DISTRIBUTION AND REDISTRIBUTION:

THE SHADOW OF THE NINETEENTH CENTURY

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1. Introduction

Why do advanced democracies cluster into some that are highly inegalitarian and redistribute very little and others that are highly egalitarian and redistribute a great deal? Related, why do some economies rely a great deal on free market exchange while others are permeated by a dense network of non-market regulations and organizations? As Korpi reminds us in a recent World Politics article (Korpi 2006), explaining this diversity, and its persistence, is a main task for anyone interested in understanding the workings of modern capitalism.

Korpi agues that power resource theory (PRT) provides the most convincing account of this pattern. He and others see the clustering of countries on distribution and redistribution as a function of the organizational strength of the working class. A rich literature in this tradition documents how the size and structure of the welfare state is related to the historical strength of the political left, mediated by alliances with the middle classes (Korpi 1983, 1989, 2006; Esping-Andersen 1990; Stephens 1979; Huber and Stephens 2001). Korpi goes on to suggest that the recent attempts to emphasize the role of employers or production regimes (including some of our own work) are either causally spurious (2006, 171) or easily accommodated within the power resource framework.

We disagree and see some important limitations to the power resource approach that the alternative outlined in this paper avoids. First, if it is true that the welfare state is built on the shoulders of an unwilling capitalist class, it is hard to understand the continued enthusiasm of capitalists to invest in economies with large, "de-commodifying" welfare states. As argued by Lindblom (1980), Przeworski (1986) and others, economic performance under capitalism depends on the cooperation of capital. And, the remarkable fact about the observed relationship between spending, investment, and national income in advanced democracies is that there is none (Lindert 1996). Among contemporary democracies, the countries with the largest welfare states are no poorer than countries that spend much less. If we want to understand how capitalism has thrived in large redistributive welfare states, power resource theory is simply no help.

Second, although there is mounting evidence for a fairly strong relationship between left partisanship and redistribution (see, for example, Hicks and Swank 1992; Huber and Stephens 2001; Kwon and Pontusson 2005), there is no explanation in PRT for why the left is strong in some countries and not in others. Such strength is only weakly related to unionization (Iversen and Soskice 2006), and unionization is itself left as an unexplained variable. Moreover, if we use a simply left-right conception of politics, as advocated by PRT, there are strong theoretical reasons to expect governments to be centrist. Although Downs applied his argument only to majoritarian two-party systems, the median voter theorem also applies to unidimensional models of legislative politics in multiparty systems. Essentially, no proposal or coalition can get majority support that deviates from the position of the median legislator (Laver and Schofield 1990). PRT does not explain why the median voter theorem is systematically violated.

Perhaps then redistribution is a function of the preferences of the median voter? One of the most cited papers in the political economy literature by Allen Meltzer and Scott Richard (Meltzer and Richard 1981) argues precisely that. A key result is that if one holds mean income constant, and with a standard right-skewed distribution of income, higher levels of inequality is associated with a lower median income and more demand for redistribution. The implication is that an equal distribution of market income and government redistribution should be negatively correlated. But as noted in the first paragraph this is not the case. Data for advanced democracies consistently show equality in market income to be associated with high redistribution (Bénabou 1996; Perotti 1996; Lindert 1996; Alesina and Glaeser 2004, Moene and Wallerstein 2001). Figure 1 illustrates this "Robin Hood paradox" for a sample of countries.

[Figure 1 about here]

The alternative that we outline in this paper not only solves this puzzle, but explains why some countries are dominated by center-left governments. Moreover our approach explains why this has not undermined the incentives of employers to invest in the

economy. Our alternative is rooted in a varieties of capitalism framework (Hall and Soskice 2001) and builds on much of the work that Korpi criticizes (in particular Swenson 2002 and Mares 2004). As in Estevez-Abe et al. (2001), we emphasize the complementarities between economic, political, and social institutions and provide a comprehensive causal explanation for the contemporary patterns of distribution and redistribution going back to the late 19th century.

In brief, we argue that the economies of the last half century with a relatively egalitarian distribution of income and high levels of redistribution were organized economically before industrialization and before the franchise in more cooperative ways (especially in terms of guilds and rural cooperatives) than economies with high inequality and little redistribution. And even before the breakthrough of democracy these non-liberal countries had (limited) systems of representation that functioned in a manner not too different from current systems of proportional representation (PR). During the early 20th century the coupling between economic coordination and PR became institutionalized under universal suffrage, and this, we argue, produced the correlation between distribution and redistribution illustrated in Figure 1. Unions and left parties certainly played a role in this process, as argued by Korpi, but we can only understand this role if we take into account the organization of the economy and why employers in some cases had an interest in cross-class collaboration. The strength of the left is in some measure a function of the institutional choices made by employers and the right in the 1920s and earlier. More critically from our point of view, institutions that promoted equality in the distribution of wages co-evolved with institutions that promoted redistribution. This co-evolution resulted in a remarkable persistence in the comparative patterns of inequality and redistribution: The high equality, high redistribution economies today appear to also be the ones with these traits during most of the 20th century and even earlier.[1]

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[1] Although very long time series do not exist, comparing data on income inequality and government spending for the 1950s and 1960s to the 1980s and 1990s reveals high levels of persistence in both. The cross-time correlation for income inequality is .92 for 10 advanced democracies and .84 for a larger sample of 38 countries -- including democracies and non-democracies, as well as developed and less developed countries. For total government spending (an imperfect measure of redistribution), the correlation is .85 for 20 OECD countries

In developing our argument we begin by explaining the positive relationship between distributional equality and redistribution. We propose in section 2 that the correlation is indirect: Two factors, the electoral system and the degree of economic coordination each impact on both distribution and redistribution. Proportional representation (PR) promotes both distributive equality and especially redistribution; so does coordinated capitalism with an even greater impact on distribution. PR promotes center-left coalitions; and coordinated capitalism, by encouraging the generation of specific skills, reinforces both median voter and business support for wage compression and strong welfare state insurance.

The positive correlation between distributional equality and redistribution is in turn explained by a positive correlation between PR and coordinated capitalism. Using a composite measure of PR[2] and two measures of non-market coordination,[3] Figure 2 illustrates how countries cluster into a PR-coordinated group and a majoritarian-uncoordinated group (even if there are some questions about where Ireland and France, according to one of the measures, belong). Because coordinated capitalism and PR determine distribution and redistribution, a full account of the correlation between the two pulls us back into the nineteenth century where these institutions became linked up in the process of industrialization and democratization.

[Figure 2 about here]

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[2]
  The proportionality of the electoral system measure in the last column is a composite index of two widely used indices of electoral system. One is Lijphart's measure of the effective threshold of representation based on national election laws. It indicates the actual threshold of electoral support that a party must get in order to secure representation. The other is Gallagher's measure of the disproportionality between votes and seats, which is an indication of the extent to which smaller parties are being represented at their full strength. The data are from Lijphart (1994).

[3]
  One (marked by triangles) is Hall and Gingerich's (2004) measure of nonmarket coordination, based on the existence of coordinating institutions in industrial relations and the corporate governance system. The other (market by squares) is Hicks and Kenworthy's (1998) index of coorperation, which measures the extent to which interactions between firms, unions, and the state are cooperative as opposed to adversarial.

Section 3 offers a historical explanation of the positive correlation between PR and coordinated capitalistic systems based on Cusack, Iversen and Soskice (2007). The argument is that the countries in which there is now a high degree of coordination, and in which economic coordination was beginning to move to the national level as industrialization developed through the second half of the nineteenth and the start of the twentieth centuries, had previously been primarily coordinated at the local and regional levels. Locally coordinated economies favored the development of specific assets, and the choice of PR – occurring in most of these economies between 1910 and 1925 – reflected the need for local and regional economic interests to ensure representation at the national level to protect and regulate these assets. Despite its redistributive consequences, the choice of PR was largely a choice by the right, and it could have reversed the choice in light of its distributive consequences. Even in countries with a strong left, the center and right parties have held a legislative majority in most of the 20th century. PR is no accident.

In section 4 we revisit power resource theory. We point out that our explanation is fundamentally different from power resource theory because it is not the power resources on the left that have *caused* the institutional differences that we observe. Employers and the right did not choose PR because it feared the power of the left. Had that been the sole motivation in designing electoral institutions PR would have emerged only by mistake. But employers and the right deliberately chose PR because of the opportunities this representative system created for collaborative arrangements with labor in which common interests, especially in the regulation and expansion of specific human capital, could be effectively attended to. Once in place, PR and center-left dominance undoubtedly increased redistribution beyond the ideal point of employers, but it was a price they were willing to pay to realize the economic potential of their enterprises.

2. The positive relation between distributional equality and redistribution.

In this section we argue that the positive correlation between distributional equity and redistribution is not the result of a direct causal relation (one way or the other). As noted

above, the best known candidate causal explanation, Meltzer-Richard, implies a negative correlation. Moene and Wallerstein (2004) derive a positive relation based on an insurance argument, but though elegant it rests on an implausible assumption[4].

Instead we suggest that two factors, the extent of consensus in the political system and the degree of non-market economic coordination, have both impacted in similar ways on both distribution and redistribution. As we illustrated above, and as Gourevitch has documented in greater detail, political systems with proportional representation (PR) are strongly correlated with coordinated market economies or CMEs (Gourevitch 2003). In the next section we sketch an historical account of why that should be so. Here the focus is on the relationships between PR and coordination on the one hand and distribution (D) and redistribution (R) on the other. The argument follows the rough causal sketch in Figure 3.

[Figure 3 about here]

2.1 Coordinated Economies

The more the organization of firms and economic institutions facilitate the coordination of economic activity, especially wage-setting and skill-formation, the more likely the political economy is to promote both distributive equality and redistribution. We look at two mechanisms through which this occurs and which have been the subject of considerable research.

2.1.1 *Social policy preferences and Redistribution.* There is a substantial amount of literature which argues that one of the comparative advantages of CMEs is that they provide incentives for employees and companies to invest in industry, occupation and/or

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[4]
 Moene-Wallerstein assume that benefits are targeted to the non-employed and that risk aversion is sufficiently high for the relationship between income and preferences for spending to be positive in the relevant interval around the median voter.

company specific assets. A key condition for employee preparedness to make such investments is that there are adequate protections in the event of company or industry failure. As argued in Estevez-Abe et al (2001), some combination of three types of protection are directly involved: First, wage protection is needed to guarantee that relative earnings in the industry or occupation do not fall; this protection normally takes the institutional form of coordinated wage bargaining[5]. Second, employment protection reduces the likelihood that companies dismiss employees. Third, unemployment protection in the form of high replacement rates and conditions on acceptable reemployment is important, and the more so to the extent that company level employment protection is reduced. Of these three protections the third, protection of income in the event of unemployment, impacts most directly on redistribution, and it can be conceived more broadly as a protection of income not only when workers are forced into unemployment, but also into jobs where there skills are not fully employable. Any social insurance system that helps maintain a certain level of expected income regardless of adverse employment conditions – including health insurance and public pensions -- serves as a protection of specific skills (Iversen 2005).

There is an important contrast here with LMEs, especially in the last 30 years. The institutional framework in LMEs has not permitted major programs of investment in specific skills. Vocational training, whether in professional schools (law, engineering) or community colleges, provides relatively general skills which enable movement across company and industry boundaries as well as retraining. And while skill-specificity and consequent long tenure in CMEs can eliminate mid-career labor markets, labor markets in LMEs are becoming more flexible over time. Portable skills mean that employment insecurity is less of a concern, and that more people can use their market power to demand adequate insurance against illness and old age.

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[5] We shall see that this is not the only use of coordinated wage bargaining.

Business social policy preferences and Redistribution. Governments decide on replacement rates. In doing so they respond to pressure from organized interests. Unions will naturally support unemployment protection. But against widely held views, the pioneering work of Peter Swenson, Cathie Jo Martin and Isabela Mares has provided a wealth of historical evidence that employers are not necessarily advocating a minimal welfare state (Swenson 2002; Martin 2000; Mares 2003). In CMEs the combination of strong employer organizations and their acceptance of the case for non-minimal replacement rates has meant that there is a floor to replacement rates as well as duration of benefits. There may be more than one reason why employers should want non-minimal replacement rates. We will rest here with the argument that they are necessary for persuading employees to invest in deep specific skills. Of course, actual replacement rates are also influenced by government partisanship; as will be seen, CMEs tend to have more than average left of center governments; so business associations in CMEs may well call for reductions in replacement rates. The critical point is that organized business in CMEs has not engaged, nor had the motivation to engage, in promoting the wholesale dismantling of the welfare state.

Organized business in LMEs has played a different role[6]. Concerned to promote unilateral management control within companies, its interest has been in flexible labor markets and weak unions. For both reasons, having a minimal welfare state has been important to it. However, organized business has been weaker in LMEs than in CMEs. This reflects the lack of business coordinating capacity in LMEs. It also reflects, as we will see, political systems based on majoritarian elections and single party government, which undermines the incentives of parties to cater to business interests (Martin 2006). Thus, although business has been anti-welfare state in LMEs, its impact has been blunted by its lack of political power. The exception is the US, where weak party discipline and power-sharing between executive and legislature enable business to effectively promote a minimal welfare state agenda through individual congressmen.

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[6]
   At least in recent decades, though see Swenson for the US in the interwar period.

Voters' social policy preferences and Redistribution. Employees with specific skills have an interest in wage and unemployment protection, and insofar as skills are firm-specific also in employment protection. In Iversen and Soskice (2001) we show the relatively weak conditions (especially risk averseness) that have to be satisfied in order for specific skills workers to vote for more redistributive spending at given levels of income. Using ISSP comparative surveys we show that this is indeed the case. In so far as CMEs encourage investment in specific skills, therefore, we expect voters in CMEs prefer higher replacement rates than voters with equal incomes in LMEs. This translates into higher actual spending and redistribution if political parties are able to commit to long-term platforms that insure currently employed workers (who are more likely to be politically decisive) against future loss of income. As we argue below, such commitment capacity tends to be greater in PR electoral systems where, unlike majoritarian systems, winning the next election is not everything, and where parties can ally themselves openly with groups (such as unions) that promote long-term social spending (see also Iversen 2005, ch. 4). The empirical correlation between vocational training activity (as a measure of specific skill) and redistribution through taxes and transfers is illustrated in Figure 4.

[Figure 4 about here]

2.1.2 *Coordinated/centralized wage bargaining and Distribution.* Why should coordinated economies be more associated with egalitarian distribution of income? The basic argument is that coordinated economies encourage collective and coordinated wage bargaining, and that collective, centralized and coordinated bargaining leads to more egalitarian outcomes (Wallerstein 1999; Rueda and Pontusson 2000). The relationship is illustrated in Figure 5.

[Figure 5 about here]

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The explanation has several components. Coordinated economies privilege bargaining procedures in which the locus of bargaining is above the company level, so that there can be some degree of coordination across bargaining units. There are two reasons for this. The first is well known and related to the macroeconomic need for a competitive real exchange rate. The second links to the insurance function of "wage protection" for employees with deep specific skills at the company and/or industry level. If workers are to focus their investment in human capital in specific skills they need some guarantee that their earnings will not drop dramatically relatively to those of other occupations. Hence the support of skilled unions for wage coordination across different bargaining units (or for centralized wage bargaining).

The next question is then why coordinated bargaining should lead to a more compact distribution of earnings. One reason has to do with the nature of union bargaining, which has been shown to lead to more compact distributions (Freeman 1980). Loosely speaking, effective bargaining requires that union threats of action are credible; this in turn requires that there is wide support within the bargaining unit for the union's position; and in turn that the bottom half of the workforce are not unrewarded. Another way of phrasing this is that unions representing different income groups have to consent to the bargaining proposal of the union central before it can be effectively advanced to employers. This gives low wage unions the capacity to demand their fair share of any agreement, as long as low-skilled labor is a complement to skilled labor in production (Iversen 1999). The more centralized the wage-bargaining, the more encompassing the bargaining unit, and the more compact the resulting distributional outcomes (we will address recent changes in collective bargaining institutions in section 4).

The second reason is this: Suppose that all that coordinated bargaining did was to keep relativities constant, so that if N individuals start off with real wages [$w_1, w_2, \ldots, w_N$], they will have real wages [$kw_1, kw_2, \ldots, kw_N$] after a certain period of time. Now imagine a decentralised system starting off with the same real wage vector, and that the wages of each individual after the same period are drawn from a non-degenerate random distribution with mean kw_i. Then the distribution of the second group will be wider than

that of the first over time since some will have wages below kw_1 and some above kw_N.
Thus, the equality of the distribution of individual incomes will depend on the degree of
coordinated wage bargaining.

2.1.3 *Summary.* CMEs have had positive effects relative to LMEs on both the extent of
redistribution and the degree of distributional equality. Both voters and business in CMEs
have interests in higher replacement rates on average. And business has a more substantial
influence on government in CMEs via corporatist arrangements. As Moene and
Wallerstein (2003) have emphasized, we need to more pay attention to the insurance
function of the welfare state rather than simply the redistributive function. That is the
argument in **2.1.1**   Because CMEs have a comparative advantage in the creation of
specific skills, there is an insurance need for high replacement rates,[7] and these in turn
reinforce the comparative advantage of companies in international competition.

CMEs equally have more centralized and coordinated wage-bargaining than
LMEs. An important reason for this is the insurance function which wage protection offers
those with specific skills who get locked into companies or occupations. Moreover CMEs
need effective employee representation at the plant and company level (Hall and Soskice
2001); but this raises the danger of competitive wage-bargaining in the absence of
centralized and/or coordinated unions. And for reasons explained in **2.1.2** the more
centralized is collective bargaining the greater the distributional equity.

2.2 PR Political Systems

As Gourevitch has pointed out, and as Figure 1 above illustrated, electoral systems with
proportional representation are closely linked statistically to coordinated market
economies (Gourevitch 2003). In section **3** we seek to explain why that is the case. In this
sub-section we discuss the consequences of PR systems for distribution and redistribution.

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   The insurance function operates of course in LMEs as well, but with a greater weight of general skills
less insurance is needed.

Three linkages from PR to R and D seem of particular importance. In the first place, PR electoral systems in advanced economies have a bias towards left of center governments over the period since the Second World War; this is almost the inverse of majoritarian systems (see Table 1). We sketch in **2.2.1** an analytic argument as to why this may be the case and why it will lead to an increase in redistribution. The second linkage is via the educational system. Standard microeconomic theory says that the relative wages of two individuals will be equal to the ratio of their marginal productivities, absent any influences which might result from market imperfections, including collective bargaining. Since the ratio of marginal productivities is closely related to the human capital ratio, the distribution of educational attainments will play a large part in determining the underlying distribution of earnings from employment. We show in **2.2.2** that the electoral system is correlated with the educational attainments of low income groups and argue that there is a good reason why this should be the case. Finally, as we explain in section **2.2.3**, PR encourages voter turnout and facilitates a better understanding among the poor of their economic interests. This reinforces the effects of PR on education and redistribution.

[Table 1 about here]

2.2.1 *Electoral systems and redistribution: the PR bias towards center-left governments.* Table 1 shows the data on government partisanship in advanced economies between 1945 and 1998, derived from Cusack and his associates (Cusack and Engelhardt 2002). The scale is a composite index of three expert surveys of the left-right position of political parties in each country. The partisanship of the government is a weighted average of the ideological position of each party times its proportional share of government seats.[8] Note we compare this measure to the position of the median legislator (which is defined as the left-right position of the party with the median legislator). This should take account of any factor that may shift the whole political spectrum in one direction or another – such as

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[8]

   We excluded governments that were coded as centrist by the one expert survey (Castles and Mair) which explicitly identified parties as such.

the possibility identified in section **2.1.1.** that the demand for "left" policies is greater in specific skills countries.

What accounts for this surprising relationship? We sketch out here an argument developed in detail elsewhere (Iversen and Soskice 2006). There are three income groups in an economy, L, M and H. Under PR there are three parties, *L, M* and *H,* each representing one of the groups and sharing the respective group's goals ("representative" parties). *M* is formateur and has to choose a coalition partner. The key intuition is that a party is less capable of looking after its interest if it is excluded from the coalition. Since *M* benefits more from taxing an unprotected *H* than from taxing an unprotected *L*, *M* will choose *L* as coalition partner. This can be modeled in a number of different ways; the only bargaining structure which is excluded is a take-it-or leave-it offer from M^9. The basic point is that it pays *L* and *M* to form a coalition and take resources from the excluded *H* party, rather than *H* and *M* forming a coalition to take resources from an excluded *L*. Thus the upshot is that PR systems tend to privilege center-left coalitions and that such coalitions redistribute more than center-right coalitions.

Majoritarian systems operate quite differently. The three parties are replaced by two, a center-left (*LM*) and a center-right (*MH*) party, both competing for M. If both parties could commit to an M platform, then each would win 50% of the time. But they cannot: M electors believe that there is some possibility that an *LM* government will be tempted to move left and an *MH* government to move right. The fundamental bias in majoritarian systems arises because, ceteris paribus, M has less to fear from an *MH* government moving right than from an *LM* government moving left. Under reasonable assumptions the former leads to lower benefits going to M but also to lower taxes on M, while the latter implies higher taxes on M with the proceeds redistributed to L. Parties will try to deal with this problem by electing strong leaders who are willing and capable of

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  If *M* can make a take-it-or-leave it offer, it can enforce M's ideal point on either *L* or *H.* But this is not the reality of most coalition formation where counter-offers are invariably both made and considered.

ignoring the pressures from the party base ("leadership parties"). But platform commitment can never be complete.[10]

Note that the insights of this model are completely lost in one-dimensional models such as Meltzer-Richard's, or indeed power resource theory. The reason is that these models artificially imposes a symmetry on the distributive game where the interests of M are always equally well aligned with the interests of L and M. With three parties in a PR system this means that M is equally likely to ally with H as it is to ally with L. Likewise, in a majoritatian system, any deviation from an M platform is equally threatening M whether it comes from the center-left or the center-right party (e.g., the center-left party is forced to share with M even if L sets policies).

There is one important qualification to our argument. The center-left bias of PR systems is less pronounced in countries with large Christian Democratic parties. Among the latter, the proportion of center-left governments, measured as in Table 1, reduces to 57 percent, whereas it is 63 percent for the sample as a whole. This also implies that for PR countries without strong CD parties, notably Scandinavia, the center-left advantage is more pronounced: 71 percent. The reason for this difference, we believe, has to do with the cross-class nature of CD parties. Because these parties include constituencies from L, M, as well as H, differences in distributive preferences between these groups has to be bargained out within the party. This produces a more center-oriented platform than we would usually associate with a center-right party, and this in turn makes CD parties more attractive coalition partners for "pure" center, or middle class, parties. The logic that leads center parties to ally with the left is therefore broken, and in countries (such as Germany and Italy) where CD and center parties have at times been held a majority of seats, the influence of the left has been reduced. Where such CD-center majority coalitions have not been feasible, as has often been the case in Belgium and the Netherlands, we observe frequent coalitions between CD and left parties, producing a unique blend of policies

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[10]
    Note that since the *LM* party is at an electoral disadvantage it has a greater need and incentive to elect centrist leaders than the *MH* party . If this holds, the distribution of wins and losses will be more even, but the political spectrum will be shifted to the right. The contrast between the centrist Clinton and the rightist G. W. Bush is a case in point.

where transfers are high and redistributive, but some of these nevertheless are directed to those with high incomes (H).

2.2.2. *Electoral systems and educational outcomes.* The center-left bias in PR systems increases redistribution of income towards lower income groups, by comparison with majoritarian systems. If so, electoral systems will also affect the distribution of educational spending, and educational outcomes in turn affect the distribution of income. Center-left governments have an incentive to spend more on L's education than do center-right or middle of the road governments in majoritarian countries. And they have a lesser incentive to spend on H's education. The model in Iversen and Soskice (2006) assumes that policies are limited to redistributive transfers. But a similar argument can be run with the three groups competing for expenditure on education for their own group. Indeed, if H opts for private education, and if there are positive externalities for M from educational expenditure on L (for example, economies of scale in school buildings), then *M* has an increased incentive to opt for an *LM* coalition[11].

Ansell (2005) has recently documented that left governments spend relatively more on primary education than right governments, which benefits low income groups more than high income groups. Boix (1998) has likewise shown that the left governments spend more on public education than right governments. Ansell also demonstrates that similar effects can be attributed to PR electoral systems.

The limitation of these results is that they do not speak directly to the skills acquired by students, which could vary with the effectiveness of educational institutions across countries. However, the OECD has run an international adult literacy survey in the years 1995-8 (OECD 2000), which does consider more directly the level and distribution of skill acquisition. We confine our attention to the advanced economies included in the

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[11]
    Though note too that this weakens the center-right bias in majoritarian systems, since a left deviation is less frightening for M.

survey.[12] The survey conducted three tests, testing writing, comprehension and quantitative skills. Figure 6 summarizes the results. The top bars (using top scale) show the percentage of adults who have not completed an upper secondary education but have high scores on document literacy. The bottom bars (using bottom scale) show the percentage of adults taking the test who get the lowest score, averaged across the three test categories.

[Figure 6 about here]

Compared to majoritatian systems at the top of the figure, it can be seen that the PR countries have far fewer adults who get the lowest scores, and they also tend to produce higher scores among those with little formal education. There is therefore a prima facie case that the electoral system is an important determinant of the compactness of the skill distribution. Since PR and coordination are co-linear, it is of course also possible that the pattern is related to the prevalence of vocational training in CMEs. Indeed we argue below that this is likely to be a reinforcing factor.

2.2.3. *Electoral systems, turnout, and political knowledge.* It is an interesting fact that when PR and government partisanship are both used as explanatory variables in a regression with redistribution as the dependent variable, PR exerts a direct positive effect in addition the effect that goes through partisanship (Iversen and Soskice 2006). It is as if the entire political spectrum under PR is shifted to the left. One reason may be that PR is associated with higher voter turnout (Franklin 1996, 2004). Since abstention is concentrated among the poor, higher turnout means that the preferences of the poor are likely to be accorded greater attention by elites (Lijphart 1999). But those who have an economic interest in redistribution are not always cognizant of that interest, and they do not always vote to advance it (Bartels 2004). In addition to voting, people must therefore

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[12]
   Flanders have been included for the sake of completeness, but it is likely that linguistic ability among adults is limited as a result of internal migration.

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also actively seek an understanding of their own economic interests. It is therefore significant that the distribution of political knowledge has also bee found to be more egalitarian in PR systems (Abrams 2004).

What explains this effect of electoral system on voting and political knowledge? This is a fundamental question for political economy because it speaks to two issues that are at the heart of any understanding of democratic capitalism: why some people acquire costly information about politics when we would expect them to be "rationally ignorant," and why some people vote when we would expect them to "rationally abstain" (Downs 1957). Both puzzles spring from the fact that individuals are rarely able to affect the outcome of an election, and therefore have no incentive to spend time and effort participating in it.

We have argued elsewhere that the solution to these puzzles lies not in what voters want from politicians, but what they want from the people who really matter to them: their friends, family, neighbors, and colleagues (Abrams, Iversen, and Soskice 2005). People do not acquire information and go to the polls, we argue, because they are particularly dutiful (as many have argued) or because they are fooled into thinking their vote matters (as others have argued). Rather, they do so because such behavior is sometimes an important source of respect and standing in the groups and networks to which people belong. Most people have a strong desire to participate effectively in the discussions and activities of the groups to which they belong, and once these discussions and activities turn to politics, knowledge about politics and willingness to act in the collectively defined interest become a key marker for the relative standing of individuals in the group. People's welfare – in the very tangible sense of how much others respect and value them – can therefore become defined in part by their knowledge and participation in politics.

Organized groups and political parties understand the functions of networks in motivating people politically, and they will try to make use of these networks for political ends. Political parties and groups can use their local presence to try to shape the agenda through face-to-face contacts and by initiating discussions about political issues. The intensity of such behavior will increase around elections, but the hot political issues of the

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day can, and do, find their way onto the agenda between elections. Contacting people in localities that are likely to be responsive to the political message is one method. Making use of party or group members, or sympathizers, who can take on the role of "opinion leaders" is another.

The implication of this argument is that political information and participation vary with the strength of collective organizations such as parties, unions, and churches. Such organizations tend to be strong where economic activities are highly coordinated and where agents have made heavy investments in co-specific assets – in CMEs in other words. The importance to politicians and groups of mobilizing voters is also likely to vary with the electoral system. As we have just suggested, in majoritarian two-party systems the need to convince the median voter that leaders are credibly committed to a centrist platform means that parties cannot appear to be too beholden to the interests of their more extreme constituents. They *do* have an interest in getting these voters to turn out, of course, but parties cannot create strong party organizations around these voters if this is seen by the larger electorate to tie the hands of political leaders. If they did, any pronouncement of centrist platforms would be discounted by the median voter.

Multiparty PR is different because representation does not depend on capturing the median voter. Parties are therefore free to mobilize more narrowly-defined segments of the electorate – subject to the constraint that too narrow targeting will invite the formation of new parties and undermine the attractiveness of the party as a potential coalition-partner in government. The incentive to represent relatively narrow interests has to be weighted against the potential costs of fragmentation and marginalization in the legislative arena. Still, multiparty PR is far more conducive to the mobilization of narrowly defined interests than two-party majoritarianism, and no group is likely to remain un-represented if such groups can support the existence of a party. Compared to majoritarian systems, parties are likely to have stronger party organizations and less autonomous leaders. The result is that participation and political knowledge in PR systems tend to diffuse to those who have a strong interest in redistribution.

3. Patterns of industrialization and representation in the late 19th century

PR systems and CMEs explain at least partially both distributive equality and redistribution, with the qualification we noted concerning Christian Democracy. In turn, PR systems are strongly positively correlated with CMEs. It is this correlation that is the focus of this section.

Specifically, we need to answer the following set of questions. First, what explains why some countries adopted proportional representation in the early 20th century? Second, why had the same countries developed at least proto-coordinated institutions at the national level by the same period? And third, what explains the different coalitional patterns across these same PR countries – dividing roughly the Scandinavian from the Continental (Christian Democratic) welfare states? One country is difficult to place, France. So a fourth issue to explain is French exceptionalism.

In answering these questions we claim that it is economic interests that are the ultimate drivers. In doing so we go against the accepted wisdom of comparative political science of the last thirty plus years: Since Rokkan's analysis of 1970 (Rokkan 1970), Cusack et al. (2007) is the only serious challenge to the view that social cleavages (religious, territorial and ethnic) explain PR. And since Esping-Andersen's analysis in 1990 (Esping-Andersen 1990), it has been further accepted that these same cleavages, in particular the religious, help explain patterns of welfare states. We believe that this reflects a failure of both political scientists and historians to work on the bridge between party politics and the economic interests embedded in production systems. Two of the books on which we rely on most to make our argument are Thelen (2004) – on the development of training systems – and Herrigel (1998) – on decentralized production regions. Yet neither of them mentions party politics, nor religion. The exceptionally useful book edited by Manow and van Kersbergen (2007) on religion and the welfare state focus on the role of political parties and religion, but it largely neglects detailed discussion of production

systems. Linking the development of parties with the representation of economic interests will be the subject of this section.

3.1. Economic interests and systems of representation

Following Cusack et al. (Cusack, Iversen and Soskice 2007) we stress the need to analyze PR systems more broadly than has been customary. Two quite different analyses of PR are put together in that article: on the one hand, PR has been analyzed by Huber and Stephens (2001), Iversen and Soskice (2006), Manow and van Kersbergen (2007), and implicitly by Baron and Ferejohn (1989), in terms of minimum winning coalitions. By contrast to this *exclusionary* view of politics, a quite different *inclusionary* approach, that of "consensus" bargaining, has been promoted by Lijphart (1984), Crepaz (1998), and Powell (2000), among others. Here we follow Cusack et al (2007) in arguing that PR systems typically embody both approaches. But they deal with different policy areas: The minimum winning coalition determines distributive outcomes, so that after PR adoption what matters for the redistributive aspects of the welfare state is the governing coalition. We argued in the last section that PR will be biased to the center-left, though we also noted how a centrist coalition involving a CD party might exclude the social democrats and thus generate a welfare state with less redistribution. The precise nature of coalitions is discussed further in the third part of this section.

The consensus aspect of PR is reflected *inter alia* in the strength of opposition parties in legislative committees. This relates to regulatory politics if there is general agreement that a wider range of interests, represented by government and opposition parties, should have a role in decision-making. Our basic contention is that this arises in economies in which investments in co-specific assets are important (Iversen 2005). This is the case, as for example, in major schemes of vocational training, when many different agents (workers, companies, unions, business associations) make serious investments which depend upon commonly agreed regulatory frameworks. Under such circumstances political systems which can systematically exclude particular interests (as is the case under

majoritarian systems) are inimical to the development of co-specific assets and institutions to regulate these. The last part of the 19th and the first part of the 20th century was a period of intense economic institution building at the national level, so that these issues were of great importance for the construction of the political system.

The core argument of this section takes industrialization as the key independent variable. Through the period local economic networks developed into national networks, just as simultaneously labor moved into industry from agriculture and artisanal or unskilled pre-industrial work in the towns. At the same time entrepreneurs and financers grew up both from the bourgeoisie and perhaps state officialdom and from small scale artisan owners and farmers and independent peasants.

The argument rests on the quite different impact industrialization had on economies depending on two related dimensions of those economies: one that refers to the organization of production and one that refers to the organization of the state. Specifically, we observe the following patterns across these dimensions:

i) Pre-industrial rural and urban local economic system: All the states which subsequently emerged as PR/coordinated states had locally coordinated rural and urban economies with some mixture of rural cooperative and regulated artisan systems; peasants owned or had tenure over their land. We will argue that both Scandinavian and Continental states apart from France fit into this description; and that their differences arise from the nature of rural and urban production systems in the two areas. By contrast, those states which emerged as majoritarian/liberal had large independent farms and landless agricultural labor and weakly- or unregulated artisan systems.

ii) The pre-existing structure of the state: All the states which subsequently emerge as PR/coordinated states were originally Standestaaten, with functional representation of economic interests, while none of the Majoritarian/liberal states were. Differentiating between these three basic cases allows us to explain the origins of liberal, continental and Scandinavian systems, the task of the following three sections.

3.1.1. Liberal economies and majoritarian political systems. In the liberal case (see Figure 7) local economies were relatively uncoordinated historically: guild traditions were weak and their power limited or non-existent; the acquisition of craft skills was haphazard, formal certification did not exist and the supply of craft skills was relatively low; equally in agriculture, farming was dominated by large farmers, so the agricultural labor force was largely a dependent one of landless workers; with some exceptions an independent land-owning peasantry did not exist.

[Figure 7 about here]

The consequence of these local arrangements was twofold. The absence of local coordination implied an absence of major areas of co-specific assets. Hence as local economic networks became regional or national, there was no corresponding push to develop coordinating mechanisms at the national level to manage investment in co-specific assets by different economic groups.

The second consequence was that the industrial labor force as it developed could not call on a major pool of craft workers, nor was there an available mechanism for training. The industrial workforce in these liberal economies was relatively unskilled. This had a major effect on the form which unions took: Since it was almost impossible in this pre-Fordist world to build effective unions from unskilled workers, unions were explicitly craft-based.

Union strategies also depended on the organization of employers. The political structure of the liberal state was anti-corporatist. Thus businesses found it difficult to develop strong self-disciplining associations. This meant that businesses were nervous of investing heavily in training workers in transferable skills. Because employers associations could not sanction individual employers who stepped out of line, it was not possible to force unions into becoming highly disciplined bodies themselves, with whom they might negotiate on a long-term basis. Instead the interest of craft unions was to control/reduce the supply of skills to increase their bargaining power and control job content within

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companies to prevent dilution of skill needs by substitutions of unskilled labor. Because union discipline was not easy to maintain, craft unions were at risk of fragmentation, especially where labor market conditions were heterogeneous. This reinforced the political interest of employers in deregulated labor markets, minimum welfare and unemployment benefits in order to weaken the power of unions. Industrially it favored the introduction of technologies which reduced the need for skilled labor.

The consequence of these mutually reinforcing centrifugal incentive structures between unions and employers during this critical formative period for labor market arrangements was to place the liberal economies firmly into the zero-sum game, or minimal winning coalition, camp. Business had no pressing need for a consensus political system which would enable or endorse the bargaining out of an institutional framework of regulating labor markets and skill formation.

This lack of business and union interest in participation in cross-class collective action to develop a certified system of skill formation, and the prior inability of either unions or business to coordinate to solve collective action problems in a sustained way, impacted directly on the political system. In the first place such legislation as there was (in the UK Factory Acts regulating in particular women and children's work and safety) was designed to be enforced by the state through inspectors and ultimately through the courts. Much of this (low cost) legislation probably reflected the view that the unskilled working class could be controlled by women staying at home and providing a modicum of moral education to their children.

The second implication is more interesting. The split of interests between skilled workers and unskilled workers meant that the working class representation developing during this period paid no attention to skills or to the socialist notion of a unified working class (by contrast to the social democratic parties of the continent). Typically labor had a partial representation within other parties at the national level; in this, craft unions played a significant part in order to prevent or minimize anti-union legislation; while there were small socialist organizations (ILP, IWW, Knights of Labor) they were without great influence; and these parties kept skills and training off the agenda, devolving it to the

market place. Thus politically, labor was not a unified working class in national politics. It was highly segmented, and earnings differentials between craft workers and those in the large underclass (the "great residuum" as it was known to the late Victorian middle classes in London) meant that the aristocracy of labor was unlikely to vote for redistribution to the poor.

To summarize the argument in relation to the liberal economies: Political parties in these countries chose to remain majoritarian in the early 20th century and there was no move to coordinated industrial unionism or strong business associations. Proportional representation made no sense to business, to landed interests or the middle classes: On the one hand, as we have seen, business was uninterested in representation in a consensus political system since it did not want to engage with unions in building a regulated industrial relations and skill formation framework. Moreover, there was no serious artisan or independent peasant constituency (as in Scandinavia or on the continent at this juncture), let alone one capable of demanding representation in a consensus political system. This reflected the lack in all of these sectors of major investments in co-specific assets and hence the need for national bargaining environments. On the other hand, majoritarian elections were safe from the point of view of income redistribution: it forced those parties which represented in one form or another lower income groups to pay attention to skilled workers and lower middle classes if they were to win seats. Przeworski and Sprague (1988) point out that the industrial working class never held a majority of votes; but even that did not matter if the working class was fragmented and the electoral system majoritarian.

It is appropriate to finish this section by noting that across the Anglo-Saxon world at this time there were deeply important *social* cleavages. There were religious cleavages in England (between the dissenting churches and the Anglican established church), in the US between Catholics, Anglicans and Lutherans, in Australia between Catholics and Anglicans, let alone in Ireland. Moreover in both New South Wales and Ireland Catholic education had been sharply attacked. There were major ethnic divisions in the US, Ireland and Australia. And, within the right, England was divided socially, religiously and

territorially, between the dissenting, urban, industrial class and the Anglican, rural, landowners and tenant farmers. None of these divisions played a role in hindering the continuation of majoritarianism. Our argument is that these social cleavages did not cover important co-specific asset groups which demanded to be included in consensus representation at the national level in the early 20th century as industrialization pushed economic networks up to the national level from the regional and the local.

3.1.2. Continental States: Proportional Representation and Coordination. We now turn to explain the adoption of PR and economic proto-coordination in the continental states during the period of the late C19th and early C20th. We also want to explain the post-PR adoption pattern of coalitions: in these states, the Christian Democratic party played a major role in most coalitions, generating a particular welfare state as discussed earlier – so-called catholic or conservative or continental welfare states. (The French welfare state has much in common with this, but its genesis is quite different. So it is excluded from this group of states and analyzed later).

The broad historical functioning of this group of countries is set out in Figure 8. The first major difference in the starting points from those in the liberal economies in Figure 8 relates to agriculture and urban economic life. Both peasantry and artisans operated within locally coordinated frameworks. Peasants owned or had strong tenure on their land, and the artisan urban sector was formally or informally regulated[1]. Moreover there was substantial skilled artisanal and small-scale industrial work in the peasant countryside. This is also true of the Scandinavian states to be discussed in the next subsection. Indeed the important common consequence for all these non-liberal states – continental and Scandinavian – was that more or less effective and more or less formalized artisanal training systems existed. These implied that a larger proportion of the work force

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[1] There are exceptions on land ownership, including East Prussia and the Mezzogiorno, as well as the Ruhr region in W Prussia. In all these economies guild organization had been traditionally strong, and had in some cases transmuted into functionally equivalent forms under the impact of transforming liberal regimes.

had craft skills than was the case in the liberal economies. Thus industrialization in all these economies could draw on a potentially large supply of skilled workers.

This had in turn, as Thelen insightfully noted, major implications for the development of union strategies. For, while unions initially developed along craft lines, they could not build strategies based on the control of the supply of skills since these were monopolized by the artisanal sector. Nor, given that unions could not control how craft skills were defined, could they build strategies based on the control of job content. In both continental and Scandinavian economies, therefore, union strategies developed differently from those of craft unions in liberal economies. For companies to use skilled workers effectively required that workers behaved cooperatively and without costly monitoring; for then skilled workers could be given responsibility, and there would be no danger to the company of hold-up. Thus union strategy gradually evolved into one of offering cooperation in exchange for collective bargaining. This in turn required that unions were in a position to discipline their members effectively.

It also required that companies did not have better alternative ways of gaining workforce cooperation. Most companies were initially deeply hostile to unions. And large companies had an alternative strategy for securing cooperation, namely segmentalism (Swenson 2002). Segmentalism was in particular effective when the proportion of skilled workers was low and when their skills could be specifically shaped for the company so that they could be given special conditions (tenure, a company welfare state) which made their cooperation worthwhile. By contrast union involvement appealed more to smaller companies which wanted to develop standardized industry skills, and which operated with a larger proportion of skilled workers.

Here a second exogenous factor enters the argument. Governance in the continental and Scandinavian states derived from a Ständestaat tradition in which government operated partially through groups (estates); the Ständestaat can be thought of as at the origin of neo-corporatist regimes (Crouch 1994). Thus little constraint was put on associational activity in developing industries – putting them in line with the way in which handwork and agriculture was organized. This is in turn reflected in the different

ways in which liberalism was interpreted outside the Anglo-Saxon world and France in the 19th century.

As Swenson has argued, organized industry in these economies put strong pressure on unions to structure themselves so as to be able to discipline their membership (Swenson 1991). This was the price which the unions had to pay for representation and collective bargaining. Thus unions centralized, even if internally they remained organized across crafts until the 1920s or later (Kocka 1986). Moreover, as skill formation in industry became part of the industrialization agenda the unions and industry became the representative partners in massive investment in specific assets; with such investments came the need for related developments in the welfare state and employee representation within the company. While many of these positive-sum issues were primarily negotiated out between industry and unions, they were also put into legal frameworks. For this reason business and the unions were deeply concerned to be represented politically in a consensus-based regulatory process.

Thus the right representing business had a strong reason to favor proportional representation, even if it could see that a majoritarian system would focus on the redistributive needs of the middle classes and thereby push out the redistributive claims of low income groups. For business had no guarantee that the median voter would support the sweep of labor market and training arrangements that it wanted, or that the unions would be cooperative in such a setting.

These developments also had profound implications for the political left which led social democracy to have different strategic interests to left parties in liberal states. For social democratic parties in both continental and Scandinavian countries represented the whole working class in ways which for example the British Labour Party did not. This was because they were interested, as were their social democratic union counterparts, in extending skills throughout the working class. Yet this strategy was hardly compatible with a majoritarian electoral system: for a social democratic party would be unable to pursue an egalitarian strategy with any hope of capturing middle class voters. Thus the political left in non-liberal countries had a double interest in proportional representation: it

could be a part of minimum winning coalitions without having to focus on middle class voters, and it allowed the indirect presence of unions – representing co-specific skilled workers – in a consensus-based regulatory framework.

Continental countries differed from the Scandinavian in one key respect. In the continental countries the peasant dominated countryside was *more closely integrated* into the urban economies than in the Scandinavian (Herrigel 1996, Katzenstein 1985). If the formerly strongly feudalized areas mentioned in footnote X are excluded, something like this pattern seems to be traceable a long way back in history; and Hechter and Brustein use the term "petty commodity production" areas to describe it (Hechter and Brustein 1980). While a great deal more work is needed to pin down the connections, these areas seem clearly related to the decentralized production regions identified by Herrigel in South and West Germany, and we will retain this term (Herrigel 2000). Herrigel pointed to the most notable of these districts in Germany, but we can imagine that on smaller scales they were widespread, and throughout the areas of western Europe where autonomous urban centers had dominated non-feudal surrounding country-sides. Guilds were sometimes but not always integrated in these networks, and there was substantial putting-out of work to small farms; there was also significant development of rural artisans; most generally the production process of goods could be spread over many different locations. As Herrigel makes clear, these urban-rural networks are complex co-specific asset groups:

> 'The [producers] are absolutely dependent upon one another…they essentially engage in highly asset-specific exchanges every time they engage in an exchange…Producers in the decentralized industrial order are part of a thick network of specialized producers that is much more than the sum of its parts. The institutions they create to govern their activities … constitute important fora to engage in negotiation and to establish understanding regarding…their individual and collective interests.' (Herrigel, 29, 1996)

These regions were by no means universally catholic. In Germany neither Saxony (pre-1871 Kingdom), nor North Wurttemberg were catholic, though most of the other areas of decentralized production, covering the south and west of Germany seem to have been. In Switzerland there were some predominantly strong rural cooperative cantons, but all were protestant (Rokkan 1970). Austria and Belgium were largely catholic countries. In the

Netherlands the catholic community was separated economically and socially from the protestant, and urban-rural networks characterized both. What is important for our argument is the assumption that in broad terms many of these networks were confined to catholic areas: this reflected the fact that religion had been largely a state choice as a result of the Peace of Westphalia.

So how did these urban-rural networks lead Christian Democratic parties to emerge as supporters of PR, key coalition partners after PR, and in many respects architects of a particular form of welfare state? We want to argue against a view which is somewhat caricatural (a mixture of Rokkan and Korpi) which goes as follows: (1) The *Kulturkampf* against the Catholic church led to a deep division between Catholics and other social forces in the continental states discussed in this sub-section. The Catholic church mobilized Catholics to defend Catholic institutions which were under attack, in particular Catholic education. Catholic parties were founded and priests told their parishioners to vote for them. This repulsed the Catholic threat. (2) So deep was the distrust by Catholics for non-Catholics on the right, that though both groups were anti-socialist they were unable to combine in a single right-wing political movement. Therefore right-wing parties chose proportional representation. (3) Catholics now became part of governments and Catholic politicians under the influence of the church chose a welfare state to prevent the rise of socialism, and to promote Catholic values of the family (transfer payments to women to provide family-based social services) and national conciliation through corporatist institutions (earnings-related insurance schemes). These were set out in papal encyclicals.

Here is what we believe happened instead. Christian democratic parties did indeed emerge from the *Kulturkampf* in the continental countries (though not from any hierarchical enthusiasm, as Kalyvas shows). But Kulturkämpfe were not sufficient: CD parties did not emerge in either France or the then independent self-governing crown colony of New South Wales in both of which catholic education was fiercely attacked by their respective governments. Our argument is that a necessary condition for founding a

highly organized Christian Democratic party was that the Catholic adherents were already members of organized groups. This was the case in neither France nor New South Wales. New South Wales as a liberal economy had traditions in autonomous locally coordinated economic groups, nor for reasons related to the role of the State did France. In New South Wales there was no local economic coordination, and where there was in France, it was not autonomous[2]. (Our argument is consistent with, but quite different from, Kalyvas's argument for French non-formation.)

This necessary condition that Catholics were members of economic organizations whose *raison d'être* persisted can, more importantly, explain why Christian Democratic parties remained strong long after the attack on the Church had subsided. Indeed, if all that held Catholics to CD parties was their priest we might have expected CD parties to have remained responsive to their hierarchies: but in fact CD parties were deliberately showing their independence from the Church already by the 1890s, and had clearly defined themselves as independent by the 1920s (Kalyvas 1996). Compellingly, Kalyvas further shows that the different Christian Democratic parties were organizing themselves as representative parties with committees for different economic interests – as indeed they are still organized.

But why should Catholics with different economic interests remain with a party which is Catholic largely only in name? Why didn't groups with economic interests closer to other parties split off? Our tentative hypothesis is that they did split off unless they had co-specific assets and negotiating networks within the Christian Democratic party which outweighed the gains available from switching to another party. Thus the rural-urban, peasant-artisan-small employer-merchant co-specific asset network acted (if our hypothesis is correct) to create a peasant-Mittelstand constituency which had an incentive to remain within the Catholic party. Another way of putting this is to see the Christian Democratic party as a negotiating community with a range of different economic interests in terms of income levels and hence redistribution, but a common interest in sharing co-

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[2] Both had Catholic parties in the post war period, the MRP in the French 4th Republic and the SDLP in

specific assets. Moreover, as local and regional networks developed in part into national networks, and as regulations over a wide range of issues germane to these urban-rural networks were increasingly set at the national political level as well as regional and local ones, so the importance of supporting a party capable of representing these co-specific asset groups grew in significance.

A support of this argument is the massive loss of Zentrum support during the 1900s as Catholic industrial and mining workers switched to the Social Democrats. Catholic industrial workers shared the economic interests of the SPD with no compensating co-specific assets held with other CD groups. Thus Christian Democratic parties had to work out a policy compromise which was sufficiently attractive to the peasantry to tie them to the party without losing other more centrist and right wing groups. Peasants were poor but also concerned about the accidents of bad harvests and foreign competition. Thus the CD compromise played down redistribution because of its other clients, but focused on insurance and agricultural protection. And since peasants were concerned about children leaving the land and reducing available family labor, a further element of the compromise was subsidizing women to stay at home.

Thus, our general hypothesis in relation to the continental countries is that peasants voted Christian Democrat to remain within co-specific asset networks so long as the party pushed social insurance for peasants and family transfers. Two types of coalitions then emerged. As outlined in the previous section, so long as Christian Democratic parties could govern with centrist parties, they would do so and redistribution remained moderate. If they could not because centrist parties were too weak, as in the Netherlands and Belgium after WWII, then they formed coalitions with Social Democrats implying a higher degree of redistribution.

3.1.3. Scandinavian states: Proportional Representation, Coordinated Institutions and

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Australia, but neither have been of any importance.

Agrarian Social Democratic Coalitions. We have already set out much of the argument for the adoption by Scandinavian economies of PR, since the incentive structures for unions and business developed in a similar way to those in the continental economies. This too explains why economic coordination was important in both groups of economies. Moreover, as in the continental economies, the nature of the broad framework agreement as it evolved through this period reinforced social democratic parties as representing the whole working class, and believing that skill formation should be universal; rather than representing de facto simply skilled workers as was the case for the major left parties in the liberal economies and in France. Thus social democracy in Scandinavia as in the continental countries stood for redistribution by comparison to counterparts in the liberal economies. Skilled workers remained important in social democratic parties, nonetheless; and their basic stance was one which favored income related benefits rather than universalism.

Our claim is that the major difference with the continental economies lay in the nature of the agricultural sector (see Figure 9). While Scandinavian peasants owned their own land and coordinated activities as in the continental countries, Scandinavian agriculture did not have the same tight links and dependency upon urban economies. Instead, the agricultural communities were tightly knit and heavily invested in co-specific asset relationships within autonomous rural cooperative frameworks. There was thus not the same logic in Scandinavia to support a peasant Mittelstand party. Instead the logic of co-specificity led to agrarian parties from which the occasional large landowner was excluded. In these agrarian parties, by contrast to Christian Democratic parties, homogeneous economic interests reinforced co-specific assets. The economic interests of peasants as discussed above favored redistribution. And because of the nature of agricultural uncertainty, agrarian parties were *more* predisposed to egalitarianism and universality than the social democratic parties.

Thus the coalitions which emerged after PR linked social democracy with agrarian parties and hence to both redistribution and universalism.

[Figure 9 about here]

3.2. Conclusion: PR, business, and the left

Our account of the origins of electoral institutions is very different from the dominant ones, which, in one form or another, builds on work by Stein Rokkan. Consistent with power resource theory, these accounts suggest that PR emerged as a result of a strong left. But if one examines the historical data there is in fact no relationship between the electoral support of the left and the adoption of PR (Cusack et al 2007). This is also true if one examines the interaction of left strength and divisions on the right, as in Boix (1999), and it can be easily illustrated with some numbers (see Table 2). Countries with a dominant right party were no more likely to retain majoritarian institutions than countries that did not. The table also shows that countries (bolded) where support for left parties was strong before the adoption of PR (or universal male suffrage in cases that remained majoritarian) were as likely to remain majoritarian as were countries without a strong left.

[Table 2 about here]

The critical variable, we maintain, was the organization of production and labor at the eve of the national industrial revolution (noted on the left in Table 2). Where guilds and agricultural cooperatives were strong, employers well organized and highly coordinated, and unions organized along industry lines, both right and left parties ended up supporting PR as a political mechanism to protect their mutual investments in co-specific assets. Where guilds and agricultural cooperatives were weak, employers poorly organized and coordinated, and unions divided by crafts, the right opposed PR in order to protect their class interests. The difference between Scandinavia and the other continental European countries was mainly one of how the peasantry was incorporated into the political system. In the former they were independently organized in rural cooperatives and formed their

own parties; in the latter they were integrated into rural-urban networks and became part of a Christian Democratic coalition. This difference in the party system affected the dynamics of coalition-formation in PR systems, and hence the level and structure of social spending.

4. Revisiting power resource theory

The account we have given in this paper of the historical origins of the contemporary division of countries into a high equality / high redistribution and a low equality / low redistribution cluster deviates notably from power resource theory, even as there are points of agreement. In this section we highlight these differences and similarities, and illustrate how they affect our interpretation and understanding of contemporary capitalism and more recent developments.

Starting with distribution, we agree that unions have played a significant role in the compression of wages. But, as Swenson has argued, this role cannot be understood without reference to the importance of employers in supporting centralized wage setting institutions and standard wage rates by skills. The support by *both* employers and unions for centralized bargaining, and indeed for a consensual industrial relations system more generally, reflects a reality where workers and employers own assets that are complements in production and cannot easily be replaced. When this is true unions gain power over employers because they can "hold up" firms that cannot easily replace workers. But by the same token, employers gain power over unions because that can "hold up" workers with skills that cannot easily be applied elsewhere. The effectiveness of both the threat of strikes and the threat of lockout thus relies on the other party having made investments in specific assets. When both sides have invested in such assets -- which is to say that they are co-specific -- there is a powerful incentive for both sides to agree to institutions that will prevent ruinous conflicts and enable continuous bargaining over the protections and reproduction of these assets.

As we have argued above, the combination of skill and industrial relations systems helps us understand cross-national differences in the distribution of wages. But how does one account for changes in the wage distribution over time? From a power resource perspective the answer will hinge on changes in unionization rates and the level of centralization in bargaining institutions. Certainly these variables are correlated with distributive outcomes (see Wallerstein 1999, Rueda and Pontusson 1999). But without a micro-theory of power, one cannot know if unions are strong because they have many members, or whether workers join unions because they are strong. Likewise, it may not be sensible to think of centralization as another power resource, but as a reflection of the mutual recognition of the need to manage and contain the use of power. Without a theory of these relations, the power resource explanation borders on a tautology of the sort that Korpi accuses Swenson of (p. 184): unions have power resources because they are influential (which correlates with a high membership).

Our alternative roots power between groups in their relative ownership of more or less mobile assets and the mutual dependencies that these ownership relations generate. In turn, patterns of ownership and power affect both unionization rates and the wage bargaining system. It is unsurprising, for example, that coordinated bargaining originated in skill-intensive sectors – especially in exports where producers are particularly vulnerable to work stoppages. But changes in the power of different groups, and the resulting effects on institutions and distribution, can also be understood (better) from this perspective. In particular, the role of semi-skilled workers in the bargaining system has varied over time in ways that cannot be explained in simple labor versus capital terms. The notable move towards centralized bargaining and compression of inter-occupational wages that occurred across OECD countries in the 1960s and 1970s must be understood in the context of the spread of Fordist mass production technologies, which created strong complementarities between skilled and semi-skilled workers and gave the latter a level of bargaining power that they had previously lacked. These complementarities were subsequently undone by technological changes in the 1980s and 1990s, especially with the application of the microprocessor which enabled small-batch production and shifted demand towards skilled

workers (Streeck 1991; Piore and Sabel 1984). In relatively fragmented bargaining systems such as the British, this meant that semi-skilled unions lost influence on union membership declined. In some northern European countries with highly centralized systems, the changes caused skilled workers and their employers (especially in the engineering sector) to break out of the centralized systems (see Pontusson and Swenson 1996 and Iversen 1996 for related accounts). Yet, in all the countries where skilled workers and employers had major investments in co-specific assets, wage coordination was re-established at the industry and at the sectoral levels. This reorganization of the bargaining systems was facilitated by powerful employer organizations coupled with a shift towards non-accommodating macroeconomic policies (Iversen 1999).

Decentralization and union decline cannot be understood in simple power resource terms because the fissures that led to institutional change ran *through* the working class and the union movement. More fundamentally, it is simple not possible to understand either union strength or bargaining centralization as exogenous variables in accounting for these changes. The main reason that semi-skilled unions in countries like Britain and New Zealand lost most of its members was the end of Fordism, which was based on a system of long assembly lines and tightly coupled production processes that gave unions the power to interrupt production. It is true that the collapse of union membership was furthered by partisan attacks on the organizational foundation of unions, but one has to ask why such attacks could succeed and why they have not since been reversed under (at least nominally) left governments. The only countries which had higher union density rates in the early 2000s, are Belgium, Denmark, Finland, and Sweden (Visser 2006, 45), and this divergence is probably explained by the role of unions in these countries in the administration of unemployment benefits and allocation of new jobs; not by their strength in wage bargaining system.

Turning to government redistribution, we agree that this is largely the work of center-left governments, and the collapse of centralized bargaining has not reduced the incidence of such governments. But the success of social democratic parties in gaining access to government power cannot be treated as an exogenous variable any more than

union membership or centralization can (Iversen and Soskice 2006). Partisanship is itself a consequence of, first, proportional representation, and, second, the absence of large cross-class Christian Democratic parties. In majoritarian countries the failure of social democracy reflects the need of parties to cater to the median voter, *not* that the left is in a particularly weak position to mobilize electoral support. As we have argued above (and in detail in Iversen and Soskice 2007), proportional representation itself was adopted by right parties because employers understood the necessity for compromise with unions in a range of policy areas that affected their joint investment in skills as well as in institutions such as collective wage bargaining, employment and unemployment protection, and training systems. Just as co-specific assets require cooperative industrial relations institutions, the rise of state regulation and economic intervention requires political institutions where the main stakeholders have representation – whether through their own parties or through cross-class parties.

Historically, the left did not play a critical role in the shift to PR. This is true in the trivial sense that the left, with one brief exception (Germany 19??), never had the parliamentary majority to impose PR, but it is also true in the sense that a strong political left did not pressure the right to adopt PR. Left support in the electorate in the election before the introduction of PR (or the first election under universal male suffrage in cases where the electoral system did not change) is only weakly related to the effective threshold of representation (r=-.29), and it has no effect in a multiple regression which includes economic coordination around 1900 as a predictor (described in detail in Cusack et al 2007). The correlation is only marginally higher in 1930 (r=-.32), so there no indication that left support earlier in the century simply hid an obvious trend in the PR countries towards subsequent left dominance. What is true is that PR is associated with center-left governments, but the electoral system is the *cause*, not the effect, of left strength.

The other factor that matters for left access to government power is Christian Democracy. As we argued above, Christian democratic parties are cross-class parties, incorporating groups from all the major economic classes, and this means that they tend to adopt relatively centrist positions on economic issues. Even if we think of Christian

democratic parties as right-of-center, they may be attractive coalition partners for "pure" middle class parties. This eliminates or reduces the advantage that the left has in the government coalition formation process. In effect, the coalitional nature of Christian democratic parties is a credible commitment *not* to pay exclusive attention to the distributive interests of high-income groups -- the way we would expect most liberal or conservative parties to do.

We believe that the differences in the coalitional structure of the Scandinavian and continental European countries go some way in explaining differences in the response of governments to the end of Fordism. Where Christian Democratic parties have been able to govern together with "pure" center parties, they have reinforced rather than attenuated insider-outsider divisions between secure skilled and (increasingly) insecure semi-skilled workers – divisions that tend to be associated with high job protection and companies relying on more firm-specific skills. This reflects the fact that workers affiliated with Christian Democratic parties tend to be skilled workers. Where Christian Democratic parties are missing or weak, as in Scandinavia, center parties have tended to ally with social democratic parties in more inclusionary coalitions that emphasize retraining over job protection. Although these countries are associated with specialization in industry and occupational skills, there is more inter-firm mobility and a large public service sector has created a second layer of very flexible jobs, mostly occupied by women.

But whether or not Christian democratic parties were electorally strong, the redistributive consequences of PR have been outweighed for business by the benefits of a system that allowed representation of different economic groups with common interests in a range of "regulatory" policies, including collective wage bargaining, training systems, and social insurance. The latter is important because it intersects with redistributive policies in ways that help explain why redistribution was not the overriding concern for the right, and why it has not seriously undermined economic performance. Even if the motive for much social legislation is redistributive, such legislation can also serve important insurance purposes since those who lose employment or income will be compensated. In turn, such insurance is critical for workers who make serious investments in specific skills,

and in that sense it is a complement to any production that relies on such skills. In economies based more heavily on general skills, workers insure themselves largely by acquiring skills that are portable, in effect reducing the insurance aspects of redistribution.

The efficiency aspects of both economic and political institutions that otherwise favor the left are critical, we believe, in understanding the long-term sustainability of these institutions in capitalist democracies. If it was truly the case that the most salient aspect of welfare states was their capacity to "decommodify" – which for Esping-Andersen means that "citizens can freely, and without potential loss of job, income, or general welfare, opt out of work when they themselves consider it necessary" (1990, 23) – not only would employers be opposed (as Esping-Andersen says) but the entire foundation of capitalism would crumble. Though left governments redistribute, social legislation is always moulded, through parliamentary committees and bureaucratic agencies with representation of different parties and groups, in such a manner as to be compatible with efficient labor markets and competitiveness. Indeed, quite contrary to Esping-Andersen's claim that the welfare state makes workers less dependent on their employers, most social protection is in fact tied to labor market participation and encourages workers to invest in skills that make them *more* dependent on their jobs and employers.

Given the dual nature of PR – redistribution though minimal winning coalitions and protection of investments in specific assets through inclusionary representative institutions – the evidence Korpi advances that the business elite often behaved in an intensely partisan manner is of course entirely consistent with Swenson's view that it also sought compromise in a wide variety of policy areas and that it benefited greatly from centralized wage bargaining, social policies, and so on. Korpi repeatedly returns to the fact that the class struggle, which he sees as the driver of the evolution of democratic capitalism, are always resolved in a manner that ensures high levels of investment and a (risk-adjusted) world level of return to capital. Somehow, and rather magically, redistribution always gets linked to efficiency. But power resource theory has no account of that linkage except to say that social democrats are "constrained by the desire to maintain economic growth" (193). Indeed democratically elected governments are constrained in this manner, but the

constraints are built into the political and economic institutions that employers and right parties helped create. In a manner not unlike neoclassical economics, power resource theory assumes that markets operate as some anonymous background force limiting the pursuit of redistributive goals. But that is of course not true. Countries in which social democrats have been successful have markets that are deeply embedded in institutions that can be traced back to before the invention of social democracy. Power resource theory cannot accommodate this fact because it is wedded to the simplistic notion of "politics *against* markets." What we have offered in this essay is a "politics *of* markets" that gets us behind the institutions that promote distribution and redistribution.

5. Conclusion

One of the most notable distinctions among current advanced democracies is that some exhibit a fairly egalitarian distribution of income with high redistribution, while others redistribute little even though that are very inegalitarian. Like Korpi, we believe that much can be learned about contemporary capitalist systems, and the economic and political institutions that underpin them, by explaining the causes of this clustering. Our strategy has been to recount some of the most important and likely causes of inequality and redistribution, and then ask why these causes tend to be linked in a way that produces the observed clustering. We have argued that a key aspect of the political system, whether the electoral system is PR or majoritarian, and a key aspect of the economic system, whether or not economic agents have made heavy investments in co-specific assets, are critical to understanding distribution and redistribution. The reason that the latter are linked is that PR and coordination are also linked. How these institutions became causally related required us to go back in time to the political and economic conditions that emerged in the latter half of the 19th century and the early 20th. Unlike Korpi, we do not believe these conditions can be adequately captured or understood with reference simply to the power resources of labor and capital.

The adoption of PR in countries with high economic coordination was occasioned by the rise of industry at the regional and national levels. Industrialization produced a need for national standard setting, as well as class compromise at the national level, at the same time as it threatened the representation of particular economic interests in the legislature. If diverse agricultural and industrial interests had been forced to merge into a single median voter party in order to survive under a majoritarian rules, it would have been very hard to attend to the specific interests of each, and class compromise of the type Katzenstein has described so effectively would have been impossible. This combination of circumstances is the genesis of PR – *not* the rise of the political left or the lack of a dominant party on the right, as so commonly assumed and implied by power resource theory. Had defense of distributive class interests been the overriding concern, the right would never have consented to PR.

Our account helps bring the politics of the origins of economic and political institutions into line with what we know about the consequences of these institutions. Majoritarian electoral rules provide the middle and upper middle class with guarantees against redistributive demands, as reflected in smaller welfare states, but only PR can ensure a party system which pays close attention to (co-)specific investments and interests – themselves organized in business associations, industry unions, and a collaborative industrial relations system. While PR is based on minimal winning coalitions in redistributive politics (with the notable exception of Switzerland), in more "technical" matters of common interest – in the areas of industrial relations, training, corporate governance, and so on – broad-based and inclusive bargaining (often facilitated by strong committees and corporatist representation in the bureaucracy) tend to prevail. In such a system, having parties that represent the salient interests is an important precondition.

A related issue is the relationship between specific interests and the nature of political parties. When interests are highly specific, as in the case of Scandinavian agriculture, these interests tend to be represented by their own parties, even when they share distributive interests with other parties. Compromises therefore have to be worked out between parties through government coalitions. When interests are highly co-specific

they often (though not always) become organized in the same party, as is the case of Christian Democratic parties in many European countries. These cross-class parties then have to work out procedures to accommodate different distributive interests inside the party. As we have argued (with Manow and Van Kersbergen 2007), there are notable consequences of these differences in the party system and coalitional politics for distribution, with Christian Democractic countries generally being less redistributive.

Yet, both varieties of PR multiparty systems stand in contrast to majoritarian two-party systems. In the former parties either represent specific interests, or can be set up to facilitate internal compromises between groups with overlapping interests, whereas in the latter parties tend to have strong leaders who are free to pursue popular electoral strategies. This corresponds to our previous distinction between representative parties under PR and leadership parties under majoritarian rules. A critical difference is that leadership parties cannot make credible commitments to protect specific interests, and therefore undermine any attempt to set up economic organizations that presupposes the political representation of such interests. This in turn undermines investments in specific assets, which are a precondition for strong unions and a cooperative industrial relations system. Economic and political institutions are linked, and both are associated with particular distributive and partisan logics. If we want to understand these interconnections it is not sufficient, as Korpi suggests, to examine only the relative power of labor and capital.

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Figure 1. Inequality and redistribution (ca. 1970-1995)
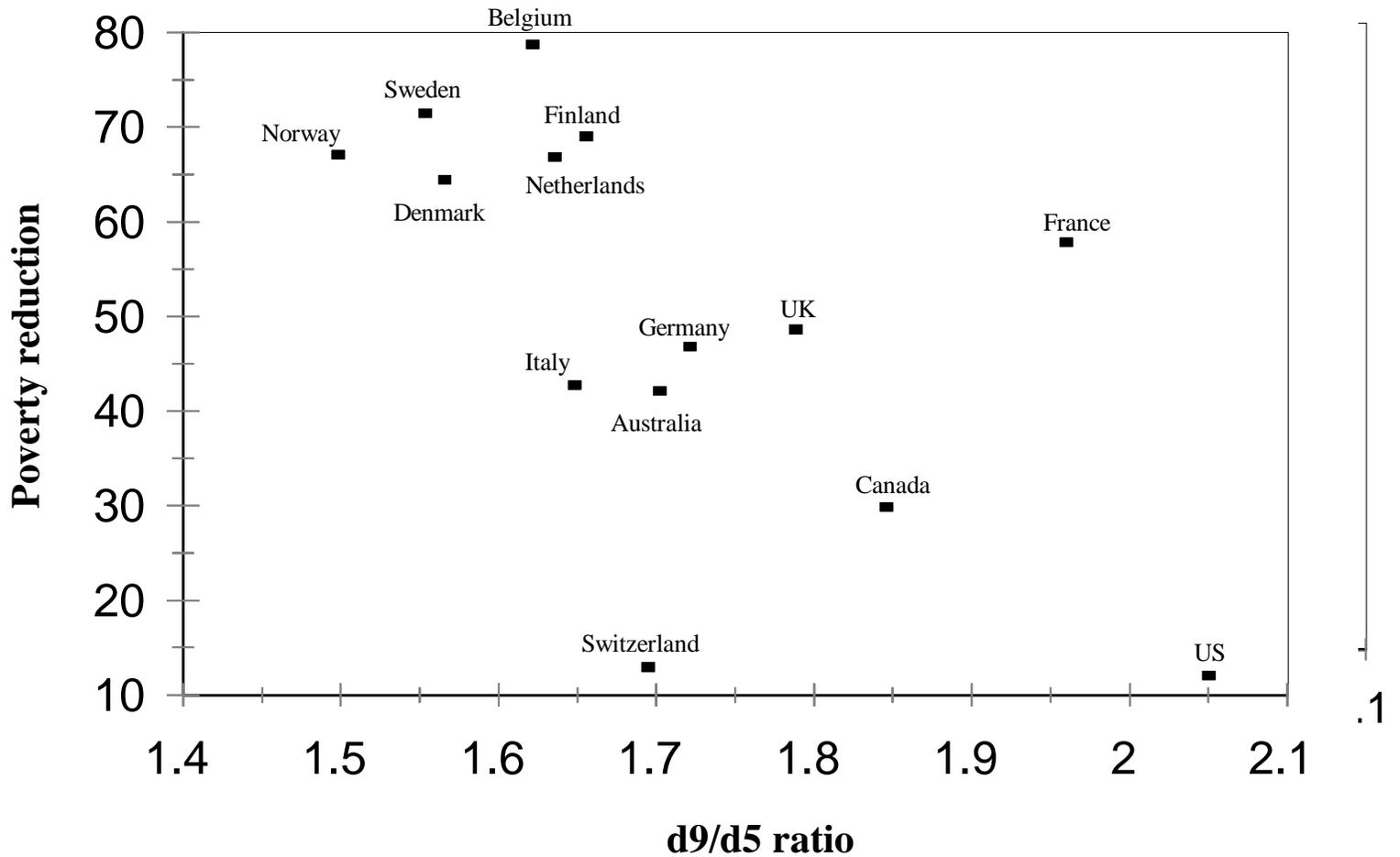
Notes: Poverty reduction is the percentage reduction of the poverty rate (the percentage of families with income below 50 percent of the median) from before to after taxes and transfers. The d9/d5 ratio is the earnings of a worker in the top decile of the earnings distribution relative to the earnings of a worker with a median income.

Sources: Luxembourg Income Study and OECD.

Figure 2. PR and non-market coordination
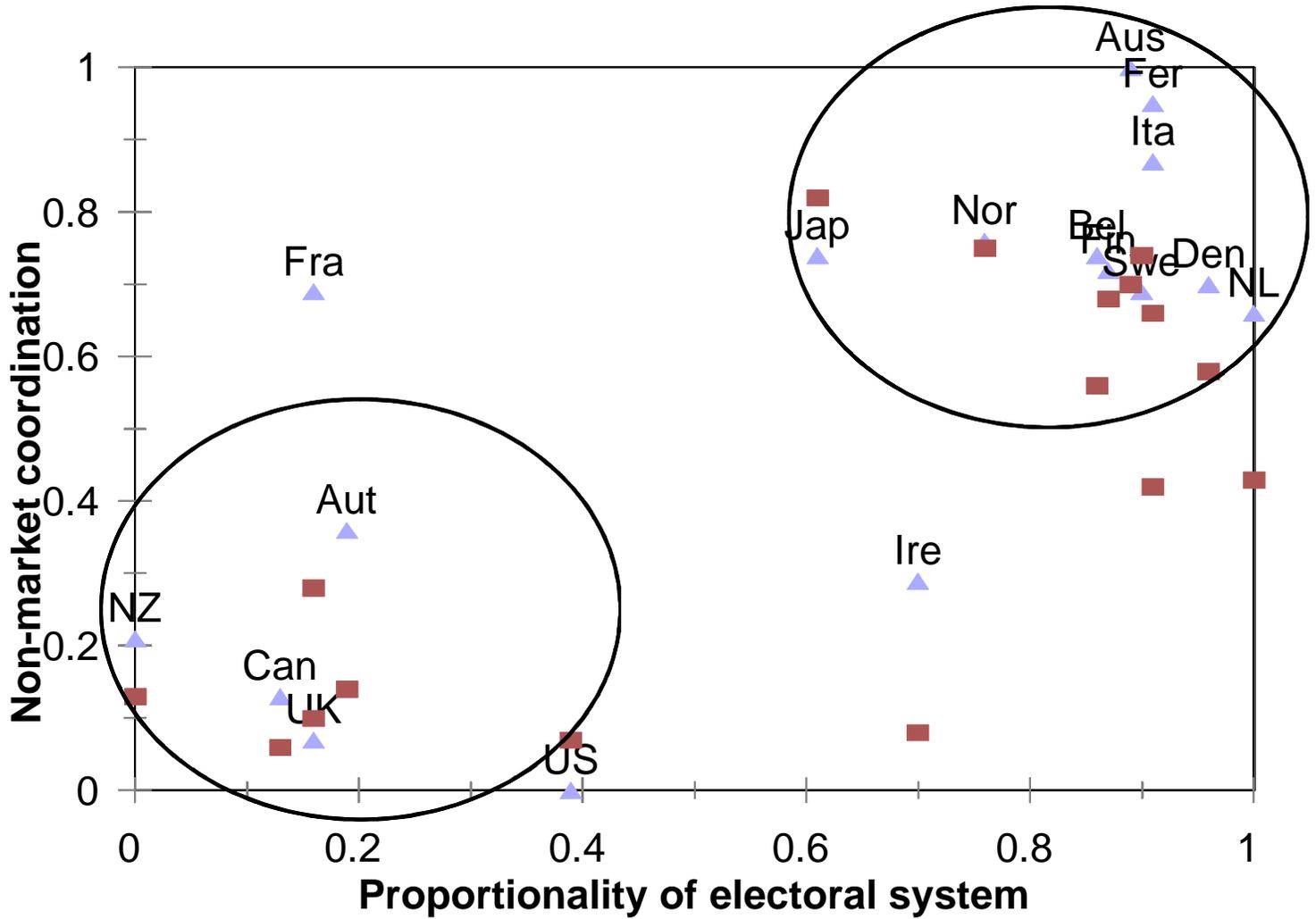
Sources: Proportionality of electoral system: Lijphart (1994); non-market coordination index (triangles): Hall and Gingrich (2004); cooperation index (Hicks and Kenworthy).

**Figure 3. A sketch of the causal argument.**
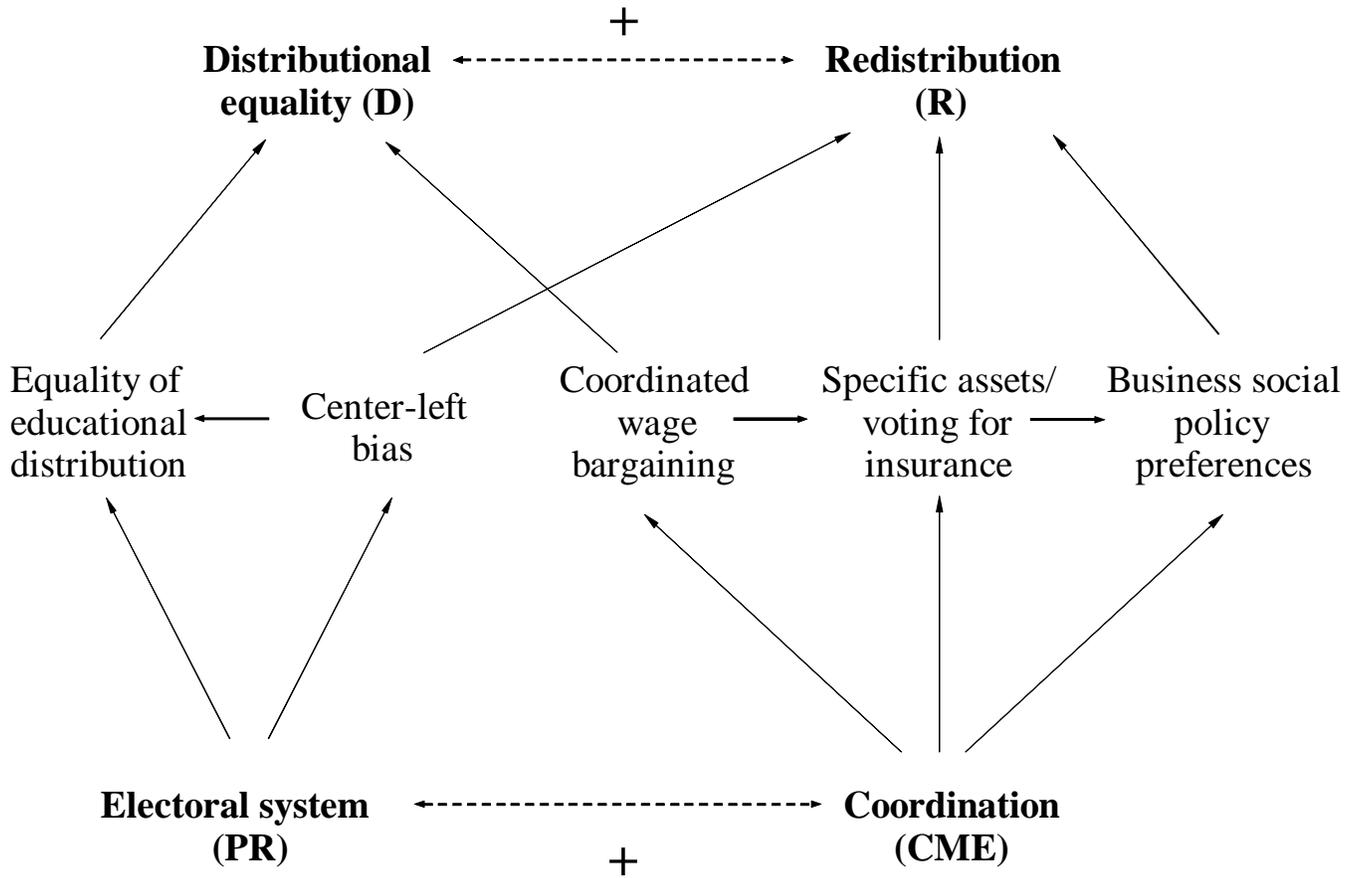
Figure 4. Vocational training and redistribution
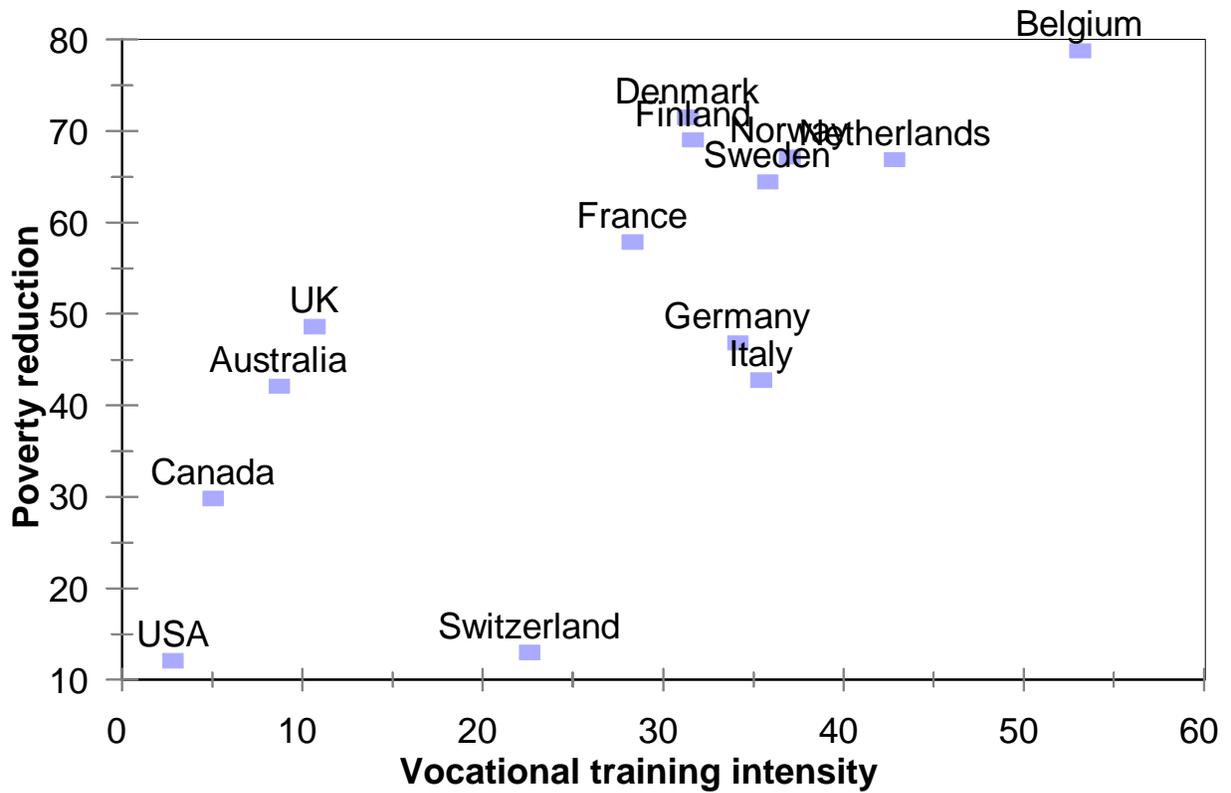
Notes: Poverty reduction is defined the same way as in Figure 1. Vocational training intensity is the share of an age cohort in either secondary or post-secondary (ISCED5) vocational training. *Source*: UNESCO (1999).

Figure 5. Earnings Equality and Centralization of Wage Bargaining
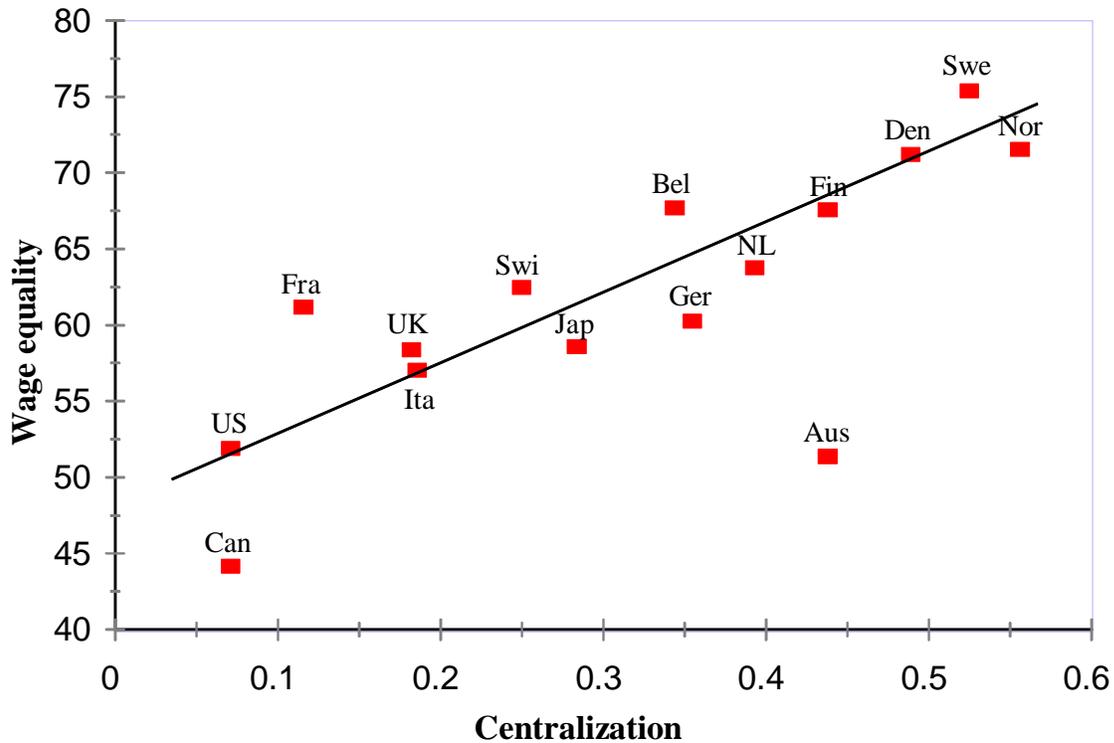
Notes: Wage equality is measured as the ratio of gross earnings (including all employer contributions for pensions, social security etc.) of a worker at the bottom decile of the earnings distribution relative to the worker at the median (d1/d5 ratios). Figures are averages for the period 1977-1993 computed from the *OECD Employment Outlook* (1991, 1996). Centralization is measured as the one divided by the number of unions at different bargaining levels weighted by relative union size ("concentration") and then transformed into a single number depending on the importance of different bargaining levels ("centralization of authority"). The index is from Iversen (1998).

Figure 6. The percentage of adults with poor literacy scores (bottom scale), and the percentage of adults with low education and high scores (top scale). 13 OECD countries, 1994-98.
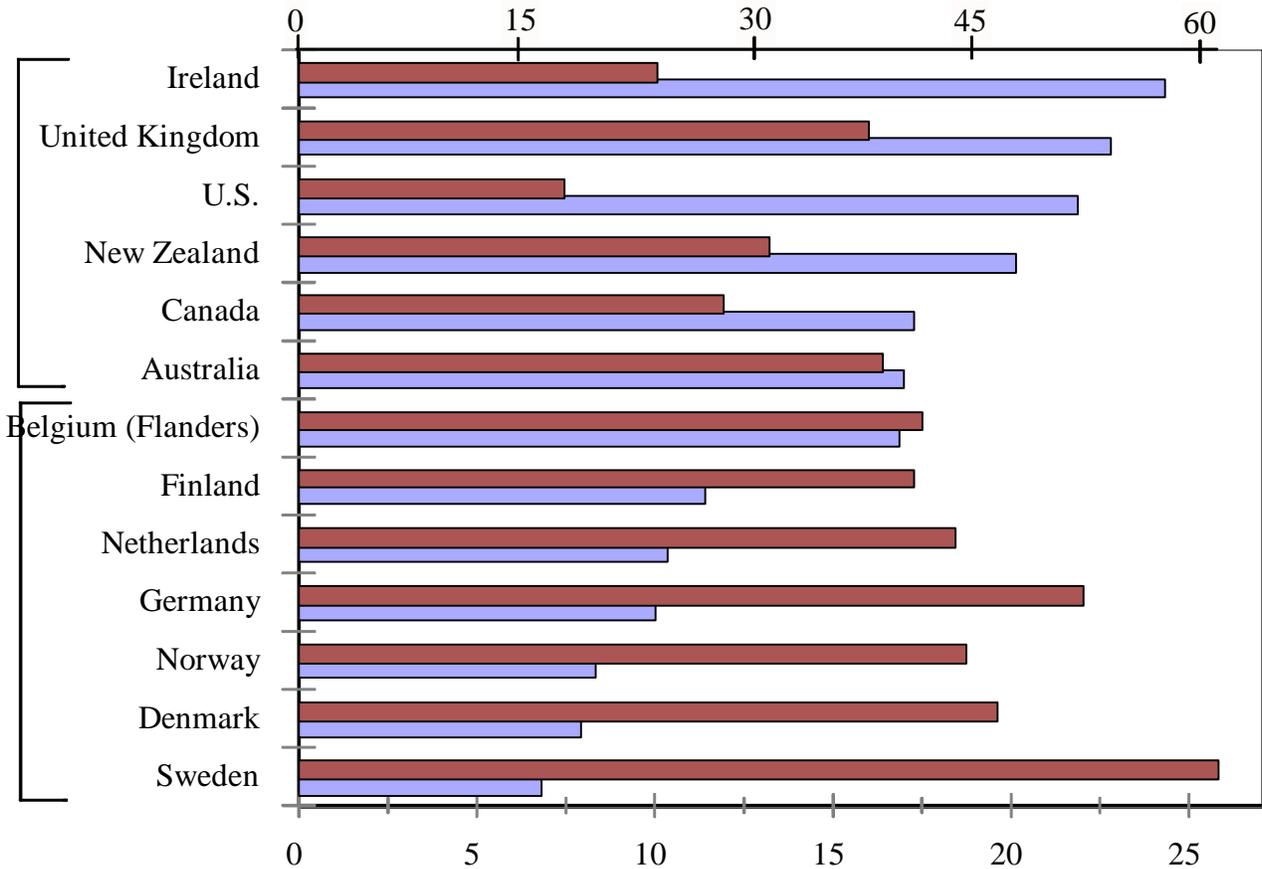
Notes: The top bars (using top scale) show the percentage of adults who have not completed an upper secondary education but have high scores on document literacy. The bottom bars (using bottom scale) show the percentage of adults taking the test who get the lowest score, averaged across three test categories.

Figure 7. Liberal economies late 19th and early 20th centuries.

Agriculture industry cleavage (protection). But no positive -sum national regulatory issues over ind skills, artisan or peasant regulation. Non co - specific asset world.

Non -socialist labour parties or lab repres in non -labour parties; skill depoliticised, devolved to market

Fragmented craft unionism; control skill supply and job content; zero -sum game with business

Large farm, non specialisation, model, dependent lab

Majority unskilled workforce as industry develops

No state incentives for business coordination

Agriculture: landless rural labour force

Urban: unregulated artisans + large unskilled workforce

State: parliamentary, non -corporatist

Figure 8. Continental states late 19th and early 20th centuries (excluding France)

Christian Democratic Party cross - class representation

Social Democratic Party, repr industrial working class

Industry Unions, grouping crafts: incentive exchange cooperation for coll barg rights

Decentralised industrial regions

Majority skilled workforce as industry develops

Coordinated heavy industry; state encouragement

Agriculture: independent coordinated peasants linked to urban economy

Urban: Guild (or functionally equivalent) traditions

State: staendestaat tradition; "liberal" officials

Figure 9. Scandinavian states late 19th and early 20th century

Egalitarian agrarian parties ⟷ *Social Democratic Party, repr industrial working class* ⟵ Industry Unions, grouping crafts: incentive exchange cooperation for coll barg rights

Rural cooperative agric + artisan

Majority skilled workforce as industry develops

Coordinated heavy industry; state encouragement

Agriculture: independent coordinated peasants *not* linked to urban economy

Urban: Guild (or functionally equivalent) traditions

State: Ständestaat tradition; "liberal" officials

Table 1. Electoral system and the number of years with governments farther to the left or to the right than the median legislator (1945-98).

		Government partisanship		Proportion of right governments
		Left	Right	
Electoral system	Proportional	291 (9)	171 0	0.37
	Majoritarian	116 (1)	226 (7)	0.66

Note: Excludes governments coded as centrist on the Castles-Mair scale.

Source: Cusack and Engelhardt 2002.

Table 2. Type of economy, party dominance on the right and electoral system

		Single right party dominance?	
		Yes	*No*
Organization of production and labor	*No guilds / cooperatives, weak employer coordination, and craft unions*	***United Kingdom**, United States*	***Australia**, Canada, **New Zealand***
	Guilds/ cooperatives, employer coordination, and industrial unions	**Belgium, Denmark**, Greece, **Switzerland**, Italy	**Germany**, **Norway**, Sweden, Netherlands
	Ambiguous cases		***France** , Japan*

Notes: *Italicized* countries retained majoritarian institutions. Bolded countries had left parties with above median electoral strength in the last election before the adoption of PR, or, in the cases where countries remained majoritarian, the first election under universal male suffrage. Referring to the same elections, single party dominance is measured by the percentage lead of the largest party over the next largest party. The "right party dominance" cut-off point is the value that would produce a number of countries with a dominant right party that is equivalent to the number of countries (7) that actually remained majoritarian.