Varieties of Capitalism in East Asia

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Outline of the lecture

• Topics of the term essay
• The VoC approach: background, puzzle and comparison (Hall and Soskice, 2001)
  • Towards an analytical framework
  • Comparing Germany and the US
  • Comparative institutional advantage, public policy-making, and economic adjustment
• Comparing capitalism in East Asia
  • Explaining East Asian capitalism
  • Capitalist institutions in Japan, China and Malaysia
  • Economic governance and changing East Asian capitalism
Topics of the term essay  (due on Jan 21)

• Compare the ancient silk road and the Belt and Road Initiative

• Discuss the impact of regional hierarchy on pre-colonial East Asia

• Explain the special roles of the state in East Asia’s economic miracle

• Discuss the similarity and difference of capitalist institutions in East Asia

• Explore the impact of regional production networks and/or the rise of China on regional cooperation in East Asia
The VoC approach: background

• Understanding the systemic variations of developed capitalist economies’ politico-economic institutions

• What are the essential institutions of capitalist economies?
  • Financial market
  • Labor market
  • Education and vocation training
  • Corporate governance and inter-firm relations

• Assumptions about the capitalist institutions
  • (Institutional) structure determines (corporate) strategy
  • Institutional complementarities
Empirical puzzles

• Britain and Germany responded differently to an appreciation of the exchange rate
  - British firms pass the price increase to customers in order to maintain profitability
  - German firms maintain the prices and accept lower returns in order to preserve the market share

• Linking corporate strategy to the politico-economic institutions
  - Britain: profitability-based financial market; fluid labor market
  - Germany: access to capitals independent of current profitability; long-term employment
The VoC approach: the analytical framework

• The relational context of the firm
  • Industrial relations, vocational training and education, corporate governance, inter-firm relations, employees relations

• Two (ideal-type) models
  • liberal market economies (LMEs) and coordinated market economies (CMEs)

• Understanding the capitalist institutions
  • Institution: formal and informal; cultural and history
  • Functions: information exchange, monitoring, sanctioning of defections
  • Institutional complementarity: employment protection, stock market capitalization, capacity for innovation, income distribution
## Comparing capitalism in Germany and the US

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<tr>
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<th>Germany</th>
<th>US</th>
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<tr>
<td><strong>Financial system/market</strong></td>
<td>Access to ‘patient capital’ that depends less on financial data or current returns</td>
<td>Access to capitals (bonds, share issues and bank lending) based on current earnings and share prices</td>
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<td><strong>Firm-level decision-making</strong></td>
<td>Consensual decision-making involving employees and major shareholders</td>
<td>Top-down and unilateral controls of the firm by the top management (CEO)</td>
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<td><strong>Industrial relations</strong></td>
<td>Industry-level wage bargain to ensure income, employment and encourage firm-specific skills</td>
<td>Market-based wages, fluid labor market encourages general skills</td>
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<td><strong>Education and training</strong></td>
<td>Publicly subsidized training schemes monitored by industry-wide associations</td>
<td>Education stress certifications in general skills, plus companies’ in-house training</td>
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<td><strong>Inter-firm relations</strong></td>
<td>Dense networks of supply chains, cross-shareholding, and industrial associations for information sharing and technology diffusion</td>
<td>Market relationship, formal contracts, and antitrust regulation; technology diffusion via labor mobility and licensing</td>
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Comparative institutional advantage

• LME and radical innovation
  • Innovative design, rapid product deployment
  • Risk-taking on new product strategies; rapid implementation; large, tightly coupled organizations that employ a diverse workforce…
  • Aim: product competition

• CME and incremental innovation
  • High quality of an established product line, consumer loyalty
  • Industry-specifically skilled workforce; secured and autonomous labor; consensus decision-making; close inter-firm collaboration…
  • Aim: product differentiation
Social and economic policy-making

• Social policies improve the operation of labor markets
  • Unemployment benefits
  • Disability benefits and early retirement benefits

• LME tends to have liberal welfare state
  • Emphasizing means-testing and offering low levels of benefits
  • Developing general skills

• CME tends to have more generous welfare state
  • Emphasizing income security under different circumstances
  • Developing specific skills
Social and economic policy-making

• LEM: Market incentive policies
  • Relying on markets to coordinate business activities
  • Deregulation

• CME: Coordination-oriented policies
  • Facilitating firm-level competencies within a dense business network
  • ‘Decentralized cooperation’

• The role of political assurance in coordination facilitation

• The co-evolution of capitalist economy and political regime
  • LME and concentration of power in political executive
  • CME and consociational, coalitional or quasi-corporatist regimes
Dynamics of economic adjustment

• Responding to globalization
  • Firm in different types of economies should react differently to the competitive pressures of globalization

• Changes in national systems
  • The adjustment process will be oriented to the institutional recreation of comparative advantage – new equilibria

• Yet, challenges of international financial market and global value chains
  • External capitals through international financial market & cross-border merger and acquisition: a potential source of instability?
  • Global value chains and growing inter-firm collaboration across national borders: firms facing different labor market, vocation training, and regulatory regimes
Reconsidering the VoC approach

• The varieties of capitalism (VoC) approach
  • Focusing on the internal coordination and organization of the capitalist systems: firm, labor, capital, technology
  • Emphasizing institutional complementarity: different spheres of the capitalist systems are mutually reinforcing
  • Two equilibria of LMEs and CMEs: the instability of MMEs

• Critique (Walter and Zhang, 2012)
  • Two ideal cases and the actual diversity of capitalism
  • Unable to explain the fundamental institutional change
  • Downplaying the influences of politics and the distribution of political power
Explaining capitalism in East Asia: the literature

• Modernization theory
  • Asian traditions and cultures’ potential hindrance to capitalism

• Neoclassical account
  • Outward-looking and market-oriented policy settings crucial to the development of capitalism

• The Developmental state
  • The state’s growth-promoting role and close government-business relations

• East Asian capitalism: state-led, network, relationship-based...
Explaining capitalism in East Asia: analytical framework

• Three waves of capitalist development
  • High-income industrialized economies: Japan, South Korea, Singapore, Taiwan
  • Low and middle-income industrializing economies: Malaysia, Thailand, Indonesia and the Philippines
  • Market-oriented former socialist economies: China, Vietnam

• Capitalist institutions in East Asia: basic characteristics
  • Business system (intra-firm relations; inter-firm networks): dominant cross-sector business groups and close state-business relations
  • Financial system (financial market and corporate governance): financial control and ‘repression’ under the developmental state
  • Labor market system (employment; labor union and social welfare): labor subordination and meager social welfare provision
Japan and business group-based capitalism

• Business system: powerful business groups
  • Japan (and South Korea till late 1990s): intra-industrial competition, cross-sector coordination, and company-based R&D

• Financial system: bank-based corporate finance
  • The main bank system (Japan)
  • State (administrative) guidance on credit allocation (South Korea)

• Labor market system: life-time employment, but in decline
  • Workers to develop firm- and group-specific skills under life-time employment
  • Rapid organization redeployment based on workforce cooperation
  • Cross-sector technology transfer

• Comparative institutional advantage in large-scale production of consumer goods, machinery and electronics (Hall and Soskice, 2001)
China and state-centered capitalism

• Business system: dominance of the state (public) sector
  • The state sector receives government support and occupies key industries
  • The private sector operates in limited areas, with greater entrepreneurship

• Financial system: underdeveloped financial market
  • The state sector (SOEs): privileged access to bank loans and state credits
  • The private sector: limited access to finance, relying on internal savings
  • Foreign (direct) investment: important but not dominant

• Labor market system: sectoral and regional inequality
  • The state sector offers more job security
  • The private sector embraces flexible job market
  • Rural migrant workers provide low-cost temporary labor
Malaysia and ethnically biased capitalism

• Business system: economic dualism
  • Growing Malay (Bumiputra) business coexists with powerful Chinese business
  • Tradeable vs. non-tradeable sectors: competitive export-oriented sectors (mostly manufacturing); protected domestic non-tradeable sectors (service, construction, real estate)

• Financial system: internally and externally dependent
  • State subsidies in favor of Bumiputras (i.e., the ethnic Malays)
  • Chinese business controls a substantial amount of domestic credit
  • Foreign (direct) investment offers a crucial source of investment

• Labor market system: ethnic segmentation
  • Ethnic segmentation across sectors: manufacturing, public sector, finance/business, transport and storage
  • Foreign and domestic migrant workers: the risk of excessive exploitation
State-society relationship and modes of economic governance

- The state actively involved in guiding economic outcomes
  - State organization of the economy: extensive or modest
- Key social groups and hierarchies coordinate economic actions
  - Social coordination of economic action: strong or weak
- Four modes of economic governance in East Asia (Walter and Zhang, 2012)

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<td>Networked</td>
<td>State-led</td>
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<tr>
<td>Personalized</td>
<td>Weak</td>
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Economic governance and East Asian capitalism

• Examining the East Asian capitalism in the 1980s (Walter and Zhang, 2012)
  • Co-governed: Korea and Taiwan
  • State-led: China, Malaysia, Indonesia
  • Networked: Japan
  • Personalized: Philippines, Thailand

• East Asian capitalism changed in the 1990s and early 2000s
  • Economic regionalization: intra-regional capital flow since the mid-1980s
  • Economic liberalization and deregulation: neoliberal reforms
  • AFC and its aftermath: economic crisis and the IMF conditionality
Changing East Asian capitalism

• Business system
  • Cross-sector business groups remain important, but with lower cross-shareholding and the family ownership
  • The government-business relationship under public scrutiny

• Financial system
  • The growth of (capital) market-based corporate finance
  • Cross-country capital flows and cross-border M&A

• Labor market system
  • More labor market flexibility and job insecurity
  • Declining union density and weakening labor influences