Varieties of Capitalism and the Limits of European Economic Integration

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Abstract: This paper considers European economic integration from the perspective of varieties of capitalism. It notes the main threats that integration potentially entails both for liberal and coordinated market economies, and assesses the likelihood of damage to the different models, in particular following the Lisbon Treaty. It is argued descriptively that both types of capitalism can continue to coexist in the European Union, and normatively that it is vital that the integration project is managed in a way that does not fundamentally endanger them.

I. INTRODUCTION

Varieties of capitalism is an influential newish theory of political economy. It posits that there are different types of capitalism. In particular, it differentiates between liberal and co-ordinated market economies, although there are other variants as well. In liberal market economies, firms coordinate their behaviour with other economic actors using the market mechanism. Employees are hired and fired as part of a fluid labour market. Capital is acquired in financial markets that are sensitive to current profits and there is a market for corporate control incentivising firms to maximise their share prices. Any cooperation with other firms may be conditioned by strict competition rules and contract laws that favour literal interpretation of written contracts. By contrast, in co-ordinated market economies, non-market based methods of coordination are also used. Employees often enjoy greater job security and unions play an important role in wage setting. Capital may be provided by banks and other long term investors and is not purely focused on quarterly earnings. Various networks of business associations and contract laws that support more open relational contracting allow cooperation among firms to develop.

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Intriguingly, both variants of capitalism feel under threat as a result of European integration. Liberal market economies are essentially worried about positive integration, harmonisation that would stifle the market-based operation of their systems. For coordinated market economies, there is a wider set of perceived threats ranging from the direct threats posed by negative integration and neoliberal directives to the more indirect worry about a possible race to the bottom. The purpose of the current Paper is to explore whether the two paradigm variants of capitalism are indeed threatened by the integration project, and how the Lisbon Treaty affects the picture. It will be argued descriptively that both types of capitalism can continue to exist in the European Union, and normatively that it is vital that the EU does not fundamentally endanger them.

II. VARIETIES OF CAPITALISM

The theory of varieties of capitalism falls within the tradition of comparative capitalism, and was posited in its classic form by Peter Hall and David Soskice in 2001.\(^1\) It has proven extremely influential. Writers in the field of political economy often situate their arguments within the analytical framework provided by this theory, or expressly argue against varieties of capitalism, seeking to set up alternative approaches.\(^2\)

Hall and Soskice regard companies as crucial actors in capitalist economies, and take a relational view of them. Companies seek to exploit and enhance their ability to develop, produce and distribute products and services profitably. To do this, they need to coordinate successfully with a range of other actors, such as employees, investors, and other companies. Coordination is particularly important in five spheres: industrial relations, vocational training and education, corporate governance, inter-firm relations, and internal coordination with employees. There are different ways these

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coordination issues can be tackled. Coordination can occur on the market place as a response to price signals derived from the conditions of supply and demand in the context of competition and formal contracting. In liberal market economies this is the main means of coordination. By contrast, coordination can sometimes rely more heavily on non-market relationships. This is a feature of coordinated market economies, where various institutions, such as business associations, trade unions, and regulatory systems, reduce uncertainty about the behaviour of others and allow for credible commitments, as well as for deliberation, while informal rules and understandings build up a common set of expectations. As a result, a firm situated in a liberal market economy will face a different set of opportunities than a firm operating in a coordinated market economy, and will in all likelihood select a strategy that takes advantage of these opportunities. Given that the institutions and informal rules tend to be nation specific, varieties of capitalism expects there to be systematic differences in corporate strategy across different countries. In particular, actors in liberal market economies will be more prone to invest in switchable assets, ie assets that can be readily diverted to other purposes, while actors in coordinated market economies are more prepared to invest in specific assets. The differences between liberal and coordinated market economies are reinforced by institutional complementarities. A particular type of coordination in one sphere of the economy may render it advantageous to adopt complementary practices in other areas as well. Accordingly, institutions of a particular type are unlikely to be distributed randomly across countries, but may well form clusters.

According to Hall and Soskice, in coordinated market economies, such as Germany, patient capital provided by banks, pension funds, and blockholders makes it possible for firms to take a long view, retain skilled workers even through downturns, and make investments that will only pay for themselves in the long run.

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4 See M Goyer, ‘Capital Mobility, Varieties of Institutional Investors, and the Transforming Stability of Corporate Governance in France and Germany’ in B Hancké, M Rhodes and M Thatcher (eds), Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy (Oxford, Oxford University Press, 2007) on the differences between investors such as hedge funds and pension funds.
This in turn is made possible by institutions such as dense business networks that allow potential investors to inform themselves reliably on a firm’s record and projects. By contrast, in liberal market economies, such as the US and more broadly the Anglo-Saxon countries, the financial system based on stock markets with a lively market for corporate control forces firms to concentrate more on current earnings and share price, and as a result imposes a shorter time horizon on the management. In coordinated market economies, the internal structure of firms tends to favour consensual decision-making which includes the voice of the employees and considers also other stakeholders, while in liberal market economies authority is concentrated in the top management and focuses on shareholder value, allowing for a rapid release of workforce. In coordinated market economies production strategies often rely on loyal highly skilled workers with considerable autonomy, capable of realising continuous improvements in products and production. Industrial relations systems support this by equalising wages to discourage poaching and by protecting workers against layoffs, while education and training systems allow workers to achieve industry- or even firm-specific skills. This may be further reinforced by generous unemployment benefits that function as an insurance policy for workers who develop specific skills. By contrast, in liberal market economies firms hire and fire workers more readily on a fluid labour market, education and training systems provide more general skills that may be useful beyond the confines of a particular firm or industry, and low levels of social benefits may further enhance the flexibility of the labour markets. Accordingly, the firms may be able to take quick advantage of new opportunities, but will find it more difficult to pursue production strategies that are based on cooperative highly skilled employees. In coordinated market economies inter-firm relations facilitate diffusion of technology, for example with the help of strong industry associations or contract laws that support relational contracting, while in liberal market economies movement of personnel between firms, as well as formal licensing agreements, may facilitate technology transfer.

It is critical to note that the varieties of capitalism theory sees neither liberal nor coordinated market economy as superior to the other. Both can result in satisfactory levels of economic performance. However, they provide different comparative institutional advantages. The institutions of a liberal market economy may offer strong support for sectors and strategies that are based on market coordination, while sectors and strategies benefiting from non-market coordination may fare better in a
coordinated market economy. In particular, the institutions of coordinated market economies may offer advantages to firms in sectors where incremental innovation characterised by small continuous improvements is critical for success. Skilled workforce with sufficient job security and autonomy may see the improvement of products and production processes as a natural part of their role. By contrast, liberal market economies may favour sectors and strategies that are based on radical innovation where firms need to take significant risks and quickly implement new strategies. This implies national patterns of specialisation, with companies of some countries concentrating in fields characterised by a need for incremental innovation, such as mechanical engineering and the production of consumer durables, while firms of other countries may thrive in fields requiring radical innovation, such as biotechnology or telecommunications.5

The theory put forward by Hall and Soskice can be questioned from two perspectives, theoretical and empirical.6 Theoretically, some authors criticise the whole notion of varieties, and instead argue for example that different systems are or should be converging to a common model.7 If this is true and all economies are or should indeed be proceeding to the same neo-liberal nirvana, albeit at different speeds, a matter that ultimately only empirical observation can settle, the argument put forward in the present Paper will lose much if not all of its force. However, many critics do accept the notion of different varieties, but seek to refine it further. It has for example been argued that the account of Hall and Soskice, while not wrong in essentials, underplays the role of the state in the systems. As a result, it has been claimed that a more nuanced understanding and typology of the different varieties is needed.8 While the original approach can undoubtedly be refined further, most such refinements seem irrelevant for the purposes of the present Paper, which ultimately relies on the key insight of various equally viable models with different comparative

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5 It should be noted that many industries associated eg with radical innovation may nevertheless contain segments where incremental innovation is more important. See S Casper, M Lehrer and D Soskice, ‘Can High-Technology Industries Prosper in Germany? Institutional Frameworks and the Evolution of the German Software and Biotechnology Industries’ (1999) 6 Industry and Innovation 5, who cite software services and platform biotechnologies.
institutional advantages. In other words, the many possible refinements do not affect the main thrust of the legal argument made here.

From the empirical perspective, the current evidence is inconclusive, with some studies finding strong support for the key arguments of varieties of capitalism,⁹ while others find much less evidence for the theory.¹⁰ In any event, it should be noted that some of the specific features of the different varieties described by Hall and Soskice in 2001 are no longer current. The world has moved on. A number of reforms have taken place in particular in Germany¹¹ and the financial crisis is affecting the regulatory regimes everywhere. Again, this is in no way a fatal blow to the theory. Instead, it accepts that the different varieties develop as a result of evolutionary pressures, and in fact they have been shaped by such pressures in the past.¹² The snapshot that was provided of, for example, Germany in 2001 was simply one image of a moving system. However, the theory predicts that the different varieties will respond differently to stimuli,¹³ as has indeed happened during the recession, when US firms have proven much more willing to shed labour in response to the downturn than German ones.¹⁴ Further, any practicable tighter regulation of the financial sector is unlikely to alter fundamentally the different basic settlements between labour and capital on which the different varieties are based.¹⁵ So far, the proposed regulatory reform has ultimately been founded on existing intellectual frameworks. The reform will hopefully correct the various market failures that the crisis has exposed and improve the functioning of all systems, but it is being shaped by the power of interest groups and the needs of each type of capitalism, and in any event relates only to a single sector. As a result, the fact that the economies of different states have evolved

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¹³ See eg Hall, above n 3.


since 2001 and will continue to evolve should not undermine the thrust of the present Paper.

III. LIBERAL MARKET ECONOMIES UNDER THREAT?

For a long time, there have been arguments that the integration project may constitute a threat to liberal market economies. Such complaints were most frequent in the 1990s when the EU harmonisation programme was in full swing following the Single European Act, but they are still routinely employed when the Union acts in the field of worker protection. Further, now that the financial crisis is resulting in more intrusive regulation, they may well acquire renewed urgency. For example, the proposed regulation of hedge funds in the shape of Alternative Investment Fund Managers (AIFM) Directive\(^\text{16}\) resulted in a prolonged political struggle with numerous predictions of doom in London.\(^\text{17}\)

The worries relate to positive harmonisation. Liberal market economies organise coordination through the marketplace. The better markets function, the more effective will liberal market economies be. Accordingly, deregulation and strengthening of markets are often the best policies for these countries. However, if the EU engages in harmonisation, in particular in the field of worker protection, it may interfere with the functioning of the market mechanism. It may render labour markets more rigid and hinder the rapid redeployment of workers from one activity to another that is one of the principal advantages of liberal market economies. The same concern can apply in other markets as well, but has been most frequently expressed in the context of labour. Further, there is a concern that two factors may render the EU prone to adopting such laws. First, the EU institutions, in particular the Commission and the European Parliament, may wish to use such regulation as an instrument for extending their own and the Union’s power. In other words, the fear is that the real agenda is the expansion of integration, rather than the protection of workers or whatever substantive policy goal is cited.\(^\text{18}\) Secondly, many EU countries are coordinated market

\(^{16}\) COM (2009) 207.
economies and not only see such laws as necessary and natural, but may even strategically push for them in order to blunt the competitive advantage of liberal market economies. A number of directives have been cited as examples of interference with labour markets in the name of worker protection. The most totemic is the Working Time Directive, which somewhat limits the ability of firms to utilise their staff rapidly to the maximum effectiveness. Another is the recently agreed Agency Workers Directive, which to a small extent curtails the ability of firms to rely on cheap temporary agency workers.

How plausible are the concerns expressed? Is there a real threat to the flexible markets of liberal market economies? While it seems clear that no such threat has materialised to any substantial extent as of today, could the EU in the future come to undermine the effectiveness of market-based coordination?

The Treaties themselves offer safeguards. The EU has a limited competence to regulate in the field of employment and worker protection, and the principle of subsidiarity expressed in Article 5(3) TEU would seem to militate against far-going action. Unfortunately there are concerns regarding the credibility of these safeguards. The willingness of the Court of Justice to police the principles of conferral and subsidiarity effectively has been called to question repeatedly.

A pertinent example is the treatment of subsidiarity in the litigation brought by the UK challenging the validity of the Working Time Directive. The UK government argued inter alia that it had not been demonstrated that ‘there were transnational aspects which could not be satisfactorily regulated by national laws’.

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measures… [or that] action at Community level would provide clear benefits compared with action at national level.”26 The Full Court, essentially following Advocate General Léger, upheld the validity of the Directive, apart from one minor point. It dealt with the subsidiarity issue with one short paragraph. It reasoned that Article 137 EC (now 153 TFEU) gave the Council the responsibility ‘to adopt minimum requirements so as to contribute, through harmonization, to achieving the objective of raising the level of health and safety protection of workers… Once the Council has found that it is necessary to improve the existing level of protection as regards the health and safety of workers and to harmonize the conditions in this area… achievement of that objective through the imposition of minimum requirements necessarily presupposes Community-wide action’.27 In other words, the Court defined the objective of the directive as harmonisation. Since Member States cannot harmonise each others’ laws, the action is clearly better taken at EU level. The problem with this line of argumentation, which has been used in other cases as well,28 is that it accepts without question the need to harmonise. There is no enquiry into whether it actually was necessary to harmonise working hours in the first place. By contrast, if the objective of the directive had been defined as improving the health and safety of workers, there would have been plenty of room for argument as to whether the EU or the Member States are better placed to protect it. The result is that the Court subtly pulled the teeth of the subsidiarity principle, and to my knowledge there are no cases where a measure has been annulled for a failure to comply with it. And as is well known, arguments based on lack of competence have fared only marginally better.29 For example, following the ruling in ENISA,30 this has allowed the EU to base its new European financial supervisory authorities on Article 114 TFEU.31

As a lawyer, one prefers cast iron legal guarantees. The EU legal system does not provide these. What it offers instead is political safeguards. First, the most sensitive matters, such as the approximation of the rights and interests of employed

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26 Ibid para 46.
27 Ibid para 47.
31 The competence is described by Moloney, above n 15, 1341 as ‘shaky’. For another pertinent example, see C Barnard, ‘The Shaky Legal Foundations for Institutional Action under the Employment, Lisbon and EU2020 Strategies’ (2009-10) 12 CYELS 1.
persons, require unanimity in the Council. This continues to be the case after the Lisbon Treaty, in particular with Articles 114(2) and 153(2)(3) TFEU preserving national vetoes. Secondly, even in areas where majority voting operates, the requirements for the adoption of an EU measure are formidable. Under the ordinary legislative procedure, after the expiry of transitional periods, what is needed in favour is: the majority of Commissioners (to put forward a proposal), at least 55% of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65% of the population of the Union, and a majority in the European Parliament. Further, according to Article 4 of Council Decision 2009/857, even after the expiry of transitional provisions if members of the Council representing at least 55 per cent of the population or the number of Member States necessary to constitute a blocking majority indicate their opposition to an act, the issue will be ‘discussed’, which may in practice mean delay, compromise or even rejection of a proposal, despite the fact that the formal blocking minority has not been reached. In the end the Lisbon Treaty does relax the requirements as compared to the operation of qualified majority voting under the Nice Treaty, but it will still remain difficult to adopt measures that liberal market economies oppose.

Further, under the Lisbon Treaty’s Protocol on the Application of the Principles of Subsidiary and Proportionality drafts of all EU legislative acts are now to be forwarded to national parliaments, which scrutinise them for their compliance with the principle of subsidiarity. A sufficient number of negative opinions can force the Union legislature to review a draft and give reasons if it is maintained. The Court has the jurisdiction to police subsidiarity, and Member States may notify actions on grounds of infringement of the principle to it on behalf of their parliaments. The practical impact of the new procedure remains to be seen, and will largely depend on

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32 See in particular Art 16 TEU and 294 TFEU.
33 Council Decision 2009/857/EC relating to the implementation of Article 9C(4) of the Treaty on European Union and Article 205(2) of the Treaty on the Functioning of the European Union between 1 November 2014 and 31 March 2017 on the one hand, and as from 1 April 2017 on the other [2009] OJ L314/73.
34 An interesting example is the Alternative Investment Fund Managers Directive proposal COM(2009) 207, which was initially strongly criticised by the UK and the industry. Following a lengthy legislative process that involved numerous compromises, even the Alternative Investment Management Association was able to greet the ‘considerable progress’ that had been made http://www.aima.org/en/announcements/aima-statement-on-aifmd.cfm.
35 Under the ordinary legislative procedure, a majority of national parliaments can also bring the legislator to consider the issue of subsidiarity before the first reading has been concluded, at which point 55% of the members of the Council or a majority of the votes cast in the European Parliament can reject the proposal forthwith.
the attitudes and capabilities of national parliaments, but it at least offers a promise of a political solution to the problem of subsidiarity review. Under the new procedure, the political institutions are expected to take charge, with national parliaments, who have the most to lose in institutional terms from any mission creep, acting as subsidiarity watchdogs.  

As an aside, it should be noted that the EU experience is remarkably similar to that of the United States. In the US, the Supreme Court has in particular interpreted the Commerce Clause of Article I, Section 8 of the Constitution broadly, allowing for the adoption of federal legislation except in the most far-fetched cases. The US experience suggests that it is generally not easy to develop formal, legal, subject-matter based safeguards. Instead, the onus has been on the political system with its inbuilt checks and balances and procedural safeguards to protect state autonomy.

It should finally be noted that the Lisbon Treaty offers some clarification to the competences of the Union. In particular, while the internal market and certain aspects of social policy are defined as areas of shared competence by Article 4 TFEU, employment policies are included in Article 5 TFEU merely as matters for coordination by the EU, using methods such as guidelines, reports and recommendations. This continues the previous situation where this policy area is governed by the open method of coordination rather than binding legal provisions. Different systems are exposed to each other, hopefully with the result of mutual learning and sharing of best practices, but are not forced to alter their characteristics.

In conclusion, at the moment it seems difficult to argue that the integration project constitutes a fundamental threat to liberal market economies. In particular the political safeguards offered by the Treaties are likely to protect them from any far-going interference with the flexibility of their labour markets.

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36 See generally R Schütze, ‘Subsidiarity after Lisbon: Reinforcing the Safeguards of Federalism’ (2009) 68 CLJ 525.
37 No federal statute was invalidated by the Supreme Court on grounds of exceeding the remit of Commerce Clause between 1937 and 1995.
38 See EA Young, ‘Protecting Member State Autonomy in the European Union: Some Cautionary Tales from American Federalism’ (2002) 77 New York University Law Review 1612 for a fascinating comparison. Of course, in practice the political and procedural safeguards have not in the long run prevented the development of an extensive corpus of federal legislation, although one should stress the many differences, such as regarding a common language, between the systems.
40 See also G Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences' (1998) 61 MLR 11 on the difficulty of achieving actual convergence even if legislative harmonisation does take place.
IV. COORDINATED MARKET ECONOMIES UNDER THREAT?

The threats allegedly facing coordinated market economies are more multifaceted. Not only is there the danger posed by neoliberal positive harmonisation, but also the challenge of negative integration in the form of far-going case law of the Court and, indirectly, the worry about a possible race to the bottom.41

In the context of positive harmonisation, the original proposals for the Services Directive and the Takeover Directive are sometimes held up as illustrations of the threats the integration project poses to coordinated market economies.42 The proposed Services Directive contained a country-of-origin principle that was expected, among other things, to undermine health, labour and environmental standards, and lead to invasion of France by Polish plumbers.43 The Takeover Directive proposal sought to limit defensive measures such as poison pills that Boards of target companies are prone to utilise to defend their positions.44 If market-oriented neoliberal directives are adopted by the EU legislature, the institutions and procedures that have allowed non-market based coordination to flourish may have to be set aside, with negative consequences for this variety of capitalism.

While the source of this threat is the same as that supposedly facing liberal market economies, the legal situation is different. The adoption of liberalising directives is undoubtedly within the competence of the EU. In most cases, the ordinary legislative procedure is employed, and national vetoes do not play a role. Although the principle of subsidiarity does formally apply, due to the shared nature of the internal market competence,45 in reality it is very difficult to argue that the EU is not better placed to regulate the opening of the European market than its Member

45 Art 4(2) TFEU.
States. However, again the political safeguards enter into play. As discussed above, even under the ordinary legislative procedure it is not easy to push a measure through, due to the need to obtain super-majority in the Council and the consent of the European Parliament. This is neatly illustrated by the fate of precisely the two directives cited above, the Services Directive and the Takeover Directive. In both cases the original proposals underwent significant changes in the legislative process and emerged without their key liberal elements. In the case of the Services Directive, the country of origin principle was replaced by a less categorical commitment to freedom to provide services, and numerous exclusions and exceptions were inserted into the text. The earlier Takeover Directive proposal was defeated in the European Parliament in 2001 after a vote where the German MEPs sided with their government, rather than according to their political affiliation. The final version rendered many of the key provisions of the directive optional rather than mandatory, and was famously described by Internal Market Commissioner Bolkestein as not worth the paper it is printed on.

In addition to positive integration, negative integration in the form of case law is also said to undermine coordinated market economies. In particular, certain recent judgments in the area of four freedoms can be portrayed as imposing a liberal market regime and undermining the systems on which non-market coordination relies. To an

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46 A somewhat similar tale could be told about the creation of Council Regulation 2157/2001/EC on the Statute for a European company (SE) [2001] OJ L294/1, where movement was only possible after sufficiently robust employee participation rules had been agreed, finally in the form of Council Directive 2001/86/EC supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L294/22. The basic model that was chosen preserves existing rights, unless the management and employees agree otherwise. See eg V Edwards, ‘The European Company - Essential Tool or Eviscerated Dream?’ (2003) 40 CML Rev 443.

47 For further illustrations, see eg A Johnston, EC Regulation of Corporate Governance (Cambridge, Cambridge University Press, 2009) 141-145 for an argument that the difficulties encountered in harmonising corporate governance can be attributed to varieties of capitalism.

48 It is also questionable whether the Services Directive would have posed a serious threat to coordinated market economies even in its original format. Its main role would have been to encourage competition in intangible products (services), rather than regulate production.


50 Edwards above n 44, 427. Admittedly the margin was very narrow.

51 For discussion, see eg T Gr Papadopoulos, EU Law and the Harmonization of Takeovers in the Internal Market (Alphen aan den Rijn, Kluwer, 2010) 119-139. It has been argued that this is an example of increasing differentiation within the single market more generally. See D Howarth and T Sadeh, ‘The ever Incomplete Single Market: Differentiation and the Evolving Frontier of Integration’ (2010) 17 JEPP 922.

extent, some liberalisation may of course be inevitable. Economic integration cannot take place without any liberalisation. If national institutions and structures were allowed persist completely unchanged, the formal opening of markets to actors from other Member States might have little impact on the ground. Nevertheless, it is true that some recent decisions can be characterised as adventurous.\textsuperscript{53}

In the field of establishment, judgments on free movement of companies since \textit{Centros}\textsuperscript{54} have given founders greater opportunities to establish a company within a jurisdiction that provides the most favourable legal environment, even if the company will trade in another jurisdiction. This may allow the evasion of many burdensome rules of national company law. From the perspective of varieties of capitalism, a particularly pertinent question is the status of national codetermination laws. Strong worker representation may be an important institution in coordinated market economies. It promotes consensual decision making and job security that in turn enable long term strategies and allow workers to invest in industry- and firm-specific skills. Can strict national requirements relating to worker representation now be evaded by establishment in a jurisdiction that does not have similar laws? The answer to this is not entirely clear at the moment. Although companies enjoy the right of establishment, Member States are entitled to apply non-discriminatory and proportionate laws justified by overriding requirements.\textsuperscript{55} There are good reasons to anticipate that the Court would uphold codetermination laws under this doctrine.\textsuperscript{56}

Other examples of possible challenges could be cited, in particular in respect of free movement of services\textsuperscript{57} and capital\textsuperscript{58} which offer opportunities to question national systems of organised labour and national company laws, but the common


\textsuperscript{56} See also Johnston, above n 47, 191-195 for a careful discussion of the arguments.


thread is the same. There is potential for the Court’s case law to disrupt the established national coordination mechanisms, but such a disruption is by no means certain. Instead, the case law is highly fact-specific, in particular as the result of the doctrine of justifications and proportionality. As long as a coordination mechanism serves a rational purpose in a non-protectionist manner, it is likely to emerge unscathed from the Court’s scrutiny.\(^59\) Further, much of the case law arises under Article 267 TFEU, which allocates the interpretation of EU law to the Court, but reserves its application to the referring national court. As a result, the decisive balancing exercise is in many cases carried out by a national court within the broad parameters established by the Court of Justice.\(^60\) This serves as a further safeguard against the danger of fundamental disruptions to key national institutions.

The final possible challenge is more indirect. The worry is that the opening of the markets that economic integration entails creates a race to the bottom, forcing countries to deregulate in order to attract inward investment and avoid capital flight. While this concern is frequently mentioned, the empirical evidence for it is sparse. Most commentators seem to agree that very little competitive deregulation is actually taking place.\(^61\)

From the perspective of varieties of capitalism, a far-going race to the bottom appears implausible. Varieties of capitalism views national institutions that support coordination as sources of comparative advantage. Increased competition that market opening creates may well spur countries to ensure that their coordination mechanisms are working effectively and efficiently, but is unlikely to lead to their dismantling. In simple terms, why would a country whose companies are strong in sectors that require loyal highly skilled workers wish to undermine the systems that create the loyalty and the skills. Instead, it is more likely that different countries maintain and perfect different varieties of capitalism and to an extent specialise in different sectors. Regulatory competition may well lead to a variety of competing systems, not to a

\(^{59}\) See JA Caporaso and S Tarrow, 'Polanyi in Brussels: Supranational Institutions and the Transnational Embedding of Markets' (2009) 63 *International Organization* 593 for an optimistic assessment of the role played by the ECJ from a social science perspective.


single uniform system, just like product market competition results in a variety of products with different benefits and disadvantages.  

Once again, the full impact of the Lisbon Treaty remains to be seen. The Treaty contains three largely symbolic but nevertheless important elements that may in particular influence the Court’s jurisprudence. First, Article 3(2) TEU contains an express reference to ‘social market economy’ as an objective of the Union. Secondly, ‘undistorted competition’ is no longer given a prominent reference in the early Articles of the Treaty, but is now relegated to a Protocol annexed to it. Finally, the Charter of Fundamental Rights is given binding legal force by Article 6 TEU. This document clarifies or reinforces the fundamental right status of many social rights in the EU legal order, and contains in its Solidarity Chapter rights such as workers’ right to information and consultation, and right of collective bargaining and action, although many of the provisions in the Solidarity Chapter may prove to be principles, which limits their enforceability.

At the very least, the Lisbon Treaty offers ammunition for interest groups and parties that argue for legislative proposals to be shaped by social considerations and for a more restrained interpretation of the EU economic law by the Court. For its part, the Commission in its recent Communication on Single Market Act emphasised the role of social elements in securing support for the internal market among citizens, and stated that the Lisbon Treaty requires it to ‘adopt a more all-embracing view of the single market.’

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62 See also Höpner and Schäfer, above n 41, 350.
64 See also Art 9 TFEU cross-cutting social protection clause.
65 See The European Convention final report of Working Group XI on Social Europe CONV 516/1/03 REV 1, at para 17. See also C Joerges and F Rödl, ‘“Social Market Economy” as Europe’s Social Model?’ EUI Working Paper LAW No. 2004/8 for a pessimistic account.
66 Protocol (No 27) on the internal market and competition, which has the status of primary law by virtue of Art 51 TEU. For discussion, see eg R Whish, Competition Law, 6th edn, (Oxford, Oxford University Press, 2009) 51.
68 See Art 52(5) of the Charter.
Directive,\textsuperscript{70} and various consultations to improve the dialogue between social partners.

As regards the judiciary, it is well known that expressions of principle and structural elements have in the past played an important role in the teleological method of the Court.\textsuperscript{71} Former Commissioner, Professor Mario Monti noted in his report on a new strategy for the single market that the controversial rulings of the Court in cases such as \textit{Viking} and \textit{Laval}\textsuperscript{72} predate the Lisbon Treaty and stated that in this ‘new legal context... the issues and the concerns raised by the trade unions should hopefully find an adequate response.’\textsuperscript{73} In a similar vein, in \textit{Santos Palhota} Advocate General Cruz Villalón opined that:

\begin{quote}
As a result of the entry into force of the Treaty of Lisbon, when working conditions constitute an overriding reason relating to the public interest justifying a derogation from the freedom to provide services, they must no longer be interpreted strictly. In so far as the protection of workers is a matter which warrants protection under the Treaties themselves, it is not a simple derogation from a freedom, still less an unwritten exception inferred from case-law. To the extent that the new primary law framework provides for a mandatory high level of social protection, it authorises the Member States, for the purpose of safeguarding a certain level of social protection, to restrict a freedom, and to do so without European Union law’s regarding it as something exceptional and, therefore, as warranting a strict interpretation.\textsuperscript{74}
\end{quote}

V. THE IMPORTANCE OF AGNOSTICISM


\textsuperscript{74} C-515/08 \textit{Santos Palhota} [2010] ECR I-0000 para 53. The Court did not address this argument.
Normatively, it can be argued that the European Union should avoid imposing a single model of capitalism on its Member States. Rather, it should ensure that both liberal and coordinated market economies can thrive within its order. This is so for a number of reasons of principle and practice.

First, the EU lacks the democratic legitimacy to make a choice between the different models of capitalism.\(^{75}\) For starters, the different varieties of capitalism tend to have different distributive consequences. In particular, liberal market economies may tolerate higher income inequality than coordinated market economies where incomes tend to be more equal.\(^{76}\) These kinds of distributive decisions require strong input legitimacy and can only be taken within a *demos*.\(^{77}\) Matters such as workers’ rights also enjoy high salience among voters\(^{78}\) and cannot be described as technical issues which can be transferred beyond democratic contestation.\(^{79}\) As stated by the German Constitutional Court in its verdict on the Lisbon Treaty, due to democratic principles, ‘European unification on the basis of a treaty union of sovereign states may, however, not be achieved in such a way that not sufficient space is left to the Member States for the political formation of the economic, cultural and social living conditions.’\(^{80}\)

Secondly, Europe as a whole is better off if its Member States represent different models of capitalism. As explained above, certain sectors and business strategies may benefit from the market based coordination of liberal market economies, for example if radical innovation is a significant feature in the field. By contrast, other sectors and strategies may require non-market coordination, in particular if cooperative highly skilled workforce and incremental innovation are important for the activity. Tolerance towards the different varieties of capitalism enables the development of comparative institutional advantages across a wider range of sectors than would be the case if the EU opted for one model or another. Diversity is a strength rather than a weakness.

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\(^{76}\) Hall and Soskice, above n 1, 21-22. However, Carlin and Soskice, above n 3, and Hassel, above n 3, are more cautious.

\(^{77}\) See eg G Majone, 'Europe's "Democratic Deficit": The Question of Standards' (1998) 4 *ELJ* 5.


\(^{80}\) BVerfG, 2 BvE 2/08 of 30/06/2009, paragraphs No. (1-421), 249.
Thirdly, even if there were a single optimal economic model, it would be impossible to establish it through deduction and study, given the complexity of the issues.\footnote{See Streek, above n 11, 178-179.} Instead, the virtues and vices of the different models may be better revealed through an inductive, evolutionary, Hayekian competitive discovery process,\footnote{FA Hayek, 'Competition as a Discovery Procedure' (2002) 5 \textit{Quarterly Journal of Austrian Economics} 9.} where the actual performance of different models is observed, successful features are imitated by competitors, and unsuccessful traits quickly discarded. Further, in the political reality of Europe an attempt to establish a single model would inevitably result in a political compromise that produced a hybrid with both liberal and coordinated features. Yet the prediction of the varieties of capitalism literature is that hybrid models will perform less well than pure ones.\footnote{Hall and Gingerich, above n 9, 470-473.}

Finally, any far-going interference with the economic model of a country is likely to prove prohibitively costly. The notion of complementarities utilised by the theory of varieties of capitalism is important here. In order for a liberal or a coordinated system to function properly, its different elements have to be in synch with each other. Non-market based coordination in one sphere of the economy may be conducive to similar coordination in other spheres as well, while the introduction of purely market based coordination in one sphere may disrupt non-market coordination elsewhere, and vice versa. As a result, a heavy handed intervention in a key area, say the regulation of takeovers, may have significant disruptive consequences elsewhere in the system.\footnote{See also La Porta, Lopez-de-Silanes and Shleifer, above n 1, 325; and Johnston, above n 47, 141-145 in the context of corporate governance.}

All of these factors counsel caution, both for the EU legislature and for its judiciary. It is crucial that both positive and negative integration is sensitive to potential disruptions to national production systems. Interventions in key areas, such as labour relations and corporate governance, need to be modest and carefully judged, lest the costs outweigh the benefits. Different elements of a national production system should not be viewed in isolation, but as parts of a complex interlocking organism. A production system might in some cases be destabilised by changes to one of its individual elements, no matter how sensible the changes might appear if considered without reference to the broader context.
There are reasons to be hopeful. Some of the often criticised features of the EU, such as its slow and complex decision making process and a heavy reliance on judicial institutions, may on occasion prove to be strengths. The EU legislative procedure involves a large number of actors, veto points and super-majority requirements, and tends to produce reflection and compromise rather than radical solutions. The current diversity among the Member States and their strong role in the system ensure that proposals harmful to any particular variety of capitalism are liable to be blocked or amended before they become the law. As regards the Court, the fact-specific case-by-case decision system employed by courts in general is unlikely to produce big mistakes.\textsuperscript{85} A judgment that is considered counterproductive will get criticised, and subsequent decisions may limit it to its facts or even overrule it, thus minimising the impact of an error. In the particular context of the EU free movement law, the flexible principle of proportionality that occupies the pride of place in this field and the role played by national courts in the preliminary reference procedure are well-suited for ensuring context-sensitive decision making. Accordingly, it seems unlikely that either the legislative or judicial institutions of the EU will pose a mortal danger to the different varieties of capitalism in Europe.

VI. CONCLUSION

To sum up, the varieties of capitalism approach to political economy argues that instead of one model of capitalism there are a number of different models, in particular liberal and coordinated varieties, which are distinguished by the different methods of coordination they utilise. Neither model is superior to the other; rather they provide advantages and disadvantages for different sectors of the economy. Intriguingly, both varieties have felt threatened by European integration.\textsuperscript{86} For liberal market economies, the spectre of directives that create labour market rigidities has loomed large. For coordinated market economies, the worries have ranged from neoliberal legislation or case law to an uncontrolled race to the bottom. The analysis of the legal situation has revealed that neither variety is likely to be in mortal peril.


\textsuperscript{86} See also Callaghan, above n 20.
The political safeguards in the legislative process, the methods employed by courts in general and the Court of Justice in particular, as well as the fact that both varieties create distinctive advantages are likely to render the challenges manageable. The Lisbon Treaty does not fundamentally alter this picture. While it does render the legislative process easier and thus promotes positive harmonisation, it contains additional safeguards for subsidiarity and offers ammunition to interest groups and parties arguing for legislation to be shaped by social considerations and for a more restrained interpretation of the European economic law. This is a good thing. Diversity will strengthen Europe and in any case the EU lacks the legitimacy and the capacity to impose a single variety of capitalism on all EU countries. The lesson for both legislative and judicial institutions is the need for modesty and sensitivity when managing the integration process, in particular in key areas such as labour relations and corporate governance, lest the costs of disruptions to national production systems outweigh the benefits of integration.

A large unanswered question looms, though. Even if the EU as a whole can and should tolerate different varieties of capitalism, is it possible or desirable to accommodate them within the eurozone, or will it in the end prove necessary for eurozone countries to converge on a single model? Recently, a debate has been raging on a competitiveness pact that might have imposed significant constraints on eurozone members. The final ‘Euro Plus Pact’ seems unlikely to shoehorn the participating countries into a single model. The pact leaves each state free to decide which specific policy actions it wishes to undertake, and the implementation of commitments will be monitored politically by the Heads of State or Government, while the reforms that are suggested in the pact are couched in language that lacks precision. However, the varieties of capitalism literature may offer an important insight into the debate. According to Soskice, there are powerful complementarities

89 For example, ‘[e]ach country will be responsible for the specific policy actions it chooses to foster competitiveness, but the following reforms will be given particular attention: (i) respecting national traditions of social dialogue and industrial relations, measures to ensure costs developments in line with productivity, such as: review the wage setting arrangements, and, where necessary, the degree of centralisation in the bargaining process, and the indexation mechanisms, while maintaining the autonomy of the social partners in the collective bargaining process”.
between production regimes and aggregate demand management systems. In particular, coordinated market economies may require tighter, more conservative monetary policies than liberal market economies.\textsuperscript{90} If this is correct, it suggests that a unified monetary policy cannot in the long run accommodate both liberal and coordinated varieties of capitalism.

Whatever the final verdict will prove to be for the eurozone, ultimately it is of course unrealistic to think that integration will leave national systems entirely untouched even if they do not participate in the euro. Integration will inevitably disturb entrenched ways of doing things. This is not a bad thing. No system is perfect. Economic integration entails increased competition both between companies and between regulations. This in turn creates incentives to increase the efficiency and effectiveness of national institutions. It also offers opportunities for mutual learning. At the same time, there is a need to avoid imposing solutions on Member States from the centre unnecessarily. A deregulatory reform may work well for a liberal market economy, as it improves the dominant method of coordination in the system, but may on occasion prove a source of counterproductive disruptions for a coordinated market economy, while a policy improving non-market coordination may prove ineffective or even detrimental for a liberal market economy, which depends on flexible markets.

Both liberal and coordinated market economies are under constant pressure from issues such as the changing patterns of consumption, economic globalisation, demographic change, and so on. Historically, they have been able to adapt to and have been shaped by such challenges,\textsuperscript{91} as well as by endogenous pressures.\textsuperscript{92} The integration project undoubtedly entails its own issues for different varieties of capitalism. However, as long as the project is managed sensitively, there seems little reason to think that it should prove fatal for them.

\textsuperscript{90} D Soskice, 'Macroeconomics and Varieties of Capitalism' in B Hancké, M Rhodes and M Thatcher (eds), \textit{Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy} (Oxford, Oxford University Press, 2007).
\textsuperscript{91} See Hall, above n 3.
\textsuperscript{92} As emphasised by Streek, above n 11.