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Bringing the State Back Into the Varieties of Capitalism And Discourse Back Into the Explanation of Change*

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Abstract

The Varieties of Capitalism (VOC) literature's difficulties in accounting for the full diversity of national capitalisms and in explaining institutional change result at least in part from its tendency to downplay state action and from its rather static, binary division of capitalism into two overall systems. This paper argues first of all that by taking state action—used as shorthand for government policy forged by the political interactions of public and private actors in given institutional contexts—as a significant factor, national capitalisms can be seen to come in at least three varieties: liberal, coordinated, and state-influenced market economies. But more importantly, by bringing the state back in, we also put the political back into political economy—in terms of policies, political institutional structures, and politics. Secondly, the paper shows that although recent revisions to VOC that account for change by invoking open systems or historical institutionalist incrementalism have gone a long way toward remedying the original problem with regard to sta-

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sis, they still fail to explain institutional change fully. It is not enough to turn to rational choice institutionalist explanations focused on the micro-foundations of action, as some do, since this does not get at the dynamics behind changing preferences and innovative actions. For this, I argue, it is necessary to add discursive institutionalist explanations focused on the role of ideas and discourse. Bringing the state back into the substantive account of capitalism actually promotes this methodological approach, since an important part of politics is political communication and deliberation on the choice of policies within given institutional contexts, economic as well as political.

In much of comparative political economy today, the state barely exists, while explaining institutional change is problematic. The "firm-centered" varieties of capitalism school (VoC) has reduced the state to its regulatory function while the approach as a whole tends to appear static, by downplaying the very real disaggregating forces in the two diverging varieties of market economies, the "liberal" and the "coordinated." There is no question that recent scholarship has made real progress in addressing these problems—some argue for more than two varieties of capitalism, others propose open systems or incremental historical institutional analysis paired with strategic action to deal with the question of how to account for institutional change. But state action nevertheless remains undervalued, the configuration and number of the varieties of capitalism is still contested, and explaining—as opposed to simply describing—institutional change continues to bedevil. In what follows, I seek to move the debate forward by demonstrating the importance of bringing the state back into the varieties of capitalism and of bringing ideas and discourse back into the explanation of institutional change.

To demonstrate the relevance of the "state" as a category for analysis, the paper shows, first, that by introducing the state as a separate category, at least three varieties of capitalism become apparent, "liberal' market economies" (LMEs), "coordinated" market economies (CMEs), and "state-influenced" market economies (SMEs), with the third variety distinctive not simply because of the greater importance of state action, but also because of how this affects the whole logic of interaction of business, labor and state. Second, the paper demonstrates that state action is a much more complicated variable than ordinarily assumed in the VoC literature. This is because state action in the varieties of capitalism needs to be differentiated in three ways: on the basis of "policy"—that is, on the extent to which state actions have not only substantively moved along a continuum from *faire* (state action) to *laissez-faire* (market action) but also the extent to which their policies encompass *faire faire* (state setting guidelines for market action) or *faire avec* (state action with market actors). On the basis of "polity"—meaning the political institutional context which may take the form of "simple" polities in which governing activity is channeled through a single authority or "compound" polities in which governing activity is dispersed through multiple authorities. And on the basis of "politics," by which I do not mean just "politics as usual"—which is largely explained within the VoC literature by recourse to a combination of two of three "new institutionalisms"—historical and rational choice institutionalist—through macro-historical explanations of institutional practices combined with micro-foundational explanations of strategic action.[1] Rather, by "politics" I also mean the kinds of interactions best analyzed by way of the newest of the "new institutionalisms"—discursive institutionalism—which focuses on the substantive content of ideas and the interactive processes of discourse, and which can help explain the reframing of strategic action as well as the reshaping of institutional practices (Schmidt 2002a, Ch. 5, 2006a, Ch. 6, 2006c; see also Campbell 2001; Campbell 2004). Discursive institutionalism serves, in a manner of speaking, as "micro-foundations" to the micro-foundations of rational choice institutionalism or, better yet, flipped over so as to appear at the top of the explanatory hierarchy, as lending insight into the full dynamics of institutional change.

[1]Although the third of the "new institutionalisms," sociological institutionalism, also contributes to our understandings of comparative political economy, we leave it aside here because the VoC school largely does. For discussion of how it fits with rational choice and historical institutionalism, see Hall and Taylor 1996, Checkel 1998, Schmidt 2006c).

The paper begins with a brief review of scholarship on the state and capitalism before engaging with the recent debates on the varieties of capitalism, and making the case for the existence of a third variety of capitalism in which state action is a defining characteristic. It illustrates the differences briefly first by contrasting the British LME and the German CME with the French SME, and then expanding the characterization of SMEs with the cases of Italy and Spain. The paper then goes on to focus on state action with regard to policy, polity and politics, making the point that the varieties of capitalism overlap to a reasonable extent in their policies despite differing coordinating mechanisms; that countries clustered in the same variety may differ in political institutional characteristics which have an effect on their coordinating mechanisms; and that politics has a tremendous and unpredictable impact on the coordinating capabilities of economic as well as political actors across varieties. Lastly, the paper examines the problem of explaining institutional change in the VoC literature. It argues that the VoC's rationalist micro-foundations do not sufficiently explain the dynamics of change, and then demonstrates how an added discursive institutionalist attention to ideas and discourse could help in this endeavor. In this context, the paper explores how the political communication and deliberation at the basis of state action, understood as government policy forged by the political interactions of public and private actors in given institutional contexts, is a significant factor in the dynamics of change in the varieties of capitalism. It illustrates with examples from the three varieties of capitalism.

Bringing the State Back Into the Varieties of Capitalism

The state has had its ups and downs in comparative political economy. After taking center stage up until the late sixties (e.g., Shonfield), it faded out only to return with vigor in the late seventies and early eighties, when the state "came back in" (Skocpol 1979, Katzenstein 1985, Evans et al. 1985), only to disappear again, this time seemingly for good. This was the result of material events linked to globalization, which reduced the assumed power and autonomy of the state, and of theoretical developments related to the rise of the "new institutionalism," which disaggregated the state into its institutional parts (see Steinmo et al. 1992; Pierson 1996). The upshot of these twin developments has not so much been that the state was thrown "back out" as that instead of remaining in the foreground of political economic research as an autonomous actor it ended up in the background, significant mainly through the effects of its variegated institutional structures and practices. The state *qua* state has been barely present as a meaningful force for political economists in the VoC school who see a binary division of capitalism into two varieties, liberal market economies (LMEs) and coordinated market economies (CMEs). Bringing the state back in, however, allows us to see at least three varieties of capitalism, with "state-influenced" market economies (SMEs) useful and necessary to account for countries that have continued to sit uneasily in either of the binary categorizations.

How Many Varieties of Capitalism are There?

Political economists in the VoC school take firms as their primary focus, consider how they coordinate with their environment, including their relationship to providers of finance, to other firms, and to labor, and explore how this works out in terms of corporate governance, inter-firm relations, industrial relations, and vocational training and education. Coordination takes two possible forms, depending on the ideal-typical variety. In liberal market economies (LMEs), the market coordinates interactions among socioeconomic actors, whereas in coordinated market economies (CMEs) socioeconomic actors engage in non-market coordination (see

Hall and Soskice 2001). The state, if considered at all, plays at most a supportive role in creating a positive regulatory environment.

Although this binary division of capitalism is highly seductive because of its parsimony, it has been the subject of many critiques, including the very basic one that a binary division into ideal-types tends to be too reductive, squeezing much too much into much too rigid a set of categories (see Crouch 2005). Another problem, addressed in the last section of this paper, is that the explanation is overly functionalist, with its emphasis on complementarity and positive feedback effects from coordination making the system largely static, overly path-dependent, and unable to account for institutional change (see Morgan et al. 2005; Crouch 2005; Schmidt 2002a, Ch. 3; Molina and Rhodes 2006). The issue that concerns us in this section, however, is the one most important for our current discussion of the role of the state, that is, that VoC has great difficulty dealing with country cases that are treated as outliers because they don't fit well into either ideal-type (Schmidt 2002a) and because they seem plagued by intra-system contradictions, misfits and perverse spillovers (Molina and Rhodes 2006). These cases include France, Italy and Spain, all countries where the state actually plays, and has in the past played, a much more significant role than in the countries that are the ideals for VoC's two ideal-types, Britain and Germany.

Although many comparative political economists have largely accepted the division of capitalism into only two varieties, a number of scholars have argued that there are at least three varieties of capitalism (Rhodes and Apeldoorn 1998; Coates 2000; Schmidt 2002a), if not four (Boyer 1996, 2004), five (Amable 2003) or more, including national varieties (Crouch and Streeck 1997), sectoral varieties (Hollingsworth, Schmitter, and Streeck 1994), or regional and local varieties (Crouch, LeGalès, Trigilia, Voelzkow 2001). Importantly, even those who seemingly accept the binary division increasingly talk about mixed market economies (MMEs) with different logics of interaction (Molina and Rhodes 2005), or "hybrids" in the case of Eastern European countries and even the country that constituted the ideal for the ideal-type, Germany, as well as Japan (Jackson 2003).

The differences among political economists on how many varieties of capitalism there are can be seen as depending mainly upon whether, as Colin Crouch puts it, one takes a "labeling" approach to create country groupings for the purpose of theoretical comparison or an "analyzing" approach concerned more with empirical realities (Crouch 2005). Another way of looking at it would be to differentiate between those who prefer parsimony, which makes for ideal-typical models and difficulties in applying to specific cases, and those who accept complexity, which may be more empirically valid but, naturally, suffers from its specificities (see discussion in Deeg and Jackson 2006, p. 21). Yet another way to explain the differences in approach, and the one used here, is to take note of how political economists preference a particular set of features in arriving at their ideal-typical models and country ideals. Convergence theorists tend to take finance and globalization as defining factors—with all that that means in terms of the internationalizing trends in capital ownership, corporate governance, and the emphasis on profits—making for convergence to a neo-liberal model, epitomized by the United States and the United Kingdom (e.g., Lane 2005, Strange 1996). Divergence theorists in the VoC school, by contrast, take firms and their coordinating mechanisms as the defining factors—with all that that entails in terms of market or non-market coordination of inter-firm relations, production systems, labor relations, as well as finance (i.e., Hall and Soskice 2001). This is what makes for the binary division into LMEs, epitomized by the U.S., the United Kingdom and Ireland, and CMEs, epitomized by Germany, the Scandinavian countries, the Netherlands, Austria, and Switzerland. Those countries that don't fit have been termed, variously, "mid-spectrum" economies (Hall and Soskice 2001) or "mixed market economies" (Hall and Gingrich 2004), which will necessarily underperform because they lack the complementarities (Amable 2003; Hall and Gingrich 2004). They include France, Italy and Spain, all three countries that can be seen as part of a third variety of capitalism.

For divergence theorists who see at least three varieties of capitalism, state action is the defining feature that serves to differentiate liberal and coordinated market economies from the third variety, which I call state-influenced market economies (SMEs). SMEs encompass countries in which the state played a distinctive role in the postwar period, intervening more, and differently, for better or for worse, than in LMEs and CMEs; and in which the state retains significant influence over business and labor, playing a more active, and different, role in the economy than the state in LMEs or CMEs, despite its retreat beginning in the mid-1980s. In Europe, country cases include France, which has moved from "state capitalism" to "state-enhanced" capitalism (Schmidt 2002a) and Mediterranean countries like Italy, which, until changes in the 1990s, was seen as a "dysfunctional state capitalism" (Della Sala 2004), "failed state capitalism" (Schmidt 2002), or part of a "Catholic-Statist Model" (Hopkin 2006) together with Spain, which has moved from a fascist state with a controlled economy to something similar to France's "state capitalism" (Royo 2005), or as part of "Latin capitalism" (Rhodes and Appeldoorn 1997) or Mediterranean "Mixed Market Economies" (Molina and Rhodes 2005) along with Italy, Portugal, and Greece. But Asian "developmental states" such as Korea, Taiwan, and possibly even Japan, can also be included in the category of SMEs, given a traditionally stronger role for the state, which remains influential, despite significant retreat, as well as closer state-firm relations and a paternalistic relationship of firms to labor (see Weiss 2003; Woo-Cummings 1999; Whitley 1999).[2]

Significantly, there is little in the VoC approach to contradict this view of a third variety of capitalism (except for its insistence on only two capitalisms), since the countries that best fit the variety of "state-influenced" market economies (SMEs) are the very ones that don't fit very well into the binary division of VoC. Thus, bringing the state back into the varieties of capitalism as an explicit category provides three advantages: 1) it helps identify a third variety of capitalism which is distinguishable on the basis of state action, grouping countries that have been left out of the two VoC ideal-types; 2) it allows us better to understand and explain the coordination processes of all political economies; and 3) it helps us to explain institutional change across countries. Points 1 and 2 are elaborated here, point 3 is the subject of the last section.

[2]If we were to add developing countries to the mix, we could see Latin American states as either another case of state-influenced capitalism, characterized by a hindering state, or yet another variety which, as described by Ben Ross Schneider (2004), is distinctive not only for the negative role of the state but also for the way in which the structure of business investment (by foreign MNCs) affects production systems—split between foreign companies where the high-tech, value-added aspects of production are done elsewhere, and national companies that do low-tech production.

The Importance of the State in the Third Variety of Capitalism

The role of the state in SMEs is theorized very differently from its role in LMEs and CMEs, such that we come up with three very different categories of states for the three varieties of capitalism. State influence, in which the state intervenes more in either an "enhancing" or "hindering" manner, serves to define "state-influenced" market economies. Arms-length relations serve to identify the "liberal" state in liberal market economies. Coordinating and facilitating activities serve to characterize the "enabling" state in coordinated market economies.[3]

In LMEs, the state is defined as "liberal" because it takes an arms' length approach to business and labor, limiting its role to setting rules and settling conflicts, and often leaves the administration of the rules to self-regulating bodies or to regulatory agencies (Hall and Soskice 2001). Here, the state acts as an agent of market preservation by providing framework legislation to locate decision-making power in companies and limit the power of organized labor (Wood 2001). In Britain, state action did not quite fit this liberal ideal in the postwar period but, since Thatcher, it has only become more liberal—ending its previous ad hoc interventionism in business, privatizing nationalized enterprises, and promoting the radical decentralization of wage bargaining—to end up with a much more hands-off relationship with business and labor (King and Wood 1999; Wood 2001; Schmidt 2002a, Ch.'s 3, 4).

In CMEs, the state is defined as "enabling" because it takes action not just to arbitrate among economic actors but rather to facilitate their activities, often leaving the rules to be jointly administered by them, while acting as a co-equal (or bystander) with management and unions in labor regulation and wage bargaining (Hall and Soskice 2001). Here, the state acts as a protector of the production system's non-market coordinating institutions by establishing and periodically renewing the framework laws that invest regulatory authority in private bodies, including employers' associations and unions (Wood 2001). In Germany, where state "enabling" is not quite as ideal as in smaller European countries like the Netherlands, Austria or Sweden, given a weaker federal state, the greater role of regional governments, and the bipartite wage-bargaining system, state relations (regional and federal) with business have nonetheless been highly supportive, by promoting cooperative business-labor relations through public law and economic productivity through targeted aid to industry in areas such as education, apprenticeship and training, and research and development. (Scharpf 1991; Soskice 1991; Streeck 1996; Schmidt 2002a, Chs. 3, 4). Moreover, whereas reforms beginning in the 1990s also involved liberalization, privatization and deregulation, they were negotiated with business and labor as opposed to imposed on them, as in Britain.

In SMEs, by contrast, the state is defined as "influencing" because it tends to intervene where it sees fit, either "enhancing" business and labor activity because public intervention has a positive impact on economic actors' interactions and productive capabilities or "hindering" it in cases where it has a negative impact on economic actors' interactions and productive capacities. In an SME like France, for example, the state in the postwar period playing an "enhancing" role, acting *in loco mercatis* where it deemed necessary, by acting in place of the markets with regard to wage-coordinating mechanisms, by taking the place of the markets through national-

[3]These categories are very close to Richard Whitley's (2005) four-fold categorization of states, with two of his categories, the "dominant developmental" states and the "business corporatist" state of Japan, encompassed by our "influencing" state in SMEs.

ized industries, or by orienting the markets through planning and industrial policies (Schmidt 2002a, Ch. 3). Since the mid-1980s, however, much of the French state's relationship with business and labor has changed, since the state no longer leads business, which has become largely autonomous as a result of privatization and deregulation, and no longer imposes wage bargains, since state withdrawal from wage negotiations has led to its radical decentralization. Nonetheless, the state continues to influence. It plays an "enhancing" role (or "hindering," depending upon one's point of view) by intervening in business when it decides to "rescue" companies from bankruptcy or foreign takeover, as in recent cases of government blocking energy and banking takeovers; and by choosing either to liberalize the labor markets, as in the case of the Villepin government's abortive attempt to increase flexibility with a two-year probationary contract for youth employment, or to "moralize" the labor markets, as in the case of the Jospin government's initiative on the thirty-five-hour work week beginning in the late 1990s (Schmidt 1996; Levy 1999; Schmidt 2002a, Ch. 4).

If it were only state action that served to differentiate France from Germany and Britain, then one might still be tempted to argue that all states intervene—some more, some less—and dismiss all talk of a third variety of capitalism. But bringing the state back in is not just about recognizing the differential role of the state. It is that in SMEs in which the state has long played an influential role, business interactions and labor relations also differ both in character and in logic of coordination from LMEs and CMEs.

Although French firms now gain much of their financing from the capital markets or from self-financing rather than from the state, they are much less vulnerable than the British, despite the high level of foreign institutional investors on the French Bourse. This is because, like the Germans, they also have large strategic share-ownerships as opposed to portfolio investment (Goyer 2003; Vitols 2001), even though the large, "hard-core" share-ownerships of major privatized companies have been dissipating (Morin 2000; Schmidt 1996). French firms' lesser vulnerability also stems from the fact that they have greater interconnectivity through informal networks based on state-related education and experience, although this is nothing like Germany's formal networks, in which business stakeholders as well as employees sit on corporate governance boards. Such informal state-networks are also a source of greater inter-firm coordination, sharing of information, and cooperation on corporate strategies than that found in Britain, even if it is no substitute for the deep network linkages of Germany (Hancké 2002; Schmidt 2002a, Ch. 4). CEOs in French firms, as a result, tend to be more autonomous than either their network-linked German or financial market-dependent British counterparts, let alone the state-led French firms of the postwar period (Schmidt 2002a, Ch. 3).

Labor relations have also been transformed. Traditionally fragmented and weak labor unions have only become weaker, except for a few strategic areas of the public sector. When the state withdrew from the organization of labor relations, having passed laws establishing direct management-worker dialogue in the hopes that a German-style coordination would take its place, radical decentralization of wage bargaining instead ensued (Schmidt 1996; Howell 1992). But although French labor relations are now more market-reliant and decentralized, they are nonetheless much more regulated than the British, given the state intervention noted above Business-labor relations, moreover, have moved from highly adversarial to neutral, much as in Britain, and lack the kind of cooperation and coordination for which the Germans are famous.

The differences in state, business and labor also make for very different logics of interaction in SMEs compared to LMEs and CMEs and, therefore, for very different mechanisms of adjustment. In the more intensively liberal market economy of Britain today, adjustment is driven by the financial markets and led by autonomous firms acting unilaterally, with comparatively little input—whether positive or negative—from the state or labor. In the more competitive coordinated market economy of Germany today, adjustment is led by firms and jointly negotiated cooperatively between business, labor and the state. In the state-enhanced market economy of France today, adjustment is firm-led in those domains where business now exercises autonomy—in business strategy, investment, production, and wage-bargaining—but adjustment is still state-driven in those domains where neither business nor labor can exercise leadership—in labor rules, pension systems and the like—or where the state sees a need to reshape the general economic environment to promote competitiveness. In either case, the logic of interaction is one of hierarchical authority rather than joint-decision or unilateral action (Schmidt 2002, p. 144)

If France were the only example of state-influenced market economies, then one might still be justified in treating the country as an anomaly, and remain with the more parsimonious binary approach to the varieties of capitalism. But, in fact, a number of countries also fit this variety—in Europe as well as Asia, as noted above. Italy and Spain are two countries in particular which scholars have recently described as SMEs, even if they have often come up with different names for it, as we have already seen.

Oscar Molina and Martin Rhodes (2005) have provided the most in-depth analysis so far for why Italy and Spain are also SMEs (although they call it "mixed market economies"—MMEs), because of the defining role of the state and the differential logic of adjustment. Focusing on industrial relations in particular, Molina and Rhodes find that to understand the coordination systems in these two countries, one needs to complement the VoC focus on the "micro-tier" of firm-centered relations with a "macro-tier" analysis of state action, the form and degree of which, they suggest, helps explain the absence of the very complementarities that serve to define LMEs and CMEs. This macro-tier, they argue, together with exogenous pressures, in particular from European Monetary Union (EMU), ensures a very different logic of adjustment. Whereas in CMEs the logic is "a process of accommodation via consensus from the bottom up" similar to the logic of joint-decision noted above for Germany, in their MMEs (our SMEs) the logic of adjustment is "top-down conflict governance," which is very close to the logic of hierarchical authority noted above for France, once we add into the equation the conflictual politics that such hierarchical authority often generates.

Although in all three countries the state has always played an influential role, the role it has played and the influence exerted have been very different, both in the past and the present. Whereas in France, state leadership in the postwar period could for the most part be seen as "enhancing," as the state promoted economic growth, in the other two countries it played more of a "hindering" role, in Italy because of state paralysis that hampered economic growth, in Spain because of a fascist state that stunted as it controlled economic growth. More recently, although the role of the state has been transformed, along with Italian and Spanish capitalisms, state intervention remains a defining characteristic, much as in France.

In Italy, the "hindering" state of the postwar period had neither the centralized authority of the French executive nor its administrative capacity. It was defined by *partitocrazia*, the politicization along party lines of all aspects of political and administrative life, so much so that, for example, appointments in the large nationalized sector of the economy were based on patronage rather than competence, and apportioned according to the electoral weight of the parties. In this context, business actors ignored the state when they could or, when they couldn't, bought it off it. Only regional governments, especially in the north-central and western regions, played an "enhancing" role for the "third Italy" of small, interconnected business (Locke 1995). With the inception of the "Second Republic" in the early 1990s, however, things got better, with the renewal of the Italian party system after its collapse at the time of the fall of the Berlin wall in the midst of corruption scandals. Privatization and deregulation began for real in the 1990s under center-left governments, as did reforms of pension systems and labor markets, although the latter slowed between 2001 and 2006 under Berlusconi's center-right government. Big business outside of the nationalized sector, although long more autonomous than state-led French business, given the predominance of family-owned private firms and the state's lack of leadership, increased its autonomy even more as a result of privatization and deregulation. Business relations with labor also improved significantly—but in this case followed a completely different course from that of France, and more like in Spain.

Instead of radical decentralization of the labor markets, as in France, both the Italian and Spanish states stepped in to help ensure greater business-labor coordination in a kind of macro-concertation between employers, unions and governments (Hancké and Rhodes 2005; Regini 2003; Royo 2002). Not only have business and labor in both countries been more organized than in France, labor has even greater capacity for disruption, given much higher union membership, and it has also had a stronger political role. Deregulation was therefore not a real option, as it was in France (Molina and Rhodes 2006). But concertation was also not easy—as the postwar Italian failure to attain corporatism attests. The more recent "state-led corporatism," therefore, was completely unexpected, given the traditional lack of organizational capacity; but it has been very different from the corporatism of traditional CMEs. Not only have the social pacts mainly been focused on reforming labor markets—to make them more flexible, to reduce labor costs and to increase competitiveness—but they have also been arrived at by much more fragmented, weakly organized economic interests. Most importantly, state action has played a greater role than in CMEs, with much less predictable results (Molina and Rhodes 2006).

Although both Italy and Spain engaged in such social pacts, Spain's were arguably more successful over the long term. Whereas in Italy, success in sustaining social pacts came only in the 1990s, in Spain social pacts worked from the late 1970s to the mid-1980s, collapsed after 1986 and reemerged in the mid-1990s. Moreover, while in Italy social pacts have always depended on positive government action to promote them—explaining the success of center-left governments in the 1990s, the failure of the Berlusconi government in the 2000s—this has not always been the case in Spain, where a number of pacts have been signed without the government (Royo 2005). For Sebastián Royo (2005), employer and union agreement in social pacts, even without government involvement, suggests that Spain may be moving closer to CME coordination in industrial relations, by contrast with France's move closer to LMEs as a result of its radical decentralization of wage bargaining. But importantly, this does not take Spain all the way into the CME camp, because there has been government involvement, only of the "hindering" kind, as evidenced by the fact that it was the failure of government-imposed reform from the mid-1980s to the mid-1990s, as well as its inability, along with employers, to impose wage moderation and curb inflation, that acted as a spur for employers to seek the renewal of social pacts (Perez 2000; Royo 2005). Equally significant is the fact that Spain has the highest percentage of workers on temporary contracts in Europe, at around 30 percent, which goes against the grain of any CME.

A similar set of distinctions could be made with regard to business coordination. The strong strategic coordination in financial markets resulting from networking and family financing—similar to Italy—also makes hostile takeovers rare, in growing contrast to France, again suggesting Spain's move toward CMEs (Royo 2005). But leaving hostile takeovers aside—which is also not that high in France, and derives from the greater liquidity of French companies by comparison with the less developed financial markets of Spain and Italy—all three countries are also closer to one another with regard to the informal networked-based ties of business than they are either to the arms'-length British or the formally networked Germans. In France, ties among big business elites based on state-related training and experience creates a closeness that has its equivalent in the family-based ties of business in Italy and Spain. Finally, it is probably no accident that the main countries (other than Poland) accused by the EU Commission of "economic nationalism" have been France, with regard to energy and banking, Italy—which, after protesting against French blocking of an Italian energy company's attempted takeover, sought to block French takeovers in banks and energy—and Spain—which blocked the takeover of an energy company.

In short, the role of the state remains greater in SMEs, with different business and labor relations as well as a different logic of coordination from CMEs or LMEs. But the role of the state is important across the varieties of capitalism, just in different ways.

Taking the State Seriously

Taking state action seriously means considering the distinctive role of the state not only in "state-influenced" market economies—as a distinguishing feature—but also in liberal and coordinated market economies, as well as in the supranational institutional context. This, however, requires going beyond the "labeling" approach to an "analyzing" one, and pushes us to consider state action in all its complexity, by deconstructing state action into its component parts in terms of policy, 'polity,' and politics.

Deconstructing State Action

State action, as defined herein, is constituted by the government policies and practices that emerge out of the political interactions among public and private actors in given political institutional contexts. State action, put more precisely, needs to be understood in terms of "policy," meaning the substantive policies affecting business and labor; "polity," meaning how such policies as well as the interactions among political and economic actors are shaped by political institutional context; and "politics," by which I mean not just strategic interactions among political actors but also political actors' substantive ideas and discursive interactions.

To be fair, VoC does not entirely neglect state action. Although the founding theory and its focus on firm-centered activity minimizes its role (Hall and Soskice 2001), the empirical work of some of its practitioners brings it into focus, including some of those writing in the same founding volume (e.g., Wood 2001; Thelen 2001). While Stewart Wood (2001) directly contrasts the regulatory role of the state in LMEs and CMEs, Kathleen Thelen (2001, p. 73) insists on the importance of political dynamics to understand why some countries have coordination and others do not. Today, moreover, scholars central to VoC, such as Hall and Thelen (2006) have made it clear that they see a key role for governments, in particular with regard to responses to international challenges, although they also insist that firms can be equally important agents of adjustment, in a *pas de deux* between firms and the state—citing examples from France as well as Germany in financial market reforms. Even more to the point for this paper, Cathie Jo Martin and Kathleen Thelen (2006) argue for the importance of state action in understanding different trajectories of change in coordinated market economies. In addition, a growing cadre of scholars, following the groundbreaking work of Peter Gourevitch and James Shinn (2005), has added an important corrective to VoC, by focusing primarily on politics with regard to the interest-based coalitions that produce different systems of corporate governance in different varieties of capitalism. This view of politics, however, nonetheless tends to reproduce one of the problems of classic VoC, by undervaluing state action.

A closer look at Gourevitch and Shinn (2005) helps illustrate the problem. In their causal model, economic interest groups made up of owners, managers and workers are the main players, while state action is limited to the political institutions which represent the "machinery that refracts the preferences and that aggregate them into outcomes" (2005, p. 8). What is missing here is state action as the product of state actors *qua* state actors, meaning the elected or unelected public officials who may have preferences separate from the main players, for example, because they are focused on the public, whether conceived of as consumers of the products produced by these firms, as small shareholders whose pensions are tied up in those firms and/or as voters who will let their views be known through the ballot box if they feel threatened as consumers or small shareholders. Equally importantly, public officials may act alone, even without the existence of a political constituency of shareholders, in anticipation of a possible future reaction from voters who will become shareholders. This is the argument of Jonathan Westrup (2005) to explain similar state actions in countries from different varieties of capitalism, Germany and Britain, in which politicians' concerns about voter response to the privatization of risk to the household created an incentive to challenge the regulatory status quo, leading to the move to create a strong, single financial regulator against the strong preferences of central banks. The point here is that although it is neater and easier to model ideal-typical coalition formations if one keeps to three main corporate governance actors, this leaves out one additional, albeit admittedly problematic, "player," the state This is because this player not only frames the action of the other players—through the political institutional context of formal institutions—but can also reframe it through policies. And such reframing is not always a direct consequence of the bargains of the three corporate governance players but may very well be because of the separate interests of state actors acting in the public interest.

In addition to the neglect of national state *qua* state action, supranational state action is also largely missing from VoC approaches. VoC does not take sufficient account of the role of international institutions (see Fioretos 2006; a notable exception is Fioretos 2001) or of the European Union (EU). For European countries, moreover, Europeanization has been a greater force for change than even globalization, with effects on EU member-states' political economies (Martin and Ross 2004; Schmidt 2002a, Ch. 1;), welfare states (see Ferrera 2005) and even democracies (Schmidt 2006a) that countries outside Europe subject to the forces of globalization alone do not necessarily experience.

State Action as Policy

Importantly, however, state action is a more complicated variable than the sketch presented so far. Although the division of states into "liberal," "enabling" and "influencing" tells us a lot about the state attitude toward the market—whether to remain at arms' length from business and labor interactions, to facilitate them or to intervene as the occasion seems to demand—and something about the differing purposes, to preserve market coordination, to protect non-market coordination or to do one or the other depending upon time and circumstance, it tells us little about the actual policies, whether their content, their implementation, or their effect. And all of this complicates the story told so far.

The first bit of complication comes from the fact that state policies in recent years seem very similar in content, as the convergence theorists would argue, since all countries have liberalized their financial markets, deregulated their businesses and increased the flexibility of their labor markets. In fact, although such policies may be similar, they are not the same. For example, countries show subtle differences in the kind and degree of liberalization of the financial markets or in the deregulation of the banking sector in keeping with their variety of capitalism (Thatcher 2002; Coen and Thatcher 2005; Lütz 2002). And they show great differences in the timing and extent of reforms in labor market flexibility within and across varieties.

But while states across varieties continue to differ in the kind and extent of reform, this is also true for states within any given variety. For example, data from Lehman Brothers on the extent of structural reform, that is, adopting supply-side measures favoring investment and market efficiency, shows that while LMEs are the top performers, CMEs are spread all over the place, with Nordic CMEs coming out only slightly behind the LMEs, while Continental CMEs like Germany, Belgium and Austria are mixed in with Mediterranean SMEs, but behind the French SME, which is only slightly behind the Nordic CMEs (see Hopkin 2006).

Another issue is that states may not act in the predicted way. For example, the "enabling" state of CMEs, despite its non-market preservation function, may act to deregulate the economy in ways that jeopardize non-market coordination. In Germany, for example, the Eichel tax reform of 2002, by eliminating capital gains tax on shares sold by banks and businesses, got rid of one of the elements holding the business-bank networked relationship together. Moreover, the "liberal" state of LMEs may appear much more interventionist than expected, by intervening forcefully to reshape the institutions that frame business and labor action, in the case of the UK by "steering" either through direct government action or through regulatory agencies (Moran 2003). And the "influencing" state of SMEs may step back to allow the social partners to coordinate their interactions in a manner similar to CMEs, as in the case of the thirty-five-hour work week in France, in which the state set the general framework within which business and labor were to negotiate the particulars of the policy for their workplaces.

Another way of thinking about the unexpected policy mix of states in different VoCs is to see that although all states have become more "neo-liberal," moving along a continuum from *faire* toward *laissez-faire*—that is, from interventionist state towards a hands-off state by doing less on its own and leaving more room for market actors to act on their own—this has not meant a slide all the way to *laissez-faire*, by leaving everything up to market actors. Rather, states have largely turned to *faire faire*, by having market actors perform functions that the state generally did in the past, with clear rules as to what that should entail. This has in particular been the pattern of LMEs, but SMEs and even CMEs have also reformed in this manner with regard to the deregulation of business and the privatization of pensions. However, many states also engage in *faire avec*, by doing a lot in collaboration with socioeconomic actors—the pattern of cooperation most typical of CMEs, through corporatism. But *faire avec* has also occasionally been instituted in SMEs, as in France, where reforms of work conditions that in the past would simply have been mandated by the state are now framed by the state but negotiated by labor and management, as noted above in the case of the thirty-five-hour work week. However, even liberal states have on occasion turned to this kind of *faire avec*. Ireland, for example, has instituted a kind of state-led corporatism in labor policy, where the state brings the social partners to the table for wage agreements (Hardiman 2003). This has also been true for Mediterranean SMEs, as discussed above.

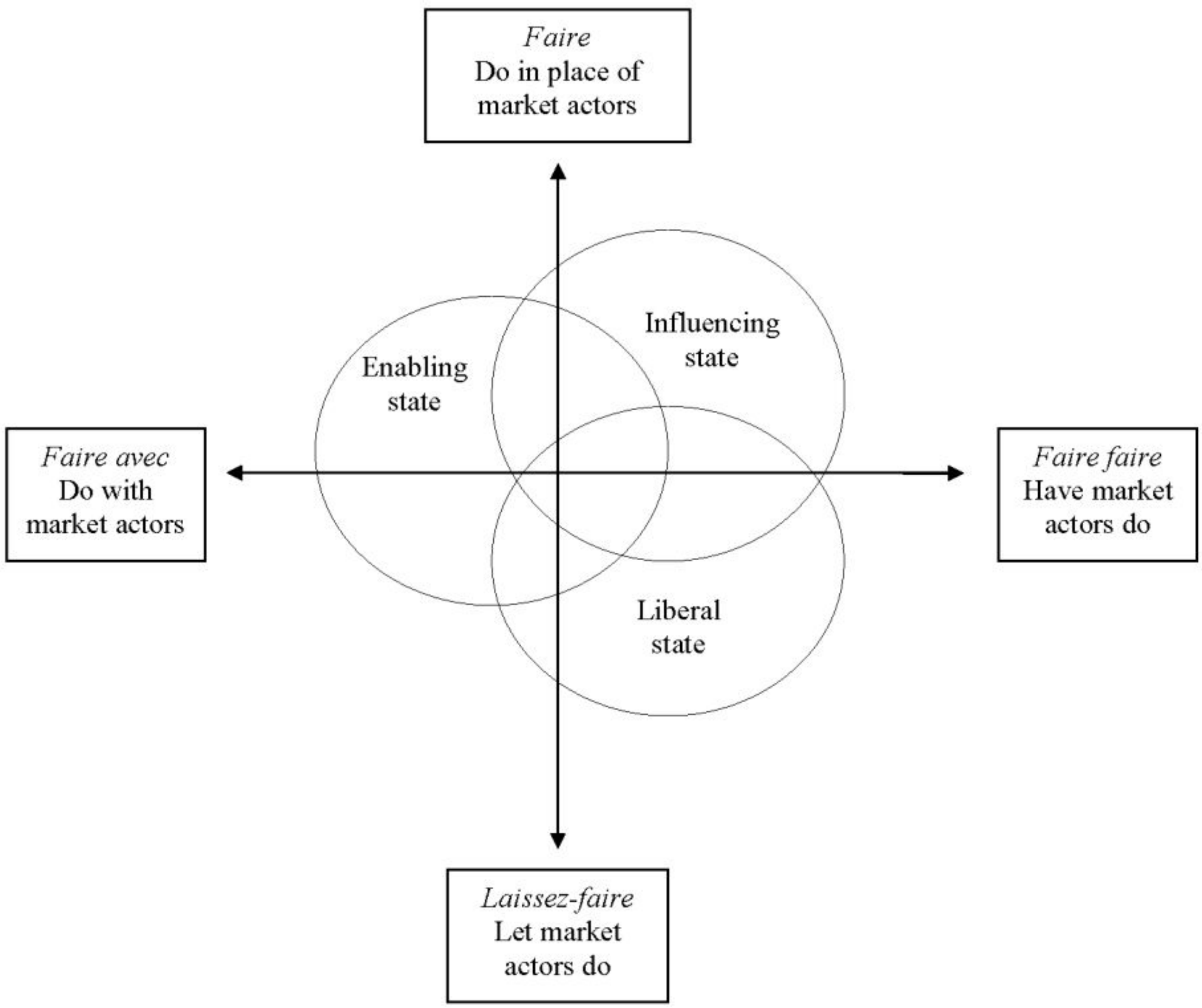

Figure 1: State actions of the three varieties of capitalism on a four fold scale from *faire* (do in place of market actors) to *faire avec* (do with market actors) to *faire faire* (have market actors do) to *laissez faire* (let market actors do)

The best way to conceptualize the new policy mix is by visualizing state action in the three varieties of capitalism as consisting of overlapping circles clustered around two axes, with *faire* and *laissez-faire* on the Y axis, to show the general trend toward greater neo-liberalism, but with *faire avec* and *faire faire* on the X axis, to show that while the state within the three varieties of capitalism continues to follow quite different internal logics, it nevertheless adopts policies that fit across all four quadrants (see Figure 1) (for a more extended discussion, see Schmidt 2004b).

State policies, in short, have become much more varied than what one might expect from the rather thin description of state action taken in the "labeling" approach to the varieties of capitalism. An "analyzing" approach, however, does not stop here, since polity and politics also matter. Policymaking, after all, does not take place in a vacuum.

State Action as Polity

Institutional context also makes a difference for state action. Formal institutions help explain how policy reform may differ among countries that cluster in the same as well as in different varieties of capitalism. One way to analyze the effects of institutional arrangements on state action in different varieties of capitalism is in terms of "simple" polities and "compound" polities (see Schmidt 2005; Schmidt 2006a, Ch. 6).[4] In "simple polities" where governing activity has traditionally been channeled through a single authority—the result of unitary institutional structures, statist policymaking processes, and majoritarian representation systems, as in the UK and France—the state is generally able to impose reform unless sanctioned through elections or protest in the streets (mainly France). In "compound" polities, where governing activity is instead more dispersed through multiple authorities—the result of federal or regionalized institutional structures, corporatist policymaking processes, and/or proportional representation systems, as in Germany, Belgium, Italy, Spain and the U.S.—the state cannot impose and therefore must negotiate widely or risk not gaining agreement on reform (esp. Germany and the U.S.) or even provoking protest in the streets (esp. Italy). In between are a number of countries which are a mix, mostly because they have unitary states but corporatist policymaking processes and proportional representation system, as in Sweden, Denmark and the Netherlands.

Differences in institutional arrangements help us understand why states with very similar policies within the same variety of capitalism may have very different success rates with regard to policy reform. Thus, for example, among LMEs, the UK under Thatcher was much more successful in imposing radical neo-liberal reforms than the U.S. under Reagan, largely because of institutional arrangements (King and Wood 1999). Analyzed in the terms of simple and compound polities, in the UK's "simple" polity, Thatcher benefited from the power concentrated in the executive by the "Westminster system" and from the majoritarian representation system that ensured that the opposition would be unelectable once it split. By contrast, in the U.S.'s compound polity, Reagan, although also benefiting from a majoritarian system, had to contend with federal institutional structures in which the Congress had greater say than the President over reform efforts, and the states could counter such efforts by their own programs; of a

[4]This is close to Lipjhart's (1984, 1999) dichotomy of 'majoritarian' and 'consensus' democracies, but it nonetheless differs in important ways. It focuses on three dimensions—structures, processes, and politics—instead of Lijphart's two (federal-unitary and executive-parties), keeping politics a separate category rather than making it the overall distinguishing dichotomy (see Schmidt 2005a, 2006, Ch. 5).

pluralist system in which business interests groups and lobbies had tremendous power to block reform and labor little power to promote it; and of a political system that has ensured that there would rarely be any agreement on reform, given two weak political parties that were fragmented internally on the left-right dimension as well as regionally by geographical interests that cut across partisan divides (Howard 1997; Steinmo 1994; Dobbin 2002). In consequence, the U.S. government has had little capacity to introduce strong government-run programs, and has instead largely left to societal actors the public goods tasks generally administered by states in other countries. This is not *laissez faire* but *faire faire*, however, since the federal government specified the guidelines which societal actors would need to follow, whether corporate actors in carrying out their programs or the courts in resolving disputes about those guidelines (Dobbin 2002).

The U.S. as a result has consistently been less able to impose radical change than the UK (King and Wood 1999). In the case of the weakening of the labor unions, although Thatcher and Reagan were equally effective in crushing labor symbolically in the early 1980s, with the air traffic controllers' strike in the U.S. matched by the coal miners' strikes in Britain, only in the UK was this followed by the government's imposition of strong anti-union laws that effectively broke the back of labor. By way of contrast, Bill Clinton's success with regard to welfare reform can be attributed to the fact that it was a negotiated package that decentralized welfare to the benefit of the states, going from a system of faire through entitlements programs to *faire faire* that was actually *laissez-faire* to the benefit of the states, which gained block grants that enabled them to allocate the fixed sums as they saw fit (Martin 2000).

We can make a similar set of arguments about the importance of institutional arrangements for the differential success of reform efforts in CMEs—although here the institutional arrangements are never "simple," since the necessary presence of corporatism ensures that they are either highly compound, as in the case of Germany and Belgium, or somewhat less compound, the case of the Netherlands, Sweden, and Denmark, given their unitary states. In CMEs generally, enabling states' reform strategies entailed liberalizing, deregulating, and privatizing in consultation and coordination with business and labor rather than, as in the simple UK LME, by state fiat. This has ensured that, rather than any significant move to *faire faire* in the work arena, new rules have continued to support *faire avec*. Moreover, reform success in both fully and partially compound CMEs is largely guaranteed where the social partners agree to reform. However, in cases where the social partners disagree, reform is much more difficult in a fully compound polity like Germany. Its federal system, in which the *Länder* have significant blocking power, can result in the "joint-decision trap" where there is disagreement on policies (Scharpf 1988) leading to "blocked reform." Its *Tarifautonomie* system of bipartite corporatism which shuts the state out can lead to paralysis where there is disagreement on labor market reform.

These institutional specificities help explain the difficulties Germany has had, in particular with regard to increasing the flexibility of its labor markets, solving its unemployment problems, or reforming pensions. By contrast, in less compound polities like the Netherlands and Sweden, the unitary nature of the state enables both countries to act like more simple polities and impose change when corporatist processes break down and/or they cannot arrive at consensus, as in the case of the reform of welfare policies in the 1990s in both countries (Schmidt 2003). However, the state is equally significant where the social partners do continue to be active in the negotiation of reform, as evidenced by the case of Denmark. The policy reform success of Denmark can in large part be attributed to the fact that the Danish state took an active role in promoting policy change through national level coordination mechanisms, using firms in order to achieve its goals of bringing the long-term unemployed into the economy. In contrast, the German state was unable to mobilize the social partners for solidaristic purposes, and instead German firms worked through the state to achieve their goals of shedding unproductive labor (Martin and Thelen 2006).

SMEs differ from one another as well. The French SME is a "simple" polity which has the power to impose policies, subject to the sanctions of elections and protest in the street, because of a unitary state, statist policymaking processes, and majoritarian policy system. This helps explain its ability to liberalize and deregulate business as well as its failure to increase labor market flexibility in the face of major protests. By contrast, the compound nature of the Italian and Spanish SMEs, riven by territorial cleavages based on regionalization on top of public-private cleavages resulting from the history of nationalized enterprises, cleavages in industry sectors and size of firms, let alone the greater organization and political strength of economic interests, helps explain the greater need to negotiate policies and the problems when political leaders seek to impose policies (see Molina and Rhodes 2005). Differences between Italy and Spain, however, can also be explained by the fact that Italy's "regionalized" state has been arguably weaker than that of Spain, in part due to the majoritarian nature of the Spanish electoral system, by contrast with Italy's fully proportional system until 1994, and its mixed majoritarian system until 2006.

State Action as Politics

There is much more to states' policy success than political institutional structure, however. Politics makes a big difference not only with regard to policy change but also with regard to institutional change in economic and political systems. What we mean by politics, however, itself remains in question. Does it limit itself to the interrelationships of power and interest among strategic actors? This is what it is for most members of the VoC school. But can it include the substantive ideas and discursive interactions of "discursive" actors, the thesis of this paper? To make the argument that politics is not just about institutions and strategic action but also about institutions and "discursive" action, however, we need to turn to the debates in political economy centered around the explanation of institutional change. This entails first considering the ways in which historical institutionalists in the VoC school have sought to overcome the inherent stasis in the theory by putting the history back into historical institutionalism, and then showing why the turn to rational choice institutionalism to explain the changes described in the revisionists' more historical VoC still does not fully account for the dynamics of change.

VoC's Historical Institutionalist and Rationalist Attempts to Explain Change

Recent developments in the VoC school have sought to remedy the static nature of its explanation of capitalist systems through historical institutionalist approaches that posit open systems or incremental evolution. Although these take us a long way forward, most such approaches tend to describe change rather than explain it. Where they seek to explain, they tend to refer to the "micro-foundations" of change as involving strategic action. But this is also problematic because rational choice institutionalist accounts of strategic action have difficulty dealing with the changing institutions posited in revisionist VoC .

Putting the History Back into Historical Institutionalism

VoC, as we have already noted, has been criticized for its static view of institutional change. The key problem is its emphasis on coordination and complementarity in capitalist systems, which makes for the beauty and parsimony of the explanation, but also for its difficulties in accounting for change. As many have already shown, VoC has difficulty handling any kind of institutional change because of the systemic logic of the explanation itself, which assumes self-maintenance. Systemic complementarity in particular suggests a functionalism that admits of little change other than positive feedbacks effects, with a homeostatic equilibrium in which changing any one component leads to adjustments in the other components, but no real transformation of the system as a whole or even evolution except at moments of "punctuated equilibrium" or revolution. This is what makes it difficult for classical VoC scholars to admit that globalization, Europeanization, or internal dynamics can lead to a loosening of the coordination, let alone to a creeping disaggregation, of the system as a whole. Even development and evolution over time become very difficult to explain.

Historical institutionalism, moreover, at least as it has originally been theorized, is no help to classic VoC. This is because it, too, sees change as rare, coming only at moments of "punctuated equilibrium" (Krasner 1988). Moreover, if theorists do see development over time, such development tends to be highly historically deterministic. Development begins with critical junctures which "set into motion institutional patterns or event chains (with) deterministic properties" (Mahoney 2000: 507), or "path dependence." Path dependence is a self-reinforcing sequence of events which, through positive feedback or self-reinforcing mechanisms, ensure increasing returns that, if lasting over a very long time, make for a "deep equilibrium" that is highly resistant to change (Pierson 2000; Pierson 2004). In short, the static presuppositions in classic VoC are only reinforced by the ahistorical nature of classic historical institutionalism. But how, then, to deal with the empirical realities of change?

Revisionist VoC scholars have suggested one of two ways out of the quandary: open systems or evolution. The open systems approach tends to see much greater contestation and contradiction in VoC (Becker 2006) and much greater possibility for development, with different subsystems able to go off in different directions (Deeg 2005). But the question here is: how much change among subsystems in any given national variety does it take before it no longer fits under the ideal-type but has become a hybrid model, is disaggregating, or even converging onto another VoC?

The more evolutionary approach to VoC has been pioneered by Kathleen Thelen (2004) and Wolfgang Streeck (Streeck and Thelen 2005). This is an approach which has essentially put the historical back into historical institutionalism by focusing on the (many) evolutionary changes that may be as, if not more, transformative than the (rarer) revolutionary moments. It abandons revolution in favor of evolution by replacing punctuated equilibrium with incremental change, and it abandons historical determinism in favor of historical indeterminacy by replacing path dependence with various processes of path renewal, revision, or replacement. Thus, paths may be "crooked" (Djelic and Quack 2005) and may diverge as a result of exogenous and endogenous factors that take countries "off-path" (Crouch and Farrell 2002; Höpner 2001; Deeg 2005; Djelic and Quack 2005). Institutions in this approach are "regimes" or "systems of social interaction under formal normative control," in which actors follow the rules because they are not only enforceable but also legitimate, imbued with authority by the society and the actors who act within them. As such, they are neither the voluntaristic institutions of rational choice institutionalists, because their obligatory character makes them more than simple coordinating mechanisms, nor the informal institutions or shared scripts of sociological institutionalists, since these are formal-legal institutions which are separable from the behavior that takes place within them. Institutional change itself, moreover, can be seen to come about through a variety of processes resulting from the continuous interaction between "rule-makers" and "rule-takers" to new interpretations of the rules. These may take the form of "displacement" and defection, "layering" through reform; "drift" through neglect; "conversion" through reinterpretation or redirection; "exhaustion" through break down. (Streeck and Thelen 2005; Thelen 2004).

Instead of insisting on closely complementary and coordinated capitalist systems, in short, revisionist VoCs describe the components of loosely connected, historically evolving varieties of capitalism, which change at different rates in different ways through different processes, by contrast with the classic systemic view of VoC. This theoretical opening also means that empirically it becomes possible to chart changes in the VoCs—toward hybrids and convergence, as well as decline (Streeck and Hassel 2003; Beyer and Höpner 2003).

From Description to the Explanation of Change? The Rationalist Micro-Foundations of VoC

All such revisionist approaches to VoC have done a great deal with regard to theorizing the different forms by which change occurs. But they don't explain why it occurred. Streeck and Thelen's (2005) discussion of layering, drift and conversion, for example, provides a rich theoretical approach to analyzing "what happened"; but it is very thin with regard to "why it happened." The most Streeck and Thelen do to explain "why" is to suggest that institutions are the object of "on-going skirmishing as actors try to achieve advantage by interpreting or redirecting institutions in pursuit of their goals, or by subverting or circumventing rules that clash with their interests" (2005: 19). Actors are clearly strategic, acting in their own interests, but there is no explicit micro-logic of strategic action elaborated here. Nonetheless, implicitly, the micro-foundations of historical institutionalist explanations of VoC are in rational choice institutionalism.

This implies that we should look for the answer to "why it happened" to rational choice institutionalist accounts of strategic action. But the problem here is that regular rational choice institutionalist accounts of strategic action assume fixed preferences with stable institutions that act as structures of incentives. If institutions change all the time, then it becomes difficult to theorize how institutions structure individual actors' incentives. Moreover, if some individual actors accept the institutions while others are seeking to redirect or reinterpret them, then actors' preferences are differentially affected by the institutions, and it is impossible a priori to know which ones. Empirical investigation of actors' motivations, their interests, and their ideas within macro-institutional context seems to be the only answer here.

In a jointly authored paper with Peter Hall, however, we do get a clearer theoretical picture (Hall and Thelen 2006) of how rationalist and historical institutionalist approaches fit with regard to individual action, and where rationalist explanations appear to act as micro-foundations for the historical institutionalist. Institutions are the objects of strategic action by economic actors who use them as resources to achieve their goals, and are always testing the limits of their power, probing the intentions of others, basing their decisions on perceived interests rather than objective ones. The rationalist "routes" to institutional change are: 1) deliberation among relevant actors and government policy; 2) defection, when action occurs without deliberation with other actors; and 3) reinterpretation, when practices gradually change while the institution formally stays the same (Hall and Thelen 2006, p. 4).

This approach is on the fence between rational choice and historical institutionalism. Institutions are more than just the incentive structures of rational choice institutionalism, as Hall and Thelen (2005) themselves make clear, since they have qualities of their own, as regularized practices and rules, and complexities due to their interaction effects. But actors are also not defined by their institutions, as in traditional historical institutionalism, since they have knowledge outside the institutions in which they operate. Importantly, moreover, actors' interests are not just the "objective" ones assumed by rationalists, but perceived interests, while deliberation and reinterpretation are part and parcel of the processes of change. Here, too, then, rational choice institutionalism doesn't help much in theoretical terms because preferences are not fixed, are "subjective" rather than "objective," and institutions not stable enough to theorize as incentives. This, then, is a very soft rationalist version of the micro-foundations, and still leaves open the question of how to explain as opposed to describe the dynamics of change. Moreover, once preferences are seen as "subjective," this leaves the way open to considering the role of ideas in helping to change actors' preferences and discourse in the process of deliberation and reinterpretation of institutions.

Thelen (2004) elsewhere suggests that the processes of change through which layering and conversion take place can be explained by ongoing political negotiation focusing on political coalitions and political conflicts. Note that this brings in collective action, as opposed to the individual action of rational actors, which necessarily brings in the state. And with state action, which entails formally changing the rules, ideas and discourse are of the essence, whether in mobilizing support, in persuading of it appropriateness, and so forth.

Bringing Discourse Back Into the Explanation of Institutional Change

Thus, although historical institutionalists in VoC have gone very far in reintroducing dynamics into the institutional stasis of VoC, they still have difficulty explaining change. The implicit micro-foundational recourse to rational choice institutionalism, to which most turn, is insufficient to explaining the dynamics of change. Only with a further discursive institutionalist (DI) approach, focused on ideas and discursive action, can we gain a full explanation of institutional change. But before considering how ideas and discourse lend greater insight into the explanation of the three varieties of capitalism, we need first to consider how rationalist/historical institutionalist accounts of strategic action within macro-structures fit against accounts of ideas and discourse.

Taking Ideas and Discourse Seriously

Importantly, many VoC scholars have already recognized the importance of ideas and discourse. To begin with, even one of the very founders of the VoC school has taken the role of ideas seriously, albeit in earlier work. Peter Hall, in an earlier incarnation, prior to his rationalist/historical institutionalist turn in VoC, was something of a discursive institutionalist in his account of the role of ideas in promoting the neo-liberal paradigm instituted by Thatcher in Britain (Hall 1993). But some VoC scholars have also more recently given a nod to discursive institutionalist accounts. Richard Deeg (2005) acknowledges the role of discourse when, in addition to defining a whole range of new ways of thinking about path dependency in order to make VoC less path dependent, he takes note of theorists who see ideas as having independent causal force of their own, rather than just as tools in the hands of powerful actors (e.g., Lieberman 2002, Lehmbruch 2001). Pepper Culpepper (2005), by contrast, takes us one step further when, in his discussion of the politics of institutional change in vocational education in Switzerland and Austria, he adds to his rationalist/historical institutionalist explanation of employers' interests with regard to legal change a discursive institutionalist account of the role of political discourse in the legitimization of such change.

One function of discourse is certainly legitimization. But discourse goes beyond after-the-fact justification and legitimization. It can also bring about change, which was Peter Hall's (1993) argument. Interestingly, even Christel Lane, in arguing that the unraveling of coordination in Germany is likely to lead to convergence to the LME model, nevertheless suggests that this might be stopped were there an emerging "coalition of industrial managers, employees, and politicians working for a new as yet inchoate compromise solution;" but she notes that the ideas are lacking (Lane 2005, p. 105).

These four examples suggest that rationalist/historical institutionalist VoC scholars naturally turn to ideas and discourse, whether as the catalyst for change or as an accompaniment to change. But other than in the early Hall, none of this is developed theoretically in these works.

There are any number of scholars working in comparative political economy, however, who have gone to the other side, so to speak, by focusing on the ideational and discursive side of institutional explanation. Such "discursive institutionalists" include those interested more in the substantive content of ideas, that is, in what people say, and those more focused on the interactive processes, that is, on who speaks to whom, about what, in which ways. On the substantive dimension, scholars tend to consider both the cognitive arguments that seek to justify change in terms of its necessity, with an account of the "facts," and normative arguments that seek to legitimize change in terms of its appropriateness, with an appeal to values (e.g., Blyth 2002; Hay 2001; Jobert 1992; McNamara 1998; Campbell 2001, 2004; Rothstein 2005). On the interactive dimension, scholars tend to divide between those focused on the "coordinative" sphere of discourse, in which policy actors talk mainly to one another in the process of generating and/or reaching agreement on reforms (e.g., Lehmbruch 1999), and those more concerned with the "communicative" sphere of discourse, in which political actors translate the reforms developed in the coordinative sphere into more accessible language in order to communicate them to the general public for discussion and deliberation (see Schmidt 2000, 2002a, Ch. 5, 2006a, Ch. 5). Importantly, the communicative discourse is mostly absent from VoC, possibly because of the neglect of state action. But this is also critical to understanding institutional change, in particular in countries or situations where the communicative discourse of political leaders is needed to promote institutional reform.

Institutional context also matters, however. In "simple" polities, where a restricted group of state actors tends to make policy, the coordinative discourse among policy actors tends to be thin and the communicative discourse to the general public much more elaborate, a natural consequence of political leaders' need to legitimate the ideas generated by a restricted policy elite in order to avoid electoral sanctions or protest. In compound polities, by contrast, the coordinative discourse among policy actors tends to be highly elaborate, given the large number of policy actors generally involved in policy construction, whereas the communicative discourse tends to be thin, since political leaders have to be careful not to jeopardize those policy actors' compromises in their pronouncements to the public. Given these different spheres in which discourse is most developed in the different kinds of polities, one does best to look for the causal influence of discourse in the communicative sphere for simple polities, by evaluating the impact of political leaders' discourse on the public, in the coordinative sphere for compound polities, by seeing whether there is agreement among policy actors (Schmidt 2000, 2002a Ch. 5, 2006, Ch. 5).

The content of ideas, the interactive processes by which those ideas are generated and communicated, and the institutional context in which they occur all have significant implications for our three varieties of capitalism. In a very preliminary way, we could point to the role ideas and discourse have played in promoting such change, whether in pushing greater liberalism in LMEs like the UK and the U.S., reinforcing cooperation in CMEs like Germany and Sweden, or reducing state influence in SMEs. Beyond this, however, we need to ask about discursive interactions in institutional context, that is, who is talking to whom where. Here, we could note that LMEs divide between simple polities such as the UK where the communicative discourse is most pronounced and compound polities such as the U.S., where the coordinative discourse is more pronounced, even though the communicative is stronger than on average because of the U.S.'s majoritarian politics. CMEs, by contrast, are all likely to have a strong coordinative discourse, given corporatism, although those with unitary states like Sweden and the Netherlands are also likely to have a more elaborate communicative discourse than federal Germany. SMEs, finally, are also split between simple polities like France, with a strong communicative discourse, and compound polities like Spain and Italy, where the coordinative discourse is much stronger.

As we shall see, ideas and discourse provide an additional, if not deeper, explanation of institutional change in the three varieties of capitalism by focusing on the substantive content of ideas and on the dynamics of discursive interaction. In what follows, this is shown through brief contrasting cases in all three varieties of capitalism.

Ideas and Discourse in LMEs

In LMEs, puzzles that rationalist/historical institutionalists have difficulty explaining for the UK and the U.S. include such questions as: How do we explain that Thatcher's radical neo-liberal reforms have lasted, with the opposition party electable only once it had abandoned its past policy ideas and embraced neo-liberalism? Why was it that Thatcher succeeded in transforming business and labor but not welfare? And why is it that Blair has been able to transform welfare in ways that Thatcher could only dream of? But also, how do we account for the fact that, in the U.S., reform was much less extensive?

There can be no doubt that Thatcher's success in instituting neo-liberal reform owes a great deal to the formal macro-institutions of the UK's simple polity that enabled her to impose reform and to win elections, given a divided opposition. But the fact that such reform took hold, lasting despite subsequent changes in government, owes much to the highly effective accompanying communicative discourse through which Thatcher sought to persuade the general public not only of the superior logic of the liberal market economy but also of its appropriateness in terms of the country's historically liberal values (Marquand l988). The proof of this is in the fact that until the Labour Party accepted the neo-liberal ideas and renewed its communicative discourse with its talk of the "third way," it remained unelectable. Evidence is also in the opinion polls which, already by 1987, showed a shift toward more neo-liberal values with greater acceptance of individual responsibility, materialism and inequalities of income (Taylor-Gooby 1991). Moreover, even though many remained unconvinced by Thatcher's discourse, especially in the early years, there can be no question that as her policies began to take hold, altering people's experiences of work and welfare, the discourse performed a retrospective legitimizing function, by providing the public with a positive way of thinking and talking about their new experiences (Schmidt 2000, 2002a, Ch. 5, 6).

Importantly, however, there were limits to Thatcher's persuasiveness. Whereas her communicative discourse of "the enterprise culture" resonated with regard to business and labor reform, her discourse contrasting "the worthy poor" with "the feckless and the idle" was not very persuasive with regard to welfare reform, as evidenced by the fact that Thatcher herself pulled back, fearing electoral sanctions in areas where the public (and in particular her own electorate) was clearly strongly opposed to any cuts (Pierson 1994; Rhodes 2000). In the end, Thatcher managed to make the welfare state meaner in non-universalistic areas (e.g., aid to single mothers and youth) but not much leaner overall, in particular with regard to universalistic areas such as health and education, although she did introduce competition even into these areas. Why Thatcher's failure in this welfare? Bo Rothstein's (1998, 2005) discussion of universal institutions helps us here. Britain's universalistic programs were much harder to cut because people trusted them and supported them, by contrast with the particularistic programs that benefited only the few. So programs for single mothers could be cut somewhat, but the National Health Service was not. It took Blair to extend the Thatcher revolution to the welfare arena, with a communicative discourse that did resonate as it appealed to values of equality and compassion as much as to neo-liberalism by promising to "promote opportunity instead of dependence" through positive actions (i.e., workfare) rather than negative actions focused on limiting benefits and services, and by providing "not a hammock but a trampoline," not "a hand out but a hand up" (Schmidt 2000, 2002b).

In the U.S., by contrast with the UK, the presence of a strong communicative discourse did not have a significant impact, whereas the absence of a successful coordinative discourse was a problem for reform efforts. The U.S. is arguably the only compound polity where the communicative discourse is as important as the coordinative, especially with regard to reframing the coordinative discourse in order to promote agreement in a country where the political institutions almost militate against it (as noted above). But even so, neither Reagan, the "great communicator," nor Clinton were able to overcome the institutional constraints that ensured against rapid reform in the U.S.. However, Reagan's communicative discourse did arguably better than Clinton's in leaving a lasting influence on the American system, the result of the conservative bias of the institutions and the historically liberal values of the culture that makes it much easier for the state to retreat than to intervene (Dobbin 2003).

Ideas and Discourse in CMEs

In CMEs, puzzles that rationalist/historical institutionalists have difficulty explaining include such questions as: Why has Germany been so unsuccessful in reforming its labor and welfare institutions? Why is it that Germany has been subject to "drift" with regard to labor market flexibility rather than "layering" or "reinterpretation"? How do we explain the persistence of

Sweden's cooperative collective bargaining institutions, against all odds? Why did government cutbacks of disability benefits in the Netherlands fail to make much difference?

There is no question that Germany's macro-institutional setting makes reform very difficult unless all are agreed. But why are business and labor at a stalemate? And why has government failed to facilitate their agreement? The reasons cannot be fully accounted for using rationalist explanations about competing interests, since it is in fact in all parties' interests to move forward. The difficulties come from the fact that the various parties conceptualize their interests differently. The unions remain largely neo-Keynesian, blaming EMU and macroeconomic policy for the lack of growth and resisting flexibilization, while management remains largely monetarist and increasingly neo-liberal, seeing EMU as a good thing and structural reform as necessary. But there is more to it than this. German business and labor have differed in the past, in particular in the early postwar period. But at that time, political leaders stepped in with a communicative discourse that served to develop a new paradigm for business-labor relations, and indeed, for the management of the economy as a whole. The "social market economy" became the background understanding which set the limits for all future policy discussion. The problem today is not just, as revisionist VoC scholars have already shown, that the closely-knit structure of the social market economy has been disaggregating. It is also that political leaders have failed to come up with a new communicative discourse that could serve to reframe the coordinative discourse between business and labor, providing both with new common understandings that would enable them to go forward (see Schmidt 2002a). In fact, there has been little discourse, and little reform, with the little reform that there has been coming without much discourse

Schröder, for example, put through Hartz IV without much legitimizing discourse. Although his forbearance in the face of protest increased his standing in the opinion polls after a while, simply because for once he was consistent, this did not do much to legitimize the reforms themselves. The major problem with the Hartz IV reforms is the fact that merging earnings-related unemployment compensation and means-tested social assistance into a single system violates the public's basic beliefs about the appropriateness of an insurance-based system. So the government would have needed to explain why it was legitimate to depart from the insurance principle, which it did not do.

Similar problems also bedevil the unions, where the official discourse supportive of continued nationally-established (regionally patterned) wages and bargaining is at odds with the increasing informal decentralization of wage bargaining, with growing numbers of flexible agreements, as workers accept to toil longer hours for lower pay in order to ensure that they don't lose their jobs altogether as a result of plant-closures or offshoring. These concessions can of course be explained through a parsimonious rational choice explanation in terms of strategic action, since it is naturally in these workers' interests to keep their jobs, given the difficulties of finding others at the same pay, if at all, given high unemployment in Germany. The process of change might itself be described in historical institutional terms as defection or drift. But how can we explain why there is little layering at the moment? Or reinterpretation? Only by turning to the role of ideas and discourse. The fact that union leaders continue to claim in their communicative discourse to the public that they are unwavering in their determination to hold on to their national, regionally-patterned system of bargaining, that they are in other words unwilling (or unable) to change their ideas about German wage bargaining, and engage creatively with the new realities, means that they are not likely to learn from the changes, anticipate problems, and create a new "layer" of agreements. Ideas and discourse matter, in other words, not only for scholarly purposes of explanation, but for real world changes in understanding that can lead to innovative shifts.

While Germany's collective bargaining system is suffering from increasing problems, Sweden's has managed to survive over a much longer period without the same difficulties. This is another puzzle that rationalist/historical institutionalists have difficulty explaining. Bo Rothstein (2005) shows that the answer lies in institutions which, rather than neutral incentive structures or path-dependent rules, should be understood as the carriers of ideas or "collective memories" which make them objects of trust or mistrust as well as changeable over time, as actors' ideas and discourse about them change in tandem with changes in their performance. This helps explain the genesis and persistence of public institutions that are trusted to act in the interests of all—such as the Swedish welfare state or collective bargaining system—as opposed to more particular institutions which promote self-interested behavior on the part of citizens. Rothstein takes us back to the 1930s for the moment from which Swedish collective bargaining evolved into a trusted "public institution" based on peaceful and collaborative industrial relations. The defining moments came first in the early 1930s when, in response to a violent strike in which five people were killed, a successful coordinative discourse among policy actors was joined by a persuasive, cooperation-oriented communicative discourse by one political leader, Per-Albin Hansson, which even-handedly condemned the violence of the military while also chiding the strikers. This then became the basis for a collective memory which. in the late 1930s, at the time of agreements on collective bargaining institutions, served to remind all parties to the discussions that cooperation was both possible and desirable (Rothstein 2005, pp. 168-98). The collective memory continues to underpin the collective bargaining system today, even though the bargaining system has changed greatly, in particular since the employers pulled out of the national central system, but continue to participate in sectoral bargaining.

The Netherlands is an interesting case of discursive success in two separate spheres working at cross purposes: the communicative discourse in the political sphere, by which government leaders gained public support for major cutbacks in disability eligibility, and the coordinative discourse in the policy sphere, in which the social partners agreed to privately insure the new risks of income loss through collective reinsurance agreements. The result was that the benefit cutbacks hardly affected the bulk of Dutch workers, and that more drastic reform measures were mooted a decade later (Kuipers 2004).

Ideas and Discourse in SMEs

In SMEs, puzzles that rationalist/historical institutionalists have difficulty explaining include such questions as: Why was France so successful at transforming business and labor relations, but not the welfare state? Why was Italy able to reform in the 1990s, and not before, nor much after, under Berlusconi?

In France, the macro-institutional setting gives the state tremendous power to impose. But the public also has great ability to resist, taking to the streets on a regular basis when disapproving of government policies. Thus, the puzzle is: why were political leaders successful in imposing radical reforms on business and labor as well as on the state but not in the welfare arena? Strategic action takes us some of the way: confronted by crisis, having found that their neo-Keynesian policies had failed miserably, worsening rather than resolving the problems, they chose to switch to monetarism and budgetary austerity in 1983. Mechanistically, globalization made them do it. In the moment of deliberation, moreover, calculations of interests played a large role—interests of the country (to remain part of the EMS or not), interests of widows and orphans (if major devaluation of the franc were decided as a consequence of quitting EMS), interests of the party (to remain a credible political player), interests of the men in power (to retain power), and so on. But at the moment of decision, it was mainly about the battle of ideas, with all the parties to the debates seeking to persuade one man, President Mitterrand, one way or the other, about how to think about France's current interest and future standing in the world, as well as about his own. This is the only time we could talk about a moment of "punctuated equilibrium," of tectonic shift, although here too, of course, it was prepared in advance by changing ideas among the various parties to the debate and took a long time to implement, waiting until the right was in power for major privatizations and deregulation, even though the socialists had already been preparing the ground between 1983 and 1986. Importantly, however, the subsequent communicative discourse about the shift sought to legitimize it by talking of the economic necessity of reform as well as its appropriateness, through appeal to national pride in France's ability to maintain the strong franc, the "franc fort" (Schmidt 1996).

If we fast-forward to the 1990s and early 2000s, another problem looms, the reform of the welfare state. How do we explain France's great difficulties in engaging in major reform, especially in contrast to its great success in reforming business? For welfare, the reforms constituted historical institutional layering at best (Palier 2005). Strategic action within political institutions again gives us a preliminary answer. Governments did not have the courage to push through the reforms opposed by unions acting in their own self-interest. But this does not explain the divisions among the unions, or the fact that the public in survey after survey agreed with the need for reform, but continued to support the strikes and demonstrations. Why couldn't the government and unions reach agreement? One answer takes us back to historical institutionalism, with the fragmented structure of unions themselves. But another takes us forward to the failure of government after government to develop the ideas that could serve to legitimize change, or to engage in a legitimizing communicative discourse when making what reforms they did make. Instead, political leaders consistently claimed that they would protect "social solidarity" when they clearly were not, as unemployment kept rising. And they were mostly silent when they imposed reform, communicating little to the public (in particular Juppé in 1995, Villepin in 2006) and coordinating not at all with labor (Schmidt 2002a, Ch. 6).

But how, then, was Italy able to go much farther than France in welfare reform in the 1990s, given institutions that demanded negotiation, and a history of consistently failed negotiation? The explanation is partly in the communicative discourse that evoked the *vincolo esterno*—the external constraint or, better, "opportunity"—from the EU as necessary and appropriate, that appealed to national pride in making the sacrifices necessary to ensure that Italy joined EMU from the start, that cast the EU tax as the "price of the last ticket to Europe" (Radaelli 2002, pp. 225-6), and that legitimated the pension reform necessitated by joining EMU through appeal to social equity—to end unfairness and corruption as well as to give "piu ai figli, meno ai padri," more to the sons, less to the fathers, so as to ensure intergenerational solidarity (Ferrera and Gualmini 2004; Schmidt 2000). This was accompanied by an equally effective coordinative discourse among highly-placed policy actors who crafted the highly successful macroeconomic discourse based on sound monetary policy that pushed state and societal actors alike to accept the austerity budgets, the one-off EU tax, and the labor and pension reforms necessary to enable the country to accede to European Monetary Union. But it was also spurred by a coordinative discourse with the unions which, in 1995, for example, engaged not just national union leaders with business and government in triparitite discussions but the entire union rank and file in deliberations which culminated in a referendum that ensured that opposing union members would accept the "procedural justice" of the vote, and therefore not stage wildcats strikes, as they had in the past (Regini and Regalia l997; Locke and Baccaro 1999). Berlusconi, by contrast, both in his short tenure in 1994 and his longer one from 2001 to 2006, did none of this, using a communicative discourse to the general public to accuse all of the left, and by extension the unions, of being communists. His attempt to impose policies failed time and again in the face of union strikes.

These cases show that ideas and discourse are part and parcel of institutional change, helping to explain it, sometimes complementing rationalist or historical institutionalist explanations as a further influence on change, sometimes the most important influence, but never the only influence. These cases also demonstrate that state action, whether in the form of policies, polity, or politics, also play a role in institutional change, although often a more direct role in simple polities than in compound ones, and a more central role in SMEs than LMEs and CMEs when it comes to the interrelationships of business and labor.

Conclusion

Bringing the state back in to the varieties of capitalism, in sum, has a variety of benefits. It enables us to recognize the significance of state action in capitalist systems and, as part of a "labeling" approach, aids in the identification of a third, distinctive variety of capitalism. But it also takes us further, as part of an "analyzing" approach, to understand state action in all its variety, in terms of policy, polity, and politics. And politics in turn points us to the role of the communicative discourse by political leaders as an important part of institutional change.

Bringing discourse back into the explanation of institutional change in the varieties of capitalism also has a number of benefits. It first and foremost adds another set of factors, the role of ideas and discourse, to strategic action and macro-historical structures in the explanation of institutional change. Secondly, it shows the importance not only of the communicative discourse of political actors—thus bringing the state back in—but also that of the coordinative discourse of economic policy actors, with or without political actors. Equally significantly, it helps to explain the dynamics of change. Historical institutionalists have already gone beyond the historical determinism of path dependence and the ahistorical stasis of punctuated equilibrium to describe incremental change. But to explain change, they remain stuck on strategic action, disregarding all of the problems such an approach itself has in explaining change, given presuppositions about fixed preferences and stable institutional structures as incentives. Discursive institutionalism shows how to go beyond this by explaining the dynamics of change—evolutionary as well as "revolutionary"—in terms of discursive action. This serves as an addition to, if not a substitute for, strategic action.

The ideas and discourse of discursive institutionalism, as a result, could be seen either as alternative micro-foundations to rationalist ones, or even as discursive micro-foundations to the rationalist micro-foundations of historical institutionalist macro-institutional explanations. Talking about ideas and discourse in this way, as the micro-foundations of the micro-foundations, puts it at the end of a hierarchy beginning with the macro-foundations of historical institutionalist structures and practices, following with micro-foundations in rational choice institutionalist strategic action, to end with the micro-micro foundations of discursive institutionalist ideas and discourse. The problem with this is that it could seem to imply that ideas and discourse are the least visible, the most complex, and the most inaccessible to social scientific analysis, and therefore that they may not be worth taking seriously. We have shown here that ideas and discourse can and should be taken seriously, and that they can and should be theorized—but differently—in discursive institutionalist terms.

With this in mind, we could just as easily and more appropriately put discursive institutionalism at the beginning, rather than at the end, of the explanatory hierarchy with rationalist and historical institutionalist explanation. In fact, flipping the hierarchy to begin with the discursive institutionalist enables us to focus more on the question bedeviling social scientists today, which is how to explain the dynamics of institutional change. In this sequence, the other methodological approaches complement the discursive, providing the background knowledge related to the "crystallized" ideas about interests that come from rational choice institutionalism and the "frozen" regularities and routinized actions that come from historical institutionalism. Thus, the results of historical and rational choice institutionalist investigations could be seen as good shortcuts for getting at the uncontested regularities and rationalities of institutionalized behavior and interactions. But to explain change, we need something more: discursive institutionalism.

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