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## THEORIZING VARIETIES OF CAPITALISM: ECONOMICS AND THE FALLACY THAT “THERE IS NO ALTERNATIVE (TINA)”

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### ABSTRACT

The VoCs approach to capitalism has the potential to transform economics. It tacitly emphasizes the plasticity of economies, whereby their character and outcomes are significantly a matter of choice. This paper augments VoCs theory to include a distinction between varieties and varietals of capitalism. Drawing on biology, varieties correspond to species and varietals correspond to sub-species. The paper proposes an analytical framework that unifies VoCs theory. It adds a mesoeconomics that links macroeconomics and microeconomics. That mesoeconomics concerns the institutions, behavioral norms, rules and regulations, and policies that characterize the economy and influence its performance. The mesoeconomic structure is described using the metaphor of a box, the six sides of which correspond to the major dimensions of capitalist economies. The design of the box is the product of societal and political choices, which places politics at the center of VoCs analysis. Policy space and policy lock-in are important concerns as they impact the choice set. The fact that economies inevitably involve choice means there is an inescapable normative question regarding what type of capitalism society will have.

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# Theorizing varieties of capitalism: economics and the fallacy that “There is no alternative (TINA)”

## Abstract

The varieties of capitalism (VoCs) approach has the potential to transform economics. It implicitly emphasizes the plasticity of economies, whereby their character and outcomes are significantly a matter of choice. This paper augments VoCs theory to include a distinction between varieties and varietals of capitalism. Drawing on biology, varieties correspond to species and varietals correspond to sub-species. The paper proposes an analytical framework that unifies VoCs theory. It adds a mesoeconomics that links macroeconomics and microeconomics. That mesoeconomics concerns the institutions, behavioral norms, rules and regulations, and policies that characterize the economy and influence its performance. The mesoeconomic structure is described using the metaphor of a box, the six sides of which correspond to the major dimensions of capitalist economies. The design of the box is the product of societal and political choices, which places politics at the center of VoCs analysis. Policy space and policy lock-in are important concerns as they impact the choice set. The fact that economies inevitably involve choice means there is an inescapable normative question regarding what type of capitalism society will have.

*Keywords:* Varieties of capitalism, varietals of capitalism, mesoeconomics, globalization, policy space, policy lock-in

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## 1. Introduction: TINA versus varieties of capitalism

Margaret Thatcher often used the phrase “There is no alternative” to justify her agenda to remake the British economy in a Neoliberal image.<sup>1</sup> That phrase has become known as TINA and the thinking behind it has seeped into public understanding. The result has been a tacit straitjacket which has restrained economic policy for forty years. According to its logic there is not just no

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<sup>1</sup> The phrase was first used in a speech to the Conservative Women’s Conference, 21 May 1980, as “There is no real alternative”.

alternative to capitalism, there is no alternative to Neoliberal capitalism.<sup>2</sup>

In the last twenty years there has emerged a compelling new discourse under the banner of varieties of capitalism (VoCs).<sup>3</sup> That terminology was introduced by Hall and Soskice (2001) and its appealing common sense opens the possibility of breaking free of the TINA delusion. This paper critically explores the new discourse. It argues that the VoCs framing has achieved what four decades of heterodox economics research has been unable to accomplish: a magical combination of words that effortlessly lifts the spell of TINA.

The terminology has kicked open the door, but the advantage needs to be pressed. That advantage will fail absent a theoretically coherent and comprehensive analytical framework. This paper argues the existing VoCs discourse is still under-theorized. First, there is need to distinguish between “economic theory” and the “theory of VoCs”. Second, the theory of VoCs needs to distinguish between “varieties of capitalism” and “varietals of capitalism”. The latter are variations within a particular variety.

The paper proposes an alternative analytical framework rooted in the view that the economy is a socially constructed organization. That lens on the economy moves “choice” to the front and center of the VoCs discussion. In sharp contradiction of TINA, societies have choice regarding the VoC they want. That choice is subject to constraints, and an interesting feature is that past choices can constrain the current and future choice set via a process of policy lock-in and lock-out (Palley, 2017/18). That said, some space for choice will always be present. TINA

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<sup>2</sup> Neoliberalism is a political economic philosophy that consists of two claims, one political and the other economic. The political claim is that a free-market *laissez-faire* economy is necessary for the promotion and protection of individual liberty. The economic claim is that a free-market *laissez-faire* economy is the best way of delivering economic prosperity since it ensures economically efficient outcomes. Palley (2012, Chapter2) provides a fuller discussion of the history of neoliberalism and critiques thereof.

<sup>3</sup> In the rest of the essay VoCs refers to the plural (varieties) and VoC refers to the singular (a variety).

does a double injury. First, it blinds society to the existence of choice. Second, it smuggles in thinking and policies that lock-in the Neoliberal VoC.

## **2. TINA and mainstream economics**

The TINA construction of the economy draws importantly on mainstream economics. Absent that support it is doubtful TINA would have managed to gain and sustain the traction it has. The connection to mainstream economics is evident in multiple ways. First, it is reflected in the Washington Consensus doctrine of the 1990s, which still prevails even if its repeated failures have compelled proponents to tone down their advocacy. The Consensus was defined by Williamson (1990), and it constitutes the basis for the standard economic reform package for troubled economies advocated by the IMF, the World Bank, and the US Treasury Department.<sup>4</sup> The doctrine tacitly claims to provide an economic model for economies of all stripes, be they developed, emerging market, or developing economies.

Second, TINA thinking draws on core economic theory as described by the competitive general equilibrium (CGE) model (Arrow and Debreu, 1954). That theory posits an “ideal” economy which is used to benchmark economic analysis. Real world economies are interpreted via that ideal, but they are marked by “market imperfections” and “government policy failures”.<sup>5</sup> The important point is the ideal is viewed as universal and applying to all economies. Given that frame, mainstream economics explains VoCs in terms of pathologies which induce deviations

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<sup>4</sup> The Consensus consists of ten policies: fiscal discipline, elimination of subsidies, market determined positive real interest rates, tax reform that broadens the base with moderate marginal tax rates, competitive exchange rates, trade liberalization, liberalized inward foreign direct investment (FDI), privatization, deregulation, and legal secure property rights. Liberalized inward FDI has often been interpreted as capital account liberalization. Williamson disagreed with the latter.

<sup>5</sup> Market imperfections include imperfect competition, monopoly and oligopoly, natural monopoly, information asymmetries, externalities, and failures in the provision of public goods. Government policy failures include bureaucratic failure, regulatory capture and rent seeking, and policy implementation failure.

from the ideal, combined with differences in natural endowments and differences in stage of development as measured by the extent of accumulated capital and technological know-how.<sup>6</sup>

Third, TINA thinking draws on orthodox economics' meta-identification with 19<sup>th</sup> century forcefield physics (Mirowski, 1988). That meta-identification is visible in the constructs of indifference curves in utility theory, isoquants in production theory, and the notion of market equilibrium as a gravitation point. The natural world of physics is given and there is no choice. Modelling economics on physics has inclined mainstream economics to view the economic system through a similar "no choice" lens, though market failure and government failure introduce a wedge in which human action matters.

Analytically, the notion of an ideal economy promotes cookie-cutter TINA policy thinking, exemplified by the Washington Consensus. It also promotes the notion of convergence among economies. Above all, it promotes mechanistic thinking that is eloquently captured by Solow:

"The best and the brightest in the profession proceed as if economics is the physics of society. There is a single universally valid model. It only needs to be applied. You could drop a modern economist from a time machine.... At any time, in any place, along with his or her personal computer; he or she could set up in business without even bothering to ask what time and which place. (Solow, R.S., 1985, p.330)."

### **3. A brief literature review of VoCs theory**

In Molière's play *Le Bourgeois Gentilhomme*, Monsieur Jourdain learns to his surprise and pleasure that he has been speaking "prose" all along. Monsieur Jourdain's experience has lessons

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<sup>6</sup> The attraction to the notion of an ideal economy has deep roots in the history of economic thought, going back to the late 19<sup>th</sup> century *Methodenstreit* controversy between the German historical and Anglo-Saxon schools which was won by the latter. The German historical school emphasized the economic importance of local institutions, laws, customs, norms, and context (i.e., a form of VoCs analysis). The Anglo-Saxon school emphasized axiomatic reasoning which has led to the construct of an ideal economy rooted in its axioms.

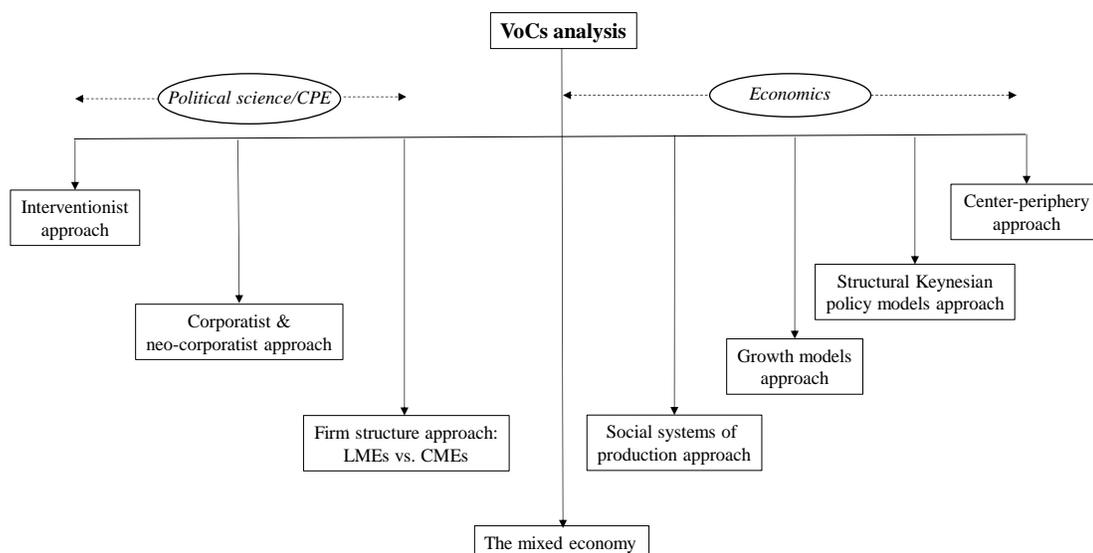
for many economists who may be unaware that they have been talking about VoCs all along.

This section provides a brief literature review that helps frame the subsequent argument. Unfortunately, the literature is fragmented as it comes from different disciplines that are significantly siloed owing to the character of academia.<sup>7</sup> Figure 1 provides a taxonomy of the existing approaches to VoC analysis. The figure shows that analysis has principally developed within the political science sub-discipline of comparative political economy (CPE) and economics. Reflecting differences in disciplinary focus, the two sides of Figure 1 tend to emphasize different features. Political science emphasizes the role of the state as an economic actor, and it also views the economy through the lens of “governance”. Economics focuses on the structure of the economy, economic policy, macroeconomic performance, and income distribution. That said, there are obviously significant overlaps as the state and policy go hand in hand.

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<sup>7</sup> Given the scale of the literature and the fact that it is significantly outside my own discipline of economics, I engage this endeavor with trepidation. The justification is that “outside” eyes can sometimes yield new insights. I apologize in advance for omissions.

Figure 1. A taxonomy of prior contributions to VoCs analysis.



### 3.a The interventionist approach

Borrowing from Hall and Soskice (2001), the first column is labelled the interventionist approach which is associated with the work of Shonfield (1965). The success of post-World War II (WWII) capitalism, referred to as “modern capitalism”, is attributed to a new interventionist state. Part of that intervention is Keynesian demand management policy, but it is also much more. Planning and an array of supply management interventions that shape the composition of output, the investment share, and the distribution of income are argued to be critical.

France is identified as the poster child of success, while the UK is a disappointment. In diagnosing that difference in outcomes Shonfield (1965) emphasizes the role of the French statist tradition which provided a bureaucracy and a culture enabling the interventionist state. That is contrasted with the British political tradition which lacked those features and even inclined against them. That perspective and line of argument is absent in economics, and it opens the door

to CPE. Shonfield's analysis focused on post-WWII Western Europe and identified the state as a key actor for modernizing laggard economies. That reasoning carries over to developing economies in which the state is a key actor for helping late industrializers catch-up (Amsden, 1989; Wade, 1990).<sup>8</sup>

### ***3.b Corporatist and the neo-corporatist approach***

The second column is labelled the corporatist and neo-corporatist approach. Corporatism is an economic governance paradigm that was widespread in the fifty years from 1920 to 1970.<sup>9</sup> It views the economy as consisting of three major actors: government, business, and labor. It advocates an economic governance structure in which business and labor form organized blocs, and then collaborate with government to shape economic outcomes. It is a form of centralized market governance and contrasts with decentralized market governance.

In the Neoliberal era (1980 – today) corporatism has been on the retreat politically and intellectually. However, corporatism still provides a theoretical pole that is relevant for traditional CPE VoCs discourse which emphasizes economic governance. Additionally, it can be argued corporatist residues survive. For instance, it can be argued corporatism is relevant to Esping-Andersen's (1990) trichotomization of welfare state capitalism consisting of liberal (Anglo-Saxon), social democratic (Nordic), and conservative (Continental Europe) regimes. The last tend to be associated with countries that have a corporatist political history. A connection can

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<sup>8</sup> An open question is the relationship between Shonfield's (1965) "interventionist state" and the "developmental state". Is the latter just an amplification of the former with application to developing economies? Or is it a qualitatively different phenomenon requiring separate classification? One possible way of thinking about that is the interventionist state operates in the center, whereas the developmental state operates in the periphery.

<sup>9</sup> It is often pejoratively associated with fascism, but it is better understood as being apolitical (Schmitter, 1974). Thus, there is social democratic corporatism which emphasizes worker-centered tripartism. There is also Christian Democratic corporatism that emerges out of Catholic teaching on the economy (Schasching, 1998). The latter advocates government, business, and labor come together to deliver a "just" economy that delivers work which is consistent with "human dignity".

also be drawn to Hall and Soskice's (2001) framework of liberal market economies versus coordinated market economies which is discussed next. Some CME countries have a corporatist political history.

The neo-corporatist approach (see Berger, 1982) emerged in the late 1970s and 1980s. It was spurred by the relative macroeconomic success of Germany and other Northern European economies, both in maintaining growth and containing inflation during the difficult stagflation decade of the 1970s. In the neo-corporatist model economic success is explained through the lens of "coordination" which is an analytical refinement of the original corporatist argument. With the assistance and blessing of government, business and labor coordinate to deliver superior macroeconomic outcomes. Neo-corporatist coordination is argued to have been particularly successful regarding wage-setting (see Calmfors and Driffill, 1988). The argument is coordinated wage bargaining avoids the prisoner's dilemma problem whereby individual unions have an incentive to leapfrog each other with excessive wage demands, thereby generating macroeconomically sub-optimal outcomes. An essential feature of the neo-corporatist approach is a strong dense union movement that can speak on behalf of labor.

The neo-corporatist approach was fashionable in the 1970s and 1980s, when inflation was a dominant concern. However, with the political and intellectual triumph of Neoliberalism and the fading of inflation concerns, political advocacy of and analytical interest in neo-corporatism has also faded.

### ***3.c The firm structure approach: LMEs vs. CMEs***

The third column is labelled the firm structure approach and it represents the approach of Hall and Soskice (2001) who coined the term VoCs. They make the firm and its employment relations the fulcrum of VoCs analysis:

“We want to bring firms back into the center of the analysis of comparative capitalism and, without neglecting trade unions, highlight the role of business associations as key collective actors in the political economy (Hall and Soskice, 2001, p.4).”

The central analytic construct is a distinction between liberal market economies (LMEs) and coordinated market economies (CMEs), which are distinguished by the way in which firms coordinate with and relate to each other and other economic actors.

“Broadly speaking, liberal market economies are distinguishable from coordinated market economies by the extent to which firms rely on market mechanisms to coordinate their endeavors as opposed to forms of strategic interaction supported by non-market institutions (Hall and Soskice, 2001, p.33).”

LMEs engage via arms-length market transaction, with firms being hierarchically organized and having the goal of shareholder value maximization. CMEs engage with other actors more in the spirit of partnership and via implicit long-term contracts.<sup>10</sup> The two modes of coordination are supported by different regulatory regimes, and they co-exist because the two modes have different comparative advantage rooted in the type of goods and services produced. Consequently, the modes produce different patterns of specialization of production.

The firm structure approach represents a major change of direction in CPE theory. It moves away from a focus on the state to a focus on the firm, though the state remains visibly present through its influence on the legal system and labor market policy. The approach also rests on microeconomic logic rather than macroeconomic logic, though the goal is still to explain macroeconomic performance differences.

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<sup>10</sup> Hall and Soskice (2001) focus on four dimensions in which LMEs and CMEs are distinct: industrial relations, education and vocational training, corporate governance, and inter-firm relations.

The firm is identified as the central institution of capitalism, and Hall and Soskice use the Coase (1937) – Williamson (1975, 1985) theoretical paradigm to explain the existence and organization of firms. Their approach to employment relations is tacitly informed by the implicit contracts/handshake approach pioneered by Baily (1974) and Azariadis (1975). Within the firm, the focus is on firm governance, control, and decision making. That focus connects with the debate over the shareholder value maximization (SVM) paradigm which has been argued to undermine economic performance (see Lazonick and O’Sullivan, 2000). LME firms attend exclusively to shareholder interests and are dismissive of other stakeholders’ interests, whereas CMEs are more attentive to the latter.

Hall and Soskice’s (2001) firm structure approach is seminal in VoCs analysis, but it is subject to critique which helps identify where the analysis needs to go. A first set of critiques constitutes internal critique that examines specific claims. For instance, Akkermans et al. (2009) question the claim that LMEs are radically more innovative than CMEs. Another internal critique focuses on the adequacy of the distinction and whether it can encompass all country capitalisms. That has led to a proliferation of VoC types.<sup>11</sup> The big question is whether Hall and Soskice are too parsimonious with their two types, or whether their analysis is too one-dimensional (i.e., the firm), thereby compelling a proliferation of types to handle the multi-dimensional nature of capitalism? The latter is this author’s view.

A second critique is silence on capital - labor conflict and exploitation. That silence stems from adoption of a neoclassical theoretical framework. The neoclassical theory of the firm

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<sup>11</sup> For instance, Molina and Rhodes (2007) introduce the notion of “mixed market economies (MMEs)” to explain Italy and Spain, so the framework does not even work for Western Europe. Similarly, King (2007) introduces the notion of “liberal dependent post-communist capitalism (LDPC)” to characterize Central and Eastern European economies.

derives from the neoclassical exchange paradigm. The starting point is the assumption that economic activity is motivated by the possibility of mutually beneficial exchange. The Coase (1937) – Williamson (1975, 1985) approach to theorizing the firm identifies impediments to market exchange which the firm solves. The result is an economy of markets and firms in which the addition of hierarchically organized firms helps reap more of the potential benefits of exchange. However, that is just one theoretical perspective. The Marxist theory of the firm (Marglin, 1974; Bowles and Gintis, 1990) views the firm as an instrument of exploitation so that the economic process is about both mutually beneficial exchange and conflictive exploitation.<sup>12</sup> The co-existence of exchange and conflictive exploitation renders the economic process one of bargaining, which is inevitably characterized by power. That too is absent in Hall and Soskice's (2001) approach, despite power and its distribution being essential considerations in capitalism.

A third critique is the narrow microeconomic focus. The “LMEs versus CMEs” headline is broad and encompassing. However, upon excavation, the approach is purely microeconomic and centered on the firm, its employment relations, and its relations with supplier firms. That is insufficient to characterize capitalism. It is akin to looking at capitalism through a keyhole.

A fourth critique concerns the issue of destiny or choice. The general tenor of the argument is that CME VoCs are found rather than made in that they cannot be readily constructed by policy (though the analysis is sufficiently ambiguous to leave the door ajar). That said, the CME VoC can be undermined by policy. CMEs seem to exist because of choices made long ago for unknown reasons. The two forms can co-exist because the CME form confers benefits on certain types of industries, giving them institutional comparative advantage that enables survival.

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<sup>12</sup> Palley (1998a, 2018) provides a simple model showing how the logic of exploitation can generate productive inefficiency. Firms may choose methods of production and organization that yield a smaller economic product but a larger profit share, yielding higher a level of profit.

However, TINA lurks in the shadows as the LME form seems to be the natural order that competition inclines the economy toward. That is a consequence of Hall and Soskice's (2021) underlying Neoclassical theoretical perspective which renders LMEs the benchmark natural order.

That leads to a fifth and fundamental critique regarding taxonomy. Hall and Soskice argue the LME versus CME distinction is primitive, yet CMEs appear to be eroding. In this author's view that erosion is due to the Neoliberal economic system, as has also been argued by Baccaro and Howell (2017) regarding European industrial relations. In that case Neoliberalism should be identified as a variety of capitalism, which is the argument developed in Section 4 below.

### ***3.d The mixed economy***

Column four transitions from political science's contribution to VoCs analysis to that of economics, with the latter's contribution largely coming from heterodox economics. That is likely because of the TINA inclination of contemporary mainstream economics which impedes engagement with VoCs analysis.<sup>13</sup>

Column four is labelled the mixed economy, which was an analytical approach that was popular in the Keynesian era (1945 – 1980), especially in British discourse. Figure 2 illustrates how the mixed economy perspective can be fit into a VoCs perspective. Economies take the form of mixed economies or centrally planned economies. A mixed economy consists of a mix of privately owned and state-owned enterprises. Hall and Soskice's (2001) firm structure approach can then be inserted below that, reflecting alternative ways of organizing privately owned

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<sup>13</sup> Mainstream economics does recognize varieties of economic systems, which has the letter P in the JEL classification system. However, that field is substantially a historical leftover from the Cold War era when economists studied central planning and there was also interest in collectivist economic organizations.

enterprises. The state-owned sector can be divided into nationalized industries and publicly provided goods and services. The latter includes such things as defense services, transportation networks, and welfare state services.

Figure 2. The mixed economy approach to VoCs.

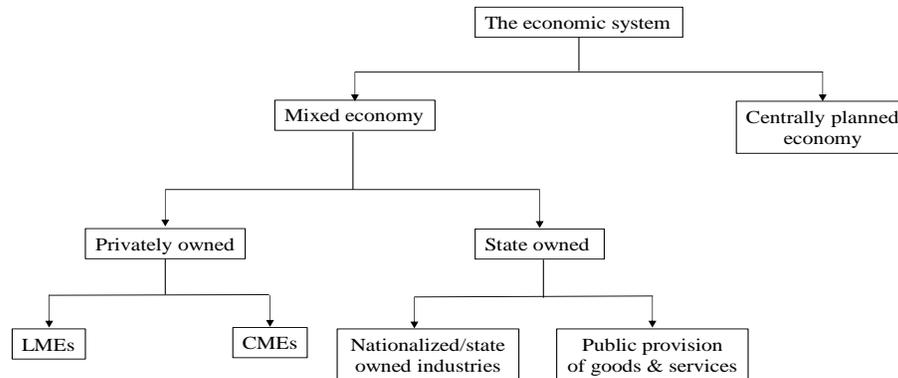


Figure 2 illuminates several features. First, the mixed economy construct was very much a product of the Cold War, being juxtaposed with centrally planned economies. Second, since the end of the Cold War, the mixed economy concept has been discarded by mainstream economics in favor of the terminology of private enterprise or free-market economy. That is a mistake since government continues to provide significant services and be a large part of all economies. Third, the big issue surfaced by the mixed economy approach is the relative size of the privately-owned and state-owned sectors, plus the composition of the activities within the latter.

Fourth, Figure 2 surfaces an important distinction between “ownership” and “governance”. The mixed economy approach was concerned with ownership. The focus was on the private vs. state owned distinction which was central to the issue of nationalization. Hall and

Soskice (2001) are concerned with governance and organization of firms, which has become the focus of the modern theory of the firm.

Fifth, the mixed economy approach foreshadows critique of Hall and Soskice's (2001) framing of VoCs. Even if one accepts their LME/CME analytic distinction, it only applies to a portion of the economic system and is insufficient to fully characterize the economic system. Capitalism is a multi-dimensional system, which suggests VoCs need a multi-dimensional characterization. That critique also applies to the growth models approach which is discussed below.

Sixth, the mixed economy frame tacitly blesses government intervention. Nationalization was justified for industries with natural monopoly characteristics, strategically important industries, and as a tool for modernization of capital-intensive industries. Public sector provisioning was driven by the rise of the post-World War II welfare state, and it was justified on grounds that the private sector under-provided public and merit goods (e.g., health and education). The Neoliberal era has challenged that blessing. Nationalized industries have been largely privatized on grounds that they are politically contaminated in ways that promote productive inefficiency, and it is claimed problems such as natural monopoly can be better dealt with via regulation. The welfare state has also been under political attack and that attack has been supported by mainstream economic reasoning (Palley, 2020).

Seventh, the state-owned portion of the mixed economy consists of nationalized industries and services produced by the welfare state (e.g., health and education). Nationalization was one of the tools in the interventionist approach of Shonfield (1965), showing the two approaches are complementary.

Eighth, though not surfaced, politics lurks behind the mixed economy approach. It is relevant as it affects the relative sizes of the privately owned and state-owned sectors. As shown by Esping-Andersen (1990), politics is also relevant to the size of the welfare state.<sup>14</sup>

In sum, the mixed economy approach provides a useful angle for beginning the process of theorizing VoCs. Its replacement by the concept of a free-market economy has been a step back in understanding as the state sector remains a large and critical component of every capitalist economy. Unpacking the logic of a mixed economy reveals the multi-dimensional nature of capitalism. However, the mixed economy approach is still only partial as there are other critical dimensions it misses. The challenge of theorizing VoCs is to construct a framework that can capture all those dimensions, rather than just some. Such a framework is proposed in Sections 6 and 7 below.

### ***3.e The social systems of production approach***

The fifth column in Figure 1 is labelled the social systems of production approach and refers to the French Regulation School and the Social Structure of Accumulation (SSA) School.<sup>15</sup> The former was pioneered by French economists Michel Aglietta (1979) and Robert Boyer (1990). The latter was pioneered by David Gordon, Richard Edwards, and Michael Reich (1982), who can be described as belonging to the US Neo-Marxist school. The two approaches share

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<sup>14</sup> Esping-Andersen (1990) distinguishes between liberal, conservative, and social democratic welfare state regimes. Palley (2018) argues that economic analysis of the welfare state should distinguish between mode of financing and mode of production of welfare state services. Welfare state regimes systematically differ regarding the size and scope of the welfare state, and those regimes also differ in how they finance and organize the production of welfare state services. Different political regimes choose different combinations of mode of financing and mode of production of welfare state services.

<sup>15</sup>The label “social systems of production” is borrowed from Hall and Soskice (2001), but they only refer to the French Regulation School. The absence of reference to the SSA school likely reflects the siloed nature of the academy which impedes dissemination of ideas. It also likely reflects the fact that SSA theory is part of heterodox economics which is ignored by mainstream economists and institutionally suppressed, thereby limiting its exposure.

considerable elements in common, reflected by much co-authored work (e.g., Bowles and Boyer, 1989). For that reason, they are treated as a unified approach in Figure 1.<sup>16</sup>

The Regulation and SSA approaches shift the focus of analysis to long run macroeconomics, reflecting their Marxist roots. Two fundamental components of Marxist thought are that the core problematic of capitalism is capital accumulation, and that process takes place in the economy which is a system of social relations. The problematic is enduring, but the systems of social relations vary and change. Hence, the relevance for VoCs theory, but it is also a very different rationale compared to those that have come out of political science/CPE.

The SSA approach views capitalism as being organized through socially negotiated regimes of accumulation which generate long wave growth cycles that end with crisis and a proclivity to stagnation. Crisis may then trigger the creation of a new accumulation regime. The Regulation School shares that broad perspective, but it is analytically finer. It distinguishes between the “regime of accumulation” and the “mode of regulation”, which together constitute the “mode of development” (Boyer, 1990). The regime of accumulation refers to the organization of production, including the determination of functional income distribution. The mode of regulation refers to the governance and disciplining of the system via policy and competition, both domestic and international. It parallels SSA analysis in that modes of development are prone to crises which can catalyze the creation of a new mode of development.

Several features are worthy of note. First, capital accumulation is central, and accumulation is prone to crisis via the Marxist mechanism of a falling rate of profit owing to rising capital intensity. Second, the organization of production and technology are central aspects

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<sup>16</sup> See McDonough et al. (2010) for an excellent succinct summary of these two schools.

of the analysis. Third, capital - labor conflict is also central. Fourth, technology and conflict converge in the labor exploitation process. Firms are organized and technology is endogenously developed by capitalists to discipline labor and increase capital's share.<sup>17</sup>

Fifth, the approach's Marxist inclination initially imposed a supply-side focus that was anti-Keynesian and had difficulty applying to the short run. That has been resolved by embracing the Kaleckian formulation of aggregate demand (AD) in which functional income distribution matters. That embrace has contributed to convergence with Post Keynesian economics which has long advocated Kaleckian macroeconomics with its notion of demand regimes (wage-led versus profit-led). A key contribution to this convergence were the Neo-Kaleckian growth models of Rowthorn (1981) and Dutt (1984) which are the foundation of the growth models approach discussed next.

Lastly, the Regulation/SSA approach initially tended to ignore financial considerations, but that has been remedied by embrace of the construct of financialization (see Tabb, 2010). That provides another source of convergence with Post Keynesian economics which has also engaged the construct of financialization (Hein, 2015; Hein and Treeck, 2010; Kohler et al., 2019; Palley, 2007, 2021a; Stockhammer, 2004).

### ***3.f The growth models approach***

The sixth column in Figure 1 refers to the growth models (GM) approach proposed by Baccaro and Pontusson (2016). They are political scientists so it might be placed on left-hand side of Figure 1. Instead, it is placed on right-hand side for two reasons. First, that placement fits better with flow of the narrative in Figure 1. Second, it rests on the Neo-Kaleckian approach to growth

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<sup>17</sup> This approach to firms was articulated by Marglin (1974), while the approach to technology was articulated by the historian David Noble (1977). In economic models, those features are captured through the effort extraction process (Bowles and Gintis, 1990).

developed by Post Keynesian economists, who have long worked extensively along similar lines, albeit not characterizing their research as VoCs analysis.

The GM approach adopts a macroeconomic perspective that focuses on the different components of AD and shows how different patterns of AD growth are associated with different demand drivers, particularly functional income distribution. Those different patterns of demand growth twist the structure of the economy, giving rise to economic and political consequences.

As mentioned above, the GM approach is theoretically grounded in the Neo-Kaleckian growth models of Rowthorn (1981) and Dutt (1984) which give a prominent role to the wage share. The growth model of Bhaduri and Marglin (1990) is also important as it introduced the distinction between wage-led versus profit-led growth.<sup>18</sup> Initially, much empirical research was directed at identifying whether country growth was wage- or profit-led (see Stockhammer and Onaran (2013) for a survey of findings).

In part, spurred by Baccaro and Pontusson's (2016) GM formulation, that empirical work has been elaborated to include additional influences on demand growth via debt-led and export-led growth (Hein and Martschin, 2021). The former aims to incorporate effects of financialization on growth, while the latter incorporates long-standing Keynesian arguments often associated with development economics. Now, the framework is being further expanded to incorporate welfare state characteristics as determinants of demand growth (Hein et al., 2021). That expands the set of possible demand growth regimes.

The GM approach has become popular owing to its emphasis on wage-led growth which speaks to major contemporary political concerns. However, it too is subject to critique. First,

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<sup>18</sup> Kaleckian macroeconomics distinguishes wage-led versus profit-led demand. Neo-Kaleckian growth theory distinguishes wage-led versus profit-led growth.

according to Neo-Kaleckian growth theory, if an economy is wage-led, a lower wage share and increased personal income inequality (Carvalho and Rezai, 2016; Palley, 2017) will slow growth and lower economic activity. However, that underlying theory of growth is contested within Post Keynesian economics, though the technical arguments have not crossed the divide into political science/CPE. One critical technical issue is whether the long run equilibrium rate of capacity utilization is variable and subject to influence by AD. If it is not, the claim of wage-led growth fails.

Second, the GM approach has a narrow macroeconomic focus on growth. However, growth is just one facet of capitalism, albeit a critical one. In a sense, the GM approach is the twin of Hall and Soskice's firm structure approach. The latter looks at capitalism through the keyhole of microeconomics, while the latter looks at capitalism through the larger keyhole of macroeconomics.

Third, the GM approach characterizes different patterns of demand growth as corresponding to varieties of capitalism, but there is a danger of defining varieties of capitalism in too shallow a way such that it loses significance by becoming just a list. For instance, export-led growth is widely viewed as being dependent on an under-valued real exchange rate. That might be better interpreted as a policy strategy rather than a variety of capitalism. That conceptual problematic is addressed in Section 5 below.

Fourth, and most importantly, the pattern and rate of growth of demand is a manifestation of underlying structures. That calls for a deeper theoretical dig that explains those structures: what are they, how do they affect the pattern of demand and demand growth, how did they come about, and what determines their evolution? Those issues are tackled in Sections 6 and 7 below.

### ***3.g Structural Keynesian policy models approach***

The seventh column in Figure 1 is labelled the Structural Keynesian policy models approach. It is the approach this author advocates, and it is further elaborated in Section 6 below which argues many of the variety of approaches to VoCs analysis can be synthesized within it. The essence of the approach is that economies are constituted by rules:

“Structural Keynesianism views the notion of a natural market as a fiction, and instead maintains that markets are governed by rules and cannot exist without them. Some rules work better than others in promoting economic stability and social good, and the challenge is to establish those rules that do these things best (Palley, 1998b, p.xviii).”

The Keynesian part of structural Keynesianism reflects the role of AD in determining output and growth, and AD is significantly influenced by income distribution. The structural component reflects economic policies, regulations, and institutions which are the matrix constituting the economy’s rules. That matrix affects the distribution of power, which in turn affects income distribution.

Figure 3, drawn from Palley (1998c, p.349), illustrates how the structural Keynesian policy models approach can be applied to explain the different macroeconomic outcomes in the US and Europe in the period 1980 – 2008. The US pursued a policy model (box B) that undercut the wage floor but generated expansionary macroeconomic conditions. The result was relatively full employment with rising income inequality. Europe pursued a policy model (box C) that maintained the wage floor but generated contractionary macroeconomic conditions. The result was relatively high unemployment, but the increase in income inequality was less. A policy model of expansionary macro policy plus maintained wage floor (box A) would have generated greater shared prosperity. A policy model of contractionary macro policy plus lowered wage floor (box D) would have generated depressed conditions characterized by higher unemployment and higher income inequality.

Figure 3. Taxonomy of policy configurations.  
 Source: Palley (1998b, p.349)

		Wage floor maintained	
		Yes	No
Expansionary macro policy	Yes	A.	B. US
	No	C. Europe	D.

That approach is now being independently adopted by political science/CPE. Thus, Blyth and Matthijs (2017) call for recalibrating international political economy to incorporate macroeconomic policy regimes. However, the connection is not made to the Structural Keynesian policy models approach, reflecting the siloed nature of academia.

**3.h The center – periphery approach.**

The eighth column in Figure 1 is labelled the center – periphery approach. That approach originated out of the Latin American structuralist school of economic development (Prebisch, 1950).<sup>19</sup>

Mainstream economics distinguishes between high-income, middle-income, and low-income economies. Economies are distinguished by their capital-labor ratios and their state of technological advance, with the development challenge being capital-deepening and

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<sup>19</sup> See Fischer (2015) for an excellent survey.

technological upgrading. The center - periphery approach maintains that the global economy is organized on systematically structured lines that privilege the center (developed economies) over the periphery (developing economies).

For Prebisch (1950), the global financial system constituted an important source of disadvantage as trade patterns generated financial flows to the center, thereby lessening financial constraints on its growth. In contrast, the periphery was subject to underlying financial outflows that impeded development and created proclivities to financial vulnerability and boom-bust cycles.<sup>20</sup> Furtado (1963) argued colonial development meant the periphery's pattern of development was outwardly focused, reflecting its role as supplier of primary commodities to the center. He also saw the periphery elite's cultural identification with the center and its imitative consumption behavior as problematic.

The center - periphery approach was taken a step further by Marxist dependency theory (Frank, 1966) which characterized the structure in terms of exploitation whereby the center expropriated surplus and ensured a subordinated pattern of development. Appealing to Marxist labor value theory, Amin (1976) characterized the pattern of international trade as one of unequal exchange between center and periphery. That resonated with the findings of Prebisch (1950) and Singer (1950) which showed the periphery was subject to secularly declining terms of trades, with the price of its exports (primary commodities) falling relative to the price its imports (manufactured goods) – a pattern that is now being repeated with periphery manufactured goods exports. Both dependency theory and center - periphery theory resonate with the Braudel (1979, vol. 3) – Wallerstein (1974) world systems approach which argues the global economy should be

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<sup>20</sup> See Pérez Caldentey and Vernengo (2016) for a full economic analysis of this phenomenon.

understood as a systemic whole rather than just a collection of national economies.

It is dangerously easy to view the center – periphery relationship as a one-way street with the periphery subordinate to the hegemonic center.<sup>21</sup> However, the periphery also impacts the center, as illustrated by contemporary globalization (see Section 6.3 below) – even if it has been designed by the center. The center – periphery approach also significantly changes the interpretation of globalization. The conventional view is globalization promotes convergence via the combination of capital mobility and wage and profit rate equalization (Stolper and Samuelson, 1941). However, a center – periphery perspective suggests “hierarchy” is the destination, with periphery economies occupying a lower standing in the order. Rather than convergence there is diversity, but it is not diversity of choice. It is diversity imposed by the global economic system. From the standpoint of VoCs analysis, the center – periphery approach implies economies need to be indexed by their position in the global economy.<sup>22</sup>

Lastly, another quasi-related approach is Gerschenkron’s (1952) late industrializer framework. That framework is less pessimistic as it adds the twist that in some circumstances there can be benefits to being a late industrializer as countries can leap-frog the development process. They do so by adopting the technology and know-how of early industrializers, thereby avoiding the costs of innovation and learning which go with being first.<sup>23</sup> From the standpoint of VoCs analysis, it requires indexing countries according to whether they are early or late industrializers. If the issue of late industrialization fades with time, the relevance of such

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<sup>21</sup> That pitfall is encouraged by the fact that the center-periphery construct was developed by economists from periphery countries.

<sup>22</sup> An interesting question posed by developments over the past forty years is whether China is part of the periphery or a new center (Fischer, 2010, 2015).

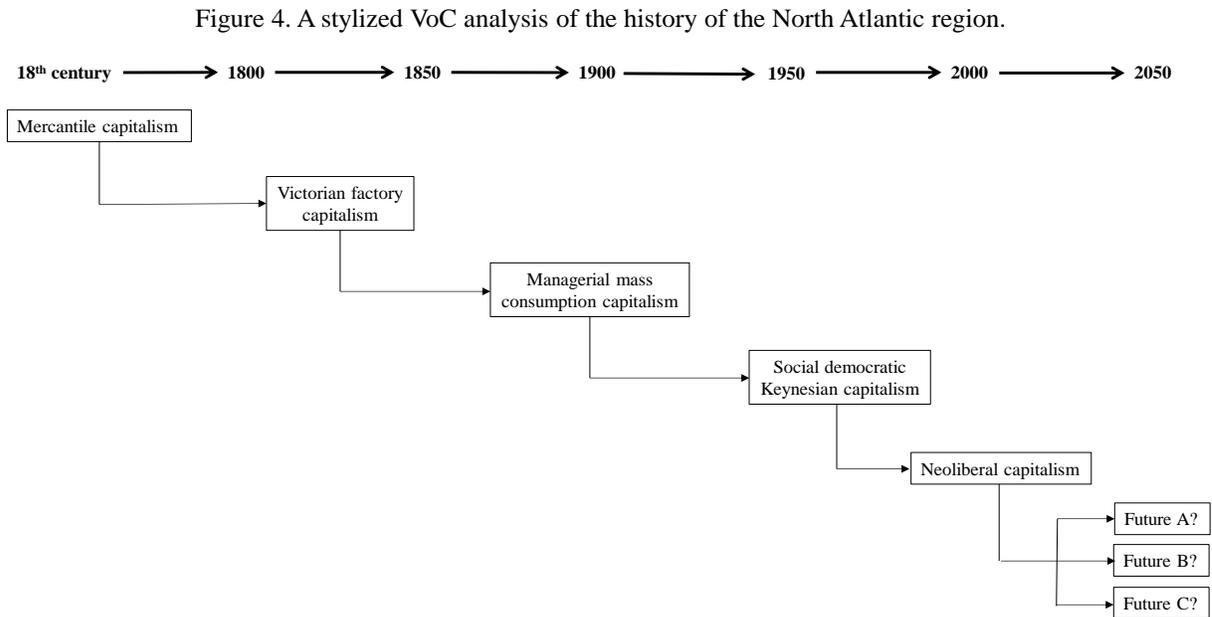
<sup>23</sup> Institutionally, late industrialization manifests itself in the financial structure, via reliance on investment banks to channel capital rather than decentralized financial markets. That reflects the fact markets may not yet exist, and banks may also have superior analytical insight that enables better allocation of scarce capital.

indexing would also fade with time.

#### 4. Historicizing VoCs analysis

Section 3 provided an overview of the theoretical terrain of VoCs analysis. There are two striking features. First, the discourse appears quite fractured. Second, it exhibits a tendency to focus on the present, giving little attention to history. An exception to that is the SSA approach, but even there the attention is modest. This section argues that a focus on history is important and has major theoretical implications.

Figure 4 provides a stylized history of VoCs in the North Atlantic region. It begins with 18<sup>th</sup> century mercantile capitalism followed by Victorian factory capitalism, managerial mass consumption capitalism, social democratic Keynesian capitalism, through to the current moment of Neoliberal capitalism.



The figure has multiple implications. First, it uses a taxonomy that is very different from that in Figure 1 describing the existing VoCs discourse. The taxonomy is constructed in terms of

a historical characterization of capitalism rather than in terms of current technical characteristics. Second, the figure refers to just the North Atlantic region. The implication is capitalism may vary by geographic region, reflecting differences in both natural resource endowments and history (i.e., economic, political, and social history). If capitalism varies by region, an essential question is what is the relationship between those regions? To what extent is there a single world capitalist system versus a system of interacting capitalisms, and what is the dynamic between the pieces and the whole?<sup>24</sup> Those questions resonate with the issues raised by Latin American structuralist theory, dependency theory, and world systems theory.

Third, today's capitalism is characterized as Neoliberal (Palley, 2021b), but the capitalism of the future is an open question. Capitalism is a socially constructed system which, though not free to be anything, has space to take on a range of possible forms. That is the central argument of this paper. There is choice, contrary to the TINA doctrine. One of the challenges of VoC analysis is to identify the margins and scope for choice. Moreover, those margins and scope are affected by past choices via the logic of lock-in (Palley, 2017/18).

Fourth, Figure 4 shows how capitalism is a sedimented system. Victorian capitalism is still present via the institution of the factory. So too are the late 19<sup>th</sup> and early 20<sup>th</sup> century business innovations of mass market consumption and the managerially controlled firm.<sup>25</sup> Keynesian social democratic capitalism is also still very present through the welfare state and counter-cyclical macroeconomic policy. The innovations of earlier capitalisms endure, reflecting

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<sup>24</sup> As regards interaction, one might distinguish between static and transformational interaction. For instance, Keynesian macroeconomics identifies a form of static interaction in the form of cross-country AD spillovers which change the level activity within the existing system. Technological spread and competition constitute transformational interactions which change the structure of the pieces and/or the system.

<sup>25</sup> Identifying mass market consumption and the managerially controlled firm as a VOC shows how VoC analysis connects intimately with business history as exemplified by the work of Chandler (1977).

the sedimentary process.

Fifth, capitalism should be understood as a dynamic self-transforming process, which connects with the logic of the Austrian school of economics as represented in Schumpeter's (1942) theory of creative - destruction. The changing nature of capitalism calls for a theory of transformation, which is currently a lacuna within VoC analysis. Figure 4 is suggestive of the type of factors that are important for such theory. (i) Technology is important, be it engineering or intellectual technology. Victorian factory capitalism was spurred by the steam engine and its provision of a powerful reliable centralized source of power. Mass market consumption capitalism was spurred by intellectual innovation regarding product marketing (e.g., advertising and brands). Managerial capitalism was driven by organizational change within business. (ii) Events matter. Thus, the rise of social democratic Keynesianism was spurred by the Great Depression and World War II. The former served to discredit capitalism, while the latter created a decisive political opening for reform. The turn to Neoliberal capitalism was spurred by the stagflation dislocations of the 1970s. (iii) Ideas matter. Keynes' formulation of Keynesian economics explained the Great Depression and full employment in World War II, and Keynesian counter-cyclical stabilization policy was an important under-pinning of post-war social democratic Keynesian capitalism. Likewise, the ideas of the Chicago School of economics were important in the turn to Neoliberal capitalism. (iv) Politics matter. Changing the political consensus was critical in both the turn to social democratic Keynesian capitalism and the turn to Neoliberal capitalism. In both instances policy has been critical, and policy turns on politics.

Sixth, Figure 4 is suggestive of a wave theory of VoCs akin to Kondratieff long-wave theory. The taxonomy in Figure 4 shows VoCs as being long-lived and the factors driving change (discussed above) have a resemblance to those in Kondratieff theory. The latter

emphasizes major technological breakthroughs which spawn accelerated growth that then crests and dies back as opportunities for application are exhausted. A long-wave VoCs theory embraces a wider construction of technology defined as scientific and engineering ideas, business practice and organization, and policy ideas.

Seventh, the turn to social democratic Keynesian capitalism and Neoliberal capitalism were both driven by “crisis” events. For the former it was the Great Depression and World War II. For the latter it was the stagflation of the 1970s. That suggests crisis theory has a role to play in VoC analysis, with crisis sometimes being the handmaiden of the death and birth of VoCs. That connects with the SSA Marxist approach in which regimes of accumulation exhaust themselves, thereby eventually calling forth a new regime. However, the Marxist formulation of crisis is specifically constructed in terms of the falling rate of profit, whereas a VoCs perspective would permit a wider set of causes of crisis such as changed social expectations or economic dislocation from causes other than a falling rate of profit.

Looking to the future, multiple potential crises lurk over the horizon. Those include catastrophic climate change, employment dislocations caused by robotics and artificial intelligence, societal dissatisfaction with economic inequality and economic insecurity, and economic stagnation caused by Keynesian demand failure. Interestingly, those potential crises could set up a VoCs reversal that brings back a modified form of social democratic Keynesian capitalism. Indeed, the Neoliberal era can be interpreted in such terms, with Neoliberal capitalism being an attempt to bring back a modified form of pre-Keynesian capitalism. The implication is capitalism circles back as well as moving on.

## **5. Theorizing VoCs**

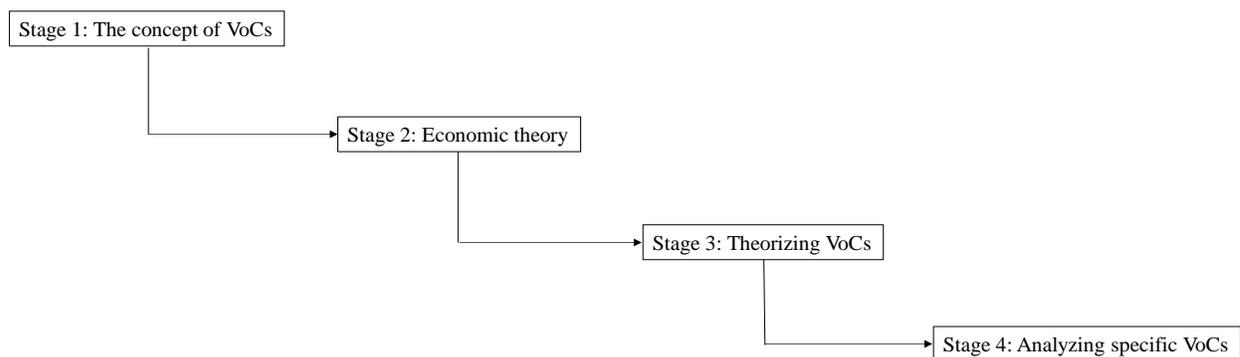
Figures 1 and 4 provide two alternative taxonomies of VoCs analysis. Figure 1 taxonomizes

VoCs in terms of theoretical approaches. Figure 4 taxonomizes VoCs in terms of historical experience. At first blush, the two figures appear orthogonal, which speaks to deficiencies in existing VoCs theory. The analytical challenge is to construct a theoretical framework which can piece the two together consistently. The balance of the paper is directed to that end.

### ***5.1 The inescapable choice: which economic theory?***

The starting point is recognition that capitalism is an economic system, which means explaining it (and its varieties) inevitably calls upon economic theory. Consequently, VoCs analysis confronts the inescapable issue of which economic theory to use in theorizing capitalism. The challenge of theorizing VoCs is illustrated in Figure 5 and involves four stages. The first stage begins with acceptance of the legitimacy of the concept of VoCs. The second stage concerns selecting an economic theory with which to analyze VoCs. The third stage involves applying that economic theory in the analysis of VoCs. The fourth stage involves dissecting VoCs theory to accommodate “varietals” of capitalism.

Figure 5. The four stages of theorizing VoCs.



The first stage issue re the legitimacy of the VoC concept was addressed in Section 2's critique of TINA. The VoCs concept rests on the view that the economy is a socially constructed system. That view rejects the notion of a fictional ideal economy against which existing arrangements can be benchmarked. This sub-section addresses the issue of selecting an economic theory with which to analyze VoCs.

Existing proponents of VoCs analysis are significantly Keynesian in inclination. The main features of Keynesianism are: (i) the notion of demand determined output; (ii) the inability of economies to rapidly self-adjust and restore full employment via price level, nominal wage, interest rate, and exchange rate adjustment; (iii) belief in the real effectiveness of monetary policy (i.e., fully expected monetary policy has real effects), which is usually viewed as implying a belief in a long-run trade-off between inflation and unemployment;<sup>26</sup> (iv) belief in the effectiveness of fiscal policy, which implies the fiscal multiplier is always positive (though its size may be counter-cyclical) and bond financed fiscal policy is effective.<sup>27</sup> That belief inclines VoCs practitioners to be against fiscal austerity, as exemplified by Blyth (2014).

The Keynesian disposition of existing VoCs theory puts it at loggerheads with mainstream economics which either rejects or substantially qualifies all four of the above Keynesian propositions. That observation illustrates the significance of economic theory which is an issue that has not been adequately confronted. The economic theory adopted in stage 2 will shape subsequent stage 3 theorizing regarding the institutions and functioning of VoCs. That is because the chosen theory will impact the interpretation of institutions and policy choices.

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<sup>26</sup> Contemporary mainstream macroeconomics also believes in the effectiveness of monetary policy, but its role is to stabilize employment around the natural rate of unemployment. Keynesians make a stronger claim whereby monetary policy can shift the equilibrium unemployment rate.

<sup>27</sup> The potential ineffectiveness of bond financed fiscal policy rests on the Neo-Ricardian hypothesis (Barro, 1974) which is a pillar of modern mainstream macroeconomics.

VoCs theory has originated out of the political science sub-field of CPE. That origin has enabled it to escape the strict confines of contemporary mainstream economics. Hence, the prevalence of traditional Keynesian thinking. It is doubtful such analysis would have been able to emerge from within economics. In a sense, VoCs theory has flown under the radar.<sup>28</sup>

That is the good side of the story. The downside is VoCs discourse has been insufficiently attentive to theoretical controversy over how the economy works. As VoCs analysis gains standing it can expect to confront critique on those grounds. The danger is it will confront pressure from mainstream economics. That may take the form of being dismissed on grounds that it is theoretically unsound. Alternatively, it may be captured by mainstream economics and redirected back into the TINA mold.

There are some signs that this issue is already surfacing, as evidenced by emerging debate regarding the macroeconomic frame for VoC analysis. The incipient debate is captured by comparing papers by Stockhammer (2021) and Hope and Soskice (2016). Stockhammer (2021) advocates the GM approach and proposes a Neo-Kaleckian growth model supplemented by the inclusion of inside debt, the presence of which impacts AD and can be the cause of financially induced cycles and instability. In contrast, Hope and Soskice (2016) advocate using a New Keynesian styled macroeconomic framework.

In its most sophisticated form, New Keynesian macroeconomics is referred to as dynamic stochastic general equilibrium (DSGE) theory. It draws its inspiration from Arrow-Debreu (1954) theory but modifies the CGE model to incorporate nominal rigidities and market failures. That

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<sup>28</sup> On a personal note, I have long envied political scientists who feel confident and capable of engaging in discussion of capitalism without going through the misery of economics training. Capitalism was always my motivating interest, but I felt I had to study economics first. To my deep disappointment, I found not only does economics dismiss the notion of VoCs, it also dismisses the notion of capitalism. Economists talk of capital, but not of capitalism.

approach has been substantively criticized (see Dullien, 2009; Podkamminer, 2021; Storm, 2021).

From the standpoint of the current paper, the critique is New Keynesian macroeconomics tacitly adheres to TINA thinking because it retains the Arrow-Debreu CGE pedigree, albeit camouflaged by nominal rigidities and market failures. In effect, it retains the notion of an ideal economy that benchmarks economic analysis for all economies. Variety is implicitly deemed a product of economic pathology and the imagined ideal provides a blueprint of what society should aim for. Consequently, it also implicitly pushes a normative agenda aimed at a creating a CGE economy.<sup>29</sup>

An even deeper critique of the neoclassical CGE ideal is its ontological impossibility. The fact that the theory is still embraced speaks to its ideological character. Moreover, intellectual engagement is treacherous as engagement tacitly legitimizes CGE theory, and engagement also risks trapping the critic in an unwinnable debate with a fiction.<sup>30</sup> In sum, CGE based theory (which includes New Keynesian DSGE theory) constitutes a misleading basis for theorizing VoCs.

All theory imposes abstraction, and all theory also aspires to be universal. That is true of both Keynesian and Marxist theory. Keynesian theory asserts the universality of the principle of aggregate effective demand determined output. Marxist theory asserts the universality of the

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<sup>29</sup> Neoclassical economics emphasizes market failures. Those failures are realistic, and it sometimes appears as if they are interpreted as justifying the paradigm. However, those failures are fully consistent with Keynesian and Marxist theory, and there is nothing exclusive to Neoclassical theory about them. For instance, Adam Smith (2004 [1776], p.102-124) was aware of the adverse effects of collusion and restriction of trade and movement in *The Wealth of Nations*. Keynesian and Marxist theory accept those failures but reject interpreting them as the cause of departure from an ideal economy that would otherwise exist.

<sup>30</sup> Arrow-Debreu (1954) theory is a logically tight construction. The only way to disprove it is to engage with its assumptions, but that is what mainstream economics does its utmost to prevent.

problematic of capital accumulation and a falling rate of profit. However, unlike Neoclassical CGE theory (on which New Keynesian DSGE theory rests), neither Keynesian nor Marxist theory assert an ontologically impossible ideal economy for purposes of understanding capitalism.<sup>31</sup> Instead, both are open process theories that deliver different economic outcomes under different institutional settings and contexts. Those settings are influenced by history and political choice, but there is no ideal. That makes them a superior basis for theorizing VoCs.

The analytic openness and enduring relevance of Keynesian and Marxist theory is illustrated by consideration of Neoliberalism. Palley (2012, 2021b) argues that Neoliberalism constitutes a VoC which replaced the prior social democratic Keynesian VoC. However, Keynesian economic logic continues to apply, as does Marxist logic. Neoliberalism has not undone the logic of either. It has just placed them in a new institutional and political context. Thus, from a Keynesian perspective one might argue we now have military-industrial plutocratic Keynesianism which aims to implement demand management policy by tax cuts benefitting corporations and the wealthy, and monetary policy that aims to underwrite and inflate asset prices capitalism (Palley, 2021a, p.484-486). Galbraith (2008) provides an alternative characterization labelled “predator state” capitalism, whereby the state is controlled by Big Business which preys on the state.

Putting the pieces together, the existing VoCs discourse leans toward Keynesian and Marxist frames. There is good analytical reason for that. However, it also means the existing

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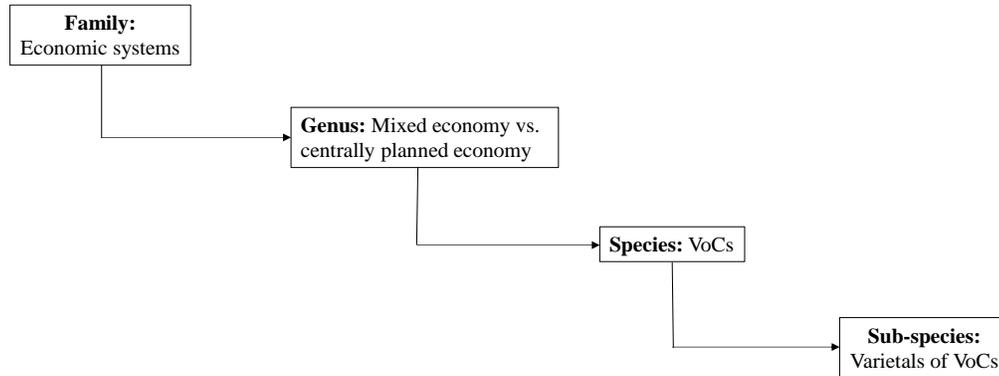
<sup>31</sup> Marxist theory also has a teleological idealistic dimension when viewed as a theory of history. Thus, Marx argued capitalism was a long and necessary stage through which society passed on its way to socialism. The logic of that teleological dynamic was capitalism is inherently beset by contradictions in the capital accumulation process and socialism resolves those contradictions. Removing that historical prediction strips away the teleological ideological dimension. In that case, Marxist theory reduces to one of proclivity to economic crisis. Capitalist accumulation is beset by contradictions that generate recurrent crises, each of which requires a system reset. However, the system can remain capitalist.

discourse leans away from mainstream economics and tacitly threatens it. Consequently, if mainstream economics engages VoCs theory, it will seek to impose a New Keynesian DSGE theoretical frame. Were that to happen, it would be a step back and the promise of VoCs discourse would be diminished.

### ***5.2 Varieties vs. varieties of capitalism***

Stage 3 concerns the challenge of identifying and theorizing specific VoCs. Taxonomy is a key tool whereby biologists organize their understanding of the world, and it is a useful starting place for theorizing VoCs. Borrowing terminology from biology, there are four ranked categories: family, genus, species, and sub-species. Figure 6 applies that borrowed terminology to VoCs theory. The family is economic systems. The genus consists of mixed economies and centrally planned economies. All capitalist economies are mixed economies, with each having a large state sector. However, they differ in the scale and composition of that sector. The species is VoCs. At the bottom, comes the sub-species which refers to varieties of VoCs, which are varieties within a specific VoC.

Figure 6. A taxonomy for VoCs theory.



Varietals of capitalism (sub-species) are the most difficult category as they are easily misclassified as varieties of capitalism (species). Sub-species/varietyals share major characteristics with species/varieties, but they also have different facets. Classification mistakes occur when facets are misinterpreted as major characteristics.

Social democratic Keynesian capitalism illustrates the sub-species/varietyal problematic. Western Europe exhibited the paradigmatic form of social democratic Keynesianism. It had large government organized welfare states that provided the full array of welfare state services (housing, healthcare, education, public pensions, and unemployment income support), and its Keynesian macroeconomic stabilization policy emphasized fiscal policy fine-tuning. In contrast, US social democratic Keynesianism was a varietyal that can be described as New Deal military-industrial Keynesianism. It had a smaller welfare state, preferring to provide social protection via tax subsidies (Garfinkel and Smeeding, 2015; Palley, 2020). It also had far larger military spending. The New Deal aspect reflects openness to infrastructure spending and agricultural

price supports. US Keynesian stabilization policy also emphasized counter-cyclical monetary policy. Western Europe was also more friendly to labor unions and tripartism. That shows how neo-corporatism is consistent with social democratic Keynesian capitalism, and it is better understood as a facet rather than a VoC. The important point is the US and Western Europe both had social democratic Keynesian capitalism, yet there were significant differences reflecting the fact that they were varietals (sub-species) drawn from a shared variety (species).

Neoliberal capitalism also exhibits different varietals. Palley (2012, p.21-31) distinguishes between “hardcore” and “softcore” Neoliberalism, with hardcore Neoliberalism corresponding to the paradigmatic form advocated by the Chicago School of economics. Softcore Neoliberalism is associated with the MIT School of economics and advocates some cushioning of the harsh effects of a deregulated internationally open economy. Using that frame, the US corresponds to hardcore Neoliberal capitalism, whereas Western Europe corresponds to softcore Neoliberal capitalism. Note, Hall and Soskice’s (2001) firm structure approach is consistent with Neoliberal capitalism, with the LME versus CME distinction being a varietal marker. Baccaro and Pontusson’s (2016) growth models approach is also consistent with Neoliberal capitalism, with different growth regimes corresponding to varietal markers rather than different VoCs.

The variety vs. varietals distinction is a critical part of the proposed approach to VoCs theory. It helps reconcile the existing literature described in Figure 1 with the historical framework in Figure 4. According to the logic of Figure 4, the existing VoCs discourse described in Figure 1 has a proclivity to characterize “varietals” as “varieties”. That said, the challenge of identifying and explaining varietals may be more difficult and much more rewarding than that of identifying varieties. VoCs tend to be long-lived so that in any era the principal challenge is one

of identifying varieties. Consequently, choice between varieties of capitalism is the principal margin of choice at any moment.

Lastly, CPE truly comes into its own regarding the question of varieties. Brief reflection suggests history and socio-political factors may be decisive for understanding and explaining why countries choose one variety over another. That makes sense for explaining differences between the US and Western Europe in the eras of both social democratic Keynesian capitalism (1945 – 1980) and Neoliberal capitalism (1980 – today).

## **6. Box economics: an alternative theoretical framework**

The previous section argued that the analytical challenge is to construct a theory of VoCs that is rich enough to account for both different VoCs and multiple varieties within a particular VoC.

This section presents an analytical framework that does that.

The current CPE approach to VoCs theory is dominated by the Hall and Soskice's (2001) firm structure approach and Baccaro and Pontusson's (2016) growth models approach. Those two approaches represent dramatically different perspectives. The former is microeconomic and focuses on firms' governance, employment relations, and inter-firm relations. The latter is macroeconomic and focuses on different demand growth regimes. The two tend to be presented as competing approaches. However, rather than being at odds, this section suggests they are consistent. The problem is something is missing so that the theory is incomplete.

The framework presented below argues there is a missing middle "mesoeconomics", which can be understood in terms of the Structural Keynesian approach discussed earlier. As shown below, not only does that framework help reconcile the firm structure and growth models approaches, it also provides a general framework for considering varieties of capitalism. It does that by surfacing the different economic margins that serve to define varieties.

Figure 7 shows a more generalized formulation of the Structural Keynesian policy models approach presented in Figure 3 in Section 3. The structural characteristics of the economy are now described as a demand regime (macroeconomic) and a supply regime (microeconomic).<sup>32</sup> The demand regime can be Keynesian or Neoliberal, while the supply regime can be social democratic or Neoliberal. A Keynesian demand regime corresponds to the virtuous circle growth model described in Palley (2012, Chap. 9) in which investment drives productivity growth which drives wage growth, thereby driving demand growth that spurs investment. The Neoliberal demand regime breaks the circle by severing the productivity - wage growth link. Instead, demand growth is driven by credit and asset price inflation. The social democratic supply regime corresponds to an economy which is regulated (especially the labor market) to the benefit of labor. The Neoliberal supply regime corresponds to a deregulated economy.

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<sup>32</sup> “Demand regime” replaces “Expansionary macro policy”, and “Supply regime” replaces “Wage floor maintained”.

Figure 7. The reformulated Structural Keynesian economic policy model.

		Supply regime (microeconomic)	
		Social democratic	Neoliberal
Demand Regime (macroeconomic)	Keynesian	A. 1945 - 1980	B. US post-2008?
	Neoliberal	C. Western Europe: 1980 - 2008?	D. 1980 - today

The social democratic/Keynesian combination (Box A) corresponds to the social democratic Keynesian VoC that ruled from 1945 – 1980. The Neoliberal supply/demand combination (Box D) corresponds to the VoC that has increasingly prevailed since 1980. However, regime combinations can be hybrids. Thus, prior to the 2008 financial crisis Western Europe might be described as a combination of a weakening social democratic supply regime plus a strengthening Neoliberal demand regime (Box C) marked by fiscal austerity and tight monetary policy. In the US there was more of a shift to a pure (hardcore) Neoliberal regime (Box D), but it too preserved some of the Keynesian demand regime via large counter-cyclical budget deficits. That said, as noted above, contemporary US Keynesianism might be better described as military-industrial plutocratic Keynesianism as budget deficits were significantly due to tax cuts for corporations and upper income households. Additionally, the New Deal dimension fell away as infrastructure spending declined as a share of GDP. Those observations reaffirm the relevance of the “varietal” construct discussed earlier.

## 6.1 Meso-economics and box economics

Meso-economics is key to filling in the economic details of regimes. As shown in Section 7 below, it is also what connects the economics of VoCs with the politics of VoCs, thereby providing a unified theory.

The demand regime concerns macroeconomics. The supply regime concerns microeconomics. Figure 8.a shows meso-economics as being the piece that links the two, and it can be described in terms of box economics (Palley, 2011; 2012, Chap 9.) Meso-economics concerns the government sector, the rules and regulations governing markets and firms, and economic policy. Using a computer metaphor, the meso-economic component describes the economic software that governs the economic hardware. That meso-economic programming affects both microeconomic behaviors and macroeconomic outcomes, and that influence is captured by the directional arrows in Figure 8.a.

Figure 8. Meso-economics and box economics.

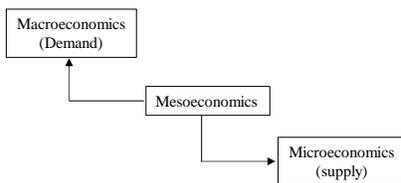


Figure 8.a. The relationship between macro-, meso-, and microeconomics.

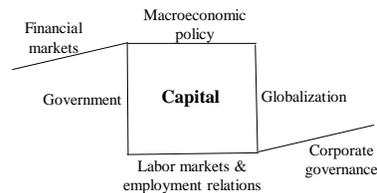


Figure 8.b. The social democratic Keynesian box (1945-1980).

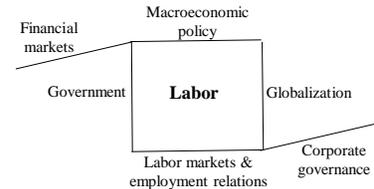


Figure 8.c. The Neoliberal box (1980-today).

The meso-economic software governing the economy can be described via the metaphor

of a box. A box is a six-sided three-dimensional object, but in Figures 8.b and 8.c it is reduced to two dimensions.<sup>33</sup> The economic logic of the box is as follows. Capitalism is a social system, with organized production and transacting that involves social relations. The core social relation is that between capital and labor, and that relation has an inescapable conflictual character. Power is central to the relationship and its effects ramify through the political economic system. It is especially relevant for the functional distribution of income (i.e., the wage - profit share split), which in turn affects AD, the rate of capital accumulation, the character of technological innovation, and political influence.

The balance of power is affected by the institutions, customary behavioral norms, rules and regulations, and laws governing the economy. It is also affected by macroeconomic conditions (e.g., the unemployment rate). The box represents that matrix of influences. It identifies six critical margins where those influences come into play and affect the balance of power. Those margins are (i) labor markets and employment relations; (ii) the government sector which concerns public sector employment, the scale and scope of welfare state services, and the scale and scope of economic and social regulation; (iii) macroeconomic policy which affects the unemployment rate and rate of growth; (iv) globalization which impacts how the international economy affects the national economy; (v) corporate governance which influences the goals and behaviors of firms; and (vi) the financial sector which exerts control over corporations and affects the macroeconomy via provision of credit and asset prices.

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<sup>33</sup> The metaphor of a box is attributable to the late Ron Blackwell to whom I am intellectually indebted. My original framing of the problematic was four-dimensional (a square). Ron viewed both corporate governance and finance as standalone factors related to power, whereas I initially viewed finance exclusively through the lens of AD and was inattentive to the importance of corporate governance.

The box is at the core of the proposed approach to VoCs analysis.<sup>34</sup> First, the box is central to the functioning of the economy and the determination of economic outcomes. Second, its design reflects both history and ongoing political choices, as well being influenced by technology and the organization of production. The role of choice means capitalism is not a natural order characterized by singularity. Instead, capitalism is a socially constructed system. History and choice also explain why capitalism has a national or regional character.

The box is central to the capital – labor relationship as its design impacts the balance of power. In each era the box has a dominant tendency regarding that relationship, favoring either capital or labor. Figure 8.b represents post-World War II social democratic Keynesian capitalism which favored labor so that capital is “in the box”. Figure 8.c represents Neoliberal capitalism which favors capital and boxes in labor. Thus, earlier restraints on capital have been removed, as have supports for labor, and capital has also been given new supports and new options via Neoliberal globalization which is fundamentally different from post-WWII globalization (Palley, 2018).<sup>35</sup>

## ***6.2 Some further refinements***

Capital and labor are labelled above in monolithic terms, but the reality is they are fractured. For instance, Epstein (1992) distinguishes between industrial and financial capital. Additionally, industrial capital can be split into domestic and multi-national capital, while labor can be split into manufacturing and service sector workers. Those sub-groups have slightly different

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<sup>34</sup> Recently, Hassel et al. (2020) have proposed a framework that has similarities with the box model. They link aggregate demand and supply via socio-economic institutions, and those institutions can be interpreted as analogous to the sides of the box.

<sup>35</sup> For a fuller analysis of the six sides of the box as it applies to the US economy and how it has changed in the Neoliberal era, see Palley (2012, Chap. 4, p. 37-40 and Chap. 9). Eisner (2011) provides a history of US political economy which can be read through lens of the box framework.

interests, which affects how they are impacted by the box and how they would like the box designed.

Recalling the distinction between varieties and varietals, a key challenge is how to decide when differences in the design of the box warrant classification as a different VoC. Earlier, it was noted that VoCs are sedimented with innovations of the past carrying through to new VoCs. Figure 7, describing the Structural Keynesian approach, shows there can be hybrid models that are part social democratic Keynesian and part Neoliberal. Analytically, those complications mean it will be a judgement call as to when changes are sufficient to warrant reclassification of variety.

Lastly, the box is a dynamic structure that is constantly in flux. It is subject to marginal changes owing to changes in policy, changes in ideas and understandings, changes in behavioral norms, and changes in technology and business organization. That puts the process of change at the center of VoCs analysis. If the box is constantly being reconfigured, the factors driving reconfiguration are the ultimate determinants of the box's character. That requires consideration of political and societal forces which are addressed below in Section 7.

### ***6.3 Connecting the existing literature to the box.***

Figure 1 provided a taxonomy of the major strands of existing VoCs literature. That literature dovetails with the box. Shonfield's (1965) interventionist approach can be identified with the macroeconomic policy and government sides of the box. Tax incentives are used to stimulate and direct private sector investment and R&D spending, and government uses its bureaucratic capacity to plan economic growth and coordinate public and private investment.

The neo-corporatist approach can be identified with the labor market and employment relations side of the box, with government encouraging coordinated sector wage bargaining

between business and organized labor.

The firm structure approach (Hall and Soskice, 2001) also integrates neatly with the box. The approach takes a microeconomic angle on VoCs, and that angle intersects with the “labor markets and employment relations” and “corporate governance” edges of the box. It also illustrates the narrowness of the firm structure approach which neglects the many other dimensions of capitalism.

Baccaro and Pontusson’s (2016) growth models approach is macroeconomically focused. That explicitly connects it to the “macroeconomic policy” edge of the box, but the approach also connects with the box in its entirety. The functional distribution of income is critical in Neo-Kaleckian growth theory which underlies their growth models approach, and the box is intrinsically connected to determination of the functional distribution of income via its impact on the capital – labor balance of power. The mesoeconomic logic of the box therefore reinforces the growth models approach, but growth is still only one facet of a VoC.

The SSA and Regulation Schools also have significant complementarity. The box can be interpreted as akin to a social structure of accumulation. However, SSA theory has historically concentrated on labor relations, exemplified by the 1950 Treaty of Detroit in which the United Auto Workers negotiated a five-year contract with General Motors that became the standard for the US auto industry. That contract is interpreted as symbolizing the cementing of a new post-war SSA between Big Business and Big Labor. In contrast, the box spotlights the many other dimensions that go into defining a VoC. The box can also be interpreted as akin to a comprehensive regime of regulation. The box surfaces the critical issues of capital – labor conflict and power, with its multiple margins influencing power and economic outcomes in a capitalist economy.

Lastly, the box framework connects with the social justice law and economics perspective on capitalism (Pistor, 2019). Corporate law is critical for corporate governance and the behavior of the firm. Contract law is essential for all markets, labor law is essential for labor markets, and securities and bankruptcy law are critical for financial markets. Thus, law plays a critical role on multiple margins of the box, thereby influencing the balance of power between capital and labor.

### 6.3 More on globalization and the box

Globalization has been a key margin of Neoliberal capitalism, and the box diagram helps understand that issue as it relates to VoCs theory. Figure 9 shows how globalization fits into the box framework. The left-hand box denotes the center (Northern economies), while the right-hand box denotes the periphery (Southern economies). Globalization links the two.

Figure 9. Neoliberal globalization and box economics.

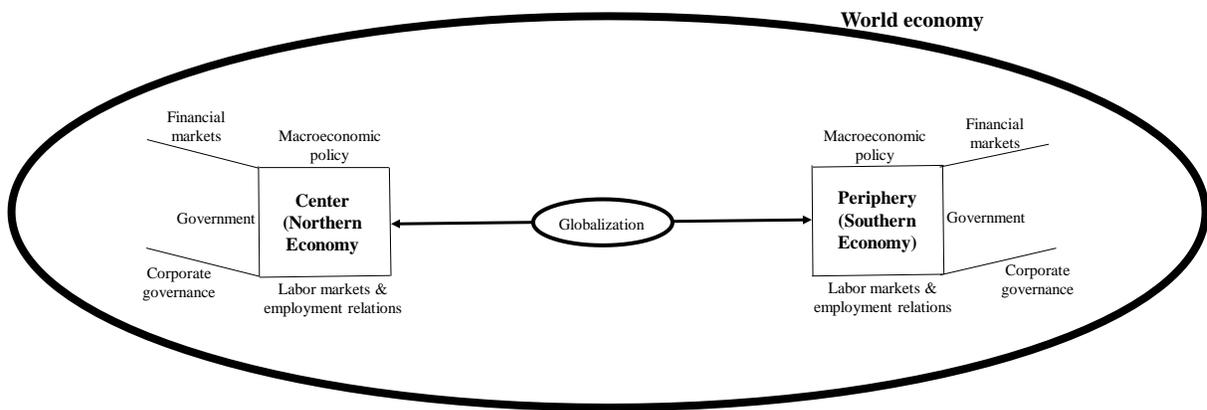


Figure 9 yields several immediate insights. First, it shows how globalization serves to integrate national economies. Globalization is driven by a combination of private sector innovation (e.g., technological and organizational innovation) and policy (e.g., tariff removal and

establishment of global intellectual property rights). Private sector innovations reduce the costs of internationally organizing economic activity. Policy changes also reduce those costs and may also make other jurisdictions economically more attractive.

Second, globalization is intrinsically relational and transformative. It is relational because it brings different economies together. It is transformative because doing so changes economies. The impact will depend on the character of the economies being joined and how they are joined. Joining together creates new conditions of competition and margins of competition, which change economic behaviors and choices. Figure 9 illustrates how Neoliberal globalization has increased contact between Northern (center) and Southern (periphery) economies. That has taken a high toll on Northern manufacturing employment and wages which have been impacted by increased integration of Southern economies. In contrast, post-WWII globalization increased integration between Northern economies and the effect was beneficial for Northern manufacturing and wages (Palley, 2018). That shows how the economic character of globalization can vary.

Third, globalization raises issues about the relation between individual economies, their respective positions in the world economy, and the workings of the world economy. Figure 9 highlights that countries occupy different positions in the global economy which is germane to the VoC characterization of country economies. That is captured by the classic “center” versus “periphery” distinction. It also shows countries are impacted by other countries so that the evolution of national VoCs stands to be impacted by developments elsewhere. Those impacts work via such mechanisms as inter-dependency (e.g., AD spillover effects), competition, and demonstration effects. The character of cross-country impacts will also depend on the character of the global economic system, which will affect the performance and viability of VoCs. That

reasoning is behind activist demands for an “alternative globalization” to replace Neoliberal globalization. Analytically, it is reflected in Rodrik’s (2011) construct of the globalization trilemma and the debate over globalization’s impact on national policy space (Palley, 2021c). Globalization impacts policy space, and policy space impacts the viability of policy interventions associated with Shonfield’s (1965) interventionist state.

In sum, globalization is a special side of the box because of its relational transformative character. Once globalization is recognized, national VoCs analysis is compelled to take account of both other country economies and the economic architecture of the global economy that governs relations between country economies.

## **7. Mind the economics but don’t forget the politics**

The primary goal of this paper has been to surface how capitalism involves meaningful choice. Contrary to Mrs. Thatcher, there are alternatives. The analytics of the box is the terrain of economics. At this stage, I want to close the paper by venturing into the question of how countries choose the design of the box. That is the terrain of political science since the design is essentially an issue of collective choice.<sup>36</sup>

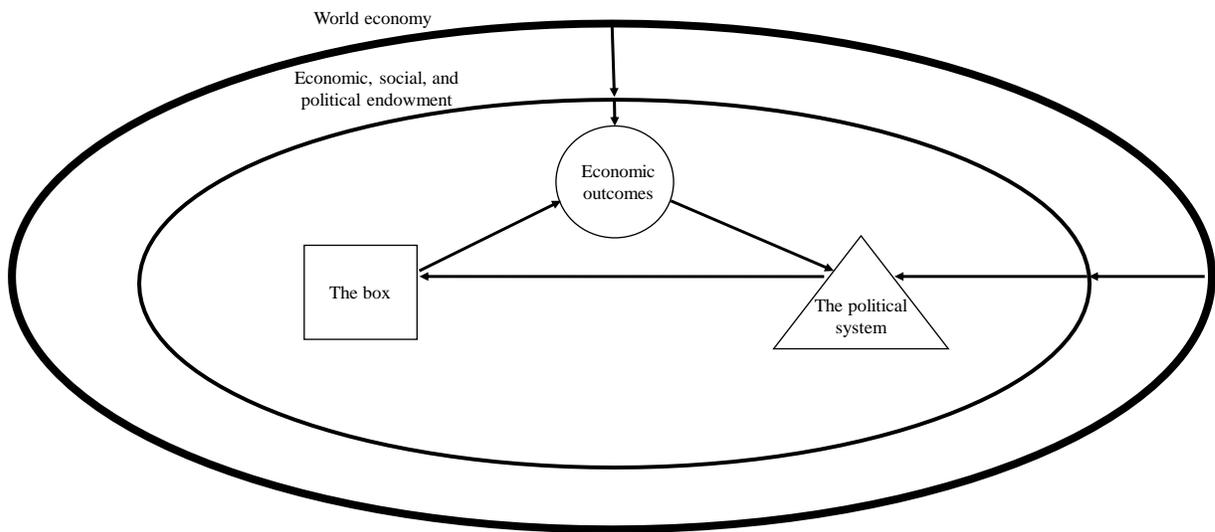
### ***7.1 A stylized political – economic framework***

The task of explaining the design of the box is massively complicated. The starting point is a simple stylized model illustrating the interface between economics and politics, which helps frame the discussion. That model is illustrated in Figure 10 which provides a topographical mapping of the political economic nexus.

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<sup>36</sup> I venture across the boundary with trepidation, but if political scientists can engage in economics, it seems only fair that economists be allowed to engage in political science.

Figure 10. Design of the box: the interaction of economics and politics.



The outer oval refers to the world economy, reflecting the fact that every national economy is part of the world economy. That means it is subject to the workings of the world economic system, is impacted by other economies in that system, and is impacted by the place it occupies in the world economy. Those factors constrain and restrict the available choice space, thereby influencing the ultimate design of each country's box. As noted above, the center versus periphery distinction is key for characterizing the place economies occupy. Periphery economies face constraints that are not in play with center economies.

The inner oval is labelled economic, social, and political endowment. Every economy has a history and an endowment that it brings into the present. The economic endowment refers to its state of economic development, institutions, laws, business organization and practices, capital-labor ratio, level of technological development, accumulated wealth, distribution of wealth, etc. The social and political endowment refers to cultural and ethical values, behavioral norms, the complex of social relations, and beliefs. Those beliefs include ideas about how the economy

works. Cultural and ethical values will influence the type of economy the country wants (i.e., what might loosely be termed social preferences). Beliefs about how the economy works will influence what arrangements society thinks are viable (i.e., the perceived choice set), and they may also influence beliefs about what is desirable. The TINA doctrine is evidence of the power of ideas. If arrangements are believed to be unviable, they will not get a political hearing and not be tried.

The political economic system is placed within those two ovals. It consists of the political system, the economic box, and the set of economic outcomes generated by the economy. The two outer rings constitute context within which the system is set. The factors represented by those rings influence the behaviors of both economic and political actors, as symbolized by the inward arrows.

The political economic system constitutes a loop whereby the political system impacts the design of the box, which impacts economic outcomes that then feedback to impact political outcomes. Palley (2007; 2013, Chaps 1 and 12; 2021a) shows how financialization has been driven by financial interests pushing policies that changed the structure of the economy, thereby changing economic outcomes which in turn feedback to impact political power. The looping process is also analyzed by Palley (2017/18) in the context of the problem of lock-in which is discussed in Section 7.4 below. Political developments can lock-in changes in the economy and vice-versa. Acemoglu (2010) argues policy reforms in developing economies cause economic changes that may cause further (perhaps offsetting) policy changes. In a closer vein, Acemoglu and Robinson (2013) illustrate how policy reforms recommended by economists have economic impacts that feed back to affect political equilibrium in the political sector.

Political science has traditionally focused on the interaction between electoral politics and macroeconomic performance (see Hibbs, 1987). The electorate rewards or punishes politicians for economic outcomes, which leads politicians to devise economic strategies that please voters in a way that creates a winning coalition. Now, there is growing awareness of the importance of politics for VoCs analysis (see Hall and Thelen, 2009; Thelen, 2012; Hall, 2020). The box makes clear the reason for that. It substantially defines the VoC which is significantly a political creation. Applying traditional political science logic, politicians in democratic polities will have an incentive to adjust the box in ways that foster a winning coalition of voters. Conventional coalition interest group politics and the determinants thereof should therefore be an important consideration in explaining the box and its evolution.

There are three critical features to Figure 10. First, the endowment (economic, social, and political) influences the structure of the economy. It does so by influencing the understandings and behaviors of political system actors, thereby directly impacting the design of the box. The endowment also impacts behaviors of economic agents which determine economic outcomes, thereby influencing the political system and indirectly influencing the design of the box. The influence of history and societal values is a recurrent theme in the VoCs literature. The model in Figure 10 explains that influence which is represented by the arrows of influence from the endowment into the political economic system. Shonefeld (1965) emphasized the importance of the France's statist tradition and administrative capacity in explaining France's superior use of the interventionist tool set compared to the UK. That tradition and capacity have roots in France's history of absolute monarchy. Hall and Soskice (2001) emphasize the historical path of economic development in explaining the practices of coordinated market economies (CMEs).

Differences in history, political tradition, and beliefs are also relevant to explaining why neo-corporatist wage-setting arrangements prevail in some countries and not in others.

Second, the looping process in Figure 10 directs attention to power, both economic and political. The political system substantially designs the economy, while the economy influences outcomes in the political system. That renders politics and economics inseparable, and power is the essential bond between the two. Political power determines political outcomes which shape the box and economic outcomes, thereby influencing the distribution of economic power. The latter then influences political power and political outcomes. That looping process is central to the findings of Bartels (2008) and Gilens (2012) re the connection between economic inequality and political inequality.

Third, the system is highly dynamic. Internal developments and external shocks to both the economy and the political system can cause changes in the design of the box via the above mechanism. Capitalism is a live system which is constantly being adjusted and recalibrated in response to changing circumstances. That raises questions of how to assess and categorize such changes, which is discussed in Section 7.3 below.

### ***7.2 Political systems as a characteristic of VoCs?***

Figure 10 shows the political system having a significant impact on the economy via influence on the design of the box. That raises the question whether there is a systematic relationship between the character of the political system and VoCs, and whether the political system constitutes a marker of capitalism? That argument is made by Milanovic (2019) who distinguishes between “liberal democratic capitalism” and “state capitalism” in his thesis of “capitalism alone” (i.e., capitalism as the globally hegemonic economic form).

Milanovic's focus is geo-political competition and whether the developing world will follow the US model or Chinese model. He argues the latter has the current advantage of fast growth, but it faces future economic challenges from the deleterious effects of corruption. Siegel et al. (2004) make a different argument which is that liberal democracy avoids policy induced economic black holes. Democracy is a mechanism for correcting policy mistakes. Authoritarian polities lack that course correction mechanism. Consequently, they tend to get locked into failing policies.

A binary political framing is very parsimonious. Instead, capitalism might be quarterized politically into liberal democratic capitalism (e.g., UK, Canada, Australia), neo-corporatist democratic capitalism (e.g., Western Europe), plutocratic democratic capitalism (e.g., USA), and state capitalism (e.g., China). That expanded framing introduces additional political markers.

China's state capitalist political system has a large state-owned industrial sector – what used to be called “nationalized industries”. It is also characterized by a greater degree of planning, reflected in extensive public infrastructure investment. France, with its statist political pedigree, has a history of emphasizing economic planning and it also supports national industrial champions. Germany and Northern European countries (neo-corporatist democratic capitalism) are more supportive of worker council representation within firms and sector wage bargaining. Lastly, the US (plutocratic democratic capitalism) has embraced “hardcore” Neoliberalism, whereas the other Anglo-Saxon economies (liberal democratic capitalism) have embraced “softcore” Neoliberalism.

Anglo-Saxon countries have a history of constitutional monarchy, a common law legal tradition, and democracy is organized on a parliamentary first past the post principle. Western Europe has a history of absolutist monarchy, a Roman law legal tradition, and democracy is

organized on proportional representation. Since all have roughly the same level of economic development, that suggests those political and legal differences may contribute to explaining differences in varieties of capitalism.

There is logic to that as the political system fundamentally impacts the economy via design of the box. Employment relations are a form of political problem, and it makes sense that countries would seek to solve them in a similar way to how they solve other political problems. The implication is the political system may be another meaningful marker for both varieties and varieties of capitalism.<sup>37</sup>

### ***7.3 Theorizing change within and of VoCs***

The discussion of Figure 10 emphasized how capitalism is a dynamic changing system. That begs a theory of change, the first step of which is to identify what constitutes change. That question relates to the distinction between varieties and varieties. There is need to distinguish between (a) changes of variety, (b) changes of variety, and (c) changes within a variety. Note, that framing introduces a distinction between “of” and “within”.

Regarding changes within a variety, governments respond to the ordinary course of events and make policy changes. For instance, the monetary policy authority may decide to change its inflation target or interest rate setting policy guideline. Governments also turnover through the normal political process, which may deliver policy change that affects the box. For instance, a new government may raise the minimum wage which impacts the “labor market and employment relations” side of the box. Such policy recalibrations constitute changes within a

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<sup>37</sup> The political taxonomy begs the questions of whether it is sufficient to incorporate the political systems of East Asia and Latin America, and whether their political systems impact their capitalism?

varietal and are commonplace. For a democracy, they can be explained by the conventional political science of electoral politics and interest group competition.

A more difficult task is to define changes of varieties of capitalism. That begins with acceptance of the proposed “variety vs. varietal” distinction. A change of varietal corresponds to substantive change of the box, yet still leaves the overall character unchanged. As for the politics of varietal change, they too fall within the confines of conventional political science coalition interest group analysis. The impulse for change is the forces that make for changing power of interest groups and changing interest group demands, which then change political outcomes.<sup>38</sup>

Change of variety constitutes more fundamental change. Recalling Figure 4’s stylized history of North Atlantic capitalism, variety change can be driven by technology, business practice, and politics. The shift to Victorian factory capitalism was driven by changed technology. The shift to managerial mass market capitalism was driven by changed business practice, while the shifts to both social democratic Keynesian capitalism and Neoliberal capitalism were politically driven.<sup>39</sup>

Events and ideas matter for politically driven change of variety. Dislocating events were critical for both the shift to social democratic Keynesian capitalism and the shift to

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<sup>38</sup> Drawing on current events, President Biden’s economic program can be viewed as a change of varietal. His Build Back Better program proposes introduction of universal pre-Kindergarten education, an expanded permanent child tax credit, significant climate change related investment, marginal changes to low-cost housing provision, and marginal changes to Medicare that expanded coverage and lowered costs. Additionally, the Biden administration supports a significant increase in the minimum wage and passage of The Protecting the Right to Organize Act. The US would remain characterized by Neoliberal capitalism. However, the program would deliver a “softer” version, constituting a change of varietal. The Biden administration’s difficulty getting its agenda passed reflects its insufficient coalition strength, and it is also hobbled by the US political system which permits gerrymandering of Congressional districts and gives excessive Senate representation to conservative rural states.

<sup>39</sup> It could be argued the Neoliberal era has witnessed a change of variety through Neoliberal globalization. The first twenty years corresponded to national Neoliberal capitalism. Since the mid-1990s, there has been a shift to global Neoliberal capitalism driven by the founding of the World Trade Organization, the North American Free Trade Agreement, and the full admission of China into the global trading system.

Neoliberalism. The Great Depression was critical for the former, while the stagflation of the 1970s was critical for the latter. Changed ideas are also critical. The Keynesian revolution in macroeconomics was critical for the shift to social democratic Keynesian capitalism, while the shift to Neoliberalism was assisted by the rise of the Chicago School of economics. Both dislocating events and changed ideas foster the political demand for and supply of change.<sup>40</sup>

#### ***7.4 Policy space and policy lock-in***

Varieties and varietals of capitalism reflect politically shaped societal choices. That makes the choice set a key issue, which connects to the issue of policy space. That issue has been raised in connection with Neoliberal globalization which is argued to reduce and twist policy space (Palley, 2021c). It does so by rendering infeasible policies which were previously feasible. That can be either by changing the cost – benefit profile of policies, or via international agreements that explicitly make certain policies illegal (e.g., tariffs and subsidies).

Rodrik (1997, 2011) notes how globalization creates economic winners and losers, while making it more difficult to implement policies that compensate and protect losers. In effect, it raises the costs and lowers the benefits of policy interventions that compensate. Chang (2002) characterizes international trade agreements of the past forty years as “Kicking away the ladder” by making illegal previously effective development policies. Those examples illustrate the policy space issue and connect with the discussion in Section 3.h regarding the designed character of the center – periphery relationship.

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<sup>40</sup> In both instances, there were also other supportive political developments. In the 1930s and 1940s it was the political competition and threat provided by communism and the Soviet Union. In the 1970s it was social backlash spurred by the civil rights movement, the peace movement against the Vietnam War, and the anti-establishment counterculture movement.

Another mechanism whereby globalization has shrunk policy space is via intellectual monopoly, which connects with the earlier discussion of the Washington Consensus. Part of globalization has been intellectual globalization whereby technocrats from around the world are trained at elite institutions such as Harvard University's Kennedy School. They then take that training back to their countries where they shape policy according to what they have been taught. The International Monetary Fund, the World Bank, and other multi-lateral institutions are also part of this mechanism, providing conduits for global implementation and enforcement of dominant ideas.<sup>41</sup>

As regards VoCs analysis, shrinking policy space has two important implications. First, reduced policy space will tend to reduce heterogeneity of capitalism. A smaller choice set means less variation of choice outcomes. That is very relevant for evolution of varieties of capitalism and would predict economies display increasing similarity under Neoliberal capitalism. Second, reduced policy space cuts off paths of development. Consequently, emerging market economies may get trapped and rendered unable to close the gap with developed economies. In terms of core – periphery theory, shrinking policy space cements the existing structure.

The issue of policy space connects with the issue of policy lock-in and lock-out (Palley, 2017/18). The logic of policy lock-in is that policies may be very hard to reverse, and even if they are reversed the economy may not revert to its initial condition. Consequently, policy decisions regarding design of the box may near-irrevocably change the economy's structure, changing both the economy's performance and future policy possibilities.

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<sup>41</sup> That mechanism is exemplified by Chile's infamous "Chicago boys" episode in the 1980s, when former students of Milton Friedman implemented a Neoliberal economic program for the Pinochet dictatorship along lines suggested by the Chicago School of Economics.

Policy lock-in is illustrated by the euro and trade agreements which have created new institutional arrangements and business patterns that are very costly to reverse. Those costs lock-in the new arrangements. In the US, globalization has resulted in evisceration of manufacturing labor unions. Those unions were formed in a different political era and reversing globalization policy would not bring them back in full. Even standard macroeconomic policy may have hysteretic effects by causing changed economic outcomes that impact the distribution of wealth and income, thereby causing changes in political power that may lock-in the changed policy.

Lock-in is also important for understanding financialization (Palley, 2021a, p.487-489) as it has increased stock market participation and home ownership, which has changed people's economic interests and political economic identification. Additionally, lock-in helps explain the political economics of the welfare state (Palley, 2020, p.603-605) as the creation of benefits and entitlements creates new political constituencies that make repeal of such changes difficult.

As regards VoCs analysis, lock-in helps explain the durability and persistence of both varieties and varietals of capitalism, which can endure even if performance is poor. Lock-in also explains why cross-country differences may persist, as lock-in keeps countries different once they have gone down different paths. Lastly, and counter-intuitively, lock-in also explains homogeneity because diversity may be hard to recover once lost. In effect, lock-in can be a form of quasi-extinction mechanism. Thus, if shrinking policy space reduces 'softer' varietals of Neoliberal capitalism, lock-in makes it hard to recover those varietals.

## **8. Conclusion: taking stock**

The VoCs approach to capitalism has the potential to transform economics. It implicitly emphasizes the plasticity of economies, whereby their character and outcomes are significantly a matter of choice. The paper augmented VoCs theory to include a distinction between varieties

and varieties of capitalism. Drawing on biology, varieties correspond to species and varieties correspond to sub-species. Varieties are rarer, whereas varieties are plentiful. Ironically, varieties may be far more important, as economies are characterized by a given variety at each moment in time and change of varietal is easier and more common.

The paper proposed an analytical framework that unifies VoCs theory. It adds a mesoeconomics that links macroeconomics and microeconomics. Mesoeconomics concerns institutions, behavioral norms, rules and regulations, and policies that characterize the economy and influence its performance. The mesoeconomic structure was described using the metaphor of a box, the six sides of which correspond to the major dimensions of capitalist economies, with globalization being a special side. The box metaphor illustrates how economic arrangements can favor capital or labor.

The design of the box is the product of societal and political choices, which places politics and power at the center of VoCs analysis. Policy space and policy lock-in are important concerns as they impact the choice set. Since the box is a product of socio-political choice, country capitalisms are marked by their political and legal traditions.

The fact that economies inevitably involve choice means there is an inescapable implicit normative question regarding what type of capitalism society will have? Mrs. Thatcher's TINA argues for Neoliberal capitalism and uses the rhetorical trick that it is the only viable form. Mainstream economics has helped promote that view. VoCs analysis potentially frees economics from the TINA straitjacket. In doing so it creates a research agenda that is a blend of positive and normative economics. The positive agenda is to understand the workings of alternative varieties and varieties of capitalism. The normative agenda is to help guide society in its deliberations regarding different varieties and varieties. My personal take on that agenda is what I term

“economics for democratic and open societies”. At a time when democracy is threatened by a rising tide of political intolerance and proto-fascism, it is vital we understand what economic arrangements are needed to support democracy and open society.

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