Varieties of Capitalism in Light of the Euro Crisis

Peter A. Hall

Minda de Gunzburg Center for European Studies
Harvard University
27 Kirkland Street
Cambridge MA 02138
phall@fas.harvard.edu

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The Euro crisis began, at least in symbolic terms, on November 5, 2009 when a new Prime Minister announced that the Greek budget deficit would be 12.7 percent of GDP, more than three times the amount projected for that year by the outgoing government. This sparked a crisis of confidence in sovereign debt and European banks that forced Greece, Ireland, Portugal, Spain and Cyprus into torturous negotiations with the European Union, followed by bail-out programs that imposed various combinations of fiscal austerity and structural reform on them. Almost seven years later, the effects of the crisis are still palpable. The Greek economy has lost a quarter of its value; levels of unemployment are close to 20 percent in parts of southern Europe; and the average level of economic activity in the Eurozone as a whole has only now regained its level before the global financial crisis of 2008-09.

Feverish attempts to identify the causes of and potential solutions to the crisis have inspired multiple literatures including analyses in comparative political economy associated with varieties of capitalism. The objective of this paper is to explore the implications of the crisis for such analyses. I will ask: what have theories about varieties of capitalism contributed to our understanding of the crisis? How has the crisis advanced our understanding of varieties of capitalism? And what has it revealed about the limits of that understanding?

I will argue that varieties of capitalism (VofC) approaches are revealing about both the roots of the crisis and the response to it. Efforts to understand the crisis have also extended VofC theories in four directions. They have inspired scholars to evaluate the relationship between varieties of capitalism and regimes of macroeconomic policy, giving rise to an emerging literature on growth models that integrates the demand-side of the economy into theories once oriented primarily to its supply-side. Second, they have led to more intensive investigation of the political economies of East Central Europe and southern Europe, advancing, in particular, understandings of mixed market economies (MMEs). Third, the crisis has drawn attention to the international dimensions of varieties of capitalism. Fourth, it has highlighted the extent to which varieties of capitalism face problems of adjustment generated by shocks exogenous or endogenous to the domestic political economy, thereby injecting an element of dynamism into such analyses and underlining the extent to which adjustment must be seen as a political as well as economic problem.

At the same time, the Euro crisis has brought some issues to the fore with which the VofC literature has yet to come fully to grips. Prominent among these is the politics of reform. Southern European countries are being called upon to alter the institutional structure of their political economies and the regulatory regimes supporting them, but we know relatively little about how coalitions will form around such efforts and which will prevail. Moreover, although VofC analysts have a good deal to say about why economic performance might be poor in the mixed market economies of southern Europe, they do not yet have clear ideas about how to improve it. In particular, we need to know more about how various kinds of capitalist economies can take advantage of skill formation and innovation to prosper in an era of knowledge-based growth.

A number of factors converged to produce the Euro crisis. The spark setting it off was official revelation of the Greek fiscal position, itself the product of a patronage-based political system that reduced tax revenue and swelled public spending. But structural problems had been intensifying for some time in the form of a large expansion of debt, much of it in the private sector, especially in the context of asset booms in Spain and Ireland, and growing current account imbalances in the Eurozone, to which the spreads on sovereign debt became increasingly sensitive (De Grauwe and Ji 2013; Iversen and Soskice 2013). Shifts in financial practices also made that debt more susceptible to speculation (Gabor and Ban 2012). Partly for these reasons, some have observed that the Euro crisis was simply a European version of the more general financial crisis of 2008, while others maintain that it was inevitable in of a monetary union that was not an optimal currency area (cf. Copelovitch *et al*. 2016).

However, the theories of monetary economics most widely advanced to explain the Euro crisis are incomplete. Financial turmoil in the wake of a credit boom certainly played a major role. But such a perspective cannot explain why these booms and the subsequent crisis of confidence in sovereign debt were more pronounced in some countries than others. The emphasis of optimal-currency-area (OCA) theory on the lack of labor mobility and central fiscal stabilizers in Europe also does not get us very far (McKinnon 1963; Kenen 1969; Krugman 2012). It helps explain why the crisis was so severe but tells us little about its origins, since they do not seem to lie in the asymmetry of exogenous economic shocks anticipated by that theory (Boltho and Carlin 2012). Moreover, EMU was not the only monetary union that failed to live up to the criteria conventionally-specified for an optimal currency area (Matthijs and Blyth 2015; Schelkle 2016).

In this context, theories oriented to varieties of capitalism fill some important gaps. They explain why trade imbalances built up to become signals for speculation against sovereign debt and why asset booms leading to credit crises were more likely in some parts of Europe than others. In short, a variety-of-capitalism perspective identifies structural weaknesses in monetary union that go well beyond the evident inadequacies of the institutions managing it.

Toward Growth Models

In the course of developing this perspective on the Euro crisis and preceding global financial crisis, scholars have extended varieties-of-capitalism accounts in important ways. Some have developed deeper analyses of how wage-setting varies across the coordinated market economies of northern Europe and mixed market economies of southern Europe (Hancké 2013a, b; Johnston 2012; Johnston et al. 2014), while others have delved more deeply into the relationship between the organization of production and macroeconomic policy regimes (Iversen and Soskice 2012; Hall 2012, 2014; Baccaro and Pontusson 2016; Iversen *et al*. 2016). Out of these analyses has emerged the important contention that countries with different varieties of capitalism tend to operate different growth models, understood as alternative approaches to securing economic growth, based on the number of instruments they have available for managing the economy and how those are used.

The coordinated market economies (CMEs) of northern Europe, including Austria, Belgium, Finland, Germany and the Netherlands, have generally relied on the expansion of exports in order to secure growth. In the first instance, that export-led growth model was made possible by the institutional infrastructure characteristic of CMEs, which supports high levels of coordination among producer groups, thereby facilitating coordinated wage bargaining, cooperation in vocational training schemes that confer high levels of skill and the incremental innovation favorable to medium or high-technology production (Hall and Soskice 2001). Although the past three decades have seen a devolution of bargaining toward the firm level and flows of international capital have loosened relationships between firms and national banks, the institutions characteristic of these political economies remain well-suited for the promotion of high valued-added exports (Iversen and Soskice 2012; Iversen *et al*. 2016). Institutional capacities for the strategic coordination of wages are especially important here because they give coordinated market economies an instrument for containing the labor costs linked to the competitiveness of exports (Hanké 2013a, b; Johnston et al. 2014; Höpner and Lutter 2014).

However, the recent literature suggests that the successful operation of these export-led growth models also depends on a complementary set of macroeconomic policies (Iversen 1999; Carlin and Soskice 2009; Iversen and Soskice 2012; Iversen *et al* 2016). Coordinated wage bargaining is facilitated by non-accommodating monetary policies oriented to a hard exchange rate which assures producers that exorbitant wage increases will not be accommodated through devaluation. Moreover, where the central bank faces a set of wage bargainers coordinated enough to internalize the effects of macroeconomic policy, it can effectively deter wage increases with threats to tighten monetary policy (Hall and Franzese 1998; Soskice and Iversen 2000). The complement to this monetary stance is a restrained fiscal policy, which is especially important in such contexts because it limits public-sector wage increases that might otherwise raise the real exchange rate and damage competitiveness (Johnston 2012; Hancké *et al.* 2014; Iversen et al. 2016).[1] Table One confirms that these political economies are especially reliant on exports.

Mixed Market Economies and Other Growth Models

Among the countries of the new monetary union, however, were some with different varieties of capitalism (Pontusson 2005; Amable 2003). These include the mixed market (or Mediterranean) economies of southern Europe, encompassing Spain, Portugal, Greece and Italy.[2] Hall and Soskice (2001) suggested that these countries display a distinctive variety of capitalism, marked by some capacities for coordination in the sphere of corporate governance and limited capacities for strategic coordination in the sphere of labor relations, but said little more than to note that these political economies reflect a legacy of high levels of state intervention in the economy (see also Hall and Gingerich 2009; Schmidt 2002). However, the prominent role played by these countries in the Euro crisis has inspired considerably more investigation.

A series of studies have confirmed that these Mediterranean economies lack institutional capacities for the strategic coordination of wages, aside from periodic but short-lived social pacts (Hancké 2013a; Johnston and Regan 2015; Molina and Rhodes 2007). They reveal that, although international competition induces wage moderation in export sectors, the sheltered sectors of these economies are especially prone to inflationary increases in wages that damage exports by raising the real exchange rate (Johnston *et al.* 2014). In large measure, the problem lies in trade unions that are relatively powerful but lack incentives to cooperate with each other on wages because they are divided into competing confederations. Similarly, although there are relatively high levels of cross-shareholding in these countries, business associations lack the capacity to impose wage restraint or to operate collaborative training programs on a large scale; and recent research suggests that relationships between business and the state there are typically based on clientelistic relations with individual firms (Evans 2015; Hassel 2014; Featherstone 2011).

Because the organization of producer groups makes coordinated wage bargaining difficult, these political economies lack a key instrument for operating an export-led growth model. As a result, Hall (2012; 2014) argues that the governments of mixed market economies are more inclined to pursue demand-led growth, namely, economic growth based on the expansion of consumer demand, an approach also characteristic of liberal market economies (Iversen and Soskice 2012). This growth model is also especially suitable for economies in which small and medium-sized businesses are responsible for a large portion of economic activity (Gambarotto and Solari 2015). Its macroeconomic corollary is broadly accommodating monetary and fiscal policies designed to push up levels of domestic demand.[3] Table Two suggests that the role played by domestic demand is greater than that of exports in a representative group of liberal and mixed market economies (see also Table One; Hope and Soskice 2016; cf. Picot 2015).

In liberal market economies where trade unions are relatively weak, it is often possible to operate a demand-led growth strategy without much inflation; but, where unions are stronger, as in most mixed market economies, an accommodating macroeconomic stance is often accompanied by moderate but significant levels of inflation. On the one hand, inflation serves this growth model because it provides a further stimulus to consumption (and disincentive to saving). On the other hand, it erodes the international competitiveness of a nation's products. Therefore, another economic instrument of importance for countries operating demand-led growth strategies is the capacity to alter the exchange rate and, prior to the run-up to monetary union (when aspiring members were constrained by a hard currency policy), mixed market economies tended to rely more heavily than coordinated market economies on periodic devaluations to offset the effects of inflation on the competitiveness of their national products (see Table Three).

Of course, devaluation offsets the effects of inflation on national competitiveness only if nominal wages do not immediately adjust; and there is appropriate skepticism in the literature about whether it is a useful instrument of adjustment, especially in Europe where nominal wages are often flexible and real wages rigid (Bean 1992). In the years prior to EMU, however, devaluation seems to have worked relatively well for Europe's mixed market economies. Devaluation was often followed by a relatively-persistent decline in unit labor costs (see Hoepner and Spielau 2015; Petrini 2013 and Appendix One).

Based on these observations, it should be apparent how variations in European capitalism contributed to the Euro crisis. It was difficult to operate both types of growth models successfully within a single monetary union. For the coordinated market economies of northern Europe, monetary union offered a relatively propitious environment. Fears that German wage coordination might suffer with the disappearance of the Bundesbank soon proved unfounded, as the independent European Central Bank committed itself to a non-accommodating monetary policy; and, even if it was occasionally breached, the Stability and Growth Pact encouraged fiscal restraint (cf. Hall and Franzese 1998). Moreover, the neighboring markets for these countries exports were rendered more secure because the member states could no longer depreciate their exchange rates against one another.

In the first instance, entry into monetary union also fed demand-led growth in the mixed market economies of southern Europe, notably by lowering interest rates and expanding the volume of available credit, as confidence effects led European financial institutions to recycle the funds generated by growing northern trade surpluses into them with seeming disregard for the accompanying risks (Blyth 2013). As a result, most of these economies grew relatively rapidly during the first decade of the new currency.[4] But partly because their governments lost the exchange-rate instrument formerly used to offset the effects of inflation on competitiveness, their intra-EU exports grew more slowly than those of their northern neighbors while their imports increased rapidly. At the same time, inflation reduced real interest rates in the south and fueled asset booms in Spain and Ireland that would eventually burst.

No doubt, the authorities should have acted earlier to dampen down these booms, but, because they could no longer operate an independent monetary policy, that became difficult (Johnston and Regan 2015). Doing so via fiscal policy alone would have required policies so austere as to be at odds with any aspiration to demand-led growth and efforts to put the brakes on lending by the southern banks were short-lived because that put them at a disadvantage vis-à-vis their foreign competitors (Carlin 2013; Schelkle forthcoming). As a result of growing surpluses in the north and deficits in the south, substantial imbalances on the current account built up inside the Eurozone, ultimately serving as a signal for speculation against sovereign debt, after the European central bank indicated it would reduce the liquidity it provided to national central banks (see Figure One).

Experience under the Euro also confirms the observations of VofC theorists that it is not easy to alter the institutional infrastructure of a political economy (Hall and Soskice

2001; Yamamura and Streeck 2001; Thelen 2004). In the early 1990s, some suggested that competition under a single currency would force institutional change or new growth models on the member states (cf. Krugman 2013). Such hopes had been fueled by the success with which aspiring entrants managed to contain inflation and sustain their exchange rates during the late 1990s in order to qualify for entry. But the social pacts negotiated for that purpose proved only temporary expedients made possible by the presence of a strong external constraint in the form of the Maastricht criteria (Featherstone 2004; Avdagic *et al*. 2011). Capacities for export-led growth depend on durable structures for strategic coordination among producer groups that emerge only out of a long process of prior historical development.

Of course, Ireland also became a debtor country amidst the Euro crisis. To some extent that can be traced to its structure as a liberal market economy and corresponding propensity for demand-led growth. But inspection of the Irish case has also reveals the emergence of another kind of growth model. There was certainly a substantial expansion of consumer demand in Ireland during the early 2000s. But Ireland also pioneered what might be described as a 'liberal export model' subsequently adopted in some of what Bohle and Greskovits (2012) describe as the 'neoliberal' economies of East Central Europe. These countries remain liberal market economies in the sense that their firms coordinate their endeavors largely through competitive markets.[5] But, in order to secure economic growth, they depend especially heavily on low corporate taxes to attract foreign direct investment, much of it oriented to assembly for export into the global value chains that are becoming important features of the international economy (Nolke and Vliegenthart 2009). Although there is some variation here, notably between the 'embedded liberalism' of the Viségrad countries and the ‘neoliberalism’ of the Baltic states, low tax rates tend to imply relatively low levels of social spending, which also encourages such investment by holding down the reservation wage (Bohle and Greskovits 2012).

The key role that exports play in such political economies is evident in Table One; and several features of this growth model became especially significant in the wake of the global financial crisis. Many of these countries recovered rapidly partly because the flexible labor markets in these liberal market economies meant that the elasticity of wages with respect to unemployment was high, rendering domestic deflation effective for reducing unit labor costs. At the same time, because their economic growth was more dependent on exports than domestic demand, when their trading partners recovered, these economies could move back toward higher levels of growth even in the context of domestic deflation (Kuokštis 2011; cf. Mabbett and Schelkle 2015). By contrast, because the mixed market economies of southern Europe are more dependent on domestic demand for growth, the deflation forced on them by the bail-out programs of the EU, while designed to lower unit labor costs and make their products more competitive, takes a greater toll on aggregate rates of growth.

It should be stressed that none of these arguments suggest that the presence of different varieties of capitalism within the monetary union was the sole cause of the Euro crisis. At least three other factors made that crisis more likely. One was the ‘financial promiscuity’ of an era that saw a vast expansion of lending and borrowing across Europe, rendering debtors susceptible to the crisis of confidence that erupted in 2010 (Sandbu 2015: 213; Blyth 2013). A second was the inadequacy of the institutions devised to accompany the monetary union, marked by a paucity of capacities for sharing risks across the member states (Schelkle forthcoming). A common banking union with supervisory teeth might have been able to dampen down asset booms and render the European banking system more robust, while a central bank capable of purchasing sovereign debt might have staved off the initial crisis of confidence. Moreover, national governments made plenty of policy mistakes, most notable in the case of Greece; and the halting response of the EU itself, rooted in inadequate institutions for coping with a crisis made it worse (Sandbu 2015).

However, VofC analyses indicate that the economic strains underlying the crisis were rooted, not in the asymmetric economic shocks anticipated by OCA theory, but in the institutional asymmetries of different varieties of capitalism yoked together in a single monetary union. Those asymmetries encouraged governments to follow divergent growth strategies that led to rising imbalances on the current account, while the exigencies associated with a common currency and monetary policy limited their capacities to correct those imbalances or to off-set the pernicious side-effects of such strategies.

International Dimensions

Both within Europe and across the globe more generally, the economic crises of 2008-10 have drawn attention to the ways in which different varieties of capitalism interact on an international plane. Indeed, Iversen and Soskice (2012) argue that the international interdependence of coordinated and liberal market economies provided a structural basis for emerging global imbalances. By virtue of their institutional capacities for export-led growth, many coordinated market economies tend to run surpluses on their current account, while liberal market economies focused on demand-led growth often run trade deficits. Recycling of the surpluses of coordinated market economies into investment in liberal or mixed market economies, in turn, allows the latter to sustain the trade deficits induced by demand-led growth models. This tendency is especially pronounced in countries with large and internationally-important financial sectors, such as the U.S. and U.K., whose financial sectors press governments for the lighter regulation that feeds debt-financed demand (Kalinowski 2015). Moreover, the key role that these two countries play in international financial transactions encourages off-setting inflows of capital that allow them to run trade deficits for considerable periods of time, bolstered in the American case by a reserve currency (Carlin and Soskice 2015; Iversen and Soskice 2012; cf. Gabor and Ban 2012). At the international level, some liberal and coordinated market economies maintain a symbiotic relationship.[6]

The coordinated and mixed market economies of the Eurozone stand in a similarly asymmetric relationship to each other, albeit one that is more pathological than symbiotic because mixed market economies have greater difficulty than liberal market economies containing inflation and unit labor costs. As inflation renders their products increasingly uncompetitive, there is a risk that the inflows of capital necessary to sustain imbalances in trade will dwindle, leading to the kind of credit crisis seen in 2010. However, persistent trade imbalances are surely present in other monetary unions as, for instance, between the American states. Thus, one of the intriguing issues still unresolved in political economy asks: what kind of institutional arrangements, if any, ranging from a full banking union to more fluid transnational equity markets, might make persistent imbalances of this sort feasible in the Eurozone (Hall 2015a; Schelkle forthcoming)?

The Euro crisis has also drawn attention to the distinctive effects that developments in the international economy have on different varieties of capitalism, often as a result of the latter's inherent comparative institutional advantages (Fioretos 2011; Nolke 2016). In the early 2000s, for instance, a number of international developments intensified the trade imbalances apparent between northern and southern Europe (DeVille and Vermeiren 2016). By virtue of how their production is organized, many of the coordinated market economies of northern Europe are adept at producing high quality goods of high value. In the German case, that includes capital goods. By contrast, based on lower levels of skills, the mixed market economies of southern Europe have tended to specialize in agricultural products, some types of services such as shipping and tourism, and the production of medium-quality consumer goods at relatively low cost (Hausmann and Hidalgo 2014).

Thus, rapid economic development in the emerging economies of China, Russia, Brazil and India provided important new markets for capital goods and high-quality products from northern Europe at the same time as it posed significant new competition in the low-cost production characteristic of many firms in southern Europe. A parallel dynamic played out on the European continent following the transition to democracy in East Central Europe. All of a sudden, the economies of southern Europe faced formidable new competitors in sectors where they formerly had advantages in low-cost production. The Viségrad nations in particular secured key positions within the value chains supplying German industry that might otherwise have gone to southern Europe (Dustmann *et al*. 2014). As this experience indicates, there is room for more investigation into the effects that changes in the international economy have on distinctive varieties of capitalism.

Adjustment as an Economic and Political Problem

The Euro crisis has underlined the value of approaching the problems of contemporary political economies as problems of adjustment – to developments endogenous or exogenous to the domestic economy. Entry into the single currency was itself an economic and institutional shock that called for adjustment within the member states and the sovereign debt crisis of 2010 another such shock mandating further adjustment. In the first instance, such a focus directs our attention to the range of instruments available for economic adjustment, and varieties-of-capitalism approaches make some distinctive contributions to such analyses. In particular, they see firms, as well as governments, as important agents of adjustment and the institutionalized relationships in which firms are embedded as central components of a country's capacities for economic adjustment.

In an earlier era, mainstream accounts of economic adjustment focused primarily on the tools of fiscal and monetary policy, encompassing changes in the exchange rate to which monetary policy is coupled in open economies. More recently, and with particular vehemence in the wake of the Euro crisis, economists have come to see regulatory reforms designed to make markets in products or labor more intensely competitive as another tool to be used both to accomplish some immediate economic adjustment and to alter the long-term capacities of an economy for adjustment to shocks. However, building on a prior literature about neo-corporatism, varieties-of-capitalism analyses expand these conceptions of the instruments available for adjustment to include the institutional capacities of various economic actors for strategic coordination (Schmitter and Lehmbruch 1979). Among these, institutional capacities for wage coordination were especially relevant in the run-up to the Euro crisis, but the relevant range of capacities include those that make possible various kinds of skill formation, technology transfer and finance central to the long-term growth prospects of a country.

Analyses of the Euro crisis suggest that, in some cases, various instruments can serve as substitutes for one another. Depreciation of the nominal exchange rate, for instance, can sometimes be used as a substitute for domestic deflation to hold down the real exchange rate, setting up a familiar choice between 'external' and 'internal' adjustment. However, the recent literature on growth models indicates that some instruments may also be complements to others: it is usually easier to coordinate wages, for example, in the context of non-accommodating macroeconomic policy. In short, one of the few salutary effects of the Euro crisis has been to draw attention to the prominence of adjustment problems in the political economy, and one of the contributions of the varieties-of-capitalism literature has been to show that the types of adjustment problems that arise and the range of instruments available for addressing them are conditioned by the organization of the political economy.

At the same time, in contrast to some others, the varieties-of-capitalism literature emphasizes that there are also political dimensions to any adjustment process. The ability of a country to utilize specific tools or to accomplish particular economic goals depends as much on what is politically feasible as on what is economically desirable (Bohle and Greskovits 2012). Although understanding of such issues is still underdeveloped, the VofC literature points to at least three ways in which the political dimensions of adjustment may be construed.

The first might be termed a ‘coalitional perspective’ which stresses that governments can act only if they can form coalitions among voters and producer groups around the economic strategies associated with adjustment. Walter’s (2016) nice analysis of adjustment in East Central Europe provides an illustration. Asking whether governments relied on external or internal adjustment in the wake of the global financial crisis, she finds that the outcome was driven, not only by national economic conditions such as existing levels of debt, inflation and unemployment, but also by the extent to which the costs of alternative strategies would be borne by constituents of the governing parties – a factor that is likely to be influenced, in turn, by the character of electoral rules (Iversen and Soskice 2006).

Iversen and Soskice (2012) develop a coalitional argument to explain why the governments of many coordinated and liberal market economies have responded to contemporary economic shocks by retaining, rather than changing, the macroeconomic regimes central to their export-led and demand-led growth models, despite considerable international pressure for change. In this respect, they go well beyond alternative accounts that focus on what is ‘efficient’ for each political economy. In coordinated market economies such as Germany, for instance, they expect political resistance to proposals to reduce the trade surplus via a more accommodating fiscal policy because the latter would threaten the demand for and wages of skilled workers in the export sector (as domestic consumption becomes a larger share of economic activity), unless cutbacks in vocational training reduce the supply of skilled workers; but they argue that such cutbacks will be resisted by employers in the export sector lest they raise that sector’s wage bill and by low-skill workers who fear that such an initiative would increase their numbers, putting downward pressure on their wages. Thus, both of the major parties in Germany resist an approach to adjustment widely mooted by others in Europe because such a change in policy would incur opposition from employers who are an important constituency for the Christian Democratic party, and low-skilled workers who are core constituents of the Social Democratic party. Moreover, such core constituencies have considerable influence within the type of parties typically found in countries with electoral systems based on proportional representation.

Conversely, Iversen and Soskice argue that, even if it would be desirable for liberal market economies to step back from demand-led growth strategies, there will be political resistance there to more restrictive macroeconomic policies because increases in interest rates or spending cuts will tend to make both skilled and unskilled workers worse off, unless the supply of low-skilled workers is increased via spending on vocational training. However, the latter is likely to inspire resistance on the grounds that increased supply will reduce the wages of skilled workers, a group prominent among the median voters influential in the majoritarian electoral systems found in many liberal market economies. Of course, electoral outcomes turn on many factors, but this is an important move in the recent literature on varieties of capitalism to explain policy, not only on efficiency grounds, but with regard to the political coalitions likely to form around particular policy options.

Similar considerations help explain the halting response to the crisis by a diverse set of member states and why movement toward a 'fiscal union' is resisted in many parts of Europe, even though some experts believe such a union is crucial to the survival of the Euro. Fiscal union itself is simply an institutional shell: the real issue is what kind of policies it would adopt. As Iversen and Soskice note, substantial groups of producers in northern Europe are likely to favor the relatively-austere fiscal stance that is complementary to coordinated wage bargaining, while support for a vigorous counter-cyclical policy is likely to be stronger in southern Europe where economic growth has been more dependent on domestic demand. Inherent difficulties agreeing what new European institutions should do, linked to the producer coalitions of different varieties of capitalism, constitute one factor in the contemporary stalemate.

However, there are many reasons why voters are currently resistant to giving more powers to EU institutions, not least a populist electoral politics that has seen the rise of radical right parties opposed to transnational transfers and any augmentation of EU powers in northern and eastern Europe and of radical left parties in southern Europe seeking an end to economic austerity (Frieden 2016). This is an important political phenomenon with which the varieties-of-capitalism literature has not yet come to grips. A literature initially oriented to explaining why there is more than one path to growth and where each path finds political support has tended to focus on those who gain from particular types of growth strategies rather than those who may lose from it. Designed to explain how different nations prosper in the context of globalization, it has had less to say about the revolt against globalization now enveloping the developed world. In this realm lie important research agendas.

A second perspective on the political dimensions of economic adjustment, with echoes in the VofC literature, points to the importance of such issues. That perspective suggests that the purpose of economic policy is not simply to secure prosperity but also to resolve endemic social conflict over the distribution of resources (Pontusson 2005a; Hall and Thelen 2009). Moreover, the intensity of social conflict and the frequency with which it bursts into the political arena varies across political economies based on the capacity of the social institutions in each country to resolve such conflict in other arenas, including the realm of industrial relations and employer-employee relations where resources are allocated between capital and labor. Goldthorpe (1978) made a parallel point some years ago when he observed that inflation may not simply be a monetary phenomenon but a reflection of the failure of social institutions to resolve distributive conflict effectively (see also Rowthorn 1977; Petrini 2013). An uncontrolled spiral of wages and prices can be the default option when producers cannot find an authoritative way to allocate resources between capital and labor.

From this perspective, one can see why devaluation of the exchange rate might be the most feasible strategy for some governments seeking to cope with the effects of inflation on the competitiveness of national products, even if it is not the most economically-efficient solution way to cope with inflation (cf. Eichengreen and Sachs 1985; Rodrik 2008). Alternative methods based on domestic deflation are likely to be unpopular and especially difficult to accomplish in precisely those countries where inflation is most likely in the first place, namely those where trade unions are powerful enough to resist wage cuts but fissiparous enough to make coordinated wage bargaining infeasible or where firms enjoy oligopolistic advantages and pricing-power built on close relations with governments. In such settings, a successful deflation may require much higher levels of unemployment than it would elsewhere (Hall and Franzese 1998; Soskice and Iversen 2000). In short, this literature reminds us that governments have to approach issues of adjustment, not only as matters of how to render the economy more efficient, but as issues about how best to contain social conflict; and it draws our attention to the ways in which the institutional features of a political economy condition the economic costs and political feasibility of any particular course of adjustment.

A third perspective on the political dimensions of adjustment inspired by the Euro crisis emphasizes the extent to which national capacities for adjustment turn, not simply on the trajectory of a country's *economic* development, but on the character of its *political* development. Iversen and Soskice (2009) indicate how the economic and political institutions of a nation might co-evolve to generate political arrangements that reinforce specific varieties of capitalism. However, the Euro crisis reveals a darker side to such relationships. The case of Greece is an especially salient reminder of how much the structure of the state can influence the economic strategies adopted by governments. Several scholars have argued that the Greek approach to economic adjustment in the first decade of the Euro was deeply conditioned by weaknesses in its political executive and by the limitations of a patronage-based political system (Featherstone 2011; Trantidis 2015). Factors that made it difficult for the Greek state to raise revenue or control expenditure allowed public sector deficits and debt to balloon out of control

Hassel (2014) advances a parallel argument about the political economies of southern Europe. She suggests that the legacy of state intervention common to these mixed market economies inspires a distinctive pattern of adjustment in which firms and produce4r groups turn to the state for protection in the face of economic challenges rather than change their practices. In her view, the other members of the Eurozone have been insistent on structural reform in these economies precisely in order to break longstanding relationships of this character between producers and the state. Bohle and Greskovits (2012) note that the ability of states in East Central Europe to weather the global financial crisis of 2008-09 depended as much on the capacities of their political systems as on their economic situations. They argue that response to the crisis was conditioned by the character of each country's political system and its political experience since the transition to capitalism. Party systems that threw up few alternatives to neoliberal strategies and had prior experiences of prior crisis facilitated the political acceptance of deep deflation in the Baltic countries when it was not elsewhere.

A Lingering Question: What Now for Southern Europe?

One of the most important questions still on the agenda of the Euro crisis is: how can the political economies of southern Europe prosper again in its wake? For analysts of varieties of capitalism this is a question about how mixed market economies might most effectively be reformed. The European Commission and northern member states appear to have embraced a particular answer. In a series of memoranda accompanying the five bail-out programs it has sponsored, the EU has insisted, not only on cuts to budget deficits, but also on extensive structural reforms designed to reduce the role of the state in the economy and render markets in labor and goods more intensely competitive. In effect, the EU seems to be trying to turn mixed market economies into liberal market economies.

On a broad-brush interpretation of VofC analyses, that appears to make sense: liberal market economies have generally performed better than mixed market economies on aggregate economic indicators (Hall and Gingerich 2009). However, this may be too simple a view. Since the mixed market economies of southern Europe lack the fluid capital markets and capacities for radical innovation that characterize other liberal market economies such as those of the U.S. and U.K., deregulating their markets for goods and labor may simply encourage firms to focus on forms of low-wage production that deliver a relatively poor standard of living compared to the higher value-added production central to the prosperity of most developed economies. Indeed, there is some evidence for this view. When similar labor-market reforms were implemented in Italy, they depressed rather than increased the rate of growth of productivity, as firms used them to sustain low-cost forms of production (Lucidi and Kleinknecht 2010).[7] In a world where low-cost producers face increasing competition from emerging economies, this strategy does not appear to be promising.

Moreover, most liberal market economies follow demand-led growth strategies that the fiscal rules of the Eurozone have made more difficult. So the related issue is whether southern Europe can find any viable alternative to the demand-led growth models used in the past. Some European officials may see the liberal export models of Ireland and East Central Europe as the desirable endpoint. But to argue that such strategies can work just as well in southern Europe is to ignore the large contribution that processes of 'catch up' may be making to rates of economic growth in East Central Europe; and, as more states adopt a model that turns on attracting foreign investment with very low corporate tax rates, the effectiveness of the model itself may decline.

However, it must be said that the varieties-of-capitalism literature has not generated an alternative answer to the question of how to reform mixed market economies so as to generate higher levels of economic growth. This is a pressing issue for many economies well beyond southern Europe. Moreover, to tackle it, varieties-of-capitalism analysts will have to pay more attention to the ways in which contemporary capitalism is being transformed. In particular, we need deeper analyses of the service sectors that are now a major component of all economies, of the growing role of finance, of technological change, and of new global supply chains. Changes in each of these spheres are closing off some avenues to growth while creating opportunities along others (Wren 2013; Soskice 2013; Tassey 2014; Hall 2015; Huo 2015).

These types of developments are especially pertinent to, and in some cases problematic for, the mixed market economies of southern Europe. All these economies are especially reliant on tourism and services, such as banking in Spain and shipping in Greece. And, with some variation, all tend to be laggards on the parameters associated with success in a knowledge economy, including skill formation, the scope of higher education, digital access, and the funding of research and development (Veugelers 2016). The deflationary reform programs pressed by the EU tend to impede progress in these realms, since many of the preconditions for knowledge-based growth require substantial levels of investment in public goods, such as education, before private-sector initiatives generate knowledge-based growth.

Moreover, Beramendi *et al*. (2015) suggest that political conditions in southern Europe are not propitious for increasing such investment. They argue that the self-employed, who form a large proportion of the electorate in these countries, are unlikely to be supportive of public investment and that large segments of those electorates are attached to consumption. However, their analysis is only a first-cut into this problem. We need to know more, not only about what kinds of policies are likely to foster high value-added production in southern Europe and elsewhere, but also about how growth coalitions might form around those policies.

Conclusion

In sum, efforts to understand the global financial crisis and ensuing Euro crisis have taken theories about varieties of capitalism in more dynamic directions that draw attention to issues of adjustment, and in more political directions oriented to identifying the coalitional underpinnings behind economic strategies. The crisis has inspired important efforts to integrate the demand side into the supply side emphasis in varieties-of-capitalism analyses, yielding a rich new body of work on national growth models. This literature has been revealing about the structural roots of the Euro crisis and about the factors lying behind the responses to it. However, there is much that remains controversial in these formulations, notably about how best to specify national growth models, and this literature has brought to the fore several issues that remain unresolved, including the key problem of how southern Europe can best secure economic growth.[8]

Notwithstanding the expectations of some, the integration of Europe has not yet brought about the disintegration of national varieties of capitalism. Despite changes in all political economies associated especially with liberalization, the coordinated market economies of northern Europe continue to operate quite differently from the liberal and mixed-market economies of Europe (Thelen 2014). But the opportunities provided by European integration itself have seen a number of countries experiment with alternative growth models, including most notably the liberal export model of Ireland and East Central Europe. For the southern European countries that can no longer operate the demand-led growth models pursued prior to the crisis, however, economic experiments are on-going. The danger, of course, is that some parts of Europe may end up with growth models without growth. In that respect, the Euro crisis is far from over.

As European officials seek new routes to economic growth, however, they would do well to bear in mind the most basic tenets of the varieties-of-capitalism perspective. Leaving aside the many debates about how to classify countries and distinguish growth models, virtually all who write from such a perspective argue that economic success is dependent, not simply on the right choice of policies, but on the deeper institutional infrastructure of the political economy. Instead of seeking a single set of ‘best practices’ deemed applicable to all economies, they maintain that there is more than one route to economic prosperity, and finding an appropriate national path requires adapting social and economic policies to the institutional conditions of specific political economies. The sources of that lesson lie in European history, and it would be ironic if at this moment of crisis European officials forget what the history of their own continent teaches.

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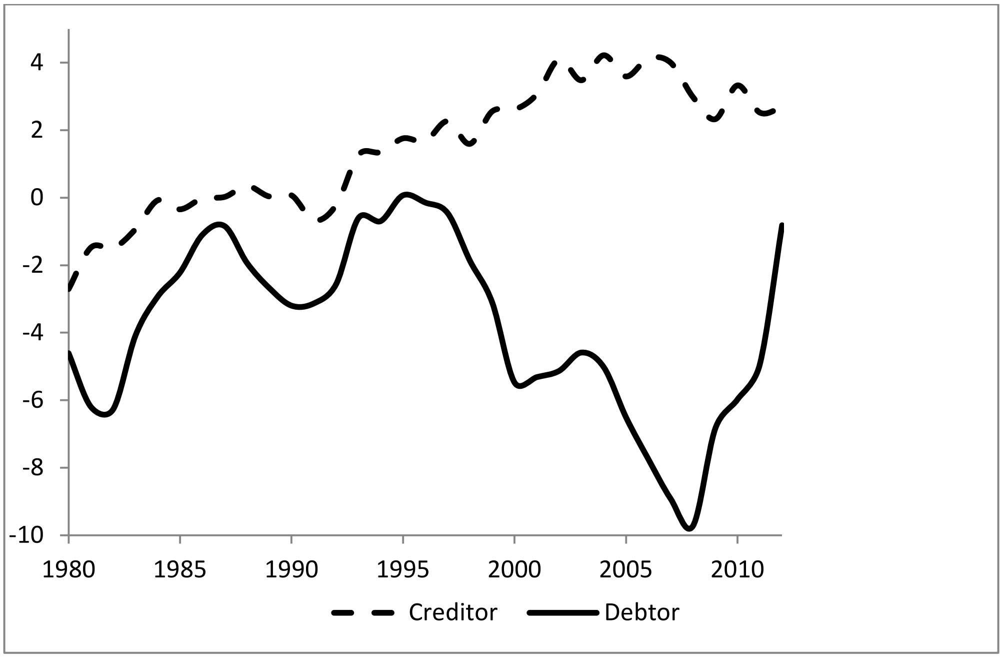
FIGURE ONE: Current account imbalances in the Eurozone 1980-2012 (% GDP)



Note: Creditors include Austria, Belgium, Finland, France, Germany and the Netherlands. Debtors include Greece, Ireland, Italy, Portugal and Spain. Source: Johnston and Regan 2014 and AMECO database.

TABLE ONE: Export dependence by varieties of capitalism and growth models, 2007

	Exports % GDP			Exports % GDP		Exports % GDP
Coordinated Market Economies			*Liberal Market Economies*		*Mixed Market Economies*	
Nordic			*Demand-Led*			
Denmark	52		UK	29	France	27
Finland	45		US	11	Greece	23
Norway	45		Australia	20	Italy	29
Sweden	51		Canada	37	Portugal	31
			NZ	29	Spain	26
Continental			*Export-Led*			
Austria	56		Ireland	79		
Belgium	81		Czech Rep	68		
Germany	46		Estonia	67		
Netherlands	73		Hungary	81		
Switzerland	51		Latvia	42		
			Poland	41		
			Slovenia	69		

Source: OECD, World Bank.

TABLE TWO: The contribution of domestic demand and the external balance to GDP growth 2000-08

	Export led CME		***Demand-led LME***		***Resource-led LME***		***Demand-led MME***	
	Germany	Japan	UK	US	Australia	Canada	France	Italy
Real GDP Growth	1.46	1.22	2.21	2.08	3.20	2.28	1.61	0.73
Contribution of domestic demand	0.83	0.75	2.43	2.15	4.69	3.46	2.12	0.82
Contribution of the external sector	0.63	0.46	-0.23	-0.07	-1.37	-1.16	-0.51	-0.08
Growth in net exports as a share of GDP	5.6	1.24	-2.83	-4.88	-1.43	3.50	-0.49	-0.09

Note: The cells indicate average annual percentages for the years of the trade cycle running from the low point of GDP in the early 2000s to 2008. *Source:* Hein and Mundt 2012.

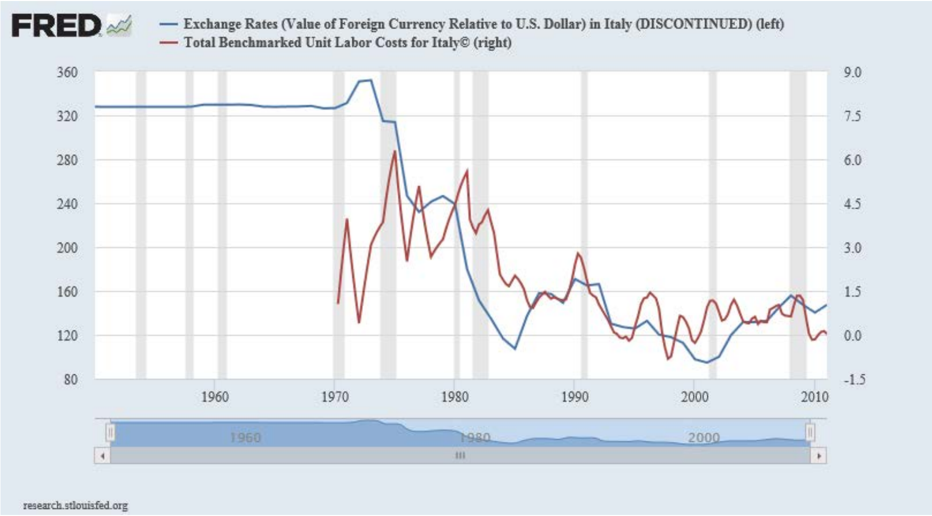
TABLE THREE: Nominal exchange rate changes and average inflation rates, 1980s and 1990s

	Average annual change in the nominal exchange rate		Average annual change in inflation	
	1980s	**1990-98**	**1980s**	**1990-98**
Austria	2.41	1.40	3.84	2.61
Belgium	- 0.56	1.33	4.90	2.26
Finland	1.43	- 1.27	7.32	2.24
Germany	2.89	2.00	2.90	2.73
Netherlands	1.84	1.32	3.00	2.60
Export-led average	*1.60*	*0.96*	*4.39*	*2.49*
Greece	- 11.67	- 4.83	19.50	12.05
Italy	- 2.41	- 1.45	11.20	4.38
Portugal	- 8.83	- 0.87	17.35	6.59
Spain	- 2,34	- 1.57	10.26	4.44
Demand-led average	*- 6.31*	*- 2.18*	*14.58*	*6.87*

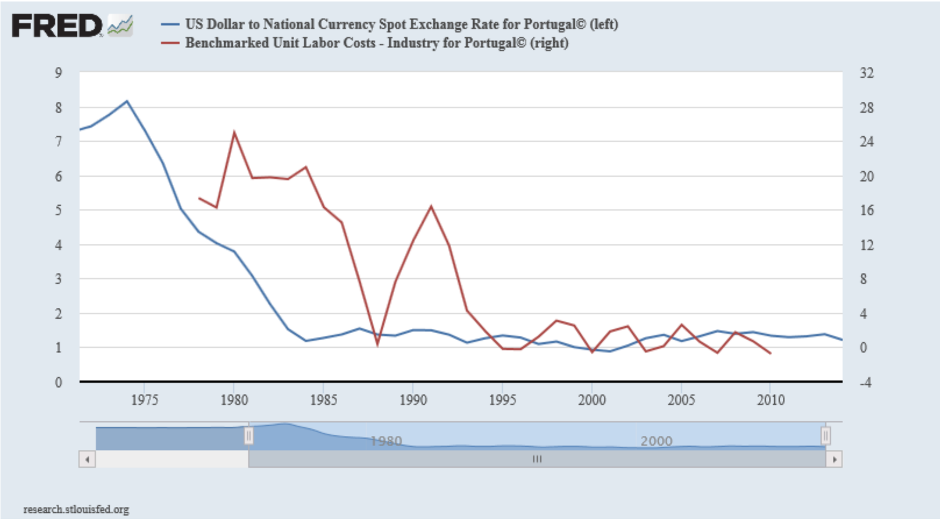
Source: Johnston and Regan 2014 from the AMECO database.

APPENDIX ONE: National Exchange Rate and Unit Labor Costs in Italy, Portugal, France, Greece and Spain

Italy



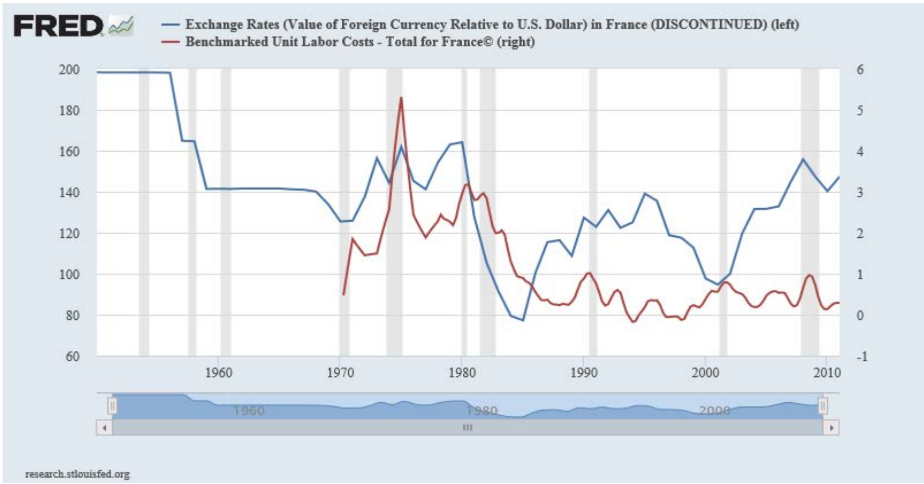
Portugal



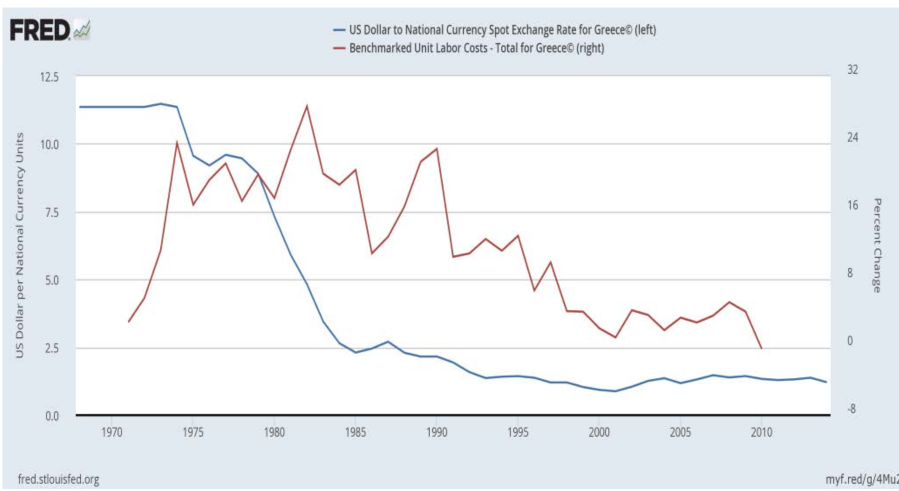
Notes: Exchange rate is value of foreign currency relative to the US dollar. Benchmarked unit labor costs are for whole economy (industry in Portugal).

Sources: US Bureau of Labor Statistics, OECD. Retrieved from FRED, Federal Reserve Bank of St. Louis.

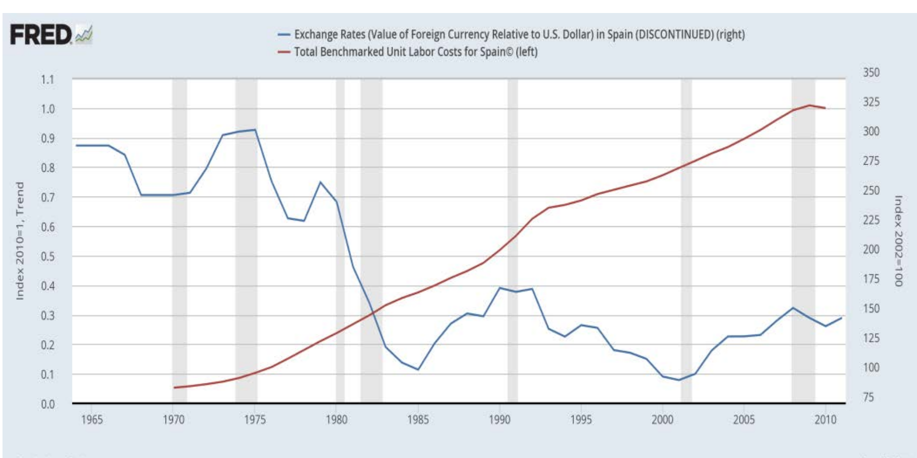
France



Greece



Spain



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Notes

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[1] Note that this tendency does not preclude episodes of fiscal expansion at some moments in time, for instance, in response to German reunification or in the immediate aftermath of the 2008-09 financial crisis; and, as Baccaro and Pontusson (2016) note, institutional structures and macroeconomic policies may not always be tightly-coupled. They argue, for instance, that there is more room for expansionary fiscal policy when the price elasticity of demand for exports is low.

[2] Needless to say, there are some important differences among these countries not discussed here; and I leave aside the case of France although it now bears a strong resemblance to the MMEs of southern Europe.

[3] Note that there are exceptions to this rule, as when the Thatcher government took an austere policy stance in the UK during the 1980s in order to weaken the trade union movement.

[4] The notable exception is Italy where growth has been stagnant for more than a decade.

[5] It should be noted that this liberal export model did not preclude a serious social pact in Ireland or neocorporatist arrangements in Slovenia (Bohle and Greskovits 2012; Regan 2012)

[6] There is a parallel symbiosis between the liberal American economy and the mercantilist policies of some emerging market economies such as that of China.

[7] This is an outcome anticipated by Streeck (1991) who argues that protective regulation in labor and product markets can act as a productivity whip encouraging firms to improve the skills of their workforce and the quality of their products.

[8] For example, see Baccaro and Pontusson (2016) and the commentaries in that issue.