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Persistent Crisis and Path Dependence: The Foundations and Boundaries of Systemic Change†

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Abstract: This article highlights the growing common ground in the literature on comparative capitalism, and locates it within the present period of extended crisis, and the material foundations of the latter. We highlight the importance of path dependence, if the latter is not seen in mechanistic terms, but rather in terms of the persistent effects of historical legacies, even if these are open to reinterpretation over time. There is growing evidence that complementarity represents sub-sets of institutions exerting quite specific and focused effects; this means that systemic reforms may have less effects on the overall character of national institutions than is commonly assumed.

Keywords: Institutional change, historical institutionalism, corporate governance.

JEL Classification Numbers: B15, B25, B52

1. Introduction

This article seeks to consolidate and extend the existing literature on comparative institutional analysis through exploring the emerging common ground between different strands of socio-economic institutional thought, the effect of present trends and developments in the world economy, and the persistence of path dependence. It is argued that sets of national institutions and associated complementarities are less closely coupled than is commonly thought, and far reaching systemic reforms in one area, may not endanger sets of rules and practices in other areas. Finally, we explore the consequences of long historical legacy and the relative durability of national institutional orders despite mutation and change for how we understand path dependence, and the replicability of mature capitalist models into other national contexts.

2. Similarity and difference in socio-economic institutional analysis

A key issue in the literature on comparative capitalism is that institutions can denote many different things, and be used in many different forms of analysis. Key faultlines include firstly, the relative hierarchical nature of institutional arrangements, secondly, the internal coherence and utility of different sets of institutions, thirdly, the primary level of analysis, fourthly, the relative plasticity of institutions, and finally, whether value judgements are attached to particular national institutional regimes. Firstly, as

Wood (2011) notes, a key distinction is between dominant approaches in the economic literature towards institutions, which see them as encouraging rational actors to make particular patterns of decisions, with property rights being the most important determining factor, and most other traditions, which see institutions as multifacetted, without a single feature being dominant.

Secondly, whilst internal debates within, and critics of, institutional analysis have been quick to deploy the term 'functionalist' as the most brief way of damning opponents, there is much diversity (even within the works of Parsons himself) (see Parsons, 2013), as to how closely institutional arrangements are aligned, and whether alignment does make for persistence. Although it is often assumed that these go hand in hand, orthodox economic approaches to institutions would hold that whilst one is inevitable (ultimately, institutions seek to protect property owner rights, or those of other interest groupings), the latter does not hold (some regimes will persistently work less well than others) (Wood, 2011; Brewster et al., 2011). For example, a very influential strand of thought, associated with La Porta and colleagues (1999; 2002), suggests that civil law systems dilute property owner rights so much in favour of other interests, that they lead to sub-optimal macro-economic outcomes. Yet, legal origin is clearly something that cannot be easily changed, so by the same measure, sub-optimal institutional arrangements can persist for quite protracted periods of time. Of course, La Porta et al.'s tendency to focus upon carefully selected time periods and sets of countries that show common law systems in the most favourable light, means that the times when common law systems do much worse (yet somehow persist) are ignored.

Again, within the Varieties of Capitalism literature, highly functional and closely aligned systems, such as Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs), co-exist with other rather less effective institutional orders (Hall and Soskice, 2001). Although the early literature on comparative capitalism held that functionality would drive out dysfunctionality, and that the latter would inevitably converge to the former, later work has recognised that the latter incorporates quite persistent and durable elements, and that actors will often chose (even if only partially functional) familiarity over uncertainty (see Hancke et al., 2007).

Although functionalism is, of course, one of the core sociological traditions, sociological approaches to institutional analysis have increasingly highlighted the close and dynamic interaction of structure and social action. Although the most widely cited approach to this is the works of Anthony Giddens (1984), in fact this draws on a very much longer sociological tradition, encompassing the works of Norbert Elias (1984), and, much earlier, Simmel's conceptualisation of the subjective and the objective (Simmel, 2011). What this approaches have in common are that actors remake social structures through their conscious and unconscious decisions, in a manner that both continuously challenges the existing order, yet exhibits a strong preference for continuity.

Of course, historical institutionalist, with their assumption that institution building represents a relatively uncommon response to great systemic crisis, have always had reservations about the general functionality of institutional regimes (Sorge, 2005; Thelen, 1999); rather, interest groupings are forced into settlements or compromises, with the resolution of great questions of social order and property allocation being prioritised over short-term economic or political concerns. Hence, institutional settlements are never wholly functional, even if particular features may be closely aligned in promoting a particular social, political and economic solution (Lane and Wood, 2009). Finally, regulation theory has similarly held a strong view as to the temporarily confined nature of institutions, and that any period of growth is underpinned by formal and informal regulatory arrangements that incorporate their own internal contradictions, gradually bringing about their decline (Boyer and Saillard, 2005). Hence, functionality and alignment are never complete.

In practice, there has been an increasing common ground between the regulationist, Varieties of Capitalism and Historical Institutionalist literatures in this area. The most visible feature is that there is a recognition that all institutional mediation is necessarily contingent and temporary, an argument that was always central to regulationist thinking (see Boyer and Saillard, 2005). However, a distinction is that traditional regulationist theory saw change as stemming from internal contradictions in a dominant production paradigm and its associated regulatory supports, necessitating a period of adjustment prior to the development of a new material basis for growth (ibid.). In contrast, critics of the early literature on comparative capitalism condemned it as overly functionalist in that it assumed that institutional mechanisms are likely to persist given strong associated complementarities (Streeck, 2005). In response, current strands of the literature suggest that no set of institutions are perfectly aligned or work perfectly for all players, making change inevitable at some stage or another (Hall and Gingrich, 2009). However, this thinking is also very much global in nature, and highlight the role of external players, such as MNEs in potentially evangelising or driving change (Morgan and Kristensen, 2006). However, at the same time, regulationist writing has increasingly emphasised the transnational pressures posed by global trends towards financialization (Boyer, 2010). Although it cannot be argued that the latter represents a coherent growth regime - as it has brought with it more volatility than sustainable growth - the process would suggest that change is driven by both internal contradictions and external pressures (Boyer, 2010). This is both a far cry from early regulationist writing with its emphasis on the structural crisis of fordism, and its possible successor, and much in common with influential components of the literature on comparative capitalism. In simple terms, change is seen as incorporating both endogenous and exogenous elements, but with a preference for the latter.

What remains distinct is that regulationist theory retains a very much stronger political and moral component; it is strongly empathised that present policy trajectories and associated organisational practices are undesirable both in their capacity to generate sustainable growth, and in terms of their effects on the majority (Boyer, 2011). In contrast, within the literature on comparative capitalism, these assumptions are more implicit (Hall and Gingrich, 2011). Indeed, the Varieties of Capitalism literature has always held that both liberal (LMEs) and coordinated market economies (CMEs) were equally viable (Hall and Soskice, 2011), even if a great deal of the rationale behind these arguments was to prove the viability of more coordinated markets at a time when neoliberal governments enjoyed increasing confidence in the US and the UK.

3. The complex effects of energy transitions

In my earlier work, I argued that the structural nature of change was primarily exogenous, driven by long energy transitions (Wood, 2013). We have entered an unusual period of a return to cheap oil, and yet, non oil and gas alternatives still increasing their importance in the bulk of developed economies. Whilst this may seem to be the product of active state policy, it should be noted that in many national contexts there are hidden and active state subsidies in favour of hydrocarbons, the UK being an exemplar in terms of the present government's aggressive promotion of fracking. What perhaps the most telling development of all, is that the oil and gas industry has become hyper-financialized. In other words, increasingly the main focus has become on the leverage of debt, and the usage of hype as a means of sucking in new investment. It is quite telling that recently BP funded a substantial dividend out of debt and asset sales (Callus, 2016). However, it is within unconventional and new potential shale gas fields that the financialization process has become most pronounced. It has become increasingly clear that the fracking industry owes its existence not so much to technological advance (although this undoubtedly plays a role), but rather to the ability to access cheap money. By some estimates, it has run up some trillion dollars of essentially unplayable debt (Rowell, 2016); low oil prices have made it increasingly unlikely that this will ever be repaid. Although debt defaults were widely predicted by the industry's critics, the industry has proved remarkably adept repackaging and refinancing debt, and through hedging, deferring inevitable great losses that low oil and gas prices bring. In other words, the industry's great achievement has been deferring the inevitable, and in placating creditors - who can ill-afford mass defaults - despite ever greater obscurity as to its financial basis.

The causes of temporarily cheap oil are complex and multifaceted, and range from the re-entry of Iraq and Iran into world markets, but also because many of those countries historically being willing to pay the most for oil and gas become most advanced in their move towards alternatives. This does not mean that there are not massive increases in the demand for hydrocarbons in the developing world; however, as institutional mediation is weaker, macro-economic growth is more volatile in such countries, and with it, demand and relative ability to pay.

What is significant is that in countries that have been the most advanced in the usage of alternative energy sources, the latter appear quite resilient, when compared to unconventional oil and gas sources, above all, fracking (c.f. Wustenhagen and Bilharz, 2006). This would highlight the very different investment horizons between unconventional oil and gas, and alternative energy sources, and, as we have seen, the highly financialized nature of the former.

Finally, the self reinforcing nature of crisis is not to be underestimated; the reallocation of resources in favour of small elites, creates structural problems in consumer demand, forcing further rounds of outsourcing and cuts in wages to keep prices low, in turn, reducing the ability of a growing proportion of populations to consume other that via debt (Stockhammer, 2008). It is important in highlighting developments of global structural significance, one cannot say that the crisis is wholly and exclusively down to a single cause (Jessop, 2016). Financialization is perhaps the most commonly fingered culprit of the crisis; however, it could be a argued that its very uneven nature, and its strong sectoral and spatial bias makes it a less convincing primary mover. Again the rise of specific elites segments - such as owners of highly fungible assets - is unlikely just to have happened, suggesting some or other material set of causes. In contrast, the material basis of long energy transitions - and what they do to circuits of capital - appears to be, at the very least, a convincing candidate for what is happening, as a key part of a complex and multi-dimensional process.

4. Agents of change

Hall and Gingrich (2011) argue that, as key actors support particular sets of institutions and practices for the benefits they confer to them, they will constantly test the boundaries of the system in order to see if the proportion of benefits accruing to them can be increased. This would suggest that even actors doing quite well out of a system might wish to challenge it, even if doing so brings risks with it (ibid.). This might also suggest that outsiders - above all, MNEs - that have the fewest ties to an existing order might be most inclined to drive this process (Dore, 2008; c.f. Teece, 2014). However, recent survey evidence would suggest that 'norm entrepreneurs' are relative unlikely to fall into either those that most benefit from the system or MNEs (Brewster et al., 2016). Rather, it seems that, in the case of CMEs, those firms most likely to pioneer low end HRM practices that are at odds with the prevailing dominant ways of doing things, are those located in sunset industries facing real crises of competitiveness (ibid.).

In other words, rather than a creative - or opportunistic - process of testing the limits of the share of what one party might obtain, major challenges appear to be driven by those least benefiting from the system, and, hence, most willing to gamble on its demise. A caveat is in order here. The process of systemic defection is due to a complex combination of internal and external factors, including the energy transition issue alluded to above. Nor should one fall in the functionalist trap; it is not simply a case that if systems stop working, their raison d'être vanishes. The uneven performance of national economies and the diversity of interests within elites means that a consensus that an existing order is no longer tenable is relatively unusual; rather the process of challenging existing models is a dynamic one, leading, in many instances, to new rounds of compromise and trade off. And, whilst there are strong centrifugal pressures, there are also centripetal ones. Even if sub-optimal, there are advantages conferred by familiarity; players not only have detailed knowledge on the advantages conferred by specific institutional arrangements, but they also have devised routines for compensating for systemic weaknesses (Crouch, 2005; Lane and Wood, 2009). Finally, there is the issue of memory. Whilst it would be incorrect to conclude that institutions have a fixed 'shelf life', recollections of past orders and historic crises are at least partially subjective, and open to individual and collective bouts of reinterpretation (Lane and Wood, 2009). As the time gap from formative periods of crisis and institution building recede, the subjective component of memory is likely to increase, promoting either pressures to abandon what might be seen as outdated and burdensome regulations or to revive past institutional pillars whose relative importance has diminished (c.f. Sorge, 2005).

5. Path dependency and the consequences of formative events

Quite clearly, the present condition of the world is one associated with both global change and persistent diversity. This raises the question as to relative path dependency, what constitutes formative institutional events, and in the absence of a shared common ground around the latter. What sets liberal market economies apart is that all the established Anglo Saxon ones apart is that national development was kickstarted by large scale, and fundamental, acts of primitive expropriation. In the case of the United Kingdom, this involved the West African slave trade and other similarly extractive ventures, but above all, the colonisation of India, and, subsequently, the protected and closed circuits of trade within the British Empire. The United States similarly experienced rapid development on the expropriation of indigenous peoples and access to both vast land and mineral resources. A similar story may be told in Australia, and, to some extent, Canada. It is thus simply incorrect to argue that the formative feature of the Anglo-Saxon institutional tradition is the protection of private property rights (c.f. La Porta et al., 1999). Rather, it is an original sin of primitive expropriation, followed on by institution building aimed at legitimising the expropriate wealth, and subsequently, through reinforcing the rights of property owners, through bedding societal patterns of ownership down.

This may, of course, explain the limited social mobility in many liberal markets when compared to other developed varieties of capitalism. After a period of initial flux, the primary function of institutions was cementing of private property rights, even if the act of primitive expropriation was relatively recent. It also explains why attempts to replicate the liberal market model elsewhere in the world have not been nearly as successful. Rather, neoliberal reforms have often been associated with the reallocation of state property to political insiders, either directly, or through a process that enables them to achieve the same goal. Again, once this has bedded down, this leads to the rise of insider corporations, whose prosperity is dependent on government patronage, and who secure oligopolistic or monopolistic market positions in providing traditional social and infrastructural services (Wood and Wright, 2015). This of course, highlights a limitation of arguments that, no matter how achieved, privatisation leads to greater efficiencies and better delivered public services.

But, if the foundation and rise of all major liberal markets are associated with large scale acts of primitive expropriation, does this meant that, within the post-Medieval period, primitive expropriation automatically leads to liberal market style institutions in the parent country? The evidence is not so. The Spanish and Portuguese empires represents an important counter-example. What sets these two countries apart is that the experience of colonial expansion came to early for the full beneficial effects to be felt. Both Spain and Portugal between the mid fifteenth and eighteenth century had much less developed states; rather the great wave of colonial expansion gave late Medieval institutions a major new lease on life. This lead to the persistence of, and, indeed, the infusion of new life, into late Medieval weak states, powerful concessionaires and indirect authority over far flung colonial possessions (Benton, 1999; Acemoglu et al, 2000; Lynch, 1992; Newitt, 1999). However, there are many other examples where large scale primitive expropriation failed to provide the basis of a modern neoliberal state; other striking examples would be the Netherlands (wealth dissipated through protracted wars with Spain and then England), and Russia (insufficient returns given the scale and scope of the colonial drive) (see Wilson, 1966; Khodarkovsky, 2002). Hence, it should be emphasised that whilst large scale primitive expropriation at a formative stage appears to be a precondition for a mature LME, primitive expropriation in the modern era does not necessarily terminate in this. Whilst all developed liberal markets were associated with large scale outward orientated primitive expropriation at key phases of their modern development, this is not the case with all developed economies per se. In other words, a massive infusion of capital may make it possible for specific combinations of elites to develop sets of rules - and bed down associated sets of practices - that facilitate the utilisation of externally acquired wealth in an optimal fashion.

Whilst potentially constituting primitive expropriation of a sort (Holmstrom and Smith, 2000), disorderly privatisation of the sort encountered in Russia and many other East European countries involved the redistribution of assets already inserted in the modern economy, rather than the infusion of new ones via colonial expansion. Indeed, a feature of such developments has been, a tendency wherever possible to liquidate acquired state assets and to move the proceeds to offshore tax havens (or quasi-tax havens, such as the City of London); in other words, inwardly expropriated wealth being moved abroad, rather than externally expropriated wealth being fed back to metropoles. More broadly speaking, without the massive infusion of capital provided through primitive expropriation, the shortfalls of the neoliberal model - above, all, an unequal distribution of wealth, leading to structural crises of demand and associated knock on costs in terms of wellbeing - become much more evident.

This does not mean that national systems follow a linear path of development (Streeck, 2010). Given the long crisis of the first half of the twentieth century, elites within the principle of LMEs from the 1930s onwards were sufficiently shaken to countenance Keynesian experiments (Patashnik, 1999). The reasons behind the rise and fall of Keynesianism are well documented, even if they remain controversial (Howitt, 1986). From the 1970s onwards, LMEs slowly reverted to broad form, a process most evident in the UK and the US. This does not mean that the neoliberalism promoted in the latter two countries amounted to the same as policies, say, in the early 1900s. As Streeck (2010) notes, even if states may move to and fro from market excess, this occupies a very different point of time in national development. Indeed, as Lane and Wood (2009) note, attempts to rebuild the arrangements and practices of the past invariably lead to quite different systems, even if some of the building blocks (or restored ‘rubble’) look broadly familiar. In the case of 1980s onward liberalization, a key feature has been the liquidation and reallocation of the accumulated assets of listed firms. As highlighted by the literature on financialization, regulatory reforms opened the way for the abandonment of the traditional Chandlerian notion of the firm, to one that represents the vehicle for the short-term maximisation of shareholder returns (Grahl and Teague, 2000). Increasingly, the latter was achieved not through orthodox industrial and commercial activity, but through excessive debt leverage, share buy-backs, and the sale of assets (ibid.). And, whilst the rise of owners of highly fungible assets who lacked ties to particular firms or industries might seem familiar to a student of the 1920s, this grouping are distinct from traditional conceptualisation of rentiers in that they include Sovereign Wealth Funds (Wood, 2013).

Again, this process of revived liberalisation was less pronounced in Australia, Canada and New Zealand. This would reflect the impact of specific historical experiences and compromises, leading to greater embedded countervailing power by regions and interest groupings, forcing compromise and coalition building to a greater extent than, has, to date, been encountered in the US and the UK (Konzelmann et al., 2012). Interestingly, New Zealand did experiment with hardline neo-liberalism in the 1980s, but a 1996 change of electoral system towards proportional representation on the German model, enhanced the power of societal interest groupings and smaller political parties. A very much greater prospect of coalitions reduced the opportunities for neoliberal governments to act unilaterally (see Heitshusen et al., 2005).

What this all tell us about path dependence? As the historical institutionalist remind us, paths of national development are not simply about the following of a particular trajectory through embedded rules and associated patterns of behaviour, but also about the long impact of formative historical events, that in turn, represent the product of very specific historical sets of circumstances, with outcomes that represent a combination of accident and design (Thelen, 1999). This is a further reason why the LME model is so hard to replicate; the best efforts of neoliberal reformers notwithstanding, the only post-state socialist countries that can seriously be considered at representative of the LME archetype are the Baltic states, most notably Estonia. Even within the latter, there are important features that set it apart from this model. This would include a relatively high degree of employment protection (Eamets and Masso, 2005), a proportional electoral system (Taagepera, 2002) that in turn forces coalitions and compromises, and the strong presence of Nordic MNEs. The latter's behaviour would be likely to reflect not only the range of opportunities afforded by the country of domicile, but also country of origin effects, which could suggest the following and dissemination of specific dimensions of cooperative HRM commonly associated with coordinated markets (see Morgan and Kristensen, 2006).

6. Complementarity

A final question is the issue of complementarity. There is a wide body of literature on the subject, with an increasing consensus around the view that complementarity encompasses not only practices that build on systemic strengths, but also ones that compensate for weaknesses elsewhere in the system (Crouch, 2005; Lane and Wood, 2009). What has become increasingly apparent is that the removal of some systemic features does not mean that others persist, or even become more pronounced; an obvious example is Germany, where the Hartz reforms to the German labour market did not preclude the revival of the German model of corporate control, or, indeed, the persistent vitality of the national training system (Haberly, 2014). What this would suggest is that the foundations of complementarity are more elusive than commonly presumed, and that perhaps, the literature on comparative capitalism has overstated the importance of inter-institutional ties, and discounted the effects and relatively autonomous paths of individual or sub-sets of institutional arrangements.

7. Conclusion

There is little doubt that the present condition is one of great uncertainty. No national institutional framework looks especially durable or immutable, reflecting structural changes in the global economy and the relative power of owners of highly fungible assets. At the same time, this paper highlights the importance of path dependence, if the latter is not seen in mechanistic terms, but rather in terms of the persistent effects of historical legacies, even if these are open to reinterpretation over time. Each of the mature families of capitalisms has its own sets of historical endowments and traumas. In the case of liberal markets, the role of primitive expropriation during key phases of the eighteenth and nineteenth centuries as a foundation of development and growth is not to be underestimated. At the same time, this casts doubts over the replicability of the LME model, or indeed, the infusion of any other set of developed institutional arrangements into economies and societies that have very different historical legacies. However, path dependence does not mean that institutional arrangements are not subject to constant adjustment or redesign. What we now know about complementarity is that it reflects less the effect of closely coupled institutional arrangements, and more the consequences of sub-sets of institutions exerting quite specific and focused effects; this means that systemic reforms may have less effects on the overall character of national institutions than is commonly assumed.

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