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Citation: Schwartz, H. (2010). Small States in the Rearview Mirror: Legitimacy in the Management of Economy and Society. *European Political Science*, 9(3), pp. 365-374. doi: 10.1057/eps.2010.26

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Link to published version: <https://doi.org/10.1057/eps.2010.26>

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Small States in the Rear-view Mirror: Legitimacy in the Management of Economy and Society

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Abstract

Small States in World Markets is about political efficacy and legitimization rather than scoring who is ahead in the economic sweepstakes. Its case for democratic corporatism rests on norms, particularly stability, rather than on narrow measures of economic efficiency. But stability and the efficacious management of the economy and social problems requires a degree of technocracy that undermines the legitimacy of the management process itself by helping to produce populist revolts.

Key words: [corporatism, legitimacy, governance, Katzenstein]

Small States in World Markets, and its older sibling, *Corporatism and Change*, are now 25 and 26 years old. Both were immediate successes, as *Small States* attracted the Woodrow Wilson Foundation Prize and launched Peter Katzenstein from the low earth orbit he had already attained from editing *Between Power and Plenty* into the permanent geo-synchronous orbit occupied by only a few of the American political science elite. What made *Small States* (SSWM hereafter) such a success? Does SSWM hold up in the harsh light that illuminates hindsight? Given limited space I will answer the first question by looking at the relationship of SSWM to the broader comparative capitalism literature. This leads to the second issue of whether SSWM holds up, which I consider by looking at how immigration by non-Europeans and non-Christians has affected the ideology of social partnership and the practical political efficacy at the heart of SSWM's argument. To put the main point briefly, SSWM is more a book about political efficacy and legitimization than it is a book about scoring who is ahead in the economic sweepstakes. It rests its case for democratic corporatism on norms, particularly stability as an end in itself, rather than on the production of a higher ranking in the comparative capitalism league table. The long run problem, however, is that stability and the efficacious management of the economy and social problems requires a degree of technocracy that undermines the legitimacy of the management process itself by helping to produce populist revolts.

From Modern Capitalism to Small States, from Small States to Varieties of Capitalism

SSWM was a remarkable success. Google Scholar credits it with roughly 2200 citations, which puts it in the same league as the much later *Varieties of Capitalism* (VOC) or Wendt's *Social Theory of International Politics*, both of whose currency amplifies their counts. SSWM reoriented an entire generation of American scholarship on Europe away from the four large Western European countries and towards Europe's interstices. But in one way, SSWM represented the end of an arc of scholarship on comparative capitalism that started with Andrew Shonfield's (1965) *Modern Capitalism*. In another, SSWM represented the apogee of that arc, if we locate VOC as an end point.

Shonfield revived the institutional economics pioneered by Thorstein Veblen in the early 1900s and formalized by Frank Knight and John Commons in the 1930s – a great achievement. Mainstream economists largely looked at the micro-economic behaviour of firms acting in isolation. Shonfield largely focussed on the relationships among states, organized firms and unions. The Depression and World War 2 had decisively shifted these relationships away from laissez faire and towards various flavours of cooperation and state direction of the economy. In particular, Shonfield argued, states had become heavily involved in the process of wage formation, on the one side, and the quality and quantity of investment needed to validate those wages on the other side. Intervention stabilized those economies macro-economically, and facilitated a massive micro-economic shift away from traditional agriculture and towards manufacturing and industrial agriculture. Intervention stabilized politics too. Rising real wages, full employment, and stable returns on capital moved politics away from the extremes of the 1920s and 1930s.

Shonfield saw the political contradictions his modern capitalism contained. States' control over investment and intervention in wage formation enabled them to reduce what economic debates of the 1930s called the socialist calculation problem. As Hayek had pointed out, 'if detailed economic plans could be laid down for fairly long periods in advance and then closely adhered to, so that no further economic decisions of importance would be required, the task of drawing up a comprehensive plan governing all economic activity would be much less formidable... Economic problems arise always and only in consequence of change' (Hayek, 1984: 215). Hayek understood the market as an information aggregating and processing machine that reacted to changes more quickly than any bureaucracy. Could states really replace this machine and plan? Shonfield's states diminished the information problems in two ways that matter here.

First, post-war states in effect 'created information' through state directed investment programs and through their participation in collective bargaining. As Eichengreen (2008) argues, state investment programs gave market actors advance information about market opportunities and the size and stability of demand. State participation in collective bargaining reduced uncertainty, thus setting limits on outcomes

and assuring that bargains would largely stick. At the same time, centralized business organizations and union federations gave states access to private information that otherwise might remain hidden in the economy, while binding actors' behaviour.

Second, as Hayek notes, 'problems arise only in consequence of change.' States' pursuit of stability through a levelling of wages and a homogenization of consumption reduced volatility in the quantity and quality of demand. States – except for the United States – could plan because they were chasing a known model: the fordist, mass production, mass consumption, assembly-line based mechanical technologies first rolled out in the United States (Aglietta, 1979; de Grazie, 2005). So information was in effect already known to states and to the organized business and labour supporting these states politically.

Each of these economic management features contained a dark side that gave Shonfield's analysis an owl of minervish tinge. *Modern Capitalism* was published in 1965, on the eve of a decade of intense strife between management and labour, particularly in automobile production, the archetypical fordist industry. *Modern Capitalism* indeed anticipated this strife in its discussions of the breakdown of cooperative collective bargaining in the Netherlands in 1963. Disputes over fair shares, the monotony of work, and the homogenization of the labour force animated this strife. Shonfield also took particular pains in *Modern Capitalism* to consider the consequences of concentrating so much power into so few hands. The two final chapters of *Modern Capitalism* deal with the decreasing public accountability of insulated managers, bureaucracies and economic interest organizations. Shonfield correctly understood and predicted the delegitimizing consequences of this insulation. The late 1960s and 1970s saw explicit challenges from both left and right to centralization, bureaucratic control, and the standardization and routinization of life under fordism. States' and organized interests' management of some economic information displaced other economic information – for example about the social and environmental costs of mass production – into new political and cultural conflicts.

SSWM can be read as – and in some sense was sold as – a treatise on proper economic management, just like the bulk of Shonfield's *Modern Capitalism*. SSWM

noted that big countries were becoming more like small countries in terms of their vulnerability to global markets and to the turbulence in those markets in the 1970s. This turbulence directly threatened the economic stability of the 1950s and 1960s. SSWM offered up the small states as models for dealing with the turbulence that Katzenstein apparently viewed as a novel but irreversible feature of the global economy. But SSWM did not offer the small states up as models for economic growth, even though it notes in passing that the average American often had a lower standard of living than the average smallster. SSWM makes very careful and limited claims about both the transferability and economic efficacy of the small state model for larger states. Indeed, Katzenstein takes pains to avoid both the fallacy of composition – not all economies can be above average – and the notion that economic efficiency is the primary goal.

Rather, SSWM's major concerns and claims cover the issue raised in Shonfield's last two chapters: can actors maintain political legitimacy given the new economic realities. Katzenstein (1985: 29) defined his yardstick for success as 'the extent to which social coalitions, political institutions, and public policies facilitate or impede shifts in the factors of production that increase economic efficiency with due regard to the requirements of political legitimacy.' SSWM can thus be seen as a meditation on Shonfield's concerns about legitimacy.

This is why SSWM can be seen as the apogee of the project Shonfield started. Just as Shonfield's analysis harkens back to the deleterious economic consequences of the Great Depression, Katzenstein's harkens back to the Depression's deleterious political consequences. Shonfield feared that the institutional arrangements needed to stabilize modern capitalism would diminish individual rights and freedoms. I think that Katzenstein feared that the failure to manage the new turbulence would bring about the same kind of political instability that savagely extinguished individuals and individual rights in the 1930s and 1940s. Thus SSWM is profoundly conservative despite its evident admiration for European social democracies. At heart, SSWM expressed a yearning to preserve for as long as possible the cooperation and solidarity that underpinned the post-war compromise. Katzenstein, recall, defined democratic corporatism largely in terms of processes and ideologies reflecting cooperation and sharing: an ideology of social

partnership and voluntary and continuous bargaining over conflicting interests conducted through (Shonfield's) centralized system of organized interests.

Yet the last of these three defining features is, as Weber would put it, ethically neutral. Even if we limit 'a centralized system of interest groups' to corporatist polities, this does not guarantee cooperative bargaining and shared sacrifice. States in Manoilescu's Romania, Mussolini's Italy and Vargas' Brazil all centralized and organized economic interest groups for purposes different from Katzenstein's social and liberal corporatist states. A centralized system of organized interests is simply a machine. The important issue is the shared sense of social purpose animating that machine. (And much of Katzenstein's later work focussed precisely on the social construction of interests and political identity.) SSWM is not ethically neutral. The ghost in SSWM's state machines is the lingering political lesson of the depression: cooperation and compensation were better than conflict and catastrophe. The archetypical policy this spirit and machine produced is thus incomes policy designed to provide domestic compensation for those battered by global gales (Katzenstein, 1985: 49).

Shonfield saw the cost of shifting away from the economic message of pre-war classical liberalism. Unconstrained markets were flexible, but neither durable nor stable. The market needed the state in order to avoid self-destruction, even if this came at the price of some individual liberty. Katzenstein inverted the pre-war classical liberalism lingering in Shonfield's politics. An individualistic polity and winner-take-all politics were also neither stable nor durable. Individuals needed to be corralled into organizations and to accept some limits on economic gain in order to avoid a destructive politics triggered by economic changes. Individuals needed the state and disciplined interest organizations to avoid the total loss of liberty characteristic of the 1930s. And Katzenstein, recall, wrote SSWM when state evisceration of unions was just gaining speed in the Anglo-countries, and when finance was displacing manufacturing as the politically dominant fraction of those business communities. Elsewhere, collective bargaining was decentralizing, with what were then unknown consequences for continuous bargaining over conflicting interests.

SSWM's deep argument about the attractiveness of the democratic corporatist model thus rests on norms rather than narrow economic success. Seeking good enough returns with a placid politics was better than doing better via tumult. This turned out to be a good strategic choice. Cracks were already visible in the small states' economic foundations when Katzenstein was writing. SSWM mentions the apt and widely attributed snark about Denmark being on a fast train to hell, albeit at least travelling first class. But at that time the Netherlands was also projected to soon have its entire workforce on disability pensions, Belgian public debt had pierced the 100 per cent of GDP level, and a series of bourgeois coalition governments in Sweden had embarked on a costly and disastrous nationalization spree. The 1990s saw substantial shifts in economic and social policy, though not always in the principle of compensation, as the seven dwarfs sought to dig themselves out of the hole they fell into in the 1980s (Jones, 2008). Meanwhile, though not all of the big economies prospered in the 1990s, the disorderly, disorganized and conflictual American economy did substantially better than its organized competitors. Still, small state cooperation, coordination and compensation delayed the income inequality and consequent criminal and social pathologies emerging everywhere in the OECD. Economic outcomes thus don't provide a handy way to assess the durability of SSWM's argument. This was neither Katzenstein's criterion nor his main point. The real question then, if we want to assess SSWM with the benefit of hindsight, is the durability of democratic corporatism as a politically efficacious system for maintaining the legitimacy of a given and benign system of political and social power.

Before doing that I want to anchor SSWM against the other benchmark I suggested above: *Varieties of Capitalism* (VOC). Like SSWM and *Modern Capitalism*, VOC is a product of its time. Where *Modern Capitalism* sought to explain placid macro-economic waters and SSWM dealt with navigating an unexpected run of rapids, VOC reflects the triumph of business and of micro-economic models at century's end. Micro-economic behaviours create and sustain VOC's institutional complementarities, even if it takes negotiation to arrive at decisions in coordinated economies. While negotiation matters, it is all about the adjustment of economic interests, particularly in manufacturing, and not about a particular conception of justice.

Like SSWM, VOC is cautious about idealizing one specific politico-economic model, essentially arguing: different models for different kinds of assets. Yet VOC equally avoids any consideration of the normative issues that animated *Modern Capitalism* and SSWM. VOC thus radically narrows the scope of inquiry in both *Modern Capitalism* and SSWM. SSWM reoriented *Modern Capitalism* away from a predominant focus on ‘who is getting more aggregate economic and employment growth’ towards a focus on political efficacy, towards ‘who is best able to keep all parties bought into a stable social compromise.’ VOC, by contrast, worries mostly about institutional complementarities rather than final ends, and micro-economic issues in manufacturing rather than macro-economic stability. VOC explains businesses’ attachment to some social programs through micro-economic rationality, rather than an attachment to cooperation as a process that yields legitimacy to outcomes that might require short run sacrifices. Like *Modern Capitalism* and SSWM in their time, VOC has a similar owl of minerva feel to it. Manufacturing still matters, but the bulk of consumer demand is gradually shifting away from manufactured goods narrowly and towards both services and goods with high levels of embodied information. In this sense, VOC provides a radically narrower vision than either *Modern Capitalism* or SSWM, which at least exposed the bones of the prior set of compromises.

VOC’s silence on norms is even louder when we consider the bifurcation of the seven dwarves since the 1980s. Even as SSWM was published, the notion of a distinct Nordic model was emerging. Unlike the low country and Alpine dwarves, these societies saw increases in union density – surely a precondition for and confirmation of successful collective bargaining – from the 1970s onward. And if Rothstein (2001) is correct, a central part of the success and distinctiveness of the Nordic model is a high level of social capital, or legitimacy, that sustains social compromises. By contrast, Belgium and Netherlands saw increasing political disunity (Jones, 2008). VOC has thus round-tripped to *Modern Capitalism*’s practical concerns for economic management while losing its moral concerns.

The unbearable darkness of immigrants

With that in mind, does SSWM still shed light on the path forward? An ideology of social partnership and consensus building lies at the heart of SSWM's argument about political accommodation both as an end in itself and also as a means towards economic adaptability. Yet it is hard to see that ideology persisting going forward. Katzenstein stressed that smallness itself matters – elites in small countries can gather around a dinner table to hammer out incremental, reactive and flexible responses to changes in their environment. But size itself is not sufficient, or New Zealand, Ireland and Finland might qualify for the democratic corporatism label. Indeed, some political elites in 1980s New Zealand sought and failed to recast New Zealand's political and collective bargaining institutions in a corporatist direction (Castles *et al.*, 1996). In the 1990s, Ireland similarly fashioned something like a corporatist social pact, which some analysts credit for at least part of the Irish miracle (Daly, 2005, disagrees).

Social partnership in the seven dwarves reflected three factors that are all decaying. Katzenstein focussed on the shared experience of the 1930s – already now three generations past and thus barely a lived experience for one of those generations. He had less to say about the relative immobility of capital, although relative mobility was at the heart of the distinction between social and liberal corporatism. Increased capital mobility has decreased trust between capital and labour and undermined the conditions for successful corporatism (Schwartz, 1998). But the most important political factor is that the incredibly ethnically homogenous populations created or existing in the 1920s and 1930s have disappeared. Homogeneity made cooperation easier, and prevented the exclusion of economic losers.

Where Katzenstein's America had to cope with the increasing globalization in the form of rising import penetration and competition for local industry, globalization has challenged the small states via rising immigration. Rising immigration has transformed these once homogenous societies into something closer to fractious and factionalized America. Immigrants now account for double digit percentages of the population in most of the seven dwarves. Switzerland has always had a large immigrant population, but mostly from its neighbours and Portugal. Immigrant populations in Sweden, Austria and

Belgium now rival or exceed the 12.5 percent level currently found in the United States. Denmark, Norway and the Netherlands remain below or at the 10 per cent level (OECD 2007: 328). Yet even in these last three countries, immigrants have been a politically contentious, consensus threatening issue the past decade or two.

Put aside spectacles like Theo van Gogh's murder or the Danish Mohammed cartoon controversy. What makes immigrants problematic for the democratic corporatist model is that their presence has prompted the emergence of uncoalitionable anti-immigrant parties, and that immigrants have no easy path (or desire?) to assimilate. The uncoalitionable Norwegian Progress Party (Fremskrittspartiet) is the second largest and most dynamic party in Norway, capable of capturing a quarter of seats in Parliament. The Danish Peoples Party (Dansk Folkeparti) similarly is now the third largest party, and the second largest workers' party. Though uncoalitionable, its indispensable if tacit support for minority right-of-centre governments bought it significant restrictions on immigration. And so on down the line with the Belgian Vlaams Belang, the Austrian Freedom Party (FPÖ), the Swiss Peoples Party (SVP) and the Dutch Party for Freedom (Partij voor de Frijheid). Only Sweden's Democrats (Sverigedemokraterna) had yet to break through the threshold for parliamentary representation as of early 2010, though it was surprisingly successful in the 2006 local elections. The anti-immigrant parties signal the erosion of the social consensus behind democratic corporatism. Inclusion and the discipline of the organized cannot be taken for granted, as explicit populist welfare chauvinism (Mudde, 2007) means the welfare state cannot be used to promote economic flexibility.

Meanwhile the newer, darker immigrants are not partners anywhere. It was easy enough for people who thought first of themselves as citizens and perhaps only secondarily as taxpayers to be solidaristic when the losers from economic transformation were one's rural relatives, or a late middle age uncle made redundant by new technology, or the poorly educated parents who launched one's own ascent into middle class stability. Their spells of unemployment or ill-health were 'naturally' understandable and politically acceptable. By contrast, darker, non-Christian immigrants remain behaviourally opaque to the larger community. This opacity prevents an understanding of the usual life events

that might reduce labour market participation in societies in which labour force participation remains an irreducible component of the moral claim on state and thus social resources. Labour force participation for small state immigrants (even in Switzerland) is uniformly lower than for the native population. Indeed, male immigrants participate at rates lower than native women in Scandinavia (see Table 1) (OECD, 2007). This contrasts with the larger economies, where immigrant labour force participation rates approximate or sometimes exceed natives' participation rates (OECD, 2007). Distrust and thus separation ensues.

Table 1: Labour Force Participation rates in 2005, percent

| | AT | BE | DK | NLD | NO | SE | SZ |
|---------------------------|-----------|-----------|-----------|------------|-----------|-----------|-----------|
| Male native | 75 | 67 | 81 | 82 | 77 | 76 | 85 |
| Male immigrant | 68 | 61 | 69 | 69 | 67 | 64 | 81 |
| <i>difference</i> | -7 | -6 | -12 | -13 | -10 | -12 | -4 |
| Female native | 63 | 57 | 73 | 69 | 72 | 73 | 73 |
| Female immigrant | 56 | 39 | 53 | 53 | 60 | 58 | 63 |
| <i>difference</i> | -7 | -18 | -20 | -16 | -12 | -15 | -10 |
| immigrant Male net | 5 | 4 | -4 | 0 | -5 | -9 | 8 |
| native Female | | | | | | | |

Source: OECD, *Migration Trends*, 2007

Moreover, as Unni Wikan (2002) has argued, immigrants find themselves bereft of the possibility for integration into the larger social compromise or consensus that underpins democratic corporatism. State policy has essentialised immigrant cultures, locking immigrants out of assimilation. Citizenship appears to be an empty legal formality that carries with it no further obligations, including work. Immigrants, meanwhile, cluster in tight communities with denser connections to their place of origin than to the local society, locking themselves into a condition of difference. So immigrants remain sojourners excluded from the machinery of compromise behind SSWM's democratic corporatism. Sadly, where an ideology that accommodates immigrants exists,

as in the United States, Canada or Australia, there is little consensus about a social partnership. Where a consensus on social partnership exists, as in the smalls, there is little ideological basis for accommodating (darker) immigrants. And immigrants find exclusion even in death. In Denmark, Muslims lack a cemetery of their own (Klausen, 2005).

The fights around immigration and immigrants reveal the slow erosion of ideology of social partnership and consensus building. But this is not to blame the immigrants for their mere presence. Rather, the fights around immigration reveal precisely the problems with elite economic management already signalled in *Modern Capitalism*. The disenchantment with technocratic politics, conformity, and control that motivated the great factory riots of the 1960s in Shonfield's big economies play out now as cultural riots in the seven dwarves. Elites in the seven dwarves have managed immigrant (non-)assimilation the same way they managed welfare state transformation in response to the shocks of the 1980s.

The Dutch, for example, fixed their employment problem through the famous 1982 Wassenaar Accord, in which the state induced wage moderation from unions in exchange for promises of investment from business (Visser and Hemerijck, 1997; for a critique, Salverda 2005). Wassenaar's deal on wages and welfare state reform, though not mentioned in SSWM, is surely precisely what Katzenstein was thinking of when he constructed SSWM. Yet Wassenaar and its cognates in the other six countries led to a politics of disenchantment with elite driven deals. Wim Kok, the Netherlands' prime minister through much of the 1990s and an architect of Wassenaar and other technocratic adjustments to the Dutch welfare state, went on to a fabulous career in the EU after dismissing the Pim Fortuyn phenomenon as media hype. But he fled a disgruntled electorate that brutally punished his Labour Party in the 2002 election subsequent to his resignation. The same electorate also rejected a similar politics of elite driven 'Europeanization' in the 2006 referendum on the European constitution. Dutch dikes don't wall off this kind of politics from the rest of Europe. All the small state anti-immigrant parties are populist parties channelling resentment against the elite management of the economy and society that is isomorphic with democratic corporatism. And they are uniformly euro-sceptical. Democratic corporatism (and European

integration) might indeed be good in some objective sense for the disgruntled – indeed there is evidence that populist voters shift to traditional parties as unemployment rises (Bjørklund, 2007) – but no one has asked them if this is so. Shonfield's concerns about technocratic management of the state and the firm remain live issues today.

Conclusions

SSWM is a moral tract wrapped in a comparative capitalism kimono. It argues that a specific form of political rigidity can produce economic flexibility, and by thus allowing adjustment with legitimacy, also preserve political stability. SSWM thus provided one answer to the question Shonfield raised at the end of *Modern Capitalism*: can the technocratic management that the modern economy and firm make necessary accommodate the preservation of individual rights and individual deviance? Katzenstein argued that political legitimacy and consensus permitted better, in the sense of flexible, economic management, and that in turn, this flexibility helped maintain political legitimacy. However the social basis for legitimate management of the economy has decayed since the 1980s. The social cohesion created by homogenous populations and a shared, if later vicarious, experience of the Depression and Second World War is a currency now spent. Marketization everywhere has given primacy to the economic flexibility tail rather than the political legitimacy dog, making it unlikely that elites will replenish the social capital spent on flexibility and Europeanization in the 1980s and 1990s. Political economy's current obsession with micro-economic models sheds little light on why that particular account needs an injection of new funds. Even if SSWM's answer to Shonfield's question failed to foresee the emergence of non-European immigration, Europeanization, and marketization, its logical structure provides a good guide for understanding the possible consequences of those phenomena. Populism in the 1920s and 1930s turned into a brutal politics as the Depression wore on. The current global financial crisis may make Katzenstein's message about stability important again.

Acknowledgment

The author would like to thank Gerard Alexander, Christine Ingebritsen, Anders Ravik Jupskås, Sjur Kasa, Audie Klotz, Peter Mayer, Lars Mjøset and especially Bent Sofus Tranøy, etc for comment and criticism. An early version was presented to the Norwegian Political Economy Working Group, which also provided helpful feedback. Errors remain mine.

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