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Comparative Analysis of Capitalist Economies: a Focus on Europe and its Different Models

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Abstract

Capitalism is a widely discussed topic in economic as well as in sociological studies. Since the early '90s, after the collapse of the economic systems of socialist Countries, it has become the main way of organizing the economy in most of the world. This article is set to describe the features of Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs), as defined in the literature on the topic, with particular reference to the European context. Even if such description is based on traditional elements, it can be useful in order to study the current evolutionary patterns of the two main models of capitalism, not only in a European perspective but also in a global one.

Keywords
Capitalism, Democracy, Political economy, Corporate governance, Europe

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Capitalism is a widely discussed topic in economic as well as in sociological studies. It has been one of the main themes of analysis of classical social scientists such as K. Marx, É. Durkheim and M. Weber[1], not forgetting G. Simmel and W. Sombart, while contemporary authors are set today to identify its evolutionary trends, especially after the great economic crisis of 2008-2015.[2]

There are many definitions of capitalism in scientific literature, but it can be simply identified as a system of wage-labour and commodity production for sale, exchange and profit, rather than for the immediate need of the producers.[3] It involves "an economy in which private ownership dominates, and the market is the primary mechanism for determining the production and the distribution of goods to people, for profit and in response to market demand."[4]

Since the early modern age, capitalism is traditionally connected with the historical development of Western Europe and Anglo-Saxon countries, which provided the principal, but not the only, means of industrialization.[5] In its evolution, it went together with the forms of liberal democracy and the rise of the welfare state.

After World War II, for many decades, Western states which adopted capitalism were confronted by the Soviet Union and the countries of the Comecon system, relying on socialism, a system where "the economy is predominantly publicly owned (e.g. by the state, workers or community) and production is planned by public bodies to meet what the planners decide is socially needed."[6]

Since the early '90s, however, after the collapse of the economic systems of these socialist countries, capitalism has become the main way of organizing the economy in most of the world. Even if it has spread almost everywhere, it does not occur in just one single model. The variety of capitalist systems is broad. Nonetheless, it is possible to identify two main models of capitalism, to which the economic systems of different countries may be referred. They are not always labelled with the same terms in sociological and economic literature, but all authors have considered the same groups of countries and agreed on their structural features and differences.

1. A. Giddens, *Capitalism and Modern Social Theory*, Cambridge University Press 1971.

2. P. Diamond, *The Crisis of Globalization: Democracy, Capitalism and Inequality in the Twenty-First Century*, I.B. Tauris 2019.

3. G. Marshall, *Dictionary of Sociology*, Oxford University Press 1998, (2nd ed.), p. 53.

4. L. Martell, *The Sociology of Globalization*, Polity Press 2017, (2nd ed.), p. 40.

5. A. Giddens, *The Consequences of Modernity*, Polity Press 1990.

6. L. Martell, *The Sociology of...*, op. cit., p. 40.

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The role of the market in the regulation of the economy is not recognized today only in very few countries, such as for example North Korea and Cuba. Many others are still experiencing a long and sometimes difficult transition to a market economy, while new forms of capitalism are consolidating. Among these countries, it is worth considering the case of China and its odd system based on "capitalism without (liberal) democracy", involving the presence of representatives of the Chinese Communist Party in the boards of corporations.

This article is set to describe the features of the two main models of capitalism, *Liberal Market Economies* (LMEs) and *Coordinated Market Economies* (CMEs), as defined in the literature on the topic, with particular reference to the European economic context. Even if such description is based on traditional elements of the two models, it can provide interesting hints to study their current evolutionary patterns, the relations between them and also their relations with other forms of capitalism, not only in the European perspective, but also the global one.

The varieties of capitalism in the "political economy" perspective

In the last decade of the 20th century, the confrontation between market economy and planned economy eventually came to an end. After the collapse of the countries adopting the latter, the debate about the best way of organizing the economy seemed restricted to the former, and many social scientists brought interesting theoretical contribution on the issue.

One of the first authors to deal with the topic was M. Albert, who made a clear distinction between *Anglo-Saxon capitalism*, occurring mainly in the United Kingdom and the United States, and *Nippon-German capitalism*.[7] The latter is also called *Rhineland capitalism* in its European declination, to include not only Germany but also other countries around it, sharing the same culture and institutional organization.

With regard to the same countries, L. Thurow[8] defined two models in terms of *Anglo-Saxon capitalism*, based on the "paradigm of the consumer", and *communitarian capitalism*, based on the "paradigm of the worker".

Taking into account also the contributions of the two abovementioned authors, we are set to conduct our study using the analytical categories of P.A. Hall and D. Soskice, according to which there are LMEs and CMEs operating in individual countries all around the world.[9] LMEs, in addition

7. M. Albert, *Capitalism Against Capitalism*, Whurr 1993.

8. L. Thurow, *Head to Head. The Coming Economic Battle Among Japan, Europe and America*, Morrow 1992.

9. P.A. Hall, D. Soskice, *An Introduction to Varieties of Capitalism*, in: *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*, eds. P.A. Hall, D. Soskice, Oxford University Press 2001, pp. 1–68.

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to the UK and the US, occur in Australia, Canada, New Zealand and Ireland, while CMEs, occur in Germany and Japan, as well as in Switzerland, the Netherlands, Belgium, Austria and the four Scandinavian countries.

These two groups of countries show interesting structural differences, with consequences affecting also the organization of interests and the processes of decision-making and implementation of policies. It must be stressed, however, that not all the major world economies can be exactly framed into one of the two models. France falls between these two forms of capitalism, and so does Italy.

This study lies in the theoretical perspective of political economy, an actor-centered approach considering an economy as a terrain populated by multiple actors, each seeking to advance their interests in a rational way in strategic interaction with others.[10] Even if relevant actors may be individuals, firms, producer groups or governments, it is stressed that "this is a firm-centered political economy that regards companies as the crucial actors in a capitalist economy. They are the key agents of adjustment in the face of technological change or international competition whose activities aggregate into overall levels of economic performance."[11]

In a relational conception of the firm, it is considered to be an economic actor seeking to develop and exploit core competencies, also called dynamic capabilities. These capacities are crucial for firms in order to develop, produce and distribute goods and services profitably.[12] To this end, the quality of the relationships the firm is able to establish both internally and externally becomes very important. While inside relationships are basically set with employees, on the outside there is a wide range of important actors to deal with, including suppliers, clients, collaborators, stakeholders, trade unions, business associations and governments.

The approach described here focuses on five spheres in which firms must develop relationships to resolve coordination problems that are central to their core competencies:

- industrial relations;

- vocational training and education;

- corporate governance;

10. F.W. Scharpf, *Games Real Actors Play: Actor-Centered Institutionalism in Policy Research*, Westview Press 1997.

11. P.A. Hall, D. Soskice, *An Introduction...*, op. cit., p. 6.

12. D. Teece, G. Pisano, *The Dynamic Capabilities of Firms: an Introduction*, "Industrial and Corporate Change", 1994, Vol. 3, Issue 3, pp. 537–556. DOI: 10.1093/icc/3.3.537-a

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- inter-firms relations;

- relations with employees.

In this perspective, national political economies may be compared by reference to the way in which firms resolve coordination problems they face in these five spheres. The principal distinction is between the above-mentioned LMEs and CMEs.

In LMEs, firms coordinate their activities primarily via hierarchies and competitive market arrangements, in a context of competition and formal contracting. "In response to the price signals generated by such markets, the actors adjust their willingness to supply and demand goods or services, often on the basis of the marginal calculations stressed by neoclassical economics."[13] Coordination mechanisms are different in CMEs, where firms depend more heavily on non-market relationships to set up coordination with other actors and to construct their competencies. These coordination modes include "more extensive relational or incomplete contracting, network monitoring based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive, relationships to build the competencies of the firm."[14]

These models of capitalism must be assumed in a typical-ideal dimension. On one hand, market relations and hierarchies are of course important to firms in all the economies considered, while, on the other, even in liberal market economies firms enter into some relationships that are not fully mediated by market forces.

In any national economy, anyway, firms face a set of coordinating institutions whose character is not fully under their control and will gravitate toward the mode of coordination for which there is institutional support. Also important are the roles of culture, informal rules, and history.

The presence of institutional complementarities reinforces the differences between LMEs and CMEs. Two institutions may be considered "complementary" if the presence of one increases the returns from the other. Fluid labour markets, for example, may be more effective at sustaining employment in the presence of financial markets that transfer resources readily among undertakings, thus maintaining a demand for labour.

13. P.A. Hall, D. Soskice, *An Introduction to...*, op. cit., p. 8.

14. Ibidem.

In the next paragraph we shall describe the two European economies that are closer to the LME model and to the CME model, respectively, the United Kingdom and Germany, with regard to the five areas in which firms must resolve coordination problems. In particular, aspects of corporate governance in both political economies will be analysed. Other spheres of coordination will be described, special attention being paid to non-market institutions of the German system. Later, we shall discuss the question of convergence or competition between the two models in the European dimension.

LMEs and CMEs in Europe: the UK vs. Germany

Corporate governance in the UK and Germany: "shareholder model" vs. "stakeholder model"

The first sphere we shall deal with in order to define the two models of capitalism is *corporate governance*. It refers to the mechanisms concerning ownership and management of large corporations and the way they gain access to capital markets. The solutions devised for these problems affect both availability of finance for particular types of projects and the terms on which firms can secure funds. Specific features of the two systems of corporate governance are very important in order to understand the differences in the organization of the whole set of a company's internal and external relationships.

A broader definition of corporate governance includes:

- the nature, size and regulation of capital markets;

- the structure of ownership of companies;

- the relationship between the management and various stakeholders in a company;

- the structure of companies themselves (unitary or two-tier boards);

- the methods of bringing about corporate restructuring.[15]

15. S. Woolcock, *Competition among Forms of Corporate Governance in the European Community: the Case of Britain*, in: *National Diversity and Global Capitalism*, eds. S. Berger, R. Dore, Cornell University Press 1996, p. 181.

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According to Kester the term refers to "the entire set of incentives, safeguards, and dispute-resolution processes used to order the activities of various corporate stakeholders, each seeking to improve its welfare through coordinated economic activity with others. Thus, the term implies more than simply the process by which the board of directors relates to corporate shareholders and top management."[16]

The process of integration of the European Union has stressed in the last decades the peculiarities of single national systems of corporate governance. The main difference is between the "shareholder model", the British version of the Anglo-Saxon corporate governance, and the "stakeholder model", found in Germany and with variations in some neighbouring countries.

The Anglo-Saxon system of corporate governance puts emphasis on equity finance for business. Capital markets therefore tend to be large and regulated in a manner favourable to trading in equities. The London Stock Exchange is by far the largest in Europe with more than 2,500 listed companies. Its stock capitalization used to be about 90% of GDP, while it was just about 20% in Frankfurt, where the number of listed companies was just around 600.[17]

As banks provide a relatively small share of business finance, the links between banks and companies are not strong. Ownership of shares is largely in the hands of institutional fund managers, whose focus is on a relatively short-term return on capital rather than longer term market share issues. In the 1990s, shares owned by other companies accounted for just about 4% against 42% in Germany. On the contrary, shares ownership by financial institutions was more than 50% against a quote of just 20% in Rhineland. The percentage of shares owned by households in the UK was double than in Germany.[18]

The British system of corporate governance shows no evidence of extensive cross-shareholdings. A typical configuration among the majors is a *public company*, a shareholding company whose capital assets are owned by a great number of investors taking just a (relatively) small stake in it, in a "portfolio investment" logic. According to Franks and Mayer, in 1990 in the UK there was a single shareholder owning more the 25% of total capital in just 16% of the first 170 listed companies.[19] These quotes were about 85% in Germany and 80% in France.[20] Windolf and Bayer, with regard to the first 500 companies in each country, report that in 1990 in the UK 48.6% of shareholders owned less than 5% of a company's total capital against 9.5% in Germany.[21] On the contrary, just

16. W.C. Kester, *American and Japanese Corporate Governance: Convergence to Best Practice?*, in: *National Diversity and Global Capitalism*, eds. S. Berger, R. Dore, Cornell University Press 1996, p. 109.

17. S. Woolcock, *Competition among Forms...*, op. cit., p. 185.

18. S. Vitols, *Varieties of Corporate Governance: Comparing Germany and the UK*, in: *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*, eds. P.A. Hall, D. Soskice, Oxford University Press 2001, p. 342.

19. J. Franks, C. Mayer, *Ownership and Control*, mimeo 1994.

20. M. Bianco, S. Trento, *Capitalismi a confronto: i modelli di controllo delle imprese*, "Stato e Mercato", 1995, No. 43 (1), p. 73.

21. P. Windolf, J. Bayer, *Cooperative capitalism: corporate networks in Germany and Britain*, "British Journal of Sociology", 1996, Vol. 47, No. 2, p. 212.

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4.9% of shareholders had a stake worth more than 75% in the former country against a percentage of 38.1% in the latter.

Insider trading or bankruptcy regulations also discourage institutional shareholders from playing an active role in British companies. Links between the stakeholders in the company and management also tend to be weak. As a result, takeover is a typical practice for corporate restructuring. With regard to A.O. Hirschman's well-known analytical categories[22], it occurs when shareholders are tempted to accept bid premiums and sell or "exit" rather than become actively involved in the rescue by "voicing" concern about the performance of the management.

The Rhineland form of corporate governance relies more on debt financed by banks, which have retained relatively close links with companies in many ways. The economic life in Germany has been dominated for many years by its three biggest financial institutions: Deutsche Bank, Dresdner Bank and Commerzbank – until 2009, when the second of these banks was incorporated into the third one. Also important is the network of local saving banks, especially for the operations of small and medium size companies. In recent years, the role of large commercial banks has declined, as they divest themselves of many holdings. Banks have an influence on companies through their role as shareholders in their own right, through their role as proxies for smaller shareholders, through participation in supervisory boards, or by fulfilling the role of the lender of last resort in crisis.

Capital markets are smaller and have fewer public companies. The relationships between companies and stakeholders – investors, employees, and local communities dependent on the company for their prosperity – tend to be closer than in the Anglo-Saxon model and as a consequence have a two-tier system of corporate governance. It has been stressed that "When problems arise, the normal practice is for these stakeholders to voice concern and for changes in management to take place, rather than stakeholders «exit» and a change in ownership. This characteristic enables implicit contractual relationships to develop between management and the stakeholders and means that takeovers or change in ownership are not the norm for corporate restructuring. Finally, consensus has a higher priority than in the Anglo-Saxon system, both within society and the company. Within the economy as a whole it is supported by the social market economy; within the company it is supported by solidarity in the shape of moderate wage differentials and institutions such as works councils."[23] To some extent, CMEs do not appear to be as open as LMEs, since the

22. A.O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press 1970.

23. S. Woolcock, *Competition among Forms...*, op. cit., pp. 183–184.

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market for corporate governance typically "provides companies with access to finance that is not entirely dependent on publicly available financial data or current returns."[24]

According to an emblematic image, these economies rely on a "patient capital."[25] Access to this kind of financial resources "makes it possible for firms to retain a skilled workforce through economic downturns and to invest in projects generating returns only in the long run. The core problem here is that, if finance is not to be dependent on balance-sheet criteria, investors must have other ways of monitoring the performance of companies in order to ensure the value of their investments. In general, that means they must have access to what would normally be considered «private» or «inside» information about the operation of the company."[26]

A clear-cut distinction among the two systems of corporate governance refers to management boards. The Anglo-Saxon company law is based on existing directors and a unitary board system that is seen as most efficient. In Rhineland, companies are managed with a two-tier system, where a "supervisory board" (*Aufsichtsrat*) presides over a "management board" (*Vorstand*). The supervisory board includes representatives of shareholders, banks (creditors as well as shareholders), employees and, in some cases, even local communities. In all companies employing more than 2000 people, employees elect 50% of *Aufsichtsrat*'s members. The president of the supervisory board, however, is decided by shareholders and is entitled to have the casting vote in case of a tie. The supervisory board has no direct managing functions but is in charge of inspecting and monitoring the activities. Its main power is to decide the composition of *Vorstand*, the board including a company's top managers, in charge of the day-to-day management, and keep it under continuous monitoring.

Supporters of the unitary board system appreciate its effectiveness, because of the concentration of power and responsibility in a single body. The two-tier system, however, lets the supervisory board evaluate the managers' performance in a more independent way. It also offers room for discussing and compensating different points of view on strategic issues. Once decisions are taken in such a board where all the stakeholders are included, they can be implemented with no more vetoes or delays.

24. P.A. Hall, D. Soskice, *An Introduction to...*, op. cit., p. 22.

25. V. Ivashina, J. Lerner, *Patient Capital. The Challenges and Promises of Long-Term Investing*, Princeton University Press 2019.

26. P.A. Hall, D. Soskice, *An Introduction to...*, op. cit. pp. 22–23.

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Comparative advantages and development trends of the two systems of corporate governance

An analysis of corporate governance institutions and firm strategies in Germany and UK makes it evident that there is no "one best" system of corporate governance but that the two systems have different comparative advantages. According to S. Vitols et al.[27], these are based on differences in the organization of capital markets, company law and employee participation, which in turn lead to differences in corporate governance practice in the following six areas:

- the different organization of capital markets leads to more pressure from shareholders to maximise share value in Britain than in Germany;

- the main role of the supervisory board in the German two-tier board structure is to give "stakeholders", in particular labour, veto rights over important management decisions;

- decision-making among top management is consensus-oriented to a greater extent in German companies than in British companies;

- the pattern of unilateral decision-making among top management in Britain can also be found in the relations between top management and employees in British companies;

- companies in both countries are increasing the role of project teams in the governance processes;

- the pattern of consensus decision-making in Germany is reinforced by formal inclusion of employee representatives, which leads to a greater concern with the employment impact of strategic decisions and with the process by which underperforming business units are allowed to improve performance or be sold off.

With regard to corporate governance in other big players in the European Union, France for example has a system that falls between the two above-mentioned models. It has been recognized that "Paris has a larger capital market than any of the German capital markets, but smaller than London. It has more links between financial and industrial concerns than Britain, but less than Germany. Takeovers play a greater role than in Germany, but not as great as in Britain. The state has

27. S. Vitols et al., *Corporate Governance in large British and German companies: comparative institutional advantage or competing for best practice*, Anglo-German Foundation for the Study of Industrial Society 1997, pp. 35–36.

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played a more important role in France than in either Britain or Germany, and this is reflected in the remaining state holdings. There are also cross shareholdings in France, but not as many as in Italy, where the leading industrial concerns have an extensive network of cross-shareholdings."[28]

Systems of corporate governance in the two political economies have been affected by the consequences of globalization processes. CMEs have been successful until the early 1980s, but after that period Anglo-Saxon economies proved to be more effective. In the last decades, the British system of corporate governance has been submitted to little improvements, while the Rhineland model had the need to substantial changes to cope with an economic and financial context characterized by greater interdependency at the global level.

Studies or investigations into "poor" corporate governance in the UK tend to focus on how to improve the operation of these unitary boards rather than the overall system of regulations and practice. A number of reports have been published in the 1990s prompted by the concern about cases of gross mismanagement and "fat cat" pay increases secured by executive directors.

The German system instead faced bigger changes in the 1990s, even if partial and incremental. More emphasis was put on modernisation and development of the financial system, while the institutions of co-determination (*Mitbestimmung*) remained untouched.

A new Corporate Governance Code was adopted in 2002. The aim of the document is to make rules more transparent for both national and international investors in a world where financial markets are completely interconnected, thus strengthening confidence in the management of German corporations. The Code addresses all major criticisms, especially those coming from the international community, levelled against German corporate governance, namely:
- inadequate focus on shareholder interests;

- the two-tier system of the management board and the supervisory board;

- inadequate transparency of German corporate governance;

- inadequate independence of German supervisory boards;

28. S. Woolcock, *Competition among Forms...*, op. cit., p. 184.

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- limited independence of financial statement auditors.

Each of these five points has been addressed in the provisions and stipulations of the Code, also taking into consideration the legal framework. It is clear that the Code cannot cover all details of every single issue; instead it provides a framework that individual companies will have to fill in.

Conclusion

Among the main features of the European business environment there is the existence of different kinds of capitalism. Insofar as all countries are considered to be market economies, there are many varieties that can be placed on a continuum between CMEs and LMEs. In practice, Germany and the UK are, respectively, the economies that can be better identified with these ideal types, while other countries tend either to get closer to one of the two poles or fall in the middle.

These aspects of heterogeneity have consequences for economic activities at the European level, especially after the development of two integration processes: institutional integration, carried out by the European Union, and socio-economic integration under the pressure of globalization. Different systems of capitalism, in fact, mean also different business cultures as well as different considerations and attitudes towards the role of the market and the freedom of private enterprise.

Many important issues can be raised about this situation, which are summarized here in two interlinked questions. First, it must be understood what is happening to the different European capitalist systems: whether they are going towards convergence or competition. Second, it must be taken into due account that these differences have a strong impact on the process of policy-making and law enforcement at the European level.

With regard to single political economies in the last twenty years, as it has been described, British capitalism has changed very little, proving to be adaptive to the challenges of globalization. Germany, on the other hand, has undergone more substantial transformations, even if not affecting the very basis of its institutional organization.

A more complex situation appears if we consider a bigger picture. The main institutional achievements of the European Union include the establishment of the Single European Market, since 1993, and the adoption of a common currency by 12 European Countries since 2002. It is more dif-

ficult to get to a consensus when the new rules and institutions can damage some country's interests. Decision-making at European level very often implies long delays or endless mediations. This has been, among others, the case of the creation of a common ground of rules and regulations for companies operating in Europe. Because of institutional differences and national interests to be safeguarded, the ministers from EU Member States finally approved the Directive on cross-border mergers as late as in 2004, after 20 years of talks, drafts, objections and watering-down. By the way, both one-tier and two-tier systems of company management have been allowed. Therefore, we agree with S. Woolcock as he was imagining that "For the foreseeable future, Europe will continue to be characterized by competition between different forms of corporate governance, rather than converge toward a single model of Euro-capitalism."[29] Twenty years later, we might add, these processes have gone even further in the institutional dimension, with the withdrawal of the United Kingdom from the European Union in January 2020 following the results of the referendum held in 2016.[30]

29. Ibidem, p. 196.

30. M. Sandbu, *Brexit and The Future of UK Capitalism*, "The Political Quarterly", 2019, Vol. 90, Issue S2, pp. 187–199. DOI: 10.1111/1467-923X.12648

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