

Institutions Within Which Real Actors Innovate

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Neo-institutionalist analysis has been highly successful at both making possible a critique of neo-classical accounts, and rendering analytical an approach which might otherwise lapse into narrative empiricism. It has also established the importance of institutions among the characteristics of national economies which confer comparative advantage (Hall/Soskice 2001a: 36–44). This has further made possible analysis of the diversity of contemporary capitalism, challenging the view that capitalism must mean perfect markets, with empirical variations from this ideal implying imperfections which will disappear through competitive struggle.

However, in its currently dominant forms neo-institutionalism embodies two flaws which limit its application and distort its conclusions. The first is a conflation of theoretical models and empirical cases through a research strategy of seeking the unique theoretical box to which an individual case shall be assigned. The second is a tendency to ignore human actors' capacities to react creatively to constraints imposed by their institutions. The two flaws come together in that the seamless web of institutional coherence implied by the former leaves agents no scope to practise creativity.

Neo-institutionalist theory is therefore ripe for confrontation with the arguments developed by Renate Mayntz and Fritz Scharpf in their concept of actor-centred institutionalism. This provided a balanced approach. On the one hand it did not follow neo-classical economics into elaborate but abstract theories in which institutional constraints and particularities were assumed away. At the same time – and this is more important for our present task – it did not reify institutional constraints to the point where they denied the role of maximizing, if boundedly rational and imperfectly knowledgeable, collective and individual agents. The Mayntz/Scharpf model:

gives equal weight to strategic actions and interactions of purposeful and resourceful individual and corporate actors and to the enabling, constraining and shaping effects of given (but variable) institutional structures and institutionalized forms. (Scharpf 1997: 34).¹

As he later developed it in detail, Scharpf's core model is that familiar from two-actor, non-cooperative game theory (Scharpf 1997: 31). By sketching in for his actors some realistic assumptions and goals framed by their institutional context, he is able to achieve considerable explanatory and some predictive power in a way which remains analytically rigorous but also more empirically comprehensible than much pure theory in this field. That particular game-theory model is not directly relevant to our current purposes. The main theory underpinning contemporary institutionalism is that of path-dependence, which concerns parametric decision-making modelled through Polya-urn processes (Arthur 1994). It is therefore this theory which has to be refashioned as actor-centred if studies of varieties of capitalism are to be rescued from being deterministic and functionalist. This requires modelling a "game against nature" rather than against other strategic players, and thus produces a different set of models from game theory, though these can be developed in a manner generally analogous to Scharpf's (Crouch/Farrell: 2002). Central to the argument is the theoretical possibility – though certainly not the probability – that entrepreneurial agents may succeed in making radical changes that refute the logic of their path dependence. But only some forms of institutional analyses of contemporary capitalism can be used for this purpose.

In the following discussion I shall analyze models of capitalist diversity along two dimensions: the number of types they identify, and the range of institutions they embrace. From this develops the conclusion that theories identifying a relatively larger number of types but concentrating on a limited range of institutions are the most suited to an actor-centred approach; those having the opposite characteristics are more likely to be determinist. The implications of this become clearer when we consider the application of the two approaches to empirical cases.

1 Scharpf's concept of "actor" usefully includes corporate and collective actors (Scharpf 1997: ch. 3). There are problems of coordination for collective actors, but these can be incorporated in the theory of the institution concerned (*ibid.*: 59).

1 Approaches to Neo-institutional Analysis

That capitalist economies might take diverse forms has been long recognized, but this diversity has often been seen as a matter of historical development. This was true of Weber's approach, that of the advocates of post-war modernization theory (e.g. Kerr 1960), and of the French *régulationistes* who followed Gramsci's identification of a Fordist phase of capitalism to succeed the classic free-market form (Boyer/Saillard 1995). These approaches, different from each other though they are, all envisage an evolutionary process; some forms of capitalism supersede earlier ones. These are not therefore theories of a true diversity in the sense of a continuing multiplicity of forms, the historical superiority of any of which might never come to an issue.

Analysts adopting this latter approach have been more rare. The *locus classicus* was Shonfield's (1964) work, which examined the role of various institutions immediately surrounding the economy in a number of western European countries, the USA and Japan (for example, banking systems, government structure, and government planning mechanisms). Although he thought some were more efficient than others, he did not talk in terms of historical transcendence. Shonfield was one of the last of the "old" institutionalists. His approach was narrative and his analysis non-formal. Within academic economics this kind of work gradually became excluded from consideration from the 1970s on.

Meanwhile, as Trigilia (1999: chs. VIII, IX) has shown, from the 1940s to the 1970s sociologists virtually gave up studying the economy at all, apart from within developing societies. Although Parsons (1951) had claimed sociology to be the empress of all the social sciences, he granted economics a fully autonomous kingdom within her empire. The mid-twentieth century US sociology which he so heavily influenced therefore had little to say about economic institutions once they had achieved their initial differentiation from the rest of society, whether in European economic history (Smelser 1959) or in contemporary modernization.

Except where, as in France and to a lesser extent Germany, economists put up some resistance to neo-classical dominance, it was largely left to political scientists to sustain the academic study of institutions surrounding the economy – generally under the banner of "political economy", though using that term in a different way from economists themselves. However even they tended to avoid the core of the economy, concentrating on the more

Figure 1 Approaches to the Study of Capitalist Diversity



obviously socio-political parts: industrial relations, the welfare state, and local development. It seemed to take the collapse of Soviet communism, removing from the scene the only complete alternative to capitalism, to make observers aware of its systematic internal variety. Throughout the 1990s the literature on the subject grew rapidly, with sociologists eventually joining the task.

The various approaches which have emerged can be grouped according to the position they take towards two components of the analysis: the number of types of capitalism they identify, and the range of institutions they claim to bring within their generalizations. Figure 1 plots some major approaches according to these variables.

1.1 How Many Types of System?

The smallest number of theoretical types consistent with the idea of diversity is two. Of these, one is always the free-market model of neo-classical economics. This constitutes the principal intellectual antagonist for neo-institutionalists, even when they argue that it accounts for only a highly specific form of capitalism (Boyer 1997). There must therefore be at least one other form. At the other extreme there is no theoretical limit to the number that might be identified, but more than five or six are rarely proposed. Given the relatively small number of cases of advanced capitalism (currently around 25), it is difficult to sustain more than a handful of types without lapsing into empiricism.

The position of a theory across this spectrum depends on the range of social sciences which have influenced its construction. Those that derive primarily from economics are likely to be dualistic: the range of possibilities can be reduced to those which follow the laws of the perfect market and those which do not. There is then recourse to other social sciences to characterize the “non-pure-market” option.

The work of Michel Albert (1990), who made the original contribution to this kind of analysis, is typical. He modelled two types of capitalism, seen in an antagonistic relationship. They are labelled in geo-cultural terms as Anglo-Saxon and *rhéнан* (Rhenish). The former defines free-market capitalism, considered to be embodied in the Anglophone countries. The second takes its name from certain characteristics considered to be common to the riparian countries of the Rhine: Germany, the Netherlands, Switzerland, more problematically France. However, not only is the author uncertain whether France’s institutions fully belong to this type (an anxiety which was one of his main motives in writing the book), but Japan and Scandinavia are considered to be part of it. More disconcerting (at least from our perspective) than an image of the Rhine rising under Mount Fuji and entering the sea at Saltsjöbaden is the broad institutional range being gathered together

to form this second type. The essential idea is a capacity to make long-term decisions that maximize certain collective rather than individual goods. But this means ignoring differences among the very different forms of co-ordination found.

A very similar analysis to that of Albert has appeared recently under the editorship of Peter Hall and David Soskice (2001b), in their “Varieties of Capitalism” approach – though the French author receives scant acknowledgement in their work. Again a model of a free (or liberal) market economy (LME) is established as one pole and identified with the Anglophone countries. And again Germany is at the centre of a second type, called a coordinated market economy (CME), where social and political institutions engage directly in shaping economic action. As with Albert, the former type (LME) depends on labour markets that set wages through pure competition and permit very little regulation to protect employees from insecurity, and on a primary role for stock markets and the maximization of shareholder value in achieving economic goals. Such an economy is considered by the authors to be poor at making minor adaptive innovations, because employers make inadequate investment in employee skills which might produce such innovations; but it excels at radical innovations, because the combination of free labour markets and external shareholders makes it relatively easy to switch resources rapidly to new and profitable firms and areas of activity. A CME, featuring corporatist wage-setting, strongly regulated labour markets and corporate financing through long-term commitments by banks, follows exactly the reverse logic.

Hall and Soskice (2001a) stress strongly that they are depicting two *enduring* forms of capitalism, because each has different comparative advantages. However, those of the CME form are capable solely of minor adaptations within traditional, declining industries, while LMEs have assigned to them all future-oriented industries and service sectors. In the end therefore this analysis is no different from that of economic orthodoxy in predicting a long-term future for the Anglophone economic model alone. It also follows conventional wisdom in arguing that the superiority of American firms over German ones results from the fact that in the Anglophone countries all managerial power is concentrated in the hands of a chief executive (CEO) who is required to maximize shareholder value, with employees engaged on a hire-and-fire basis with no representative channels available.

The authors briefly consider diversity within the CME form, recognizing differences between what they call “industry-based” coordination of the German type and “group-based” coordination found in Japan and Korea

(*ibid.*: 34), and, like Albert before them, accept that France is somehow different (*ibid.*: 35).² But this diversity is discussed in three pages of a 68-page chapter and is more a token acknowledgement that all is not well with the model than an attempt to come to grips with the implications of the weakness. With the exception of two authors (Culpepper 2001; Hancké 2001), the other contributors to their volume do not show much awareness of the limitations of the dualism. (Thelen [2001], for example, treats Italy as almost unambiguously a “German-type” “coordinated” economy.)

Some authors have gone beyond dichotomies. Esping-Andersen’s (1990) analysis of different forms of welfare state again uses a geo-cultural scheme, but also embodies variables relating to the outcomes of political struggle, or dominant political traditions. Again, one starting point is the liberal capitalism associated with Anglophone countries, and another is Germany, producing a conservative, “continental European” model. There is however a third, social-democratic pole, geographically associated with Scandinavia. Critics of this model have concentrated partly on identifying mixed cases (Castles/Mitchell 1991), or on breaking up the over-extended “conservative continental” category. A fourth type has now been clearly established, separating southern European welfare states from this one on the basis of the large role occupied by the family (Naldini 1999) and other informal institutions (Ferrera 1997); but all retain the geo-cultural approach.

A much stronger move away from dualism, which also neither starts from nor privileges the free-market model, is the scheme of Richard Whitley (1999). He builds up a set of fully sociological models of capitalism based on six types of business system, related to a number of different behavioural characteristics (*ibid.*: 42). He also presents five different ideal types of firm (*ibid.*: 75), and a diversity of links between these types and certain fundamental institutional contexts (the state, financial system, skill development and control, trust and authority relations) (*ibid.*: 84). Significantly, Whitley’s main fields of study are Japan and other Far-Eastern economies, not the USA and Germany.

2 The origins of the CME model lie in an earlier paper by Soskice (1990), where his aim was to demonstrate that the collective bargaining systems of France, Japan and some other cases usually classified as decentralized were in fact coordinated and therefore essentially similar to Germany, the Netherlands and Scandinavia. He was engaged in criticizing a concept of centralization being used in the economics literature to define *some* non-pure-market countries (Calmfors/Driffill 1986) in order to produce an idea of coordination that would cover them all.

Simplifiers like Hall and Soskice could argue that they are applying the principle of parsimony and Occam's razor to over-complex schemes of Whitley's kind. They could claim that, while there is clearly a loss of information if one collapses "coordinated industrial district, compartmentalized, state-organized, collaborative, and highly coordinated" mechanisms into the single idea of a CME, that idea seizes on the essential point that divides all these forms from the pure market one: coordination.

But is coordination the fundamental attribute of all these other types? On what grounds could this quality be regarded as more fundamental than the characteristics which divide these types, especially since the coordination takes place at very different levels? Recent developments in the governance approach (Crouch et al. 2001) draw attention to the role of collective competition goods provided by various governance modes in local economies, without demonstrating any "coordination" at all, indicating the possibility of analyses more moderate than those addressed at the macro-economy. Meanwhile Hage and Alter (1997) have convincingly demonstrated analytical distinctions among several institutional forms; in that case, to apply Occam's razor to reduce them all to one idea of coordination is to cut into serious flesh. Further, as Whitley's formulations demonstrate, the relationships between different forms and different behavioural characteristics present a varied patchwork of similarities and differences, not a set of polar contrasts. This suggests that individual empirical cases might well comprise more complex amalgams still of elements from several theoretical types.

As hinted, a final approach which builds on sociological and political science concepts of action and departs strongly from dualism is the so-called governance school. Developed initially by US and German scholars (Hollingsworth/Schmitter/Streeck 1994), it has recently joined forces with French *régulationistes* (Crouch/Streeck 1997; Hollingsworth/Boyer 1997b), bringing together the greater scope for diversity envisaged by the former with the connection to social forms of the organization of economic production of the latter. Because it looks principally at the way in which economic action is governed, its focus is on action rather than structures; structures emerge from the encounter between the actions of maximizing agents and the rules that are framed both to facilitate and to restrain the maximizing search.³ Several main means by which a capitalist economy can

3 It is important to note that, just because this approach deals with rule-making, it is not necessarily concerned solely with either formal rules or the restraint of economic actors.

be regulated are identified: the market, the state, corporate hierarchies, formal associations (as in neo-corporatism), informal community, with authors sometimes further distinguishing networks from community. Hollingsworth and Boyer (1997a: 9), who set out this model, describe it rather generally as a “general taxonomy of institutional arrangements”. They later (*ibid.*: 12) present a more complex model of “governance” which derives from it, though the additional structures identified in this mainly elaborate empirically the basic terms, which remain the theoretical bedrock. Hollingsworth and Boyer relate their governance modes to a more formal matrix of modes of coordination (horizontal and vertical) and of action motives (self-interest and obligational). An action-centred orientation thus contributes to the greater complexity. The market is present as a type and often remains a starting point or even a limiting case, but contrasts between it and other forms are not the sole focus of the account; these latter can be compared with each other without necessarily relating back to the market.⁴

By including both the market and the corporate hierarchy as forms of capitalism, the governance approach and Whitley’s model are able to distinguish analytically between pure markets and the heavily compromised ones with imperfect competition found in sectors dominated by large firms and their attendant supplier networks, able actively to shape their market environment. Researchers working within the Varieties of Capitalism school are forced into one of two responses. One is to regard giant firms and imperfect competition as phenomena found in both types of economy and therefore an irrelevant variable. This seems to be the position of Hall and Soskice themselves – though the relevant passage is worded ambiguously:

All capitalist economies also contain the hierarchies that firms construct to resolve problems that markets do not address adequately (Williamson 1985). In liberal market economies, these are the institutions on which firms rely to develop the relations on which their core competences depend.
(Hall/Soskice 2001a: 9)

The second possibility – and part of Hall and Soskice’s ambiguity – is to assimilate large corporate hierarchies to the liberal market model. For example, when Lehrer (2001), working within the Varieties of Capitalism frame-

Particularly in the work of the *régulationnistes*, rules are seen more as means by which economic actors attain their goals.

4 This makes their model superior to the adaptation of it by Crouch (1999: ch. 6) to provide a set of types, each of which contrasts solely with the pure market type.

work, describes British Airways' decision to shift away from a preoccupation with safety, reliability and punctuality towards more lucrative goals as the privatized firm produced a more centralized management than its state-owned predecessor, he has to cite this as an instance of pure market coordination. In fact, for Lehrer the degree of power of the CEO becomes almost the sole indicator of the liberal market.

This issue is not marginal. The core of the LME concept is the neo-classical free market; this cannot easily be extended to include oligopolistic corporate hierarchy. And yet several of the examples which are claimed to embody the LME include major elements of this quality: for example, the US approach to standardization, whereby the standards of individual corporations become national or even global ones without state or associational support. This cannot be a liberal market process (*pace* Tate 2001). It is a defining characteristic of a pure market that no one firm is able to impose conditions on others. If a single firm is able to impose such a thing as a standard, there is not open competition, and that firm has been able to impose entry barriers. An important aspect of the economic history of the initial triumph of the market model in the USA concerns the way in which many basic standards were imposed, usually by law, in a *neutral* manner that ensured a level playing field across a vast country and made market entry relatively easy. This did secure the true conditions of a competitive market. This does not seem to be the case today in the new economy, where standards are owned by individual corporations. Many of the successes of US firms in the new economy comprise combinations of first-mover advantage with the large scale and international political weight of the country. This does demonstrate an important characteristic of the US variety of capitalism and helps explain its success in many new economy sectors, but it is misdescribed if it is defined as "liberal market". It could indeed be described as an instance of "coordination" – the quality lacking *per definitionem* in an LME. Hall and Soskice are building into their model a functionalist balancing item, implying that hierarchy will exist to the extent that it can "resolve problems" (as the above quotation from Hall/Soskice 2001a: 8 puts it). They are not building their theory deductively, but are reading back empirical features of the US case into the model. It is not possible within this methodology to ask: "Is everything that goes on in the USA necessarily the embodiment of free markets?"

The errors involved in adding compensating or complementarity factors to a theoretical model will be discussed below. Meanwhile we note the high price which is being paid for parsimony in the reduction of all types of

economy to two. We must now pass to a consideration of the second variable in this account of theories of capitalist diversity: the range of institutions covered by the theory.

1.2 Institutional Range

At the narrow end of the range researchers concentrate on one theme: the set of extra-economic rules which (for rational-choice institutionalists) have been constructed or (for sociological institutionalist) have emerged to guide economic behaviour, albeit within a context of other relevant institutions. At the wide end authors will try to demonstrate how a range of other institutions, not directly part of the pure market economy but including for example the political system, the pattern of industrial relations, the welfare state, relevant parts of the education system and family and local community structure, may be pulled into a common *Gestalt* compatible with and contributing to the form of the economy.

Welfare regime theory and governance theory are examples of single-institution theories. They direct our attention, respectively, at forms of income maintenance outside the labour market, and at key institutions in rule formulation and enforcement within the economy. *Régulationiste* forms of governance theory go further and link governance to social systems of production (Boyer and Hollingsworth); or may make even larger claims about, for example, the implications of economic regime for family structure. Whately's model similarly extends further than governance of the economy to include major elements of its structure, and like *régulation* theory, observes links to the family and other ostensibly non-economic institutions.

Creators of single-institution models may try to increase their scope by developing hypotheses about links between the core institution and others. If theorists go beyond this point, and build the hypothesized links into the model, they turn themselves into general institutional theorists. For example, the point of origin of the Hall and Soskice model was a highly specific theory about forms of labour-market regulation, subsequently extended to all other elements of the economy and making certain claims about the polity too (Soskice 1990). Multi-institutional theories of this kind are potentially very powerful explanatory devices, if they can demonstrate how the inter-institutional links which they require are forged. They face three problems: the question of agency; identification of the logic of coherence; and the possibility of functional equivalents. Together these present severe

challenges to ambitious theory builders. As Scharpf (1997: 29–30) points out, social scientists usually lack the knowledge of enough variables to construct full explanations and predictions; it is therefore better that we work with small and medium-sized mechanisms that render things plausible, rather than general theories.

The question of agency. Apart from the limiting cases of societies which have been centrally and effectively designed by very powerful rulers with a taste for institutional homogeneity, a theory of macro-societal coherence requires assumptions of evolutionary functionalism. As in biological evolution, the exigencies of the struggle for survival can be considered to favour certain social forms over others. But this begs certain questions. First, biological evolutionary theory, similarly to economic theory, depends on very large numbers – verging on infinity – of individual agents seeking to maximize their chances. Those which survive will be those which happen to have found successful formulae. But when the universe of study is nation states undergoing advanced industrialization and post-industrialism, we have nothing like a number bordering on infinity. Not only do we have just a few examples, but these are not discrete, individual examples; they are bound together within an overall system, related to each other by comparative advantage, interdependence, and also combinations of economic and politico-military dependence (Wallerstein 1974–1989). These relations may themselves be outcomes of historical accident or conquest unrelated to the issue of economic performance. National economic history does not provide us with a universe resembling that of biological evolution. We have no idea where the forms of capitalist economy known to us stand on a continuum of an infinity of possibilities (Sabel/Zeitlin 1997).

The problematic identification of the logic of coherence. Even if the problem of the agency of coherence is solved, we cannot be sure what coherence across institutional fields means, because there are two totally opposed possibilities: similarity and complementarity.⁵ The idea of *Wahlverwandschaft* is often used to describe the process whereby institutions find some kind of

5 There are grounds for confusion in the fact that economic theory uses the term “complementary goods” to refer to two commodities, where a drop in the price of one leads to a rise in demand for the other. Aoki (1994) has extended this usage into the institutional sphere, to refer to institutions, the enhancement of one of which will assist provision of the other. This takes us very far from the everyday use of “complementary”, which implies that one item *makes up for the deficiencies* of the other. I here use complementary in this latter sense.

fit together. But such a fit combines elements of sympathy and contrast with little *a priori* guide as to which of these opposed principles applies at any one point. The logic of similarity argues that institutions with similar properties will be found together; that of complementarity that those with balancing, opposed properties will do so. The idea of *Wahlverwandschaften* certainly has its place within research in this field, as it helps us reconstruct the ways in which institutions acquire internal coherence (Powell/DiMaggio 1991: 63–82). As Hall and Soskice put it (2001a: 17–21), particular institutions can develop similar capacities in neighbouring spheres, such as corporate governance, vocational training, and collective bargaining. Similarly, the political system should function like a market, with a large number of actors pursuing their goals in a system which achieves balance through the sheer number of transactions and the incapacity of any one group to dominate. This is the model of pluralism embodied in US political theory and regarded as replicating in the polity the conditions of the market economy. It is not only analogous to the economic system, but it helps to sustain the market economy by preventing accumulations of political power.

The logic of complementarity on the other hand argues that institutions outside the market should operate to offset its potential malfunctions: the state should provide strong, uncompromised support for free-market institutions, keeping at bay sectional demands for special interventions – centralized strength and lack of compromise being characteristics opposite to those of pluralism. A family pattern complementary to a free-market economy might be one which provides resources of emotional support and maintenance of the worker to offset the rigours and insecurities of the labour market (e.g. Parsons/Bales 1955).

Theories of similarity are likely to reflect a model of societies as having been shaped by more or less conscious design, at least of the fictional social contract kind, as one might expect powerful shaping forces to seek some degree of homogeneity in the structures they produce. Theories of complementarity however reflect a strong functionalist logic, as they assume that evolutionary survival has privileged those social forms in which different institutions operate together in a way which balances the whole.

Examples of both approaches can be found in the literature. For example, there is widespread agreement among economic historians that the common law system of Anglophone countries was more favourable to the growth of the free-market economy than the civil codes of most of continental Europe (North 1990: 96–97). This is an example of similarity: the common law approach does not permit a central authority to frame an *a priori* comprehen-

sive code, but it evolves gradually in synchrony with, and in the same manner as, developments in the market economy itself. Possession of a common law tradition and being Anglophone have a virtual one-to-one correspondence, as both derive from having been part of the British Empire. However, when it comes to political institutions where Anglophone countries (or at least the only two which are systematically studied in the comparative literature, the UK and the USA) differ sharply, observers find themselves drawn towards contractarian or functionalist approaches depending on the country they are regarding as paradigmatic. Those focusing on the USA draw attention to the similarities between the mode of operation of the highly fragmented, strongly decentralized political system and the market economy. Those focusing on the UK stress how the strongly majoritarian and centralized character of its politics reduces the role of lobbies and pressure groups, enabling government to maintain the rules necessary to a market economy (Wood 2001: 254–256).⁶

There is a danger that theory-builders will move between opposite logics as they choose, presenting an overall account which looks plausible but which is not vulnerable to counter-factual test. This usually happens because they construct their models by working from a small number of empirical cases which they regard as paradigmatic, and embed its characteristics, which will contain a mass of similarities, complementarities and mere accidents, into the theoretical type. But, as Weber (1907 [1981]) argued, a type should be developed as a “one-sided accentuation” of logically implied characteristics, representing that it is the imposition of a single rationale, from which of course it is fully expected that empirical cases will diverge.⁷ This does not permit mixing the logics of similarity and complementarity.

Theory can be permitted to combine contrasting rationales if it posits either a central group of actors who can be considered to have skilfully fashioned major elements of the society after their interests, or a compromise between identified major actors engaged in power struggle. But the more actor-centred a theory is, the more it will postpone the search for such links

6 Drago (1998) has demonstrated how this quality of aloofness from organized interests applied even more strongly to the Chilean dictatorship of Augusto Pinochet, a regime which introduced a free-market level playing field because, having liquidated all opponents, it did not have to pay any attention to special lobbies on behalf of particular producer groups.

7 Weber himself, and most scholars who use ideal types do not try to produce models of entire social formations; that is rather the goal of functionalists, Marxists and some other kinds of totalizing theory.

to its empirical application rather than its initial formulation. For example, it is possible to show how South African and Northern Irish capitalism took advantage respectively of racial and religious segregation to segment and maintain dominance over the labour force, even though such segregation in itself contradicts market principles – a case of complementarities rather than *Wahlverwandschaften*. It was however an error to move from that observation to the thesis that segregation was functionally *necessary* to capitalism – as South African and Irish Marxists used to do. Capitalists were certainly able to *make use* of racial and religious discrimination, but this was the result of skilful action, not system requirements. And eventually they were able to shed their dependence on these forms of labour control when their negative features outweighed their (for employers) positive ones.

We should notice some implications of the different conceptions of types for the issue of endogenous diversity. This will mainly be important when we turn from models to cases, but the issue exists already at the level of types and models themselves. If a theory is constructed according to evolutionary functionalist principles, it will produce models embodying heavily determined path dependences. If however it is based on actor-centred assumptions, whether of a single dominant interest or of social compromise, it contains within itself the possibility that the identity of dominant actors or parties to the compromise may change. This may take place within the polity or some other sphere of society, for reasons exogenous to the logic of economic performance, and may thus disrupt the economy's path dependence. An important recent example would be the implications for labour markets in many nation states of autonomous changes in women's expectations.

Models which incorporate social compromises are likely to exhibit a further source of prior diversity, in that a compromise will necessarily embody certain contradictory elements. These may produce complementarities of the kind discussed above. For example, the compromise between capitalist and religious elites in most European countries in the late 19th and early 20th centuries left the family with certain guarantees of autonomy from capitalism and therefore enabled it to survive as a source of certain kinds of stability and non-market collective goods, from which the capitalist economy may have subsequently benefited, though it could not itself have created it (Crouch 1999). But compromises may simply result in certain contradictory components being left "lying around", possibly but not necessarily becoming forms of serendipitous redundant capacity (Streeck 1997: 205 ff.).

The possibility of functional equivalents. Functional equivalents, alternative ways of producing similar outcomes, can heavily offset the determinism and reliability of the *Gestalt* which theorists assume (Regini 1996; Kristensen 1994; Whitley: 1997: 10–11). As Scharpf puts much the same point:

institutions ... cannot influence choices and outcomes in a deterministic sense. Institutionalized rules, even if they are completely effective, will rarely prescribe one and only one course of action. Instead, by proscribing some and permitting other actions, they will define repertoires of more or less acceptable courses of action that will leave considerable scope for the strategic and tactical choices of purposeful actors. (1997: 42)

Instead, he argues, we should start with the institutional explanation, moving beyond it and losing its parsimony when explanation requires.

For example, some institutionalists have argued that certain characteristics of vocational training systems (mainly those found in Germany) are more or less necessary for the successful conduct of certain industries, for example machinery (Finegold/Soskice 1988). Regini (1996) however has demonstrated how the Italian machinery industry found quite different but effective solutions to the problem. Similarly, Hall and Soskice (2001a) claim that CMEs cannot make use of inter-firm movements of skilled personnel, while firms in LMEs find it difficult to retain staff for long periods. However, Germany exhibits occupational rather than organizational labour markets: its vocational training system publicly certifies skills, facilitating skilled workers in moving between firms (Marsden 1999). Meanwhile, some of the leaders of large-scale innovation among US firms have developed systems of internal careers, non-transferable pensions and share options to retain key staff.

1.3 Approaches to Analysis: Conclusions

It follows from the above that models of capitalism (or any other institution) are more likely to be favourable to an action-centred approach, the larger the number of types they identify and the smaller their institutional range, that is, those in the bottom right quadrant of Figure 1. Theories which identify a higher number of types are naturally more likely to produce analyses which see more than one model at work in a given empirical case, and therefore to envisage the possibility of creative actors combining and recombining elements of these models as they confront new challenges. As for the

second dimension, the more ambitious that theories are in their institutional scope, the more they require functionalist assumptions, and these are inimical to actor-centredness.

However, Hall and Soskice (2001a), who have been used here as the main exemplar of dualist and multi-functional theory, claim very prominently that their theory is “firm-centred”, and therefore presumably actor-centred. They claim to construct their model in terms of the possibilities facing an individual firm within the institution set of a given type of economy.⁸ Nevertheless, they see firms as totally trapped within the institutional resources of their nation state. Even if one grants that this is simply a theory which cannot be applied to transnational firms, there remains a puzzle: if successful firms are entrepreneurial and profit-maximizing, should they not be expected to try to change elements of their national context that inhibit them, or to seek to construct through other means institutions which their nation state does not provide? This firm-centred theory has no place for the entrepreneurial firm; firms are passive “institution-takers” in the same way that the firms of neo-classical theory are price-takers (e.g. Casper 2001). As Scharpf puts it (1997: 46), in addition to the formal rules of game theory, the study of policy – which I would argue is a closely related field to that of entrepreneurship – needs “anarchic fields with minimal institutions”.

The centrality of the nation state in this and many other theories of capitalist diversity is also problematic. At one level the case is well made. Very large elements of governance do operate at the level of the nation state, as states have been the main sources of law, and most associations and organizations target themselves at them. Given that markets are framed by law, of the modes of governance usually discussed in governance theory, the state itself (obviously), markets, and various levels of associations are all heavily defined at national level, while community and informal association exist at a lower level. There are also of course methodological advantages in being able to treat nation states as discrete units of analysis. Theorists of the diversity of capitalism are therefore eager to play down the implications of globalization, and contest the naive assumptions of much other literature that globalization reduces the significance of national differences (Hall/Soskice 2001a: 54–60; Whitley 1999: ch. 5; Hirst/Thompson 1997).

8 They take for granted an Anglo-American concept of a firm capable of being an unproblematic unitary actor – a model which does not easily transfer to, say, East Asian economies (Whitley 1999: 32).

However, one can fully accept all these arguments without accepting the implicit conclusion that the nation state serves as a hermetically sealed container for organizations. This seems particularly true of international corporations, which can transcend national systems and construct their own mechanisms (Grant 1997); but even firms which are nationally owned and operate primarily within one nation state should not be assumed to be without access to knowledge, links and practices existing beyond the borders. Of the modes of governance, corporate hierarchy seems the one least plausibly analyzed at a solely national level. Theories which are more modest in the extent of their institutional claims are more able to transcend the nation state, because they are claiming less about an ensemble of institutions. Thus Hollingsworth and Boyer (1997a: 4) are explicit that their scheme can also be used at sub-national and transnational levels (see also Coleman 1997).

Those institutionalists who are closest to economic theory define institutions as sets of rules which actors frame and with which they agree to comply in order to solve the Hobbesian problem (Knight 1992; North 1990). Such approaches are more actor-centred than those of functionalists, but only within limits. They derive strictly from social contract theory, and although contractarians always insist that they use the contract only as an heuristic device, their modelling of human action always carries with it ideas of clarity of purpose which are compatible only with a real, historical contract. If theory remains guided by this approach it will have difficulty in dealing with the informal norms and understandings which are important to real-life institutions (Scharpf 1997: 38), and in treating institutions as historical accretions, built up non-strategically by masses of different actors, by no means necessarily acting in concert with each other, but all partly constrained by the institutional structures which they inherit and which they in turn try to adjust. It is this balance between the constraints of probably incoherent institutions and the strivings of actors which is necessary to actor-centred institutionalism.

A focus on governance or rule-making also assumes that purposive human action rather than functional adequacy lies behind the sources of difference. This can then lead straight to acceptance of the contractarian frame of reference, but social compromises often take the form of permitting contradictions to rest unchallenged, differing from the all-considered positive-sum deal of social contracts. Approaches which acknowledge this are more likely to accept an accumulating chaos of structures in empirical cases, though this need not prevent them from producing theoretical schemes which rationalize and schematize certain typical outcomes of compromise.

2 From Models to Cases

The differences which have been identified among neo-institutionalist theories clearly have implications for how they relate theoretical models and empirical cases. There are broadly two ways of doing this: the labelling and the analytical methods. The two approaches are analogous to the two different forms of categorization found on bottles of mineral water: water is labelled as either still or sparkling – the water “is”, unambiguously, one or other of these types; and the detailed chemical analysis of the elements and compounds, traces of which can be found in the water – the water “contains” these chemicals.

The neo-institutionalist researcher following the former strategy inspects the characteristics of an empirical case and decides which of a limited number of theoretical models it most closely resembles. The case is then considered to be an example of that model and labelled accordingly, all features of it which do not fit being considered as noise and disregarded. In defence of such procedures Hollingsworth (1997: 268) claims that, even if an individual society has more than one social system of production, one will dominate. This is possibly true, but it should remain an hypothesis, not an *a priori* methodological assumption.

The researcher following the analytical approach considers to what extent traces of each of a series of models can be found within the case; there may be no conclusion as to which form it most closely corresponds, or even if there is, that information remains framed in the context of the wider knowledge of its attributes.

Now, theories in the top left-hand quadrant of Figure 1 are most likely to be associated with the labelling approach: labelling works best when there is only a limited number of models to which cases can be assigned; a multi-institutional approach becomes highly complicated if it has to be used analytically rather than for labelling. Conversely, the analytical method is most likely to be found among theories in the bottom right quadrant. These can best demonstrate their richness when showing how complex an individual case can be, and for that require a large number of models, but therefore are only really feasible when a very limited number of institutions is being considered.

Each form of categorization has its advantages and limits. The strongest point of the labelling approach is its clarity. The designation of still or sparkling is always far more prominent on the water bottle than the detailed chemical analysis, and it is the only information in which most consumers

are interested. Likewise, policy makers, investors and other users of social research into forms of capitalism probably want to know simply “is this economy like the USA or like Germany?” The labelling model is also of value when measuring instruments are crude. We do not have in the social sciences finely tuned ways of measuring how much of a particular element is to be found in something as complex as a national economy; we might however be able to say, broadly, what an economy is more or less “like” – in other words, which simple model it most resembles.

Further – and this has been fundamental in turning many researchers towards a labelling approach – research strategies of this kind can apply reasonably rigorous statistical tests to data concerning a small number of cases (the small n problem in macro-comparative research). This has been particularly important in work on comparative capitalism. Is unemployment higher in liberal, conservative or social-democratic welfare states? Are exports higher in liberal or coordinated market economies? Chi-squared and other simple tests can be used to answer such questions among the very small n of all-OECD countries, provided cases can be seen as examples of models, and provided there is a very limited number of categories. This point also enables us to understand the reluctance of researchers to accept hybrid cases, otherwise the obvious bolt hole for those wishing to reconcile labelling and analysis. The Dutch and British welfare states may well be mixed examples of, respectively, continental and social-democratic, and liberal and social-democratic types. But if the researcher is trying to apply a chi-squared test they have to be put in one or another box or be excluded, reducing n . Hybrid cases quickly become treated as having a dominant feature plus a lot of noise, which is ignored.

The disadvantages of this approach include obviously its crudeness, but also – and this is our fundamental concern – its incapacity to help us confront scope for change and innovation. Let us assume an actor-centred approach with knowledge being problematic for the actors. They will have easier access to knowledge which already exists in practical form close to them than to that which is remotely or only theoretically available. “Closeness” here means principally institutional closeness: the capacity of the actors to have access to the institution in which the relevant knowledge is embedded. The more heterogeneous the context within which actors operate, the more opportunity they will have of encountering practical knowledge which they have not used before in the immediate context, but which is part of the more general repertoire which is relatively accessible to them. This leads to the hypothesis: *that institutional heterogeneity will facilitate inno-*

vation, both by presenting actors with alternative strategies when existing paths seem blocked and by making it possible for them to make new combinations among elements of various paths.

Labelling theories present actors with functionally integrated institutions of a pure model; they can innovate only within its predictable terms. An analytical theory, in contrast, presents actors with an empirical complexity made up of elements of a number of models, enabling them to use enterprise and combine these in new ways, making use of serendipitous redundancies embedded in empirical incongruencies. The two approaches present opposed logics of research. What is noise for the labeller becomes grist for the mill of explaining what actors can do for the analyst. A high degree of diversity within a case, a problem for labelling theory, becomes for an analytical theory a crucial independent variable for explaining innovative capacity.

The point can be illustrated with a further significant example. A labelling theory, such as the Varieties of Capitalism approach, is required to attribute the innovative capacity of the Californian economy in information technology to characteristics of the dominant LME model of which the US (and therefore the Californian) case is seen as the paradigm. Other characteristics of Californian economy and society which cannot be reduced to the idea of pure markets are ignored as noise. Among these are the role of immigrants within this sector, and the role of the US Defense Department in stimulating advanced science in southern California through both the aerospace and computer industries and the innovation of the Internet.

The reasons why communities of immigrants are often the repository of entrepreneurial skills has been well demonstrated by Granovetter (1973); the characteristics of immigrant communities there described cannot be reduced to the terms of the LME model. Further, immigrants, whose socialization and education has been largely completed outside their country of arrival, seriously challenge the assumption of hermetically sealed nation-state populations which, we have noted, is fundamental to this functionalist form of neo-institutionalism.⁹

The role of the Pentagon in the Californian economy is more widely recognized, but it is dealt with through a certain stylized narrative: Its support was essential to the establishment of the sector in its early stages, but as the

9 The fact that we are here talking about the Californian (possibly even southern Californian) economy rather than generalizing about the US one is a further demonstration of the dangers of a hermetic approach to nation states.

sector matured, so it moved on to a pure free-market model. The implication is that as the fully mature form of the sector emerges it is seen to be a pure market one, conforming to the model to which the US (Californian) economy is approximated, and therefore the earlier stage can be disregarded – becomes in effect so much noise.¹⁰ But, as Wordsworth remarked, “The child is the father to the man”. Just because a particular form of an industry existed at an early point does not make it less important. It does not mean that somehow, had actors thought about things more expertly, they would have seen that they did not need these early stages and would have gone straight to the pure market. Indeed, it is precisely at the early points of truly radical innovation that the pure market model seems to have been least present. It is notable that Hollingsworth, though generally in favour of seeing only one dominant model in each nation state, sees some possibilities of deviation from the dominant social system of production in the USA (1997: 294–295), and indeed attributes some important performance advantages to these. There is something wrong with theories which attribute to certain defined characteristics of an economy developments which historically did not come into existence through those characteristics.

These disadvantages of the labelling, or simplifying functionalist, approach become the advantages of the analytical one. Following this latter methodology, we would not try to discover to which pure type the Californian economy most approximates and then ignore everything else about it. Instead, the research question becomes: traces of which various models can we find within this economy? We would then note the existence of the strong Pentagon role (an element of state governance, following governance theory) as well as the role of immigrant communities (community governance), and also, importantly, immigrants as conduits for exogeneity and hence sheer diversity of choice of action paths other than those given by the local society alone. We would then give an account of the Californian economy which would explain its capacity for innovation in computers and information technology, not in terms of the hegemony of one particular model, but of a particular pattern of diversity of choices, alternative paths, and complementarities (in the full sense of the word) at the disposal of its entrepreneurial actors. The particular pattern is empirical, but, like the analysis on the side of the mineral water bottle, it is theoretically informed.

10 In reality even in maturity these sectors show considerable tendencies rather than pure market forms of governance.

This point has profound implications. The Varieties of Capitalism theory – like orthodox economics – must always propose a move towards pure markets and hence the elimination of incongruities – that is other elements of governance existing within a given economy – if that economy is to acquire capacity for radical innovation. The analytical approach would make the diametrically opposed suggestion that increased institutional diversity might provide actors with more possibilities. While in the case of an economy heavily characterized by, say, associational or state governance, this might imply recommendation of the acquisition of more free-market features; for an economy already close to this pole it would probably propose the opposite.

But the analytical approach also has its weaknesses. We rarely have in macro-sociology or political economy measuring instruments of the kind at the disposal of the chemist analyzing the mineral water. If we could say: “the Californian economy comprises x% pure market governance, y% basic state support, and z% immigrant community dynamic effects” – we would be saying something very significant. But we can only say: “The impact of immigrant communities may be important as catalysts for innovation ...” The analytical approach thus runs the risk of being wrong-footed as less “scientific” by an alternative presenting a false scientific precision. The appropriate response is to move to a more rigorous form of analysis. It will rarely have the statistical apparatus it needs, but can improve the scientific quality of its modelling, taking care to avoid lapsing into narrative empiricism. This can be achieved if scholars formulate abstract models, not only of institutional types on the lines discussed so far, but of how actors might set about innovating within those institutions. In doing this the starting assumption must remain the sheer difficulty of innovation: a central achievement of institutionalist approaches based on path dependence theory is to argue that institutions determine (though not perfectly) what actors do, even to the extent of deflecting them from what might be individually maximizing paths.

Elsewhere (Crouch/Farrell 2002) I have tried to formulate a number of ways how, within the framework of the path dependence model, actors might switch paths. Path dependence theory is based on the Polya urn model, which represents the reverse of pure probability theory. An actor draws balls of one of two colours from an urn. Whereas in probability theory the chances that a ball of a particular colour will be drawn in a particular round is in no way influenced by what happened in preceding rounds, in the Polya urn a new ball of the same colour is added to the urn every time that a

particular colour is drawn. The past directly affects future choices, and there are potentially infinite increasing returns to scale, in contrast with the assumption of diminishing returns fundamental to the equilibrium concepts of neo-classical theory. The contention is plausible in many social situations, in particular those where social actors face a learning curve and/or more or less deliberately construct institutions to embody and routinize the choices and behaviour patterns which they have found in the past to work best. Institutions convey strong first-mover advantages (Scharpf 1997: ch. 5). This is where theories of path dependence, therefore of institutional determinism and the structuring capacity of dominant models, and therefore of capitalist diversity start.

The problem which occurs when applying this approach to situations which eventually challenge existing paths is that it is unable to model the actor who notices that her current practices are no longer effective and is therefore motivated to search for new possibilities. In that sense, path dependence is not truly actor-centred. Its agents respond solely to mathematical stimuli. A properly scientific actor-centred approach must simultaneously accept the full force of what path dependence theory is telling us about the sheer difficulty of change in a context of increasing returns, and posit the potentially creative actor who, within these constraints, nevertheless finds a way out. Hall and Soskice (2001a: 11–12), explicitly building on Scharpf, accept the need for theory to allow actors (in their case firms) to use deliberation and reflection to deal with new or unfamiliar challenges. But this implies a need for a theory of how such responses to challenges are made, which requires a theory of how path dependence can be avoided. And for this, actors must be liberated from theoretical institutions which are based on strong functionalist assumptions.

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