

DISCUSSION FORUM II

On Wolfgang Streeck *Re-Forming Capitalism: Institutional Change in the German Political Economy*, Oxford, Oxford University Press, 2009

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Wolfgang Streeck's (2009) *Re-Forming Capitalism* is a major contribution to comparative political economy and institutional theory in at least three respects. First, it proposes an analysis of the transformations that the 'German model' has experienced over the past two decades or so. By thoroughly reconstructing the trajectories followed by five sectors of the German economy—namely, collective bargaining, intermediary organization of capital and labour, social policy, public finance, and corporate governance—Wolfgang Streeck shows how a great deal of change has made the most important pillars of the German model more fragile and, most importantly, how the evolution of each sector has reinforced the impact on the coherence of the whole model caused by the transformations taking place in the other sectors. The conclusion to be drawn from the first part of the book is that the German model either no longer exists or will not exist for long. The second contribution of the book is a theory of institutional change. Criticizing the most static and functionalist aspects of the Variety of Capitalism literature, the book argues that

a theoretical framework focusing on (historical) change, not stability, should be adopted. The principles presented in *Re-Forming Capitalism* could be used profitably for the analysis of models of capitalism other than the German one. Third, taking inspiration from K. Polanyi, Wolfgang Streeck proposes a dynamic theory of capitalism based on the opposition between the disorganizing principle of capitalism, in its quest for profits, and the desire of society for organization.

The analysis of the five sectoral trajectories is not just an important contribution to the empirical work on capitalism in general and Germany in particular; it is also a significant application of the theory of institutional complementarities to the analysis of institutional change. Most critiques of this theory have targeted its alleged static character and functionalism, and some parts of *Re-Forming Capitalism* echo such criticisms (p. 102 and p. 106, for instance). Nevertheless, the book is an illustration of how the theory of institutional complementarities can contribute to the analysis of the destabilization of a model of capitalism. Just as cumulative principles may lead to 'virtuous' or 'vicious' cycles, institutional complementarities may reinforce the functioning of the most important institutions of a model ... or work the other way around once one or more institutions start to weaken. The reinforcing mechanisms will then combine the destabilizing forces at work within each sector and accelerate the demise of the system.

The evidence proposed in the book makes it very clear for Germany that the *same* complementarities that once reinforced the German model have worked to weaken it. This mechanism of 'institutional complementarity in reverse' is also important if we are to understand that the transformations of the German model are not the result of evolutions taking place in one sector alone, such as the financial sector, which then disturbed an otherwise perfectly stable and efficient system. The book shows convincingly that most of the other sectors had experienced a weakening of their key institutions before the changes in the corporate governance sector took place. *Re-Forming Capitalism* argues convincingly against the predictions of the bulk of the Variety of Capitalism literature on the process of 'bifurcated convergence', according to which under the pressure of globalization, liberal market economies would become more liberal whereas coordinated market economies, such as Germany, would tend to become more coordinated. Far from this perspective, the analysis proposed by Wolfgang Streeck does not find much evidence of self-correcting mechanisms that could bring the German model back to a coordinated economy equilibrium. On the contrary, the evidence points to an accelerated demise of the model. The evidence also shows that the reforms undertaken in the past decade, allegedly to improve the sustainability of the model, have actually weakened its foundations.

Transformation and change are the main themes of *Re-Forming Capitalism*. In discussing what the adequate framework for the analysis of institutional change should be, the book raises the old 'history vs. structure' problem. Although

insisting on the necessity to take history and change into account, *Re-Forming Capitalism* is based on a framework ‘sufficiently abstract to be applicable in principle to institutions in general, regardless of historical and geographical location’ (p. 102). This is indeed a necessity if social sciences want to go beyond mere storytelling. The analysis of social systems requires a certain structure of ‘deterministic causation’, even if it should be understood that the theoretical framework that one uses cannot entirely determine the historical situation which is analysed. This is, in fact, a prerequisite of *any* analysis. One must be able to define an object before analysing it, which can only be done with some hypothesis concerning the relative stability of this object; the minimal requirement being that the object of the analysis, in this case the German model, exists at all.

The French *regulation* theory has met similar problems when dealing with the crisis of the Fordist mode of *regulation*. In order to understand the crisis of Fordism, one needed to analyse why Fordism had not *always* been in crisis. More generally, the question is to understand how a social structure in which crisis should prevail can have a relatively stable existence *for a limited time period*. *Re-Forming Capitalism* adopts the same viewpoint as the French *régulationnistes*: ‘In short, what needs to be explained are order and stability, while gradual change toward public disorder may be expected as normal’ (p. 246). The perishability of social structures is an important aspect of the theory presented in *Re-Forming Capitalism*. The identification of a structure does not imply its endless reproduction; its analysis should bring to light the forces whose development will lead to an alteration of the structure and its ultimate demise.

The use of a theoretical representation of a social structure does not imply any assumption of functionalism, efficiency or global stability. Even the concept of ‘equilibrium’ is too often confused with the notions of uniqueness, efficiency, statics or stability. Cycles and irregular trajectories may be equilibriums, and multiple equilibriums may exist. For these reasons, a simple dichotomy between equilibrium and change is sometimes more misleading than enlightening. It is striking that some of the most significant propositions put forward in *Re-Forming Capitalism* could be analysed with the help of formal tools such as dynamical systems. There are several ways to introduce history into the analysis of a given structure, for instance through equilibrium selection: there may exist a multiplicity of paths *ex ante*, but a unique trajectory *ex post*. More importantly, the type of relatively slow decomposition that *Re-Forming Capitalism* analyses for the German case, with periods of acceleration of change once a certain threshold has been crossed, could be reproduced with the help of a dynamical system admitting both slow and fast dynamics¹ (the former applying to parameters that govern the latter)

¹London (1997) has formally modelled the breakdown of the Fordist growth regime with such tools.

and bifurcation theory. In fact, the book seems to use the concept of bifurcation without naming it: a small smooth change in the parameter values of a system causes a sudden ‘qualitative’ change in its behaviour.

Regarding the theory of institutional change that *Re-Forming Capitalism* proposes, some questions may be raised about the distinction between ‘Durkheimian’ and ‘Williamsonian’ institutions (Chapter 11). The former create obligations and are exogenously imposed, the latter reduce transaction costs and are voluntarily contracted. Wolfgang Streeck defines institutional change under capitalism as ‘[a move] toward progressive erosion of social obligations in favour of voluntary, individually “rational”, contractual social relations’ (p. 246). Like Karl Marx’s theory on the tendency of the rate of profit to fall, this is a strong statement that would need to be analysed at greater lengths. The proposition that capitalism would systematically imply the erosion of social obligations in favour of voluntary arrangements could be challenged from both an empirical and a theoretical point of view. Regarding the latter, one could formalize configurations of interests for different social groups in which it would be in the interest of both capitalism and capitalists to impose obligations and thus stabilize a certain social order. Regarding the former, the history of industrialization shows that the process of disciplining workers to fit the requirements of the factory organization has been based on (legal) obligations and sanctions and not just on contractual relations (Deakin and Wilkinson, 2005). The interpretation of factory legislation as a ‘defence of society, including capitalists, against the very real danger [...] of the capitalist modernization of production destroying its own foundations’ (p. 267), which Wolfgang Streeck reminds us was Karl Marx’s interpretation, raises the question of who ‘society’ is. The idea that ‘society’ (or ‘capitalism’) would be some entity able to take measures functional to its own survival would be contrary, of course, to the non-functionalist stance of *Re-Forming Capitalism*, and Wolfgang Streeck rejects the idea very explicitly. It remains that the dynamics of conflict between the drive to dissolve the social obligations and the desire for stability is not very tightly linked to the social groups that would support each alternative.

Also, as an economist, I find fault in *Re-Forming Capitalism* for neglecting macroeconomic factors. More precisely, what is striking in Wolfgang Streeck’s book is its mostly pre-Keynesian treatment of the macro-economy. For instance, I think that *Re-Forming Capitalism* overemphasizes the labour-cost aspect of wages and pays no attention to the role of wages in aggregate demand. This concern with labour costs is extended to social benefits (and contributions) and the welfare state in general. The reader gets the feeling that, if the German model is falling apart, it is largely because of the ‘unreasonable’ growth of social expenditure and labour costs, which deteriorate German competitiveness, depress labour demand, and generate unemployment. The public (and social) finance problem is indeed at the centre of the book. Rising public debt is seen

as both the consequence and cause of the demise of the German model, and the ‘unreasonable’ demands of pensioners and trade unions are said to make matters much worse than they would be otherwise.

It is noteworthy that *Re-Forming Capitalism* pays relatively little attention to the receipt side of the problem and particularly to tax cuts. Also, the fact is somewhat overlooked that the public finance problem is, in large part, endogenous, not only because firms’ shedding of labour increases demands for social compensation—that part is taken well into account in *Re-Forming Capitalism*—but also, and maybe more importantly, because real wage stagnation has depressed aggregate demand—thus producing unemployment—and social contributions, which depend on the levels of employment and wages. Starting from this, one could easily develop another set of ‘destabilizing’ complementarities: low wages imply low social contributions and low aggregate demand; depressed demand leads to slow growth, which implies a rise in public deficits; the increased importance of exports in the dynamism of demand puts competitive pressure on wages, which further aggravates the problem.

Simple statistics² reveal that the problem may be located where *Re-Forming Capitalism* is not looking. Income distribution in Germany has been constantly evolving to the benefit of profits and the detriment of wages, at least since the early 1990s. Productivity per worker rose by over 10% between 1996 and 2008, whereas individual real wages *fell* by 5%. The comparison with other European countries is also telling. Household demand in the Eurozone, minus Germany, increased (in real terms) by about 15% between 2002 and 2009, whereas it remained stagnant in Germany. The level of unit labour costs in the Eurozone, minus Germany, stayed about the same between 1996 and 2008 but dropped by an impressive 15% in Germany. The consequence is that a cure of wage austerity and welfare state retrenchment could very well send the patient to the cemetery rather than to the recovery room.

Finally, one may wonder, in the light of events in the past couple of years, whether the emphasis on *public* debt is deserved. Before the State, in Germany as in every other developed country, had to come to the rescue of banks, the problem of public debt was dwarfed by that of *private* debt. The forthcoming problems in public finance have indeed been caused more by the reckless behaviour of the financial sector than by the ‘unreasonable’ demands of trade unions.

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²See Natixis (2009a, b, c).

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Wolfgang Streeck's recent volume on 'Re-Forming Capitalism: Institutional Change in the German Political Economy' is a highly important contribution to both the empirical and the theoretical debate on the development of industrial relations, the welfare state and the labour market. The book is a potential classic, as it, first, unites core insights into recent developments of the German political economy—which is particularly helpful for foreign readers—and, second, embeds the empirical story into an inspiring theoretical approach that will probably inspire further research.

Given this, it seems appropriate to concentrate the discussion of the volume on five major comments: (i) the theoretical approach, (ii) the method, (iii) the empirical statements on the German case, (iv) the probable development of the German political economy in the current crisis, and (v) implicit normative implications.

First, in particular, for readers who are familiar with the earlier work of Wolfgang Streeck on the German model of 'non-liberal' capitalism, the major contribution of the volume is not the empirical material presented but is the innovative theoretical approach. Wolfgang Streeck strongly argues against a static and functionalist view of institutional arrangements and developments as well as rejecting overly simplified 'economistic' reasoning when it comes to explaining institutional choices and changes. He is certainly right in stressing the open, often contradictory and, above all, historical character of the political economy and institutional environments in capitalist systems. What is particularly remarkable is the emphasis on the role of actors at the micro-level, who reproduces institutional rules only in an imperfect way—and they also work around the existing rules in pursuing their specific preferences. The approach suggested by Wolfgang Streeck stresses the process dimension of policies and institutions and the