

# Power in a Complex Global System

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# 4

## VARIETIES OF FINANCIAL CAPITALISM, CRISIS, AND ADJUSTMENT

Plus ça change, plus c'est la même chose

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In the last three decades, advanced industrial countries have faced challenges arising from the globalization of financial markets.<sup>1</sup> European economies faced additional pressures from the Single Market Program with its supranational regulation and adoption of a single currency. Scholars suggest that European bank-based systems have become similar to the Anglo-Saxon model, where securities markets and investment banks dominate. For Rajan and Zingales the fact that, in continental Europe “since 1980, the stock market capitalization to GDP ratio went up more than thirteen times, while the proportion of investments financed through equity issues went up sixteen times,” is clear evidence of a convergence trend.<sup>2</sup>

This chapter advances the view that the bank-based versus capital-market-based dichotomy is *not* obsolete and that cross-national heterogeneity in financial structures and practices in advanced democracies has persisted over time. The global financial crisis of 2008, caused primarily by the excesses of deregulation and securitized subprime US residential mortgages, underlined the weaknesses of market-based financial systems. The variation in the intensity of the crisis and in national policy responses reflected differences in national models of financial capitalism. The extent and character of state interventions in the economy as a response to the crisis served to reinforce the particular institutional features of the preexisting models as opposed to undermining them.

The continued viability of financial capitalism's institutional diversity in the industrialized world hinges on institutions of nonmarket cooperation's ability to mitigate class and sectoral conflict among different sociopolitical groups – financiers, industrialists, and workers – interested in preserving bank-based finance. Among the most visible of such cross-class institutions that define the degree of corporatism in a country are centralized structures of business confederations, coordinated wage bargaining, as well as cohesive government and interest group interrelations.<sup>3</sup> In my earlier work, I found evidence that the high degree of strategic coordination

through extra-market institutions contributed to the development of banking markets (measured by credit allocation) but it has been less conducive to the development of capital markets (measured by the size and the activity of stock markets and by the degree of liquidity that stock markets provide to the economy).<sup>4</sup> My goal here is to show that coordinating institutions have not only helped corporatist countries cope with financial globalization by compensating societal groups through bank-centered finance and cross-shareholding, but also with the recent financial turmoil and postcrisis stabilization.

The coalitional approach sketched here draws on the strengths of two bodies of literature. With the corporatist theorists I argue that an ideology of social partnership and consensus building through corporatist institutions, which lies at the heart of Katzenstein's argument, has proved to be an important adjustment mechanism to the instability of international financial markets.<sup>5</sup> From the interest group theories, I take the insight that when interests of societal groups are misaligned, economic outcomes can be disastrous for a country's development.<sup>6</sup> In economies where market coordination is prevalent, the political strategies of entrenched private interests aim to influence the regulation and policies, rather than to forge a compromise.<sup>7</sup> The pervasive influence of the City of London on British economic policies and of large investment banks on US policies might explain the extent of economic crisis, the crisis management, as well as international regulatory positions of national authorities.

This chapter offers empirical support for the explanations underlying the importance of domestic structures. It parallels the argument made by Lake in his contribution to this book to the extent that he considers domestic structures as "negotiated, dynamic, and a product of politics." However, unlike Lake, who observes the common trends across industrial democracies, I highlight the national differences in forms of financial capitalism. Contrary to the conclusions of Schwartz in this volume, moreover, my analysis suggests that in spite of a high degree of capital mobility, financiers are still willing and able to make durable bargains with labor and participate in nonmarket coordination. Banks have been pivotal in sustaining a social compromise over institutions of nonmarket coordination that afforded them protection from outside competition,<sup>8</sup> while allowing their successful adaptation to the new rules of liberalized financial markets.

### **Alternative models of financial capitalism**

The dominant tradition in the comparative financial economics literature distinguishes between market-based (arm's length) and bank-based (relationship-based) financial systems.<sup>9</sup> In market-based systems of finance, financial markets directly channel capital from savers to investors. Relations between financial institutions and firms rest on an arm's-length market basis and limited short-term lending arrangements. Securities and derivatives are the main source of long-term finance for firms. Capital markets are large, active, and characterized by high levels of transparency and dispersed shareholding. Recent literature on corporate governance

suggests that countries with more developed capital markets tend to have more effective investor protections.<sup>10</sup>

In bank-based systems, banks and other financial intermediaries provide loans to firms for financing their investments. Firms are closely connected by dense corporate networks of cross-shareholding that facilitate the exchange of private information and determine the reputation of managers. Banks hold large ownership stakes in firms, allowing them to closely monitor and influence the firms' strategic decisions.

The classic explanation of financial systems' national diversity, developed by Gerschenkron, emphasizes access to long-term capital, linking the timing of industrialization to the financial system's organization: whereas British industrialization was market-financed, French and German industrialization were financed by banks.<sup>11</sup> With France as the prototypic case, Zysman applied Gerschenkron's insight to the story of industrial policy in the postwar period and suggested an additional model of finance: a credit-based system in which financial relations are dominated by government-administered prices.<sup>12</sup>

The varieties of capitalism (VOC) literature, introduced by Hall and Soskice,<sup>13</sup> has become the most prominent tool to explain the persistent divergence among models of financial capitalism, highlighting their comparative advantages.<sup>14</sup> Recent advances in the VOC school of analysis have identified several trends in financial development involving some or all of the following processes: bank disintermediation and a shift toward increasing self-finance and market finance by large and publicly listed firms; securitization and a shift toward investment and trading; a decline in the prevalence of cross-shareholdings and the weakening of relationship banking; the growing importance of nonbank financial institutions in corporate governance and equity markets, and others.<sup>15</sup> However, the VOC literature remains inconclusive about the extent and nature of these changes and whether these reforms led to convergence among financial systems.

The argument proposed here is linked to the institutional theory of stability and change in global finance. National financial arrangements do not remain frozen in time but adjust to changing domestic or international environments. This chapter acknowledges that the financial systems of advanced democracies witnessed substantial reforms in corporate governance as well as the expansion of securities markets. But there is a significant institutional inertia regarding financial institutional structures.

### **Persistent heterogeneity of financial systems**

The historical development of capital markets did not follow a monotonic path, as Rajan and Zingales argue.<sup>16</sup> They document how, in 1913, corporatist countries such as France, Belgium, and Austria had more developed capital markets than the United States did. After the war, many European countries and Japan changed their political and legal institutions: stronger trade unions, protectionist lobbies, rent-seeking business groups, and banks all pushed for a system that suppressed equity

markets and favored insider control and state intervention in finance.<sup>17</sup> As a result, financial sectors in these countries became bank oriented. In contrast, the United States and the United Kingdom moved away from the postwar social compromises of managerial capitalism and pluralistic industrial relations to shareholder-oriented corporate governance and active capital markets.<sup>18</sup>

In recent decades, we have witnessed important developments in national financial structures as a result of financial globalization, deregulation, and economic integration. These developments have led to the reconfiguration of coalitions and how they shape the institutional structures of finance in advanced democracies. The old coordination institutions have been transformed and evolved.<sup>19</sup> Stakeholders in corporatist countries tried to preserve the existing forms of coordination by reducing it to a smaller group of insiders.<sup>20</sup> After the crisis in the 1970s, Sweden emerged with a new, less labor-inclusive model of coordination that involved the decline of centralized wage bargaining as well as the elimination of formal interest-group representation at the board of several public agencies.<sup>21</sup> But in Denmark and other small European states, corporatist institutions have become more decentralized and inclusive, involving new actors (for example, representatives from various professional associations and geographic regions) and improving the capacity to develop “collectively shared understandings of international competition” based on a better process of information exchange and strategic coordination among various actors.<sup>22</sup> Streeck and Kenworthy’s recent review of research on corporatism suggests that limited (if any) convergence has been found in interest-group organization and participation in recent decades.<sup>23</sup>

The overall trajectory of financial development in bank-based systems reflects a remarkable stability of nonmarket coordination. Cross-class coalitions were able to defend nonmarket coordination and the institutions of bank-centered finance as part of the new corporatist arrangements. In spite of formal regulatory changes, the existing practices of corporate cross-shareholding, designed to protect firms from international competition and hostile foreign acquisitions, appear to be largely preserved.<sup>24</sup> According to Culpepper who examines corporate governance reforms in France, Germany, and Italy since 1990, only France has experienced major changes: cross-shareholdings among large French banks and nonfinancial firms have been replaced by British and American institutional investors.<sup>25</sup> However, Clift argues that although the “*noyaux dur*,” the crux of French financial capitalism, partially unraveled as a result of privatizations, the distribution of share ownership remains very concentrated (for example, fifteen families control nearly 35 percent of the capitalization of the French securities market), hostile takeovers are rare, and corporate governance strategies continue to protect managerial elites and marginalize minority shareholders.<sup>26</sup> Three main networks, organized around Société Générale, Crédit Lyonnais, and BNP-AXA, dominate the French financial regime: thirty directors of these banks hold among them 160 seats on the boards of large French firms.<sup>27</sup> Still others claim that the contemporary French model has evolved into one that successfully combines weakening coordination institutions with short-term arm’s-length finance and a hybrid corporate governance system.<sup>28</sup>

Germany, a paradigmatic bank-based system, has preserved the institutional architecture of “stakeholder” governance, including codetermination and work councils.<sup>29</sup> Despite intense international pressures, the German government did not support the European Union Takeover Directive in 2001, and thus successfully resisted weakening of its Codetermination Law, the centerpiece of the country’s corporate governance structure.<sup>30</sup> Callaghan argues that German corporate cross-shareholdings remain quite high, in spite of a recent decline. In particular, she argues that the controlling influence of banks is much greater than what their equity holdings suggest.<sup>31</sup> For example, in 1992, the top twenty-four banks in Germany controlled an average of 85 percent of voting rights, but only 13 percent by virtue of their own shareholdings.<sup>32</sup> In 1996, the supervisory boards of twenty-nine of the one hundred largest firms were chaired by representatives of Deutsche Bank alone.<sup>33</sup>

Following the regulatory changes in the 1990s, the Italian banking system has remained bank-centered albeit in a different way. The largest Italian banks – UniCredito, Intesa Sanpaolo, IMI, Capitalia, and Monte de Paschi de Siena – still control 40 percent of the banking network, and a small elite of “financial and political power brokers” continues to influence the functioning of banks and the distribution of credit.<sup>34</sup> In Sweden, equity markets are still characterized by many cross-shareholdings that protect national champions from hostile takeovers.<sup>35</sup> As in Italy, “informal” models of coordination through families remained a stable feature of the Swedish economic model.<sup>36</sup> The Netherlands successfully preserved a stable system for wage coordination, but investor-firm relations and relations among firms and their suppliers have become short term and arm’s length.<sup>37</sup>

Notwithstanding these recent reforms along Anglo-Saxon lines, banks still dominate in traditionally bank-centered systems. Large French and German banks have expanded their foreign and trading operations, engaged increasingly in investment banking (for example, derivatives trading, securities arbitrage), and internationalized their activities while searching for profit-making opportunities.<sup>38</sup> But small domestic banks have preserved strong links to regional economies in most continental European countries and remain the most important source of external finance for small and medium enterprises (SMEs).<sup>39</sup> Local banks not only provide adequate capital on competitive terms, and thus reduce the attractiveness of external equity finance, but also facilitate their existing customers’ access to securities markets.<sup>40</sup>

Table 4.1 and Figure 4.1 show some comparative data on the level of financial development, measured by the International Monetary Fund’s (IMF) Financial Index, which captures three key elements of a financial system: first, the degree of bank intermediation; second, the degree of financial intermediation through nonbank financial institutions (for example, investment banks, pension funds, equity funds), nontraditional activities undertaken by banks (for example, the securitization of loans), and the use of new financial instruments (for example, derivatives); and third, the importance of securities markets. The index ranges between 0 and 1, with a higher value representing a greater arm’s-length nature

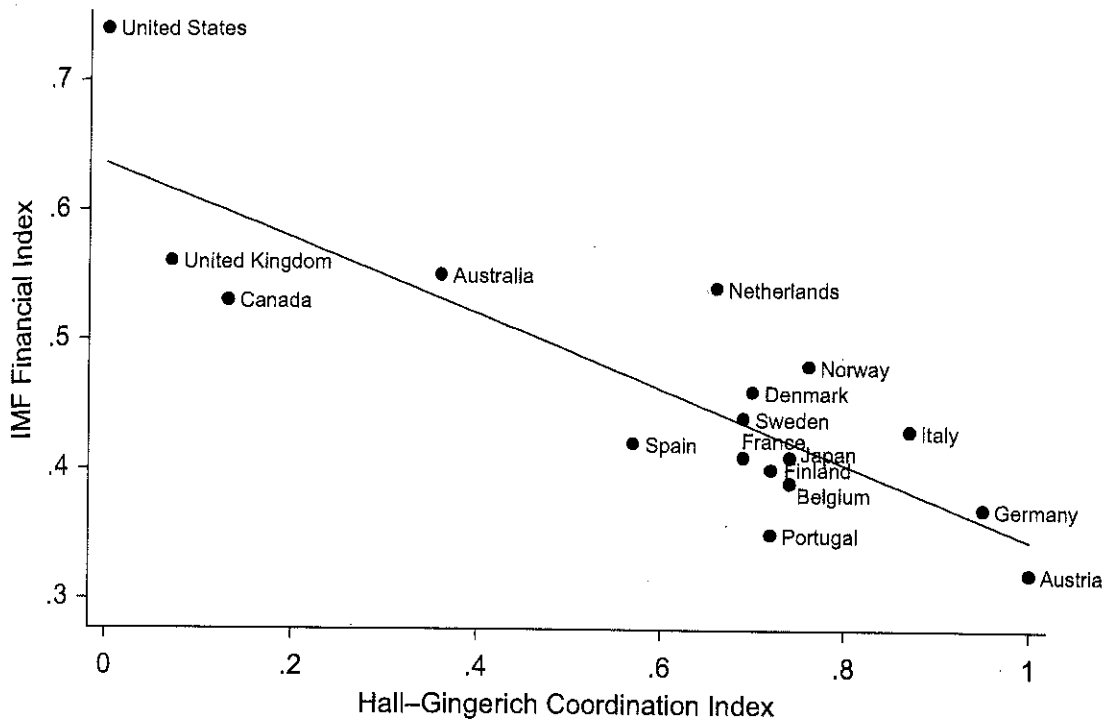


FIGURE 4.1 Strategic coordination and arm's-length finance in 2004.

TABLE 4.1 Financial systems characteristics across advanced democracies

Country	Coordination index (1990–5) <sup>1</sup>	Financial index (2004) <sup>2</sup>	Bank concentration index (2005) <sup>3</sup>
Australia	0.36	0.55	0.77
Austria	1	0.32	0.72
Belgium	0.74	0.39	0.89
Canada	0.13	0.53	0.87
Denmark	0.7	0.46	0.77
Finland	0.72	0.4	0.98
France	0.69	0.41	0.66
Germany	0.95	0.37	0.74
Italy	0.87	0.43	0.54
Japan	0.74	0.41	0.44
Netherlands	0.66	0.54	0.92
Norway	0.76	0.48	0.95
Portugal	0.72	0.35	0.88
Spain	0.57	0.42	0.43
Sweden	0.69	0.44	0.92
United Kingdom	0.07	0.56	0.58
United States	0	0.74	0.39

Notes:

<sup>1</sup> Hall and Gingerich 2009.

<sup>2</sup> IMF 2006.

<sup>3</sup> The bank concentration index is defined as a share of deposits in the largest five banks. The index for Austria is for 2001. Barth, Caprio, and Levine 2001, extended to 2009.

of the financial system.<sup>41</sup> This index can accommodate the range of systems observable in advanced democracies, including the so-called “market-based” banking system, identified by Hardie and colleagues, in which commercial banks depend less on deposits to finance their lending and more on borrowing from financial markets and other financial institutions.<sup>42</sup> It also recognizes that non-bank financial intermediaries have become important actors in financial markets. I employ a measure of strategic coordination developed by Hall and Gingerich that incorporates data on corporate governance (shareholder power, dispersion of control, size of stock market) and labor relations (level of wage coordination, degree of wage coordination, labor turnover) from the 1990–5 period.<sup>43</sup>

As Figure 4.1 demonstrates, for our sample of seventeen advanced democracies, a high degree of nonmarket coordination is indeed strongly negatively correlated with arm’s-length financial intermediation (–0.79). Inspection of Table 4.1 and Figure 4.1 reveals that the United States, the United Kingdom, Australia, and Canada have the most developed capital markets and the lowest levels of coordination. In contrast, Germany, Austria, Belgium, and Portugal exhibit the lowest content of arm’s-length finance and corresponding high levels of strategic coordination. The average stock market capitalization as a ratio to GDP during 1995–2004 ranged from 140 percent in the United Kingdom to 40 percent in Italy.<sup>44</sup> There are some prominent outliers, such as the Netherlands, which combines a relatively high level of strategic coordination with market-based finance. Japan, the Netherlands, Sweden, and the United States exhibit the presence of large nonbank financial institutions issuing more credit to the private sector than do the deposit money banks.<sup>45</sup> Table 4.1 also shows that bank-based financial systems tend to have more concentrated ownership than arm’s-length systems. A high degree of the banking industry’s concentration hinders foreign penetration and preserves the sector’s domination by a small number of domestic financial institutions. Japan is an outlier with a low bank concentration index: although there are three major banking groups (“megabanks”), the banking sector is composed of nearly 400 regional banks, Shinkin banks (cooperative regional banks), and the Japan Post Bank.<sup>46</sup>

### **The variety of responses to the global financial crisis of 2008**

Cross-class coalitions and their institutional settlements facilitated domestic political consensus to pursue economic policies that shielded corporatist countries from the fluctuations of global finance. The corporatist social networks sustained the institutional foundations of bank-based financial systems’ comparative advantage by providing greater financial stability and countercyclical lending to smooth economic shocks. The global credit crisis has affected advanced democracies’ financial systems with different intensity. The institutions of nonmarket coordination cushioned corporatist countries from the direct impact of the crisis and provided them with an adequate degree of stability at a time of difficult economic



transformation. Therefore, the roots of the crisis as well as the responses of the public authorities to the turmoil appear to be shaped by distinctive national models of financial capitalism.

The global financial crisis exposed the unsustainable nature of the arm's-length financial systems of the United States, the United Kingdom, and of smaller countries such as Ireland, Iceland, and New Zealand. These countries were most severely affected by the crisis mainly because of their domestic finance's excessive exposure to the toxic subprime assets. Prior to the crisis, the deregulation of financial markets drove the development of big investment banks and the "shadow banking institutions," such as hedge funds. The shadow banking system and new financial products were accompanied by excessive bank reliance on market funding (rather than on deposits), trading, and investment income.<sup>47</sup> In the United States, the gradual relaxation of the 1932 Glass-Steagall Act's barriers between commercial and investment banking allowed the proliferation of "too big to fail" financial institutions pursuing risky business operations. The British authorities governed the financial system through a "light regulatory touch," increasing the power of the City of London, which has become the central driver of national economic growth. As a result, London accounted for 80 percent of hedge funds managed in Europe, 47 percent turnover in cross-border derivatives, and 46 percent of global equity trading.<sup>48</sup>

In contrast, in countries with bank-based systems, banks featured relatively low levels of leverage and low exposures to risky activities, and thus suffered smaller losses when the crisis hit. For instance, while the United States securitized over 60 percent of new mortgages with mortgage-based securities, France and Germany securitized less than 5 percent.<sup>49</sup> Most European banks engaged in retail banking markets rather than in investment banking. Similarly, while pension funds (and other nonbank financial intermediaries) have become important in Anglo-American economies, pension fund sectors remain relatively weak in France, Germany, and Italy.<sup>50</sup> Therefore, a lesser exposure to international banking and a lower degree of arm's-length transactions appeared to be an advantage in the recent turmoil.

Likewise, a cross-national variation in fiscal and bank-rescue reform measures adopted by governments in the wake of the global financial crisis tends to broadly reflect the degree of strategic coordination. The government rescues of systematically important banks were obviously motivated by concerns about the consequences of a systemic banking crisis, but the distributional concerns and institutional factors played a role here too. In corporatist countries, the national crisis-management solutions and bank bailouts were the outcome of a political bargaining process among economic actors to find collective solutions, with the government playing a coordination role.<sup>51</sup> Corporatist institutions have proven useful in facilitating trust and reassurance, as well as in providing a basis for bargaining and policy agreements among coalitional actors. These institutions have subsequently constrained coalitional actors to act in accordance with these agreements.

Most German banks have been barely affected by the crisis. Each type of bank in Germany's three-pillar banking sector – savings banks, cooperative banks, and private banks – has a system of joint and several liability, meaning that no individual member bank is allowed to go bankrupt.<sup>52</sup> The German government adopted a hands-off, voluntary approach to bank rescues, leaving banks to decide to use the recapitalization measures and guarantees in line with the industry-led solution to the crisis, thus expecting the banking industry to share the costs.<sup>53</sup> Nonetheless, in line with the idea of “collective solidarity through the state,” the German federal and regional governments established special programs to provide credit to SMEs facing a credit crunch. As a consequence, saving and cooperative banks have increased their medium- and long-term lending to SMEs and households.<sup>54</sup> Due to relatively high automatic stabilizers of the German welfare state (that is, large unemployment benefits and the Kurzarbeit scheme involving fewer working hours and government subsidization of workers' salaries), the average annual fiscal stimulus package put forward by the German government was comparatively low.<sup>55</sup>

In France, the program of bank rescues was initiated by a cohesive, small group of big banks with strong interbank ties and orchestrated by then President Sarkozy, who placed his friends and advisors into key positions in newly merged or restructured banks, thus cementing the contract between finance and the state. As in the German case, the French government did not attempt to intervene in the corporate governance of the rescued banks, held only nonvoting shares, and attached very few conditions to bank recapitalization schemes.<sup>56</sup>

In sum, corporatist governments committed fewer resources to the financial sector, were less ready to share the burden of bailouts, and mostly avoided nationalization of banks. The resulting bank rescue packages were thus less costly to taxpayers. Financial support that governments provided to the banking sector during 2008–10 in the form of recapitalization and guarantees as a percent of gross domestic product (GDP) was the lowest in Finland (0.06 percent), Italy (0.26 percent), and Japan (2.4 percent).<sup>57</sup> Consensus-oriented countries with centralized systems of interest representation were also inclined to provide more conservative fiscal stimuli than countries with market coordination. The need for discretionary fiscal stimulus was mitigated by the extent of automatic stabilization, which tends to be particularly strong in corporatist countries with well-developed social security systems, but weak in countries such as the United States, New Zealand, or Switzerland.

In countries lacking strong interest-group associations that would enable banks to speak with one voice, the government imposed rescue packages in a top-down manner.<sup>58</sup> Past literature in the interest-group tradition has shown that banks are able to capture the policy-making process. Where individual ailing banks preserved close political ties to national governments, they were able to obtain bailouts to cover their liquidity needs.<sup>59</sup> The government rescue packages were generous to creditors but involved high public costs. In the United States and United Kingdom, the financial sector has enjoyed privileged access to policy making through lobbying and campaign finance money.<sup>60</sup> As a result, both the US Troubled Asset Relief Program and the British support to the financial sector were quite massive (14 percent of GDP in

the UK).<sup>61</sup> Furthermore, instead of political bargaining, these government programs relied on market-led adjustment strategies. The British government pursued a bank rescue strategy that aimed at maximizing shareholder value, charged high interest rates for government aid to banks, and promised to return nationalized banks (Northern Rock, Bradford and Bingley, and Royal Bank of Scotland) to the private sector after they became economically viable, in order to preserve the competitiveness of the domestic financial industry.<sup>62</sup>

However, some variation in policy responses to the crisis among noncorporatist countries can be observed. Ireland and Iceland were also among those countries that most noticeably created property booms and experienced a particularly deep subprime crisis. In Ireland, the bank bailout package has been the most expensive to taxpayers; it amounted to nearly 264 percent of GDP during 2008–10.<sup>63</sup> Anglo-Irish Bank, the biggest offender, which engaged in aggressive property-related lending, funded on wholesale markets, was nationalized in 2009. But the Irish government did little in terms of discretionary measures and pursued instead the policies of fiscal austerity. Likewise, in an environment lacking coordination structures and featuring conflictual state–labor relations, the strong centralized Icelandic government was able to impose drastic fiscal-adjustment measures. Prior to the crisis, politically strong sectors – including the fish industry, farmers, and the financial industry – captured the government and thus benefited from government protection and favorable treatment at the expense of labor or disfavored industries.<sup>64</sup> The three largest Icelandic banks with close ties to the government engaged in risky borrowing in international markets to finance the aggressive expansion of domestic investment companies. This resulted in an “oversized” banking system with assets eight times the country’s GDP that, as Gros argued, “transformed the country into a hedge fund with negative capital.”<sup>65</sup> Paradoxically, the Icelandic government did not recapitalize banks and let various parts of its domestic banking system fail.<sup>66</sup>

In sum, corporatist institutions once again facilitated cross-class compromises that helped societies share the burden of economic adjustment during the global financial crisis, following a domestic path that Katzenstein depicted nearly thirty years ago. Katzenstein identified three characteristics of “democratic corporatism” that helped societies to successfully accommodate economic challenges: an ideology of social partnership expressed at the national level; a relatively centralized and concentrated system of interest groups; and voluntary and informal coordination of conflicting objectives through continuous bargaining between interest groups, state bureaucracies, and political parties to address undesirable outcomes of economic change.<sup>67</sup>

## Reconsidering the role of the state

Different modes of coordination and state–business relations that exist across advanced industrial countries tend to be associated with a different role of the state. In most corporatist countries, the state has continued to play an important role, either

as a “promoter” of economic activity, or as a “compensator” for the coordination institutional deficit.<sup>68</sup> Particularly in the mid-spectrum economies – France, Italy, Spain, and Portugal – that exhibit strong strategic coordination in financial markets but not in labor relations, the state coordinates national bargains.<sup>69</sup> In doing so, it facilitates political consensus and provides legitimacy to the system. In times of crisis, the government can act as a “negotiator” in political bargaining among coalition members over the process of economic stabilization and reform.<sup>70</sup>

Corporatist governments have supported nonmarket coordination and bank-based finance by effectively influencing private banks to lend to certain sectors and firms in order to improve the allocation of funds and compensate losers from globalization. Government politicians in turn compensated banks by defending their interests and preventing hostile takeovers.<sup>71</sup> In their efforts to preserve national comparative institutional advantages, governments tried to limit the influence of foreign institutional investors. For example, as a reaction to the penetration of the French system by foreign mutual and pension funds, unequal voting rights (for example, voting ceilings limiting the voting rights of certain investors) and ownership ceilings have become prevalent as new instruments to limit the influence of foreign capital.<sup>72</sup>

Simultaneously, the state has been an important driver of financial globalization and often a promoter of stock markets’ development. The growth of French securities markets in the 1990s was, to a great extent, spearheaded by increased government demand for finance, since increasing budget deficits led to increased government bond issues.<sup>73</sup> The French government has actively sought the development of the securities market.<sup>74</sup> The interventions of the French “post-dirigiste” state have remained pervasive in other areas, too. These include bank privatizations, which involved Finance Minister Balladur selecting the buyers, as well as recent bailouts when the government introduced its close allies into managerial positions within the rescued banks.<sup>75</sup> The role of the state in economic governance in France and in other corporatist societies thus remains central, although different than in the past.

The recent financial crisis, which has produced large losses at banks and led to massive government interventions to mitigate its consequences, may have further reinforced the active role of the state in financial and economic development. Mervyn King, the former Governor of the Bank of England, has reminded us that “banks are global in their life and national in their death or rescue from death.”<sup>76</sup> Despite structural distinctions underlined in this chapter, national governments in both corporatist and noncorporatist societies played a key role in moments of crisis. They bailed out and nationalized insolvent banks, provided credit guarantees, coordinated and enforced mergers, and pushed for a stronger international financial regulatory framework. The crisis responses further illustrate that a strong state can persuade and coerce powerful societal actors into agreements or ensure that these commitments are credible, typically by imposing negative sanctions for noncompliance.<sup>77</sup>

The nationalization of banks also suggests that “state-directed and managed, formal and informal, intermediation of the financial system” has not lost its pertinence.<sup>78</sup>

As a result of financial sector stabilization policy, the French and German governments have become majority shareholders in several banks, with the aim of rescuing these banks and ensuring continued domestic lending. Governments have also used the crisis to promote national banking champions. For instance, BNP Paribas took over the Belgian and Luxembourg branches of Fortis Bank with the assistance of the French government.<sup>79</sup> The continued protection of semipublic regional banks (such as Landesbanken in Germany) is evidence of the strong political importance of regional governments.<sup>80</sup>

Paradoxically, although liberal market countries emphasize the limited role of the state, their governments introduced the largest fiscal packages in a Keynesian attempt to stimulate their economies through deficit spending. Australia, Canada, and New Zealand have introduced discretionary fiscal packages in response to the financial crisis, amounting to over 4 percent of 2008 GDP, with the US American Recovery and Reinvestment Act of 2009 at 5.5 percent of their 2008 GDP being the largest.<sup>81</sup> Similarly, the UK government used a strong dose of expansionary policy (both monetary and fiscal) coupled with devaluation to help the country to recover from the crisis. This analysis thus suggests we ought to bring the “state back in” when examining the politics of reform and adjustment in capitalist economies.

## **Conclusion: financial governance after the crisis**

This chapter suggests that corporatist institutions have persisted over time, preserving traditional patterns of banking and collaborative views of corporate finance in spite of financial liberalization, deregulation, and crises. In recent decades, corporatist governments instituted extensive financial reforms in corporate governance that altered ties between finance, industry, and labor in order to realize the competitive advantages of the bank-based system, instead of converging toward a single capital-market-based model.

The 2008 global financial crisis sparked a debate about the end of the dominance of the Anglo-Saxon model of financial capitalism, or what Buiter calls “transaction-based financial capitalism,” which encouraged deregulation, financial innovations, and credit booms.<sup>82</sup> Its central assumptions – “impatient markets” and shareholder-oriented finance – which were fundamental to the success of liberal market economies, are now seen in a more critical light. The crisis has done some damage to arm’s-length financial intermediation. The share of nontraditional bank-based intermediation that involved excessive bank reliance on market funding has fallen in some countries (France, Germany, Spain) and continues to grow at a much slower pace in others (the United Kingdom and Switzerland). Certain types of new financial products, such as private-label residential and commercial mortgage-backed securities or collateral debt obligations, have disappeared.<sup>83</sup> The interventions of governments have reinforced the central position of banks while relationship banking has regained its prominence. The worst economic crisis since the Great Depression did not lead to a convergence of models of financial and economic governance.

The crisis has reinforced rather than undermined coordination among coalition actors and regenerated the corporatist arrangements, now confronting the tighter economic constraints of borderless financial markets. One of the key lessons of the recent financial turbulence is the continued importance of the nation-state in economic governance. The editors of this volume advance this claim by stressing the central role of the nation-state in managing systemic financial risk and providing global public goods. In addition to governments, after the peak of the crisis, the major central banks played prominent roles in restoring financial and economic stability by alleviating global liquidity problems.<sup>84</sup> Financial crises thus provide a useful reminder that “markets could not and did not manage themselves.”<sup>85</sup>

The crisis has also led to demands for global policy coordination and new rules for global financial markets. Huge bank rescue packages using taxpayers' money politicized financial regulation in most countries, and led to popular pressures in favor of stricter regulation and increased involvement of the representative political institutions, such as the US Congress and the European Parliament.<sup>86</sup> The crisis paved the way for the reform of international financial architecture: the G-20 gained prominence as a major global forum to deal with global crises, the role of the IMF was enhanced, and the new Financial Stability Board designed to coordinate and implement international standards was created.<sup>87</sup> Nonetheless, national strategies toward financial regulation continue to diverge considerably in cross-country comparison. There is a tension between the diverging approaches to financial regulation advocated by national governments to preserve their distinctive models of financial capitalism. While coordinated countries such as France and Germany have traditionally pushed for stringent financial regulation (for instance, stricter control of hedge funds and higher capital requirements for banks), the British authorities, keen to protect the City of London's leading role in financial services, have been reluctant to cede oversight of financial services to the European level.<sup>88</sup> Although the British authorities' opposition to strict regulation of financial markets underwent a quick reversal after the crisis, they warn against protectionism and overregulation of the financial industry.<sup>89</sup> More attention should be devoted to the question of vested financial interests if regulatory reform is to be legitimate and effective.

I agree with those who argue that the future of financial globalization as well as global financial governance will be determined by the actions of national governments trying to balance their international obligations with domestic political imperatives.<sup>90</sup> National economies are constrained by models of governance that bind their populations and governments. In the waning days of the US imperium, to refer to Lake's chapter in this book, the European Union may help fill the financial governance gap at the global level by providing leadership in setting the rules of international finance.<sup>91</sup> Yet global agreement on a bold international regulatory order may be possible only if it does not threaten national institutions and political processes. As Rodrik argues, “an architecture that respects national diversity does more to advance the cause of globalization than ambitious plans that assume it

away.”<sup>92</sup> It remains to be seen if the sovereign debt crisis and the economic trauma that accompanies it will reshape the existing institutions so that they promote new rule making for global finance.

## Notes

- 1 For helpful comments on earlier drafts of this contribution, I thank Bruce Jentleson, Robert Keohane, Louis Pauly, Sofia Perez, and Herman Schwartz.
- 2 Rajan and Zingales 2003a, 8.
- 3 Hicks and Kenworthy 1998.
- 4 For statistical estimations of the impact of strategic coordination on financial development on a sample of eighteen advanced democracies over the period of 1960–2005, while controlling for alternative explanations and for endogeneity bias, see Grittersová 2013.
- 5 Cameron 1984; Katzenstein 1985; Scharpf 1991; Hicks 1999.
- 6 Rajan and Zingales 2003b. The role of vested interests in institutional stability and change is also explored by Lake in this book.
- 7 Hancke, Rhodes, and Thatcher 2007.
- 8 In Germany, for example, Länder governments step in to protect small banks for the benefit of small firms’ access to finance. Rosenbluth and Schaap 2003.
- 9 La Porta *et al.* 1998.
- 10 La Porta *et al.* 1998.
- 11 Gerschenkron 1962.
- 12 Gerschenkron 1962; Zysman 1983.
- 13 Hall and Soskice (2001) identify two distinct models of capitalism: coordinated market economy, where nonmarket institutions play a coordinating role; and liberal market economy, where market forces dominate.
- 14 Deeg 1999; Schmidt 2002; Amable 2003; Culpepper 2005; Gourevitch and Shinn 2005; O’Sullivan 2007; Cioffi 2010; Pinto, Weymouth, and Gourevitch 2010.
- 15 For excellent surveys of recent comparative research on financial systems, see Deeg and O’Sullivan 2009 and Deeg 2010.
- 16 Rajan and Zingales 2003b.
- 17 Corporatist systems of financial allocation and greater social insurance were born in the 1930s and 1940s in the midst of the Great Depression, fascism, and World War II, which increased voters’ insecurity. For the historical origins of corporatism, see Katzenstein 1985; Streeck and Kenworthy 2005; Perotti and von Thadden 2006; and Roe 2006.
- 18 Jackson and Deeg 2012.
- 19 Katzenstein 2003a.
- 20 Deeg 2012, 1118.
- 21 Streeck and Kenworthy 2005, 458.
- 22 Campbell and Pedersen 2007, 321–3.
- 23 Streeck and Kenworthy 2005. Nonetheless, some scholars have underlined the importance of cultural homogeneity and societal cohesiveness for the viability of power-sharing corporatist arrangements (Campbell and Hall 2009), while others have pointed to the dangers of the dramatically increasing proportion of non-European immigrants and the concomitant rise of anti-immigrant parties for their continuing relevance in small European states (Schwartz 2010 and in this book).
- 24 Culpepper 2005.
- 25 *Ibid.*
- 26 Clift 2007, 551, 561.
- 27 Clift 2012, 577.
- 28 Goyer 2006; O’Sullivan 2007.
- 29 Vitols 2004; Cioffi 2010, 8; Deeg 2011, 561.
- 30 Callaghan 2009; Cioffi 2010. The Codetermination Law adopted in 1976 allows German employees to select half of the supervisory boards of large companies.

- 31 Callaghan 2009.
- 32 Jurgens, Naumann, and Rupp cited in Callaghan 2009, 742.
- 33 Beyer and Hopner 2003.
- 34 Quaglia 2009, 10.
- 35 Hall 2007.
- 36 Jackson and Deeg 2012, 1122.
- 37 Kenworthy 2006.
- 38 Hardie and Howarth 2009.
- 39 Deeg 2011.
- 40 Ibid.
- 41 IMF 2006.
- 42 Hardie *et al.* 2011, 16.
- 43 Hall and Gingerich 2009.
- 44 IMF 2006, 1.
- 45 Demirguc-Kunt and Levine 1999.
- 46 IMF 2012, 157.
- 47 Deeg 2012, 1261.
- 48 Talani 2011.
- 49 IMF 2006, 8.
- 50 Clark 1998.
- 51 Moschella 2011; Clift 2012; Grossman and Woll 2012.
- 52 "Germany's Banking System: Old Fashioned but in Favour," *The Economist*, 10 November 2012.
- 53 Hardie and Howarth 2009, 1031.
- 54 "Germany's Banking System."
- 55 Schirm 2011, 56–7.
- 56 Clift 2012, 582–4.
- 57 IMF 2010; European Commission 2011.
- 58 Grossman and Woll 2012.
- 59 Ibid.
- 60 Johnson 2009; Hacker and Pierson 2010.
- 61 European Commission 2011.
- 62 Moschella 2011; Weber and Schmitz 2011; Clift 2012.
- 63 European Commission 2011.
- 64 Thorhallsson 2010.
- 65 Gros 2008.
- 66 Carey 2009.
- 67 Katzenstein 1985, 30–3.
- 68 Hancke *et al.* 2007, 21–5.
- 69 Royo 2008.
- 70 Moschella 2011.
- 71 Koehler 2007.
- 72 Clift 2007, 562.
- 73 Clift 2012.
- 74 O'Sullivan 2007.
- 75 Ibid., 577.
- 76 Quoted in Fariborz 2011, 510.
- 77 Thelen 2012.
- 78 Budd 2012, 13.
- 79 Hardie and Howarth 2009, 1031–3.
- 80 Buckley and Howarth 2010, 122.
- 81 OECD 2010, 109.
- 82 Buiters 2008.
- 83 IMF 2012, 97–8.



- 84 Fariborz 2011, 508.
- 85 Pauly 2002, 82.
- 86 Helleiner and Pagliari 2011.
- 87 Ibid.
- 88 Zimmerman 2010.
- 89 Schirm 2011, 53–4.
- 90 Pauly 2002; Zimmerman 2010.
- 91 Posner 2010. See also Abdelal and Krotz in this volume.
- 92 Rodrik 2009.