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1

Introduction

THIS IS a book about the political economy—the terrain where capitalism and democracy meet—and how it changes. The political economy is consequential. From its operation flow aggregate levels of economic growth and productivity that drive national prosperity as well as the distributions of income, economic security, and life chances that determine the quality of life, and even life expectancy, for many people. National variations in the operation of the political economy yield very different outcomes. In the United States, real income per person has risen by more than 130 percent over the past twenty-five years, while in Italy it has increased by barely 50 percent. Equally dramatic changes occur over time in how political economies generate and distribute prosperity. Developments of great moment can happen in a single lifetime.

Consider how much the advanced economies have changed in merely eighty years since the end of the Second World War. Entirely new types of goods and services now dominate production. In 1955, General Motors, Standard Oil, and US Steel were the largest American companies by revenue, and the top fifteen US companies were all manufacturers or oil companies. By 2022, the largest American companies were Walmart, Amazon, and Apple. Five of the top fifteen firms were in healthcare, and only one was a domestic manufacturer (of pharmaceuticals). The distribution of income shifted just as dramatically. During the 1950s, the chief executives of large American companies earned about twenty times more than their average worker. Today, those executives are paid 350 times more than their workers—taking home each year about nine times what the average American earns in an entire lifetime. Three out of four American workers once believed they could get ahead through hard work. By 2014 barely half of them thought so.¹

The role of the state in the economy has also shifted over these years. In the late 1940s, the British government pinned its hopes for economic growth on a wave of nationalizations that brought two million workers into the public sector. In 1956, a Republican president approved the largest public works program in American history in order to expand the interstate highway system. Within a few decades, however, the British government was privatizing those enterprises, while American presidents were intent on cutting taxes and deregulating industries.²

Many of these developments are puzzling. Why do economies that are so much more prosperous today than they were in the 1960s distribute their national product so much more unequally? Is higher income inequality an inevitable concomitant of economic growth? Do technological advances that make many lives better have to entail the loss of secure jobs? Why do huge corporations deemed so valuable today employ so few people? These are questions that can be answered only by understanding how political economies change.

They are questions about the future as well as the past. Contemporary political economies are in the middle of a new technological revolution built on digital technology, bioengineering, and artificial intelligence. Paradoxically, however, innovations with the potential to make many people better off come with immense social dislocations that impoverish the lives of many others.³ This is a common feature of technological revolutions. In 1835, the French observer Alexis de Tocqueville noted something similar when he wrote from Manchester, England, the home of the first industrial revolution: “From this foul drain, the greatest stream of human industry flows out to fertilize the whole world. From this filthy sewer, pure gold flows. Here humanity attains its most complete development—and its most brutish.”⁴

Thanks to the development of welfare states and the economic growth of ensuing centuries, our situation may not be so dire. In some respects, however, it is even worse because that growth came at the expense of changes to the climate that threaten the future of the planet. The world is changing fast, and there is real uncertainty as well as understandable anxiety about what the future will bring. In recent surveys, many Americans have said that they fear technology more than death, and most people in the developed democracies now believe that life will be worse for their children than it has been for them.⁵ These uncertainties raise many issues. How effectively can Western polities mitigate the adverse social effects of rapid technological change? On what basis will leaders summon up the means to do so? Can we expect the

companies of the future to provide decent jobs? Where will the political fault lines in high technology societies lie?

Social science has produced important analyses about how political economies function and why they differ from one another.⁶ Answering such questions, however, requires looking beyond comparative capitalism to consider how political economies change over time. We need to understand how new economic challenges arise and how key actors respond to them. We need to think in terms of adjustment trajectories rather than varieties of capitalism and consider their determinants. Moreover, to understand how political economies change, we cannot simply study the present. We need to look back at how political economies have moved from the past to the present. By seeing how countries managed previous economic challenges, we can gain a better understanding of how they might cope with those they face today.

Some view these issues primarily in material terms, amenable to a purely economic analysis. But the relevant outcomes are not simply products of the economy. They flow from interactions between markets and states within the larger unit we can think of as a political economy. These interactions matter because states do not simply redistribute income or supply public goods. They also promote innovation, regulate markets, and mitigate their adverse effects. As Karl Polanyi observed eight decades ago, markets are not natural emanations of the human condition but institutions whose shape is heavily dictated by states.⁷ Nineteenth-century British Prime Minister William Gladstone put it well when he said, “Budgets are not merely matters of arithmetic, but in a thousand ways go to the root of prosperity of individuals, and relations of classes, and the strength of Kingdoms.”⁸

Examining the interaction between states and markets will also throw light on a problem that has perplexed observers for more than a century, namely, how to understand the problematic but crucial relationship between capitalism and democracy. At stake are questions about the balance of power between these two spheres. To what extent can the elected representatives of a popular will influence the actions of national and multinational firms? When must governmental decisions be subordinated to the dictates of capital? One school of thought views capitalism and those who manage it as the dominant partner in this relationship. Another argues that democratic politicians have always had the upper hand.⁹

Most of these analyses treat capitalism and democracy as immutable institutional structures that admit of only one answer to questions about this balance of power. There is a certain logic to that perspective because capitalism

and democracy have been remarkably durable. But what we can learn from focusing on their institutional structure alone is ultimately limited because key features of capitalism and democracy change over time.¹⁰ The industrial capitalism of the early twentieth century was very different from the knowledge economy of the twenty-first century, and the character of democratic representation changes over time in tandem with shifts in political cleavages, ideologies, and social organization. Hence, to understand what follows from the intersection of capitalism and democracy, we must see them not simply as institutional systems but as artifacts that evolve across time and space. We need ways of conceptualizing specific phases of capitalism and democracy.

That is the task of this book. Its objective is to answer three overarching questions.

1. *How do political economies, understood as the terrain on which capitalist economies and democratic polities intersect, vary over time?*
2. *What factors drive changes in the political economy?*
3. *What are the processes through which these changes occur?*

My focus is on transformations in the political economies of the developed democracies in Western Europe and North America over the eighty years since the Second World War. In spatial and temporal terms, this is but a small slice from the vast history of capitalism, but the United States and the European Union are still the world's two largest economies, accounting for more than 40 percent of global production, and they are the subject of large literatures in comparative political economy. Some of the observations I draw from them may also apply to other cases.

The developments I trace are consequential for many types of outcomes. Among the most important, and the one on which I concentrate, is the distribution of well-being. Because capitalism sets the parameters for much of daily life, shifts in its operation can have dramatic distributive consequences. As Thomas Piketty and others have observed, over the initial postwar decades the distribution of income became more equal, but inequality increased dramatically after that, albeit at different rates across countries (see figure 1.1).¹¹ Employment also became less secure over this period and the livelihoods of many people became more precarious—a development that is less often noted but at least as consequential for human well-being.¹² Behind the figures for aggregate levels of economic growth lay a profound transformation in who could get good jobs, where they would be found, and what kinds of jobs they would be. Employment and income were reallocated between men and

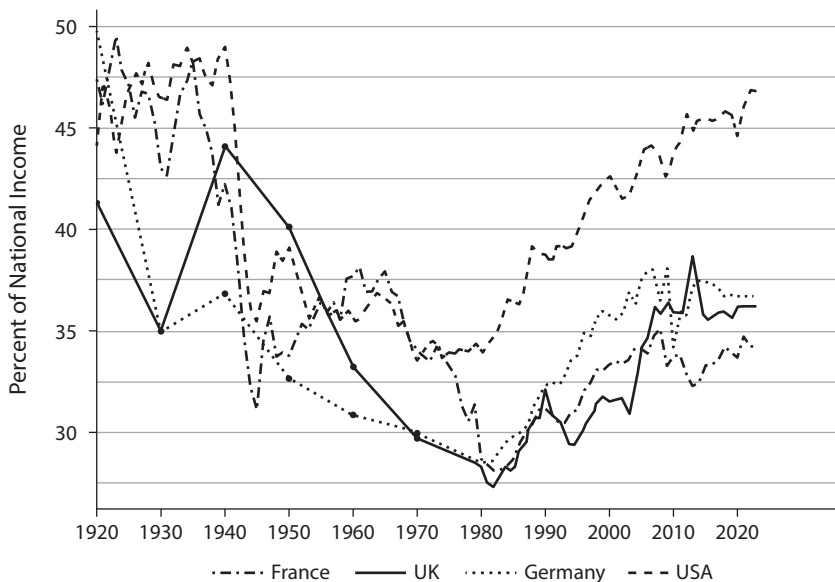


FIGURE 1.1. Top decile income shares, 1910–2020

Note: Based on data from the World Inequality Database (WID). Dotted lines interpolate over missing data for Germany and the UK before 1980.

women, between people with more or less education, and between those living in large cities versus outlying areas.¹³

The economic effects of these developments were profound, but the consequences were more than economic. Some of these developments tore apart the sinews of social life, shifting gender relationships, intensifying competition for employment, altering social expectations, and throwing entire communities into decline.¹⁴ Those experiences then shaped political perspectives, yielding new electoral alignments whose complexion has left deep marks on the conduct of politics and what governments can do. Appreciating how the political economy has changed is important for understanding how contemporary politics has changed.

How then should the most significant changes in the advanced political economies over the postwar decades be described? These have been eventful years but any account of changes in the character of the political economy should do more than cite a collection of contingent events. It should be grounded in a perspective that highlights the core interdependencies of capitalism and democracy seen as mutually reinforcing systems of economic and

political relationships. To be sure, those two systems are often only loosely coupled, but the political economy is best seen as an entity whose effects are generated by mutual interaction among its constituent parts.

Accordingly, I am going to develop an analysis based on two core concepts. The first is what I will call *growth regimes*—a concept designed to capture changes in the principal modalities through which societies seek prosperity.¹⁵ The second is the concept of *representation regimes* which I use to identify changes in one of the core features of democracy, namely, whose voices are heard and with what force in the processes of policymaking that influence the direction of the economy.

Growth Regimes

When I refer to growth regimes, my point is not that economic growth should be the sole national objective, especially at a time of looming climate change. But governments and their citizens generally seek rising standards of living, for which economic growth is a prerequisite, and new approaches to securing it have been central to changes in the political economy. I argue that the post-war period has seen three separate growth regimes, each marked by distinctive ways of generating economic growth and distributing its fruits.

The fulcrum for my understanding of growth regimes is the observation that two key sets of agents sit at the center of all capitalist economies, namely, firms and governments. It is difficult to overstate their roles. At the micro level, the institutional practices and policies of these two agents condition the lives and livelihoods of most people. At the macro level, it is firms operating within the purview of public policy that generate economic output, and together these two agents distribute the benefits of economic activity in the form of incomes, working conditions, and economic security. Moreover, any theory about how political economies change should identify the agents of change, and I see firms and governments as the principal agents of adjustment driving political economies along new paths as they respond to evolving sets of economic, social, and political challenges.¹⁶

Why attach so much importance to firms? In general, comparative political economists are more likely to focus on governments or organized producer groups, leaving the study of firms to business schools. But varieties-of-capitalism perspectives remind us that firms deserve a central place in such analyses. In capitalist economies, business enterprises are the principal units responsible for production, and as their strategies change so do the terms on

which capitalism operates. If one of the purposes of examining how political economies change is to understand why the distribution of well-being shifts over time, firms must also be at the center of the analysis because their practices condition as many dimensions of well-being as public policies do.¹⁷ Firms decide who is going to be hired, the wages they will be paid, their tasks, hours and working conditions, and in many cases the benefits they will receive. The policies of a person's employer often impinge more directly on their lives than those of a distant government.

A growth regime is constituted, therefore, by the principal institutional practices that firms and governments deploy for generating and distributing economic output, and movement from one regime to another is marked by substantial shifts in those practices. These include major changes in how companies organize production, regulate work, raise capital, or market their products, as well as in the policies governments adopt for macroeconomic management, regulating markets, fostering skills, and supporting people without employment. What renders a growth regime more than a disparate collection of practices, however, is how the practices of firms and governments interlock, often reinforcing each other, to yield specific sets of outcomes. Only in tandem do firms and governments generate distinctive patterns of economic growth and determine how it is to be distributed.

There is nothing functionalist in this formulation: my point is not that the strategies of firms and governments *must* reinforce one another—sometimes they do and sometimes they do not—although we see a coherent growth regime only when they do and observers of capitalism will not be surprised to find that they often do. Governments tend to adapt their policies to the strategies of large companies, partly because the resources of those companies give them privileged access to policymakers and partly because democratic governments depend for reelection on securing levels of prosperity that are possible only if they retain the confidence of the business community.¹⁸ By the same token, firm strategies respond not only to market incentives but also to the strictures and opportunities posed by prevailing regulatory regimes and to the macroeconomic climate promoted by governments.¹⁹

As a result, growth regimes are typically characterized by *complementarities* between firm strategies and government policies. That is to say, in a well-functioning growth regime, the efforts of firms to make profits are rendered more efficient by many of the policies pursued by governments, and the efforts of governments to promote economic growth are more efficacious when they are congruent with prevailing firm strategies. Therefore, although many factors

drive political economies from one growth regime to another, one of the key features of this movement is a process in which firms and governments adjust their strategies until they are congruent with each other.

Three Growth Regimes

Based on this conceptual framework, we can identify three growth regimes in the postwar history of the Western democracies. I label these the growth regimes of an era of modernization, which ran from 1945 to about 1975, an era of liberalization extending from 1980 to the late 1990s, and an era of knowledge-based growth that began around the turn of the twenty-first century. Each is described in detail in the following chapters.

During the era of modernization, the strategies of large firms were heavily based on Fordist approaches to manufacturing, a quest for economies of scale, vertical integration followed by conglomeration, and an orientation to employees as well as shareholders. Many governments were committed to modernizing their economies. They regularized collective bargaining, pursued newly interventionist policies based on active fiscal management or economic planning designed to sustain demand for manufactured goods within the context of a fixed exchange rate regime, and built welfare states to improve skills and mitigate the human costs of economic modernization.

The 1980s ushered in a new growth regime for an era of liberalization that lasted about two decades. Firm strategies were reoriented toward delivering value for shareholders, which prompted a new focus on the core competencies of firms and efforts to downsize the labor force, notably by outsourcing tasks to subcontractors—with dramatic consequences for the quality of employment. These developments were facilitated by public policies that shifted authority over the allocation of resources from states to markets and rendered markets more competitive. Governments eliminated exchange controls to promote flows of capital across national borders, deregulated markets for products, labor, and finance, privatized public enterprises, reduced the generosity of social benefits, and tied the receipt of those benefits to new work requirements.

Toward the end of the 1990s, the growth regime shifted again, ushering in an era of knowledge-based growth, as firm strategies responded to new technological developments and an increasingly open global trading system. Three features of firm strategy were distinctive to this regime: the rapid and intensive deployment of digital technologies to production and sales, a shift away from

investment in physical assets toward investment in intangibles such as patenting, trademarking, or research, and the movement of manufacturing into global value chains accompanied by the large-scale offshoring of jobs. Public policies encouraged these changes in firm strategy. New trade arrangements, such as the North American Free Trade Agreement (NAFTA), the admission of China to the World Trade Organization (WTO), and bilateral investment treaties incorporating protections for intellectual property rights facilitated the development of global value chains. Governments expanded college enrollments to meet the demands for skilled labor generated by technological change, and they utilized public funds as well as risk-tolerant financial regulations to expand high-technology enterprises. Eventually, to address climate change, the vulnerability of supply chains, and the social dislocation caused by an ongoing technological revolution, they also turned toward more interventionist economic policies.

Distributive Implications

These movements were consequential for the distribution of well-being as well as national prosperity. The growth regime of the era of modernization promoted rapid economic growth and delivered more than 60 percent of national income in the developed political economies to labor, reducing income inequality to the lowest levels seen in a century.²⁰ Employment became increasingly secure and prosperity spread geographically as manufacturing grew in smaller towns and cities.²¹ Shifts in the occupational structure that saw more white-collar employment increased social mobility.²² This was not a perfect society. Pockets of poverty remained, and opportunities were more limited for women than for men, but an expanding social safety net supported people without employment, and the fruits of economic prosperity were relatively widely shared.

By contrast, the growth regime of the era of liberalization that began in the 1980s shrank the share of national income going to labor and increased levels of income inequality, especially at the top of the income distribution in Anglo-American economies, as the salaries of managers increased more rapidly than those of production workers and rising rates of return privileged people with financial assets.²³ Employment security declined for large swaths of the workforce, and outsourcing trapped many workers in low-wage secondary labor markets. In some countries, the prospects for social mobility declined for each successive cohort entering the labor force.²⁴ Slower rates of economic growth

contributed to these results, but many of the distributive outcomes stemmed from changes in firm strategies and public policies.²⁵

The era of knowledge-based growth brought further social dislocation, as technological revolutions do.²⁶ Skill-biased technological change and the rapid offshoring of manufacturing jobs polarized the occupational structure, eliminating many middle-skill jobs that were once vehicles for social mobility. Forty percent of workers in Europe were soon in nonstandard employment.²⁷ The movement of skilled jobs to high-technology urban clusters exacerbated regional disparities in income and employment.²⁸ A turn toward social investment expanded educational opportunities and improved the lives of many working women, but active labor market policies tied the social benefits of many people to low-wage work.²⁹ The network effects and economies of scale associated with twenty-first-century technologies also generated monopoly rents, especially for firms at the apex of global value chains, thereby increasing inter-firm inequalities in profits and wages.³⁰ Amid a political backlash, many governments adopted more interventionist economic policies, but whether these will foster more equality of opportunity remains uncertain.

Representation Regimes

If the concept of growth regimes captures key developments in the operation of postwar capitalism, we also need to consider how democracy changes over time. That is important for two reasons. First, public policies are constitutive of growth regimes and politics conditions the policies governments adopt in response to economic challenges. Therefore, we cannot explain how growth regimes arise or change without taking political conditions into consideration. Second, to understand how the relationship between capitalism and democracy shifts over time, we need to be attentive not only to developments in capitalism but also to developments within democracy. That entails charting changes on the political side of the political economy.

For this purpose, I am going to employ the concept of a *representation regime*. I use this term to refer to the processes through which the preferences of citizens are brought to bear on the public policies that yield an authoritative allocation of resources.³¹ At any point in time, all democracies are characterized by the presence of a distinct representation regime which specifies whose voices are heard and with what force over that allocation. In normative terms, these regimes can be judged by the quality of the representation they provide.

In positive terms, they can be analyzed as factors conditioning the public policies that become constitutive of growth regimes.

The types of outcomes that follow from the representation regime depend on power relations and the coalitions that can be formed in two prominent institutional arenas. One is the arena of producer group politics, where organizations speaking for various segments of labor and capital are the principal actors. This arena encompasses a number of forums for consultation between producer groups and the state, including the industrial relations system which accords representatives of labor and capital formal roles in the determination of wages and working conditions.

The other relevant arena is that of electoral politics, where political parties mobilizing distinctive electoral coalitions are the main actors. In both realms, the character of representation varies across countries and over time, and in subsequent chapters we will see how these variations affect growth regimes. In general, developments in electoral politics are important to movements from one growth regime to another, while producer group politics is especially consequential for the distinctive adjustment paths that nations follow.

Producer Group Politics

Producer group politics is an arena of “organized combat” where how the contending social groups are organized is especially pertinent to the outcomes.³² How labor and capital are organized affects the policies underpinning growth regimes in three ways. The organizational strength of the two groups conditions their relative influence over public policies.³³ Stronger labor organizations, for example, are generally associated with more generous welfare states.³⁴ How producers are organized also affects how they come to see their interests and therefore which interests are expressed most strongly in this arena.³⁵ The transition to a knowledge economy, for instance, was different depending on whether a nation’s trade unions spoke for employees in services or primarily for those in manufacturing.³⁶ The organization of producer groups also bears on what types of policies governments can implement. Where large portions of the workforce are represented by a centralized trade union confederation, for example, it is easier for governments to enlist organized labor in efforts to control inflation or contain unit labor costs and, where employers are well organized, it is easier for governments to operate effective vocational training schemes.³⁷

For these reasons, although all the developed democracies moved through three growth regimes, cross-national variations in producer group politics inflected the shape those regimes would take in particular countries. Differences in how producers were organized led national governments to respond to common challenges in different ways. As a result, producer group politics has proved especially central to generating what I will describe as national adjustment trajectories.

Changes over time in producer group politics also had important effects on the evolution of representation regimes. In some cases, these changes altered the force with which the voices of labor and capital spoke to governments—with corresponding effects on the public policies at the heart of growth regimes. After collective bargaining arrangements established in the 1950s and 1960s strengthened organized labor, for example, European governments responded with new social and industrial policies, while the waning power of trade unions in the subsequent era of liberalization limited the capacity of labor to stave off the market-oriented policies of that era.³⁸ At the same time, renewed efforts to organize business helped to make the United States a neo-liberal pioneer.³⁹

However, producer group politics is not simply about the overall power of capital and labor. Changes in the influence of different segments of labor and capital and in how those segments viewed their interests also affected the voices that emerged most strongly from the representation regime. As secular economic developments created new divisions of interest between various types of producers—such as large and small employers or blue-collar and white-collar trade unions—those divisions had consequences for what governments were pressed to do and hence for the public policies constitutive of growth regimes.⁴⁰

Electoral Politics

The impact of electoral politics on growth regimes remains a matter of controversy in the field of comparative political economy. The predominant view in the field has long been that producer groups, in the form of trade unions and business associations, dominate the choices made by firms and governments.⁴¹ This is a plausible stance, since producer groups usually have the clearest stakes in economic policies and the most resources with which to influence them. In recent years, however, some analysts have urged the field to acknowledge the influence of electorates over the direction of the economy.⁴² But this incipient

electoral turn is hotly contested, and the most influential contemporary view holds that there is a specific division of labor between the two arenas: electoral competition is said to matter only for issues of high salience to voters, such as the provision of social benefits, while the details of economic management, regulatory policy, and industrial relations are worked out in the realm of producer group politics.⁴³

If we focus on the normal politics of policymaking within a growth regime, there is much to be said for this view. But, if we want to understand major changes in the direction of political economies which is my principal concern here, I think we need to be more attentive to the role that electoral politics plays in the process whereby nations move from one growth regime to another. Specific issues can be mobilized into and out of the electoral arena, and as this happens, the balance of influence over those issues between the two arenas in the representation regime can change, with consequences for whose interests a growth regime is likely to address and the corresponding relationship between capitalism and democracy.

From this standpoint, the problem becomes one of understanding just how electoral politics impinges on the choices that governments make about economic and social policies. In particular, we want to know whose interests are represented in the electoral arena and whether they are expressed strongly enough to influence policy. There is a large literature, of course, about whose interests come to the fore in elections, with different analyses emphasizing the impact of constitutional structures and electoral rules, the role of median voters, and the partisan composition of governments.⁴⁴ However, most of these analyses focus on how the quality of representation varies across nations or over relatively short periods of time, whereas the focus of my analysis is on changes that occur over long periods of time as growth regimes shift.

In this longer-term context, some features of the electoral arena that may be important for explaining short-term or cross-national variations in the nature of representation recede in importance while others come to the fore. For instance, constitutions and electoral rules rarely vary over the decades that I examine. Median voter models that ascribe electoral outcomes to the views of decisive voters positioned in the middle of a distribution of opinion can explain the outcomes of individual elections, but for my purposes they generally fail to say enough about how the concerns of those median voters change over time. The voice of the middle class may always be important, but we need to know why it speaks in different tones at different times and places.

Even accounts that associate representation with the partisan complexion of governance supply only part of the story. Shifts in the governing party can sometimes explain changes in policy over the short term. But when scholars look across decades, one of their most striking findings is how often the positions of mainstream political parties have moved together in tandem, especially on issues about how to manage a capitalist economy.⁴⁵ The convergence of mainstream party platforms toward neoliberal policies during the 1980s and 1990s has often been noted but, as figure 1.2 indicates, that was preceded by a parallel convergence toward the left in many Western democracies during the 1950s and 1960s.⁴⁶ In short, if we are concerned about long-term changes in whose voices are heard, the more consequential electoral development may not be changes in the partisan hue of the government but changes that occurred in the programs of all mainstream political parties. The differences between the political platforms of the British Labour party in 1945 and in 1997, for example, are at least as consequential as differences across British party platforms at any one point in time.

This observation directs our attention to what I will call changes in *the terms of electoral contestation*—namely, shifts over time in the issues most salient to electoral competition and in how those issues are framed. The terms of electoral contestation matter because scholars frequently find centripetal dynamics in electoral competition. That is to say, all mainstream parties aspiring to office often have to address a common set of issues at the heart of each election, even if their approaches to those issues take on a partisan cast.⁴⁷ As a result, the terms of electoral contestation are usually translated into policy. Ever since the work of E. E. Schattschneider, scholars of agenda-setting have noted that what political parties are fighting over usually matters more to the subsequent course of policy than which party wins.⁴⁸ And this point speaks to issues of representation because it suggests that the interests of specific social groups are more likely to be heeded when issues of special concern to them rise toward the top of the electoral agenda.

Therefore, the question becomes: why do some issues acquire prominence on that agenda while others remain on its margins? In my view, two factors are largely responsible for that. The first are major real-world events.⁴⁹ The events of most relevance to this study are likely to be episodes of recession or inflation with widespread adverse consequences. Parties competing for office must react to such events, and their responses will be inflected by prevailing doctrines about how to manage them. The shadow of mass unemployment during the Great Depression of the 1930s, for instance, hung over the platforms of

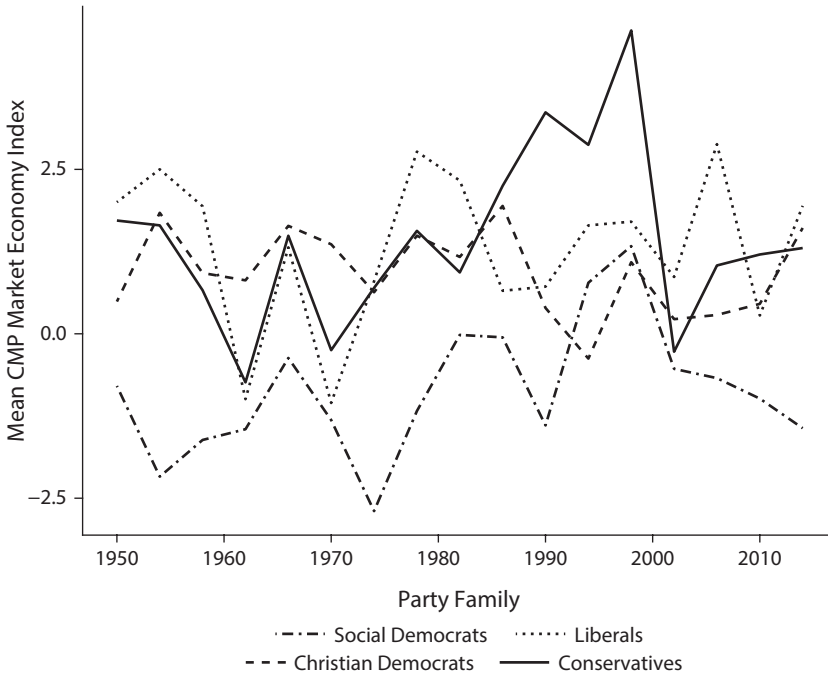


FIGURE 1.2. Support for “free markets” in the platforms of European political parties, 1957–2015

Note: Party positions on the free market economy index of Lowe et al. 2011 indicating the prevalence in party platforms of support for a free market economy and market incentives as opposed to more direct government control of the economy. Author’s calculations from Comparative Manifesto Project data. Higher values indicate more support for free market positions. Countries include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, and the United Kingdom.

political parties competing for office in the 1940s and 1950s, and parties seeking office after the economic crisis of the 1970s could not avoid addressing issues of inflation and economic stagnation.

The second factor driving which issues are most prominent on the political agenda is the prevailing structure of political cleavages—a concept with a distinguished history.⁵⁰ Following standard practice, I use the term to refer to systematic divisions of outlook or interest between large sociodemographic groups, often associated with collective identities and underpinned by social organizations, that lead to systematic differences in voting behavior. Because they reflect major lines of social conflict, the presence of distinctive cleavages

pushes specific kinds of issues onto the political agenda. Hence, as the political cleavage structure changes, so do the terms of electoral contestation, thereby altering the types of policies pressed on governments and the policies they are likely to pursue, including the economic and social policies constitutive of growth regimes.

Three Representation Regimes

The representation regime of the *era of modernization*, stretching from 1945 to 1975, proved central to the adoption of the policies that underpinned the growth regime of that era. At the beginning of this period, memories of the mass unemployment and political crises of the interwar years pushed issues of poverty and employment to the top of the political agenda. And the prevalence of industrial manufacturing proved conducive to an electoral politics dominated by a class cleavage dividing blue-collar workers from a white-collar middle class. Across Europe, the political left emerged stronger from the war, and the subsequent regularization of collective bargaining strengthened the voice of trade unions pressing for full employment and more generous social benefits. Together, these factors pushed issues of economic inequality and social justice to the forefront of electoral politics.⁵¹ As a result, this was a period in which democratic polities reined in what had once been a freewheeling capitalism. Most Western governments adopted full employment as a goal and interventionist means for achieving it, as well as extensive systems of social insurance which formed the basis for what a British archbishop at the time called a new “welfare state.”⁵²

A very different set of political conditions underpinned the next growth regime developed during an *era of liberalization* that began around 1980 and lasted for two decades. In this period, governments retreated from activist industrial intervention toward more reliance on markets for the allocation of resources at the cost of increasing income inequality and more precarious employment. The immediate impetus for these changes in policy came from the economic crisis of the 1970s, which left policymakers disillusioned with the failure of existing policies to lift their economies out of stagflation. But changes in the representation regime also facilitated the movement to new types of policies.

Central to these changes was a shift in the structure of political cleavages. By the early 1980s, three decades of prosperity had eroded the class cleavage, as figure 1.3 indicates, and fostered new sets of post-material cultural values,

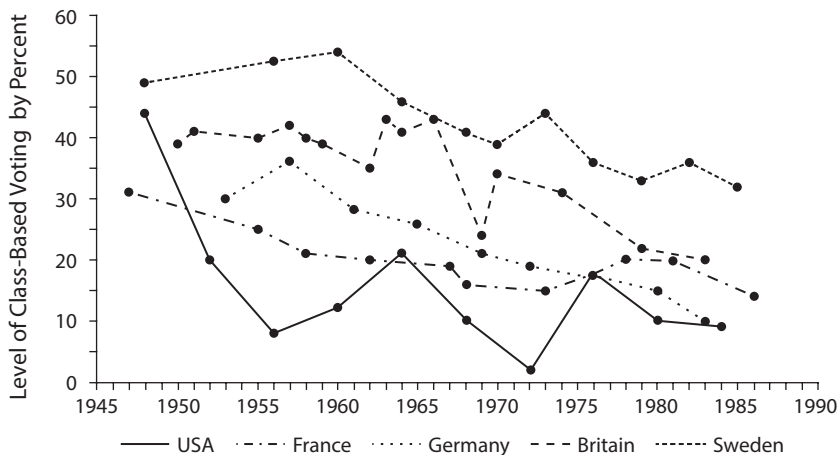


FIGURE 1.3. Alford index indicating the level of class-based voting, 1945–1990
Note: The Alford index reports the proportion of the working class voting left minus the proportion of the middle class voting left. Reproduced with permission from Manza et al. 1995.

which gave rise to a cross-cutting cleavage based on support for and opposition to those values.⁵³ Voters committed to gender equality, racial equality, environmental protection, and multiculturalism were arrayed against others more concerned about law and order, immigration, and the protection of their traditional national culture. As the salience of these cultural issues grew, the focus of electoral competition shifted away from issues of economic justice. Seeking a new reservoir of votes, center-left parties began to appeal to middle-class constituents on the basis of cultural issues, which made it difficult for them to act primarily as parties of working-class defense. Instead, many became more receptive to neoliberal policies that served the interests of their new middle-class constituents.⁵⁴ As a consequence, party platforms converged to the right (see figure 1.2).

At the same time, in keeping with neoliberal doctrines, many governments transferred more authority over policy to independent central banks, parapublic agencies, or the European Union, thereby rendering electoral competition less central to economic policymaking.⁵⁵ Influence over economic policy moved toward the producer group arena, where business interests are always powerful, at a time when labor unions were being weakened by high levels of unemployment, growing foreign competition, and market-oriented initiatives.

As a result, the balance of power between capitalism and democracy in this era shifted toward the owners and managers of capital.

By the end of the 1990s, the developed economies were entering a new growth regime associated with an *era of knowledge-based growth*. Movement to this regime was initially prompted by the diffusion of new digital technologies and falling tariff barriers which increased the opportunities for investing abroad. But, over the course of this era, the representation regime gradually changed as well, and electoral politics assumed a new importance as the political cleavage structure shifted once again. As in earlier instances, the roots of this shift lay in the effects of the previous growth regime. Increases in income inequality and economic insecurity during the era of liberalization inspired growing discontent, which was then reinforced by social dislocation during the new growth regime as skill-biased technological change and offshoring eliminated many well-paid jobs. These developments opened up a new populist cleavage between well-educated voters with favorable prospects within this knowledge economy and others with more modest levels of education who feared being left behind by it.⁵⁶

The result was a gradual political realignment, as many working-class voters abandoned mainstream parties for politicians mounting right populist appeals, while middle-class voters were drawn to Green parties and parties on the center-left. The electoral arena became a more hostile battleground as populist politicians mounted bitter challenges to established parties and, although it spoke with a different timbre, the electoral voice of the working class was now louder than it had been in some decades.⁵⁷ This new cleavage shifted the terms of electoral contestation once again. The populist challenge brought issues of inequality and regional decline to the top of the political agenda, and many governments responded by turning away from market liberalism toward more interventionist economic policies in the hope of weaning discontented voters away from the populist right.

Processes of Change in the Political Economy

If developments in the postwar economies can be seen as a series of movements between distinctive growth and representation regimes, what drives these movements? What are the principal features of the process through which political economies change? These are not easy questions to answer because political economies contain many interlocking parts and the process of change has multiple dimensions. There is no demiurge here, and efforts to find a master process

behind changes in the political economy, such as globalization, financialization, or liberalization, often oversimplify the problem. However, comparative political economists have taken a variety of approaches to these issues, each with some purchase on the problem, and before turning to my own formulations, I want to begin by considering the insights and limitations of these approaches.

The Systemic Imperatives of Capitalism

One important perspective locates the sources of change in the political economy in dynamics intrinsic to the system of capitalism itself. Although drawn in broad brushstrokes with limited attention to political detail, the recent portrait painted by Wolfgang Streeck exemplifies this approach. In his account, the driving force behind change in the political economy is “the relentless endogenous pressures for expansion” of capitalism, and the key development in recent years has been the internationalization of economic relations.⁵⁸ The Keynesian policies of the 1960s are said to have given way to neoliberal ones during the 1980s when “the profit-dependent classes began to look for an alternative . . . and found it in de-nationalization, also known as ‘globalization’ . . .,” which weakened labor enough that “capital was able to press for a shift to a new growth model, one that works by redistributing from the bottom to the top.” At that point, “democracy ceased to be functional for economic growth and in fact became a threat to the performance of the new growth model; it therefore had to be decoupled from the political economy.” This account ascribes much more causal influence to capitalism than to democracy. In general, “it is the dynamism of capitalist development that dictates the agenda of political choices, instead of the other way around.”⁵⁹

There is considerable insight in this view because capitalism *is* a system of interconnected parts that move in tandem over time and it has had extraordinary resilience, not least because it confers high levels of economic and political power on those who gain the most from it. Ever since James O’Connor identified two key functions on which the survival of capitalism depends—namely, a need to secure the accumulation of capital and a need to ensure the legitimation of the system—it has been tempting to interpret changes in the political economy as modifications made to ensure the performance of those functions.⁶⁰ We learn something from thinking about capitalism as a system, and Streeck is surely correct both that the dynamics of capitalism condition the agendas facing politicians and that capital gained the upper hand during the 1980s.

Whether those dynamics fully dictate the political agenda, however, is more dubious and contested by scholars such as Fred Block, who cites many instances in which politicians have taken initiatives opposed by capital.⁶¹ The real problem with an approach based on systemic imperatives is that there are always alternative ways in which those imperatives can be addressed, just as there are many ways in which the functions of accumulation and legitimation can be satisfied. As Robert Merton observed, specifying functional needs does not tell us much about how they will be satisfied.⁶² Moreover, although capitalists undoubtedly occupy privileged positions within contemporary democracies, legitimating capitalism also requires some responsiveness to public opinion. As a result, the relevant politics is more complex than analyses positing that policies serve the interests of capital would imply. We would be remiss to ignore the systemic imperatives built into capitalism, but relatively little about the specific course of events can be read directly from them.

Capital versus Labor

Another influential approach to the problem of explaining how political economies change begins from similar observations about the structural conflicts endemic to capitalism but accords more importance to the politics through which they are resolved. It has been most prominently advanced by a group of scholars advocating “power resource” approaches to politics.⁶³ Influenced by the observation of Karl Marx and Friedrich Engels that “the history of all hitherto existing society is the history of class struggles,” these scholars explain outcomes in the political economy primarily as the product of conflict between organizations representing capital and labor.⁶⁴ That conflict is present in two realms: the sphere of industrial relations, where employer organizations confront trade unions, and the realm of electoral politics, where social democratic political parties speaking for a working class compete with conservative or liberal parties whose platforms usually reflect the interests of capital. According to this perspective, the character of public policies, wages, and working conditions can be explained by reference to the balance of power between labor and capital, which depends on the capacities of organizations on each side of this conflict to mobilize support.⁶⁵

This is a powerful heuristic. It focuses the analysis on one of the most fundamental issues in the field, namely, the relative well-being of working people vis-à-vis the owners and managers of capital. And it speaks directly to the antinomy at the heart of capitalist democracies, where a small number of

wealthy actors control the means of production and reap most of its rewards, even though the polity is nominally responsive to the entire populace. In the context of globalization, this approach has been especially illuminating about how the ability of capital to exit the national economy increases the power of employers vis-à-vis workers who cannot leave the nation if their demands are not met.

However, this approach tends to oversimplify the politics of the political economy because capital and labor are far from unitary actors. Electoral conflict is based on the mobilization of complex coalitions made up of multiple groups whose interests are often not well captured by the concepts of *labor* and *capital*. Even in the arena of producer politics, outcomes are frequently driven by cross-class coalitions in which some segments of capital or labor unite against others. As Peter Swenson has observed, cross-national variations in the outcomes of such conflict often turn, not on differences in the balance of power between the organizations of capital and labor as power resource theorists contend, but on national differences in how these organizations construe their interests.⁶⁶ And those differences are often rooted in national variations in the organization of the political economy. In a world where changes in the occupational structure have reduced the cohesiveness of the working class and multiple types of interests divide capitalists, it has become increasingly difficult to explain economic and political outcomes primarily by reference to class conflict, even though the outcomes can be consequential for each side.

Technological Change

Many economists prefer to explain the outcomes in which I am interested as the product of a key material process, namely, technological change. Over the course of centuries, the importance of technological change is indisputable. Marx remarked on the significance of the movement from the hand mill to the steam mill, and economic historians have shown that technological revolutions have dramatic effects on politics as well as the economy.⁶⁷ The decades I examine encompass the last of these revolutions based on the diffusion of digital technologies and the development of artificial intelligence.

Accordingly, no account of how political economies change can ignore the effects of this technological revolution. It has shifted the terms on which economic growth is secured, how people work, how they communicate, and many other dimensions of how they live. As Carles Boix notes, some of the most

important consequences of this revolution flow from shifts in the occupational structure.⁶⁸ Every technological revolution eliminates whole categories of jobs and creates new ones. Today, skill-biased technological change threatens many routine jobs in manufacturing and services, and it has polarized the occupational structure, as the number of high-skilled positions has increased, sometimes along with low-skilled positions, while the availability of middle-skill jobs on which many people once depended for a decent living has declined.⁶⁹ Technological change has also altered the geography of jobs. As Torben Iversen and David Soskice note, the digital revolution has moved many well-paid jobs into large metropolitan areas where high-tech firms take advantage of the synergies available in knowledge clusters.⁷⁰ As a result, entire communities that once prospered on manufacturing are declining, and these developments have had political effects. While some groups within the populace suffer, others prosper; political alignments are shifting and politics as a whole has become more turbulent as many people confront the uncertainties that accompany rapid technological change.

However, technological change cannot be the end of the story. Large-scale social effects follow not from new inventions but from their diffusion, and technology does not diffuse itself. How it spreads depends on the strategies adopted by a nation's firms and the incentives that governments supply for its uptake, as national variations in the adoption of digital technology indicate.⁷¹ We need to understand the institutional conditions underpinning the diffusion of these new technologies. Moreover, public policies can magnify or moderate the distributional conflicts that come in their wake.⁷² Any analysis must assign a role to technological change, but it is only one of several components of the process whereby political economies change.

Globalization

The other macroprocess often said to drive changes in the postwar political economies is globalization.⁷³ This is a nebulous term, sometimes said to include flows of people and ideas, but there is no doubt that the declining barriers to international flows of trade and capital at its heart have had profound effects on the developed political economies. They have accelerated the movement of manufacturing jobs to emerging economies and inspired many firms to reorganize their endeavors. Globalization has also had significant political

implications. Dani Rodrik, one of the most insightful scholars of this phenomenon, argues that, when trade agreements begin to cover an increasing range of regulatory issues, they circumscribe democratic decision-making, and many analysts suggest that, as the risk of capital flight rose, governments became more responsive to financial markets and less mindful of their own electorates.⁷⁴ When it assumed more authority over a single market and common currency, the European Union became the object of popular resentment, and the offshoring of jobs fueled a potent political backlash across the developed democracies.

One of the virtues of arguments that associate changes in the political economy with globalization is the attention they draw to the importance of international developments for the fate of domestic political economies. Nation-states have always been Janus-faced: looking outward to the international world and inward toward their own domestic societies.⁷⁵ Some years ago, John Ruggie argued that interventionist economic management was possible during the era of modernization because of the room for maneuver that postwar international regimes offered national governments, and the emergence of a Cold War motivated much of the American spending on research and development that fed a new technological revolution.⁷⁶ Today, there are echoes of this again as geostrategic competition between China and the West threatens a new age of protectionism. There is also no doubt that freer flows of capital during the 1980s and 1990s contributed to shifts in firm strategies and public policies. International developments are factors to which firms and governments have to respond.

To go further and take globalization as a *deus ex machina* largely responsible for changes in the postwar political economies underestimates, however, the extent to which international regimes are the products of negotiation among governments, and it tends to underplay the leeway that nation-states have within those regimes. For many developed democracies, international regimes have been an instrument for realizing their economic strategies rather than simply an impediment to them. Therefore, to understand how political economies change, we need to understand why those strategies were adopted. Similarly, the wide variation in how national political economies operate suggests limits to what the forces of globalization can dictate.⁷⁷ In sum, changes in international regimes and global conditions have been important factors affecting how political economies change, but they are far from the sole drivers of those changes.

The Role of Ideas

A fifth approach to the problem of explaining how political economies change emphasizes the architectonic role played by evolving sets of economic ideas. Mark Blyth has developed some of the most sophisticated versions of this approach.⁷⁸ He observes that episodes of economic crisis are often moments of Knightian uncertainty for policymakers, which new economic ideas resolve by providing new portraits of the economy with both positive and normative dimensions. By coordinating actors' expectations, those new ideas then facilitate coalition formation, the dismantling of old institutions, and the construction of new ones.

In striking work with Mattias Matthijs, Blyth characterizes changes in the postwar political economies as a shift between two macroeconomic regimes, each built around the principal target at which policymakers aimed.⁷⁹ Describing full employment as the operative target between 1950 and 1975 and inflation as the target since 1980, they argue that these targets were then embodied in institutional structures. From this perspective, ideas about what the principal target of policy should be are the cornerstones of successive economic regimes.

By highlighting the key roles that ideas play in the construction and legitimation of policy regimes, this approach offers an antidote to perspectives that treat ideas as a purely epiphenomenal veil for actions driven by material interests. Economic theories deserve a place in any account of how political economies change. They provide a lens through which actors facing the uncertainties of a changing economic situation interpret their otherwise ambiguous interests, as well as a means for coordinating on strategies to advance those interests.⁸⁰ These analyses also remind us that the durability of specific ideas depends on how firmly they are institutionalized within the political economy. The world is certainly not ruled by ideas alone, and we should not overestimate the impact of some simple policy targets. But any account of how political economies evolve must consider the role of ideas in this process.

An Alternative Perspective on the Process of Change

Subsequent chapters will discuss in detail how and why the developed political economies moved from one growth regime to another. However, here are the basic elements of my approach to this problem.

A Process of Mutual Adjustment

As I have noted, the core components of a growth regime lie in the prevailing practices of firms and governments, which interlock more or less tightly to constitute the approach a nation takes to the problem of securing prosperity.⁸¹ Accordingly, I see firms and governments as the principal agents of adjustment in the economy whose actions move nations from one growth regime to another, and it is changes in their practices that must be explained.

The movement from one growth regime to another takes place via a process in which firms and governments respond to evolving sets of challenges. Although some economic developments pose challenges for both of these actors, firms and governments operate on distinctive institutional terrains that render each more responsive to different sets of incentives and opportunities—and hence to somewhat different types of developments. The survival of companies depends on maintaining their profitability within the context of markets on which they secure capital, technology, or labor and on which they sell their goods or services. Therefore, companies respond primarily to changes in market opportunities. The survival of democratic governments, on the other hand, depends on their reelection. Therefore, they respond most directly to changes in the views of voters and the terms of electoral contestation. Because voting behavior is sensitive to prevailing economic conditions, however, democratic governments must also address challenges to the performance of the economy.⁸²

Charles Wilson oversimplified a complex relationship when he said that “what was good for our country was good for General Motors and vice versa.”⁸³ But we can see the symbiotic relationship out of which growth regimes are constructed. Because levels of prosperity depend on the investments of a nation’s companies, democratic governments must be sensitive to the views of firms, lest they damage the “business confidence” crucial to their own reelection.⁸⁴ Conversely, firm strategies also respond to public policies because those policies affect the market context within which companies must operate.

Hence, firms and governments often move in tandem, as each makes incremental adjustments to its practices in response to the actions of the other. At the inception of the era of modernization, the efforts of governments to establish new international and domestic institutions were indispensable to subsequent shifts in firm strategy, and government initiatives to liberalize financial markets and free up flows of international capital when the era of liberalization

began set up the contests for corporate control that forced many firms to focus on shareholder value. In these respects, we might say that governments led the transition to those two growth regimes. In the era of knowledge-based growth, global value chains flourished only after governments negotiated new trading regimes, but firm strategies were already changing in response to the opportunities offered by new digital technologies. In short, it takes both sets of actors to construct a growth regime via processes of mutual adjustment in which neither one is invariably the first mover.

A Response to Challenges

To some extent, the shifting strategies of firms and governments have to be seen as responses to challenges flowing from secular developments that lay beyond the control of any one nation. These challenges did not dictate the responses that would be made to them. There were multiple ways in which firms and governments could cope with the dilemmas they posed. But many of the shifts in firm strategies and public policies observed over the postwar decades were taken in response to five macro-level challenges.

- The challenges of industrial modernization were especially acute during the early postwar decades. They entailed moving manpower from agriculture into industry and, in Europe, the challenge of rebuilding and modernizing industries in order to compete with the United States, an economic colossus that had escaped the physical destruction of the war. Although these challenges were daunting, they ultimately offered the prospect of higher rates of economic growth because industrial workers were considerably more productive than those in agriculture.⁸⁵
- The challenges of deindustrialization followed and gathered pace during the 1970s as rising incomes and falling prices for manufactured goods shifted consumption and employment toward services.⁸⁶ By 2024, Walmart was the largest American employer. The principal problems here were how to create new jobs in the service sector and how to ease the transition for workers whose manufacturing jobs were disappearing (see figure 1.4).
- Next came the challenges of international economic openness, generated by falling tariff barriers, the expansion of trade, and freer flows of capital across national borders. Trade barriers had been declining since the 1960s, but it was only after exchange controls were removed during the 1980s that the

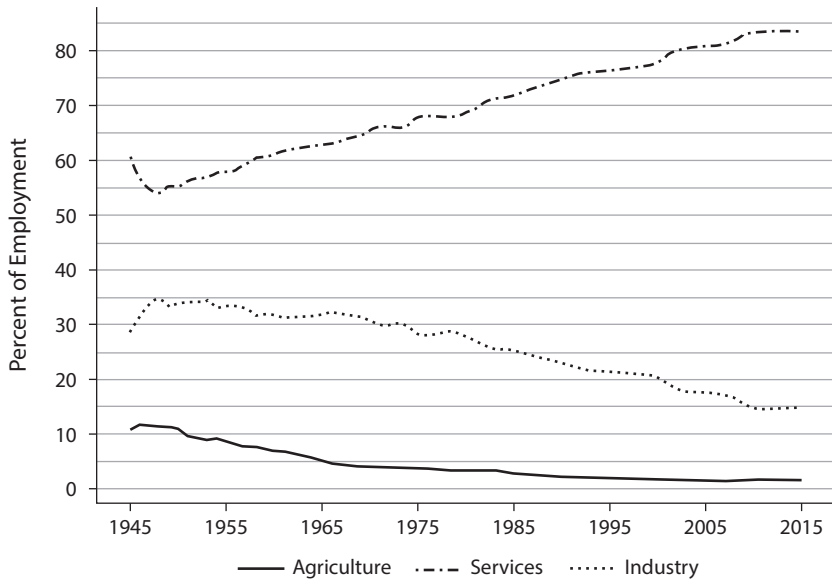


FIGURE 1.4. Employment by economic sector in the United States, 1945–2015

Note: Based on data retrieved from Herrendorf et al., 2014.

volumes of international trade and foreign direct investment rose exponentially (see figure 1.5). For firms and governments, these developments posed the problems of how to compete effectively in the context of stronger emerging economies and how to attract the foreign capital that became an increasingly important source of investment.

- By the end of the twentieth century, the developed democracies also faced acute challenges posed by skill-biased technological change. The viability of firms became increasingly dependent on how effectively they could deploy new digital technologies. For governments, the principal problems were how to encourage firms to adopt the new technology, how to meet rising demand for skilled labor, and how to provide decent jobs for the many people who lacked the relevant levels of skill.
- The fifth set of challenges are geopolitical. For almost fifty years after the Second World War, the Western democracies were locked in a Cold War with the Soviet Union, which conditioned the international regimes adopted in the 1940s, the construction of early welfare states, and the efforts of the United States to secure technological supremacy.⁸⁷ During the 1990s, the transition to capitalism in China and Eastern Europe then

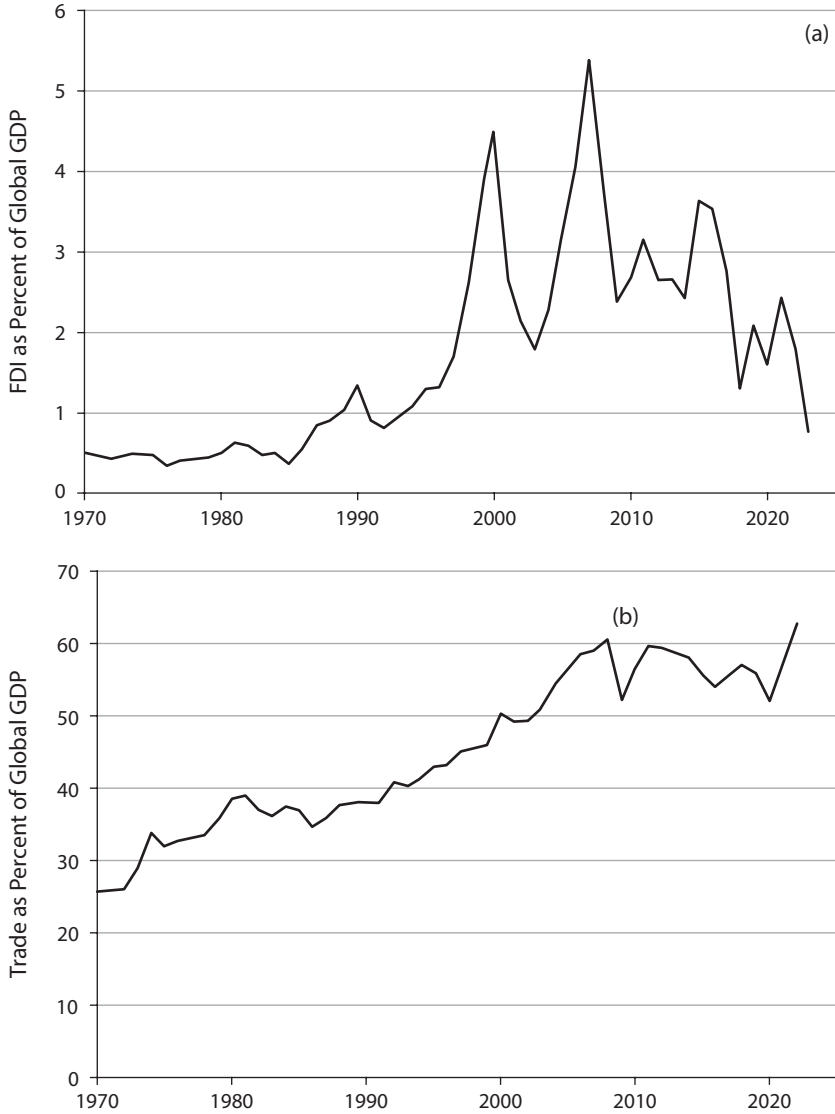


FIGURE 1.5. Trade and foreign direct investment as share of global GDP, 1970–2023

Note: Panel (a): Net inflows of foreign direct investment as a share of global GDP. Panel (b): Trade measured as the sum of exports and imports as percent of global GDP. From Our World in Data based on data compiled by the IMF, World Bank, and OECD.

offered new markets and sites for production. These had dramatic implications for firm strategies until rising tensions with China during the 2000s led governments and firms to reevaluate the security of their supply chains and openness to Chinese imports.

Although governments could resist or accelerate these processes, they could not stop them. By subsidizing industrial firms, for instance, deindustrialization could be slowed for a time but not reversed.⁸⁸ Similarly, although the opening of the international economy was the product of collective action by nation-states, once borders had been opened to new flows of goods and capital, firms and governments had to adjust to them. Firms and governments responded to these challenges in a wide variety of ways that were conditioned as much by politics as by economics. But these challenges provided the backdrop to the politics and policymaking that was to ensue.

Endogeneities

If the challenges posed by these secular developments figure in the process whereby nations moved from one growth regime to another, an even more striking feature of that process is the role played by developments intrinsic to the growth regimes themselves—which scholars often refer to as endogeneities. As each regime matured, it generated unintended consequences that contributed to its decline and the emergence of a new growth regime as governments and firms sought new ways of coping with those consequences. It is only a slight exaggeration to say, as Adam Przeworski does, that “the only motor of history is endogeneity.”⁸⁹

The growth regime of the era of modernization, for instance, was undone by its very success in achieving full employment. Low levels of unemployment gradually strengthened the bargaining power of trade unions to the point that wage bargains were squeezing corporate profits by the end of the 1960s, thereby reducing the rates of investment on which economic growth depended. Powerful trade unions also contributed to the rates of inflation that would set the governments of the 1970s on a search for new policies that eventuated in the growth regime of the era of liberalization.⁹⁰

That growth regime, in turn, helped to create the conditions that would yield a knowledge-oriented growth regime at the end of the century. During the 1980s and 1990s, financial liberalization unleashed a torrent of risk-tolerant capital that proved crucial for the commercialization of digital technologies,

and enthusiasm for more open markets in this period inspired the trade regimes that would make global value chains possible.⁹¹

Parallel endogeneities also affect developments within the representation regime. In the producer group arena, for instance, after widespread prosperity strengthened trade unions during the era of modernization, high levels of unemployment subsequently weakened labor vis-à-vis capital during the era of liberalization. Within the electoral arena, the changes in cleavage structures that underlie movements to a new growth regime are also often products of economic developments under the preceding growth regime. By eroding existing cleavages or stimulating the appearance of new ones, those developments can alter the terms of electoral contestation, prompting the shifts in public policy that characterize the next growth regime. Prosperity during the era of modernization, for instance, eroded the class cleavage that sustained the policies of that era and promoted the emergence of a new cultural cleavage that became central to policymaking during the next growth regime.⁹² This is one way in which changes in growth and representation regimes are closely bound up with one another.

The Process of Change

Although firms and governments react to secular developments, to see their actions as automatic responses to those developments would obscure the open-endedness that characterizes key turning points in the political economy. Firms did not react homogeneously to global flows of goods and capital, for example, and the movement from Keynesian to neoliberal policies should not be seen as a process in which a blanket of neoliberal ideas was simply thrown over Western policymakers.⁹³

Instead, as Blyth observes, we need to recognize that transitions from one growth regime to another generally take place in contexts of great uncertainty, as firms and governments struggle to understand evolving economic circumstances and how to cope with them. Antonio Gramsci put the problem more dramatically when he observed that “the crisis consists precisely in the fact that the old is dying and the new cannot be born,” noting that “in this interregnum a great variety of morbid symptoms appear.”⁹⁴ With this in mind, we can say that the process whereby one growth regime gives way to another has had several recurring features.

First, the *motivation* for the changes in policy that mark the movement from one growth regime to another often lies in the experience of a deep economic

(continued...)

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