A Systemic Cycle-Oriented Framework of Institutional Change

5.1 Introduction

As Chapter 3 has shown, the number of authors arguing for the better development of endogenous theories of institutional change has grown in previous years, and there are attempts to include new drivers of institutional change such as economic growth models. To this end, Chapter 2 has argued for the usefulness of Arrighi’s thought which enables perceiving the global picture as more than just the sum of its national parts and supplies a theory of change in a unit of analysis broad enough to capture the relevant processes. Arrighi explains both national and global developments cyclically through his concept of the systemic cycle, which makes them well suited to be explained as endogenous elements in a framework of institutional change. Furthermore, trade positions are often a result of development strategies which Arrighi has called extensive and intensive and interpreted them as successive deeper and wider elaborations of the division of labor through the centuries since the late middle ages. The previous chapter has developed these strategies further in explaining them as supply- and demand-driven growth strategies with the former one being more compatible with general free market policies sometimes critically known as “neoliberalism.” This chapter will offer a new framework of institutional change which takes development strategies, trade, and global economic development explained by the systemic cycle into account. Alongside these elements, it will also
contextualize them through the inclusion of others, more familiar drivers of change: technology, power relations, transnational conditionality, and institutional starting positions. Finally, as this framework is to be illustrated in Chapters 6, 7, and 8 by changes in labor institutions in the USA, Germany, and P.R. China, this chapter will explain the selection of these three cases and the selection of the post-1980 timeframe.

5.2 Drivers of Institutional Change: Building the New Framework

As stated in the previous chapter, a good theory of endogenous institutional change must strive to include all significant drivers of change that it logically can. A particular issue of institutional change theory is the insufficient inclusion of drivers of institutional change stemming from the economic environment. Both global economic development and trade positions create specific opportunities which institutional changes may capture, and the Arrighian conceptualization of the systemic cycle provides us with a theory which may predict them. On this basis, a dynamic of specific developmental strategies may develop, for which Arrighi has offered a simple framework of intensive and extensive strategies developed further in the last chapter. This section will explain the three channels of institutional change—path dependence, systemic cycle-driven power relations, and institutional design. Through these three channels, we can observe an interaction of several significant drivers of change: technology, transnational conditionality, starting institutional positions, trade relations, the systemic cycle, developmental strategies, and power resources/political struggle. The section will close with connecting these elements in a framework of institutional change suited to the purpose of identifying drivers of change in labor institutions in the USA, Germany, and China since 1980.

There are three channels of institutional change emphasized in Fig. 5.1—these will be narratively explored in the rest of this section and connected graphically at its end. Firstly, there are the path-dependent effects of the existing institutional structure. The institutional frameworks often tend to change in predictable and stable ways because of the efficiency/successfulness of their growth model (where changes need to be comprehensive due to the complementarity of successful institutional frameworks, are therefore expensive, and have unpredictable effects). Also, the path dependence is caused by the relationship of power
resources and institutions where the power resources of those favored by the institutions can be used to maintain their stability. Therefore, path-dependent effects are the first possible channel of institutional change taken into account by Fig. 5.1. However, the pressures toward institutional stability or stable change stemming from such path dependence are confronted with other types of pressures which may be directed toward change. They may be a result of a changing economic environment or changes in power relations, both of which are precisely what this framework seeks to endogenize. In any event, the result of institutional change will be the balance between several types of pressures of which path dependence is merely one.

The second channel of institutional change is a complex interaction of technological change, power resources, and the systemic cycle including phases of the systemic cycle, developmental strategies, and trade relations. Considering the timeframe of this analysis, technology in its cumulative aspect represents the most long-term process which could be considered a driver of institutional change. This makes it a context for all other
processes, but that should not suggest technological determinism. Technology plays a part in economic development only through a necessary interaction with mid-term processes including the developmental aspect of technology, i.e. with the technology actually in place in production (and it could go in the labor-saving or the labor-intensive direction). The effects could therefore be either greater or smaller capacity of labor to exert political pressure and influence institutional change. Specifically, the USA was already a capital-intensive market in the timeframe considered here. The capital deepening should be considered a driver of the systemic cycle (as it suggests greater capital accumulation), but it has already taken place in this case. Since 1980, the manufacture jobs have been replaced by service jobs, and the trend was exacerbated by growing net imports (i.e. by the trade positions driven in turn by the systemic cycle). In Germany, the trend was similar as the markets already underwent capital deepening, but the systemic cycle playing out in the USA as the center of the world-system caused an improving trade position in Germany (increasing the importance of manufacture in the economy) although service sector employment was taking over (decreasing it). The result was a dualistic labor market with well-protected manufacturing core and a liberalization of the most others. The mentioned timeframes mean that the cumulative aspect of technology is exogenous to our analysis which does not predict great shifts in innovations. In China, the trend was entirely different with a development and capital deepening taking place in the past decades (and in the context of the US systemic cycle with an influx of manufacturing jobs) with the effect that employment in manufacturing sector was rising together with the service sector subsuming technologically outdated agricultural employment. This enabled the vast influx of low-cost labor into manufacturing sector enabling labor-intensive techniques to dominate the developmental aspect of technology in China. The developmental aspect of technology is therefore important, but it significantly overlaps with our understanding of the systemic cycle, and we have subsumed this type of process under the developmental strategy as a part of the systemic cycle.

It follows that the interplay of technological factors, the overlapping global process of the phases of the systemic cycle, and developments in trade relations all help determine the sectoral composition of employment. This suggests something of the developing power relations—i.e. the significance of manufacturing for the economy as a whole (manufacturing jobs being important as they are most easily organized due to the skill specificity they entail). These economic factors then come into
interaction with the more overtly political ones which codetermine the decision-making playing field. The changing sectoral composition is only significant in the context of the initial institutional structure (protecting some actors and not others and suggesting an initial and somewhat path-dependent power resource composition) and the newly developing power relations (union density, bargaining coverage) which is an indirect result of both the initial institutional structure and the sectoral compositions changes. All of this influences the developmental strategy (intensive, extensive) which is crucial in determining the institutional change in labor markets. Factors favoring an intensive strategy are the scarcity of labor (and a developing capital-intensive developmental technological aspect), a CME-like composition of initial institutions, an increasing role of manufacturing labor (itself a function of the systemic cycle and trade positions), and the increasing ability of labor to organize. Inverse also holds true: an extensive strategy is favored by the overabundance of labor, an LME-like composition of initial institutions, a decreasing role of manufacturing labor (itself a function of the systemic cycle and trade positions), and the decreasing ability of labor to organize.

Finally, there is the third channel, focusing on visible formal power in transnational conditionality and electoral politics. These two short-term drivers can only become intelligible within the presented complex nexus. The first is included here for the sake of completeness and is endogenous in the sense of the world-system. The issue there is the relative power of states and transnational organizations, and current or aspiring centers of the world-economy are not likely to be significantly affected. The second is the most visible level of formal politics with parties vying for political power by ostensibly offering policy programs to the voting public. However, it is clear that more than mere informed interest is at play in voting behavior and that a range of issues can be operationalized politically including the cultural, the symbolic, and the ideological. It would therefore be naïve to claim that the power relations directly translate into electoral coalitions. However, it is possible that sometimes electoral coalitions do in fact form with the goal and ability to influence institutional change. In other cases, it is worth reminding that formal institutions (i.e. those likely to be influenced via elections) are merely one of the three relevant aspects, while the informal and avoidable aspects are equally likely to be influenced by power relations as the formal ones.
5.2.1 Channel 1: Path Dependence—The Importance of Institutional Starting Positions

Institutional starting positions are central to the study of institutional change, as no change occurs without the significant context of what it is that changes. The same liberalizing tendencies can exert pressure in many developed countries, and yet they will manifest in drastically different ways. Part of the reason for this lies in the substantial starting differences in these countries. By its very definition, the “starting” position is an imagined static context preceding institutional change. However, an implication of stasis is not always a realistic one, even if it is necessary in the sense of an analysis always having to start at some point in time (in our case 1980) and gauge change against this benchmark. Institutions are not static, but evolve over time, and if the institutional frameworks of the VofC are what we are observing, it would take a mid- to long-term perspective to delineate.

Chapter 3 developed the fundamental elements of institutional economics and static comparative research of institutions. Some of the most promising research in this vein was conducted through or explicitly against the Varieties of Capitalism approach—and it can serve us here to very briefly show the importance of starting positions. This approach postulated that developed capitalisms are grouped into two general varieties: liberal market economies (LME) and coordinated market economies (CME). Even though both are market oriented, these two types organize economic activities through very different mechanisms. The former functionally couple the impatient capital of the stock markets with flexible labor laws and low capacity for labor organization and non-specific skill sets in workers while the latter (also) functionally couple the patient capital of large banks with more rigid labor laws, larger union presence, and specific skill sets managed by well-developed vocational training systems. The first (LME) type was modeled after the economic, legal, and political structure of the USA (Chapter 6), while the second (CME) type was modeled after the economic, legal, and political structure of Germany (Chapter 7). However, China (Chapter 8) is one of the countries which do not easily fall into either category. Varieties of Capitalism (alongside much institutional thought) more often than not look for elements of stability in institutions. According to VofC, if the existence of specific institutional arrangements in a well-developed system is preconditioned by the complementarity within the institutional framework, then
an institution will tend to remain in place regardless of power relations underlying it.

This approach is a specific example of the path dependence principle suggesting that developments in critical junctures tend to significantly influence further reform choices. New institutionalism traditionally placed too much emphasis on the combination of path dependence and critical junctures. The result was sometimes a stationary view of institutions, all but blind to issues of endogenous change (much like the original VoC views), and this is precisely the limitation that this thesis is attempting to help transcend. Nevertheless, it would be misleading to suggest that path dependence was not an important element in play. Even though institutional thought must no longer be satisfied with merely explaining stability, it is clear that previous choices and structures restrict the plausible choices today and therefore contribute to the shape and direction of institutional change.

The present scheme will explain the varied influences behind Chinese development as well as the dynamics of German and US development. These starting positions suggest a different path of institutional change in these countries. The global incentives for policy reform were universally geared toward free markets in the 1990s and early 2000s, the various countries responded to these liberalization pressures differently.

**Interactions with other drivers and the result**

(a) **Power resources:** initial structure has a path-dependent effect via power relations. A structure which has very low labor organization capacities but is oriented toward profit maximization (e.g. LME) will exhibit pressures to further flexibilization as it will have no power structures capable and willing to prevent it. A structure with high labor organization (e.g. CME) may exhibit pressures toward lesser flexibilization as there are power structures which may undermine such a project. In both cases, institutional structure presents itself as a historical compromise between societal powers and its functioning is dependent on the balance of these powers (most notably employees and employers).

(b) **Phase of the systemic cycle:** financial expansion will progress more quickly with financial deregulation or without formal institutions which would prevent rapid capital accumulation. Historically, an initial corporatist CME-like structure may have delayed a move...
from material to financial expansion in the 1970s, while the market-oriented LME structure in the USA accelerated it.

(c) Developmental strategy: on the most elementary level, one could be tempted to argue along the lines of path dependence: a coordinated market structure allows a strong institutional channel for labor organizing power to act through and be active in attempting to achieve labor-friendly results. This would suggest that path-dependent effects push toward an intensive developmental strategy and path-dependent effects of a market-oriented initial structure push toward an extensive developmental strategy. However, social reality is far more complex. Developmental strategies need to shift in response to the changing political-economic environment if they are to be successful, and this suggests a different line of reasoning. The point in time in which the circumstances and power compromises embodied in the initial institutional structure have changed is the point in time which is ripe for an alternative developmental strategy which will, if successful, be institutionalized as a part of the new institutional structure. If we opted for a narrower unit of analysis, this institutionalization could be interpreted as a critical juncture. Critical junctures (as we have seen in Chapter 3) are periods of large decisions with long-term path-dependent results. However, they are by definition exogenous. If we were willing to redefine critical junctures to be endogenous, then the initial steps of developmental strategies would certainly provide the critical junctures crucial to this framework. If successful, these strategies could ex-post be defined as critical junctures, would provide elements of the institutional result, which in turn provides us with a path-dependent channel of the next institutional change iteration.

(d) The result of institutional change: path dependence of initial structures tends to produce stable change in the direction of initial institutions. This framework suggests that while this is one of the tendencies, there are several other influences connected with economic development, global processes, and power that are endogenous to our analysis and compete with path dependence, diminishing its effects.
5.2.2 Channel 2: Complex Interaction of Power Relations and the Systemic Cycle

The second channel of institutional change is more complex than the first one. It hinges on an interplay of five drivers, including the predictable fluctuations of structural power as a result of technological and systemic cycle shifts. Figure 5.2 shows the interactions within this channel.

Phase of the systemic cycle, developmental strategies, and trade relations constitutes the three systemic cycle drivers, organized here according to the timeframe necessary for their development. Figure 5.2 also shows their interactions with the long-term driver of technology shifts and the power relations. The rest of this segment will elaborate these interactions, and a simplified version of Fig. 5.2 will be included in the comprehensive Fig. 5.3 at the end of this section.

![Figure 5.2: Channel 2—power relations and systemic cycle](image-url)

**Fig. 5.2** Channel 2—power relations and systemic cycle
5.2.2.1 Technology

Technology is an important element in growth and development—although the selected timeframe and the complexity of the subject require us to use it as an exogenous variable. As we have seen in the previous chapter, we can discern the cumulative and the developmental aspect of technology. The former refers to actual innovations, which can only be treated as exogenous to the framework as they not predictable and their effects may take a long time to manifest in terms of productivity and growth. The latter refers to the application of technology (e.g. capital deepening) and could be understood as endogenous as underdeveloped (lower tier in the world-system) countries can experience a growth-boost by enjoying the possibilities of technological catch-up, while the developed world experiences such boosts only in periods of great technological transformation. By treating these two aspects as a single driver, we avoid
unnecessary complexity of the framework, but more importantly, also conform to the selected timeframe, which is relatively brief from the point of view of technological shifts. In any event, the crucial point is the changes in employment compositions and the role of labor in the economy. Owing to the long-term technological tendencies of the twentieth century, a developed, post-industrial economy hinges on the service sector, which largely employees easily replaceable personnel operating in a decentralized context. This influences both the structural and associational labor power, as labor has severe issues in organizing (lower associational power), and the workers have a diminishing role in the economy (lower structural power). The inverse also holds true, as an agricultural country experiencing an industrial shift may find the power of its labor increasing in both elements.

**Interactions with other drivers and the result**

a) **Power resources**: as technology changes, it creates different methods of production, which may substantially change the power resources. Historically, it reduced the number of workers needed in manufacturing. This changed the elementary power resources and diminished the bargaining position of labor.

b) **Developmental strategy**: a technological shift may create new investment possibilities making the old growth models obsolete and trigger a choice of new developmental strategy.

5.2.2.2 **Phase of the Systemic Cycle**

Dynamics of phases of the systemic cycle may greatly influence the distribution of power resources. The periodization of these dynamics is dependent on large crises which can be indicators of shifts in accumulation regimes. The process of economic development in the developed world (core) tends to fluctuate between periods of material and financial expansion. The mechanism of this shift is a wide profit crunch occurring in the real sector and the capital fleeing into the more short-term-oriented financial activities and triggering the financialization (financial expansion). This suggests different prospects for labor as the inability of generating large profits in manufacture also means that a traditionally unionized labor has become unattractive for use in production (i.e. capital will move into a less labor-intensive use of speculative finance).
The systemic cycle is best described as a sum of interacting and overlapping global processes with specific geographic origins (cores or centers). It consists of two distinct general types of processes: material and financial expansion. Both together may take more than a century to develop (i.e. Arrighian long centuries), but their duration has increasingly diminished historically and our chosen timeframe suggests that these processes cannot be analyzed in terms of entire financial-material-financial scope. We are interested in the period after 1980, and the US financial expansion has taken 35 years from the signal crisis of 1973 to the terminal crisis of 2008. We are now arguably observing the initial period of the new material expansion which may take even less. In other words, the systemic cycle processes that we are interested in are mid- to long-term duration processes.

Interactions with other drivers and the result

(a) Trade relations: material expansion (particularly in the context of the extensive developmental strategy) suggests a substantial trade surplus, while a financial expansion of the old center suggests a widening trade deficit.

(b) Power resources: material expansion creates more manufacturing employment, creating a bigger role for manufacturing labor in the economy, suggesting more bargaining and organizational power. A shift from material to financial expansion suggests lower manufacturing employment levels and lower labor power.

(c) Developmental strategies: financial expansion signals the waning of power in the old center and its finishing phases provide a context for the choice of the developmental strategy in prospective new centers. The successful developmental strategy becomes the new global center and leads the new material expansion.

5.2.2.3 Trade Relations—Current and Changing Positions in the World-System

The systemic cycle suggests that employment shifts away from areas in which manufacture-related activities are facing a profit crunch (core areas during financial expansions) and into semi-peripheral and currently underdeveloped areas which can hold promises of larger profits in manufacture (e.g. China since the 1980s). Such a shift holds specific incentives for institutional change with workers in deindustrializing countries becoming
increasingly superfluous and therefore decreasingly powerful. Liberalizations of labor markets may, then, proceed with greater intensity. An employment importing country on the semi-periphery does not, however, automatically move toward greater coordination of labor as a prerequisite for this is twofold. Firstly, the workers must become scarce and therefore gain functional bargaining power, which can then manifest in formalized power relations (greater union density, higher-level collective bargaining, and more bargaining coverage). Secondly, the institutional framework must be able to orient toward such a move, according to issues of institutional complementarity.

In this view, the trade relations are a somewhat delayed effect of the systemic cycle, but they are certainly influenced by a vast number of other factors as well (global prices of goods, resources and transport, exchange rate changes, etc.). A significant and durable change in trade relations could be observed in the short- or mid-term.

**Interactions with other drivers and the result**

(a) **Power resources**: an increase in trade surplus suggests an increasing role of manufacturing in the economy and a greater bargaining power of the workers. An increase in the trade deficit suggests a diminishing role of manufacturing in the economy and a lower bargaining power of the workers.

(b) **Transnational conditionality**: a large trade surplus is a conceivable way to development and growth. It can therefore contribute to the countries’ power substantial enough to avoid transnational conditionality.

(c) **Systemic cycle phase**: a shift from trade surplus to a trade deficit is compatible with a shift from material expansion to a finance expansion.

(d) **Developmental strategies**: an extensive strategy is oriented to the export markets in its growth model, while an intensive strategy is oriented toward domestic markets. This duality was logically developed in the previous chapter (as high wages of the intensive strategy contribute to domestic demand but reduce external competitiveness and low wages of the extensive strategy reduce domestic demand but increase external competitiveness). However, this is a matter of strong tendency rather than mutual exclusiveness as an intensive strategy could still attempt to formulate a strong
export niche—what defines it as intensive is the relatively larger importance of the domestic markets rather than the absence of export markets.

5.2.2.4 Developmental Strategies
We can state this in another and less general way by utilizing Arrighi’s dichotomy of intensive/extensive accumulation regimes. If we interpret the modern iterations of intensive and extensive accumulation regimes as those seeking the demand for their output increase at home (intensive) or abroad (extensive), we can again see that specific institutional change incentives attach. A country with an intensive accumulation regime looks for domestic demand for its output and enters into a specific dialectic between real wages as the source of a demand increase and real wages as a source of rising costs of production. The latter can either drive the aggregate prices upward (triggering wage-pull inflation and/or reducing the quantity demanded) or drive profits downward. This suggests a domestic equilibrium like the ones found in the Keynesian era of the first three decades after World War II in the developed world (Chapter 6). If such a regime is undergoing a material expansion, this expansion is fully compatible with rising labor coordination tendencies, as each job is important not only because the skill set of the worker employed is scarce, but also because it carries in it the vital element of aggregate demand. China may be currently turning toward such a regime (Chapter 8).

On the other hand, in an extensive accumulation regime, material expansion is intended for consumption abroad. Real wages primarily factor in as production costs to be frozen or eliminated in order to manifest as international competitiveness. Therefore, it may become necessary to move toward greater liberalization of labor institutions. This is indicative of Germany since the adoption of the euro (Chapter 7).

Developmental strategies are, in this context, a mid-term phenomenon, plausibly taking a longer time to develop than issues of transnational conditionality or electoral policies, but a shorter time than issues of substantial technological change.

Interaction with other drivers and the result

(a) Power resources: intensive strategies increase the resources of workers which can increase their capacity to organize and vice versa. However, the long-term effects of intensive strategies could be the diminished bargaining position of workers (as they have a diminishing role in the economy) and vice versa.
(b) **Trade relations:** extensive strategy focuses by definition on external markets suggesting an increase in exports, while intensive strategy focuses on domestic markets (see above).

(c) **The result of institutional change:** developmental strategies have clear short-term societal winners (labor in intensive strategy) and losers (labor in extensive strategy). As the intensive strategy is a likely effect of high power resources of labor and as these are likely increased in the short run by the intensive strategy, this strategy is essentially the moment in which the compromises of power relations are institutionalized. In other words, the changing power relations overcome path dependence of the initial structure and help formulate a new strategy and a successful developmental strategy becomes a part of the result of institutional change. Once more, if the strategy is successful, and if we are willing to redefine critical junctures as endogenous events, this institutionalization can **ex-post** be interpreted as a critical juncture.

### 5.2.2.5 Power Relations

Power is crucial to this framework and its functioning, and it is also the node in which the first two chapters can come together most fruitfully. Chapter 2 has outlined the approach to labor power in the context of the world-system (via Silver and Wright). Associational power refers to the ability to organize, whereas structural power refers to the bargaining position of labor which stems from its location on the labor markets and the workplace. Chapter 3 showed the dynamic relationship between institutions and power (via North, Korpi, and Thelen). Institutions can be thought of as results of power relations and compromises between the interests of various groups endowed with power resources. Likewise, a change in institutions can be thought of as induced by a change in the power relations. Power resource theory tells us that institutions are a function of political power held by various organized groups. An institution is a compromise between various powers (e.g., organized labor and organized employers) and institutional change is a result of a change in power relations underlying the institution.

In this context, the relevant position of labor is underlined by the capacity of labor to organize and influence decision making. The relevant data according to the power resource theory would therefore consist primarily of union density and collective agreement coverage. Together, these figures testify to the power of organized labor in terms of the
labor they represent (and could mobilize in strikes or otherwise) and the scope of its actions (bargaining coverage figures can be much higher than density figures). If unions have a high membership rate (i.e. density) and conduct bargaining which applies to majority of workers, then its power position is certainly strong and vice versa. Such power relations are results of at least mid-term processes as densities dissolve in terms of decades rather than years.

The most visible institutional change is one that occurs through formal political channels (next driver). But, as explained in the previous chapter, the Northian conceptualization of institutions accepted here sees institutions as far wider reaching than the legislative power could provide by itself. In terms of labor market reforms, the actual protection of labor is a result of not only the laws regulating labor, but also the practices of collective bargaining and the leverage represented by the unions. Therefore, the most essential element of power relations is the irreplaceable nature of the workers these organized labor structures represent. A worker in a setting which promotes high skill-set specificity (manufacturing workers in the CME context in the Varieties of Capitalism approach) is difficult to replace as he represents an investment in the specific skill set needed for his job description. A worker with a low skill-set specificity (a tertiary sector worker or a worker specific for the LME economy) represents an easily replaceable asset. In the first case, a representing union may wield substantial power, while in the second case it most likely does not. We must, therefore, distinguish between at least mid-term power relations, which are a matter of the ability of labor and/or capital to organize and protect its interests through all institutions, and short-term electoral coalitions, which build upon these power relations (but also the cultural, symbolical, personal, unconscious, etc.) in order to produce change in formal institutions. The relationship between these two levels is not one sided: it is not a matter of power relations stemming from production determining the electoral coalitions and results. Rather, these processes are parallel: the power relations are a matter of the bargaining position and organizational capacities and the electoral politics leading to the control of formal political institutions may mobilize these or other capacities.
Interactions with other drivers and the result

(a) Phase of the systemic cycle: organized investor interests and the absence of opposition may accelerate the shift from material to finance expansion via quicker financial deregulation and vice versa.

(b) Developmental strategy: as explained above, a dynamic between path dependence via power relations and a shift to a new growth model.

(c) Result of institutional change: power relations in many ways determine the effectiveness of formal reforms (as the mobilization of relevant power resources enables the reflection of the intent of formal institutions in informal institutions and prevents their avoidance).

5.2.3 Channel 3: Institutional Design—Domestic Politics and Transnational Conditionality

The last driver and one with the shortest timeframe is the formal political channel, which describes the institutional change that is induced either through domestic politics (e.g. electoral, legislative, executive) or the transnational conditionality of various transnational organizations. As explained above, these attempts at reforms are the most visible and provide for one of the three channels of institutional change identified here. However, their effectiveness is dependent on power resources and path dependence (including issues of institutional complementarity).

Specifically, Chapter 3 has explored the Beramendi project which hinges on the democratic process and the role that these groups play in terms of enticing electoral coalitions designed to capture their votes. While such a focus is interesting and significant, the substitutions of the more invisible mid-term power relations and mid- to long-term path dependence for the highly visible and short-term electoral and coalitional policies do not seem advisable. However, if its limitations are properly understood, the formal political relations can be an informative driver of change.

Not all power-driven institutional change has its origins within states. Institutions may be influenced by various transnational organizations either by offering advice or by exerting pressure. The latter mechanism becomes important if the organization in question holds a resource needed by the state (e.g. funds needed to stabilize a crisis or fund developmental projects) and is in the position to condition its use with the
enacting of institutional reforms. This suggests that the prevailing intellectual ambience in these transnational organizations is relevant, but not as relevant as the external power position of the state. A large, developed, and economically stable state is far less likely to be in the position to be transnationally conditioned than a small, underdeveloped, and economically destabilized state. As an additional note, this driver would be considered exogenous if the unit of analysis remained the isolated national state. However, the world-systemic lens allows us to view individual states in the context of the global world-system in which the power relations between states and between transnational organizations and states become endogenous issues—as they are covered by the used theory and its models. Conditionality as conceived here is most often a short-term horizon driver of change. It is a visible form of power in which a transnational organization influences a state by applying pressure and attempting to achieve reforms in accordance with its own economic agenda.

Benefiting from a world-systemic lens, we can see that the transnational conditionality is dependent on existing power relations between individual states and transnational organizations. Firstly, the most powerful states most strongly influence the rules and decision making in large transnational organizations. Secondly, the most powerful states are least likely to be put in the position of being dependent on the conditionality.\(^1\) The two possible types of formal political power are grouped into a single driver as they (a) share a timeframe and (b) transnational conditionality may or may not be present (it is not in our three cases). However, even when it manifests itself, the ultimate influence will have to be exerted via the domestic formal political channels (the executive power entering into international agreements and/or legislative power passing of formal institutions).

**Interactions with other drivers and the result**

(a) **Developmental strategy**: transnational conditionality can influence large parts of the developmental strategy by requiring changes in labor laws or even specific macroeconomic (investment, fiscal, monetary…) targets.

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\(^1\) The only exception for this timeframe may be the Chinese accession to the WTO in 2001, although it had little bearing on labor institutions.
(b) Result of institutional change: formal domestic politics play a crucial part in formal reforms (as the control of formal political institutions enables an explicit attempt at reform). Transnational conditionality can also influence the final institutional framework, but the focus on visible results suggests a focus on a change of formal institutions rather than a change in the underlying power resources which will tend to determine the informal and avoidable aspects of institutions.

5.3 The Framework of Change in Labor Institutions

Complex institutional systems are outcomes of many necessary and sufficient causes, making them difficult to analyze in terms of causality. Our strategy consists instead of expanding the notions of embeddedness and complementarity via externalities in order to accommodate the elusive endogenous change in a sufficiently broad (global, world-systemic) unit of analysis. The rest of this section will explain the time-based logic of embeddedness, according to which institutions are embedded not only in other institutions (as explained by Ostrom, Williamson, and others) but also in contextual factors which provide externalities conducive to change or stability. In this sense, we can conceive of a hierarchy of institutional drivers which is based on time—with long-term (40+ years), mid-term (10–40 years drivers), and short-term drivers (–10 years drivers).

A process taking a longer time to develop provides a context for the development of a process with a shorter period of development. In this sense, these drivers of institutional change (themselves institutions or economic and political processes) are embedded in higher order processes (i.e. those of longer duration). Long-term technological change provides a context for institutional frameworks and systemic cycles which in turn provide a context for the development of power resource relations and the implementation of development strategies, which are themselves a context for the development of trade relations which finally support the short-term processes of electoral coalitions and transnational conditional pressures. This hierarchy of embeddedness does not, however, necessarily imply one-way causality (as New Institutional Economics/NIE authors might well assume according to their conceptualizations of embeddedness). Even though (e.g.) development strategies and power relations
provide the crucial context for the electoral politics, they can certainly stand to be modified by the outcomes of elections. Therefore, while this NIE-influenced hierarchy provides crucial insight into the relationship of institutional drivers, it does not help us to decode their effects. To do so, we must turn to VofC notions of institutional externalities. Through the prism of this analogy, it becomes apparent that institutional drivers reinforce or undermine each other’s effects and that the role that they play can only be made apparent in context with other drivers.

It is also worth noting that institutions in this framework are effectively evoked in several positions which are a consequence of their definition. The definition of institutions-as-rules structuring activity suggests that there are active institutions governing each of the institutional drivers (e.g. tariffs and international agreements governing trade and financial and corporate regulation governing the systemic cycle). However, this is another factual, but ultimately irrelevant and tautological position where institutions exist by definition and therefore must be functional. This framework suggests that specific labor institutions are most clearly discerned on the level of starting institutional frameworks (where we can observe the complementarity with other institutions) and on the level of the development strategies which suggest either strong or flexible regulation of labor, provided we observe development strategies through the lens of demand management (as we did in Chapter 4). In other words, we have institutions explicitly evoked in the initial institutional structure and the result of institutional change, but the third institutional element is the developmental strategy which may, in the case of its success, become a part of the long-term institutional result (hence the double-arrow in the representation in Fig. 5.3).

Focusing on the temporal embeddedness could favor observing top-down mechanisms, which would suggest a form of determinism. However, there are feedback loops which exist on every level, with the most significant ones shown in the figure. Starting from the bottom, the two short-term drivers can influence almost every other level described. The outcomes of elections and transnational conditionality can influence the mid-term processes: power relations (e.g. by the passing of laws and regulations inhibiting or promoting labor organization or its functioning in bargaining practices), trade positions (e.g. by changes in trade policy), systemic cycle (e.g. by tax incentives or stimulus packages temporarily increasing profits and staving off the shift from material to financial), and developmental strategies (e.g. by the expansion of the household
demand via tax reforms). By doing so, they influence the long-term processes in adding to a new institutional framework which then provides the context for a new iteration of institutional change, promoting a new type of developmental aspect technology (e.g. encouraging a specific type of investment) or even the cumulative aspect (promotion of R&D).

Same holds true for the possibilities of feedback in processes of longer duration. Changing power relations in favor of labor can be a powerful deterrent and/or a generator of informal political pressure which may be exerted in the direction of a more progressive taxation (i.e. a changing developmental strategy) and may lead to higher wages which can contribute to a profit crunch (leading to the financial stage of the systemic cycle) or a deteriorating trade position (if felt in price levels). On the other hand, a change in developmental strategy has effects on trade relations and the systemic cycle (same reasons reinforced in both counts). Finally, the systemic cycle in its shift from material to financial phase starts a form of deindustrialization even though production may remain capital-intensive (USA since 1980). Or, a material expansion of aspiring centers (Germany, China since 1980) causes an increase in capital deepening. In either case, it is a change in the developmental aspect of technology effected by a lower order process.

The obvious existence of these feedback loops suggests that neither determinism nor functionalism are prudent assumptions in institutional research. Determinism would suggest one category shaping all others, while the modern structures of capitalism seem to be composed of numerous local (i.e. national) and global, economic and political, dynamic, overlapping, and mutually interacting complex processes. Functionalism would suggest the existence of institutions is merited on their functionality, instead of the power alliances and specific processes which underlie them (something that the VofC agenda is often accused of). This framework is built on the premise of continuous and power-laden mutual interaction of both institutions and economic and political processes. The selection of successful cases prohibits us to explore the decidedly dysfunctional combinations of institutions and their drivers, however. Nevertheless, it remains clear that institutions can be contended or stabilized by those with power, and that institutional frameworks which are dysfunctional in terms of growth and development can be maintained by vested interests of powerful minorities. The numerous examples of underdeveloped countries with corrupt elites should point to the desirability of avoiding functionalism as an assumption in institutional analysis.
This suggests an interpretation of difficulties in deliberate and successful reform initiation. For a government (which is a short-term, 4-year formal political process in most Western democracies) to initiate a labor market reform, it must first recognize the prevalent power-positions (which are results of mid-term processes) and which may work to informally subvert the new formal institutions and render them inactive. It must then successfully manage to build this reform into a successful growth model, or it will be self-defeating (it must be aligned with another mid-term process of 10–15 years). Finally, for the institutional reform to give positive results in terms of growth or unemployment, it must be aligned (complementary) with a mid- to long-term process of institutional frameworks (particularly with financial market regulations and educational systems, but also macroeconomic management) which we treated as initial structures. A successful reform of the formal (regulatory) aspect of the labor market must either identify and align with processes already underway or initiate a very broad reform covering diverse areas (i.e. labor, education, finance, and macroeconomic management) and negotiate this broad reform against the vested interest in all of these areas.

This framework has suggested a logical alternative where the temporal hierarchy of institutional drivers may even render the formal political process irrelevant, as the results of uncodified practices may provide a stronger effective institutional protection than the formal system or undermine the formal system and result in effectively more flexible institutions. An example of a stronger effective network was Germany where the wide-spread protection awarded by collective bargaining was sufficiently strong that a minimum wage law was passed only in 2015. Such regulation was not deemed necessary before due to the strong effective institutions on the level of informal uncodified bargaining processes. An example of an undermined formal system is the Chinese labor regulation which is formally among the strongest in the world but has been largely unenforced for decades as the power relations and informal practices do not support it. Either way, neither a purely top-down nor a purely bottom-up mechanism is something to be expected in institutional change. This framework used a temporal embeddedness of drivers in an attempt to clarify their mutual interactions and feedback loops in the interactions of three recognized channels of institutional change.

In the event of successful developmental strategy change, the elements of the strategy become the new rules of the game (i.e. the strategy becomes institutionalized). Figure 5.4 shows a simplified model of such successfullness.
The change in developmental strategy changes the rules of the game and sets new power-distributional patterns, causing path dependence (Channel 1).

The change in strategy provides a critical juncture.

Successful developmental strategy

Fig. 5.4 Success of developmental strategies in labor institutions

If the strategy were unsuccessful (perhaps due to the lack of complementarity with existing active arrangements), it could merely signify a failed reform. However, a successful change in developmental strategy (e.g. shift from extensive to intensive) institutionalizes new rules of the game. This shift may \textit{ex-post} be identified as a critical juncture, but Fig. 5.4 shows such path deviation (i.e. a shift in strategy) as a result of formal political processes (which we identified as channel 3) or shifts in labor power resources effecting a change in its ability to influence the more informal aspects of institutions (channel 2). Once institutionalized, the developmental strategy sets the tone for further development, setting in a path dependence of its own (channel 1). However, once we acknowledge the full macroeconomic effects of such shifts, we must also notice that the long-term effects may run counter to the initial intentions. If a labor-friendly high-wage intensive strategy is institutionalized,
it will reduce the international competitiveness by raising the costs of production. The new intensive strategy will provide an internal market for higher price goods, but in an open economy, cheaper foreign goods will eventually crowd out some domestic manufacturing. In this event, a successful shift to intensive strategy (originally enabled by high structural labor power) eventually reduces the structural power of labor, enabling an eventual shift back into an extensive strategy.

5.4 Illustrating the Framework of Labor-Institutional Changes

The next three chapters will illustrate the central claims of this chapter by applying this framework on the labor institutions in China, Germany, and the USA since 1980. This section explains this selection by focusing on the choices of institutions, cases, and intervals in turn.

5.4.1 The Importance of Labor Institutions

It seems almost redundant to point out that class-based politics has largely lost its thrust in recent decades. This made labor power a somewhat unattractive area of research. However, while this old reason for studying labor is perhaps gone, there are a number of crucial reasons to focus on labor institutions. Firstly, demand management is greatly influenced by income distribution, which makes labor institutions a prime (and under-recognized) subject for macroeconomics-inspired research. It also makes labor institutions intertwined with growth models. Secondly, labor can be, and historically often was, mobilized to achieve political goals. This makes the presence or absence of manifestation of political labor power a relevant political science issue. Thirdly, the combination of visible power foundations and economic effects of labor institutions makes them a relevant issue in the study of institutional change as labor institutions include the predictors of institutional change that can be found in existing literature.

5.4.2 Case Selection: USA, Germany, PR China

The three cases could be interpreted as a most different case study design. As shown in Chapter 3, the USA and Germany are consistently discerned in typologies as typifying different varieties of advanced capitalism. China, on the other hand, represents a third distinct option where the rule of law and organized labor are yet to fully develop. However, these cases
were selected according to the findings of the systemic cycle approach described in Chapter 2. The USA was clearly the center of world production in the latter half of the twentieth century, as well as the center of global finance, political and military power. In using Arrighian systemic cycle theory, one would expect to see a waning hegemony/center of the world-system in the years following the crisis of 1973 which would also suggest a financialization in this aging economic center. When we observe the macroeconomic data on the USA in this period, we therefore expect to see signs of reduced production and increased financial activity. The selection of the two remaining cases reflected the need to locate competitor-states for the new hegemony or rather the competitors for the new world-systemic center of production as the first step toward such a hegemony.

Looking at data on net trade in goods in billions USD (OECD 2020), three large economies dominate. USA has sported the largest trade deficit since mid-1970s (at yearly record level in 2018 at $872 billion and at $854.4 billion in 2019), while China and Germany have enjoyed the largest trade surplusses in the past 15 years (at $417.7 billion and $256.7 billion in 2019, respectively). They were only surpassed in specific years by Russia and Saudi Arabia (which are energy-dependent exporters whose exports are far more volatile in value). This data shows the value of trade in produced, physical items and it is particularly relevant as it represents the first element in Wallerstein’s discussion of hegemony. As we will observe in following chapters, manufacturing labor tends to be most productive and most protected by regulation and prevalent practice.

Table 5.1 shows the cumulative net goods exports of the three selected cases in the 1992–2016 period as reported by OECD in current USD billions.

| Time                     | Cumulative net goods exports (1992–2001) | Average year (1992–2001) | Cumulative pre-global recession (2002–2008) | Average year (2002–2008) | Cumulative (2009–2016) | Average year (2009–2016) |
|--------------------------|------------------------------------------|---------------------------|---------------------------------------------|--------------------------|------------------------|--------------------------|
| Germany                  | 492.6                                    | 54.7                      | 1488.6                                      | 186.1                    | 1985.3                 | 248.2                    |
| USA                      | −1855.9                                  | −206.2                    | −5273.2                                     | −659.2                   | −5503.8                | −688                     |
| China                    | 169.4                                    | 18.8                      | 932.4                                       | 116.6                    | 2517.3                 | 314.7                    |

Source of data OECD 2017; own calculation
Table 5.1 shows the evolution in these three states. It is clear that the combined global effect of German and Chinese trade (both consistently in surplus) has grown increasingly comparable to the global effect of US trade (consistently in deficit). In the 1990s, the combined cumulative surplus of China and Germany was approximately at 1/3 of the US trade deficit in goods; in the years preceding the global recession of 2009 (2001–2008), the Chinese and German surpluses stand at almost 1/2 of US deficits; and in the post-recession years; they climb to over 4/5. Table 5.1 omits the post-2016 era, which was marked by protectionist inclinations of the Trump administration in USA and the COVID-19 pandemic. The former resulted in significant trade confrontations in 2018 and 2019, and the responses to the latter produced a sharp and wide-spread economic downturn in 2020. The results of these events may not be fully understood for some time. However, such data as is currently available does not suggest that the trends described here will be substantially affected.

All of this suggests that China and Germany are the two suitable candidates for the next center of the world-system in a Wallersteinian/Arrighian sense. These are the two countries with the largest global export of goods which together make up most of the net deficits of the old center which has turned to a financial expansion in the past 40 years and has become the importer of goods. According to Arrighi, these two countries should be expected to compete with alternative organizational innovations which could cement their material expansions eventually translating in a massive financial expansion of their own following a period of global dominance of one of them and a signal crisis eventually serving as a harbinger of the shift from material to financial expansion.

5.4.3 Interval Selection: 1980s to Today

The period since 1980 has been momentous for labor institutions as it brought wide sweeps of liberalizations in very specific national contexts. These were also accompanied by large-scale historical shifts toward free markets and geopolitical oscillations from bipolarity via unipolarity to multipolarity and with the rise of China as a global superpower. The general idea is to make sense of these shifts via the systemic cycle theory, and in this context, organizational innovations in the systemic chaos periods may result in a central position in the world-system. Therefore,
they represent new ways of being more productive and more competitive as an exporting center. They also represent ways of economic growth beyond demographic growth, by which national economies become richer. World-systems analysis assumes the unity of these two world center characteristics, and Arrighi’s analysis of the systemic cycle shows us how these two are diachronically connected. A geographic location will start to assume the role of the most competitive part of the world during the inevitable downturn in competitiveness of a far richer world-systemic center now turning to financial activity. With time, this most competitive location will become the new world-systemic center: it will grow richer and expand its production and trade for decades. However, the initial competitiveness increase is owed to a specific political-economic innovation—i.e. a specific set of policy reforms best suited to economic expansion. Within the systemic cycle logic, the relevant dates for such an innovation are 1973 at the earliest and 2008 at the latest (i.e. the period between the signal and the terminal crisis roughly delimiting the period of financialization in the old center or the USA).

This interpretation is crucial to the idea of the systemic cycle, but also unintelligible outside the actual historical context. Arrighi interprets the 1973 crisis as a signal crisis, which caused a shift into the hard financial expansion. This crisis was accompanied by several shocks. The Nixon shock was the 1971–1973 breakdown of the Bretton-Woods system of currency stabilization with the USD no longer serving as the anchor of currencies, ushering a new period of uncertainty in international trade. The OPEC shock (1973–1974) was intended as an economic punishment of the Western world for its support of Israel in the context of the 1973 Yom Kippur War. It introduced a period of higher oil prices which presented substantial challenges for the trade balances of the underdeveloped world and other oil importers. The Volcker shock sharply increased key interest rates in the 1980–1981 period in the USA in an effort to curb inflation. The repercussion was a different financial atmosphere with more abundant capital (due to the Nixon shock) but temporarily more difficult to procure by regular crediting channels (due to the Volcker shock)—spelling out some difficulties for the increasingly externally indebted developing world as well. All these developments provided a context for the Reagan era deregulations and liberalizations that would produce what David Harvey has called a neoliberal state (Harvey 2005). Other state-wide free market experiments could be found from Chile and UK in the 1970s to the transition in Central and Eastern Europe in the early 1990s.
The pressures toward the free markets were strengthened through the conditioned loan activities of international organizations like the IMF and the IBRD, spreading what has become the free market policy-prescription mainstream known as the Washington consensus (Stiglitz 2002). It was in this context that a general pressure toward liberalization could be felt. We can interpret this as a pressure toward the extensive capitalism strategy which is deregulationist and attempts to reduce production costs in order to produce competitive exports. Again, from the Western point of view, the first strategy could describe the first decades after World War II with various types of protection combining into a Keynesian welfare state. The second strategy may sound like the prescriptions of the Washington consensus that strived to formulate policy advice in the 1980s, 1990s, and early 1990s through the free market orientation of mainstream economic science. However, actual economic development strategies do not necessarily change though a change of atmosphere in the economic science, or a change in prevalent opinions in international organizations. After all, many voices predicted a regulatory race-to-the-bottom as a result of increasing trade openness and the liberalization of capital flows in the 1990s. As capital became migratory and labor remained stationary (Tilly 1995), it stood to reason that a new globalized world would suggest that foreign investment would flow toward countries which had least regulation and therefore enabled the most profit. This would trigger competitive deregulation and supposedly destroy the welfare state. While such pressures certainly materialized, the results fell far short of expectations (Weiss 1998). Certainly, the institutional changes were mostly neither instantaneous nor enormous. Various countries dealt with pressures toward liberalization in various ways as shown in Chapter 3. Arrighi can help us understand such changes in a broader historical context. A general free market-oriented shift in the last few decades from the Western perspective (i.e. toward extensive capitalism) does not mean that trade-related pressures will not incentivize a shift toward more regulation and higher worker incomes in China. In fact, in order to interpret the modern institutional shift, we must first understand the role that these shifts play when embedded in broader strategies interacting with trade positions and the systemic cycle itself.

However, practical considerations have pushed the present research agenda somewhat, as the macroeconomic data is sometimes unavailable for the period before 1980 and it is more prudent to start the analysis later, when more details may be observed. Also, this year is consistent
with the initial Chinese moves toward liberalization which have started through the 1980s. The following three chapters will therefore focus on events occurring post-1980 and analyze latest available data, which in practice puts the end-date in 2018 or 2019.

5.5 Conclusions

The goal of this chapter has been to use the elements explained and interpreted in the first three chapters in order to develop the approach to institutional change of this thesis. The primary method was the construction of an overarching framework of institutional change which encompasses several institutional approaches and an Arrighian approach to global capitalism and its iterations. The approach hinges on the idea that modern global capitalism has variegated national effects which have specific institutional repercussions. These effects can be thought of as endogenous due to the world-systemic unit of analysis which allows us to treat national institutions as sub-units of a far larger system. In order to analyze the effects of global capitalism on national systems, we must first understand the many levels which shape the national institutional outcome.

To do so, the chapter has used the conceptualization of institutions from Chapter 4, which draws on North, power resource theory, and new institutionalism to provide a concept of power-based and temporally grounded institutions which are capable of path dependence and path deviation according to the complex interplay of various political and economic factors which we have identified here as institutional change drivers. Their mutual interaction was depended on externalities and embeddedness. Using a logic of complementarity (VofC), this chapter suggested that there are institutional externalia (effects which a specific institution may exploit) not only in other institutions, but also in various political and economic processes which therefore contribute not only to institutional stability as assumed by VofC but, in their changing nature, to institutional change. Using a logic of embeddedness (NIE), this chapter further suggested that these drivers are mutually contextualized according to the timeframes necessary for each driver to develop. The long-term processes of technological change and institutional frameworks (considered here as institutional starting points) provide the context for mid-term processes of developmental strategy, trade relations, the systemic cycle, and changing power relations which in turn provide the context for
the short-term processes of formal electoral politics and transnational conditionality.

All of these together provide three distinct but overlapping channels of institutional change. Firstly, the institutional starting position provides path dependence, influencing the process of change in the direction of existing institutional arrangements. This is the channel emphasized by historical institutionalism and VofC. We have argued that it can only explain exogenous institutional change and is therefore insufficient in and of itself. Secondly, the formal political power channel (provided by national electoral politics and transnational conditionality) attempts to enact reforms to directly change institutions. This channel has been traditionally emphasized by political science (rational choice, public choice, international relations and foreign policy, Europeanization, coercive isomorphism…). We have developed a logic of temporal embeddedness of institutional change drivers to show the problems which this channel would face in providing efficient change if it existed in isolation. The third channel is the complex interaction of various institutional drivers putting the power relations and the systemic cycle in its center. We have suggested that the inclusion of systemic cycle theory allows us to predict the changes in political power of labor through several processes. The phase of the systemic cycle influences power resources as material expansion creates a greater structural power as it tends to increase the structural importance to the manufactured goods producers and financial expansion tends to reduce structural power as it decreases the structural importance of these workers. Developmental strategies are attempts at maneuvering the phases of the systemic cycles by specific aggregate demand management regimes which may initially reflect the high (intensive strategy) or low (extensive strategies) resources of labor but also influence trade. Finally, trade relations contribute in a similar way, as export increases tend to favor the structural power of manufacturing labor and vice versa. The power resources of labor can in turn influence either the formal legislative politics or more likely use the less formal structured interactions (e.g. collective bargaining) to influence the developmental strategies. Developmental strategies are themselves attempts at institutionalizing labor-friendly and domestic market-oriented intensive regimes or alternatively export market-oriented extensive regimes. If successful, the developmental strategies provide the third channel of institutional change.
Finally, the chapter explained the choice of observed institutions, cases, and the timeframe for the use of the three following chapters. Labor institutions are important because of their interactions with labor power, income distribution, and trade relations. This makes them an adequate subject for the illustration of the systemic cycle led framework of institutional change. The choice of cases of the USA, Germany, and PR China reflects their positions in the world-system. The three cases are major economies with dramatically different institutional arrangements, power relations, and positions within the systemic cycle, which makes them adequate for the illustration of a labor-oriented framework. Finally, the post-1980 period was chosen due to data availability and the fact that this is the timeframe in which the last financial expansion occurred enabling the observance of the effects of a global process on three divergent national institutional settings.

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