Diluting Varieties of Capitalism from below:
Competitive imperatives in financial markets and the end of positive coordination

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Abstract

Financial market regulation plays a central role in 'Varieties of Capitalism' (VoCs). In comparative institutionalism, the significance of regulatory transformations for the persistence or otherwise of national VoCs has mainly been debated drawing on two 'opposing forces': global structural constraints that tend to impose convergence versus national institutional complementarities that reinforce path-dependency. Neither view, however, seriously considers the role of actors that change regulatory regimes bottom-up in line with their *individual* preferences and perspectives on the costs or benefits of regulatory convergence. These individual preferences need not reflect either universal structural constraints nor institutional complementarities in national VoCs.

This paper argues that understanding regulatory change and its impact on national VoCs requires studying the individual motivations of key actors to sustain or withdraw their support for national regulatory idiosyncrasies. In its empirical section, this paper studies financial market reforms that have affected core elements of national VoCs in France and Germany. Its central hypothesis is that in regulatory reform, the implications different regulatory regimes have for cross-border competition among financial services providers are the key variable. Thus, the issue at stake is not one of divergence versus convergence because from the perspective of key actors, regulatory provisions are evaluated according to competitive implications, not their 'institutional fit' or otherwise with national VoCs. Some national idiosyncrasies therefore find continued support whereas others are strongly opposed.

INTRODUCTION

Financial systems stand at the heart of developed economies. They channel credit from savers to investors, allow the storage of value, provide tools for stimulating or dampening economic activity and facilitate redistribution between socio-economic groups and over time. Financial systems have developed differently around the world, however.[1] Most easily recognizable, some have traditionally relied on credit and relationship banking whereas in others capital markets have played a central role. These financial systems, comparative political economists have noted, have not evolved in isolation of their economic environment but have been embedded in wider ensembles of economic institutions—what has commonly been called 'Varieties of Capitalism' (VoCs).[2] The resulting 'institutional fit' of a financial system with a VoC at large became a key to its development and reproduction.

Economic globalisation, however—understood simply as the decreasing relevance of national borders for economic interactions—has seemed to exert 'pressure' on national VoCs, particularly coordinated ones. Economic openness has been argued to undermine the positive coordination of economic policy and enforce a rough convergence towards more 'Anglo-Saxon' models of capitalism.[3] By implication, financial systems have been changed because coordinated VoCs as a whole had become dysfunctional. Regulatory reforms institutionalizing such change resulted from pressure at the 'systemic level'.

At the same time, a range of scholars have studied financial regulatory reform quite independent of debates about varieties of capitalism and the constraints these exert on institutional change. Sobel, for example, has focused on competitive rivalries between financial services providers (FSPs); Laurence has emphasized cost pressures arising from capital mobility.[4] 'Thick', more detailed accounts have equally stressed a wider range of factors, often acknowledging the role of private actors in shaping reforms.[5] In contrast to the VoC-perspective, change originated within the realm of those directly concerned with financial regulation—banks, investors, etc. Institutional complementarities played but a small part in explanation for reform. Where they have been integrated, it happened mostly on an ad hoc basis, not systematically.

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[1] Franklin Allen & Douglas Gale, *Comparing Financial Systems* (MIT Press, 2000).
[2] Cf. in particular Peter Hall & David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001). The term 'varieties of capitalism' is used here in the broad sense and interchangeable with other concepts aiming at institutional complementarities (models of capitalism, social systems of production, etc.). It is not intended as an unreserved endorsement of Hall and Soskice's full model and its assertions.
[3] These distinctions have rightly been criticised for their lack of precision. Yet they summarize the general thrust of the debate and sufficiently capture the most important aspect of 'varieties of capitalism' for this paper—the positive or negative coordination of economic policies. Cf. Colin Hay, 'Common trajectories, variable paces, divergent outcomes? Models of European capitalism under conditions of complex economic interdependence', *Review of International Political Economy* Vol. 11, No. 2 (2004), pp. 231-62.
[4] Andrew Sobel, *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets* (University of Michigan Press, 1994); Henry Laurence, *Money Rules: The New Politics of Finance in Britain and Japan* (Cornell University Press, 2001).
[5] Michael Moran, *The Politics of Banking* (MacMillian, 1984); Philip Augar, *The Death of Gentlemanly Capitalism* (Penguin Books, 2000).

This leaves us with two perspectives on financial regulatory reform: one 'top-down', operating at the system-level, one 'bottom-up' with an emphasis on particularistic interests of individual actors. How do these two perspectives go together? How can we understand the interaction between (particularly private) agency, nation-level institutional complementarities and 'global' structural developments? And are there systematic dynamics behind the 'bottom-up' politics surrounding regulatory reform? Addressing the last question first, this paper presents three interrelated arguments. First, the 'bottom-up' dynamic surrounding politics of regulatory reform can best be understood as struggles by financial services providers themselves over the way financial regulation shapes the competitive environment.[6] I will call this dynamic the 'competitive imperatives' behind regulatory reform. This factor has been largely ignored; where it is recognized, that is done in ad hoc fashion. That it constitutes a systematic force in changing varieties of capitalism has not been acknowledged so far.

Second, in relatively closed coordinated market economies, 'coordinative imperatives' (the effective embeddedness of financial regulation in economic policy) and competitive imperatives have often been mutually reinforcing and 'pointing in the same direction', as it were. For this reason, public and private actors have often found it easy to unite behind a common financial market policy. This harmony disguised the fact that in fact, 'public policy' enjoyed but also depended on both public and private support.

Third, globalisation can cause coordinative and competitive imperatives to diverge. The potentially detrimental effect of economic openness on effective positive coordination has often been noted—think of credit allocation, monetary policy, etc. It can, however, also undermine *private* support for positive coordination of regulatory policy. Private actors' interest in using regulation as a market-shaping tool may come to contradict public imperatives, leading to open conflict over policy. Then, formerly positively coordinated policies may become disembedded not because they have become dysfunctional, but because private regulatory preferences point in a different direction. A Variety of Capitalism becomes diluted from below.

To sum up, this perspective considers the interaction of three factors in regulatory reform: the positive coordination of financial regulation with economic policy at large, the competitive implications of regulation for financial services providers (FSPs) and the way in which structural developments affect regulation's capacity to fulfil these roles in line with domestic actors' preferences. The first half of this paper reasons through the argument presented above. Its second half illustrates the argument with empirical evidence from German and French financial market reform over the recent two decades. Both countries count as exemplars of

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[6] This argument argues Sobel's analysis of securities markets reform. Sobel, *Domestic Choices, International Markets*. Cf. also Daniel Mügge, *Private-public puzzles: inter-firm competition and transnational private regulation*, ASSR Working Paper 05/07 (Amsterdam School for Social science Research, 2005).

coordinated market economies and both saw sweeping changes in their financial systems starting in the mid-1980s. Focusing on these early reforms allows us to study policy responses to economic openness that are not yet mediated by active policy coordination, particularly through the European Community. The impact of capital mobility should be especially well observable. That makes Germany and France in that time 'strong' cases to see just what the dynamics underlying regulatory change are.

FINANCIAL REGULATION AND VARIETIES OF CAPITALISM

The varieties of capitalism approach to comparative political economy, understood broadly, has espoused the idea that economic institutions can be understood as elements of encompassing institutional ensembles. In the strong, functionalist version of this argument, Hall and Soskice have emphasized institutions' 'complementarity'.[7] They presented impressive evidence to support their case and it has been so widely discussed to make rehearsing it here unnecessary. It appeared as though economic institutions had been 'selected', as in evolutionary theory, depending on their fit with their environment.

The functionalist logic of institutionalism relegated individual actors—public and private—to secondary importance. In coordinated market economies (CMEs) in particular, public actors simply translated political imperatives into policy. Their own interest in well-functioning economies, so the (often implicit) idea, ensured the reproduction of comparative institutional advantages. In the tussle between structural imperatives and individual agency in shaping national economies, this perspective came out in favor of structural imperatives: Rational actors could understand that coordinating their actions would generate benefits for all. From this moment on, the institutionalist logic took over.

Financial systems are an integral part of national institutional ensembles. Without employing the full vocabulary common in CPE today, John Zysman described different 'varieties of capitalism' in his classic treatment of French, British, German, Japanese and American adjustment politics.[8] He accorded financial systems a central place. Since then, financial markets' place in the VoC literature has focused mainly on their role in varying corporate governance regimes.[9] Bank-based systems, so the argument, lent themselves to supporting industries dependent on long-term finance, high degrees of inter-firm coordination and incremental innovation. Capital-market based systems, in contrast, functioned better to finance radical

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[7] Hall & Soskice (eds), *Varieties of Capitalism*

[8] John Zysman, *Governments, markets, and growth* (Cornell University Press, 1983).

[9] E.g. Mary O'Sullivan, 'The political economy of comparative corporate governance', *Review of International Political Economy* Vol. 10, No. 1 (2003), pp. 23-72; Sigurt Vitols, 'Varieties of Corporate Governance: Comparing Germany and the UK', in Peter Hall & David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001), pp. 337-60.

innovation and flexible economic adjustment. The focus on corporate governance overshadowed many other ways in which financial markets were implicated in governing national economies as a whole—particularly in monetary policy and credit allocation. In discussions about change and continuity in economic systems, the latter played secondary roles at best.

To understand change in varieties of capitalism, these policy fields are equally important, however. In coordinated market economies such as France, Germany and Japan (regardless of their other differences) governments have traditionally accorded financial services providers central roles in the execution of monetary policy and the allocation of credit. In neo-corporatism and state-led economies FSPs became agents of government policies which were connected to industrial policy at large and thus embedded in the variety of capitalism as a whole.

Some examples help to illustrate this nexus: In the traditional French overdraft economy, the bulk of money supply growth came from new credit provided by banks through state guidance.[10] This credit allocation was in turn dictated by industrial policy. Monetary policy, industrial policy and the national system of credit allocation were all intertwined. When global economic events of the 1970s forced authorities to curb inflation, they switched to the state-guided *encadrement du credit* depending on credit quotas and subsidies.[11] The policy tool had changed but FSPs still functioned as agents in all three policy areas. Encadrement was abandoned in the mid-1980s yet once more FSPs retained vital functions for the government, now in the area of managing its growing debt pile and placing new issues with patient, preferably domestic, investors. State-ownership of industries was replaced by state-'enhanced' cross-shareholdings between privatized enterprises still under governmental tutelage.[12]

In Germany, the system worked differently but to similar ends: Corporate cross-shareholdings with banks at their centre were an indirect but crucial part of the governments' industrial policy. Public Landesbanken recycled household savings to fund the deficits of both the state governments and large regional firms. Credit for small enterprises was often provided by local savings banks which had been given a clear mandate to stimulate regional development. The central banks' management of money supply, finally, rested on manipulating banks' reserve requirements.

What do all these institutions have in common? They have depended on financial regulation, broadly understood. Financial regulation codifies which financial institutions can or cannot provide financial services to certain classes of customers as well as the conditions of services provision. For example, financial regulation has specified the required domestic securities

[10] Michael Loriaux, *France after Hegemony: International Change and Financial Reform* (Cornell University Press, 1991).
[11] William Coleman, 'The French State, Dirigisme, and the Changing Global Financial Environment', in Geoffrey Underhill (ed), *The New World Order in International Finance* (MacMillian, 1997), pp. 274-93.
[12] Vivien Schmidt, 'French capitalism transformed, yet still a third variety of capitalism', *Economy and Society* Vol. 32, No. 4 (2003), pp. 526-54.

content of mutual funds, the taxes non-residents have to pay on dividends or interest income from national stocks or bonds, under which conditions domestic and foreign banks are allowed to trade shares on and off the market, etc. Regulation stimulates or encourages the evolution of the financial system in one direction or the other. In CMEs, the mentioned aspects of financial market policy have been positively coordinated with economic policy at large, and the link was financial regulation. We will return to more detailed examples in the second half of this paper.

So what role does this link play when varieties of capitalism change? The question of transformation in national varieties of capitalism had gained special salience in the wake of the globalization debate.[13] Would only a single model survive, the Anglo-Saxon one? Or should we expect continued divergence? Simplifying arguments somewhat, one school argued for convergence in the wake of economic openness.[14] A 'new embedded financial orthodoxy' would force governments to adopt financial market-friendly, read: Anglo-Saxon policies and institutions.[15] Economic openness spelled the end of positive policy coordination. Capital mobility was identified as the crucial link.[16]

More recent empirical research has shed serious doubt on this explanation. Both Swank and Mosley refuted the idea that after capital mobility financial markets would 'punish' governments championing redistributive policies through higher financing costs.[17] A range of studies found no significant link between capital mobility and downward pressure on business taxes.[18] In other words, the seemingly self-evident fact that capital mobility shifted policy in favour of large investors came in for review.

The school more sceptical of convergence countered that the institutional fit developed in different national economies would beget institutional stickiness and what came to be called

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[13] Cf. e.g. Herbert Kitschelt, Peter Lange, Gary Marks & John Stephens (eds), *Continuity and Change in Contemporary Capitalism* (Cambridge University Press, 1999); Colin Crouch & Wolfgang Streek (eds), *Political Economy of Modern Capitalism: Mapping Convergence and Diversity* (Sage, 1997); Hall & Soskice (eds), *Varieties of Capitalism*

[14] E.g. Wolfgang Streeck, 'German Capitalism: Does it exit? Can it survive?' in Colin Crouch & Wolfgang Streeck (eds), *Political Economy of Modern Capitalism* (Sage, 1997), pp. 33-54; François Morin, 'A transformation in the French model of shareholding and management', *Economy and Society* Vol. 29, No. 1 (2000), pp. 36-53.

[15] Philip Cerny, 'International Finance and the Erosion of Capitalist Diversity', in Colin Crouch & Wolfgang Streek (eds), *Political Economy of Modern Capitalism: Mapping Convergence and Diversity* (Sage, 1997), pp. 173-81; Geoffrey Underhill, 'Transnational Financial Markets and National Economic Development Models: Global Structures versus Domestic Imperatives', paper presented at the Third Pan-European Conference on International Relations, Vienna, September 16-19, 1998.

[16] Jeffrey Frieden, 'Invested Interests: The Politics of National Economic Policies in a World of Global Finance', *International Organization* Vol. 45, No. 4 (1991), pp. 425-52. Cf. Peter Dombrowski, 'Haute Finance and High Theory: Recent Scholarship on Global Financial Relations', *Mershon International Studies Review* Vol. 42, No. 1 (1998), pp. 1-28.

[17] Layna Mosley, *Global Capital and National Governments* (Cambridge University Press, 2003); Duane Swank, *Global capital, political institutions, and policy change in developed welfare states* (Cambridge University Press, 2002). For an early argument in this direction, although empirically unfounded, cf. Louis Pauly, 'Capital Mobility, State Autonomy and Political Legitimacy', *International Affairs* Vol. 48, No. 2 (1995), pp. 369-88.

[18] Barry Eichengreen, 'Capital Account Liberalization: What Do Cross-Country Studies Tell Us?' *The World Bank Economic Review* Vol. 15, No. 3 (2001), pp. 341-65, here p. 356. Reviewing quantitative studies on the impact of capital mobility, Eichengreen shows just how little scholarly agreement there is.

path-dependency.[19] Related to that but with a different emphasis, yet another school of thought presaged co-convergence or 'dual' convergence, the ever clearer emergence of two models (a liberal and a coordinated one), both of which would be viable under globalization.[20]

What united all these schools of thought, however, was their taking national sets of institutions as their units of analysis. Change in these, so the assumption, would primarily be caused by emerging dysfunctionalities at the level of the set of institutions itself (the systemic level, for short). Asking whether coordinated market economies—'Rhenish capitalism'—was still viable in the age of 'globalization' implied that its viability *as an institutional set* would decide its fate. In his review of the literature, Radice put it as follows:

> [I]t can be argued that, outside the naive approach of the new institutionalist economists, the continued viability of any particular institutional order depends not on some intrinsic, suprahistorical superiority, but on its 'goodness of fit' with its environment and its evolutionary adaptability: change then comes about when viability is lost.[21]

This paper seeks to challenge this assumption. As I will argue in the following section, it is built on an at best incomplete conceptualization of what keeps 'varieties of capitalism' together and how public and private actors coordinate their actions. Of course, more recent writing has acknowledged the pitfalls of the either 'convergence or divergence'-dichotomy; the rise of 'hybridization' as an answer to questions about institutional change has been the conceptual consequence.[22] The concept reflected an impasse in the debate: How could it both be correct that in CMEs there operated an institutionalist dynamic that helped explain complementarities and that CMEs could change in ways that appeared to defy institutionalist analysis—both in the convergence and the divergence variety? In this perspective, hybridization was a disappointing result. That need not be. As I will argue, hybridization is precisely what we should expect when varieties of capitalism change even if we accept comparativists' claims about the significance of institutional complementarities.

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[19] Sigurt Vitols, *Changes in Germany's Bank-Based Financial System: A Varieties of Capitalism Perspective*(Wissenschaftszentrum Berlin für Sozialforschung, 2004). Radice' perspective can also be subsumed under this heading. Hugo Radice, 'Globalization and national capitalisms: theorizing convergence and differentiation', *Review of International Political Economy* Vol. 7, No. 4 (2000), pp. 719-42.

[20] Hall & Soskice (eds), *Varieties of Capitalism* For a thorough discussion of this school of thought, cf. Hay, 'Common trajectories, variable paces, divergent outcomes?'

[21] Radice, 'Globalization and national capitalisms', here p. 730.

[22] E.g. Christel Lane, 'Globalization and the German model of capitalism – erosion or survival?' *British Journal of Sociology* Vol. 51, No. 2 (2000), pp. 207-34; Richard Deeg, *Institutional Change and the Uses and Limits of Path Dependency: The Case of German Finance*(MPIfG, 2001); Glenn Morgan & Izumi Kubo, 'Beyond path dependency? Constructing new models for institutional change: the case of capital markets in Japan', *Socio-Economic Review* Vol. 3 (2005), pp. 55-82. Schmidt's monograph remained (wisely) undecided on the question, identifying a general shift towards market-based institutions coupled with continuing path dependency. Cf. Vivien Schmidt, *The Futures of European Capitalism* (Oxford University Press, 2002).

COORDINATIVE AND COMPETITIVE IMPERATIVES IN FINANCIAL MARKET REFORM

Regulatory reforms need actors to design them, to rally political support and to implement them. Many accounts of political change omit this important step: They reason directly from structural causes to structural outcomes.[23] But just how do macro developments—a breakdown of the Bretton Woods system of fixed exchange rates or the growing use of financial securities in lieu of bank credit, for example—shape the actions of those inside policy communities?

In the case of financial markets, it is important to remember that policy communities tend to be fairly circumscribed.[24] They often include the finance ministry, the central bank, FSPs themselves and regulatory agencies insofar they exist and have any significant independence. Non-financial corporations, in contrast, are rarely directly involved. The institutionalist perspective had implicitly assigned public actors a clear role. They combined an awareness of institutional complementarities and an eagerness to exploit these to optimize policy and therefore gain political advantage. In contrast, the role of private actors was much less clear. In neo-corporatist settings, they allegedly coordinated firm behaviour with government policy. Their own motivations to do so remained in the dark; by and large, private actors' preferences and agency played no *systematic* part in changing economic institutions and their embeddedness.

That is all the more surprising because early scholarship on regulatory politics gave private interests pride of place. Stigler for example argued that producers would systematically beat other stakeholders at influencing regulation, leading to 'regulatory capture'.[25] That was counterintuitive. Business regulation is commonly justified with reference to consumer interests or the 'public good'.[26] The case for producer dominance built on Olson's insight about collective action problems.[27] Stigler had argued that producers had a double edge over consumers: Their relatively low numbers facilitated coordinated lobbying and high individual stakes induced higher investment into such activities compared to consumers.[28]

Stigler built his case on evidence from American politics; certainly at the time of his research, conditions there were sufficiently different than those in European coordinated market economies to make comparison difficult. Still, his intuition holds important lessons for scholars

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[23] This 'Durkheimian' mode of social scientific reasoning is quite widespread, not least in structuralist political economy. Cf. Peter Abell, 'On the prospects for a unified social science: economics and sociology', *Socio-Economic Review* Vol. 1, No. 1 (2003), pp. 1-26.
[24] Cf. William Coleman, *Financial Services, Globalization, and Domestic Policy Change* (MacMillian, 1996); Daphne Josselin, *Money Politics in the New Europe. Britain, France, and the Single Financial Market* (MacMillian, 1997).
[25] George Stigler, 'The Theory of Economic Regulation', *Bell Journal of Economics* Vol. 2 (1971), pp. 113-21; Gary Becker, 'A Theory of Competition among Pressure Groups for Political Influence', *Quarterly Journal of Economics* Vol. 98, No. 3 (1983), pp. 371-400; Sam Peltzman, 'The Economic Theory of Regulation after a Decade of Deregulation', *Brooking Papers on Microeconomics* (1989), pp. 1-59.
[26] E.g. Charles Goodhart, Philip Hartmann, David Llewellyn & Liliana Rojas-Suarez, *Financial Regulation: why, how, and where now?* (Routledge, 1998).
[27] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press, 1965).
[28] For service providers' role in financial regulation, see e.g. Sobel, *Domestic Choices, International Markets;* Stephen Harris, 'Regulating Finance: Who Rules, Whose Rules?' *Review of Policy Research* Vol. 21, No. 6 (2004), pp. 743-66.

of European regulatory politics. To begin with, producers have an important stake in regulation—it matters to them, and they have something to win or to loose in regulatory politics. This holds quite independent of a coordinated or liberal policy environment.

A socio-economic perspective on regulation supports Stigler's intuitions about producer dominance. Fligstein has argued that the central pillar of 'market-making' is not the *introduction* of competition, but its *avoidance*.[29] And a central instrument in this market-making was, and is, regulation.

> Much of the market-making project is to find ways to stabilize and routinize competition. Much of the history of the largest corporations can be read as attempts to stabilize market for these firms in the face of ruinous competition and economic downturns. [..] Finding ways to compete that do not revolve around price competition alone has proved pivotal to producing stability for firms in all advanced industrial societies.[30]

Market stability—understood as the stability of populations of producers—stands centre stage. The survival of producers is constantly endangered unless social institutions somehow reduce their uncertain position. Examples of such institutions include monopoly and patent rights, tariffs against foreign producers, business regulation that locks in market positions, ownership structures that ameliorate competition, or the formation of business associations.

From the perspective of firms (in our cases FSPs) financial regulation fulfils a very different function than from the viewpoint of public actors: For FSPs, the most important aspect of financial regulation is the way in which it confines the competitive landscape by 'defining' the shape of financial markets.[31] In a process reminiscent of Gidden's structuration, financial services providers both adapt to their regulatory environment (for example in their business model and regional dispersion) and at the same time try to influence it to their own advantage.

Where socio-economic scholars such as Fligstein have emphasized the importance of regulation for the reproduction of a stable population of market participants and continuity in general, the line of thinking can easily be adapted to changing conditions. If producers perceive serious threats to their market positions or new opportunities appear on the horizon, they may push for regulatory change to address those threats or exploit those opportunities.[32] The key

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[29] Neil Fligstein, 'Markets as Politics: A Political-Cultural Approach to Market Institutions', *American Sociological Review* Vol. 61, No. August (1996), pp. 656-73; Ibid., *The Architecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies* (Princeton University Press, 2001).
[30] Fligstein, *The Architecture of Markets*, p. 5.
[31] Richard Vietor, 'Regulation-Defined Financial Markets: Fragmentation and Integration in Financial Services', in Samuel L. III Hayes (ed), *Wall Street and Regulation* (Harvard Business School Press, 1987), pp. 7-62. Arguably, much regulation emerged at the behest of (what we would today call) private actors to solidify guilds' cartels. Cf. John Braithwaite & Peter Drahos, *Global Business Regulation* (Cambridge University Press, 2000).
[32] Regarding regulatory protectionism as an answer to competitive threats experienced by leading firms in a sector, cf. Tony Porter, 'Hegemony and the Private Governance of International Industries', in A. Claire Cutler, Virginia Haufler & Tony Porter (eds), *Private Authority and International Affairs* (SUNY Press, 1999), pp. 257-82.

variable here is not so much profit per se, but the long-term viability of the firm and its *relative* market share.

Looking at domestic markets, Andrew Sobel has shown how commercial banks in Japan, the US and the UK have pushed for the decompartmentalization of financial markets in the face of falling interest rate spreads and rapidly growing securities markets that they had hitherto been excluded from.[33] Kroszner and Strahan have demonstrated that the dilution of the 1927 McFadden Act prohibiting bank interstate branching in the US was best explained by private interests and regulatory capture.[34]

Looking at cross-border trade, regulatory provisions can function as trade-barriers, again fine-tuning market shares, this time between domestic and foreign firms.[35] Regulatory politics assume the properties of trade politics. Milner's insight that internationalization of firms' business activities changes their trade policy preferences can be extended: Preferences for regulatory protectionism should equally change with internationalizing business activities.[36] Firms' interest in internationalization and the scrapping of regulatory barriers may derive from technological change creating new economies of scale as much as increasing cross-border activity itself.[37] Laurence had argued that capital mobility would induce regulatory change because investors' exit option from national markets would shift regulatory regimes in their favour.[38] From our perspective, capital mobility also has an impact, but a very different one: Capital mobility opens up the possibility of transnationally integrated forms of financial services provision. Financial services providers push for change not because they face a threat but because they see an opportunity. The element eventually ushering in change is not a global regime enabling the mobility of capital itself but one enabling the mobility of financial services that live of capital's intermediation.

On second thoughts, it is not that obvious that capital mobility itself would generate adaptive pressures. In countries with a history of current account surpluses—Japan and Germany, for example—the potential effects of capital mobility itself are mitigated by capital's abundance.[39] Rather than resisting change, both countries have liberalized their capital accounts remarkably early, particularly considering their reluctance regarding general financial market reform. Countries with current account deficits, in contrast, face a different problem altogether:

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33 Sobel, *Domestic Choices, International Markets*.

34 Randall Kroszner & Philip Strahan, 'What drives deregulation? Economics and politics of the relaxation of bank branching restrictions', *Quarterly Journal of Economics* Vol. 114, No. 4 (1999), pp. 1437-67.

35 For financial services, cf. Louis Pauly, *Opening Financial Markets: Banking Politics on the Pacific Rim* (Cornell University Press, 1988).

36 Helen Milner, *Resisting Protectionism: global industries and the politics of international trade* (Princeton University Press, 1988).

37 On the role of technological change in internationalization, see e.g. Susan Strange, 'The Future of Global Capitalism; or, will Divergence persist forever?' in Colin Crouch & Wolfgang Streeck (eds), *The Political Economy of Modern Capitalism* (Sage, 1997), pp. 182-91, here p. 185; Winfried Ruigrok & Rob Van Tulder, *The Logic of International Restructuring* (Routledge, 1995).

38 Laurence, *Money Rules*.

39 What is an issue, of course, is the way the financial system *intermediates* capital. Here, the troubles German SMEs (the *Mittelstand*) have securing adequate finance is telling.

Over the medium to long term, empirical research has found, national savings and investments correlate extremely closely.[40] The effect of capital mobility on this finding is small and limited to short-term disequilibria. In other words, countries face intertemporal budget constraints irrespective of capital mobility.[41] Much economic adjustment may have been *mediated* by financial markets but the latter need not have been its *cause* itself. Considering these findings, it is everything but self-evident that capital mobility in itself is the major propellant behind regulatory change and potential convergence. Even less obvious is that such a link would work via constraints that capital mobility has been alleged to impose on national varieties of capitalism as a whole.

In contrast to the exaggerated focus on capital mobility *per se* (i.e., from a macro-economic perspective), the role of FSPs' changing preferences in effecting regulatory transformation has been largely overlooked. At the source of these changing preferences lies securitization.[42] The capital intensity of state-of-the-art securities markets operations generate high economies of scale and a preference of large firms for cross-border expansion. In addition, securities markets have been evolving rapidly, with ever more complex products added to investment banks' offing.[43] Cutting edge products, in turn, come with premiums for firms bringing them to the market first. Bank loans, in contrast, became commoditized decades ago; the profitability of the lending business dwindled already in the 1980s.[44] Fee income-generating financial products were seen as the future profit sources for large financial institutions. That meant fostering securities markets at home and pushing for access abroad.

Irrespective of policy coordination, public actors are generally favourable to their industries' calls for regulatory enhancement. This willingness is increased through the complexity of the topics involved. The more public actors 'puzzle', the more room private actors have to push their own 'solutions'. Indeed, as the steady stream of calls for neo-liberal reform from 'business leaders' in talk shows and newspaper editorials evidences, company representatives try hard to 'render the contingent necessary'.[45] Whether contingent or not, when public actors give in to such pleas it would be misleading to think that they enhanced the broad-brush 'competitiveness' of whole economic 'sectors' or even financial systems.[46] What is at stake is the

[40] The classic study is Martin Feldstein & Charles Horioka, 'Domestic Saving and International Capital Flows', *The Economic Journal* Vol. 90, No. 358 (1980), pp. 314-29.
[41] Ramon Moreno, 'Saving-investment dynamics and capital mobility in the US and Japan', *Journal of International Money and Finance* Vol. 16, No. 6 (1997), pp. 837-63. Moreno basically confirms Feldstein's and Horioka's findings.
[42] In a nutshell, securitization refers to substituting tradable securities (bonds, for example) for hitherto non-tradable financial assets and liabilities (bank loans and deposits, for example).
[43] Frank Partnoy, *Infectious greed: how deceit and risk corrupted the financial markets* (Times Books, 2002).
[44] Cf. Vittorio Grilli, 'Financial Markets and 1992', *Brooking Papers on Economic Activity*, No. 2 (1989), pp. 301-24.
[45] Matthew Watson & Colin Hay, 'The discourse of globalisation and the logic of no alternative: rendering the contingent necessary in the political economy of New Labour', *Policy & Politics* Vol. 31, No. 3 (2003), pp. 289-305. Cf. Angus Cameron & Ronen Palan, *The Imagined Economies of Globalization* (Sage, 2004).
[46] As Cerny seems to argue, cf. Cerny, 'International Finance and the Erosion of Capitalist Diversity', here p. 177.

enhancement of individual firms' positioning by regulatory means—a rather old phenomenon in regulatory politics. As in trade politics in general, governments have tended to readily dole out regulatory favours to domestic firms (particularly larger ones) to cement or enhance their market fortunes.[47]

That leaves us with two schools of thought. From a varieties of capitalism perspective financial regulation, to cut a long story short, supports financial markets' due place in a national set of economic institutions. Regulatory change should follow functional imperatives. If positively coordinated elements of regulatory regimes become dysfunctional, we should expect adaptation if possible and abandonment if not. For the sake of simplicity, we can call this logic 'coordinative imperatives'; public actors are its 'agents'.

From the perspective of firms, regulation reproduces their market positions. If these come under threat or new opportunities emerge, we should expect firms to push for regulatory change. We can call this logic 'competitive imperatives', for short. Dominant domestic firms are its agents. How do these two imperatives in regulatory policy making go together? Do they at all? Can they be reconciled in a single framework?

In relatively closed coordinated market economies, coordinative and competitive imperatives are easily synchronized, often to the point where one of the two becomes invisible. Governments and the top financial services providers have traded the reproduction of an oligopoly for FSPs against the latter's cooperation in positive policy coordination. If markets for financial services are essentially national, a single regulatory regime can contain the specific idiosyncrasies that are functional in the respective VoC as well as accommodate the competitive concerns of firms. In coordinated market economies, policy making for financial markets has united private and public actors in closely knit policy communities to fine-tune this double function of regulation. From an institutionalist perspective, the private interests in the reproduction of this system were concealed by the functionalist logic of institutional complementarities. In a trick of the eye, the conditions for private support of positively coordinated policies seemed to vanish.

Conceptually, regulatory regimes can therefore be challenged from two sides: Public actors discover dysfunctionalities (as for example when the French overdraft economy was faced with growing capital mobility) and adapt insofar possible. But private actors can also withdraw their support because their regulatory preferences shift in a new direction, inspired by rising competitive opportunity costs of sticking with the contemporaneous regime. Both 'challenges'

[47] Marc Busch, *Trade Warriors: States, Firms, and Strategic-Trade Policy in High-Technology Competition* (Cambridge University Press, 2001).

could have endogenous and exogenous causes. For the sake of this argument and the debate in general, exogenous ones are more relevant, so that we will henceforth concentrate on those.

Considered this way, coordinated market economies can both have functional complementarities that public actors seek to reproduce (if possible) and at the same time be subjected to regulatory reform demands that have nothing to do with 'pressures' operating at the systemic level. Put differently, varieties of capitalism do not need to become dysfunctional to change. It is sufficient if due to exogenous developments (securitization or technological change, for example) private actors withdraw their support for positive coordination. They have become diluted from below.

Again drawing inspiration from Milner, this process should gather steam as it progresses. Zysman's observation that the prevalence of capital markets (compared to banking) correlates with a growing distance between private actors and 'the state' give it an additional twist.[48] Zysman had a static comparison in mind, but this finding should also apply to changes in financial systems over time. The development of active capital markets where hitherto they played no role further undermines the coupling of public and private regulatory preferences. In that case, the process of decoupling has an inherent momentum.

Because important forces for change develop irrespective of institutional complementarities, 'hybridization' of VoCs is something that we should *expect*. The 'logic of change' does not necessarily operate at the level of institutional sets but also below or next to it, as it were, in the realm of competitive imperatives. VoCs do not change as 'wholes', and acknowledging their public/private foundations, there is no reason to believe that they would. Of course, in actual reforms, competitive and coordinative imperatives are mixed. Still, particularly when the two come together, FSPs often use the reform momentum to push change in a direction that coordinative imperatives themselves would not warrant.

The cases below, drawn from French and German financial market reform, aim to show how competitive imperatives were an important and systematic element in the reform of financial markets and, by extension, the national varieties of capitalism at large. Changes looking fairly random from an institutionalist perspective now exhibit systematic patterns. Most examples refer to the period before serious European integration began, i.e. up to 1992. Many crucial reform initiatives introducing capital markets in Germany and France fall into this time. International coordination of financial market politics was still in its infancy; the 'adaptive pressures' other scholars have argued for should therefore be strongest. In addition, this period allows us to witness the discussed dynamics much more clearly than when European politics blur the picture.

[48] Zysman, *Governments, markets, and growth*. Cf. Coleman, 'The French State, Dirigisme, and the Changing Global Financial Environment', here p. 288.

The following empirical material is meant to underline four points in particular: First, competitive imperatives played at least as much a role in regulatory reform as coordinative ones. Second, 'pressure' for change came from inside national economies as much as from outside. Third, 'competition between financial centres' mirrored competitive imperatives, not coordinative ones. Financial system changes justified in the name of this competition reflected business strategies, not adaptive pressures on economic institutions per se. Fourth, the divergence between coordinative and competitive imperatives increases over time as the financial industry internationalizes and capital markets gain ground.

COMPETITIVE IMPERATIVES IN FRENCH FINANCIAL REFORM

French financial reforms of the 1980s had been devised as a comprehensive package initiated by Jacques Delors as finance minister and fully developed under Pierre Bérégovoy.[49] In the first half of the decade, the main initiative still rested with the Trésor and its top officials. The socialist nationalizations had subjugated financial institutions to the state so that coordinative and competitive imperatives were not only coupled but actually united in a single set of actors. The 1984 Banking Act aimed at tearing down barriers between different banking segments and introducing 'competition' between financial institutions ranging from the local *Caisse d'epargne* to commercial giants such as the Banque National de Paris. This 'competition' was still state-controlled and a means to a policy end (a more flexible allocation of credit) rather than a release of financial institutions into the market wilderness. At this point, competitive imperatives were still fully subordinated to coordinative ones.

In the *petit* Big Bang, as French stock market reforms became known, competitive imperatives became distinct from coordinative ones but were still successfully reconciled. The spirit was still one of 'what is good for big French banks is good for French capitalism' and vice versa. The Stock Exchange Reform Act of 1988 was meant to create a French investment banking industry that could mirror Britain's with the difference, of course, that it was intended to support an industrial structure more reminiscent of the German one.[50] Eventually, these reform steps were to create a dynamic that transformed French finance much more than had been originally envisaged.

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[49] For a more comprehensive overview of French financial reforms, see William Coleman, 'Governing French banking: regulatory reform and the Crédit Lyonnais fiasco', in Mark Bovens, Paul 't Hart & Guy Peters (eds), *Success and failure in public governance: a comparative analysis* (Edward Elgar, 2001), pp. 326-42; Coleman, 'The French State, Dirigisme, and the Changing Global Financial Environment'; Loriaux, *France after Hegemony;* Morin, 'A transformation in the French model of shareholding and management'; Schmidt, 'French capitalism transformed'; Jonathan Story & Ingo Walter, *The Political Economy of Financial Integration in Europe: The Battle of the Systems* (MIT Press, 1997).

[50] French reforms not only wanted to imitate German universal banking, as has often been pointed out, but go much further. Many French securities markets reforms pointed beyond contemporaneous German practice. Here, inspiration was clearly drawn from developments in Britain.

French stock market reform came only *after* the 1986-88 stock market boom that had been fuelled by privatizations of the conservative government. In 1987, the number of direct shareholders quadrupled, fed mainly by 14 privatisations raising FFR72.5bn.[51] A full 3.8m people signed up for the shares of Paribas alone.[52] It took no stock exchange reform to raise capital for privatizations or IPOs in general. Reforms did not address a dysfunctionality of French capitalism per se but boosted the market position of large financial institutions. Before reforms, stock broking had been the reserve of *agents de change* who officially were no broking firms but government-appointed officials. As in many other countries, commercial banks in France were eager to secure a piece of the growing securities business.[53] When agents de change were turned into commercial *sociétés de bourse*, the new law allowed other financial firms to progressively swallow them. In effect, what had happened elsewhere was to be repeated in Paris: Large financial players could effectively buy themselves into the stock market by folding specialist firms into their own operations.[54] By the end of 1990, close to 80 per cent of them had effectively been taken over by larger firms. The removal of bond trading from the stock exchange monopoly in 1987 equally served banks' business interests: The market share of large FSPs who could henceforth act as market makers surged to 73 per cent in the first half of the following year.[55]

Developments around French futures and options trading show how competitive imperatives increasingly followed their own rationale. MATIF—the French derivatives exchange introduced in 1986—had been the brainchild of the Trésor and became an instant success. Soaring trading volumes, however, generated rising profits for the stock brokers—the aforementioned *agents de change*—and sparked the jealously of the banks cut out from the action. The latter wanted to make markets in futures contracts themselves rather than being obliged to trade through the *agents de change*. The conflict got out of hand, and the banks referred it to the Treasury. Considering the weight of state patronage at the time, this escalation was remarkable. When the banks finally prevailed, the head of the stock exchange, Xavier Dupont, spoke of a 'civil war' that the authorities had had to put to an end.[56] The struggle continued, however, as the reform initiative passed more and more to the private sector and competitive struggles. A mere two years after the settlement, a consortium of French banks and a Swedish specialist set up rival exchange, dubbed OMF, much to the chagrin of the MATIF and its official sponsors.[57] The sponsoring banks, coincidently, were the two who had already broken ranks by setting up their

[51] 'French tentacles', The Banker, November 1988.
[52] George Graham, 'French bourse flourishes after years of evolution', Financial Times, March 11, 1987.
[53] Sobel, *Domestic Choices, International Markets*. Canada saw similar developments. Cf. Stephen Fidler, 'Deregulate or risk being left behind', Financial Times, October 21, 1987.
[54] Graham, 'French bourse flourishes after years of evolution',
[55] George Graham, 'Major reforms under way', Ibid.September 29, 1988.
[56] George Graham, 'A late run for the winning post', Financial Times, April 7, 1987.
[57] George Graham, 'Taste for regulation revived', Financial Times, November 2, 1989.

capital market operations in London—BNP and Paribas—plus Crédit Commercial de France, which had been privatised in 1987.[58] With growing independence, financial institutions more and more opted out of cosy public-private arrangements and became pace makers of French financial reform.

The competitive imperatives behind 'competition between financial centres' became obvious in the row over so-called 'block trading'. The French government had traditionally been highly sceptical of block trading.[59] In the second half of the 1980s, inter-corporate cross-shareholdings had come to replace direct state ownership of firms as the anchor of interventionist industrial policy. While privatizations had created literally millions of small shareholders in France, larger stakes continued to be held by strategic investors, usually with state sanctioning.[60] In this system, the presence of institutional investors taking large stakes for speculative purposes would have borne high disruptive potential and contradicted coordinative imperatives. French regulation therefore impeded block trading by forcing brokers to publish information about deals that would cause prices to move against them.[61] Only matched deals were allowed off the Paris exchange.

In consequence, investors interested in large-scale trading in French shares moved to an electronic trading system in London known as SEAQ International. It offered less transparency and thus better conditions for trading large positions without a loss. By the end of the 1980s, this London-based system had attracted around 30 per cent of French equity trading, done mainly by big banks established in the City. French brokers were the big losers because business had moved off their home turf. The advent of the SEAQ International had introduced cross-border competition for broking services—not capital—where there had been none before. In 1991, French broking firms stepped up pressure and called for relaxation of block trading rules.[62] The commission studying the matter was chaired by René de la Serre, head of Crédit Commercial de France (CCF).[63] Privatized in 1987, CCF's deference to government preferences could no longer been taken as a given. The report of the private study group unsurprisingly called for the permission of block trading. Representing domestic brokers reeling over business lost to London, the stock exchange council quickly endorsed its findings. Eventually, the government gave in to

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[58] George Graham, 'After the scandal, the real trouble starts', Financial Times, July 4, 1988.
[59] In a nutshell, block trading refers to the trading of large swaths of shares in one go; it is usually the preserve of institutional investors.
[60] Cf. e.g. 'French tentacles',
[61] The issue at stake can be summarized as follows: If a financial institutions plans a large transaction it is eager to hide it intentions from the market lest prices move against it. It favours lower disclosure standards and a time lag with which it has to report trades done to the authorities which may publish the data. If financial institutions are allowed a certain secrecy in their dealings, however, they may use this to the disadvantage of particularly smaller investors. These investors hear of transactions that may hurt their positions only long after the fact. In addition, lower disclosure rules might encourage all sorts of market rigging and other collusive behaviour among participants.
[62] William Dawkins, 'Bourse regulators back plan for reforms', Financial Times, July 10, 1991.
[63] William Dawkins, 'Block trading review on the way', Financial Times, September 9, 1991.

pressure from domestic firms and eased block trading impediments, albeit less radically than some reformers would have liked.[64]

The argument outlined above suggests not only that competitive imperatives play an important role in propelling reform, but also that in the absence of such imperatives, coordinative imperatives are likely to prevail. In this respect, 1989 reforms of the French takeover regulation are a good example. In contrast to what advocates of the convergence pressures of capital mobility would expect, industrial policy considerations prevailed over 'pressures' to appeal to international investors.[65] French public actors did their best to complement the privatisations under first Mitterrand and then Chirac with the build-up of a German-style system of cross-shareholdings. To bolster (still rather capital scarce) companies' ability to participate in this restructuring, the reform of the French takeover code in 1989 blatantly ignored what in Anglo-American markets would have been considered justified minority shareholders' concerns. Once a company had acquired 33 per cent of another company's shares, the law decreed, it would have to bid for another 33 per cent, bringing its share up to two thirds of the target company's capital. That was enough for effective control but decreased the value of the remaining third still in the hands of minority shareholders. As titles to partial corporate control, the last 33 per cent were worthless. That made shareholdings in French companies much less attractive, certainly for foreign outsiders. It depressed demand, share prices, and—crucially—capital inflows. But the law enabled French companies to restructure with sanctioning from above and in spite of their stretched capital resources. Rather than appealing to global investors, the reform of the takeover code became an instrument of industrial policy.

Many of the reforms eventually transformed not only French financial market institutions themselves but also economic practices at large—what Morin has called the shift from the 'financial network economy' around 1990 towards the 'financial market economy' a decade later.[66] Much of the regulatory groundwork for this shift was pushed by individual firms with an agenda that had little to do with the viability of the French VoC per se. Of course, that is not to say that coordinative imperatives—the interest of public actors in embedding financial markets in economic policy at large—have played no role. Their influence was much lower than is commonly assumed, however. Crucially, coordinative imperatives deriving from 'globalization pressures' were hardly determining for reform trajectories. As the example of the takeover code reform shows, the French government was quite capable of following its own policy line regardless of the global mobility of capital.

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[64] Alice Rawsthorn, 'French try to recapture lost trade in securities', Ibid.February 7, 1992.
[65] 'French tentacles',
[66] Morin, 'A transformation in the French model of shareholding and management'.

COMPETITIVE IMPERATIVES IN GERMAN FINANCIAL REFORM

In the case of German financial reform, we equally find both coordinative and competitive imperatives at work. [67] Just as in the French case, in early reforms both imperatives were still easily reconciled. Take Germany monetary policy: when a wave of new financial instruments started to appear on global financial markets—floating rate notes, zero coupon bonds, etc.—the Bundesbank introduced them only cautiously in Germany, fearing that they might obstruct monetary policy. For example, it resisted calls for Certificates of Deposit (CDs) which would function much like time deposits for lenders but in contrast to those would be tradable.[68] The Bundesbank had used banks' reserve requirements against time deposits as a preferred instrument to expand or contract credit. CDs, it had initially found, would not fall under reserve requirements.[69] Thus, if time deposits would be replaced by CDs, the Bundesbank would loose one of its favourite instruments. At the same time, the private sector called for their introduction because their attractiveness to borrowers meant that business was lost to players in the Euromarkets where they were readily available. When the Bundesbank finally did introduce CDs in Germany, it refused to fully give up its hesitations—and against its earlier intentions introduced reserve requirements also for CDs.[70] However, it compensated national banks by lowering the overall level of reserves these had been required to deposit with the central bank, freeing up DM8bn of capital. Competitive and coordinative imperatives had been reconciled.

This became more difficult in the introduction of a futures and options exchange some years later. The Deutsche Terminbörse (DTB) was launched in 1990.[71] In tune with many German reforms, it came relatively late. The City's LIFFE had been opened in 1982, France's MATIF in 1986 and the Swiss Soffex in 1988. This German exceptionalism had done little to worry the Bundesbank or the finance ministry or, for that matter, German banks. Indeed, the Bundesbank had been decidedly cool on the matter because it feared that Bund futures in particular might disrupt its way of managing government debt and conducting its monetary policy.

Once other countries started to introduce their derivatives exchanges, German banks grew anxious. Unless Germany established its own exchange, so the worry, foreign competitors might start offering products referring to German securities such as equity options or bond

[67] Susanne Lütz, 'Finanzmarktregulierung: Globalisierung und der regulative Umbau des "Modell Deutschland"', in Roland Czada, Susanne Lütz & Stefan Mette (eds), *Regulative Politik: Zähmung von Markt und Technik* (Leske + Budrich, 2003), pp. 103-70; Jonathan Story, 'Globalisation, the European Union and German Financial Reform: The Political Economy of 'Finanzplatz Deutschland'', in Geoffrey Underhill (ed), *The New World Order in International Finance* (MacMillian, 1997), pp. 245-73.
[68] The idea of a CD is to earn the interest of a longer-time deposit while giving the lender full flexibility to get the loan back at any time—by simply selling the CD to someone else.
[69] Jonathan Carr, 'Challenge on several fronts', Financial Times, May 13, 1985.
[70] Jonathan Carr, 'Bundesbank to allow issue of D-Mark CDs', Financial Times, December 20, 1985.
[71] Katharine Campbell & Deborah Hargreaves, 'Frankfurt fights to regain bunds', Ibid.November 26, 1990.

futures.[72] More importantly, they feared that cash markets might follow the derivatives trading, deserting the Frankfurt markets they controlled. The top firms—Deutsche Bank, Dresdner Bank, Commerzbank and Deutsche Girozentrale—set up a committee to study the matter. It soon encountered legal obstacles to setting up a German derivatives market. Dresdner's chairman used its position as head of the German Federation of Private Bankers to send an official wish-list with necessary regulatory changes to the government in the federation's name. Despite some hesitations, the government eventually complied. A year later, most of the required legal changes were underway while the banks themselves worked out regulatory details.[73] The competitive concerns of FSPs overruled the coordinative imperatives represented by the Bundesbank's hesitation.

Taking a closer look, other aspect of regulatory reform resembled trade politics much more than 'adjustments to global pressures'. In securities underwriting, for example, the Bundesbank kept a tight lid on foreign competition, even if the rules were eased over time. The process started when the Kohl-government abolished a 25 per cent coupon tax on foreign holdings of German bonds in October 1984 as high US interest rates and a high Dollar had put German primary markets under pressure.[74] For once, capital mobility that normally rewarded German investors with higher returns turned back on the government. As hoped, the measure more than tripled foreign holdings of Bunds over the following two years.[75] In 1986, after consultation with German banks and the Bundesbank, the government for the first time invited foreign banks to participate in the Federal Bond Consortium through which the government placed its debt in the market.[76] The aim was not so much to let foreigners in, but to increase demand for German government securities and thereby drive down financing costs. Almost a third of the new players came from Japan, easing access to that country's huge savings pool. With the foreign players' share fixed at 20 per cent of the total, however, there remained clear limits to serious competition and a foreign challenge to domestic dominance of the market. Coordinative imperatives had pushed for adaptation, but competitive imperatives had salvaged regulatory protectionism.

This fixed share was only lifted when Germany faced the higher financing needs arising from reunification. Now, the placing power of foreign players become highly important. The Bundesbank introduced a partial auctioning of the bonds in 1990, meaning that fixed quotas were

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[72] Haig Simonian, 'Frankfurt studies the options game', Ibid.June 10, 1987.
[73] Haig Simonian, 'Swiss Influence Plan For New Exchange', Ibid.July 13, 1988.
[74] It coordinated the move with the French, who abolished a similar tax, rather than moving unilaterally. Rupert Cornwell & David Housego, 'Paris joins Bonn in plan to abolish withholding tax', Financial Times, October 4, 1984.
[75] Jonathan Carr, 'Foreigners May Join DM Bond Consortium', Ibid.June 12, 1986.
[76] Jonathan Carr, 'Foreign Banks Drawn Into German Bonds Net', Financial Times, July 14, 1986.

loosened.[77] The top brass of German banking had hardly let go of this lucrative business without compensation, however. Deutsche Bank's attempts to get a foot in the American primary government bond market had been frustrated for years. Now that the Bundesbank was about to grant more freedoms to foreign institutions, the New York Fed finally reciprocated by granting Deutsche Bank 'primary dealer' status.[78] 'Liberalisation' had not been a unilateral affair, but taken place on a mutual basis. Tit-for-tat FSPs were given mutual market access. The main losers—certainly in Germany—were the smaller players, such as cooperative banks, which had been complaining about too small allotments for years and now got nothing in return for falling commissions.

This trade politics-like aspect of regulatory reform was even more obvious in the case of corporate bonds: In 1985 the Bundesbank had allowed foreign FSPs to lead-manage foreign issues of DM-denominated bonds in Frankfurt.[79] The move was primarily intended to increase the standing of Frankfurt as a financial centre opposed to the City's Euromarkets where D-Marks were also readily available. More than anything business going through Frankfurt promised a cut of the fees for German banks. Foreign corporations in need of German currency would probably approach their national FSPs first; attracting foreign issues to Germany therefore meant allowing foreign FSPs to lead-manage the issues and take part of the associated fees. German banks had such rights in most other important countries—apart from Japan. Thus, when the Bundesbank discussed its ideas with foreign banks in Frankfurt, it scheduled an extra meeting with representatives of Japanese banks and announced that in effect, they would be excluded from the new privileges until Japanese authorities would make concessions to German firms.[80] Again liberalisation stood in the sign of 'updating Frankfurt', but not to the detriment of the large German players. Indeed, German institutions continued to dominate the Frankfurt market; instead of introducing stiff competition, one senior US banker found foreign lead managers in Frankfurt rather 'like gnats buzzing around German heads'.[81]

As Lütz has found, the large commercial banks were an important driving force behind the 'Finanzplatz Deutschland' initiative seeking to promote securities markets and Frankfurt as a financial centre.[82] The latter broke a long tradition of spreading share trading over eight exchanges, including four larger ones. It sparked the ire of smaller players as well as regional authorities but the coalition behind the initiative prevailed. Again, however, it would be

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[77] Katharine Campbell, 'Bundesbank in first move to update issue practices', Ibid.July 10, 1990.
[78] Patrick Harverson & Katharine Campbell, 'Wall St yields to Deutsche Bank', Ibid.December 20, 1990.
[79] John Davies, 'West Germans open bond sector to foreign managers', Financial Times, April 13, 1985. A foreign issue in this case refers to selling bonds of non-German corporations denominated in DM to a German audience.
[80] Jonathan Carr, 'Bundesbank presses for greater deregulation', Ibid.April 10, 1985. The rules for Japanese firms were only eased more than two years later, in October 1987. Haig Simonian, 'Japanese Bring D-Mark Issues', Financial Times, October 2, 1987.
[81] Jonathan Carr, 'Germans see no profit in novelty', Financial Times, August 2, 1985.
[82] Lütz, 'Finanzmarktregulierung'.

misleading to think of this move as part of a unilateral adjustment to pressures to make national financial systems more attractive for mobile capital. On the ever contested issue of insider trading rules the Germans dragged their feet as long as possible, never minding disgruntled investors.[83]

Even more startling to the outside world, however, was the total absence of anything resembling a takeover code that would have guaranteed corporate outsiders some kind of security should they want to launch a bid. Up to the present day Germany has frustrated efforts by other European countries and the Commission to come up with a meaningful arrangement. Contrast this with the social democratic government's decision to scrap the 50 per cent capital gains tax on long-term shareholdings on from 2002.[84] The tax had hitherto kept large German corporations—and large financial institutions more than anyone else—from ridding themselves of the cross-shareholdings that had been so important for the 'Deutschland AG'.[85] Next to pressure from financial institutions for whom the shareholdings had become dysfunctional as cement in the now waning 'Hausbank' relationships, this development reflected the growing importance of capital markets in Germany itself. The decision stemmed from 1999, when the stock market was still riding high and boosting 'shareholder value' and freeing capital for acquisitions stood high on corporate agendas. Growing capital market importance, we had argued above, had in turn not happened 'naturally' or been owed only to external pressure—agency from financial institutions had played a crucial role. Again, the shift from a bank-based towards a capital market system, driven largely by competitive imperatives, set in motion a dynamic of financial system change that central to disembedding German financial markets from its 'traditional' variety of capitalism.

CONCLUSION

Rather than necessarily disintegrating at the systemic level, coordinated varieties of capitalism can be diluted from below. In relatively closed coordinated market economies it often is relatively easy to satisfy both public actors' and large producers' policy preferences in a single regime. Because of this double support and political over-determination, as it were, comparative institutionalism has tended to overlook that also positively coordinated institutions still depend on key private actors' support for their viability. This support, I have argued, derives especially from the impact of the regulations on the competitive position of firms. These competitive imperatives, as I have called them, may start to warrant regulatory reforms that undermine the positive coordination of national financial markets with economic policy at large. For example,

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[83] Joseph McCahery, 'Market Integration and Particularistic Interests: The Dynamics of Insider Trading Regulation in the US and Europe', in Geoffrey Underhill (ed), *The New World Order in International Finance* (MacMillian, 1997), pp. 50-75.
[84] Tony Major, 'Abolition of tax set to speed economic change', Financial Times, December 19, 2001.
[85] For an overview of the complicated structure, see Story & Walter, *The Battle of the Systems*, p. 184.

firms may start promoting regulatory convergence on 'neutral ground' to facilitate mutual market access.

The arguments presented here caution against perspectives on institutional change that ignore how alleged structural imperatives are filtered through domestic constituencies. Once we realize that key actors are unlikely to take macro-imperatives—such as salvaging the national VoC—into account but follow their own, much narrower interests instead, 'hybridization' of VoCs becomes the expected outcome. Still, the term is misleading. The institutional result is a hybrid only with respect to ideal-typical institutional sets. From the perspective of private actors institutional complementarities matter little. Instead, they witness a continuing process of market making and re-shaping through regulatory reform that is far from finished. For them, disembedding financial markets from CMEs and thereby imposing change on whole national economies is little more than collateral damage on the road to building truly global market for financial services.