹³ concerning Denmark, and Becker and Schwartz⁴⁷ comparing small European states to Germany and the US). It is also seen in regions that have evolved shared institutions and identities that facilitate change and innovation rather than simply reproduction. The sorts of dialogues, debates and cooperation that occur in regions and small states are much more difficult to achieve at the national level in large societies where the complexities of interest group formation and political representation reduce the potential for change. Even stasis at this level, however, does not necessarily crush local efforts at restructuring and change. These sorts of communicative capacities to create new responses to problems have been labelled as characteristic features of 'institutional competitiveness.'⁴⁸ In this model, the emphasis is not on any particular patterns of economic organization or firms as being what creates competitiveness but on the ability of a society continually to experiment and introduce new ways to solve problems. This capacity is embedded in the institutions that have created the consensual means to dynamically search for new solutions.

Striving for prosperity in Europe in these new conditions is therefore unlikely to be a matter of reproducing national pedigree models. Even if there was a golden age when such models were accurate descriptively and effective normatively that period has gone. Diversity has been re-introduced into national systems and new challenges arise from this to create a new economic, social and political settlement. All social settlements can be described as forms of compromise building between the more powerful and wealthy segments of a society and the less powerful but usually more numerous sections. If European societies are to move towards a new form of prosperity, they face this task again in a new environment where their population and their economy is much more diverse and heterogeneous than previously, making it more difficult to build institutions through consensus but even more necessary.

So what role is the European Union able to take in this process? The first mildly optimistic prognosis is that the EU in its various Framework Programmes has been influential in creating linkages across different societies and in this way allowing learning effects to occur. This in turn increases the possibility of the sorts of creative experimentation with new and hybrid models of production and services that offer the potential for innovation and growth in the knowledge economy. Secondly, the EU focus on regions, the open method of coordination and the building up of intellectual assets through mobility amongst researchers has similar positive effects as does the provision of funds for structural adjustment and development in poorer regions. So the EU can facilitate diversity and experimentation.

For both the EU and national governments, however, the obvious problem concerns those groups and sectors that are left behind and the impact of this on the wider society. The corporatist bargain that seems to hold most groups in small states together is always more tentative in large societies such as Germany. As individual and family fortunes get tied more closely to the firms in which people work and the global competitiveness of these firms, there will be increased differentiation within society in terms of financial rewards and career development. Many less skilled employees will be trapped in employment that offers low wages, poor conditions of work and limited job security. Increasingly it appears that these workers will be migrants from new entrants to the European Union, thus reinforcing internal diversity within societies. As a result, cities such as London and Paris become even more divided as the high rewards of employment in financial and professional services go hand in hand with a vast number of poorly paid workers in the personal services industries – hotels, cleaners, shop workers, fast foods, transport, hospitals etc. The social tensions that emerge from this juxtaposition reveal themselves in crime, illegal immigration and potential conflict between ethnically divided communities. In this context, sustaining and building welfare states, corporatism and the necessary levels of personal and corporate taxation becomes increasingly problematic from an economic point of view, whilst increasingly necessary from a political viewpoint. Can societies achieve ‘institutional competitiveness’ whilst facing such dramatic challenges? In conclusion, the idea that there are national models of capitalism that define the ways in which governments and firms act is looking untenable theoretically and increasingly unrealistic as the basis for policy-making. I have proposed in this paper that societies are becoming more diverse and the question now is how to use this diversity productively. I suggest that there are two possible routes for European societies in these circumstances.

The first involves embedding employees in global markets through their positions in MNCs by virtue of their distinctive knowledge assets. Thus, states improve education and training, establish world class universities and encourage

inward investment. The result is that prosperity will come less from being a citizen with rights to employment and security and more from being an employee in a global firm. This then raises the question of whether such prosperity will be spread from those firms and regions that have strong positions in the global economy into other parts of the society or into other parts of the EU where these global firms are absent or small in number. Here is where the real dilemma lies. Efforts to create whole societies of globally competitive economic actors may have a chance in small societies like Finland but in larger societies this is unlikely to happen, and achieving this across all the diverse EU states including the latest entrants is even more difficult. Thus, institutions remain key to economic prosperity but many people without skills and knowledge are left out, having to take poorly paid and insecure jobs in a context where public welfare regimes have been reduced or have never been well developed.

The alternative also requires investment in education and skills but not just technical skills. It requires an education in civic institutions and an encouragement towards sociality, cooperation, networks, creativity and innovation, characteristics that other economies, outside Europe, find difficulty reproducing however well they can develop engineering and mathematical skills. It requires ensuring that the public sphere is legitimate, active, participatory and involving rather than corrupt, torpid, and dominated by self-reproducing elites. It requires the resources for individuals and firms to experiment and innovate without fear that failure will be final and disastrous. Above all it requires the capacity for public debate about change and public will to implement the outcome of such debates even in contexts where strong disagreements remain. This is the real meaning of 'institutional competitiveness' – a continued capacity to analyse, change and innovate at the level of the society not just the firm. Political scientists have identified that democratic politics is often about short-term decision-making spurred on by the accidents and emergencies of history and the thought that an election is just around the corner. They have, however, also argued that where 'the shadow of the future' can be made palpable to politicians, there can be long-term decision-making which enables credible commitments to be made, foregoing current rewards in the hope of long-term benefit. The 'shadow of history', in the sense of the potential displacement of European economic prosperity, is now hanging over us. The temptation, most obviously in the UK, but also in other European countries is to go at least partly down the American route – to leave people to find their own position in an unequal economic system and to give up on the creation of 'institutional competitiveness' capacities in the society as a whole. As can be seen in the USA (and to a degree, the UK), this can lead to very high levels of personal wealth and income for the few, very comfortable standards of living for a middle class dependent on well-paid jobs in corporations, professions and to a lesser degree public services, and a

substantial population which is insecure and in many cases impoverished. This in turn leads to reduced participation in elections, pork barrel politics in the legislature, a general cynicism about political actors, high levels of crime and a divided society. The hope for European societies is that they take the other turn – reviving political culture, building new mechanisms of participation and creating a new form of institutional competitiveness out of diversity and difference. Whether that can be achieved is the challenge faced by European politicians and policy-makers. In the meantime, academics also face a challenge – to drop outdated models and confront the new complexity. In this paper, I have tried to take a step in that direction.

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