Chapter 1

Capitalist Diversity in Open Economies

Openness to international markets, technological revolutions, and the booms and busts that accompany capitalism periodically ignite debates across Europe over what economic system is best suited for achieving broad economic goals such as structural reform, growth, and social equality. At the core of these debates are alternative answers to the question of what economic model is best placed to help a country modernize its industrial structure as technologies and markets inevitably change. Answers have entailed different prescriptions to what should be the division of labor among public authorities, markets, and organized social groups in harnessing a country’s financial, material, and human resources. Though some economic models have been more popular in some periods—centralized ones in the 1950s and 1960s, coordinated models in the 1970s and 1980s, and the liberal market economy during the 1990s and much of the 2000s—there has been no point since 1950 when governments in the major industrial economies of Europe successfully sustained the same type of market economy. Europe’s market economies, in fact, were intense laboratories of institutional innovation and reform.

Why are some national economic models sustainable over time while others disintegrate? What explains the fact that some countries are able to transform their economic institutions successfully when others fail? These are important questions with many domestic and international implications. Economic models that are stable often aid governments in implementing structural reforms, securing economic growth, and promoting social progress. Stability in national designs also frequently helps to ensure that governments’ commitments to international agreements remain credible over time and may enhance the prospects for international cooperation. Yet too much stability can be a source of concern if a country is unable to adapt to new circumstances such as major shifts in international markets. The ability of countries to reform successfully and at times to transform a model of economic governance is, therefore, imperative if they are to secure domestic goals and meet international obligations over time.

Governments often stake much political capital on protecting valued historic designs and transforming those they deem inimical to their economic agendas. Yet,
historically, their ability to successfully implement reforms to the basic institutions of advanced capitalism has been mixed across countries, time periods, and areas of economic governance.

This book examines the political origins of diversity in national patterns of institutional reform. It finds that the ability of governments to variously sustain and transform core designs of a diverse set of economic models depended on how successfully they built and maintained support among domestic economic groups, especially within the business community. The degree to which that community supported government reforms was important because the reverse—active opposition—tended to stymie reforms and make transformative agendas unsustainable over time. Moreover, support from the business sector was key, for without it the very capacities and competencies that governments sought to create within that sector as a means of spurring economic growth—competitive innovation practices, new skills, advanced knowledge, and more—would fail to materialize and thus decrease the chances that economic reform agendas would deliver intended results.

In building support for their economic reform programs, governments participate in what Joseph A. Schumpeter (1942) described as a process of “creative destruction” in which institutions inimical to capitalist innovation are jettisoned to enhance the performance of the corporate sector. Their political ambitions served by economic growth, governments have incentives to dismantle or displace economic institutions that constitute comparative disadvantages for sectors targeted for modernization as a means of promoting economic expansion. But governments also frequently aim to protect historic designs that are highly valued by domestic constituencies for the purposes of staying competitive and guarding against the risks of greater competition. Indeed, in a global economy where competitive pressures are great and where international agreements may undermine the ability of governments to sustain historic designs, the protection of national designs has itself become a creative process. Governments embrace a variety of subtle and incremental reforms and often attempt to ensure that domestic designs are legally protected through international agreements.

The cumulative effects of patterns of institutional destruction and protection, a process in which the nature of modern market economies can be said to be creatively reconstructed has been a persistent feature of post-war Europe. Often misrepresented as a stable region where advanced capitalism was firmly grounded, Western Europe was a place of relentless institutional innovation after 1950. The consolidation of advanced capitalism after World War II was not inevitable (Maier 1987; Mazower 2000; Tilly 2009). Nor was its later development a linear process. Variations in national reforms, evident both in moments of comprehensive and transformative reforms and in periods of relative calm—the periods that Schumpeter (1942) described as economic revolutions and their absorption—were nowhere more apparent than in programs associated with changes to the structural composition of the industrial sector in Europe’s largest economies.
After 1950 governments regularly sought to modernize national manufacturing and financial services industries by reforming the institutional building blocks of the modern market economy, including national financial, corporate governance, industrial relations, and innovation systems. They sought to rebuild national industry and move toward peace-time production with a particular focus on consumer goods and heavy machinery (Shonfield 1965; Eichengreen 2007). This entailed a transition from large agricultural sectors and an often-fragmented industrial landscape that was undercapitalized into economies defined by large advanced manufacturing firms oriented toward mass production. In the mid-1970s, governments sought to bring about a transition to more flexible and more specialized forms of production in higher value-added product markets and expanded the service sectors (Piore and Sabel 1984; Streeck 1992). In most countries, this transition involved a move from highly labor-intensive industries to ones characterized by greater levels of human capital and technological intensity. Finally, with the 1990s digital revolution, governments sought to compel firms to pursue more knowledge-intensive product markets and actively targeted the expansion of the information and financial services industries (Hall and Soskice 2001a; Zysman and Newman 2006).

Table 1.1 summarizes the aggregate outcome of domestic reforms in Europe’s largest economies from 1950 to 2008. During the 1950s and 1960s, France and Germany undertook reforms in major supply-side domains and successfully sustained centralized and coordinated market economies. They rebuilt their systems of industrial relations, corporate governance, and finance, as well as promoted distinct arrangements for industrial innovation. Although Britain also undertook comprehensive reforms and attempted to transform core designs in these domains in ways more similar to a centralized economic model, reforms were not sustainable in that country.

During the 1970s and 1980s Germany’s institutional trajectory was characterized by greater specialization of established designs through the extension of core features of the post-war coordinated market economy. However, France’s and Britain’s trajectories took different routes. Britain rejected its earlier experiments with alternative forms of governance and gradually consolidated a liberal market economy after 1979. Reforms were comprehensive and covered important areas: the industrial relation and financial systems were deregulated, an active market for corporate governance was encouraged, and governments took a less active part in shaping institutions for innovation. In France, where institutional experimentation was particularly extensive, neither efforts to introduce a limited set of liberal reforms in the 1970s nor efforts to extend post-war centralized designs in the early 1980s were successful. Attempts to emulate features of the coordinated market economy appeared sustainable in the latter part of the 1980s, but many of these did not prove lasting.

The trajectory of the three industrialized economies again varied from 1992 to 2008. With greater levels of economic globalization, many countries placed a stronger emphasis on market-oriented reforms in national financial, corporate
governance, and industrial relations systems. It was widely asserted that these innovations would maximize countries’ chances of benefiting from globalization because they aligned national incentives of reform to global conditions and would help economic groups adapt autonomously and quickly to increases in international market integration (e.g., Barro 1996; Alesina and Giavazzi 2006). Meanwhile, in an argument reminiscent of Mancur Olson’s (1982) classic study of the long-term effects of organized interests on the evolution of societies, coordinated economy models were said to stymie institutional innovation because they enabled economic groups to prevent major reforms (e.g., Shlaes 1994; Phelps 2007; Sinn 2007). Centralized forms of governance were also widely rejected for representing an anachronistic form of economic governance under globalization. Among many other voices, the editorial team of the Financial Times (8 April 1998) concluded during new heights of globalization: “What is left is Anglo-Saxon capitalism. It is becoming a global standard.”

Yet, for all the promised rewards from adopting the new “global standard,” patterns of reform did not converge in Britain, France, and Germany. Although the movement toward liberal policies was a significant trend across these economies, the adoption of the panoply of institutions that are associated with the liberal market economy was more limited and differentiated. Britain sustained a strategy where the internal coherence of the liberal market economy increased during the 1990s and 2000s, but France and Germany experienced patterns of institutional recombination that generated distinct hybrid systems of governance. Both countries saw fundamental change in some designs, principally in financial and corporate gover-

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<td>Britain</td>
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<td>Germany</td>
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nance institutions, but there were also important continuities, especially in their industrial relations and innovation systems.

Outline

The chapters in this volume offer new answers to why specific outcomes prevailed in distinct economic domains and why the aggregate trajectory of national reforms took their particular shape in Europe’s largest economies after 1950. They bridge the substantive concerns of the comparative and international political economy disciplines and document how the manner in which governments reconciled domestic reforms with their foreign economic policies, in particular their multilateral commitments, shaped the outcome of domestic reforms in Britain, France, and Germany.

Drawing on complementary approaches to political economy, including the varieties of capitalism, historical institutionalism, and behavioral economics traditions, this book revisits academic debates about the sources of institutional development in advanced industrialized countries. It introduces nuance to when and how historical legacies matter and when governments were able to sustain valued national designs and when they were able to transform others in lasting fashion. It also underscores the crucial impact institutional innovations beyond national borders had in shaping domestic developments. The book concludes that how governments mediated the domestic effects of international markets through an evolving set of multilateral designs, shaped with variable success, had profound consequences for the evolution of Europe’s modern varieties of capitalism.

Capitalist Diversity in Theoretical Perspective

There is no shortage of academic texts on why governments have recorded varied success in sustaining and transforming the institutional architecture of national economies. Scholarly attention has typically peaked following major changes in the nature and composition of markets for industrial goods and services. In the aftermath of World War II and the international economic crises of the 1970s, scholars studying industrial modernization and economic management were preoccupied with the question of why governments promoted alternative models of capitalism (e.g., Shonfield 1965; Katzenstein 1978; Zysman 1983; Hall 1986). These studies showed that historical legacies, often dating to the early period of industrialization, played major roles in determining why governments promoted a diverse set of market economies. Scholarly debate was reignited in the 1990s as researchers argued over whether one or more models of advanced capitalism was sustainable in a globalized world economy and sought answers to whether high levels of economic openness would eclipse
the role of historical legacies (e.g., Zysman 1994; Berger and Dore 1996; Hall and Soskice 2001a; Baumol, Litan and Schramm 2007; Rodrik 2007).²

The role of historical legacies also featured prominently in explanations of why national variations persisted during the 2000s. Frequently invoking logics of path-dependence and positive feedback effects that have been a major part of historically oriented studies of the evolution of capitalism (North 1990; Pierson 2004), studies of capitalist diversity often suggest that historical legacies make radical changes in modes of economic governance all but impossible. Long-established and deeply entrenched designs that shape the organizational resources of governments, the capacity of economic groups to resolve coordination problems, the manner in which domestic markets have traditionally been regulated, and political institutions that give some societal groups extensive powers to veto change are common obstacles to radical reform. Rather than finding support for the thesis that economies are converging on a single model of capitalism, studies find support for anything from two to five distinct models (e.g., Doremus et al. 1998; Hall and Soskice 2001b; Schmidt 2002; Amable 2003; Pontusson 2005).

The persistence of institutional differences across countries in multiple discrete periods must not obscure the possibility that the nature and sources of these differences themselves may have varied across time. The following chapters illustrate the importance of historical legacies in shaping the evolution of national economic models during periods of greater international economic integration. However, they underscore that studies of historical legacies often overstate the degree of continuity in national systems. Although institutional differences across countries have been present over time, the nature of these differences has varied. There have been major synchronic variations across countries in all post-war periods, but greater similarities in some periods and areas than others. Diachronic differences in national economic designs have also been significant. To wit, the version of liberal capitalism that characterized Britain during the 1980s differed from that of the 2000s; the centralized market economy France employed in the early 1960s differed from that promoted two decades later; and Germany’s coordinated market economy that governments championed in the 2000s differed from the model that characterized earlier decades. Moreover, when the most recent period is compared to earlier ones, it is apparent that patterns of cross-national differences, including the direction, timing, and scope of reform, and thus aggregate patterns, varied significantly across distinct post-war periods.

If studies in the historical institutionalist vein tend to overestimate the long-term effects of historical legacies, explanations based in the rational choice institutionalist tradition tend to underestimate such effects. The latter tradition expects changes in national economic designs to be relatively rapid when international conditions alter the balance of costs and benefits that key domestic groups associate with retaining or transforming extant domestic designs. Regardless of whether the empirical focus is placed on early or late post-war periods, it cannot be said that the evolution of European varieties of capitalism was the product of a process in
which governments ensured that designs optimal for a particular form of industrial production were quickly and successfully implemented. Although some specific institutions may appear to have been designed in ways that nearly perfectly reflected the preferences of some constituencies, such conclusions cannot be drawn when the totality of reform programs are examined either in a single period or when the post-war period is viewed in its full.

Past reforms have legacies that alter the distributional consequences of new reforms. Such legacies may not be as enduring as some historical institutionalist accounts may suggest, but they often alter the political realities that governments confront and thus the case with which they build support for comprehensive and radical reforms. Moreover, many reform programs take place against the backdrop of unintended consequences and situations where earlier reforms created new constituencies with stakes in preserving designs. Depending on the constellations of these factors, governments have varied in their embrace of comprehensive and transformative reform agendas. They have variously promoted encompassing reform agendas and engaged in a variety of incremental reform strategies that sought to downgrade the importance of historic designs, promoted others by infusing them with new mandates, and introduced new designs. However, the outcome of these efforts have varied significantly across time and countries, ranging from successful and failed efforts to consolidate complex models of governance, to sustainable agendas of institutional specialization and transformation, to partial transformations that brought new hybrid systems of advanced capitalism (see table 1.1). To account for these variations, this book revisits methodological, empirical, and theoretical features of the debate on the nature of capitalist diversity.

Why Europe after 1950?

A focus on Europe’s largest economies has distinct methodological advantages when assessing alternative explanations for why national patterns of institutional development vary. Because Britain, France, and Germany industrialized relatively early and are often associated with diverse traditions of capitalism, they represent an appropriate set of cases for testing arguments about historical legacies. They also offer a good foundation for examining arguments about the role of international forces in potentially trumping national factors in determining the institutional trajectory of countries. It has been suggested in recent contributions to international and comparative political economy that high levels of market integration and dense forms of multilateralism are associated with a convergence in national institutions. If that is the case, then there should be no better place to observe such a trend than among Europe’s most industrialized economies. Since the 1950s these economies have been a great deal more exposed to international markets than other large economies and have over time become governed by a significant and growing number of multilateral rules, especially in the context of the European Union and its precursors.
Two features of this volume’s research design help revisit debates about capitalist diversity. First, it goes beyond the narrow focus on developments after the early 1990s, which characterized the most recent installment of the debate about the sources of capitalist diversity to placing at the center synchronic and diachronic variations in the institutional structure of national varieties of capitalism. Extending the historical scope to include two other periods after 1950 offers a larger foundation for identifying the general conditions under which international factors such as market integration and international cooperation affect national trajectories.  

Second, the volume examines the evolution of institutions in four separate economic areas. Disaggregating national economic models gives greater room to draw conclusions about the type of aggregate outcomes highlighted in table 1.1 and a foundation on which to identify general conditions under which governments have been successful in sustaining or transforming specific institutions. It is common in comparative capitalism debates that scholars adopt a dichotomous dependent variable and compare national trajectories to determine whether they remain distinct or have become more alike (diversity vs. convergence, stasis vs. change). Instead, the chapters in this book distinguish four different patterns of institutional development in which economic systems are characterized either by patterns of consolidation, specialization, systemic transformation, or by patterns of recombination that lead to hybrid systems of governance. This disaggregated approach makes possible controlled and contextual comparisons that facilitate answers to questions concerning the relationship between domain-specific and systemic changes, the direction of reform, as well as areas of synchronic and diachronic variation.  

**Multilateralism Matters**

This book revisits the debate about the sources of capitalist diversity by moving beyond the narrow focus that characterizes much of the comparative political economy literature in which the institutional environment shaping the behavior of governments and domestic groups is construed as strictly national in character. An important key to explaining why national trajectories varied in Europe’s largest economies after 1950 is to explicitly recognize how governments mediated the effects of multilateral institutions at the domestic level. The large majority of studies on the topic of capitalist diversity examines national responses to economic globalization in isolation from changes in the international institutional environment. Rather than asking whether and how shifts in that environment affected the ability of governments to sustain or transform specific national designs, it has been more typical to engage in a maneuver similar to Andrew Shonfield’s classic study of post-war capitalism. In *Modern Capitalism* (1965), Shonfield quickly explained the omission of considering the role of international institutions in shaping answers to the cardinal question. Hidden in a footnote in a book that was to define several generations of political economy studies, Shonfield wrote:
There are, of course, other types of machinery, international in character, which have developed since the war... [Modern Capitalism] is, however, concerned with an analysis of national institutions of capitalism; the role of new international institutions (EEC, GATT, IMF, and others) is a large topic that deserves treatment on its own. (1965, 230, n. 16)

Shonfield would later devote attention to addressing the lacuna in Modern Capitalism (e.g., Shonfield 1972, 1976), but those following in his footsteps have tended to persist in omitting sustained attention to multilateralism. Scholars have explored the role of the EU in shaping economic governance in the recent period, among long-standing members and newer ones (e.g., Schmidt 2002; Menz 2005; Jacoby 2006; Epstein 2008; Höpner and Schäfer 2010). But the comparative capitalism literature, which remains most deeply invested in the study of national economies, devotes little attention to how the institution of multilateralism has affected domestic economic institutions over time. As Gregory Jackson and Richard Deeg conclude in an exhaustive review of the comparative capitalism literature, extant studies of the modern market economy have “rested on the assumption that capitalism is most usefully segmented for analytical purposes into distinct economies bounded by the borders of nation states” (2006, 38). Others charge the discipline with “methodological nationalism” (Callaghan 2008).

A growing literature on the “Europeanization” of the EU’s member-states has done much to fill voids in the comparative capitalism literature by examining how countries have responded to common EU rules (e.g., Cowles, Caporaso, and Risse 2001; Featherstone and Radelli 2003; Kohler-Koch 2003; Falkner et al. 2005). However, it has been organized around synchronous comparisons of national institutional variations or changes in the recent and relatively short time period and has thus left open the question of what accounts for variations over longer periods. Moreover, because this literature is mostly concerned with domestic responses to common rules, the national and international political processes through which governments and domestic groups have sought to shape the very multilateral designs that would later constrain their behavior have not been a dominant area of inquiry. As such, the creative aspects of institutional reform that are so central to the evolution of capitalism are overlooked in this literature, especially the manner in which governments alternatively sought to undermine and destroy or reinforce and protect domestic designs by securing particular forms of multilateralism within the EU.

The following chapters examine how the manner in which governments embedded national programs in multilateral contexts shaped their ability to implement domestic economic reforms. The multilateral institutions that governments established after 1950 altered the nature of markets and the terms of government intervention. These included what constraints governments could use to shape domestic financial institutions, what constituted permissible forms of direct support
for industry, the manner in which governments shaped markets for corporate control, the level of guaranteed benefits for workers, and other aspects of employment contracts. The effect of multilateral institutions has varied historically and may be weak in some cases, but with time they have become more plentiful and cover a broader scope with far-reaching consequences for the relationship among public authorities, markets, and economic groups. Acknowledging the centrality and evolving character of multilateral institutions in shaping constraints on government action is therefore critical to a nuanced understanding of why national trajectories took their particular form and why these varied over time.

In analytical terms, bridging the comparative and international political economy subfields involves a transition from conceptualizing national economies as closed systems of governance to treating them as open systems of governance. Such a transition is at the center of this book, which focuses on how the manner in which governments resolve what is known as the design problem affects their ability to build support for domestic reform agendas. The design problem is a governance dilemma that concerns how governments and other economic actors reconcile the internal integration of institutions with their integration into the external environment (Goodin 1996; Roberts 2004, 19–22; see also chapter 2). How governments resolve the design problem is material for the sustainability of domestic reforms, because their solutions may serve to either reinforce or undermine support for national reforms. For example, the construction of Europe’s internal market in the late 1980s strengthened support within the British manufacturing and financial sectors for changes to national financial and corporate governance institutions at the time. Yet the same multilateral project gradually undermined support for historic designs among such constituencies in both France and Germany.

Because neither national nor multilateral designs are constant in their form over time, the analytical transition to open systems analysis involves a move from a focus on partial equilibrium analysis to engaging in general equilibrium analysis. Jeffry A. Frieden and Lisa Martin (2002, 120) describe this shift as an “ultimate goal” in achieving a nuanced understanding of the relationship between domestic and international politics. Consonant with such a shift, this volume’s objective is not to provide a general theory of institutional development in advanced market economies. Rather, it is to identify the mechanisms through which and conditions under which governments in diverse national and temporal settings are successful in sustaining or transforming specific economic designs under diverse forms of multilateralism and what implications their record have for aggregate patterns of institutional development in national market economies.

The manner in which governments integrated national reform programs with multilateral institutions had major consequences for institutional reform agendas at the domestic level. Multilateral commitments had an impact on all major domestic constituencies on which governments relied when implementing reform agendas. However, they had particularly strong consequences for the nature of support governments enjoyed within the business sector. Beyond shaping long-
term investment horizons and product market strategies of companies by altering firms’ exposure to international markets, multilateral designs altered the ability of governments to influence in direct and indirect fashion the profile of domestic industry. Membership in international trade and monetary organizations, especially the European Union and its precursors, directly impacted the incentives of the business community to support domestic reform agendas. By focusing on how governments resolved the design problem, the following chapters show when multilateral designs served to undermine the ability of governments to sustain domestic support for long-standing national practices and when multilateral institutions had the opposite effect and instead served to reinforce existing forms of economic governance within states.

Theoretical Traditions and Behavioral (Historical) Institutionalism

Most studies of why national patterns of reform vary have focused on the choices that governments make. They often foreground the role played by constitutive or principled norms in shaping how political elites arrive at what is the appropriate or superior model of economic development. Constructivist studies explore the role of such norms in shaping economic choices across Europe, including in advanced industrialized and transition economies (e.g., Abdelal 2001; Blyth 2001; Schmidt 2002; Darden 2007). These studies offer sophisticated answers to how governments arrive at a particular mix of economic reforms and provide particularly persuasive answers to what informs the choice of governments after major crises. They also document the role played by historical events such as economic recessions, the ascendance of new economic thinking, and the priorities of historically important political leaders (e.g., Hall 1989; McNamara 1998; C. Parsons 2005).

The question at the center of constructivist studies is analytically distinct from the one in the present study. This volume’s primary focus is not why governments chose to promote a particular reform agenda, but rather the conditions under which they were successful in sustaining their agendas over time. It emphasizes that governments’ success in implementing reforms over time cannot be reduced to their intentions or choices alone. For governments to successfully implement economic reform programs, they need to secure support from domestic constituencies with stakes in reforms (e.g., Gourevitch 1986; Hall and Soskice 2001a). Like a large political economy literature, it addresses this issue with attention to the nature of key interest groups’ institutional preferences. Variations in preferences hold particular importance in accounting for patterns of institutional stability and change when the political institutions that shape the process by which societal preferences are aggregated remain relatively constant.

A comparative historical and institutional literature underscores that many interest groups have stakes in the structure of economic institutions, but it often foregrounds the role played by business groups in shaping developments in the modern market economy (e.g., Hall and Soskice 2001a; Swenson 2002; Mares 2003; Thelen
There is broad agreement within the political economy literature on the primacy of business in shaping the evolution of the modern market economy’s institutional architecture. However, because scholarly traditions make different assumptions about what motivates firms and how these respond to changes in their economic environments, they reach different conclusions about how and the conditions under which firms impact patterns of institutional development. Such differences have characterized many exchanges in the social sciences about the relationship between governments and business, including the contemporary “new institutionalism debate” that has revolved extensively around the relative merits of the rational choice and historical institutionalism traditions (e.g., Bates et al. 1998; Katzenelson and Weingast 2005a). These traditions offer alternative understandings of social actors’ institutional preferences, which in turn lead to different conclusions about the conditions under which actors like firms will support or oppose the reform agendas that governments champion.

Both rational choice institutionalism and historical institutionalism offer relatively crude views on the structure of firms’ preferences that lead to overly broad conclusions about when they will support a particular design. Theories based in the former tradition rely on global rationality models that see firms as actors who seek to eliminate the opportunity costs of operating in institutional contexts that are less attractive than alternatives. This leads to the overestimation of the frequency of preference transformations among firms with implications for what patterns of institutional development scholars expect to emerge, including expectations that radical transformations will be common and stability quickly (re)established. By contrast, historical institutionalism employs embedded rationality models that represent firms’ preferences as heavily shaped by their investments in past institutions. Such models lead to the underestimation of the frequency of preference transformations and to expectations that incremental change will be the defining feature of institutional development in advanced market economies.

This book draws on a third tradition, behavioral economics, to introduce more nuance to the conditions under which firms will support or oppose the reform agendas promoted by governments. A behavioral theory of firms helps overcome both tendencies to over- and underestimate the frequency of preference transformations. The basic finding of behavioral economics, in particular a subset known as prospect theory, is that economic actors respond differently to prospective changes depending on whether they frame departures from the status quo or other reference points as entailing losses or gains. It thus underscores that historical legacies matter not because they lock governments into a steady reform path, but because they have an impact on whether domestic constituencies frame the consequences of present and prospective reforms as advantageous or disadvantageous with respect to achieving their particularistic goals.

The situational framing effects to which behavioral economics point have implications for the study of institutional development, including the resources actors willingly devote to achieving particular outcomes, the type of incentives govern-
ments that seek their support must provide to ensure loyalty, and the circumstances under which firms’ commitments to incremental or radical reforms are credible. A behavioral theory suggests that social actors willingly devote more resources to protecting institutional advantages than jettisoning correspondingly sized disadvantages and that the intensity of preferences will decline over time as new realities are normalized. Because it expects that opportunity costs are underweighted, societal support for potentially promising reforms is expected to emerge more slowly than expected by a global rationality model if the status quo is framed as an advantage (e.g., Kahneman and Tversky 1979; Thaler 1980). However, if existing designs are framed as disadvantages, political actors are expected to be risk acceptant and to become strong supporters of radical reform (Kahneman, Knetsch, and Thaler 1991; Weyland 2008). A behavioral theory thus expects that radical reforms are more frequent and become sustainable more quickly than do theories employing embedded rationality models.

Behavioral theories of human action have a long lineage (e.g., Simon 1955; Kahneman and Tversky 2000) and inform areas of political science, notably international relations (see Levy 1992, 1997; McDermott 2004; Mercer 2005). They have been explored in the context of political economy where the focus is mostly on how policymakers evaluate the gains and losses associated with alternative economic policies (Weyland 1996, 2002; Elms 2004). In this book, their potential contributions are explored for the study of economic groups and economic institutions. More specifically, the insights of behavioral economics are used to complement contributions to historical institutionalism. Especially when informed by the varieties of capitalism literature, historical institutionalism offers insights into why firms situated in diverse contexts hold particular preferences over the design of institutions. But it offers few details on the conditions under which such preferences will intensify or be transformed and thus how different types of changes in firms’ environment will affect the credibility of their commitments to the reform agendas governments champion. What is here termed behavioral institutionalism aims to address this lacuna and is thus best understood as a variety of historical institutionalism.

Because the behavioral, global, and embedded rationality models may generate observationally equivalent inferences, the following chapters employ a research strategy that is informed by systematic process analysis (Hall 2003, 2008). This strategy of inquiry is a theory-oriented comparative approach to process tracing that aims to assess the validity of scientific inferences based in diverse traditions. It shares some features with the analytical narratives tradition (Bates et al. 1998) in that it encourages a focus on specific political governance dilemmas when examining the historical archive. Where it departs from the standard approach to analytical narratives is in its commitment to extend the study of governance dilemmas beyond a single theoretical approach and beyond a narrow type of outcome. When these principles of systematic process analysis are observed it is possible to establish whether a particular tradition is appropriate or superior in accounting for sets of
outcomes and the foundation exists for making generalizable claims with greater confidence.

**Conclusion**

The evolution of modern capitalism in Europe was closely connected to institutional innovations at the multilateral level. The following chapters underscore that multilateralism in Europe did not simply serve to “rescue” historic national designs in the early post-war period (Milward 1992), nor did it only serve to undermine nationally distinct designs in more recent times. Multilateralism has had both effects—often simultaneously in different domains of the same economy, frequently sequentially in the same domain over time, and typically in varied ways across countries. By identifying when specific patterns were apparent across time, domains, and countries, the book shows the conditional, yet often integral, role that multilateralism has played in the periodic reconstruction of national varieties of capitalism in Europe’s largest economies.

A modified historical institutional approach informed by behavioral economics helps isolate how the advantages and disadvantages firms attach to historic designs and multilateral innovations that affect such designs impact government-sponsored reform programs. This behavioral institutionalism approach explains why governments, when they promoted economic designs that delivered tangible comparative benefits to domestic constituencies and ensured that these designs were incentive compatible with the external institutional environment, were successful in creating domestic coalitions that could sustain reform programs. This approach also assists in accounting for why, when domestic and international designs were incentive compatible and the value of domestic designs increased relative to alternatives, governments were able to implement strategies of institutional specialization. Finally, behavioral institutionalism offers answers to why governments often failed to ensure stability in national designs or successfully transform targeted institutions in a lasting fashion when multilateral designs threatened historical investments that pivotal parts of the business community had in national designs.

The remaining chapters present the analytical and empirical foundations for the book’s findings. Chapter 2 explains the rationale for the book’s firm-centric approach to accounting for variations in institutional development and for behavioral institutionalism. Chapter 3 examines the core hypotheses of three models of firm behavior based in global, embedded, and behavioral rationality models. It details what form business coalitions take and identifies how, under conditions of economic openness, the interaction of different national and multilateral designs affects the credibility of firms’ commitments to the institutional designs championed by governments when different assumptions are made about what informs the utility functions of firms.
Chapters 4–6 entail case studies of economic reform programs in Europe’s three largest industrial economies: Britain, France, and Germany. These chapters examine instances in which governments succeeded and failed in sustaining or transforming national designs in the face of significant pressures for reform. They show that the outcomes that characterized these processes were often heavily impacted by how governments managed both sides of the design problem.

Although the experiences of European countries after World War II have been described as specific to that continent, the conditions under which individual countries were able to sustain and transform economic designs have theoretical and empirical implications beyond Europe. Identifying these conditions promises to strengthen integrated research agendas in comparative and international political economy. The concluding chapter outlines partial lessons for other parts of the world that are contending with how national economic reforms can be implemented under growing levels of global market integration and dense forms of multilateralism.