POLITICAL ECONOMY OF MODERN CAPITALISM

Mapping Convergence and Diversity

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THE INSTITUTIONAL EMBEDDEDNESS OF AMERICAN CAPITALISM

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This chapter makes several arguments: that contemporary American capitalism must be comprehended in terms of global economic changes; that the distinctive configuration of American capitalism has evolved over a long period and has a logic to its institutional evolution; that the dominant forms of governance of the American economy have been private hierarchies, markets, and the state, with associations being very weak; that variation in governance forms has made for varying performance of industrial sectors over time; that American economic institutions are part of a larger institutional context, and therefore are unlikely to converge with the configuration of capitalism elsewhere; and that the dynamism of American capitalism, with its heavy emphasis on a market mentality and widespread inequality in income distribution, threatens to erode the institutions which have, historically, shaped it.

Capitalism is contradictory, undermining the institutions essential for its continuation. Historically, a variety of social and political institutions have contained the destructive forces of capitalism, keeping firms in harmony with society, but the weakening of existing modes of regulation has recently created serious problems in American capitalism. In order to understand American capitalism, it is important to understand it as part of a social system of production which is characterized by the following:

1 an emphasis on short-term horizons in decisions;
2 a low capacity in most industrial sectors for making high-quality products, but high adaptiveness in some sectors to new product development;
3 a weak commitment to collective governance in the private sector but high reliance on the state as a regulatory agent;
4 a strong commitment to continuous economic change;
5 a weak commitment to economic equality.

The logic of development of American capitalism

Long-term historical factors explain why the market mentality became so pervasive in the USA, why Americans have a weakly developed civil society and have championed individualism over collective responsibility, and why they have historically preferred mass standardized products over customized and specialized ones. In the USA, there were no 'ancient' religious, aristocratic, or political authorities to overthrow, as the Americans attained democratic and modern institutions without a democratic revolution. Modernization developed without a modern state, and unlike most other advanced capitalist societies, Americans have had a decentralized state with diffused power and little policy coherence. This has resulted in the development of a conservative American political culture. In some European countries, socialist and social democratic parties gained strength by fighting for basic political rights. But not in the USA. Because working men in the USA early on enjoyed political and civil rights, there were fewer incentives for organizing along class lines.

Unlike nations with aristocratic traditions, Americans have historically highly valued entrepreneurship. American Puritanism provided spiritual legitimation for the virtues of enterprise, which, combined with the weakness of traditional communities, partly explains why Americans have historically had a weakly developed civil society. By the end of the eighteenth century, the ease of accumulating land and wealth stimulated a materialistic culture. In the absence of an aristocracy, this produced a class of merchants and manufacturers with a craving for material wealth. An egalitarian political culture, combined with Puritan traditions emphasizing hard work and achievement, reinforced the belief in the USA that one could 'get ahead' by hard work and individual initiative.

These social norms eventually became associated with the American system of standardized mass production, known as early as the 1850s as the 'American system of manufacturing'. That system came into existence before the development of a transcontinental railway system, before the accumulation of the great American fortunes, before availability of low-cost Mesabi range ores and cheap oil, and before the development of a large national market. Part of the reason for the early development of the 'American system' was the high costs of labour and the shortage of skills. But also of great importance were the norms and habits, the lack of sharp class distinctions, and the homogenized tastes of Americans. They tended to place a monetary value on almost everything and supported a market mentality more pervasive than in any other capitalist society.

As communication and transportation revolutions led to declining transportation rates, firms in numerous industries after the Civil War were able to extend product markets, increase output, utilize economies of scale and scope, and undersell smaller and less efficient firms. But after a few decades of expanding markets and impressive profits, they were faced with the classic problems of intense price competition, 'saturated' markets, idle plants, accumulating inventories, severe price declines, and the threat of bankruptcy. Efforts to cope with these problems resulted in a fundamental transformation of the American economy during the late nineteenth and early twentieth centuries.

Firms in many industries attempted to limit output and stabilize prices by resorting to ineffective informal agreements. Formal arrangements such as trade associations emerged, so that by 1900, associative behaviour had become quite common in a variety of industrial sectors. Trade associations, however, generally failed to stabilize output and prices, because the strong tradition of individualism sanctioned the freedom of American firms to behave as they wished. Also important was the large size of the country, with attendant large numbers of firms and diversity of interests among firms in the same industry. Business associations in the USA have been less developed and therefore have tended to have less autonomy, fewer resources, and less capacity to govern their members than in smaller countries. Moreover, American courts and legislatures declared cartel arrangements and many other forms of collective behaviour illegal, and in 1890 Congress passed the Sherman Anti-Trust Act.

Anti-trust law had the unintended consequence of accelerating the development of large corporate hierarchies. The courts ruled that 'loose combinations' (for example, 'gentlemen's' agreements, pools and other types of cartels) were illegal under the Sherman Anti-Trust Act, but that firms could not be held to be in violation of the law simply because of their size and market share. Before the courts would rule that 'tight combinations' were illegal, there had to be convincing evidence that the firm had engaged in abusive, restrictive, or predatory behaviour, that a company had acted with the 'intent to restrain trade', and that as a result of this 'intent', it had already succeeded or would succeed in the future in obtaining monopoly power. By acting reasonably toward competitors, firms were permitted to do things within a 'tight combination' that were illegal under a 'loose combination'. The Sherman Act encouraged firms to forsake practices of restraining competitors through loose combination, and to pursue internal strategies (for example, hierarchical arrangements) to enhance their market position and stabilize their industries. A long-term consequence of the Act was to enhance concentration of the American economy.

Horizontal and vertical mergers

There was an extensive merger movement in the late nineteenth and early twentieth centuries, with the USA having more mergers than any other country – both in absolute numbers and in proportion to the number of firms in the country. Horizontal mergers occurred with greater frequency in industries which were capital intensive, had undergone rapid expansion prior to the depression of the 1890s, and experienced severe price competition. Consolidations succeeded only when tight integration resulted in economies of scale and lower labour costs, or raised barriers to entry; in industries with high volume, large batch or continuous-process production; in industries with high energy consumption; and in those that had large markets. These included food processing, oil, chemicals, primary metals, paper, and consumer durables (for example, sewing machines, agricultural machinery, electrical equipment, elevators).

Firms in a number of other industries believed they obtained cost advantages over competitors by becoming vertically integrated. There were several motives for American firms to integrate vertically. The first was to reduce uncertainty about availability of raw materials and transport facilities by backward integration, and to attain outlets for products by forward integration. The second was to enhance market share by erecting barriers to new competition. In general, firms resorted to vertical integration because of distrust of actors on whom they were heavily dependent. Indeed, low trust among transacting partners has historically been a distinctive trait of the American economy.

Backward integration occurred when processors had few sources of supply; when it was difficult to write contracts for supply far into the future; the production technology was relatively stable; and the product was in a mature stage of the life cycle. Thus, the food processing and tobacco industries did not engage in backward integration, for they had large numbers of suppliers. But backward vertical integration was quite common in oil refining, steel, aluminium and copper, where processing firms believed sources of supply might be cut off, or supplies might become very expensive. Similarly, when firms were engaged in recurring transactions of highly specific assets, vertical integration was used to avoid monopolistic pricing (Williamson, 1975, 1985; Chandler, 1977; Lamoreaux, 1985).

There was also often an offensive strategy to backward vertical integration. Firms in some industries bought up raw materials in order to limit competitors' access. In the steel, copper, aluminium, and newsprint industries, a small number of firms gradually gained control of vital ore deposits and timber. Research and development also were increasingly vertically integrated, for it was exceedingly difficult for firms to write satisfactory contracts specifying research on new products. Firms feared that by contracting out research and development, they might lose their proprietary interests to opportunistic contractors. Firms such as American Telephone and Telegraph, General Electric, and Westinghouse used in-house research and patents to restrict competition and enhance market share.

The logic of networks in the American economy

Even after corporate hierarchies were established by horizontal and vertical integration, it was possible for firms to engage in ruinous price competition. Many first therefore looked for some form of industry-wide or collective stabilization of prices. Although it was illegal to fix prices through cartels, firms frequently employed price leadership (the dominant firm strategy) as an alternative way of collective price setting, with the price of a good being announced by one firm and the rest of the industry then adopting the same price.

The sectors in which price leadership occurred most frequently were steel, autos, copper, petroleum, agricultural implements, anthracite coal, newsprint, industrial alcohol, and the refining of sugar and corn products. While dominant firm pricing tended to stabilize prices in the short term, in the long run the leader's market share invariably declined, differences in firm size diminished, and leadership tended to decay as a result of competition. Because price leadership stabilized the industry in the short term, firms had few incentives to innovate or adopt new technologies. Hence, firms adopting price leadership as a strategy tended to decline in efficiency. While some American industries used dominant firm pricing to their advantage prior to and after World War II, Japanese firms in the same industries found themselves in fierce competition with one another for domestic market share, which helped them to be efficient and successful once they entered American markets. The Japanese pattern suggests that intensive price competitiveness without price leadership may lead to high efficiency over the long run.

To understand the importance of sources of capital for the coordination of American industrial sectors, one needs to think comparatively. In Japan and Germany, where industrialization occurred somewhat late and where mass markets were much smaller than in the USA, large firms before World War II were dependent for capital on outside financiers – the large banks in Germany and the major financial groups (*Zaibatsu*) in Japan. Historically it was common for Japanese and German firms to rely on one or two major banks for capital. Not only did those banks closely monitor the firms' operations, but they often held equity in them. In Japan there was also extensive cross-company stock ownership. These are important reasons why Japanese and German firms were able to forsake short-term profit maximization in favour of long-term goals.

In the USA, where equity markets are more developed, large firms have been much less dependent on commercial banks for financing. Indeed, during the last 35 years, the proportion of American industrial funds from commercial bank loans has been among the lowest among highly industrialized countries. Equity markets developed earlier and became more important in capital intensive industries in the USA because the country industrialized early. Substantial profits generated from textiles and sailing ships were available for investment purposes in the late nineteenth century. Specifically, investment banking houses in the USA served by the end of the nineteenth century as intermediaries between those needing and those having capital, and without this intermediary to monitor investments and corporate practices, many large firms could not have emerged.

The role of a few investment banks was so important in transforming and regulating the American railroad industry that they could determine which areas of the country would have railroad expansion, and how many railroads would be established between major cities.

After 1914, state policy was the most important reason for the declining role of investment banking in the coordination of the American economy. The Clayton Anti-Trust Act of 1914 made interlocking directorships among large banks and trusts illegal, and forbade a corporation from acquiring the stock of another if the acquisition reduced competition in the industry. In addition, in 1933 the American government forced a sharp separation between commercial and investment banking. From that point on, investment banks lost much of their access to capital and had diminished capacity to regulate or govern non-financial corporations. The net result was that both types of banks came to have little control over the modern American corporation.

American non-financial corporations thus became dependent on liquid financial markets for raising capital, on the whims of stockholders, who in turn have pressured the federal government to become involved in regulating the behaviour of the equity markets. When owners of American securities think their investments are not properly managed, they sell their assets. Since American management during the past half century has been evaluated more and more by the current selling price of the stocks and bonds of the company it manages, the American corporate structure has increasingly become embedded in an institutional arrangement placing strong incentives on short-term considerations and heavy regulation by the American state.

As a result of this short termism, shareholders in America have relatively little loyalty to the firms in which they are part owners. Individuals invest in companies for appreciation in the value of shares, and the boards of directors of American firms know that their primary responsibility is to assist shareholders in maximizing their returns or risk being removed, or worse, sued. Thus, American management is preoccupied with boosting stock prices (Garten, 1992: 122–4).

Industrial relations in hierarchically coordinated firms

During the late nineteenth century, mass production became the undisputed means of enhancing industrial efficiency in numerous sectors of the American economy, and the basic strategy for expanding markets and minimizing costs. Those firms that engaged in mass production followed a distinctive logic. Mass producers took seriously Adam Smith's prescription that the most efficient way of organizing a factory was to routinize and differentiate workers' tasks down to the smallest detail. The key to breaking manufacturing into ever more detailed operations was to employ specific purpose machinery for each task along an assembly line.

Employment was viewed as an impersonal economic exchange relationship, with machines easily substituted for workers when profitable. Whatever labour was needed to work on assembly lines could be hired or dismissed at short notice. As machinery became more and more specialized, the skill and autonomy of workers declined, and management had little incentive to engage in long-term contracts with workers or to invest in their skills.

Prior to 1960, American mass production strategies were dominant among:

1 producers of low priced, semi-perishable packaged products, with large batch, continuous process technology (for example, cigarettes, breakfast cereals);
2 processors of perishable products for regional and national markets (for example, meat packing and processing firms);
3 manufacturers of consumer durables produced with continuous process technology (for example, sewing machines, automobiles, office equipment);
4 makers of high margin production goods that were technologically complex but standardized (for example, elevators and pumps);
5 other industries which were capital intensive, energy consuming and reliant on continuous production technology (for example, chemicals, oil refining, rubber products).

In the USA, there has been considerable variation in the way that labour–management relations have been coordinated, over time and in different sectors of the economy. Despite the dominance of the standardized mass production paradigm for a number of decades, some industries were always organized differently. Indeed standardized mass production itself demanded the existence of industries organized along opposite principles as special purpose machines necessary for mass production cannot be mass-produced but have to be custom-made. In other words, industrial dualism was a logical necessity even when standardized production was the dominant technology (Piore, 1980).

Mass production was also inappropriate in industries where production was labour intensive and low in energy consumption, and where product markets were heterogeneous. Examples included lumber products, printing and publishing, and residential construction firms. These were industries where each product was relatively unique and required considerable worker autonomy. Such activities took place in settings involving long-term stable relationships among craftsmen.

Still, by 1950 numerous manufacturing sectors of the American economy were tightly integrated into a system of mass production, which was dependent on very large stable markets for products low in technological complexity and slow in their rate of technological change. American management tended to believe that hierarchically organized firms were particularly well suited for mass production and distribution. The system was complemented and supported by public sector mass education which provided a labour force with basic training in reading, writing, and discipline to work on assembly lines. American students decided voluntarily how much to invest in their own education. Over time, this voluntarism meant that the level of human capital investment was lower in the USA than in countries with apprenticeship training mandated for specific occupations. Comparing American and German workers, Hansen (1991) points out that American manufacturing workers received virtually no formal training on the job. Of the monies which American firms invested in human capital, most went to managers, technicians and supervisors. American systematic training of rank-and-file employees historically was brief, narrow, and job specific. And through the 1950s, this system struck most American managers as being quite effective.

Challenges from abroad: the postwar period

Many of the USA's industrial firms succeeded with a hierarchical form of coordination because the barriers to entry were too high for effective competition from other firms, both domestic and foreign. But the day of reckoning was to come. By 1960, various European and Japanese manufacturers were adopting some of the latest technology, at a time when transportation costs were declining and markets for high quality consumer goods were expanding. Moreover, manufacturers in Japan, Germany and several other countries had never been as committed to the hierarchical form of standardized mass production as the Americans. Indeed, those countries had very different ways of coordinating manufacturing sectors – geared more to flexible production, to strategic alliances instead of hierarchies based on vertical integration, and to collective forms of governance.

In Japan, Germany and other countries where industrialization occurred later and markets were smaller, modes of coordination which were less hierarchical and more network-like had long been common. They proved more effective once markets became unstable and consumers demanded products based on complex and changing technologies. Hierarchical coordination, by comparison, is effective when markets are stable, consumer tastes are homogeneous, and technology is not highly complex and slow to change.

Following the first world oil crisis in the 1970s, many American manufacturers producing standardized goods found themselves with products for which there was little demand, and with rigid systems of production that had little capacity to adjust. Many American firms responded to market saturation and decline in profits simply by trying to reduce costs. Some froze or rolled back their employees' wages. Others took advantage of the declining costs of transportation and communication to shift

production to low-wage areas. Because of the pervasiveness of the market mentality and the widespread view of labour as a commodity, thousands of firms reduced labour forces and introduced automated equipment. Many firms and their trade associations – especially in the shoe, textile, steel and automobile industries – pressured the government for protection against foreign competitors. Despite these expedients, it became evident that standardized systems of production were incompatible with volatile and unstable markets. Even when the market demand for certain goods remained relatively stable, less developed countries with lower wage rates were able to copy standardized products and sell them in the USA at lower prices. Hence, American mass producers increasingly faced severe price competition and losses.

Eventually, it became obvious that a different coordinating strategy was needed in many manufacturing sectors. The question was whether industries in the USA, historically coordinated predominantly by corporate hierarchies, could shift to the more flexible coordinating strategies employed by their foreign competitors, to overcome their slow response time, their inability to develop in-house components with complex technologies, and their high production costs.

Some American firms adopted certain aspects of Japanese management (for example, just-in-time production, self-managing teams, quality circles and 'statistical process control'). But this was not sufficient to transform the American economy. A nation's financial markets, educational and industrial relations systems and other socio-political factors influence sectoral and national economic performance. And the American economy cannot mimic the Japanese economy simply by adopting some of the Japanese management and work practices.

Importance of multilateral and collective behaviour in advanced capitalist societies

The dominant social system of production in American society was historically coordinated by markets and corporate hierarchies, with firms embedded in a weakly developed civil society. At the same time, there has been, for some years, an emerging subordinate system, one in which economic coordination takes place, not within firms, but within networks of cooperating actors who have developed flexible long-term relations with one another. These networks exist in the absence of highly developed associative institutions like trade unions, business associations or training institutes organized by capital or labour.

Some of the most effective American networks involve cooperative relations among university-based firms with a strong knowledge base and state and federal governments. Where such networks have been successful, much of the leadership has come from the state. Significantly, the American state has rarely sought to develop coordinating networks among manufacturing firms in more traditional industries. Rather, it has been active during the past half century in developing networks for manufacturing firms in relatively new industries addressing military and health-related needs of society. The following are products and technologies coordinated by networks firmly embedded in environments involving cooperative relations with university-based scientists and engineers, the state (especially the military), and other firms, both suppliers and competitors: aircraft, semiconductors, integrated circuits, computers, nuclear power, microwave telecommunications, new materials such as high strength steel alloys, fibre-reinforced plastics, titanium, and metal fabrication such as numerical-controlled machine tools. Without such networks, these technologies and products could not have developed in the USA.[1]

One important feature of networks is their linking together organizations with different knowledge bases. This kind of coordination is not possible within a hierarchy, as no single firm has the knowledge and resources to develop any of the technologies and products listed above. Nor could a single firm linked with suppliers develop such products. They could be developed only because firms were engaged in established, cooperative, long-term relationships with other organizations. Networks have been vital in linking experts in industry, government laboratories and land grant universities with knowledge in many different areas.

Industries in which American manufacturing is strong are those in which knowledge is constantly changing at a rapid rate and in unpredictable directions, and in which the strategies of firms are ambiguous and rapidly evolving. Because the relationship of such firms with their suppliers of capital and knowledge is also changing, they can flourish only in an institutional environment that is extraordinarily flexible, one in which scientists, engineers and venture capital are highly mobile. Such firms are born and disappear with great rapidity, just as engineers and scientists are ever shifting from one product and industry to another.

Many Americans are socialized in their educational system to be highly individualistic and to excel in entrepreneurship. Because of the pervasiveness of the market mentality, the strong tradition of entrepreneurship, the flexibility of external labour markets and the presence of venture capital markets, it has been relatively easy for American researchers and engineers to set up their own firms to commercialize new products, especially when the federal government has blessed such ventures with research and development funds and immunity from anti-trust concerns. This has been especially common in information-based industries in and around Silicon Valley, as well as in the biomedical, biochemical, artificial intelligence, and defence-related industries. With a cross-national perspective, it is apparent that network arrangements have performed extremely well in American society in advancing knowledge at the frontiers of science and in developing new products from basic science.

The American R&D system has been less successful in improving upon older products for commercial markets. The Japanese system of research

and development offers a contrast in styles. Although the Japanese are much weaker in basic science, have been somewhat less successful in developing radically new products, and may be somewhat deficient in entrepreneurial leadership, they have established close communication among researchers, engineers, and production and marketing personnel involved in existing product technologies. Japanese firms tend to be rather successful in linking scientists and engineers within established production facilities. In the USA, research and development tends to involve production personnel only in a very limited manner (Aoki, 1988; Powell, 1990; Powell and Brantley, 1992).

Because of the flexible external labour market in the USA, it is very difficult for American firms to keep knowledge proprietary. Movement of personnel from one organization to another undoubtedly facilitates communication, creativity, and development of new products. But because knowledge is so easily siphoned from American firms, they are limited in their ability to focus their talents on long-term development, whereas the less flexible internal labour market in Japan permits firms there to focus more energy on the improvement and refinement of products.

Differences in the underlying institutional structure in capitalist societies have led to substantial variation in their network structures. In the USA, networks are either state led or private–contractual in nature. In Japan, networks are socially or communally based, while in Germany they are quasi-public or associationally constructed.[2]

American-style capitalism and distributional issues

The relevance of this for the USA in the 1990s is that a number of major innovations during the past forty years has had a Schumpeterian clustering effect – innovations and discoveries in biotechnology, electronics, computers, communication, instrumentation, and new materials (synthetic and otherwise). Most of these innovations are occurring in industries in which product lives are short. The American social system of production with its institutional arrangements facilitating creativity, individualism, 'short termism' and flexible labour and capital markets fosters the development of totally new industries. Moreover, the same institutional environment has facilitated the rise of the USA to world leadership in the entertainment and publishing industries, sectors which place a great deal of emphasis on the development of new products with short lives.

There is considerable evidence that the American economy is becoming more concentrated without becoming more centralized. Large firms are becoming leaner and cutting back their in-house operations to essential 'core competencies', delegating other work to outside suppliers. While some scholars have speculated that dual labour markets would disappear in advanced industrial societies, there is increased evidence that they are becoming even more institutionalized in America. Ultimately, economic power and control is becoming not less but more concentrated within multinational manufacturing corporations and financial institutions (Harrison, 1994). While many who discuss the increasing flexibility of the American economy focus on small firms with good jobs and trained workers, there has been a tendency to ignore the low-wage, superexploitative character of many firms on the periphery that support the entire system by suppressing labour costs. For example, in Silicon Valley, an area associated with creativity, high skills, and high pay, nearly one-half of the workers perform production and maintenance tasks and are officially classified as semi-skilled and unskilled. For them, pay is extremely low and benefits are non-existent (Harrison, 1994: 115). In the meantime, the decline of the old industries, such as, steel, textiles, and construction has led to a workforce increasingly polarized between management and other highly skilled workers on the one hand, and low-skilled workers with little capacity to change their skill levels on the other. Viewing the American economy as a whole, the number of people that is highly trained is increasing, but skilled jobs are supported by a very large segment of the population with very low skills.

As American firms in both manufacturing and services engage in vertical disintegration, downsizing, outsourcing and network building across sectors and national borders, there has been a steady decline in union membership which in turn has contributed to increased wage inequality. The dramatic increase in immigration has also contributed to declining union density and rising inequality of wages (Borjas et al., 1992; Freeman, 1993). Indeed, since 1979 there has been a sharp acceleration in the growth of earnings inequality, especially among males (Levy and Murnane, 1992).

During the past decade, Americans had a larger number of new jobs than any other highly industrialized society, but a substantial proportion of these have been involuntary part-time positions with low wages and few fringe benefits, resulting in frequent job turnover. Since 1982, temporary employment in the USA has been gaining three times more rapidly than employment as a whole. Throughout the American economy, workers on average take home 7 to 12 per cent less income than in 1970 (Callaghan and Hartmann, 1991; Levy and Murnane, 1992; Karoly, 1993; Mishel and Bernstein, 1993).

Increasingly, more and more Americans have slowly been moving to the political right in response to promises of tax cuts and reductions in welfare spending. As Keynesian policies are discredited, politicians increasingly articulate political–economic views resembling those of the 1920s: there should be less state and social regulation of the economy, tight monetary and fiscal policies, and more economic coordination by the market. Although much of the American economic recovery is being driven by the expansion of new industries, these industries are embedded in an institutional framework and a political culture that are unlikely to be able to sustain the recovery.

Concluding observations

In assessing the relative roles of corporate hierarchies and networks in the USA, several points should be noted. First, since stable, homogeneous markets continue to exist for many products of low technological complexity, hierarchical coordination remains dominant in many industries. 'Dis-integration' may be occurring in other sectors, but hierarchical coordination is still widespread in American manufacturing, especially in market segments where there are relatively homogeneous tastes for inexpensive products, such as paper products, breakfast cereals, soft drinks, bug sprays, floor wax, deodorants, soaps, and shaving cream. Mass markets for these products are stable and far from saturated, and remain ready for products manufactured by semi-skilled workers and distributed by general purpose firms.

Second, the ability of the USA to produce high quality products in more traditional industries is drastically limited by the rules, norms, and arrangements which influence practices of industrial relations. An industrial relations system that facilitates diversified high quality production is one in which workers have broad skills and some form of assurance that they will not be dismissed. Indeed, job security tends to be necessary for employers as well to have incentives to make investments in worker skills. This type of incentive and skill system has become much more widespread in Japan and West Germany than in the USA, where downsizing of firms and 'sweating' of labour are more pervasive.

Third, the associational system of a country influences both its industrial relations system and its ability to engage in diversified quality production (Streeck, 1991). Where there is a well-developed civil society and associational system, firms have a greater capacity to enter into collective agreements with their competitors not to poach one another's workers. This encourages firms to develop more flexible internal labour markets, and to invest in the skills of their workforces. One consequence of the highly fragmented American associational system is a very flexible external job market combined with rigid internal labour markets, conditions which limit the development of a highly trained labour force in more traditional industries.

Fourth, capital markets in the USA have also placed constraints on the development of broad worker skills. American capital markets have encouraged firms to engage in short-term profit maximization. By comparison, firms in Japan and Germany have relied more on bank loans and cross-firm ownership as a source of capital. The short-term profit horizon of many American corporations has been due to their dependency on liquid equity markets, combined with the fact that American banks have been disinclined to provide long-term interest loans.

Fifth, as technology becomes more complex, changes more rapidly and becomes more expensive, firms are finding that various types of networks are an effective form of coordinating transactions, even in rather traditional industries. But to maximize their effectiveness as governance arrangements in more traditional industries, networks need to be embedded in a rich institutional environment involving various forms of collective behaviour. American firms with networks as a major form of coordination are very weakly embedded in institutional arrangements of a collective nature.

The social environment plays an important role in shaping the behaviour of firms, their types of products and their production strategies. If firms are embedded in an institutional environment rich in collective goods, flexible systems of production in more traditional industries are likely to be dominant. But in a society where there is a lack of such an environment, the market mentality becomes more important, and the collective goods necessary for the flexible production of high quality products and for international competitiveness in more traditional industries are lacking. On the other hand, precisely because American firms are not embedded in a rich institutional environment, they are extraordinarily adaptable, which has given them a distinct advantage in newer sectors that emphasize individualism and creativity and that have a need for well-developed venture capital markets. At the same time, underneath all the glamour of the new industries in the American economy, the institutional underpinnings requisite for sustaining a vibrant economy and a high degree of civility remain extremely weak. The long-term prognosis for American capitalism is therefore problematic, with two competing visions.

Those sharing a neo-Polanyian view (Hollingsworth, 1994) believe that effective civility and governance at the local level are in crisis, with law and order breaking down, social pathologies widespread, and boundaries among ethnic and racial groups becoming more rigid. In this view, the power to govern the states and metropolitan districts has now shifted to suburban areas. As a consequence, schools in large cities remain underfunded and become increasingly unsafe, and urban violence and despair are becoming more widespread. The gap between the life chances of minorities and those of white Americans is widening, and labour market opportunities for minorities are declining. Every American census since 1940 has demonstrated that the metropolitan areas of the country have become increasingly more segregated along lines of race and ethnicity, with middle-class whites moving to suburbia, and central cities populated by African-Americans, Hispanics, and other low-income Americans. In 1990, 60 per cent of Chicago's population consisted of ethnic minorities, while surrounding suburbs were 80 per cent white. As a result, monetary resources for coping with problems of inner American cities are in decline. The tax base of American cities has continued to diminish, while federal government spending on urban problems has declined from 18 per cent of the federal budget in 1980 to 6.4 per cent in 1990.

The implications of these trends for the next generation are threatening. If the USA is to adjust to the economic requirements of an advanced industrial democratic society during the twenty-first century, it must either rebuild or construct new institutions at the local level. If it fails in this endeavour, order and civility may well break down, and the USA would then lack the capacity to develop at local–regional levels the social institutions necessary for the governance of the economy in an advanced industrial society.

The alternative view is articulated by some centrist and conservative political leaders in the USA and is somewhat more optimistic about the nation's future. With low taxes, an inegalitarian income distribution, high immigration of both cheap manual labour and well-trained Asian engineers, the USA may be able to continue to be innovative in industrial sectors with short product lives. Also, as a result of American military power, the country can continue to offer incentives to the economic and political elites of other countries to be supportive of the American political economy, despite huge trade deficits and a falling dollar. In short, the social infrastructure of American society may be disintegrating, and crime and other social pathologies may be spreading among the surplus population, but the upper third of American society may be able to live extremely well, feasting on the social infrastructures of other countries and on the world market.[3] How long the band can continue to play on in such a world cannot be predicted with accuracy, and depends on the course of events both within and outside the USA.

Notes

1 American agriculture owes much of its success to the fact that agricultural producers have been embedded in a rich institutional environment, with cooperative activity among agricultural producers under an anti-trust exemption; dissemination by the state of university-based knowledge to agricultural scientists; and financial assistance from a number of public and quasi-public institutions.

2 I am indebted to Wolfgang Streeck for these insights.

3 These views were developed after extensive conversations with Colin Crouch and Wolfgang Streeck.

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