

**Global Capitalism vs. Diverse Societies: Challenges for Europe**  
*Background Note for the Aix-en-Provence 2007 Economic Forum*

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As an epigraph to a recent paper where he describes the irresistible development of a new strand of capitalism based on the unfettered rise of financial markets (Wolf, 2007), Martin Wolf quotes Lionel Jospin's famously well-balanced sentence "Yes to market economy, no to market society". For Europe as for other parts of the world, the issue is whether such a perspective makes sense, more precisely whether societies whose preferences differ one from another can all embrace the same global capitalism while preserving their diversity.

As recently as in the early 1990s, the question discussed by scholars and policymakers was a very different one: at that time it was widely admitted that different varieties of capitalism had developed in the US, in Germany (or Rhineland), in France, in Japan or elsewhere and that these idiosyncrasies were here to stay. Building on this logic Michel Albert (1991) famously predicted in the aftermath of the fall of the USSR that the scene was set for a rivalry between two strands of capitalism, the US and Rhineland ones.

Yet in the last decades, Europe has embraced global capitalism. It has not used the single market or the euro as instruments to preserve national idiosyncrasies or to nurture a genuinely European variety of capitalism but as means to erode national specificities and open its border to US influence. Not everybody in Europe was in agreement with this strategy and there have been many rearguard manoeuvres, but the outcome is hard to dispute: there is no such thing as a European variety of capitalism.

At the same time, however, European societies have not converged on the US model (and not even on a single European template). National social models have not vanished, public spending levels have not converged across the Atlantic, wide differences remain in tolerance for inequality, to mention just a few domains. Contrary to widely held perceptions, the enlargement of the EU has not fundamentally altered this pattern. There is therefore such thing as a European society (or as European societies).

The question then becomes, is this situation sustainable? Can a European variety of society persist at the age of global capitalism? If so, under what conditions? And if not, what can we expect from the clash between global capital and local societies?

Those are the issues we briefly explore in this note. In section 1, we start by documenting the demise in Europe of national varieties of capitalism and by explaining what role European integration has played in this process. In section 2, we show that European and US preferences remain significantly apart and that social models have not converged. We take up the compatibility of those two facts in section 3 and offer some conclusions.

### **1. Wither the European varieties of capitalism<sup>3</sup>**

Throughout the 1970s, the 1980s and the 1990s, a significant body of research was devoted to characterising the different versions of capitalist economies. From the *régulation* concept introduced by Michel Aglietta and Robert Boyer to John Zysman's distinction between

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<sup>3</sup> This section draws on Cohen and Pisani-Ferry (2007)

‘market-led’, ‘bank-led’ and ‘state-led’ financial systems, Colin Crouch and Wolfgang Streek’s discussion on the convergence of European capitalisms on the US model, and finally Peter Hall and David Soskice’s notion of *varieties of capitalism* (Hall and Soskice, 2001), the emphasis was on the diversity of national or regional models<sup>4</sup>.

There is nothing wrong *in principle* with this view. As Dani Rodrik (2001) puts it, there is now widespread agreement to consider that “first-order economic principles [such as] protection of property rights, market-based competition, appropriate incentives, sound money, and so on, do not map into unique policy packages”. Even from an efficiency standpoint, this indeterminate mapping leaves room for alternative institutional arrangements, especially in the presence of institutional complementarity as emphasised by Amable (2003). Furthermore, growth economics suggests that the nature of the efficient arrangements may depend on the stage of development: institutions that are growth-enhancing in a catching-up phase may become dysfunctional as the economy approaches the technology frontier (Acemoglu, Aghion and Zilibotti 2002)<sup>5</sup>.

The issue, thus, is not whether differences may exist and persist. Indeed, China, India and Russia are powerful reminders of the fact that varieties of capitalism do exist. There are however two questions. The first, analytical one, is where those differences are rooted. And the second, which matters from a policy standpoint, is whether they can survive integration at a global or regional level.

For the proponents of the variety of capitalism approach, they primarily stem from dissimilarities in the functioning of capital markets, as regards corporate ownership and governance structures; financing patterns; the regulatory framework; and relationships between states and markets. Goods and services markets and labour markets are part of the picture, but less essential (this is why the emphasis is put on alternative varieties of *capitalism*). To be more precise, the key features that distinguish varieties of capitalism are:

- The pattern of corporate ownership and control;
- The financing of corporations;
- The degree of competition in goods and services markets and the regulation of entry, and;
- The role of the state in allocating resources.

As clear from this list, the European single market was bound to have profound consequences. It is self-evident that national varieties of capitalism could not survive the integration of capital markets. Indeed, it could well be argued that single market legislation and European competition policy were precisely meant to eliminate them. From the integration of markets for goods, services and capital to restrictions on state aids and common legislation on financial services and takeovers, the European project has consistently undermined the very basis of national specificities in the ownership and financing of companies. Sure enough, there are still remnants of the old times, especially in sectors that are less integrated internationally like banking or energy. But references to a French or a German model of capitalism nowadays are only used in a normative way, to blame procrastination or rearguard manoeuvres in coping with change. And governor Fazio’s staunch defence of the *italianita* of his country’s banks ended up in a symbolic collapse.

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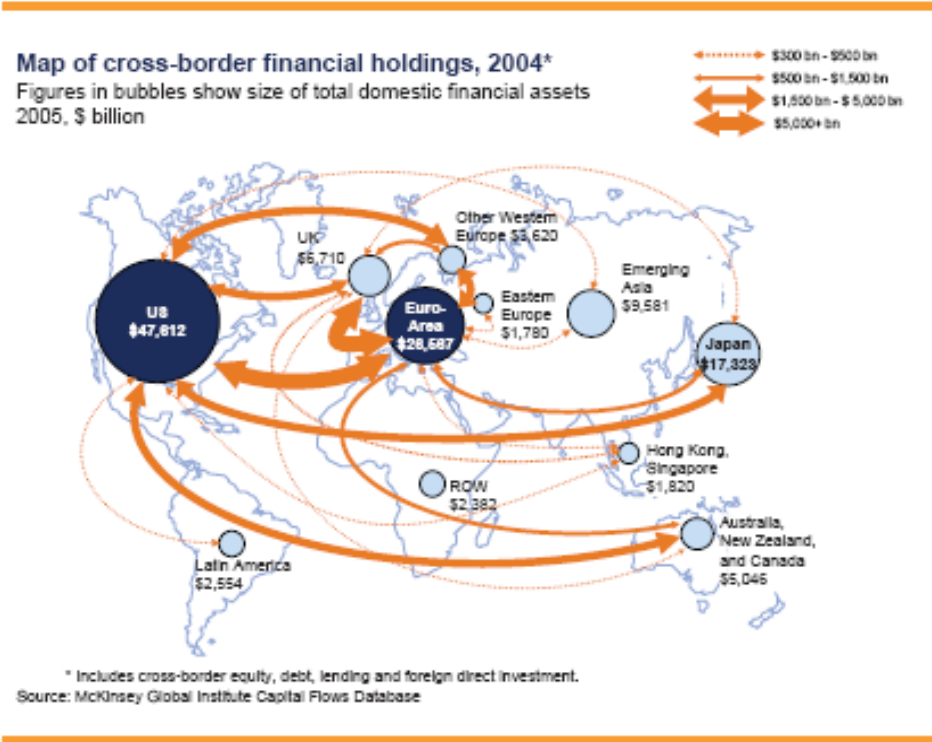
<sup>4</sup> A similar discussion can be found in Rajan and Zingales (2003), although their purpose is normative rather than positive. Rajan and Zingales distinguish between “relationship capitalism”, by which they designate the system of managed competition that emerged in the developed economies after World War II in which the role of markets in allocating resources was contained, and “arms-length capitalism”, in which financial markets drive investment choices. While Rajan and Zingales put the emphasis on financial systems, they underline the resemblance between relationship capitalism, Rhenish capitalism, and bank-based system.

<sup>5</sup> Incidentally, this implies that there is no such thing as a model best for all countries at all time, and that countries embracing the same model can differ in their actual economic performance.

What was not obvious, however, was whether European integration would play the role of a ‘shelter’ under which a genuinely European variety of capitalism could develop and replace national ones, while remaining different from that of the US, or of a mere ‘airlock compartment’ to allow internal pressure to gradually adjust to that of globalisation. Some of the key proponents of the single market, such as Jacques Delors, were certainly of the opinion that its very purpose was to preserve the specificity of the European model. An indication in this direction is that in the mid-1980s, Europe’s economic agenda relied both on a liberalisation arm and an industrial policy arm. Instead of choosing between free-market and interventionist policies, European reformers were aiming at a combination.

In the event, however, Europe embraced globalisation, not regionalism. A key decision in this respect was the financial opening of the 1990s – on the basis of a treaty that commits member countries to open up *erga omnes*, not just to their fellow EU members. This decision paved the way for a profound transformation of corporate ownership and governance in Europe.

**Figure 1: Cross-border Financial Holdings**



Other decisions followed that went in the same direction. The adoption of common prudential standards under the aegis of the Basel Committee hosted by the BIS went a long way towards eliminating discrepancies in bank behaviour towards risk. The Basel 2 standards adopted in 2004 were an important milestone as the market-based approach in the assessment of risk they endorse implies further convergence. Europe’s approach in this respect has been to fully endorse a set of rules elaborated by an international committee instead of trying to establish one of its own.

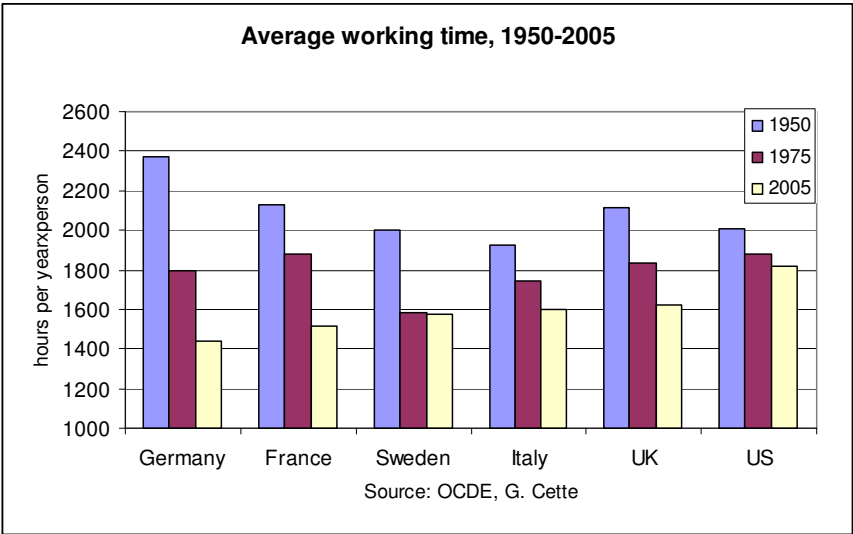
Another landmark move was in the early 2000s the adoption by the EU of an international system of accounting standards (the IFRS) instead of a specific one. This bold choice in effect gave the EU leadership in the promotion of world standards (Véron, 2007). By the same token, however, it epitomised again the refusal of the Europeans to nurture a home-grown version of capitalism that would correspond to their preferences. In fact, it is more than likely

that this was more an inability than a refusal: instead of trying to agree on the definition a set of norms, it was much easier for the EU to adopt the standards prepared by a private international body. Whatever the reason, however, there was no clearer way to signal that there was no European variety of capitalism.

**2. Worlds still apart: European vs US social preferences**

While capitalisms have converged across the Atlantic, societies have not. There is no clearer indication in this respect than the widely discussed divergence in annual working time: while in the early after-war period the Europeans traditionally worked as much or even more than their US counterparts, working time reduction through a shortening of the workweek, longer holidays or the development of part time has been widespread in Western Europe since the 1970s but much less so in the US (Figure 2). As a consequence, the average European in employment works significantly less than his or her American counterpart.

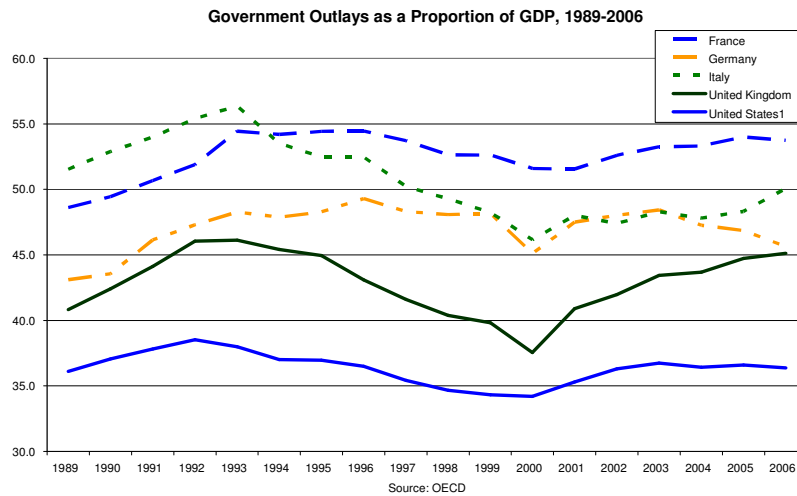
**Figure 2: Average Working Time per Employee in Europe and the USA**



Economists have discussed the reasons for this divergence. Prescott (2004) regards it as a side effect of high taxation but on the basis of implausibly high elasticities. Blanchard (2004) regards it as a pure effect of divergent preferences for leisure. Alesina, Glaeser and Spolaore (2006) take a middle stance and emphasise initially different responses to the oil shocks giving rise to path-dependency. The most important point is however that this divergence has widened over a quarter of a century exactly at the same time varieties of capitalism were converging.

Similar examples can be found in other fields. Figure 3 plots government expenditures as a proportion of GDP – a broad indicator of the role of the state in the provision of social services – for the US and the European G7 countries. It is immediately apparent that in spite of the pressures from globalisation and tax competition, no trend towards convergence can be observed over a the last two decades. Social choices differ and there is no indication that they are in the process of being revised.

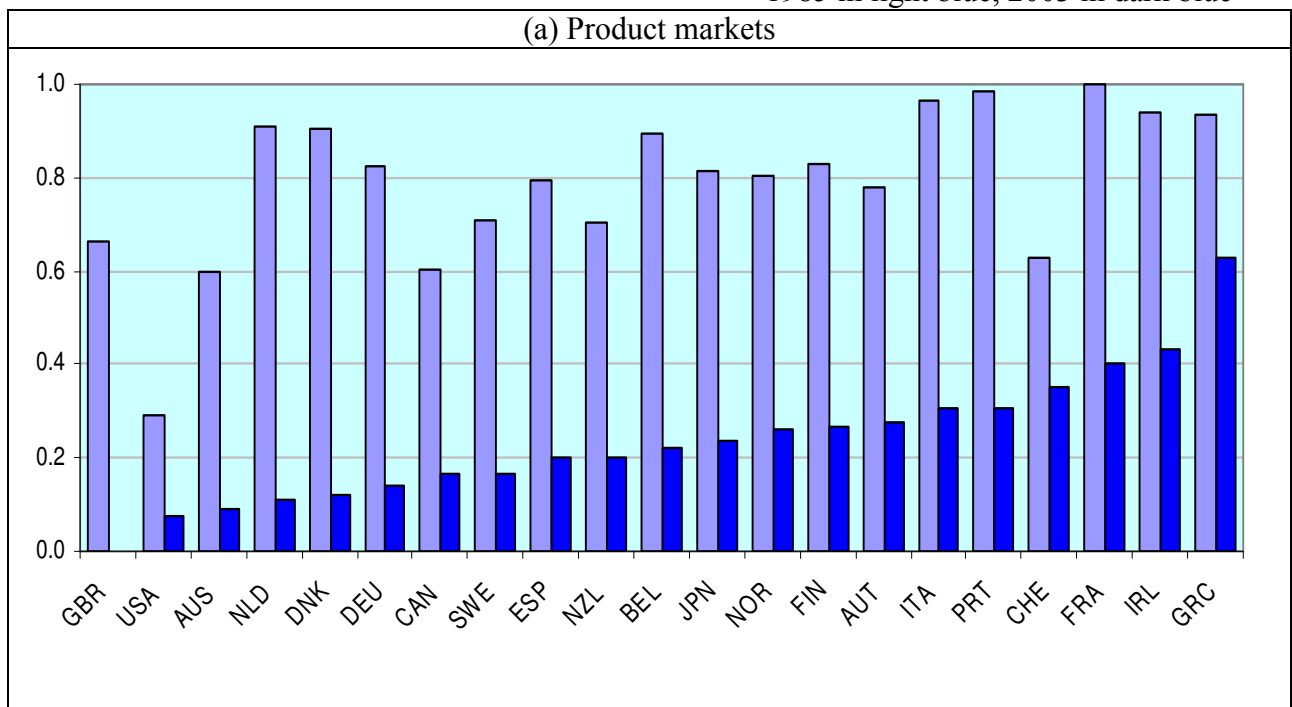
**Figure 3 : Government Outlays as a Proportion of GDP, 1989-2006**

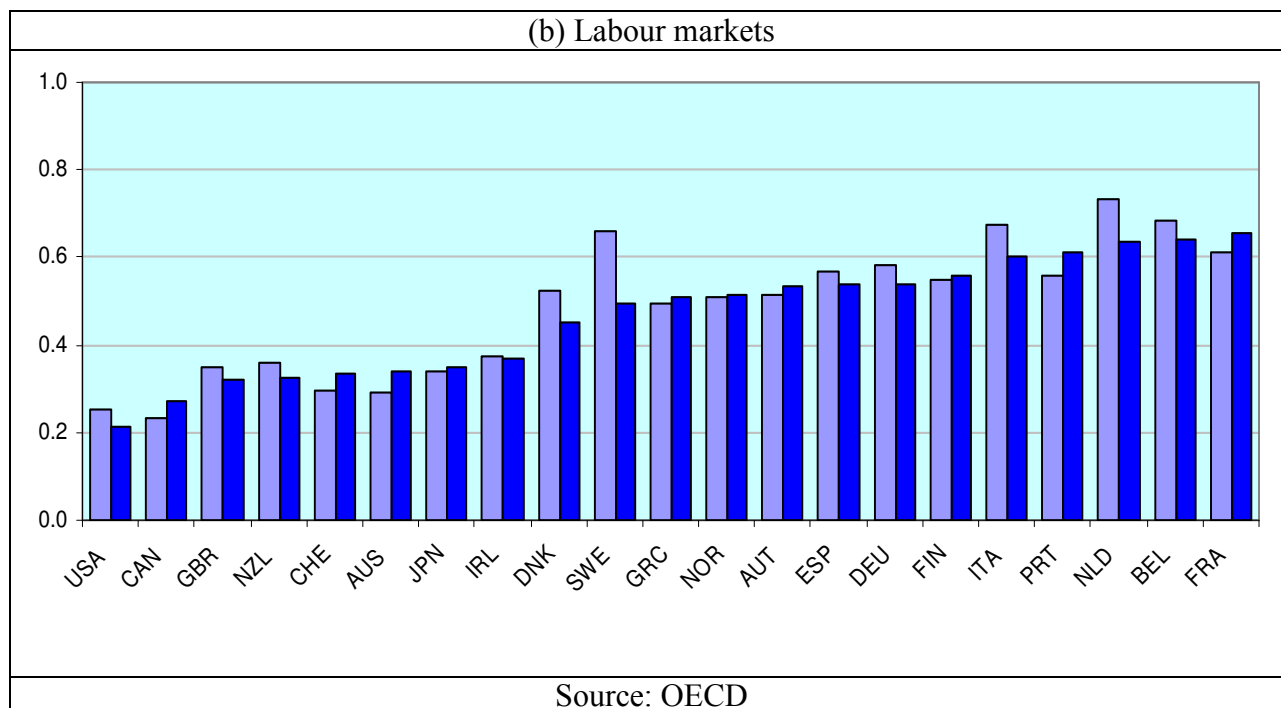


Regulation is a third interesting case because it is directly linked to market integration. Data from the OECD on the extent of products and labour market integration for a variety of countries (Figure 4). What is immediately clear is that downward convergence in the level of regulations of goods and services markets did not translate into convergence in the level of labour market regulations, which exhibit a very high degree of persistence. The former increasingly belong to the realm of the common rules of global capitalism, while the latter belong to each nation's social model. Nowhere is this distinction more acute than in Scandinavia which combines open, liberalised markets for products and capital with active state intervention in the labour markets.

**Figure 4: Indicators of products and labour markets regulation, 1985-2003**

1985 in light blue, 2003 in dark blue





Indeed, a salient feature of European integration is that Union competence for products and capital markets does not translate into competence for labour markets. While the EU has nominal competence for the coordination of employment policies, in fact labour market regulation remains essentially national.

A similar observation was made on social models by André Sapir (2005) who observed that different social models characterised by different degrees of both efficiency and equity could coexist within the single market. While acknowledging that competitive forces were putting pressure on inefficient models to reform themselves, thereby fostering convergence towards efficiency Sapir emphasised that there was no reason to expect convergence on the equity dimension, as different social models could embody different preferences for equity.

The list could be lengthened at will. What a large body of evidence illustrates is that in spite of talks about the Americanisation of Europe (and the world), societies remain in many respect *very* different.

### 3. Clash or peaceful coexistence?

The next question is, what are the implications of the combination between a globally integrated capitalism and specific societies? Are they bound to clash? Are growing grievances against speculators and locusts going to end up in a backlash against global capitalism? Are, on the contrary, diverging social preferences going to recede ultimately? Or can there be some form of peaceful coexistence and if so, can global capitalism be somewhat Europeanised?

Before entering the discussion, it is worth acknowledging that there are many more nuances in the picture than what our broad-brush image of the world suggests. To start with, Europe and the US are not alone in today's world economy and the global rise of companies from the emerging world may actually imply an increase in the diversity of capitalisms on a global scale. Second, varieties of capitalism may not be national. Actually, the rise of private equity is a strong reminder that there are alternatives to the publicly listed company. Third, societies may adapt and converge in the long run, even though the process is slow. Reforms

contemplated in several European countries are an indication of this trend. Working time may rise again in Europe, public spending and taxes may be reduced, labour markets may be liberalised.

However we still think that the tension between global capitalism and diverse societies is a central issue. To add nuances or envisage a long term in which this tension would have vanished tends to be more a distraction than a response to the question it raises.

There is no shortage of dismal predictions as regards the outcome of this tension. As developed by Jeff Frieden (2006), history tells us that the contradiction between a global economy and national politics was at the core of the failure to rebuild the economic world system after WWI. As he puts it, “The economic and political leaders who ignored or attempted to gloss over the costs of globalisation were swept aside by the people, groups and countries that experienced first-hand these costs. The *ancien regime* failed to adapt to the new economic and political realities, and collapsed.” This is a powerful reminder that however strong global integration may look like, the inherent tension with national politics is always present and can result in putting into question what is too easily taken for granted.

Two main issues are at the core of the discussion today in Europe. The first one is about the nationality of companies and the fear that mergers and acquisitions will lead to a disappearance of the ‘national champions’. France has been especially vocal on this issue but it resonates also in other countries such as Spain and Italy. The issue is far from being a new one, as illustrated by the US debate over FDI in the early 1990s and Robert Reich’s contribution to it (Reich, 1990) and its rise is very much a reaction to the speed of transformation of the European companies. Whereas ten years ago major European companies did half or their business in their home market, this proportion is now down to one-third (Véron, 2006) and is likely to decline further as corporations strive to adapt to a fast changing world economy. The process is bound to involve mergers, the disappearance of some household names, and headquarter relocation. What the proponents of national champions have failed to identify is what is the economic rationale for opposing it beyond the mere mercantilist wish to see national companies go on an non-reciprocal acquisition spree<sup>6</sup>.

The other issue is one of corporate governance and it is more prominent in the German and Dutch debates. It is not primarily one of nationality but one of behaviour – that of new shareholders who do not follow traditional paths and do not abide by traditional compromises. This is a significantly deeper debate that focuses on the clash between social preferences embodied in national explicit or implicit corporate governance models and the rules of global capitalism. To the extent societies do retain specific social preferences, whether they should be reflected in the way companies are run is a legitimate question.

Answers to this dilemma can be found at three levels:

- One is to transfer from companies to other social institutions the mandate of implementing national preferences. This has been under way for a long time, for example in through replacing traditional corporate paternalism by social insurance arrangements, but remains to be completed. The ongoing European discussion over flexicurity (which amounts to recognising that companies are not able anymore to offer job security and to building social institutions that can provide them alternative forms of security) can very much be looked at through that angle. This process is much more advanced in some European societies than in others and it is no coincidence that population in those countries is much less fearful of globalisation.

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<sup>6</sup> Acquisition by state companies or sovereign funds is admittedly a somewhat different issue.

- The second is to strive to “Europeanise” the rules of global capitalism. This may seem a challenging call but the EU has more power than it sometimes pretends to have. Having to a large extent renounced to nurture its own variety of capitalism, it now shares the responsibility for shaping the global rules – be it those of financial reporting, bank supervision or financial markets. Europe should not be shy and engage its partners in discussions on the design of rules for global capitalism, as Germany has started to do with its request for hedge funds transparency. For some time still, the only other player with an ability to shape those rules is the US, because the emerging powers of tomorrow have not yet reach the stage where they can act as co-regulators of the world economy. This is an opportunity that should not be missed.
- The third does not involve governments but private agents. European consumers and investors have considerable market power and can use it to shape corporate behaviour. The notion of corporate social responsibility does not have the same meaning on both sides of the Atlantic (for example it focuses more on workers’ rights in Europe, more on minorities rights in the US), so here again there is an issue of preference. The extent to which global companies can be responsive to social preferences should because they seriously care about their reputation should not be underestimated. There are already several examples of a significant influence of collective preferences in fields like environmental behaviour or labour rights.

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