

**European Political Economy:
Labor Out, State Back In, Firm to the Fore**

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Abstract

Much has changed in European political economy over the past thirty years, both in terms of the political economic realities and the scholarly explanations of those realities. National economic policies and policymaking have undergone major transformations, largely in response to the pressures of globalization and Europeanization. Such transformations have entailed significant alterations in the role of the state, the importance of business, and the power of labor. In light of these changes in the political economic realities, political economists have shifted their focus over time, first taking labor out of the equation, then bringing the state back in only to devalue it in light of globalization and Europeanization before putting the firm front and center. Only recently has the state been brought back in yet again while labor has made a comeback.

The Changing Nature and Study of European Political Economy

Had a latter day European Rip Van Winkle gone to sleep in 1978 only to have awakened in 2008, he would have found the European political economy barely recognizable. Having closed his eyes to the power of labor, strong state action, and the subordination of business to the needs of society, he would have opened them to the power of business, a much diminished state, and the subordination of labor to the needs of the market. Moreover, whereas he would have commenced his slumber surrounded by staunch believers in Marxian ideas about class conflict whose discourse centered around the fight between labor and capital, he would have ended it encircled by equally staunch believers in neo-liberal ideas whose discourse was all about free markets and global trade. Most immediately, however, he would have been hard put to buy himself a cup of coffee with the national coins in his pockets, given European Monetary Union, while the croissant he would have had with his coffee might have been from a French bakery, the sugar from a German beet grower, the orange juice from a Spanish orchard, the coffee cup from China, and the coffee itself from a well-known American chain, all thanks to the Single Market.

The political economic story behind this transformation begins in the late 1970s, with the policy responses to the economic crises of the period—in particular the extreme currency volatility following the end of the Bretton Woods System and the exponential increase in the competitive pressures in the capital and product markets linked to the two oil shocks. The responses to these crises produced major changes in the monetary, industrial, and labor policies of all West European countries over the course of the following decades. While the late 1970s and early 1980s were characterized primarily by the shifts in monetary policy from neo-Keynesian ‘pump-priming’ to monetarist austerity budgets, the mid 1980s saw the beginnings of the end of interventionist industrial policy and public ownership as states started deregulating business, privatizing public enterprise, and liberalizing financial markets. Changes in labor policy through deregulation of labor markets and decentralization of wage bargaining systems, by contrast, came at different junctures in different countries with differing effects. Last but

certainly not least, European integration, which took off in the mid 1980s, had the twin effects of building a European economic space—ever-deepening through the Single Market and the Single Currency and ever-widening through Enlargement—as it pushed an ever-increasing Europeanization of national economies.

Along with these changes in policies came changing ideas and discourse about the changing economic realities. In the late 1970s and early 1980s, the rise of neo-liberalism in particular offered a new set of ideas about the kinds of economic policies appropriate for capitalist systems: a free market based on competition and individualism, limited government intervention and a regulatory state, economic openness and free trade. By the late 1980s and early 1990s, the fall of communism had left no alternatives to capitalism, and East European countries embarked on their own conversion to capitalism, influenced by neo-liberal ideas as well as by the foreign multi-nationals investing in their countries and the EU accession demands for free and open markets underpinned by the *acquis communautaires*. In Western Europe across this entire time period, moreover, the internationalization of national economies and businesses was increasing in scope and intensity. But while discourse about the challenges of internationalization was widespread in the 1970s, it largely disappeared in the 1980s only to resurface with even greater resonance by the early 1990s, although now called globalization. The concerns about globalization, both in the 1970s and the early to mid 1990s, focused mainly on the rise of multi-national business as a harbinger of the decline of the nation-state. By the late 1990s and early 2000s, however, globalization's impact on labor and the welfare state had become the main worry, with 'off-shoring' the latest buzzword.

In response to these changes in the power and influence of the state, business, and labor in the face of globalization and Europeanization, scholarly attention has itself shifted over time. Political economists went from a major focus on labor in the 1970s, with corporatist analyses of the power of unions and their role in macroeconomic policymaking, to a renewed emphasis on the state in the 1980s, as it liberalized financial markets, privatized and deregulated business, and decentralized labor markets. State-centered analyses themselves, however, transmogrified into approaches that by the early 1990s denied the centrality of the state either directly, by charting its decline in the face of globalization and Europeanization, or indirectly, by disaggregating the state into its component parts, in particular through historical institutionalist accounts of the evolution of political economic institutions and practices. What is more, by the late 1990s and early 2000s, the state was totally eclipsed, displaced by business as the primary object of study in the firm-centered analyses of the 'varieties of capitalism' school. Most recently, however, the state has been brought back in yet again while labor has been making a comeback.

At the same time that the objects of inquiry in European political economy may have shifted from labor to state to firm, the focus of inquiry has expanded, growing in richness and complexity as the study of national economies has been joined by the study of an integrated regional European economy, of clusters of capitalist economies, of sectors, and of sub-national regional and local economies. Differences in how scholars approach the explanation of European political economy are also questions of analysis, interpretation, and methodology. The main analytic questions ask whether European countries are moving toward convergence or divergence, and whether the drivers of such change are the external pressures of globalization and Europeanization or the internal pressures of politics and economics. The interpretive

questions speak to whether the directions of change and/or their drivers are good or bad. The methodological questions address how to study European political economy.

The methodological answers can be roughly boiled down to the differing approaches of the four ‘new institutionalisms.’ These include the three older ones: rationalist, historical, and sociological (see Hall and Taylor 1996; Immergut 1998; Thelen 1999; Campbell 2004) and the latest one, ‘discursive institutionalism’ (see Schmidt 2002, Ch. 5, 2006a; see also Campbell and Pedersen 2001). Rationalist approaches have tended to develop institutionalist models of firm coordination or quantitative macro-statistical analyses of the impact of globalization. Historical institutionalist approaches have tended to describe the path dependent trajectories of state institutions or the incremental changes in labor practices. Sociological institutionalist approaches have tended to evoke the culturally-framed ideas and practices of government, business, or labor. And discursive institutionalist approaches have tended to detail the influence of ideas in neo-liberal policy change or of discourse in political leaders’ legitimization of economic reform.

The article proceeds by time periods, beginning with the late 1970s into the 1980s to discuss the decline of labor both as a powerful actor in European political economy and as the main object of inquiry. It then considers the early 1980s into the 1990s, when the state is brought back in as an autonomous actor only to fade from view as the disaggregating and weakening effects of its liberalizing actions make it appear in decline, especially in comparison to the forces of globalization and Europeanization. The article follows with the early 1990s into the 2000s, as the firm is put front and center not only by the convergence theorists of globalization but also by the divergence theorists of the ‘varieties of capitalism’ school. The article concludes with current trends, as both the state and labor are coming back into their own as objects of inquiry in tandem with business.

Taking Labor out

Labor was central to the study of European political economy in the 1970s and on into the 1980s, as corporatism became the main research programme of political economists. It faded as a major focus of mainstream political economy by the late 1980s. This reflected material realities, in particular the shift in balance of power from labor to capital, as well as theoretical developments, as corporatism seemed to explain fewer and fewer macro-level (national) interrelationships, even if meso (sectoral) and micro (firm) level relationships continued to attract attention (Cawson 1986; Schmitter 1989).

As a theory of political economy, corporatism was the European answer to the American pluralist theories of economic interest organization and representation that had predominated in the 1950s and 1960s. Against this, corporatist theories based themselves on the model of interest organization of the smaller European democracies such as the Netherlands, Sweden, Denmark, and Austria, with Germany as a more complicated case (see Katzenstein 1985; Lehmbruch and Schmitter 1982). In corporatist polities, organized interests remain central to the policy process, but the policymaking process is cooperative rather than competitive, and closed to all but certain ‘privileged’ interest groups, mainly business and labor, which participate with government not only in the formulation of policy but also in its implementation as "an integral part of administration" (Cawson 1986, p. 37; see also Schmitter and Lehmbruch 1979).

Just as pluralism had been the measure against which all countries were evaluated as to their ‘democratic’ potential in the 1950s and 1960s, so corporatism became the measure against which all national political economies were evaluated for their ‘democratic corporatist’ potential in the 1970s and 1980s. As such, those countries which lacked the prerequisites—including an ideology of social partnership, relatively centralized interest groups organized in peak associations which exercised power over a relatively compliant base, and bargaining between government and organized interests that was voluntary, informal, and continuous—were lower on the comparative scale than those which fulfilled the prerequisites. Leaving aside the most pointed contrast, with the United States, the less democratically corporatist countries included Britain, which had strong craft-based unions, adversarial business-labor relations, and voluntaristic negotiations which made corporatist agreements difficult to reach and almost impossible to sustain (Lehmbruch 1982); France, which had weak unions, adversarial business-labor relations, and state-imposed negotiations which obviated corporatism (Hayward 1986; Schmidt 1996); and Italy, which time and again seemed close to attaining corporatism, but which failed over and over again due to fragmented unions, weak employers’ associations, and a paralyzed state (Lange and Regini 1989; Ferrera and Gualmini 2004).

The problem for corporatist theory is that just as it was at its peak of popularity in the 1980s, corporatist reality was encountering more and more difficulties as wage-bargaining systems and cooperative labor-management relations broke down in more and more countries, including even the most ideal-typical of corporatist systems. The Netherlands was the first to go, with a period of almost total break-down in effective tripartite bargaining during the 1970s, although corporatism returned in the early 1980s, but reinstated on a new, more subordinate footing (Visser and Hemerijck 1997). By contrast, Sweden experienced the end of macro-level corporatism in the early 1980s, when the employers pulled out of the national centralized concertation process, although they continued in the sectoral (Pontusson and Swenson 1996; Blyth 2002). But equally significantly, whereas in the 1970s some could still hope that Britain or even France would develop corporatism, by the 1980s such hopes were dashed. This came first with a bang in Britain by Thatcher who smashed the unions in the early to mid 1980s and then with a whimper in France as the Socialist government failed to generate a German-style concertation system through laws creating direct management-worker dialogue and subsequent governments simply gave up on organizing centralized labor-management wage-negotiation (Howell 1992, 1995; see also Schmidt 2002, Ch. 2). In the cases of both Britain and France, the radical decentralization of wage-bargaining ensued.

It should be no wonder, then, that scholarly interest slowly drift away from corporatist theory, even if studies of labor relations continued. This shift was also understandable in a context in which the state had returned to center stage beginning in the 1980s, not only in scholarly theory but also in economic practice.

Bringing the State Back In

The state has also had its ups and downs in European political economy. After taking center stage up until the late sixties, it faded out as an object of study only to return with vigor in the late seventies and early eighties, to disappear again. This was not only the result of material events linked to the rise of globalization and Europeanization, which reduced the autonomy of

the state, but also an outgrowth of theoretical developments related to the rise of the ‘new institutionalisms,’ which disaggregated the state into its constituent institutional parts.

When Andrew Shonfield (1965) published his seminal work on capitalism, the three models he described—liberalism, typical of Britain; statism, typical of France, and corporatism, typical of Germany—were all largely defined by the state and its role in the economy. Beginning in the 1970s, this state-focused approach to European political economy was supplanted by corporatist approaches. By the late 1970s and early 1980s, however, as corporatism seemed to be breaking down in even the most ideal-typical of corporatist countries, the state came ‘back in’ as governments began increasingly taking decisions on their own, with or without the acquiescence or even participation of labor or business.

Importantly, governments that in the 1960s and 1970s may have sought to coordinate policymaking with labor and business began in the 1980s to act more autonomously in the face of crisis. But different countries took different paths even as they all sought to loosen labor markets, liberalize financial markets, and deregulate business (Schmidt 2002, Ch. 2). The UK was the first and certainly the most radically neo-liberal, as Prime Minister Margaret Thatcher, fueled by neo-liberal ideas that had developed in the 1970s (Hall 1993), abruptly turned to monetarism, brutally opened business to competition, and broke the back of labor (Gamble 1985; King and Wood 1999). France, by comparison, experienced the most extreme shifts in reform initiatives, going from a massive program of nationalization and industrial restructuring by a Socialist government in the early 1980s to a major program of privatization in the mid-1980s by a newly neo-liberal right-wing government under Prime Minister Jacques Chirac (Hall 1986; Schmidt 1996). Germany, Sweden, and Italy, by contrast, experienced comparatively little change in the 1980s, Germany and Sweden because their economic dynamism meant they didn’t need to reform, Italy because its state paralysis meant that it couldn’t reform, although it desperately needed to. All of these countries, however, engaged in significant reforms in the 1990s, as economic crisis spurred Sweden to join the EU, as the costs of unification plus the pressures of globalization pushed Germany to begin liberalizing reform efforts, and as the fall of the Berlin wall enabled the Italian state finally to shed its postwar paralysis (Scharpf and Schmidt 2000).

Even more dramatically, the fall of the Berlin Wall led to the economic transformation of Central and Eastern Europe (CEE), with the transition from command economies to capitalist economies. Here, rather than speaking of a renewal of autonomy, we would need to speak of a new role for the state. But unlike in Western Europe, where the state’s renewed autonomy beginning in the 1980s continued to be for the most part balanced out by reasonably strong non-state actors in business and labor, in Central and Eastern Europe the state’s transformation in the 1990s into a strong regulative power was not balanced out by non-state actors, as unions and business associations tended to be weak and fragmented. This entailed that market-making reforms in Eastern Europe often came without the market-correcting social policies found in the West (Bruszt 2002). But while privatization, deregulation, and liberalization became the watchwords across the CEEs, states proceeded in different ways at different paces. Some, like Poland, engendered a ‘big bang’ in political economic reform, liberalizing prices and shifting macroeconomic policy very quickly, while others were slower—some so slow, in fact, that they experienced an anti-democratic backlash, as in Bulgaria (Ekiert 2003; Aslund 2000).

Over this same time period, the EU got a new lease on life, as national leaders came to recognize that only together could they effectively respond to the economic crises that began in the 1970s. The EU's resurrection started with the European Monetary System in 1979, which was to diminish currency volatility while promoting convergence in European countries' monetary policies. This was followed by the Single Market Act in the mid 1980s, which led to tremendous state-promoted, business-oriented activity to get national firms ready for the '1992' completion of the Single Market, along with more concerted efforts regarding the harmonization and standardization of products (Egan 2001). It was followed by the Maastricht Treaty's agreement for European Monetary Union (EMU) in 1992, which was to underpin the single market with a single currency (Dyson 2002; Martin and Ross 2004). And it culminated (at least insofar as political economy is concerned) with Enlargement, as the EU exerted massive leverage—both passive, through its power of attraction, and active, through the requirements of the *acquis communautaires*—in Central and Eastern European countries in the transition from communism to capitalism (Vachudova 2005).

While European states were taking a leadership role in reorganizing national economies and building the EU, scholars were reassessing their own explanations of the European political economy. These were the earliest of the 'new institutionalists' who, concerned that the role of the state as an autonomous actor in the organization of the economy was being forgotten, sought to 'bring the state back in' (Evans et al. 1985). Significantly, the Europeanists among these scholars tended to focus on countries where the state was more active and in evidence in structuring economic relations, such as in France or Britain (Zysman 1983; Hall 1986) and the small European states (Katzenstein 1985). However, almost as soon as it began, the focus on the state *qua* state began to fade away, the result of two reinforcing developments, one in scholarly research itself, the other in material reality.

In scholarly research, the very scholars who had brought the state back in began to disaggregate it into its component parts. In their new 'historical institutionalist' approach, institutional actors are seen to be shaped by the path-dependent development of their institutions, understood as regularized practices (see Steinmo et al. 1992). The upshot this new approach in comparative political economy has not so much been that the state was thrown 'back out' as that instead of remaining in the foreground of political economic research as an autonomous actor it ended up in the background, significant mainly through the effects of its variegated institutional structures and practices.

The changing realities of national political economies in an increasingly Europeanizing region and internationalizing world also conspired to devalue the state as focus of research. But even more central to this was the fact that the state had engineered its own retreat, having divested itself of the very instruments that had ensured its autonomy. This came in the macroeconomic sphere through the turn to monetarism; in the microeconomic sphere through deregulation, privatization, and liberalization; and in the supranational sphere with the rise of international and regional trade organizations—most notably the European Union. Countries that were emblematic of state direction like France transformed themselves, with a *dirigiste* end to *dirigisme* as public ownership dropped precipitously, CEOs gained a tremendous amount of autonomy, and top state civil servants came to 'colonize business' (Schmidt 1996, 2002). Even

countries where the state intervened less, or at least less effectively, the case of the UK, significantly reduced the state's direct involvement by slashing state subsidies, and creating a regulatory state (Wood 2001; King and Wood 1999). Only in countries like Italy or Greece could one talk about an increase in state capacity, but this was largely due to greater incapacity in the past, and the role of the EU as a '*vincolo esterno*' (external constraint) (Featherstone 1998; Radaelli 2002).

The retreat of the state did not mean the end of the state, however, since deregulation signaled not an end to regulation, just a different kind of regulation (Vogel 1996). But the switch from state action to more independent public action nonetheless suggested to scholars at this time that the state remained little more than a regulator of markets, ensuring that it was no longer a central player in capitalism.

The Rise of Business and the Decline of the Nation-State?

The retreat of the state, combined with the rising importance of the international financial markets that fueled increasingly mobile capital, underpin the escalating attention to globalization beginning in the 1990s and peaking in the early 2000s (see Busch 2000). For many scholars, globalization signaled the rise of business and the decline of the nation-state (see Schmidt 1995). But how meteoritic the rise of business and how deep the decline of the state was the main focus of scholarly debate.

For some, whom we will call the convergence theorists of globalization, the demise of the nation-state was imminent, with multinationals having become so footloose and fancy-free that they could no longer be contained or controlled either by their countries of origin or those in which they invested. This echoed the discussions of the 1960s and early 1970s, in which multinationals were seen as escaping nation-state control, but which scholars quickly came to agree overestimated the power of multinationals and underestimated the ability of nation-states—home and host countries alike—to regain control through a wide range of constraints on doing business (Vernon 1971, 1985). Those predictions appeared more relevant by the 1990s. This is when convergence theorists argued that the exogenous pressures of globalization—through financial market internationalization and capital mobility fueled by government policies of liberalization, privatization, and deregulation—meant one thing alone: convergence to a neo-liberal model of capitalism, the demise of the state as a key actor in global capitalism, and the end of any significant differences between governments of the left and the right as both sought to liberalize, leading to a regulatory 'race to the bottom' (e.g., Cerny 1994; Strange 1996; see discussion in Schmidt 2002, Ch. 1).

But much as in the 1970s, the convergence theorists' arguments about the demise of the nation-state and the end of any differences among national capitalisms were exaggerated. They were countered by divergence theorists who argued that there were few signs of convergence, and that national diversity continued to matter (Berger and Dore 1996; Boyer and Drache 1996). This they demonstrated through studies of individual countries' differing political economic trajectories, whether that of Britain as 'globalization in one country' (Hirst and Thompson 2000), France as a country in which the liberalized state nevertheless continued to play an influential role (Schmidt 1996), Italy as a country in which industrial districts were the key to success (Locke 1995), or Germany in which the social market economy still predominated (Streeck

1997). But they also showed that deregulation in the financial markets produced different rules (Moran 1990; Vogel 1996); that tax policies remained highly differentiated (Steinmo 1993), without any necessary race to the bottom with regard to the welfare state (Swank 1998); and that governments of the left were largely still able to pursue their traditionally redistributive goals (Garrett 1998). Moreover, they provided evidence for continuing country-based differences in regulatory regimes (Lütz 1998a; Thatcher 1999; Coen and Héritier 2005), in industrial production systems (Hollingsworth, Schmitter, and Streeck 1994); in labor relations and training systems (Thelen 1993, 2001); and in local economies (Crouch, Le Galès, Trigilia, Voelzkow 2004). Finally, they revealed that evidence for such differences appeared not only in the economic statistics or in the institutional practices but also in the differing impact of neo-liberal ideas and the discourses of globalization in Britain and Ireland (Hall 1993; Hay 2001; Hay and Smith 2005) as opposed to those in Sweden and other Scandinavian countries (Blyth 2002; Campbell and Pedersen 2001; Campbell 2004) or France and Germany (Schmidt 2002, Ch. 6).

Whereas divergence theorists of globalization divide largely between those who argue for convergence and those who insist on divergence, theorists of Europeanization seem to opt for convergence AND divergence at the same time. This is because while Europeanization acts as a conduit for globalization, by pressing for greater openness in capital and product markets, it also serves as a shield against it, by reducing macroeconomic exposure to the vagaries of the currency markets and enhancing microeconomic economies of scale through the single market. Moreover, in exchange for state losses in autonomy and control are gains in shared state authority and joint control (Schmidt 2002, Ch. 1). Many of the very same above-named theorists who posit divergence in terms of globalization are much more circumspect with regard to Europeanization, seeing convergence and divergence at the same time in, say, the financial markets (Lütz 1998b) or telecommunications (Thatcher 1999). This stands to reason, of course, given the role of the EU in generating policies that all then must transpose and implement into national law. With European integration again, moreover, the role of ideas and discourse is important in demonstrating the development of EU policies, whether with regard to EMU (MacNamara 1998; Verdun 2000) or the Single Market (Fligstein and Mara-Drita 1996; Jabko 2006).

Putting the Firm Front and Center

Divergence theorists have ‘converged’ most recently around the Varieties of Capitalism (VOC) school, as proponents and critics alike share the conviction that there are different varieties of capitalism in Europe, although they differ on the number of varieties—two, three, four, or more; where to look for them—at national, sectoral, or subnational regional levels; which variables to emphasize—the firm, labor, or the state; and how to organize them.

The VOC school takes a ‘firm-centered’ approach to political economy with a binary division of capitalism into two main types, Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs). The only thing these divergence theorists have in common with the convergence theorists is the equally minimal role of the state and the subordination of labor. VOC theorists’ primary focus is how firms coordinate with their environment. In LME’s, the market coordinates interactions among socioeconomic actors whereas in CME’s, socioeconomic actors engage in non-market coordination (see Hall and Soskice 2001). The state, if considered at all, plays at most a supportive role in creating a positive regulatory environment.

Although this binary division of capitalism is highly seductive because of its parsimony, it has been the subject of many critiques, including the very basic one that a binary division into ideal-types tends to be too reductive, squeezing much too much into much too rigid a set of categories (see Crouch 2005). Another problem is that the explanation is overly functionalist, with its emphasis on complementarity and positive feedback effects from coordination. This makes the system static, overly path-dependent, and unable to account for institutional change, in particular in light of the very real disaggregating forces coming from globalization pressures and neo-liberal policies (see Morgan et al. 2005; Crouch 2005; Schmidt 2002, Ch. 3; Hancké, Rhodes and Thatcher 2007). Moreover, VOC has great difficulty dealing with country cases that are treated as outliers because they don't fit well into either ideal-type (Schmidt 2002) and because they seem plagued by intra-system contradictions, misfits, and perverse spillovers (Molina and Rhodes 2007).

Scholars have responded in various ways to these problems. Some have attempted to counter the functionalist bias of the approach by positing open rather than closed systems, with multilayered reference frames and relatively autonomous components, as in the Netherlands (Becker 2006), or even different patterns of interdependence in different subsystems, as in Germany (Deeg 2005). Others have sought to inject more dynamism into the system by positing incremental change in the institutional components of loosely connected, historically evolving varieties of capitalism, which change at different rates in different ways through different processes, including layering in of new elements, conversion through reinterpretation, or even exhaustion (Thelen 2004; Streeck and Thelen 2005). In either case, however, the binary nature of VOC is undermined, as open systems or incremental evolution create hybrids and/or point to the disaggregation of the variety of capitalism.

Yet others have argued that rather than the binary division of capitalism into two basic varieties, there are at least three varieties of capitalism (Rhodes and Apeldoorn 1997; Coates 2000; Schmidt 2002), if not four (Boyer 2004; Whitley 2005), five (Amable 2004) or more, including national varieties (Crouch and Streeck 1997), sectoral varieties (Hollingsworth, Schmitter, and Streeck 1994), or regional and local varieties (Crouch, LeGalès, Trigilia, Voelzkow 2001). Importantly, even those who seemingly accept the binary division increasingly talk about mixed market economies (MMEs) with different logics of interaction (Molina and Rhodes 2007) or 'hybrids' in the cases of Eastern European countries as well as Germany, despite its status as the ideal of the ideal-type (Jackson 2003).

The differences among political economists on how many varieties of capitalism there are can be seen as depending mainly upon whether, as Colin Crouch puts it, one takes a 'labeling' approach to create country groupings for the purpose of theoretical comparison or an 'analyzing' approach concerned more with empirical realities (Crouch 2005). Another way of looking at it would be to differentiate between those who prefer parsimony, which makes for ideal-typical models and difficulties in applying to specific cases, and those who accept complexity, which may be more empirically valid but, naturally, suffers from its specificities (Deeg and Jackson 2006, p. 21).

Yet another way to explain the differences is to take note of how political economists preference a particular set of features in arriving at their ideal-typical models and country ideals.

Convergence theorists tend to take finance and globalization as defining factors—with all that that means in terms of the internationalizing trends in capital ownership, corporate governance, and the emphasis on profits—making for convergence to a neo-liberal model epitomized by the United States and the United Kingdom (e.g., Lane 2005). Divergence theorists in the VOC school, by contrast, take firms and their coordinating mechanisms as the defining factors—with all that that entails in terms the binary division of capitalism into LMEs, epitomized by the US, the UK, and Ireland, and CMEs, epitomized by Germany, the Scandinavian countries, the Netherlands, Austria, and Switzerland (i.e., Hall and Soskice 2001). Those countries that don't fit have been termed, variously 'mid-spectrum' economies (Hall and Soskice 2001) or 'mixed market economies' (MMEs) (Hall and Gingrich 2004), which will necessarily under-perform because they lack the complementarities (Amable 2003; Hall and Gingrich 2004). These misfits include France, Italy, and Spain, all three countries in which the role of the state has traditionally been more pronounced. For another set of divergence theorists, such countries represent a third variety of capitalism.

Bringing the State Back In Yet Again

In recent years, political economists across the spectrum have begun to bring the state back in yet again. This has been particularly the case for those who argue for a third variety of capitalism clustered around the cases of France, Italy, and Spain, but it lately includes historical institutionalists who in the 1990s had disaggregated the state and even VOC scholars. There are a whole range of scholars, however, who never abandoned the study of the state, but now show the ways in which changes in polity, policy, and politics continue to make public action key to understanding national political economies.

For divergence theorists who see at least three varieties of capitalism, state action is the defining feature that serves to differentiate liberal and coordinated market economies from the third variety—which I call 'state-influenced' market economies (SMEs) (see Schmidt 2006b). SMEs encompass countries in which the state played a distinctive role in the postwar period, intervening more, and differently, for better or for worse, than in LMEs and CMEs; and in which the state retains significant influence over business and labor, playing a more active, and different, role in the economy than the state in LMEs or CMEs, even subsequent to the state's retreat beginning in the mid-1980s. In Europe, country cases include France, which has moved from 'state capitalism' to 'state-enhanced' capitalism (Schmidt 2002) and Mediterranean countries like Italy, which until changes in the 1990s was seen as a 'dysfunctional state capitalism' (Della Sala 2004) or 'failed state capitalism' (Schmidt 2002). But Italy and Spain have also been classified as part of 'Latin capitalism' (Rhodes and Appeldoorn 1997) and Mediterranean 'Mixed Market Economies' (Molina and Rhodes 2007) along with Portugal and Greece.

In state-influenced market economies, the role of the state is theorized very differently from its role in LMEs and CMEs, such that we come up with three very different categories of states for the three varieties of capitalism. Unlike the 'liberal' state in LMEs, which is identifiable by its arms-length relations (Hall and Soskice 2001; Wood 2001; King and Wood 1999) or the 'enabling' state in CMEs which is typified by its coordinating and facilitating activities (Streeck 1997; Hall and Soskice 2001), the 'influencing' state in SMEs—although a pale shadow of its former interventionist self—is nonetheless exemplified by its capacity to

intervene where it sees fit, either ‘enhancing’ business and labor activity or ‘hindering’ it (see Schmidt 2002, 2006b).

If it were only state action that served as justification for the third variety of capitalism, then one might still be tempted to argue that all states intervene, some more, some less, and dismiss the claim that there is a third variety. But bringing the state back in is not just about recognizing the differential role of the state. It is that in SMEs, in which the state has long played an influential role, business interactions and labor relations also differ in character and in logic of coordination, leading to different mechanisms of adjustment from LMEs and CMEs. In the liberal market economy of Britain, adjustment is driven by the financial markets and led by autonomous firms acting unilaterally, with comparatively little input—whether positive or negative—from the state or labor. In the coordinated market economy of Germany, adjustment is led by firms and jointly negotiated cooperatively between business, labor, and the state. In the state-enhanced market economy of France, adjustment is firm-led in those domains where business now exercises autonomy—in business strategy, investment, production, and wage-bargaining—but adjustment is still state-driven in those domains where neither business nor labor can exercise leadership—in labor rules, pension systems, and the like—or where the state sees a need to reshape the general economic environment to promote competitiveness. In either case, the logic of interaction is one of hierarchical authority rather than joint-decision or unilateral action (Schmidt 2002, p. 144). A similar logic of adjustment can be found in Italy and Spain when applied to the sphere of industrial relations in particular (see Molina and Rhodes 2007), where ‘top-down conflict governance’ is very close to the logic of hierarchical authority noted above for France, once we add into the equation the conflictual politics that such hierarchical authority often generates.

But taking state action seriously means considering the distinctive role of the state not only in ‘state-influenced’ market economies—as a distinguishing feature—but also in liberal and coordinated market economies. This, however, requires going beyond the ‘labeling’ approach to an ‘analyzing’ one, and pushes us to consider state action in all its complexity, by deconstructing state action into its component parts in terms of policy, ‘polity,’ and politics (see Schmidt 2006c).

We have already covered much of this above, in the review of divergence theorists’ arguments about the differential impact of globalization and Europeanization beginning in the 1990s. But it is important to highlight developments in scholarship in the 2000s that draw attention to the continuing significance of the state even in countries where it has been assumed to be largely absent. In the UK, for example, the ‘steering state’ which has emerged from the regulatory reforms of Thatcher, Major, and Blair engages in much more public intervention than in the past (Moran 2003). In Sweden, moreover, where the state has always been more present, public institutions, imbued with trust by the public as a result of ‘collective memories,’ continue to be a key sustaining factor for the Swedish welfare state and the collective bargaining system (Rothstein 2005, Ch. 1, 7). Finally, in countries as diverse as the Netherlands, France, Britain, Germany, and the UK and in sectors as different as the digital economy and the global services market, scholars have shown that the state continues to structure markets in significant ways, developing new missions, and making critical choices that are the “product of power and politics, not just path-dependence and employer ‘coordination’” (Levy 2006, p. 26).

To be fair, VOC does not entirely neglect state action (e.g., Wood 2001; Thelen 2001; Martin and Thelen 2006), in particular with regard to responses to international challenges (e.g., Hall and Thelen 2006). Importantly, however, most VOC scholars still don't take the state-like role of the EU sufficiently into account. The role of the state in European varieties of capitalism cannot be fully explained without considering the ways in which national state action comes into play at the EU level, through the 'bottom-up' process of European integration by which national actors participate in EU policymaking, and the ways in which EU 'state' action comes into play at the national level, through the 'top-down' process of Europeanization, as member-states implement policies jointly decided in Brussels.

Labor's Comeback

During the same time that the state was being brought back in, labor was making a comeback. Already in the 1990s, in response to the convergence theorists' claims, some scholars insisted that the unions' decline was better explained by technological changes (Pontusson and Swenson (1996)), and that the unions had in any event declined significantly only in some countries (Goldin, Wallerstein, and Lange (1999)). Although France and Britain both radically decentralized their wage-bargaining systems, corporatism seemed reborn in a number of the least likely countries. In an LME like Ireland and even SMEs like Italy and Spain, social pacts became the order of the day (Ferrera and Gualmini 2004; Rhodes 1997; Royo 2002). Moreover, traditionally corporatist CMEs like the Netherlands and Denmark revised the old compromises and systems of coordination (Visser and Hemerijck 1997). The renewal of corporatism, moreover, came largely from employers' own need to maintain the cooperative labour relations essential to producing high-quality products on a just-in-time basis in tightly coupled production networks (Thelen and Kume 1999; Thelen 2001). Thus, rather than globalization leading toward convergence to a single neo-liberal, deregulated model of industrial relations, it has brought continuing if not increasing divergence. This means that labor remains a force to be reckoned with, albeit differently in the different varieties of capitalism.

The latest turn taken by globalization, moreover, with regard to the 'offshoring' of jobs to the far east and 'near-shoring' of jobs to Eastern Europe, is increasing the political salience of labor. Public responses, however, depend not so much on the amount of off-shoring *per se* as on how countries' work and welfare systems cushion its effects and on how the public has come to perceive globalization generally and off-shoring more specifically. Winners and losers vary with the state of the economy and type of work and welfare system. But national publics' perceptions of who is winning or losing are also influenced by national leaders' legitimizing discourses about globalization and Europeanization (Schmidt 2007).

CONCLUSION

European political economic scholarship, in summary, has moved from a focus on labor to the state to the firm and now back to a more balanced emphasis on all three. The questions today are contemporary versions of the ones that have bedeviled scholars throughout this period: Will globalization lead to convergence now, given that off-shoring represents a major challenge to production systems and labor regimes, even if the internationalization of financial markets alone did not produce the expected convergence? Can we still talk about national varieties of

capitalism in Europe, whether two, three, or more, not only because of the very real disaggregating trends as a result of the forces of globalization and even more of Europeanization, but also because these forces also have a tendency to create supranational sectoral or even subnational regional varieties of capitalism that challenge national varieties. And finally, isn't it time to bring welfare states into the mix? But if we do so, then it becomes all but impossible to stick with two, three, or even four varieties. Labeling may indeed have to give way to analyzing.

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