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Varieties of Capitalism and Inequality

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Capitalism is an economic system built on inequalities of income and power between owners, managers, and workers, and economists often assume that reducing these inequalities impairs the performance of a capitalist economy. An influential line of analysis suggests that the best way to improve that performance is to allocate more resources via markets and intensify competition in them, following a path blazed by the United States. The argument is that greater prosperity can be secured only at the cost of higher inequality.

By contrast, comparative political economists have noted that there is more than one path to economic success: some countries attain prosperity at lower levels of inequality. The analytic problem has been to explain why that is possible and to pinpoint the key differences between political economies. When the global economic challenge was how to modernize the postwar economies, an early approach emphasized differences in the modalities of state intervention. As the challenge shifted in the 1970s toward containing rates of inflation, a second approach stressed differences in the organization of trade unions and employers which made neo-corporatist bargains that allow governments to reduce inflation at lower rates of unemployment more or less feasible.

When the central economic problem for developed political economies shifted in the 1990s toward coping with rising flows of international trade and finance, a new approach to understanding the differences between political economies became influential. This 'varieties of capitalism' analysis was initially formulated to understand differences among the developed democracies and then extended to a wider range of countries (Hall and Soskice 2001). Although

contested by some and modified by others, this approach contributes to contemporary understandings of comparative capitalism and its inequalities.

In contrast to earlier approaches that emphasized states and producer groups, varieties-of-capitalism analysts focus on firms as central actors in the economy that must coordinate multiple relationships in order to recruit labor, secure inputs and finance, access technology and manage their workforce in order to sustain a set of core competencies. For that coordination, firms rely on the institutional structures of the political economy. Hence, this approach distinguishes between 'liberal market economies' (LMEs) whose institutions promote market-oriented means of coordination and 'coordinated market economies' (CMEs) where the institutional ecology allows firms to accomplish many tasks via strategic coordination of the sort emphasized by game theory. Most of the Anglo-American economies, such as the U.S., Canada, Britain, Ireland and Australia are liberal market economies, while Japan, Korea and most northern European countries, such as Germany, the Netherlands, Belgium, Sweden and Denmark, are coordinated market economies.

The two paradigmatic cases are the United States and Germany. Large American firms typically turn for capital to arms-length bond or equity markets, where metrics for current profitability matter more than personal relationships. They favor labor equipped with the general skills provided by formal education and recruit it on flexible labor markets where trade unions and employment protections are weak. These firms often access technology through arm's length licensing agreements. By contrast, large German firms rely more heavily on bank-based finance, where reputations formed within dense inter-firm networks matter more to their access to capital. Many make extensive use of labor equipped with industry-specific skills supplied by vocational training schemes supervised by trade unions and employers. And they often engage in collaborative research and development with other companies. In short, while firms in LMEs use

competitive markets to coordinate many of their relationships, companies in CMEs rely more often on strategic coordination made possible by dense networks of business associations and powerful trade unions.

These cross-national variations in institutional ecology confer distinctive comparative advantages on firms. Companies in liberal market economies tend to be more adept at the radical innovation associated with developing entirely new products, because risk-tolerant capital markets and flexible labor markets make it easier for them to begin new ventures or wind up failing ones. Conversely, firms in coordinated market economies have greater capacities for quality control and incremental improvements to products or production processes because they recruit highly skilled workers on long-term labor contracts that incentivize those employees to share their knowledge with management.

One implication is that many political economies have a broad coherence, born of institutional complementarities, whereby the presence of certain institutions in one sphere of the economy makes institutions in other spheres more feasible or valuable. Access to patient capital based on the reputations companies form within inter-firm networks, for instance, makes it more feasible for firms in coordinated market economies to employ labor on a long-term basis than it in a liberal market economies where the dependence of companies on short-term profitability for access to capital means they often have to shed labor to shore up their profits. Similarly, the prospect of securing long-term labor contracts incentivizes workers to undertake the lengthy vocational training necessary for them to secure the industry or firm-specific skills on which many firms in coordinated economies depend.

Of course, these images of 'liberal' and 'coordinated' political economies are ideal types. Every economy contains firms with a range of strategies, and some economies have distinctive

institutional elements. It has become conventional, for example, to distinguish the coordinated economies of continental Europe from those in the Nordic world, where general skills acquired through formal schooling and universal welfare states are more important, and to identify a set of 'Mediterranean' political economies, such as those of France and Italy, where coordination in labor and financial markets has depended more heavily on the state (Amable 2003; Hall and Gingerich 2009). Efforts have also been made to identify further types of political economies, notably in the developing world (Witt et al. 2018).

This varieties-of-capitalism approach offers considerable leverage on the problem of explaining cross-national variation in inequalities of multiple types, including those associated with income, gender, and health. In comparison to LMEs, where the prominence of market mechanisms usually magnifies income inequalities, several features of CMEs tend to reduce inequality in market incomes. Stronger trade unions capable of coordinating with one another are a key factor, but the need to retain a labor force equipped with firm or industry-specific skills also inclines employers to offer generous wages, compared to firms in LMEs where workers with general skills can more readily be replaced. Accordingly, Rueda and Pontusson (2000) find that levels of wage inequality rise under right-wing governments in liberal market economies more often than in coordinated market economies.

However, wage inequality has recently increased in most CMEs, as firms contract out more jobs to secondary labor markets marked by low-wage, precarious employment, which sit alongside protected markets for skilled workers (Palier and Thelen 2010. At the same time, the increasing inequality in the top half of the income distribution in LMEs, associated with the expansion of finance in their lightly-regulated capital markets, has been more subdued in CMEs, where equity

markets are less extensive and firms' longstanding commitments to stakeholders limit their drive for 'shareholder value' (Roberts and Kwon 2017).

The differences in disposable income inequality between LMEs and CMEs and even greater, partly because the complexion of their political economies affects the redistributive strategies of governments. Indeed, there is a close correspondence between these types of capitalism and the types of welfare regimes described by Esping-Andersen (1990). Most LMEs are accompanied by 'liberal' welfare regimes offering low levels of means-tested benefits. By contrast, CMEs tend to have 'continental' welfare regimes offering generous benefits tied to employment status or 'universal' regimes with ample benefits based on citizenship. This is not coincidental. Although multiple factors affect each country's welfare regime, varieties-of-capitalism analysts observe that employers often join with workers to form cross-class coalitions in support of social policies, and both firms and workers in CMEs have reasons to support generous benefit regimes. Because it can be harder for someone with industry or firm-specific skills to find reemployment if they are laid-off, high levels of benefits tied to wages provide workers with incentives to acquire the specific skills central to production in CMEs. For similar reasons, most CMEs offer skilled workers high levels of employment protection. Conversely, because they rely more heavily on general skills and flexible labor markets, firms in LMEs tend to oppose employment protection and favor minimalist welfare regimes that limit the reservation wage. Varieties-of-capitalism analyses emphasize these types of close connections between production regimes and welfare regimes.

This approach to comparative capitalism also carries implications for gender inequalities. The general skills regimes and flexible labor markets of LMEs offer women more opportunities to secure a good job after a period of dependent care, especially if they are well-educated. By

contrast, because employers in CMEs attach more value to long job tenures and firm-specific skills, it can be more difficult for women there to find good jobs after taking time off to rear children. Accordingly, it is riskier for them to undertake the lengthy vocational training necessary for some jobs, especially in manufacturing. Hence, more women are in senior positions in LMEs, and occupational segregation by gender has been especially prominent in CMEs (Estevez-Abe et al. 2001). However, concern about these issues has encouraged the governments of CMEs to offer more generous parental leaves and daycare, and the wages of many women there benefit from collective bargaining. As a result, highly educated women tend to fare better in LMEs, while many with less education may do better in CMEs.

Although the evidence is more limited, these variations in the operation of capitalism may also condition inequalities in health through their impacts on income inequality, benefit systems and working conditions, which feed into people's health. McLeod et al. (2012) show that the experience of unemployment affects the health of middle and low-skill workers more adversely in an LME than a CME; and Barnes et al (2020) find that inequalities in income have a larger impact on the health gradient in LMEs, while education is more salient in CMEs.

Of course, the operation of capitalism changes over time and, as services and the knowledge economy gain ever larger roles in the world economy, the distinctions highlighted by this varieties-of-capitalism approach may need to be modified. But the point that cross-national variations in the operation of capitalism condition the character of a country's inequalities deserves to remain a touchstone for scholarship on inequality.

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