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How should we think about modern capitalism? A growth models approach

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Advanced capitalist societies seem to limp from one existential crisis to the next, becoming ever more fragile and unstable as a result. Yet the dominant theoretical frameworks in political economy view capitalism as fundamentally stable or, at most, subject to incremental change. In a recent volume published by Oxford University Press, *Diminishing Returns: The New Politics of Growth and Stagnation*, we develop a more dynamic framework that places disequilibrium, aggregate demand and distributive conflict centre stage. The result of a collaborative effort involving European and North American scholars, our volume emphasises the diversity of capitalist trajectories, which we reframe as a diversity of *growth models*. We do not stop at mapping diversity, however. We seek systematically to link country-level and regional developments to cross-cutting trends in the international economy, such as liberalisation, financialisation and the rise of inequality. In this short article, we present the approach and articulate the implications of the growth models perspective for our understanding of the role of labour and 'green growth' in the current moment.

Our starting point is the comparative political economy literature. The central argument of this body of research is that there is no optimal way to organise a capitalist economy; rather there are multiple viable alternatives (e.g. Hall and Soskice, 2001). But diversity has been conceptualised primarily in terms of the supply side of the economy, focusing on how institutions – industrial relations systems, welfare states, corporate governance regimes and vocational training institutions – impact the ability of key firms to compete in international markets. Our approach shifts the focus to the level and composition of aggregate demand. In some nations, growth is driven primarily by exports; in others, it is driven primarily by consumption or domestic demand; and in still others, it is balanced, in the sense that multiple growth drivers are in play, and exports and aggregate demand alternate in different phases.

Our alternative approach, the 'growth model (GM)' approach, shifts the focus of analysis from the supply side to the demand side of the economy and seeks to identify conditions for long-term growth. In taking this tack, we draw inspiration from the post-Keynesian literature in macroeconomics (PKE), which views growth as being dependent on aggregate demand, not only in the short

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run, as New Keynesian macroeconomics argues, but also in the long run, as it sees aggregate supply as responding to demand conditions (Lavoie, 2018; Storm and Naastepad, 2012). The French Régulation School is another intellectual forefather of growth model research (Aglietta, 1979; Boyer and Saillard, 2002). According to the Régulation School, capitalism is inherently unstable and can be stabilised only temporarily by putting in place the right set of institutions.

Fordism, wages, demand drivers

The analysis of Fordism, an accumulation regime in which real wages are indexed to productivity growth, is one of the Régulation School's lasting contributions. Fordism and what post-Keynesians call 'wage-led' growth are essentially the same growth model. In both models, workers' ability to obtain high real wage increases, in line with and sometimes exceeding labour productivity increases, is the key driver of demand. Wages are (partially) exogenous because they are determined by workers' power. Thus, a distributional shift towards labour stimulates consumption demand, while simultaneously increasing capacity utilisation, to which firms respond by increasing investment in order to return capacity utilisation to its 'normal' level. Investment stimulation is also beneficial for productivity because new machines incorporate the most recent technological progress, and labour productivity benefits from economies of scale. Furthermore, labour strength and protective labour institutions encourage firms to use labour more efficiently and to increase capital intensity (Storm and Naastepad, 2012). In short, the initial wage push is associated with compensatory productivity gains, resulting in the wage share increasing less than the initial wage push.

The institutionalisation of collective bargaining and the increase in trade union power that accompanied it was the key institutional innovation that brought about the Fordist era. With downwardly rigid wages Fordist industrial relations alleviated the demand-side constraint that had hampered growth during the interwar period by indexing real wage growth to labour productivity. Other institutional innovations, such as public welfare provisions and the adoption of Keynesian budget policies, contributed to sustaining demand in addition to collective bargaining. As a result, growth accelerated in the 30 years following the Second World War (Armstrong et al., 1991).

Over time, a number of problems arose within the wage-led model. The pressure exerted by wage militancy on the profit rate was one of its primary weaknesses. Although real wages boosted domestic demand, lower profits per unit of output diminished the capitalists' motivation to invest (Marglin and Schor, 1990). Restricted capital mobility and financial repression (real interest rates below those that would have prevailed in a worldwide market), mitigated the pressure for some time. But the dismantling of capital account controls made it more difficult for national policymaking authorities to undercut the global rate of return on capital, which is indexed to the global real interest rate.

The second vulnerability involved inflation. When trade unions fought for pay increases beyond productivity gains while the economy was at or near full employment, firms with market power responded by increasing prices. Generally, attempts to control inflation entailed the introduction of income policies that sought to limit wage growth to what could be 'paid for' by productivity increases (Flanagan et al., 1983). However, such policies were more effective in more centralised or coordinated negotiating systems, such as Germany and Sweden, than in relatively decentralised systems, such as France, Italy and the United Kingdom (Cameron, 1984; Soskice, 1990). In Thatcherite Britain, inflation was ultimately vanquished through a switch to monetarism and an assault on trade unions' statutory rights.

The travails of the 1970s prompted Bhaduri and Marglin (1990) to conceptualise profit-led growth as an alternative (and possibly the successor) to the wage-led growth model. In profit-led

growth, investments are more sensitive to unit profits than in wage-led growth. The shareholder value revolution (Lazonick and O'Sullivan, 2000) and international capital mobility enhance the profit-dependence of investments. In a finance-led alternative to the wage-led growth model, household spending is likewise highly sensitive to the wealth effect of rising asset values, which is positively dependent on corporate profits (Boyer, 2000). In addition, as the economy becomes more open to international trade, net foreign demand no longer constitutes a minor portion of total demand, and the trade balance improves with real exchange rate depreciation, which is in turn brought about by consumption and wage repression (Bowles and Boyer, 1995).

Policies aimed at increasing the profit share of income, such as labour market liberalisation, capital mobility and corporate governance reforms that strengthen shareholder rights, only stimulate growth if the structure of the economy is profit-led, whereas they reduce growth if the economy is wage-led. In the long run, however, profit-led growth is not viable per se because it tends to produce both overinvestment and underconsumption. Given these pathologies, two alternatives emerged from the crisis of wage-led growth: export-led growth and debt-financed consumption-led growth (Stockhammer, 2015).

The diversity of post-Fordist growth models

Some countries have been able to achieve non-negligible growth rates by easing access to credit and by exploiting the wealth effect of rising home assets (Crouch, 2009; Mian and Sufi, 2011). The United Kingdom and the United States are illustrative examples. Their debt-financed consumption models, like the wage-led growth model, rely on domestic demand as a growth engine. However, wage growth is no longer the primary driver of economic expansion, but a consequence of tight labour markets, which in turn are the result of buoyant product demand (Baccaro and Pontusson, 2016). This economic model is characterised by asset bubbles and rising household debt and is inherently unstable. In addition, for this growth model to be sustainable beyond the short term, a constant net inflow of foreign capital is necessary to fund repeated current account deficits (Schwartz, 2009).

Export-led growth has very different characteristics. In countries in which the export sector is sufficiently large and exports are sensitive to price variations, wage moderation results in a depression of domestic demand but an expansion of foreign demand. The prerequisites for export-led growth include institutions that ensure domestic wage and price moderation and an inflexible nominal exchange rate regime (Höpner, 2018). Germany in the 15 years before the financial crisis is the clearest example of export-led growth among advanced Western countries. This growth model, however, is difficult to generalise. If all nations attempt to promote export-led growth by suppressing domestic consumption, a fallacy of composition results in global stagnation. Someone, after all, has to run the corresponding deficit to match the export surplus.

The Swedish case demonstrates that domestic and external demand are not mutually exclusive growth drivers. Exports, wages and debt have all contributed to Swedish growth. Sweden's household debt skyrocketed in the 15 years preceding the financial crisis. Sweden's large public sector has boosted the wages of private sector workers in comparable occupations as well, hence stimulating household spending. Simultaneously, the growth contribution of exports has also been important, and the country has achieved repeated current account surpluses. Comparatively high levels of worker organisation in the Swedish service sector (public and private) have acted as a new form of 'beneficial constraint' (Streeck, 1997), making it less convenient for Swedish firms to rely on a wage suppression strategy for boosting competitiveness. This has had the effect of forcing capital to shift from manufacturing to service industries with a lower price sensitivity of exports, such as ICT and high value-added services. Meanwhile, because the individualisation of work relations has

been pervasive in Sweden, the ability of service and public sector unions to push for wage increases commensurate with productivity gains depends almost exclusively on their remaining mobilisation capacities, as the supporting institutions have been weakened (Baccaro and Howell, 2017).

For countries at the periphery of the global economy, growth often implies attracting foreign capital through advantageous regulatory measures (including tax incentives). Such governments can serve as compradors, or business intermediaries, as in the case of the several Caribbean tax havens with ties to the United Kingdom (Shaxson, 2019), or even as conduits for tax evasion and money laundering. Or they can serve as specialist component suppliers in global supply chains (Blyth, 2016), such as the Eastern European enterprises that feed the German car industry, or Taiwan and the worldwide semiconductor trade.

There are thus core and periphery variants of export-led growth. In the former, domestic companies sit at the top of global supply chains and reap the largest share of global profits. In the latter, domestic companies are providers of intermediate goods or suppliers of low value-added or labour-intensive final services to foreign buyers, which reduces the space for upgrading. A similar distinction between core and periphery is also applicable to consumption-led growth models. Consumption-led growth leads to a deterioration of the current account and thus is feasible only if the country has the ability to attract net foreign financial flows on a stable basis. Most peripheral countries are unable to attract foreign capital to finance their external debt when they need it the most and are therefore subject to highly disruptive 'sudden stops'.

International political economy and supranational institutions

Growth models exist at the level of the nation, but growth drivers often lie beyond them. This is not simply a facet of the growth models of smaller states such as Ireland and Latvia, whose growth models exist by virtue of foreign capital flows. Rather, it is a facet of all growth models. Consider the export-led growth model. By definition, its demand driver lies outside its borders because it cannot absorb the surplus it produces. Similarly, consumption-led models like that of the United Kingdom need to import the savings of exporters to close the gap between their imports and their exports. As such, the traditional concerns of comparative political economy need to be complemented by integrating the insights of international political economy.

Our volume achieves this both theoretically and empirically. Theoretically, we delineate five levels at which the global economy impacts local growth models at different levels of aggregation. The first level explains how individual national growth models adapt to a common external shock through processes of diffusion or copying. For example, through the spread of particular technologies or through competitive dynamics such as capital account opening. The second level examines the same process through a more systemic lens. From this vantage point, adaptations to the same economic shock are conditioned by the ability of the system as a whole to incorporate the shock rather than focus on resilience at unit level. For example, the transition from wage-led to profit-led growth models can be seen as a function of common inflationary pressures producing a shift in growth models. That is, as a unit-level phenomenon. But it can also be viewed systemically. While any one country can engineer a Fordist compromise at the level of the national economy, such domestic compromises between capital and labour rest upon the provision of stable prices and inputs. As more and more countries attempt the same compromise, such prices and inputs become more volatile, thus undermining such domestic bargains at the level of the system. US Fordism in autos, for example, and the bargains that made it possible, were contingent upon countries such as Japan and Germany not expanding their market share. Once they did, all such bargains destabilised at the level of the system as input prices became more volatile. Here the adaptation that matters lies at the level of the system rather than that of the units.

A third level incorporates power and hierarchy into its analytic structure and again focuses more on the system than the units. That level views local growth models as embedded in international hierarchies and balances of power. The dominance, for example, of the US dollar as the global safe asset is due in part to the need for export-led growth models to export their surplus earnings rather than absorb them at home. In a situation in which two-thirds of the world (East Asia, Latin America and Europe) export and one-third (basically the Anglosphere) run the corresponding deficits, a global safe asset of sufficient depth and liquidity is needed to keep the system stable. That gives the issuer of that currency, the USA, tremendous power via its central bank, as seen in the 2008 financial crisis.

Similarly, such 'hegemonic powers' tend to be the leading technological states, as well as having sufficiently large economies to absorb the surpluses generated elsewhere. This gives these states leverage in terms of who gets market access, who gets technology, who gets excluded and who gets included, and on what terms. As such, hierarchy and power at the system level have determinate consequences for what domestic growth models can exist and how they are structured.

Indeed, one can go a higher level of aggregation still, and note that pretty much all export-led growth models have been exporters for a very long time. Latin America, for example, for all its variety of growth models, is, at a continental scale, a commodity exporter, and always has been. Indeed, despite many attempts to change the commodity-based growth model no country has fully succeeded. This reminds us that the timing of incorporation into the global economy has long-run path-dependent effects that are extremely hard to change at the domestic level. Finally, our volume discusses how what seem to be national credit cycles are in fact global phenomena, and why that matters for local growth models.

Empirically, several chapters in the book show the pay-off to incorporating such a lens into the growth model framework. The EU, in particular, shows us how regional institutions can 'select for' certain types of growth model over others. Europe prior to the 2008 financial crisis incorporated a variety of different growth models. Large domestic demand-based economies, such as Spain and France, existed alongside export-based economies, such as Germany and Denmark. But these national growth models also existed within a set of regional institutions that shaped how they functioned and evolved over time.

Prior to 2008, European integration encouraged two processes. First, northern banks bought southern and eastern banking groups. These banks then recycled northern European surpluses into southern and eastern consumption and investment. When the crisis hit and these flows stopped, it triggered a debt crisis that was stemmed with bilateral lending agreements that were contingent upon structural reforms being undertaken in the southern and eastern growth models. At the same time the institutions of the EU were reformed to better police member budgets and to enforce austerity budgets. As a consequence, consumption-led growth models were 'selected out' by these new institutions as exports were boosted and imports fell. Simultaneously, northern export-led growth models were strengthened by those same reforms. The end result was that by 2013 the EU as a whole began to run a surplus against the rest of the world that persisted for almost a decade. In short, growth models may be national, but supranational institutions acting at a systemic level can condition growth strategies and even limit the choice set of possible growth models within these institutions.

The role of labour and wages

The introductory chapter of *Diminishing Returns* does not address the role of labour and wage formation in a sustained fashion, but it should be clear from the preceding discussion that trade unions, wages and labour market institutions play an important role in the evolution of capitalist

growth models. These variables have an impact on both the demand and supply sides of the economy. Collective bargaining, for instance, determines wages and thus affects household spending. Real wages depend on the interplay between nominal wages and prices. Collective bargaining influences the nominal wage growth rate directly and, indirectly, the growth rate of prices as well (because prices tend to track unit labour costs). As noted above, national collective bargaining was a crucial institution of the wage-led growth model, and its erosion has contributed to both the stagnation and the volatility of the post-Fordist growth models.

Not just the level of wages, but also their distribution affects aggregate demand. Those who rely primarily on income from labour have a greater propensity to consume than those who rely primarily on income from profits. Thus, consumption will suffer if real wages increase more slowly than productivity (which implies a fall in the wage share). Again, this may promote exports, but if the stimulus is insufficient, it will lead to stagnation. In a wage-led economy, investment is highly sensitive to the prospect of rising demand and not very sensitive to profitability (Bhaduri and Marglin, 1990). Piore and Sabel (1984: 77) emphasised the extraordinary sensitivity of investment to demand under Fordism. The anticipation of stable and rising demand for the products being manufactured is a precondition for investing in big, single-purpose factories. This, however, presupposes a largely closed economy in which neither production offshoring nor imports are viable options. Wage bargaining also impacts labour productivity indirectly through the 'Kaldor-Verdoorn' effect: as demand expands, productivity increases because economies of scale become possible (Storm and Naastepad, 2012).

Wage pressure and labour rigidities tend to encourage technological change. By increasing the price of labour, they contribute to capital deepening, which raises the amount of capital per unit of work and enhances labour productivity. Storm and Naastepad (2012) refer to this phenomenon as the 'Marx-Hicks' effect. Similarly, if labour becomes more costly, management will be encouraged to introduce organisational changes that optimise its use. The implementation of organisational changes is contingent on the type of unions and workplace relations. For instance, craft unions are known to be less amenable to workplace change because of their tendency to fight the loss of skills and employment caused by technological change, whereas encompassing unions are more likely to internalise the positive systemic consequences of technical change. These arguments on the influence of industrial relations institutions on labour productivity are applicable to the manufacturing sector. Much less is known about their applicability to the service sector, which currently dominates the economies of most developed nations. By enhancing productivity and favouring innovation, labour rigidities act as 'beneficial constraints'. It follows that the erosion of industrial relations institutions contributes to the stagnation of labour productivity.

The domestic politics of growth models

Since the 1990s, the dominant view among Comparative Political Economy (CPE) scholars, including French regulationists, has been one in which 'politics' matters primarily for the creation and preservation of institutional arrangements that incentivise economic actors to behave in particular ways. By contrast, we argue that governments play a more actively directive role and they do so, first and foremost, through their macroeconomic policies. In addition, our analytical perspective focuses attention on distributive conflicts involved in macroeconomic management. By stimulating or depressing different components of aggregate demand, macroeconomic policy shapes the distribution of earnings and profits across sectors of the economy.

The core of our approach to the politics of growth models at the national level boils down to the proposition that the stable reproduction of growth models hinges on two political conditions. First, the presence of a coalition of more or less organised interests, including corporate elites and

unelected as well as elected government officials, with a common policy agenda. Second, the ability of parties that form part of the dominant growth coalition to mobilise electoral majorities that are compatible with the coalition's agenda. Thinking about the politics of growth models in this way, we seek to go beyond the conventional juxtaposition of the 'noisy' politics of elections and public formation and the 'quiet' politics of policy-making (Culpepper, 2010).

Whether mass electoral politics trumps elite politics and interest-group bargaining, as Beramendi et al. (2015) argue, surely depends on the issues at stake and specific conjunctures. Also, politics outside the electoral domain should not be conflated with 'tripartite corporatism'. Much of the 1980s literature on producer group politics focused on more or less explicit bargaining between organisations representing business and labour, but the political influence of organised business and large corporations surely does not presuppose corporatist bargaining. To the contrary, the influence of corporate interests over government policy would appear to be inversely associated with union power and tripartite corporatism.

In our conceptualisation, these coalitions are organised around 'policy paradigms' as conceived by Hall (1993). That is, as a coherent set of propositions about how the economy works and what the overarching goals of government policy should be. Dominant growth coalitions are not 'coalitions among equals', but rather characterised by hierarchical power relations, with firms in leading sectors (and the owners of those firms) constituting the core of the coalition and other, more or less organised, groups occupying subordinate positions. Representatives of the different groups that are part of the coalition negotiate what Hall (1993) refers to as first- and second-order policy changes, pertaining to policy instruments and specific policy settings, but the policy paradigm – in other words, the growth strategy on which the coalition rests – is rarely subject to (re)negotiation.

In ordinary times, when growth models operate smoothly, there is one growth coalition that is clearly dominant and subordinate groups within this coalition – trade-unions and small business associations – do not have readily available exit options. In the domain of macroeconomic management and long-term growth policies, much of what we think of as 'coalitional politics' is about managing conflicts of interest and accommodating changes in the balance of power within the dominant growth coalition as distinct from struggles between competing coalitions.

As argued by Blyth and Katz (2005), treating political parties simply as representatives of citizens' policy preferences leaves a great deal to be desired. Governing parties of the centre-left, as well as the centre-right can and should be seen as part of the dominant growth coalition. Ministers and senior parliamentarians, along with their unelected policy advisors, participate regularly in policy deliberations that involve conflicts of interest within the dominant growth coalition and, in this context, promote the interests of one or another of the contending groups. Equally important, party leaders and the expert advisors on whom they rely play a key role in elaborating the paradigms that define the parameters of policy debate within the dominant growth coalition and in the projection of these paradigms to the public at large.

We also question the extent to which citizens' voting behaviour is determined by their policy preferences. Featuring prominently in some of the comparative political economy literature of the 1990s (for example, Garrett, 1998), retrospective economic voting – voting for incumbents when the economy is doing well, against them when it is doing poorly – deserves to be brought back to centre-stage. Most importantly for our purposes, retrospective economic voting provides a simple and quite convincing explanation of why elected policy-makers are particularly inclined to attend to the needs and demands of the firms and sectors that drive economic growth in their country. In this sense, electoral politics mediated by government parties seeking re-election represent a constraint on the ability of subordinate coalition partners to challenge the policy preferences of leading sectors.

Crucially, congruence of the politics of the dominant growth coalitions and the politics of electoral coalitions must not be taken for granted. Tensions between these two domains of politics, operating according to distinctive logics, give rise to moments of uncertainty or, in other words, periods in which it becomes more difficult, and sometimes impossible, for the dominant growth coalition to implement policies that effectively support the growth model. In such periods, the growth model itself becomes politically contested. In many liberal democracies, rising inequality and the slowdown of economic growth in the wake of the financial crisis of 2007–2008 have ushered in such a period of 'messy politics'.

Conclusions and directions for future research

Diminishing Returns is a plea to go back to some classic themes in political economy, such as the emphasis on the inherent instability of capitalism, the importance of macroeconomic policy, the effects of distribution on aggregate demand and growth, the emphasis on actors and growth coalitions. *Diminishing Returns* is also an attempt to advance the discipline by combining a CPE perspective on national diversity with an International Political Economy (IPE) perspective on the role of systemic forces. Despite similar evolutionary patterns (for example, liberalisation and financialisation), the national diversity of capitalism remains significant. But the conditions under which national variety arises and reproduces are moulded by a highly uneven and stratified international political economy in which some units have far more power than others.

Going forward, which growth model is best positioned to profit from emerging green industries becomes a critical question, and, relatedly, which growth model is best placed to make the distributional compromises necessary to effect such a transition. The approach to politics sketched above suggests that for decarbonisation to succeed it will have to generate a new coalition that not only wishes to challenge the current growth model, but must also be large and encompassing enough to create a new stable distributional order.

The Growth Models approach encourages us to examine the strengths and weaknesses of different growth models in terms of their ability to supply answers to these challenges. Some export-led growth models may find it easier to forge the coalitions needed to effect such a transition as they already have large coalitions of export sectors that sit on the technological frontier. It may also be that consumption-led models that lead in innovation and intellectual property rights stand to profit the most from green transition. At this juncture we cannot yet see. But this is undoubtedly where future research needs to go.

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