Exploring varieties of capitalism

Among various theories of the diversity of capitalism proposed in recent years, the Varieties of Capitalism (VOC) brought up by Hall and Sosckice (2001) remains the most influential yet controversial one. The VOC approach has been widely adopted in the study of Industrial Relations (IR) but also criticized by many scholars. With the increasing level of globalization and the development of technology around the world, it has been questioned that the VOC approach may be getting incapable in explaining features of capitalism in different economies since it is believed most of the economies tend to adopt a mixed capitalism style (see Jackson 2005). However, this essay, drawing on analysis of industrial relations in UK and Germany, argues that the VOC is still valid in interpreting the features of these economies and moreover, the changes in these two economies are fateful due to their characteristics as LME and CME.

Methodology and Scope of the Paper

To demonstrate the argument mentioned above, the paper analyzes the changes in respond to globalization in UK and Germany's IR during 1990s using comparative method. The two countries are selected for two reasons. Firstly, they represent the two types of capitalism proposed by Hall and Sosckice: UK is a traditional LME while Germany is a good example of CME. Secondly, since they are both European countries, the globalization impact on their economies are similar; hence make it easier to compare their innovations in IR system. In order to study the IR system in these two countries, Dunlop's model (1958) is applied. He identified three actors in the system: employers, employees and the government. The relationships among these parties are hence affected by the environmental issues such as technology, market, and so on. Dunlop defined the output of the system as the network of rules that govern the workplace (Bamber et al. 2004). Hence, this paper examines how the actors (namely government, union, and organizations) respond to changes brought by globalization and the outcomes of their responses and compare these responses to prove the argument.

The paper begins with a brief explanation of the VOC approach, and the critiques from scholars. The impact of globalization and how the impact changed the European environment is then discussed. The changes in UK and Germany’s IR system are then analyzed and compared. Conclusions and implications on the VOC approach are draw based on these comparisons.

The Concept of VOC

Hall and Soskice’s (2001) VOC approach focuses on firms and takes a relational view of firms. It argues that the coordination of firms with other actors (such as the government and trade unions) is a key success factor. The coordination involves five aspects: industrial relations, vocational education and training, corporate governance, inter-¬ firm relations and the relations with employees. However, the way to solve these five types of coordination differs from economies. Hall and Soskice suggested two ways of achieving coordination: relying on market competition or strategic interaction with institutions. Judging by the way firms coordinate with other institutions, the economies can be divided into Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs).

LMEs are economies in which firms relies mainly on the mechanism of market competition. It can be characterized as:

- well-developed capital markets and outsider forms of corporate governance;
- market-based forms of industrial relations with few long-term commitments by employers to workers and
- use of market mechanisms and contracts to co-ordinate their relations with supplier and buyer firms.

(Wailes et al., 2009)

While on the other hand, CMEs relies heavily on firms' interaction with other institutions in the economy. Its key features are summarized by Wailes et al. (2009) as:

- well-developed capital markets and outsider forms of corporate governance;
- market-based forms of industrial relations with few long-term commitments by employers to workers and
- use of market mechanisms and contracts to co-ordinate their relations with supplier and buyer firms.

Hence, it is reasonable to think that within the context of globalization, LMEs and CMEs tends to response differently. It is obvious that changes are inevitable in both types of the economies. But the questions are what changes will take place and how these changes will impact the actors in LMEs and CMEs. Hall and Soskice's (2001) had also identified several possible outcomes of globalization:

The response of LMEs and CMEs to challenges tends to be different;

LMEs are more likely to offshore while CMEs are not likely to offshore since they prefer to gain competitive advantages from workers with industrial-specified skills; and

Firms from time to time may shift some of their activities from the other type of economy (i. e. from LMEs to CMEs or CMEs to LMEs).

Critiques of VOC

Although the influence of VOC in IR study is significant, it also gains critiques from many scholars. One of the strongest arguments against VOC is that the proposed CMEs and LMEs are not enough to explain the varieties of capitalism in economies around the world. Many economies may lie in somewhere between LMEs and CMEs, and it also not appropriate to explain the emerging markets such as Asia, Latin America and so forth (Wailes et al., 2009).

Another argument is associated with the concept of institutional complementarities and the mechanism behind changes proposed by Hall and Soskice. However, the changes discussed are mainly path-dependent changes, and does not help to explain and identify the possibility of radical changes (Crouch and Farrell 2002). It has also been criticized for its institutional deterministic. According to their argument, for example, since LMEs are lack of experience in CMEs, it is not likely that a LME will evolve in a coordinated form. However, there are in reality, evidence indicating that the effort made by some LMEs to shift towards CMEs has been proved successful (Culpepper, 2003).

Globalization and Changing European Market

Globalization, often seen as one of the most significant characteristic of modern world, is greatly affecting every aspect of each society. As defined by Lauder et al. (2008), globalization is a process in which integration of economic, cultural and institutional aspects takes place among different countries. This integration can be the result of many forces such as development of technology, deregulation, international investment and capital flow, reduction of trade barriers among nations, assimilation of international standards, and so on. As a result, the process of globalization has led to the increasing level of competition among countries fostering the evolvement of management practices and methods and structure of organization. On the other hand, it has also negatively impacted the rate of unemployment and the labor movements.

Globalization has influenced the European economies significantly during the past few decades. One of the most important changes is the import of cheep products from foreign countries especially emerging markets. This has greatly severed the level competition and poses challenges in many countries including UK and Germany (Hall, 2007). Moreover, globalization has also resulted in the outflow of capital which is supposed to be invested in domestic industries. With the access to cheap labour in emerging markets such as China, industries using low-skilled workers have been facing shutdowns (Wood, 1994). All these factors have contributed to the problem of employment, which pushed European countries to shift from basic manufacturing to value-added production and service industries which requires a change in workforce skills.

As a result, the intensified competition has fostered the so called ‘ creative destruction’ as defined by Schumpeter (1949) as the adding of new jobs while reducing other jobs. This requirement for changing employment focus and skill pattern has created tension in many European economies since the replacement of jobs is a difficult and time-taking process. Moreover, given that the birth rates in many European countries are relatively lower, many countries have to keep employment rate in order to support the whole economy while the shift from manufacturing to service industries(Scharpf, 2000).

Generally speaking, while globalization has brought benefits, it poses more challenges on European countries in terms of intensified competition and the requirement of shifting from manufacture-based to serviced-based economies. These requirements however, have led to different responses of IR actors in LMEs and CMEs due to their different features as described by VOC.

IR System Changes in UK

As categorized by Hall and Soskice (2001), UK is a typical example of LME as firms are highly relying on competitive market relationship. Based on this characteristic, it is not surprising that the UK firms did not face too much difficulty when competition has been severed by globalisation. UK firms in this case were able to response to the market change rapidly and started to autonomously shift to new markets and seek for expansion.

Meanwhile, the UK government also played an important role in response to the impact of globalization due to the nature of LME. Since labours in an LME are more likely to develop their general skills compared to specialised skills, the shifting in service sector makes it easier for the people to modify their skill set. For the requirement of workforce skill changes, the government had increased the formal schooling to help labours develop new skills. To reduce the unemployment rate, the government had also implemented a so called ' New Deal' in 1997 to encourage unemployed workers seek for new jobs or go on for further trainings (Rhodes, 2000).

Low level of job protection makes it easier for firms to layoff labours and to acquire new workers to support their changing business focus. Furthermore, since the trade union has lower power in collective bargaining, the range of issues covered in collective bargaining was narrow and unions are left with the ' take-it-or-leave-it' offer (Kessler & Bayliss, 1998). This makes it easier for firms to reduce labour cost in order to bring down operation costs. However, this also holds companies back from adopting new technology and human capital development because firms can easily reduce cost by cutting down wages.

IR System Changes in Germany

On the other hand, as a CME, Germany's reaction towards the challenges brought by globalization is quite different from that of UK. The German taxation system made it hard for organizations to reduce non-wage costs (Hall, 2007). Hence, wage reduction is crucial for German firms to keep their competency in the changing market. However, since firms are provided with support by national institutions in Germany (Hall and Soskice 2001), the required shift from manufacturing to service industries has been slowed down since firms needs to negotiate with trade unions regarding to issues of workforce layoff, wage changes and so forth. As a matter of fact, the trade unions were unwilling to agree labor dismiss and changes in wages as these damage the employees' welfare.

Moreover, labour skills in CMEs are tends to be specialized which makes it more difficult for German workers to shift from different industries. Even those workers with specialized skills who shifted into new jobs found that these new employment were less secured (Gordon, 1995). The increase unemployment rate also resulted in the reduction of domestic demand. As a result, the highly coordinated and centralized collective bargaining in Germany had made the economy incapable of providing solutions to labour market problems, especially the high unemployment rate (Busch, 2005).

The challenges and difficulties faced by German firms had facilitated the development of coordination of wage bargaining Germany. For example, agreements were reached at organizational-level in smaller firms instead of sectoral level (Schroder and Silvia 2006). The loosing of wage coordination also provided firms with higher flexibility to cope with the changing marketplace (Hall, 2007). The government had also implemented regulations that granted permission for part-time labours whose wage did not need to be collectively bargained.

However, despite these changes which reduced the level of coordination in Germany, the predominance of the previous IR system remains as firms still had to coordinate with national institutions such as the government, work councils and unions. In 2006, over 60% of the workers in Germany were still covered by the collective bargaining agreements, which were around twice as that in UK (EIRO). The labour skills in Germany were still specialized rather than general (Brown, 2003). Although the government's changes in policies and regulations had positive effect in helping the economy to cope with globalization, the unemployment rate was still quite high.

Conclusion and Discussion

To sum up, this paper examines the application of VOC in the changing environment which is partly the result of globalization. Globalization has greatly impacted the European economies and brought challenges such as increasing level of competition, needs for shifting from manufacture-based to service-based economies, and requirements for alternation of workforce skill formations. However, when facing similar challenges, the response of LMEs and CMEs are different. UK as an example of LMEs, responded quickly due to the nature that firms are market driven, while Germany as a CME faced difficulties in several issues due to the strong coordination in the economy. However, in both cases, although the ways of coping with challenges were different, the outcomes of these methods did not significantly change their IR features as LMEs and CMEs. The mechanism lies behind these changes is consistent with the concept of VOC. The impacts of these changes taken place in UK and Germany reinforced their characteristics as LME and CME. It can be predicted that the future development of IR in these two economies will continue to be divergence due to their institutionalized practices as characterized by the VOC approach.

There are several limitations on this paper. Firstly, the conclusion is based on the case of UK and Germany. Both countries are typical examples of LMEs and CMEs. Hence, their reactions towards globalization may also be largely affected by their historical performance. It may still be argued that other economies, especially those ones lies between CMEs and LMEs and the emerging markets, may generate a different conclusion. Secondly, the paper did not consider the impact of multinational enterprises. Thirdly, from the long-run, it is hard to determine whether there would be any radical changes which are significant enough to shift an economy from LMEs to CMEs or vice versa. Only time will prove.