

CRITICAL INSTITUTIONALISM AND FINANCIAL GLOBALIZATION: A COMPARATIVE ANALYSIS OF AMERICAN AND CONTINENTAL FINANCE

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The globalization of financial markets is essentially an Americanization of financial institutions: institutional structures and speculative dynamism unique to American finance is rapidly displacing other financial systems. Critical institutional analysis is used to construct Weberian ideal types of the institutional structures of American and Continental financial systems. Critical institutionalism embraces the theoretical power of macro-level analysis, maintains concern for social justice but incorporates detailed analysis of meso-level institutions and organizational structures. Seven institutional structures are analyzed: 1) the extensiveness of financial market participation; 2) the structure of financial intermediation; 3) the relative dominance of primary and secondary financial markets; 4) the relative orientation of participants to investment and speculation; 5) the predominance of debt versus equity securities; 6) the organizational form of the financial securities markets; and 7) the form of financial accounting. Together, these institutional patterns support the essentially speculative character of contemporary American finance and fuel stock market powered restructuring of industry. The article examines how Germany's financial structure prevented, deflected or delayed American-style downsizing and deindustrialization in the late 20th century and ends by considering how critical institutionalism can identify important, winnable battlegrounds for labor movement and anti-globalization activists who seek to shape the future of global capitalism.

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There's an old saying in the market here that if Wall Street sneezes, London, Frankfurt and so on catch cold or come down with flue...There's a tendency in Europe to look at Wall Street as a leading indicator of what's bound to happen in our own economy. Unless there's a specific piece of very good news to offset a U.S. sell-off, we'd go down too. (Richard Hunter, head of stock trading at NatWest Stockbroker in London, on the global nature of financial markets).

In recent times, financial markets became larger, more powerful, more inter-connected, and mutually responsive. Viewed as a globalization of finance, many analysts portray finance as an inexorable force of neoliberal creative destruction that companies, workers, governments and citizens must learn to obey and respect (see Thomas Friedman 1999, 2006 for a particularly influential version of this argument). This article begins with the recognition that the globalization of financial markets is essentially an *Americanization of financial institutions*: the specific institutional structure and speculative dynamism unique to American finance is rapidly displacing other financial systems.

American financial institutions are analyzed in this article from a critical institutionalist standpoint. Critical institutionalism embraces the analytic power, macro-level analysis and engagement with issues of social justice in capitalism that was characteristic of the economic sociology of Karl Marx, Max Weber, Thorstein Veblen, and Karl Polyani. Critical institutionalism proceeds by incorporating detailed, technical, micro-to-meso level analysis of organizations characteristic of neoinstitutionalist writings in sociology, economics and organizational studies.

Considerable comparative research underlies the presentation in this essay.¹ For the sake of brevity and clarity, this essay pro-

¹ This article was informed by the following studies of comparative financial institutions: Beckhart (1954); Canals (1997); Carruthers (1996); Gibson (1890);

ceeds by constructing multi-dimensional ideal types of financial securities markets in America and Continental Europe. Weberian ideal-types do not comprehensively catalogue all essential features of phenomena but bring selective, decisive features together in a logically-constructed, empirically-disciplined heuristic device. The two ideal types delineated in this study were constructed to address the following questions:

- What institutional structure characterized securities markets in America and on the European Continent?
- How did these market structures transmit financial market power to managers of industrial corporations in America and the European Continent?
- How did financial institutions help or hinder industrial downsizing and restructuring? In other words, what did late 20th century financial institutions shape the decision-making and activity of industrial corporations and alter the fate of the workers employed within them?

Critical institutionalism avoids deductive theorizing of abstract capitalist markets to inductively theorize the structure and functioning of particular market institutions.² In this article, differences of insti-

Gibson (1892) Hirst (1931); Kindleberger (1993); Marlew (1995); Michie (1986); Michie (1987); Michie (1992); Parket (1911); Rochester (1936); Samuels, Brayshaw, and Craner (1995); Scott (1986); Shepro (1992); Smith (1929); Sobel (1988); Spicer and Oppenheim (1988); Stern (1979); Stonham (1982); Tilly (1966); Wechsberg (1966); Welker (1992).

² Mainstream economists and many economic sociologists view themselves as part of a generalizing science; their goal is the development of generalized, even universalized, models of markets. It is one of critical institutionalism's starting assumptions that markets are social institutions not efficient mechanisms and, like all institutions, their operations are shaped by historical development. The analytic task of critical institutional analysis of markets is to determine how particular, historical markets operate and with what consequences rather than to un-

tutional structure between American and Continental financial systems are highlighted and shown to shape other aspects of economic life, especially industrial restructuring.³ When compared to economies based on Continental financial institutions, America experienced more rapid, dramatic and intensive industrial restructuring in the late 20th century. This critical institutionalist study examines how financial institutions mediated corporate downsizing, deindustrialization, outsourcing and restructuring. Critical institutional analyses like the one essayed here seek to demystify capitalism's power structure, providing critics and activists with heuristics to think and act with greater effectiveness.

Dimensions of Financial Securities Markets

This section identifies seven institutional dimensions of securities markets in America and the European Continent that seem especially implicated in transmitting financial market power to industrial corporations. In the following analysis, "American" and "Anglo-American" are used interchangeably to sometimes draw attention to the British/Scottish roots of the American financial system and the commonalities between British and American financial markets. "Continental" and "German" are also sometimes used interchangeably. The data drawn upon to refine the ideal type were limited to 20th century sources, since neoliberal reforms significantly altered the Continental system in the 1990s and 2000s.

cover universal market laws. Critical institutionalism avoids modeling "markets in general" in order to investigate "markets in particular." Many of the universal dynamics of markets posited by non-critical analysts – supply and demand, substitutability, pricing – are revealed by critical institutionalism to be significantly shaped by local conditions and structures.

³ The critical institutionalist framework presented here as a study of comparative finance can also be deployed to the historical investigation of financial security markets. Such an investigation would identify the genetic origins of a particular market by identifying historical moments when features of the markets are developed.

Seven comparative institutional structures of securities markets are analyzed (see Figure 1). The first is the extensiveness of participation in financial markets, ranging from markets limited to very elite participation (Continental) to markets with mass participation (America).

The second dimension is the structure of financial intermediation of the financial market—the complexity of the linkages between suppliers of capital and users of capital, between savers and borrowers. Financial intermediation is essentially of two types: Continental bank intermediation and American market intermediation.

The third dimension is the relative dominance of primary and secondary financial markets. Primary financial markets are the site of “new issues” of securities and literally involve exchanges between financiers and industrialists. Secondary financial markets are the site of trading in already issued shares, and do not involve the provision of capital to industry but are rather locations of trading among financiers. The dominant market in America was the secondary market; in Continental primary markets, dominated and controlled by *Hausbanks* or investment banks, were far more important than secondary markets.

The fourth dimension is the relative dominance of investment and speculation. Market participants who invest buy securities and hold them to receive interest or dividends. Market participants who speculate buy securities to resell at a profit. The American market accommodated extensive speculation; Continental financial markets, controlled by *Hausbanks*, encouraged investment and discouraged speculation.

The fifth dimension is the type of security that predominates on the market: debentures versus equity. Debentures (debt) are bonds and other interest bearing securities that provide a fixed return to investors. Equities are common stock and other residual securities that provide a more variable return. Continental financial markets emphasized debt: American markets emphasized equity.

FIGURE 1. KEY DIMENSIONS OF FINANCIAL SECURITIES MARKETS:
A COMPARISON OF AMERICA AND GERMANY

Market Dimension	American Financial System	Continental Financial Systems
Extensiveness of Market Participation	Mass Participation (amateur)	Elite Participation (professional)
Structure of Financial Intermediation	Complex and Elaborate	Simple, Bank-Centered
Dominant Financial Market	Secondary Markets	Primary Markets
Dynamic of Market Participation	Speculation (capital gains)	Investment (interest)
Dominant Financial Security	Equity (Stocks)	Debt (Bonds)
Organizational Form of Securities Markets	Private Associations	Public, Regulatory Institution
Financial Accounting	Income Statement (capitalized future earnings)	Balance Sheet (creditworthiness)

A sixth dimension is the organizational form of financial securities markets, ranging from "private associations" in America to government bureaus in Continental Europe.

A seventh dimension is the form of financial accounting and the extensiveness of financial information available to market participants, ranging from quite "opaque" information systems like those of Continental Europe and some Asian economies to the so-called "transparent" systems of Anglo-American finance. Augmenting the financial accounting information available in each system is

the business press, with America's extensive and ubiquitous financial press setting a high water mark.

Together, these seven dimensions ground our explanation or interpretation of corporate reorganization for speculative gain in contemporary America.

The attributes of the American financial securities market on these dimensions can be summarized as follows. In the late 20th century, the American market for financial securities became a "mass market" dependent upon retail investing activity. As a result, a highly elaborate structure of financial intermediation developed, composed of professionals who secure and assist the participation of the masses in the purchase and sale of securities. Participants in American finance tended to speculatively trade securities on secondary markets rather than purchase new issues on primary markets. This is critical: American finance was focused upon speculators' trading of already issued securities rather than investors' purchase of new securities to raise funds for industry. Furthermore, contemporary American finance was dominated by equity securities, or "common stock," which served as the primary instrument of market participation. American financial securities markets (NASDAQ, NYSE, AMEX, for example) remained private associations, often of the partnership organizational form,⁴ which were managed to yield a profit to members. The neo-liberal regulation of American markets was limited to periodic oversight rather than managerial control: the actual daily management of securities markets was left to private associations. Market actors relied upon allegedly-transparent financial statements and a ubiquitous financial press.

⁴ In recent years, several major U.S. stock exchanges "went public" with initial public offerings, which altered the form of the exchanges from partnerships to publicly traded corporations. American securities markets are in the odd position of being managed by companies that are actively traded as a security upon them. The exchanges themselves are subject to the same "speculative management" pressures as other publicly traded firms. The analogy that comes to mind is a poker game directed by one of the chips.

The seven institutional structures of the American and Continental financial system are delineated in the following sections, some briefly and others more in-depth.

Extensiveness of Market Participation:
American Mass Market and Continental Elite Market

American financial securities markets were *mass* markets oriented toward decentralized retail investing. In sharp contrast, Continental financial markets were centralized and dominated by elite virtuosos. In America, the surplus assets of millions of investors were drawn into the financial securities market through retail financial outlets so that a broad spectrum of Americans directly or indirectly participated in the financial system. In the late 1990s, nearly one half of all American households held equity securities, either directly or indirectly through mutual funds (see Table 1). This is not to say that the financial system was in any way egalitarian: of all property in America, financial securities were among the least evenly distributed in the late 20th century (see Table 2). However, compared to financial market participation in other industrialized countries (Germany, France, Sweden), American markets relied heavily upon the participation of the retail investor for the successful floatation of new share offerings and for the maintenance and appreciation of the value of existing shares.

The retail character of American securities markets had several consequences.⁵ Retail participation boosted the volume of financial market activity and sustained a highly elaborate financial securities industry. Retail investing also enabled stock promoters to sell financial securities using the same mass marketing techniques

⁵ Britain is more akin to American markets than most other systems, though there are still important differences in the markets of each country. Historically, Britain and America are usually classified together as equity systems while Germany and other continental systems are usually delineated as debt systems. Some writers in comparative finance like to break down the two dominant systems into the "Anglo-American" and the "Continental" type of financial system.

employed to sell soap and soda pop. Corporate promoters attempted to manipulate the demand for corporate securities (and hence, trading price) with advertising, strategic press releases, earnings announcements and the like. In the short term, retail demand for securities was subject to this kind of "pump and dump" manipulation. An indicator of the significance of corporate stock promotion during the late 20th century was the emergence of "investor relations" departments at America's largest corporations. These departments grew out of and operated along similar lines as "marketing" oriented public relations departments.

TABLE 1. INEQUALITY OF EQUITY STOCK OWNERSHIP IN AMERICA
Stock Ownership by Family Income, 1989 to 1995

FAMILY INCOME (IN CONSTANT (1995) DOLLARS)	FAMILIES HAVING DIRECT OR INDIRECT STOCK HOLDINGS (PERCENT)		
	1989	1992	1995
Less than \$10,000	3.3	6.8	6.2
\$10,000 to \$24,999	13.0	18.7	23.2
\$25,000 to \$49,999	32.3	40.8	47.3
\$50,000 to \$99,999	52.4	63.4	67.3
\$100,000 and more	81.8	78.5	81.1

Source: Federal Reserve Bulletin, January 1997, available on-line at U.S. Statistical Abstract Web-site, <http://web.lexis-nexis.com/statuniv>

The degree of mass participation in American financial markets increased in the late 20th century. "Bull markets," periods of dramatically increasing values on financial markets, attract retail investors and market participation reached peaks during the "corporate revolution" of the 1890s, the great speculation of the 1920s, the long bull market of the 1960s, and the most recent bull market of the late 20th century. American retail finance was structured to facilitate this broad participation. To a greater degree than Conti-

mental markets, American finance employed a broad spectrum of professionals who direct the market participation of amateur retail investors.

TABLE 2. INEQUALITY OF EQUITY STOCK OWNERSHIP IN AMERICA
Median Value of Stock Holdings by Family Income, 1989 to 1995

FAMILY INCOME (IN CONSTANT 1995 DOLLARS)	MEDIAN VALUE AMONG FAMILIES WITH HOLDINGS (IN CONSTANT 1995 DOLLARS)		
	1989	1992	1995
Less than \$10,000	3.5	5.9	2.9
\$10,000 to \$24,999	7.4	4.3	6.0
\$25,000 to \$49,999	5.5	7.6	9.0
\$50,000 to \$99,999	10.4	15.2	23.4
\$100,000 and more	55.2	75.4	97.7

Source: Federal Reserve Bulletin, January 1997, available on-line at U.S. Statistical Abstract Web-site, <http://web.lexis-nexis.com/statuniv>

Experts provided consultation and advice; financial services firms executed trades, managed records and tracked account activity. The financial services industry depended upon retail investing, and retail investors, who purchased securities as a supplemental economic activity, relied upon these professionals.

Structure of Financial Intermediation: American Retail Markets and Continental *Hausbanks*

Retail investing required and sustained a highly elaborated system of financial intermediation.⁶ Financial intermediaries are organiza-

⁶ It would do just as well to argue here that an elaborate and powerful financial services industry requires and maintains mass investing. Sufficient evidence exists to support the notion that the financial security industry is not merely responding to tremendous mass demand for corporate securities but is consciously

tions and networks of organizations that link together users of capital with suppliers of capital by aggregating small pools of money from many sources (individual savings accounts for example) and re-distributing this capital to business firms to fund their investments in fixed assets (plant and equipment) or research and development. In America, the most important financial intermediaries included commercial banks that accumulated deposits from retail customers and made loans to businesses; investment banks that specialized in the issuance and sale of new corporate securities; venture capitalist firms that specialized in speculative funding of small growth companies; and a number of institutions who bought, held and traded previously listed corporate securities including insurance companies, pension funds, charitable foundations and mutual funds (Grinblatt and Titman 1998: 3-4).

The most important new financial intermediary that emerged in late 20th century American finance was the mutual fund. Mutual funds have a relatively long pedigree in American and British finance but attained a new significance during the late 20th century American bull market. Mutual funds, or "investment trusts" as they were typically called, were first formed in Britain after the passage of the Joint Stock Companies Acts of 1862 and 1867. They were recognized at the time as a significant innovation that made retail participation in financial markets a practical proposition. (Bullock 1959: 4-5).

Early investment trusts were focused upon providing secure "income" through consistent and significant dividend payments rather than high capital gains (Bullock 1959: 11). Though different funds maintained different investment philosophies, most popular American mutual funds were concerned primarily with generating large appreciation in value rather than high dividend payments.⁷

creating that demand. There is an active role played by stockbrokers, security salespersons and retail service agents that is missing from the text here.

⁷ The rise of investment clubs, like the famous Beardstown Ladies, was also characteristic of the latest bull market. But mutual funds were the primary growth engine of retail security purchases. For an excellent overview of the history and

Compared to systems where financial participation is limited to virtuosos, American finance employed a much larger number of persons as stock-brokers, securities salespersons, mutual fund advisors and other positions in the financial services industry (see Table 3). Since over 50 million households in America participated in the financial securities market in some way in the 1990s, most without depth understanding of investing and financial market dynamics, the system required an elaborate and complicated system of intermediation. The multi-layered complexity of the system created information asymmetries that allowed sectors to engage in pure speculative action, insulated from immediate constraints typically imposed by the profitability of underlying productive assets. Total employment in the financial services sector increased rapidly during the late 20th century. According to the U.S. Bureau of Labor Statistics, financial securities and financial services sales personnel were among the most rapidly growing occupations in the American economy between 1983 and 1997, increasing 102% during this period. The overall size of the American securities market increased by virtually all measures: total market value and volume of trading, new security issues (stock initial public offerings quadrupled between 1990 and 1996), total issues (the number of equity issues traded on the NYSE alone increased by over 1,000 during the early 1990s alone).⁸ During this period, the complex and powerful financial security industry in America reached a higher level of institutional development and power than any other historical or comparative financial market, forcing corporate managers to adopt financial perspectives and act to promote the security industry's interest.

regulatory structure of investment companies in Anglo-American finance, see Bullock (1959).

⁸ Data obtained from the *Statistical Abstract of the United States*, on-line version.

Table 3. Security Industry In America Sources and Size of Revenue and Expenses (in millions of dollars)

	1980	1985	1990	1996
Revenues, total	19,829	49,844	71,356	173,164
Commissions	6,777	10,955	12,032	27,909
Trading/investment gains	5,091	14,549	15,746	30,833
Underwriting profits	1,571	4,987	3,728	12,626
Margin interest	2,151	2,746	3,179	7,390
Mutual fund sales	278	2,754	3,242	10,081
Other	3,960	13,854	33,428	84,324
Expenses, total	16,668	43,342	70,566	156,160
Interest expense	3,876	11,470	28,093	65,237
Compensation	7,619	18,112	22,931	51,152
Commissions/clearance paid	1,055	2,314	2,959	7,376
Other	4,119	11,446	16,583	32,395
Net income, pretax	3,160	6,502	790	17,004

Source: U.S. Securities and Exchange Commission, Annual Report.
Available at the U.S. Statistical Abstract Website.

Retail investing in America required support from an entire regime of speculation, coordinated cultural and institutional support, to encourage and direct the spare cash of the masses into the market for financial securities. Retail investors did not demand shares of stock in the same way they demanded consumption items. Propaganda and other inducements were necessary to sustain retail interest in financial markets. Episodes of intense mass participation in finance have been fuelled by speculation and other non-investment motives, most importantly patriotism, the direct benefits from a completed public works project and gambling-speculation. Early sub-

scriptions to canal, shipping and railroad securities were driven by public interest and a desire for the advantages to be gained by improvements in transportation rather than a desire for fixed investment returns (Dewing 1934: 124). The first major mass movement into government finance in America took place during the Civil War and relied heavily upon the patriotic appeals and savvy marketing skills of Jay Cooke, the Government bond agent. Indeed, the following description of Cooke's campaign demonstrates the interconnection between retail security purchases, a large security sales force and emotional appeals (Myers 1970: 161).

Appeals to patriotism and demonology have been repeated during all later military government bond drives; posters for war bonds rarely mention or calculate the investment angle of the bond purchase. Purchases of common stock by retail investors have frequently been driven by short-term speculative interest, where stocks were purchased on "tips" in a manner similar to bets at a racetrack. During the Cold War in the 1950s, the New York Stock Exchange successfully launched a "People's Capitalism" campaign, in partnership with Merrill Lynch, that encouraged Americans to buy stock as a way to voice one's opposition to communism – investing in capitalism was a patriotic way to beat the Red Menace. Retail market participation has been generally dilettantish, avocational, and susceptible to emotional appeals.

One of the most striking aspects of mass participation of retail investors in late 20th century financial markets was the absence of such patriotic appeals, signaling the dominance of speculative gaming. Analysts of the 1980s Japanese "bubble" stock market noted that retail purchases of securities were driven by speculative impulse. Japan's Nikkei stock index reached an all-time record high on the last day of the 1980s: December 31, 1989. During the next nine months, the Nikkei index lost approximately 50 percent of its value. At its high point, the Japanese stock market accounted for 42 percent of the total capitalization of world stock markets (up from 15% in 1980), and was 151% of Japan's gross national product. At its height, the Japanese stock market was capable of supporting

tremendously high security valuations. Shares of Nippon Telegraph and Telephone, which was privatized in the mid-1980s, were floated at a 250 to 1 price to earnings ratio. These shares were widely held by retail investors, who saw the value of their investments plummet 80% in the ensuing three years (Wood 1992: 9-11).

The state played a role in the encouragement of American retail investing through neo-liberal policy reforms (creation of individual retirement accounts, tax policies that favor capital gains, new 401K pension rules, etc.) and through sustained political debates about the future of social insurance in America. These policies, when coupled with other macro-level changes such as corporate downsizing, layoffs, reduced pension plans, etc., created a stabilizing cultural and institutional structure that encouraged retail investing. The stabilizing "shareholder" culture of late 20th century America certainly ranks among the most supportive regimes for mass speculation known to history.

The financial security industry also directly shapes mass retail investing behavior. Purveyors of mutual funds, hedge funds, and 401K plans all competed for retail customers and create demand for other finance professionals such as stock brokers, fund managers, research analysts, and security traders. Many of these professionals were paid on commission, encouraging the generation of churn or turnover of securities to generate fees. Revenues in the security industry diminished if customers simply buy securities and hold them for a long period of time and were maximized when customers were encouraged to trade stocks actively. Retail investors who relied upon the advice and guidance of these professionals likely traded securities (speculate) at a greater rate than they would if moved solely by their own (investment) initiative. The incentive structure of professionals who direct retail investing contributed to the high turnover characteristic of American secondary markets.

Dominant Financial Market Orientations: American Secondary Market Speculation and Continental Primary Market Investing

American financial markets were primarily secondary security markets, meaning that trades of already-existing securities accounted for most the total daily volume of security sales. Primary security markets, or the "new issues market," represented a relatively small percentage of market activity. The Dow Jones Industrial Average, the Standard & Poor (S&P) 500 Index, the NASDAQ Index, the Russell 2000, and other leading financial indicators are entirely based upon trading in "already issued shares." Though initial public offerings make news when they are unusually large or very profitable, the bulk of financial news and financial activity is focused on the secondary market. Speculative processes (exchanges between capitalist and capitalist) predominate on secondary markets rather than fund-raising processes (exchange between capitalist and entrepreneur). As shown in Table 3, the revenues from "underwriting" (floation of new securities) are only a small portion of the total revenues of the security industry in America. Equity financing funnels cash to industry for the building of industrial infrastructure only when securities are initially sold/floated on primary markets. This means that in America the vast majority of financial activity remains outside of the production and consumption system.⁹ Secon-

⁹ The almost complete disconnection of financial market participation from the funding of industry is illustrated in the case of retail "Bucket Shops" that spread throughout America during the corporate revolution at the end of the 19th century. These retail "investment" shops allowed for very small "bets" to be placed on the movement of stock prices. Bucket shop customers never actually purchased shares of stock, but rather simply placed bets upon share price movement on the New York or other exchanges. At the end of the 19th century, it is likely that the majority of retail equity market participation was channeled through bucket shops. Not a single penny of these investments was passed on to industry to fund production expansion or research and development. Contemporary uses of the term bucket shops can be found in Morgenson (1997) and Schiffrin (1997).

dary markets are not a forum to raise "capital" to finance industry, but represent a field for financial speculation and bids for corporate control.

Speculation exists on many markets: commodity markets, real estate, as well as security markets. Yet, speculation is usually viewed as a by-product of market processes whose primary goal is to facilitate the transfer of property. Speculation is a process that lives off of markets created to meet the needs of producers and consumers. The emergence of speculators and speculative processes on financial markets is described in this account of the emergence of the Amsterdam market as Europe's first developed "bourse" or security exchange:¹⁰

The money market of the Netherlands developed a luxuriant growth along the lines of the traditional fiscal methods, and at the same time brought forth new forms beside the old. The bourse of Amsterdam was, in the early part of the seventeenth century, a money market of the same significance for its day as the London money market became some 200 years later. The buying and selling of securities here for the first time developed to considerable proportions, with all the excitement and the excrescence of speculation. The business spread abroad about it an atmosphere of reckless thirst for gain, which presently led to the extension of the business methods of the exchange from transactions in securities to commercial transactions in all kinds of goods (Cohn 1895: 646).

In the American financial system, the power of secondary security markets meant that speculators' private actions had powerful influence on corporate management. Speculators, not investors, determined the trading price of corporate securities and had to be taken into account by corporate managers. Speculators sell rapidly upon the release of unexpected negative news about a corporation

¹⁰ The leading position of Amsterdam as the world's primary security market was facilitated by the founding of the Dutch East India Company in 1602, whose shares immediately began trading on the exchange and were the subject of speculation.

– Thomas Friedman (1999) referred to them as an “electronic herd” -- placing tremendous pressure on corporate managers to avoid bad news and to “package and frame” such news when it must be disclosed.

Secondary financial markets “discount” information that affects values into fluctuating trading prices. This discounting function of financial markets is well known, as is indicated in this early characterization of American financial and commodity markets:

Every event of any nature whatsoever is eagerly watched for and its effects discounted. Drouths in Kansas or rains in Argentina are noted at once in the markets of New York and Liverpool. New inventions, new discoveries, changes in freight rates, economic legislation, political complications, business failures, strikes, riots, storms, in any part of the world, are quick to affect prices on both stock and produce exchanges...Events are anticipated and exert their influence before they arrive. It is often surprising to see how absolutely without effect is the final occurrence of an event of importance, provided it has been expected. It is all epitomized in the familiar saying that “Wall Street discounts everything” (Emery, 1896: 117).

In a perfectly functioning, efficient equity security market the future profits of firms would be fully discounted and already incorporated (capitalized) into the trading price of the security. Ongoing operations aligned with expectations would have little effect on stock prices: only new, unanticipated “information” would change assessments of future earnings and, hence, valuations. The larger the change, the larger the information signal sent to markets to alter valuation. The importance of fluctuating prices to successful speculation is described in this passage:

The tendency of speculation is to lessen market fluctuations and to establish prices which correspond to actual conditions of demand and supply in all places. On the other hand its activity depends upon the existence and continuance of fluctuations. The personal interest of the speculative class is not advanced by the increasing

steadiness of the market. In the case of each speculator at any particular moment, the movement of price in one direction, regardless of the ultimate value of the property, is essential to his success (Emery 1896: 171, emphasis added).

Successful speculative participation in secondary security markets requires dramatic price breaks, and in a large and "open" market where information about companies is widely distributed, price breaks are caused by disruption. One of the most important forms of price-breaking disruption in American finance is business reorganization (mergers, spin-offs, and internal reorganization). Corporate reorganization sends dramatic signals to markets that a revaluation is warranted. Speculative profits require major price breaks and business reorganization is an effective means to generate them by presenting major new information not already factored by the market into the price.

Active secondary security markets transform industrial corporations into objects of speculative trading that often overrides the status of a corporation as a productive organization. Speculators purchase property to be resold again at a profit, whether land, commodities or securities. The trade of equity securities transforms the industrial organization into an object of speculation.¹¹

Secondary markets are an important constraining and channeling force for managers of industrial organizations. This is especially true of equity markets. Equity securities represent residual

¹¹ This paragraph follows the logic of Goffman's early writings on "frames" (1962). Games are a metaphor for social life in that whenever anything crosses the boundary or frame of a game its character is transformed. What is relevant about an object is its relevance for the game rather than any inherent quality. For example, poker chips have no value outside of the game but are quite valuable within it. Ongoing activity systems, like a secondary market, have transformative power over social objects. Speculation transforms anything within its boundary into a trade object. Whatever the concrete qualities of the object, once a secondary exchange is established objects traded upon it are valued primarily in terms of projected price at resale.

profits of the firm whose value is highly subjective, variable and fluctuates widely. Hence equity markets have been noted for high levels of volatility.

Dominant Financial Security: American Equities and Continental Debt

The dominant American financial security is equity, or “common stock,” representing ownership of a firm. In practical terms, equities represent a claim on the residual earnings of a firm, the left-over earnings after all other obligations are paid. Equity securities are “subordinated” securities in that no dividends may be distributed to shareholders until all other security holders (holders of senior debt, subordinate debt, preferred stock) receive their disbursements. Unlike bonds and other interest bearing securities, the returns to an equity security are highly variable. This latter characteristic is what makes equity securities such highly prized objects of speculation. In general, stable market values are the death of speculation, while radical price swings help speculators flourish. The greater an asset’s price variability, the more fit it is as an object of speculation. The American system was quite different from Continental economies where the predominant financial security was the interest bearing bond. Bond values fluctuate depending upon creditworthiness (refers to the risk of default) and expectations for future interest rates. Equity securities’ trading price is affected by more variables and is more volatile than the value of bonds. While both debt and equity have the same floor below which their value can not fall (zero), debt instruments also have a ceiling beyond which their values cannot rise. The value of a debt instrument will not exceed the return on a risk-less government bond, which is a value equal to its capitalized return. Equities lack this ceiling, which makes them a powerful speculative vehicle.

Equities are attractive speculative objects in the American financial system for another reason: they allow shareholders to exert control over corporations in ways that debt does not. Share-

holders are entitled to vote regarding the choice of directors of the corporation, its by-laws, key decisions, etc. Holding a large share of stock gives the holder control over the corporation.¹²

American financial history is full of the exploits of stock speculators who acquired shares not to receive dividend income but to secure control of the corporation in order to manipulate corporate actions and results to affect the trading price of corporate securities. Many analysts of early financial markets, including Veblen (1904; 1923) recognized that speculative actions are an important motive for holding shares of equity: they provide the holder some control over the value of all corporate securities and hence aid in speculation.

Ownership of equity shares confers control of the corporation, such control improves the capacity to generate and capture pecuniary gains. Since the market value of corporate securities fluctuates with changing corporate actions and results, owning a controlling block of equity shares is a great benefit to a speculator. This is true not only because equity shares provide the means to manipulate the corporation, but also because large equity owners have access to "insider information" that enables shrewd timing of market moves (Emery 1896: 182).

The dominance of equity securities in the American system is interesting because they have been less important than bonds as a mechanism to raise capital for industrial enterprise. Bond financing provided the capital to build most of the railroads and other 19th century enterprises and financed the "corporate revolution" at the end of the 19th century. Historically, debentures have been the

¹² Under certain circumstances bondholders can have more control over the corporation than equity holders do. The reason is that claims upon the corporation by bondholders are senior to those of equity holders, who are mere residual claimants on the corporation's assets and income. In times of financial duress, bondholders become trustees of the firm and effectively push shareholders aside. This issue of control is a difficult one, but it is still important that the ownership of equity shares confers upon the holder a vote and some control of the enterprise

most important vehicle to raise funds for actual, tangible industrial development while equities have been the most important vehicle for speculation and battles for corporate control (Roy 1997; Chernow 1990).

Early American equities were used as a source of financing only by companies who lacked sufficient creditworthiness to borrow funds.¹³ In virtually all financial markets until the early years of the 20th century, equity financing was considered a “lower,” less prestigious form of finance than debentures. Elite investment banks avoided equity financing during most of the 19th century. Indeed, investment banking as defined by the leading practitioners in America, excluded equity financing from their profession. As late as 1912, when the Investment Bankers Association of America was formed and its first president described the activities of investment banking, bonds received central billing: “[Investment banking] broadly speaking, has to do with the organization and distribution of a secured form of credit known as bonds.” (Brooks 1987: 36). British and European purchasers of early American securities were extremely wary of American equities, even when they would purchase railroad bonds without a qualm (Chernow 1990).

Critical institutionalism, from Veblen’s writings on absentee ownership to the present study, consistently reveals the unique significance of equity securities as a control structure in American capitalism, something missing from most socio-economic analyses of modern financial systems. While differences in valuation between debt and equity securities developed in the late 19th and early 20th century, many early foundational socio-economic analysts did not effectively distinguish unique features of equity valuation and its consequences for corporate management. Marx and Hilferding, for example, appear to be dealing with equity markets in some passages in their writing because of the language employed in the English translations. Marx and Hilferding both used the term “stock” to refer to bonds, as was current practice at the time (and still current

¹³ In America, equity shares were first used on a broad basis to fund public works projects like canals, turnpikes and early railroads (Roy 1997).

practice in Britain today).¹⁴ I believe that this confusion over the term "stocks" is quite general, as is indicated in the following passage:

It should be noted that the terminology with respect to stocks and bonds was very vague in these early years. Government obligations, federal and state, were frequently referred to as stocks rather than as bonds, and even corporate issues were not always defined correctly by modern standards. When the *New York Herald* discussed the financing of railroads in its issue of December 23, 1845, it took pains to refer to railroad bonds as "debt" and to stocks as "capital stock," but that was rather unusual precision (Myers 1970: 120).

The early usage of the term in the United States was unclear. It should be noted that the term "stock" in Britain to this day refers to "bonds," while "shares" refers to "equity securities." To buy stock in Britain meant to buy debt securities (bonds), and this makes Marx's comments, and the comments of others that followed British usage, difficult to translate directly.

It is possible that many of Marx's current American readers become confused by the term "stock," believing that Marx is referring to equities when he is actually referring to interest-bearing bonds. Certainly, Marx's writings about equity markets are much thinner than his writings about interest-bearing bonds.¹⁵ Hilferding

¹⁴ See for one example the discussion of the importance of the public debt for the "genesis of the industrial capitalist" in the first volume of *Capital* (Marx 1977: 919-920). The translation here is better than many passages, clearly labeling public debt consistent with American usage as "bonds," but the later references to "stock-jobbing" and "stock-exchange" are ambiguous and could refer to either bonds or equities.

¹⁵ Marx's relative silence on equity markets should be expected of someone whose focus was the leading edge of finance in Europe and Britain. Equity securities simply were not as important as bonds for raising capital for enterprise at the time. This is true not only of the continent but also of Britain. A virtual moratorium on company promotion prevailed in Britain after the speculative crisis of the South Sea Bubble and the subsequent bubble act, which dampened equity offer-

(1910) and Harvey (1982) both devoted extended attention to Marx's specific comments on equity securities (the term "fictitious capitalization" was known and used by Marx in his writings, as so amply discussed by Harvey (1982).

Equity securities became popular in America primarily as speculative objects. This was recognized quite early in American financial history:

"Corners in grain have almost invariably resulted in disastrous failures. The reason is simple. The volume of products is large. There are too many sources of supply to permit of a monopoly. This was true even as far back as half a century ago. At that time when news of an attempted corner stormed the country farmers began sweeping their bins. As prices rose, new wheat poured in from a thousand and one unsuspected sources... Cornering stocks is much less difficult than cornering grain. There is really no comparison. In stocks one does not have the 'unknown quantity' to struggle with. The manipulator of stocks knows the number of shares out, usually he knows where they are held and how strongly they are held." (Dies 1929: 90-1).

James R. Keane, one of the best known American stock operators, attempted in the 1870s to corner the wheat market. While he understood the mechanisms involved in manipulating the prices of stocks, the openness of the wheat market led to gains that only barely covered the costs of arranging the corner. Successfully manipulating stock values requires recognition that prices can not indefinitely drift very far from underlying value – eventually indications of value accepted by the market will leak out. Dies believed that security values were held in check, in a general way, by the information transparency of the market. He wrote that "...the stock manipulator had to be wily enough to avoid going too far from the

ings well into the 19th century. Equity shares were viewed as speculation objects rather than sound investments in 19th century Britain. The equity securities of American railroads were nearly impossible to sell in Britain, although American rail bonds were quite popular (Chernow 1990; Navin and Sears 1955).

true basis of value...Knowing the precise limit was the mark of genius" (Dies 1929: 91).

The opportunity provided by equity markets for the capture of large speculative gains meant that speculation might readily shade into manipulation. Markets required organization and management to protect the integrity of market operations. The issue of the organization and management of equity exchanges are addressed in the next section.

Institutional Structure of Financial Markets: American Private Association and Continental Government Agency

The primary organizations that regulated trading in financial securities in the United States evolved out of associations initially created for other purposes. Most of the major regional and national security exchanges began as trade associations or commercial auction markets from which the exchange of financial securities and speculation eventually grew. The Kansas City Board of Trade is a good example of an exchange that was originally a trade association. Exchanges, or associations dedicated to the trading of assets, primarily handled trade in physical commodities like grain, coffee, cocoa, etc. Currency exchanging and discounting grew up around these commodity markets and eventually became recognized centers of trading in all kinds of paper, including securities. The Amsterdam Exchange was the first fully developed and organized exchange until the beginning of the eighteenth century, when London emerged as an important exchange. Crown debt was the first "security" traded on exchanges. Equity shares first appeared with the organization of the great trading companies of the Eighteenth century. Many of the processes and practices that are characteristic of security exchanges are transformations of auction practices originally utilized in the exchange of physical goods.¹⁶

¹⁶ There are delightful historical accounts of early exchanges. Some of the better are Carruther's recent account of the origin and development of London's financial district, Sobel's multi-volume account of American security markets, and

All of the major security and commodity exchanges in the United States were private associations adapted to the purpose of organized trading in standardized property. When compared to Continental markets, American financial markets were private, with government serving only in an oversight capacity and then only after 1933 (Roe 1994; Chernow 1990). Government involvement in finance has generally been minimal in American history: the United States did not have a central bank modeled on the Bank of England. Two early experiments in central banking failed, not because of ineffectiveness, but because of political opposition to centralized financial control.¹⁷ Roe (1994) argues that fragmented financial ownership in America was a result of political, not economic, forces. According to Roe, the populist tradition in America was hostile to financial centralization and free markets for corporate securities were an acceptable alternative to large central banks because financial markets, unlike banks, fragment financial control (Roe 1994: 326-7).

American financial securities markets were structured as a private association for profit making.¹⁸

The stock exchanges of this country are private voluntary associations of persons who deal in securities. They originated like any business association in the organization of certain persons for their

some of the better biographies of early American financiers, like Oberholtzer's excellent 1907 biography of Jay Cooke.

¹⁷ At least, this is the common account given for the failure of America's Second Bank of the United States. Hammond (1957) has an excellent account of the opposition to the 2nd Bank of the United States. Hammond claims that the primary opposition to the Bank was that it contributed to the financial power of Philadelphia over New York. Andrew Jackson, whose opposition finally sealed the fate of the bank, was heavily supported by New York interests. Ironically, the failure of the 2nd Bank of the United States, a failure sought in order to limit financial centralization, actually ensured that financial centralization would occur but in Wall Street, not Philadelphia's Chestnut Street.

¹⁸ The 18th and early 19th century American securities market was modeled, loosely, on the English stock market that was itself patterned on the 17th century Amsterdam.

mutual benefit and the advancement of their business.... Despite the overshadowing importance which they have come to assume in the business world as the country has advanced in wealth, they have preserved their truly private character. They are controlled by no special legislation, and they make their own rules and carry on dealings subject only to the laws which regulate such transactions everywhere (Emery 1896: 13).

The American secondary security market and produce exchanges, unlike those in Europe, were and still are private associations rather than state-sponsored institutions. The significance of private market management becomes clearer when comparison is made to European "bourses" (financial exchanges), which were formally part of the administrative apparatus of government:

The position of American stock exchanges is very different from that of the European Bourses. In England, the conditions are the same as here, but the exchanges of the continent, with scarcely any exception, exist by special legislation and are subject to more or less stringent control of government...Their rights, their duties and to some extent their methods of business are defined by special laws or by the regulations of those officials or governmental bodies to whom they are immediately answerable (Emery 1896: 13).

In America, each regional and national market for financial securities was largely self-regulating, at least until the 1930s. Each exchange established its own rules for security listing, for membership, for appropriate behavior of traders, for exchange process, etc. The "private and independent character of the New York Stock Exchange" meant that government had little direct control over the daily operation of security markets:

[On the New York Stock Exchange] privacy has been intensified by the settled policy of the exchange to keep its affairs as secret as possible... and to resent any interference from without. ...That an association which dominates the financial market, directs the course of investment, and settles the value of property for millions

of people has for nearly a century maintained itself as a purely private organization, and will perhaps continue to do so for another hundred years..." (Emery 1896: 16).

Equity security markets in America operated as profit making organizations. Investors relied upon the openness and transparency of corporate operations and results when trading. The issue of financial accounting and the business press follows.

Form of Financial Accounting: American Profitability and Continental Creditworthiness

The information transparency of the American securities market depends upon two social institutions: the financial accounting profession and the business press.¹⁹ Financial accounting documents have long been a main source of information about the companies listed on financial markets, but for much of the history of American markets financial statements were made available at the discretion of management. Security exchanges first asked companies whose shares were listed on their exchange to provide financial information on a voluntary basis in the early 19th century. Not until late in the 19th century did exchanges like the New York Stock Exchange require limited financial statements to be made available to investors once a year. Oddly, the overall impact of heightened disclosure requirements was to boost the valuation of shares as investors had greater confidence in the value of the underlying firms (Edwards 1938: 168).

Financial statements were prepared differently in each major economy in accord with two competing frameworks. On the Continent, banks served as the principle financial intermediary and financial markets were small and required different kinds of financial

¹⁹ Both financial accounting and the business press are important "social intermediaries" that link firms to financial markets in the late 20th century. These institutions are important producers and carriers of information that determine the value of equity securities on financial markets. As such, they are of immediate consequence to corporate managers who wish to maintain high valuations.

information than America's retail financial securities markets, with less control by elites.²⁰

Financial statements in the Continental system were directed toward "safeguarding the interests of creditors and providers of loan finance above those of the shareholders, creating a tendency to conservatism in valuation principles and the creation of hidden reserves" (Spicer and Oppenheim 1989: 3). In part this was due to the relatively minor role of capital markets and the major role of banks in German finance. The Continental system was also shaped by tax laws that required the payment of taxes on the profits reported in financial statements. In the U.S., income tax accounting was separated from financial reporting, so that two entirely different sets of accounting books with two different profit figures were maintained. Accounting figures on the Continent were "drawn up more for the benefit of fiscal authorities than for other users, and over-depreciation and under-valuation of assets are not uncommon" (Spicer and Oppenheim 1989: 3). In continental system, the presentation of financial statements was not left up to the company or to the accounting profession but was instead determined by government statutes and taxing authorities. Therefore, in these systems the "financial statements have been drawn up correctly in accordance with the law rather than reporting on a "true and fair view." Less regard was paid to "presenting a fair commercial view of a company's affairs to the investor" (Spicer and Oppenheim 1989: 3).

²⁰ The exact country breakdown in Spicer and Oppenheim (1989) is as follows: Germany, Belgium, Denmark, France, Italy, Norway, Spain, Sweden and Switzerland are all economies under the "Continental System." The United States, Great Britain, Ireland, Canada, Australia, Hong Kong, New Zealand, South Africa, Netherlands are all economies under the Anglo-American system. The recognition of the general divide between continental and American systems appears broadly in the financial accounting literature. My discussion of information transparency is necessarily comparative since I can think of no other way to present this material than in contrast to the German system. This section therefore meshes rather closely with the following section, which presents a thorough comparison of American and German finance.

In the Continental system, the primary users of financial statements were creditors and government tax authorities who rigidly established the form of financial statements and the rules governing their preparation. The income statement was largely irrelevant to investors in these systems because the prime concern was with the financial condition of the firm (liquidity and financial soundness, both of which were determined by the value of assets over liabilities). Also, since the tax liability of the firm was determined by reported income, there was a tendency to understate income whenever possible since it led to lower tax bills.

By contrast, Anglo-American finance privileged the equity investor and the determination of income to assess market value. Accountants constructed financial reports to focus upon profit. In America, financial statement form was not fixed by statutes and profits reported to investors were unrelated to profits reported to government for tax purposes. Maximum flexibility was granted to the accounting profession to set its own rules for the presentation of financial information in a manner "meaningful" to the investment community.

The public accounting profession in America had as its goal the interests of shareholders and the determination of earnings, which were the basis of market capitalization. In the Continental system the primary goal was the interest of bondholders. In America, equity investors were most interested in earnings since this was what most affected the value of equity securities. On the Continent, bond investors and creditors wanted to know about financial soundness or creditworthiness, since that is what most affected the value of debt. The income statement was unimportant in the Continental system because bondholders were not enriched by large profits nor were they impoverished by losses, at least not so long as sufficient cash remained to continue making debt payments and the firm remained solvent. Bondholders cared little for very high profits, since profits in excess of those required to meet interest and debt payments to creditors were "excess" profits from the creditor's standpoint. In fact bondholders often preferred to see firms increase

some of their spending – on maintenance, capital improvements, training of workers, higher salaries to retain employees, etc. – than to declare high profits and pay out high dividends.

The concept of “excess profits” remains largely unknown in the American equity system.

In the Continental system, corporations were managed under a system of *codetermination* in which a broad array of corporate stakeholders – workers, government, bondholders, shareholders – shared seats on the board of directors. In this system, financiers had only a limited capacity to extract value from the firm, a limit set by the interest/principle payments established in the terms of the debenture. Since creditors and bondholders could not “claim” the residual earnings of the firm, these earnings were often absorbed back into the corporation in the form of investment in additional plant/equipment, in raises to workers, etc.

American corporations by contrast were managed by and for the benefit of equity shareholders, who were the only group with representatives on the board of directors. Shareholders had a full claim on residual profits of the firm and were not limited by the interest payments specified in the debenture agreement. Shareholder’s take from the firm was unlimited.

Financial accounting did not require high levels of transparency in the Continental system because the major creditors, the *Hausbanks*, were insiders to company operations.

In America, both creditors and most stockholders were outsiders: mass, retail investing required American markets to require financial statements that made the inside operations of the firm “transparent.”²¹ The German *Hausbank* served to guarantee the value of listed bonds to outside investors, which made full disclosure and “investor monitoring” of firms less important.

²¹ As discussed in other parts of this report, it is astonishing just how opaque America’s transparent firms remain. In spite of the monitoring of the business press and financial accounting, a surprising amount of latitude remains for concealment and strategic representation.

Outsider's monitoring of corporate affairs also required an omnipresent business press. Manipulating financial news can generate price breaks and profits, as is demonstrated in this description of the 19th century British bond market. At the time, Britain's security exchanges dealt almost solely with public debt whose value gyrated with news from the Napoleonic wars. This offered great opportunities for speculative gain.

Another stockbroker, Benjamin Walsh, who had raised himself to membership in parliament, was finally excluded from the House on the ground of fraud. In 1814, Admiral Chochrane, prominent in the British Navy and in politics, was one of a group which circulated a false rumor concerning the death of Napoleon for the purpose of putting through a stock market deal (Edwards 1938: 11).

American business media reached a high state of development in the late 20th century and focused upon close monitoring of the trading price of equity securities. In America, the value of major equity indexes, such as the famous Dow Jones Industrial Average and the NASDAQ composite, were reported perpetually and were viewed as major indicators of national prosperity. The financial press was so central to American finance because of the combination of retail investing and private organization of exchanges. The absence of strong government management of security markets made information transparency imperative in order to track the quality of investments. The predominance of equity securities whose value fluctuated with every news item that might impact corporate profitability, fueled media analysis of macro-level economic factors, as well as industry and firm specific events that might have an impact on profits. The rapid price breaks caused by financial news kept the financial information market in a high tension and created an incentive for ever faster, ever more rapid transmission of financial news. The rapid turnover of securities in America and the complex structure of the security industry, in which most owners of securities lacked inside information about corporate decisions

and events supported the public interest in the business media.²² The growth of a large and powerful business press meant that American managers had to “perform” in both financially and dramaturgically. Not only did corporate executives have to manage their operations, but they also had to manage corporate impressions for the business press. Investor relations became a major area of top management concern (Useem 1996).²³

Unifying the Ideal Types of American and Continental Finance

The ideal type of American financial institutions can now be drawn together. The unifying logic of the system is speculation: trading securities quickly and often to capture profit from changing prices. The system depends upon mass participation in financial markets. This mass participation is facilitated by an elaborate system of financial intermediation, including an astonishing array of retail financial services and financial products. Secondary financial markets that trade already existing securities have greater prominence and power than primary financial markets that raise capital through the sale of new securities. Speculation, defined as the attempt to capture profits from trading securities with shifting values, is the dominant financial orientation. Equity securities – corporate stocks – are the most prominent speculative vehicle: millions track changes in stock market values. Stocks are traded on financial markets organized as private associations whose purpose is the generation of profit for owners not the protection of the public good. Trading of stocks on these exchanges is driven by scrutiny of financial statements that emphasize quarterly profit: assessments of these reported profits and projections of future profits are primary movers of stock prices.

²² The importance of the financial press as a social intermediary linking firms to financial markets is discussed in Krier (2005).

²³ I would like to thank David Norman Smith for suggesting this language to me. The ambiguous meaning of “performance” as a characterization of modern management roles captures countervailing tensions faced by managers.

The ideal type of Continental financial institutions can also be distilled as follows: the unifying logic of the system is investing (securing ownership in productive assets that pay dividends, interest and profit over time). The system is dominated by a small number of powerful *Hausbanks* who serve as financial intermediaries taking deposits from savers and making loans to borrowers. Primary financial markets that sell bonds (primarily) to raise funds for industrial development are more important than secondary markets that trade existing securities. Investing is more important than speculative trading: most stocks are held in or controlled by *Hausbanks* and are never traded. Bonds and bank loans are more important than equities: daily movements of stock prices are less important than in America. Financial markets are organized as governmental or quasi-governmental agencies and have as their mission the protection of the public good. Financial statements serve multiple regulatory purposes, including income tax determination, and emphasize creditworthiness and solvency more than projected profit.

Comparing the Consequences of American and German Financial Structures on Corporate Restructuring

The differences between Anglo-American and German-Continental financial institutions are striking²⁴. If financial markets are globalizing, the future of capitalism will be starkly different if indeed it is the American system that is globalized rather than the Continental system. In America, the stock market became the controlling institution in late 20th century capitalism, driving corporate mergers, re-

²⁴ This section of the article is informed by the following writings on financial history and market structure: Baskin and Miranti (1997); Chernow (1990); Cohn (1895); Dalton (1993); Dice (1926); Edwards (1938); Fosback (1992); Frumkin (1998); Graham and Dodd (1938); Grinblatt and Titman (1998); Lawson (1908); Malkiel (1992); Mayer (1992); Myers (1970); Neal (1990); Prochnow (1951); Rasmusen (1992); Roe (1994); Schabacker (1932); Silber (1992); Smith (1992); Sobel (1965; 1970); Studenski and Krooss (1952); Tobin (1992); Treweles and Bradley (1982); Treynor (1992); West and Tinic (1971).

structuring and deindustrialization throughout the last 40 years. Despite neoliberal financial reforms that partially Americanized the Continental system, the deeply embedded institutional structure of Continental finance prevented stock market dominance and American-style brutal industrial restructuring. The following section examines how particular features of Continental finance made Germany resistant to American-style industrial restructuring in the late 20th century. The following elements were particularly important: Germany's relative absence of financial securitization, Germany's relative absence of publicly traded equity securities, Germany's use of bank loans and bonds, German *Hausbanks* as organizers of industrial development, government management of German security exchanges, Germany's internal corporate governance and Germany's creditor-shaped financial accounting.

Germany and America on Securitization

While the American economy was heavily securitized, meaning that a large proportion of the total wealth of the country was represented by securities traded on financial markets,²⁵ Germany was historically much less so. The size of the market for financial securities in Germany was quite small compared to the U.S. In 1993 there were only 650 publicly listed companies in Germany, ninety percent of which were not actively traded. A mere thirty equity securities accounted for 85 per cent of the German stock market turnover in 1993. The small number of active corporate securities in Germany contrasted to about 2,000 companies in the U.K. and over 7,000 (and growing rapidly) in the U.S. At the end of 1996, Ger-

²⁵ American financial markets in the late 20th century are capable of creating "securities" of almost anything. Mortgages are routinely bundled together and "sold" to investors as a security. Real Estate Investment Trusts essentially create "securities" of the future rental income of real estate. In the mid 1990s, securities were floated that represented the "royalties" to the music of popular music artists: the artists were able to "cash out" of their rights to their music. The tremendous spurt of initial public offerings in the late 1990s saw securities traded that represented not "industrial companies" but mere ideas for them.

many had a “market capitalization to gross domestic product” ratio²⁶ of only 27 percent, compared to well over 100% in the United States. German industry did not rely upon equity financing to raise new funds: between 1991 and 1996 there were a total of 77 initial public offerings in Germany and over 3,000 in America. There were more initial public offerings in a good month in the U.S. during the 1990s than there were during this entire five year period in Germany (Deeg 1999: 94-5). The German market was did not develop a mass market for securities, especially equity securities. In 1995, only 14.6 percent of all outstanding corporate equity securities were held by households, compared to 36.4 percent of outstanding American equities (Deeg 1999: 95). Unlike the American financial system which accommodated broad retail market participation, the German system was dominated by a few elite German *Hausbanks*.

In Germany, corporations were largely self-financing, “plowing back” earnings into the firm by retaining and reinvesting free-cash flows generated by corporate operations. When external sources of financing were necessary, German firms turned first to their *Hausbank* for a loan while American firms turned to an investment banker for a flotation of securities on the public market. This pattern of financing in each country had deep roots: Roe (1994; see also Hammond 1958) argued that the central position of securities markets in America resulted from political opposition to centralized financial power—as evidenced early and most decisively by the Jacksonian attack on the Second Bank of the United States and the New Deal anti-financier legislation that broke up American multi-function banks and separated commercial and investment banking (now repealed). American banks had been legally barred for most of the 19th and 20th centuries from engaging in interstate banking, from receiving Federal charters, and from owning the equity securities of other companies. German and other Continental banks had been free to develop without these strictures, and German banks in particular grew in size as consolidation and centrali-

²⁶ The ratio of market capitalization to gross domestic product is a standard measure of the relative size of financial markets in an economy.

zation of finance continued throughout the 19th century. By the dawn of the 20th century, a handful of very powerful banks held a collective near-monopoly on corporate finance in Germany.

In America (and Britain), the most central institution for corporate finance was the financial securities market, in Germany and the continent, the most central institutions were the *Hausbanks*. This helped Germany resist the active "market for corporate control" that drove much late 20th century industrial restructuring in America.

Germany and America on Equity Securities

Another decisive difference was Germany's use of debt over equity securities in corporate finance. In Anglo-American systems (with the U.S. as the archetype), equity securities came to predominate in the financial markets to a far greater degree than in Germany and the Continent. An important contrast case to demonstrate this point was the late 19th century American world of elite finance. This system shared many features with the 20th century German system. Bankers formed the center of interconnected webs of industrial firms whose financing was in the form of interest-bearing obligations. The primary difference between contemporary Germany and 19th century America was the form of these debt obligations: bonds placed on financial securities markets in America and bank loans in Germany. The leading investment bankers, most famously the House of Morgan, sold bonds for leading corporations (mostly railroads and commodity processing firms). Unlike modern Germany, American elite financiers of a century ago relied heavily upon securities floated on a fully functioning financial market. But because the securities were debt, not equity, the impact of financiers upon the underlying companies was similar to contemporary German *Hausbank's*. Morgan in 1900, like *Deutschebank* in 2000, was most interested in maintaining the financial solvency and soundness of industrial corporations to ensure the safety of their client's securi-

ties. Both emphasized conservative cash management, solvency and a long-term orientation.

One of the most consequential institutional structures of German finance then was the dominance of debt over equity securities, which meant that financial markets – like *Hausbanks* – encouraged long-term goals off credit-worthiness and solvency rather than short-term profit.

Germany and America on Bank Loans and Bonds

Germany makes a strong contrast to contemporary American securities markets on most of the dimensions examined in this article. Though the German market, like most financial systems around the world, was increasingly conforming to the American model,²⁷ the system maintained distinct features and remained focused on debt. In German finance, a variety of bonds were available to investors, and bonds: the ratio of bonds to equities in German securities markets in 1981 was 7:1 (Stonham 1982: 108).²⁸ However, bonds in the name of industrial corporations were relatively rare in Germany. Instead, bonds were issued by *Hausbanks* and the funds forwarded to industrial corporations in the form of loans. Banks were financial intermediaries to a far greater degree than in America. Banks also dominated the German exchanges, since they were able to deal in securities, they had a virtual monopoly on stock brokering.

Germany did not development corporate equity markets during the 19th century when other major economies did. In the 19th century, only one of the German states (Prussia) enacted a general

²⁷ Deeg (1999) titles one of his chapters on recent changes in German high finance “The Anglo-Saxonization of German Finance.”

²⁸ Thorstein Veblen spent about a year in the late 1890’s translating and publishing a German “finance” text. The text, written by Professor Cohn was published under the name the *Science of Finance (1898)*. This text completely ignores corporate equity securities and focuses almost exclusively on government and corporate bonds.

company's law similar to that in Britain and the United States.²⁹ This meant that in the 19th century, when American promoters could form a joint-stock company merely by filing the appropriate forms, German promoters could only obtain a charter for such companies through a special act of the German legislative body.³⁰ This slowed the formation of joint-stock corporations, which arguably slowed the capitalist development of 19th century Germany. It also allowed Germany to avoid "the "security speculation which brought such heavy losses to both England and France during the first half of the nineteenth century" (Edwards 1938: 62).

Germany and America on Hausbanks and Centralized Finance

One interpretation of the German financial system was that of Gerschenkron (1962) who explained Germany's anti-market, bank-centered system of industrial finance as an efficient adaptation to the economic backwardness of Germany in the 19th century. German *Hausbanks* were capable of distributing German capital more effectively than speculative financial markets would have done. Banks became the central managers of the German economy, guiding its rapid development with prudence and care. Equity security markets never became a part of Germany's financial culture, as was represented in the following mid-20th century description of Germany's financial system:

²⁹ "The first modern corporation law in the United States was passed by the Connecticut legislature in 1837, although New York State had passed a less modern version in 1811. The first modern corporation act in England was the British Companies Act in 1862, although a less complete act was passed in 1855" (Brown 1971: 12 fn).

³⁰ The creation of formal, routine procedures for the formation of publicly traded corporations was important for the rapid growth of corporations in the United States and elsewhere. Without such routine procedures, a corporation can only be created by a special act of a legislative body. This necessary acts as a drag on the development of new corporations.

It has not been possible for a fully functioning capital market to develop since currency reform. This is partly due to the fact that the public largely avoids investing its available funds in bonds or shares, preferring investment in plants, dwellings, or in liquid assets, mainly in savings deposits..... Shares have been issued so far only to a comparatively small extent, and, so far as such issues have taken place, the shares were for the most part not offered to the general public but were purchased by interested circles. " (Beckhart 1954: 363).

Whether Germany's economic backwardness in the 19th century was a primary explanation or not, it is clear that Germany failed to develop a culture of mass security holding like America (and Britain) did.³¹

Germany's long resistance to equity securities may have been due to other factors. First, tax laws in Germany, unlike those in the United States, encouraged firms to utilize debt financing. Concentrations of shares were encouraged by dividend tax breaks to large holders (more than 10%) of the shares of a given firm (even cross-owned shares that are deposited in a *Hausbank* qualify for these breaks). Unlike America, where capital-gains tax rates were often the lowest rates in the tax code, the German tax system assigned high tax rates to capital gains, which discouraged trading of shares and encouraged long term holding (Deeg 1999: 95).

Germany's late development of financial institutions allowed the German states to avoid some of the negative consequences of security speculation. After 1848, the largest banks in Germany attempted to avoid "the evils of security capitalism by declaring that 'it is in no way the task of the bank to pave the way for stock-jobbing operations, and to stimulate capitalists to unproductive gambling on 'change.'" (cited in Edwards 1938: 63). When banks did issue corporate securities, they maintained the strict view that such securities are "asset backed."

³¹ The active role of banks in the management and consolidation of industry was at the center of Hilferding's characterization of "finance capital" in the German system.

In general, the business of issuing new securities by the German banks was conducted on a conservative basis, as it was their policy to emit bonds and stocks only to the actual cash value of the property of the corporation being financed (Edwards 1938: 68).

Stock watering or overcapitalization, and the speculative gains attendant upon it, were thereby avoided by German finance. The bias against speculation and security fraud remained strong in Germany throughout the 19th century. In 1884 a corporation law was enacted which prevented the "overvaluation of property and the concealment of promoters' profits" (Edwards 1938: 73).

German *Hausbanks* and debt financing coordinated through them were institutional structures that resisted stock-market driven takeovers, buyouts and downsizing.

Germany and America on Financial Market Organization

The hostility to security speculation was strong in Germany, and in 1893 the Reichstag instituted rigid controls over stock market procedure, especially margin trading and the use of futures. "The purpose of this regulation was to eliminate altogether speculation in these securities" (Edwards 1938: 74). The law proved to be ineffective, and since it was circumvented by a variety of techniques, was largely repealed in 1908. But whereas the German government was willing to attempt the curtailment of speculation, American security exchanges remained organized as private, profit-making associations largely untouched by government. The late 20th century regulatory structure of the Frankfurt Stock market illustrates this difference. Frankfurt was Germany's largest financial exchange in 1998, accounting for 75% of all German securities trading. The Frankfurt Stock Exchange was established in the 16th century "as a private institution operated by a number of merchants" but in 1808, the Stock Exchange was brought under the administration of the Chamber of Commerce (a government bureau). The Frankfurt Stock Exchange became an agency of the German government and was

controlled and managed by a complex committee (Frankfurt Stock Exchange Website, 2003). American exchanges faced no such controls, even after the New Deal reforms.

Bonds were the most commonly-traded security on the Frankfurt stock market as on all German exchanges.³² In contrast to American and some European stock exchanges, the Frankfurt market avoided listing and trading joint-stock company shares despite their increasing popularity abroad. When other German regional exchanges listed equities (Berlin was the leader) in the late 19th century, Frankfurt continued to trade only in secure government bonds. It was not until the end of the 19th century that Frankfurt joined other regional exchanges and began limited trading in joint-stock equity shares. In 1896 the German Stock Exchange Act consolidated into a uniform administration the governing bodies of all 29 German stock exchanges. Though most of these exchanges no longer exist, the German Stock Exchange Act still served in the late 20th century as the basic outline of exchange administration in Germany (Deeg 1999; Frankfurt Stock Exchange Website, 2003).

Greater government control of financial exchanges in Germany made it more difficult for highly speculative derivatives and innovative junk bond financing to develop, retarding American-style merger, buyout and raiding activity.

Germany and America on Corporate Control

The predominance of the corporate equity stock market in America led to a distinct type of "external" financial control of corporations. Corporate governance in the U.S. and Britain tended to be dominated by equity shareholders who alone elected the directors of the corporation. Shareholder's directors ensured that the corporation

³² It is important to remember that the term "stocks" in Germany refers to any financial security. Given the prevalence of debt securities in Germany, when one speaks of trading in "stocks" the normal referent is to debt instruments. Writings about German finance usually follow British usage and use the term "shares" to refer to equity securities.

was managed for the benefit of shareholders. In Germany and the Continent, however, corporate governance included representatives of other stakeholders. Agents of the great *Hausbanks* were heavily represented on the boards of directors of the firms within their network. Shareholders shared control of the corporation with representatives of banks, trade unions, employees, and government. This policy of corporate "codetermination" led to different corporate decisions and more rounded relationships between industry and the total society (see Table 4).

TABLE 4. COMPOSITION OF THE SUPERVISORY BOARDS OF THE 100 LARGEST GERMAN ENTERPRISES, 1988 (NUMBER OF SEATS AND PERCENTAGES)

Private banks	104 (7%)
Other banks	32 (2%)
Insurance Companies	25 (2%)
Trade Union Representatives	187 (13%)
Other employee representatives	542 (36%)
Representatives from industry and other business enterprises	385 (26%)
Other shareholder representatives (lawyers, notaries, shareholder association representatives, etc.)	152 (10%)
Politicians, civil servants	<u>69</u> (5%)
	1,496 (100%)

(adapted from Samuels, Brayshaw and Craner 1995: 93, data originally from Federal Association of German Banks).

German codetermination limited the power of financial markets to control corporate governance and management decision making. German corporations were largely immune to the threat of hostile takeovers that swept through American firms. American firms were vulnerable to hostile takeovers precisely because publicly traded equity securities are the vehicle used to obtain corpo-

rate control. The growth of the “market for corporate control” in the 1980s reduced the ability of insiders to control corporate actions. A “shareowner rights movement” served as a covering rhetoric for corporate takeovers and restructuring in the United States. This movement belatedly arrived in Germany, and in the late 1990s German corporations faced increasing pressure to become more “equity centered” by placing the financial returns of absentee equity shareholders above the interests of employees, trade unions, and communities.

German banks in the early 1980s held a significant portion of the total equities of German industrial firms. Especially the largest firms, like Daimler Benz, had a substantial portion of their total equity held by banks (Stonham 1982: 99). Deutsche Bank directly held about 28% of Daimler-Benz equity shares. In 1990, Daimler Benz reported that three large shareholders collectively controlled over two-thirds of the company's equity stock. However, overall, only 10% of equity was held directly by German banks in the 1990s (see Table 5).

TABLE 5. OWNERSHIP OF GERMAN CORPORATE EQUITY SECURITIES IN 1990

Private households	17%
Enterprise	42%
Banks	10%
Insurance companies	12%
Public sector	5%
Foreigners	14%

(adapted from *Samuels, Brayshaw and Craner* 1995: 95)

These statistics underestimate the degree of control that was exercised by German banks over corporate affairs. Many of the shares of a given industrial concern was held by other firms, all under the “control” or at least “leadership” of a *Hausbank*:

The large banks are shareholders of large companies in Germany. Thus, at the end of 1990, German banks were shareholders of 9 percent of all listed German companies. Furthermore, they held more than 25 percent of the equity capital of the 33 largest German companies" [which are almost the only ones traded on German stock exchange] ...The German banks also act as main depositaries of the shares traded on the Stock Exchange. At the end of 1990, the German banks held on deposit 40 percent of the market value of the shares of listed companies. If we add to this 9 percent directly held by the banks, we find that banks control directly or indirectly about 50 per cent of the equity capital of listed companies (Canals 1997: 67).

Many of these cross-owned shares were deposited with the *Hausbank* at the center of the network. Approximately 40% of all equity shares were held in deposit in Germany's great banks, and banks regularly utilized the proxy votes of these shares to leverage their control of corporate affairs (Samuels, Brayshaw and Craner 1995: 98-99).

A classic example of the relationship between a "*Hausbank*" and a company is that of Deutsche Bank and Daimler-Benz. Deutsche Bank has been Daimler-Benz's *Hausbank* and guided the merger process between the companies Mercedes and Benz. One of the consequences of this operation was that, until 1994, the president of this major industrial corporation was a senior Deutsche Bank official. This relationship has not prevented Daimler-Benz from having other banks as shareholders. Other classic examples of bank-industry close relationships in Germany are those of Volkswagen with Deutsche Bank and BMW with Dresdner Bank (Canals 1997: 169).

Cross-held shares and shares directly held by the *Hausbank* created a stable ownership structure that reduced the ability of hostile parties external to the corporation to purchase sufficient shares to challenge manager's control of the corporation. In the words of the 1990 Daimler-Benz annual report:

Daimler-Benz has a reliable and manageable shareholder structure. This assures our independence and prevents any takeover attempts, at the same time, it enables us to carry out those capital related measures which appear reasonable in the interest of our entrepreneurial flexibility (Samuels, Brayshaw and Craner 1995: 99).

The three great banks in Germany which accounted for the bulk of all transactions and served as the house banks to many of the largest corporations are Deutsche Bank, Dresdner Bank and Commerzbank.³³ In the late 20th century, German firms continued to rely upon their *Hausbanks*. A comparison between the financing of German and British firms in the late 1980s reveals a great deal of similarity in the generation of funds for financing operations in these two supposedly different systems. The major difference between the two systems being that "British companies use equity capital (capital increases) to a significantly greater extent, generating three times as many funds by this means as German companies" (Canals 1997: 171).

German codetermination, crossholding of shares and *Hausbank* dominance in corporate governance ensured long time horizons and prevented the aggressive stock-market operations of corporate raiders and others who restructured American industry for short-term gain.

Germany and America on Financial Accounting

German financial accounting standards and financial statements did not permit detailed computation of earnings comparable to U.S. firms. Since such a small number of German shares were held by unaffiliated outsiders in Germany while the majority of shares were

³³ For a very complete listing of the equity securities of non-financial firms owned by the Big Three German Hausbanks, as well as a listing of the ownership structure of the fifty largest firms in Germany (which confirms in detail the large ownership position of banks in most of the leading companies, see Canals 1997: 162-167.

controlled by *Hausbank* affiliates with inside information, public disclosure in financial statements was modest as compared to the United States. Further, the focus of German financial statements was on the balance sheet, on creditworthiness measures – liquidity measures – rather than on measures of profitability. The financial statements of German firms were not adapted to broad public shareholding by outsiders as they were in America, where financial disclosure was essential since there was greater separation of ownership and control.

The external financing of American corporations theoretically led to “arms length relationships” between investors and managers. Investors were unlikely to have any direct contact with a firm’s management and relied upon financial reports to connect investors to the firm. The internal financing of German corporations involved far less distance between firms and investors. Rather than the elaborate financial intermediation characteristic of American finance, German firms obtained financing through the simple, direct intermediation of banks. In Germany, financial accounting reports were far less important as a social intermediary linking firms to investors since the major investors were already on the inside of the corporation and have much more complete knowledge of firm activities and results than were provided to American “outside” investors through financial reports.

The primary differences between Anglo-American and German-Continental systems of financial accounting follow from the above differences in finance. In the Anglo-American system, the primary purpose of financial statements was to provide information to financial markets (holders of securities who are external to the firm) to allow them to make decisions regarding their holdings. Distributions of corporate earnings through dividends occurred at management discretion, unlike Germany where regulations controlled such disbursements, limiting them to a fixed ratio of reported earnings.

Corporate tax accounting in the U.S. was distinct from financial reporting and the details of corporate tax accounts and calcula-

tions are not normally disclosed to shareholders. In Germany, financial accounting served multiple purposes at once: determination or control of distributions and taxation as well as the determination of the "value" of the security on financial markets. In America, where equity securities predominated, accounting documents have developed with value determination as the predominant function, privileging the income statement over other documents and the calculation of profit the focus of accounting information.

German corporate taxes were paid on declared earnings, unlike American corporate taxes that bore little relation to declared earnings. No second set of "tax basis" books was kept in German firms. Under these circumstances, German corporations tended to understate income, especially since the corporation was controlled by a consortium of long-term holders who benefit by limited dividend payouts and limited taxes. In strongest possible contrast to American firms, German corporations had no incentive to overstate or smooth reported income since these actions did not benefit managers or owners in the German system (Samuels, Brayshaw and Craner 1995: 31). Indeed, the trading price of equities was traditionally of little consequence to German corporate managers, since only a thin slice of the outstanding equity shares of German firms appeared on financial markets.

In equity-dominated Anglo-American systems, there was considerable incentive to "manage" the income reported in the financial statements of the firm. The imperative to report high income in order to boost stock prices became particularly acute in the 1980s with the rise of hostile takeovers. Managers who were unable to maintain high equity prices put themselves in peril of being bought out by a hostile suitor (Krier 2005).

The high ratio of debt financing in German finance had other consequences. Debt and equity holders often have conflicting interests. Returns to debt holders are effectively capped or fixed: corporate profits in excess of what is necessary to meet debt obligations and pay interest are in a sense superfluous, especially if these profits undermine the sound "stewardship" and conservation of the

firm's long-term ability to pay interest. Returns to equity holders are not capped and vary widely, often in exponential proportion to changes in profit. Excess profits are impossible for equity holders since there is no upper limit to the potential increase in their securities value. Equity holders benefit greatly when profits rise, bond holders do not. Germany, a debt-finance system, lacked the American equity system's focus upon earnings. Creditors' interest receipts were tied to liquidity (having ready cash to meet interest payments and other obligations) and overall solvency of the firm (excess of assets over liabilities). Creditors benefitted from liquidity, equity-holders benefitted from profitability.

Financial accounting's focus upon the balance sheet rather than the income statement, in conjunction with other institutional features of German finance, reduced the incentive for German corporations to inflate income figures by cutthroat downsizing, reorganization, plant closures and other measures, was constrained in the German system.

Conclusion: Critical Institutionalism and the Americanization of Global Finance

Critical institutional analysis was deployed in this article to construct ideal types of the institutional structure of American and Continental financial systems. Seven institutional structures were analyzed and after drawing together distilled ideal types of American and Continental financial institutions, the article explained how each of these institutional structures served to prevent, or at least delay, soften and deflect, late 20th century, American-style corporate takeovers, deindustrialization, and industrial downsizing by blocking the development of stock market power. This analysis has reached a somewhat ironic conclusion: German workers and communities were defended against the most catastrophic forms of industrial change in the late 20th century by the structure of their financial institutions.

While corporate governance in America became more dominated by shareholders than ever, corporations in Germany (and other Continental economies) remained governed by the system of codetermination that balanced the interests of shareholders against the interests of workers and communities. Codetermination was a source of resistance to the rise of shareholder dominance and corresponding pressure for increased returns at the expense of other stakeholders. Despite this resistance, the Americanization of global financial institutions, including those of Germany, escalated in recent years. Throughout the 1990s, German corporations and *Hausbanks* faced pressure to develop a shareholder-dominant equity culture. In Germany, leading late 20th century exponents of "shareholder rights" were primarily small shareholders who were outsiders to the *Hausbank* network. In the "greed is good" manner of American corporate raiders, changes were sought in corporate governance and financial regulation to foster the emergence of an Anglo-American "equity culture" in corporate circles in Germany, France and other Continental countries.

Forces continue to urge German finance to Americanize, but there are also nascent forces pushing American finance to become more like finance in Germany. Recent bank and financial services mergers consolidated financial power in the hands of a very few, integrated financial giants who might evolve into a form of *Hausbank* within the United States. American banks in the 20th century were unable to become *Hausbanks* because they were barred from engaging in both commercial and investment banking by the Glass-Steagall Act of 1934. This act effectively broke up large American banks (the House of Morgan in particular) and prevented *Hausbank* relationships within American corporate finance. The repeal of the Glass-Steagall Act, forced upon Congress by the merger of Traveler's and Citibank in 1998, removed legal barriers to the exercise of *Hausbank*-like financial power. One institutional barrier to the emergence of German-style finance has fallen, perhaps opening up an opportunity for activists to press for additional reforms that incorporate more of the institutional structure of Continental finance.

American finance continued to be dominated by speculation in corporate securities throughout the 1990s and 2000s. Speculation – in securities, in commodities, in real estate – became closely associated with the American ethos and was thoroughly institutionalized as a fundamental economic process, broadly participated in, widely dreamed about, extensively acknowledged and religiously legitimated. The historical record is clear: American economic development has been essentially speculative from the founding of the colonies in the 17th century. Broad-based speculation predated the emergence of financial markets in America and financial markets developed in order to serve speculative (not government or industrial) interests. The late 20th century speculative restructuring of American industry had taproots deep in an institutionally-embedded financial system structured to allow speculators to capture gains rather than a system designed to encourage productive industry. The Americanization of global finance means that the institutions highlighted above are themselves the subject of export and are displacing other institutional structures.

This critical institutional analysis suggests that Continental financial institutions may well be important defenses against American-style industrial reorganization. Preserving or incorporating Continental (or other alternate) financial institutions may be one of the most important, and potentially successful, activities that can be practically undertaken by progressive interest groups and social movement actors. Changes in financial institutions almost always occur in the wake of crises, creating an opening for voices of reason (and protest) to create or preserve institutions that limit stock market power. Alterations in financial accounting rules, bank legislation, financial innovations, or market regulation seem far removed from the interests of labor or anti-globalization activists, but these relatively small, technical, institutional adjustments can have outsized consequences. Anti-globalization activists are already paying increased attention to finance: protests surrounding meetings of the G8 and the World Economic Forum are the major mobilizations of their movement. Labor unions, including the AFL-CIO, are paying

much closer attention to the institutional structure of finance, including financial accounting, in their attempt to protect worker pensions, health care and living wages. Critical institutionalism is a powerful tool to support these efforts.

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