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**Co-ordinated continental European market economies under
pressure from globalisation. Case study:
Germany's "Rhineland capitalism"**

by
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Abstract/ Résumé/ Zusammenfassung

Taking Germany's "Rhineland Capitalism" as a case study, the paper examines, on the basis of the "Varieties of Capitalism" discourse, the changes occurring from the process of globalisation. First, the article focuses on a comparison between prototypes of the "liberal market economy" (LME) variant, characteristic for the United Kingdom, and the "co-ordinated market economy" (CME) variant typical for Germany. It is pointed out that each type of economy has its own specific institutional balance which cannot simply be replaced by "importing" an alternative model. Nevertheless, the conditions for the CME variant have changed since the 1990s, which lead to institutional modifications due to : 1) developments in (national and international) commodity and capital markets, 2) the ensuing changes in structures of corporate governance within corporate enterprises, 3) the transformation in management career structures and the composition of management in corporate enterprises, 4) the significance of the service sector (and in particular the knowledge society), 5) the external political influence of EU integration and enlargement, and 6) the role played by (national) politics and politicians in the economic arena. These six factors of change in the German model of capitalism seem to indicate a process of convergence in the direction of a LME variant. Although the CME variant is under pressure and undergoing a transformation, the survival of existing structures and institutions in modified form and equipped with new functions indicates that new mixed forms ("hybrids") emerge securing the existence of the corporate model but not ruling out a change of course.

Cette contribution analyse, sur la base de la discussion des "Variétés du Capitalisme", le changement de l'économie de marché à caractère coordonné en Allemagne sous la pression de la globalisation. En faisant ceci, on trouvera, d'une manière empiriste, six éléments du changement institutionnel. Ce dernier apparaît (1) dans le développement des marchés nationaux et internationaux des biens et des capitaux, (2) dans la mutation des structures corporate governance à l'intérieur des sociétés de capitaux qui est lié a (1), (3) dans la transformation des échelles de carrières et dans les changements de constellation à l'intérieur des directions des sociétés de capitaux, (4) dans la signifiante croissante du secteur des prestations de service (ici en particulier du secteur de la « knowledge society », (5) dans l'exogène influence politique de l'intégration et l'extension Européennes. (6) dans le rôle que joue la politique (nationale) et ses acteurs dans l'arène économique. Il va en résulter que le changement institutionnel n'est pas un procès de convergence linéaire vers une économie de marché à caractère libéral, mais qu'il y aura des formes mixtes (des hybrides), dans lesquelles on retrouvera également des formes typiquement allemandes de relations industrielles dans de nouvelles fonctions.

Der Beitrag untersucht auf Basis der Varieties of Capitalism – Diskussion den Wandel des deutschen „Co-ordinated Market Economy“ - Modells des „Rhineland Capitalism“ unter dem Druck der Globalisierung. Dabei werden empirisch sechs Elemente des institutionellen Wandels herausgearbeitet: Dieser wird verortet (1.) in der Entwicklung auf den (nationalen und internationalen) Waren- und Kapitalmärkten, (2.) in der damit eng verbunden Veränderung der corporate governance – Strukturen in den Kapitalgesellschaften, (3.) in der Veränderung der Karriereleitern und der Zusammensetzung des Managements von Kapitalgesellschaften, (4.) durch die wachsende Bedeutung des Dienstleistungssektors (hier besonders des Sektors der „knowledge society“), (5.) durch den exogenen politischen Einflusses der EU-Integration und -erweiterung und (6.) in der Rolle, welche die (nationale) Politik und deren Akteure in der ökonomischen Arena spielen. Dabei stellt sich heraus, dass dieser institutionelle Wandel nicht ein linearer Prozess der Konvergenz in Richtung „Liberal Market Economy“ ist, sondern dass sich Mischformen (Hybride) herausbilden, in denen sich auch die spezifisch deutschen Formen der industriellen Beziehungen in veränderten Funktionen wieder finden.

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I Introduction

It has become indispensable to open up markets, liberalise trading and capital relations and make labour markets more flexible in the era of globalisation: such would appear to be the general consensus among politicians and academics alike. The predominance of neoclassical and/or neoliberal theory since the 1980s, further enhanced by the gathering pace of "globalisation", the collapse of state socialism and by the European internal market, has led to the implementation both nationally and internationally/in Europe of economic strategies aimed above all else at market freedom. Only now - given the effects of this seemingly natural and inevitable process - are institutional perspectives on the economy turning against neoclassicism and drawing attention to the potential consequences for societies hitherto ranked among the strongest economies on the world market. That strength, according to Michel Albert 1991, was derived from the embedding of their economies in the very social institutions which are under threat from the process of liberalisation. The foundation was thus laid for a modern "political economy" bringing society back into the economy, equated by many with what Kuhn describes as a "paradigm shift". The 1990s saw the rapid development of an international discourse around "models of capitalism" (Coates 2000) and "Varieties of Capitalism" (Hall/Soskice 2001), which examined in the light of globalisation the trends in and comparative advantages of all the newly (re-) emerging variants of capitalism. The importance, for industrial relations and for Europe's trade unions, of knowing more about the direction in which continental European economies and societies are heading, under pressure from internationalisation, cannot be overestimated: industrial relations constitute a key element in all the different variants of capitalism and are affected by qualitative changes whenever the goal posts move - academic commentators are unanimous on this point.

We shall begin by outlining below the differences between the two main variants of capitalism - the liberal market economy (LME) and the co-ordinated market economy (CME) - drawing on the writings of Hall/Soskice (2001), who have adopted the most trenchant and empirically

sound position in this discourse. Thereafter, using the prototype of a CME - Germany's "Rhineland capitalism" - as a case study, we shall describe and analyse the changes occurring under pressure from the process of internationalisation.

II Liberal market economy vs. co-ordinated market economy – a typology

A distinction can theoretically be drawn between two ways in which capitalism is embedded in social institutions, i.e. between the "liberal market economy" variant, characteristic of Anglo-Saxon economies (USA, UK, Australia, New Zealand and Ireland), and the "co-ordinated market economy" variant typical of most continental European countries (see Hall/Soskice 2001). When observed in an *ex-post* analysis, not only are these variants of capitalism endowed with a balanced set of functionally complementary institutions; these institutions have in fact taken shape through a lengthy historical process as the product of well-developed social cultures, power processes and technical/economic development trajectories (they are by no means merely the outcome of functionally determined development trajectories, as implied by Hall/Soskice (2001) in their analysis of the *status quo* - for a critical view, see also Höpner 2003). Our first step will be to outline the institutional structures of the United Kingdom and the United States on the one hand and Germany on the other, drawing on a comparison made by Hall/Soskice. In this discussion, these two variants serve as prototypes for the liberal and the co-ordinated models of market economies.

The United Kingdom and the United States are characterised as "**liberal market economies (LMEs)**" (on the following points see Hall/Soskice 2001a, Fioretos, Wood, Vitols – all 2001, but also Graham 1997), in that:

- "ownership" lies at the heart of all economic activity, and hence there is little co-ordination of market relationships and limited state intervention in the economy;

- the job of effecting co-ordination for the economic players is performed by highly deregulated markets (just what Adam Smith meant by his “invisible hand”);
- businesses themselves are unable, or barely able, by means of co-operation and co-ordination, to supply the economy with “public goods” or with basic supply-side goods such as vocational training and basic research and development, or to create the conditions for long-term financing;
- for this reason, businesses (in the UK mainly small ones) recapitalise on the stock market and are therefore dependent on expectations of short-term stock market gains. They prioritise profitability rather than growth and employment, and their “corporate governance” structures (single board, transparent accounting, managerial - CEO - responsibility and remuneration) are geared to the capital markets or to the shareholders’ information requirements and decisions. Employee participation is unheard-of, both on the shop floor and on the board; shop stewards are viewed as opponents;
- the level of membership of employers’ associations is low; as social partners, these associations are either weak or non-existent, and at the same time the trade unions, where they exist - in the USA there are completely “union-free regions” (see Katz/Darbshire 2000) - are organised in a highly pluralistic fashion and overwhelmingly conclude (voluntarist) collective agreements at company level;
- this has in turn led to the economy being structured in such a way that industry (!) is on average characterised by low-level, “common or garden” qualifications and poor wages, and consequently an extremely hierarchical company organisation, the use of university graduates even in skilled technical posts and as junior managers (see Bosch/Knuth 2003), and in some cases huge wage differentials:

“Where marketable skills, long-term finance, encompassing employer and labor organizations and investment in technological development are absent, firms are

forced to concentrate on products that can be produced at low costs using standardized production methods” (Wood 2001, p. 250).

Nor does this picture conflict with the simultaneous existence in the British and especially the US economy of sectors which produce high-tech goods using highly qualified workers,¹ because

- owing to their extreme dependence on the stock market (including access to venture capital) and the great flexibility of the external labour market, large companies in the UK and the USA are able to invest rapidly in product innovation with the aid of venture capital (e.g. in the pharmaceutical sector and in financial services - see Vitols 2001 - or in the high-tech field in the USA): to this end they buy in the requisite skilled labour at high cost on the labour market or even develop and maintain “internal labour markets” within companies (protection against dismissal based on the principle of seniority; generous pay packages for the highly skilled).

Germany, on the other hand, with its “Rhineland capitalism”, bears all the hallmarks of a typical “**co-ordinated market economy (CME)**” (on this point see Hall/Soskice 2001a, Fioretos, Wood, Vitols – all 2001 and Streeck 1997), in that:

- there is extensive structural co-ordination of economic activity between companies and associations through overlapping company shareholdings (“Deutschland AG” -

¹ It is however debatable whether or not the British economy can still be referred to as a “low-skill, low-wage” economy, as regularly happens in the rather idealised terminology of VoC analysis, given the large proportion of sectors in the UK requiring high-level skills (European Commission 2001). A theoretical approach based on a labour market segmentation or on a “dual labour market” - an approach developed in the USA against the background of its own “dual economy” - would probably be more telling. Nonetheless, the European Commission’s current report on employment in Europe, to which we refer here, says nothing about the actual mix of skills in the above-mentioned sectors, referring only to an increase in employment in “high-education sectors” (European Commission 2001, pp. 32 -34). Any comparison with sector-specific figures for Germany would have to take account of the fact that Germany’s commercial service sector lags behind that of the UK, and of the distortion introduced by the situation on the east German labour market.

Germany PLC), through the banks' controlling role in the form of company shareholdings and through the semi-public functions of corporatist associations, the trade unions and the state in research, social and industrial policy;

- some 90% of German companies are organised in federations of enterprises (trade associations and employers' organisations), and it is compulsory for all companies to belong to Chambers of commerce and industry. Furthermore, to take the metalworking industry as an example, the employers' organisations represent firms employing over 60% of all workers, while the Federation of Employers' Associations, according to its own data, represents approximately 75% of all companies with 80% of employees in the private sector (see Jacobi 2003, p. 26). As employers, they must square up to three large and five small trade union organisations belonging to the DGB;
- generally speaking, collective agreements apply sector-wide throughout a given region (over 60%) and are normally adopted even by companies not belonging to these associations; the state has powers to order these agreements universally applicable;
- this network of companies, the state, semi-governmental institutions (e.g. the Chambers) and trade unions enables firms to solve problems of collective action through co-operation and co-ordination, and to secure the supply of "quasi-public goods" such as vocational training, research and development, long-term finance and the dissemination of technology:

"Capital coordination facilitates product market strategies which employ the collective goods it makes possible" (Wood 2001, p. 249).

- Companies are able to do so because they are primarily reliant on long-term bank loans (from their own bankers) or, as corporate enterprises, on shareholders - the

big banks (which manage the investment portfolio), the state or insurance houses - which perceive their role in the light of long-term company policy. In other words, they are stakeholders and utilise their capital strategically. Because of the separation between the supervisory board and the management board, and thanks to employee participation (works councils and worker representatives on the supervisory board), company policy is directed towards multiple **long-term** goals (profitability plus a combination of company growth and security of employment).

- The dual system of training (vocational training comprising both general and sector-specific knowledge) is organised on a co-operative, tripartite basis. This, combined with protection against dismissal, not only enables companies to invest in upskilling the workforce without fear of “poaching” but also, given the rigidity of external labour markets, leads to greater *internal* flexibility within companies (see Bosch/Knuth 2003), which forms part of the basis for high-quality, export-oriented production.²
- It follows, then, that companies develop incrementally a process of innovation as a quality-based competitive strategy, which is why Germany lags behind in the field of high-tech production but is able to focus on “medium-tech” production in manufacturing industry.
- It is also true that in Germany (as in other CMEs) not only are skill and wage levels relatively high, but in comparison with the USA and the UK the wage spread is relatively low - not least on account of the trade unions’ pay policies and the redistribution effected by the welfare state.

² This depiction of the German labour market as being dominated by skilled labour, with a strong focus on the capital goods sector of industry and clearly in this case also on large enterprises, is disturbing to readers - at least those who are familiar with Germany’s labour market - and should not be allowed to obscure the fact that many branches of the consumer goods industry and the service sector do of course constitute a sizeable segment of the labour market, where Fordism and unskilled, low-wage labour prevail: some five million jobs fell into this category in 1990. The EU Commission’s statistics for knowledge-based sectors of the European labour market in 2000 place Germany only in a middle-ranking position, calculated according to the percentage of people employed in them (see European Commission 2001, p. 31 ff.). Streeck’s often-repeated thesis concerning Germany’s “high-quality, high-qualification, high-wage” economy likewise suffered from a one-sided concentration on industrial skilled labour, even though there is some truth in this thesis as concerns the capital goods manufacturing industry, a key sector, and the export industry.

Each type of economy, as Hall/Soskice put it, has its own specific *institutional balance* made up of a network of specific institutions (practices, norms, rules, market relationships, forms of corporate governance and trajectories of technological innovation), which are closely interwoven and often complementary. This in turn has led, for both types of economy examined here, to very specific forms of institutional balance which cannot simply be replaced by "importing" an alternative model (see also Boyer 1997 p. 92 ff.).

This undoubtedly over-simplistic and idealised description can likewise be applied, albeit in a less exaggerated form, to other continental European CME economies such as the "statist" capitalism of France or the "social-democratic" capitalism of the Scandinavian countries, which cannot be explored in any further detail here.

III Changes in the variants of capitalism under pressure from globalisation

The stability of CME forms of capitalism was first called into question with the publication of Michel Albert's book "Capitalisme contre Capitalisme" (1991). Albert argues that, as globalisation progresses, the LME type - and hence the market-based capitalism of the USA and the UK - will gain the upper hand over economies of the CME type, which are too inflexible and "sclerotic" to cope with globalised markets (functional convergence - see Streeck 1998), even though it is admitted (e.g. by Albert 1991 and Streeck 1997) that the CME type is considerably more successful in social terms. The debate has identified two "fault-lines" in the CME model: firstly, the internationalisation of money and capital markets, combined with internationally integrated production, significantly increase the "exit options" for companies (A.O.Hirschman) as compared with national systems of regulation, which are thereby placed under stress; secondly, "shareholder value" practices on the part of banks and enterprises are becoming ever more prevalent under pressure from worldwide financial markets and international competition

on the commodity markets. Both factors ultimately undermine and erode the institutional embedding of CME capitalism.

The opposing thesis, put forward by the authors of the "Varieties of Capitalism" approach, who do not deny the threat posed by the process of globalisation (see Hall/Soskice 2001a, p. 56 ff.), is that the enhanced competition resulting from globalised markets will tend rather to cause the comparative advantages of the different systems to become more pronounced; for this reason, the consequence of internationalised markets will not be convergence but divergence. This may appear to be merely an academic issue, but the response has far-reaching implications in respect of politics and the prospects for social development: after all, the institutional balance on which Hall and Soskice base their assumptions is formed in essence by the continental European social model, industrial relations and basic social consensus. These elements may have to be shelved if the Anglo-Saxon type of economy were proved superior to the CME type and had to be "taken up".

The following questions arise from the foregoing:

- *What are the (economic and political) factors which favour a take-up of the Anglo-Saxon model?*
- *And what are the counter-arguments, and/or what development trajectories are likely in the light of a confrontation between the two models or forms of institutionally embedded economies?*
- *Is it a matter of divergence or convergence - or of "converging divergences" (Katz/Darbishire 2000)?*

There is no disputing the fact that the conditions for the CME variant have changed since the 1990s, even though one need not go along with the “strong” globalisation thesis repeatedly propounded by Wolfgang Streeck in this discussion to justify his scepticism concerning the future of the CME variant. I should like to explain this, against the backdrop of an increasingly Europeanised and internationalised economy, in terms of six factors of institutional change which will be considered primarily in relation to Germany as a prototype CME:

- 1) developments on (national and international) commodity and capital markets,
- 2) the ensuing changes in structures of corporate governance within corporate enterprises,
- 3) the transformation in management career structures and the composition of management in corporate enterprises,
- 4) the significance of the service sector (and in particular the knowledge society),
- 5) the external political influence of EU integration and enlargement, and
- 6) the role played by (national) politics and politicians in the economic arena.

All these aspects are closely connected or interdependent and are separated out here merely for analytical purposes.

IV Transformation of the CME variant “Rhineland capitalism” in the 1990s

Even Hall and Soskice (2001) view the change in financial markets and its effect on corporate governance structures as a threat to the institutional stability of the CME variant. The structure of corporate governance in German corporate enterprises has altered radically since the start of the 1990s, as revealed in particular by Höpner (2003) in his comprehensive empirical study assessing annual reports, balance sheets and a database of companies established by the Cologne-based Max Planck Institut für Gesellschaftsforschung. Höpner found that over a third of large corporate enterprises in Germany (33% in 1999) had altered their accounting practices to conform with international standards - IAS and/or US-GAAP. A similar

proportion was nurturing relations with investors - an early indicator of a shareholder value policy. At the same time, a clear trend was, and is, emerging towards a realignment of profit targets in the light of capital markets (for instance through the concept of "discounted cash flow"), and management salaries were increasingly being left variable and made performance-related. All the authors cited by Höpner are unanimous that "*during the 1990s large German companies are clearly tending to gear their operations to capital markets*" (Höpner 2003, p. 53).

A number of internal and external factors lie behind these indicators of increasing capital market orientation and hence short-termism (see Höpner 2003, but also Nölke 1999, Lütz 2000, Jürgens *et al.* 2002):

Firstly, the Europeanisation and internationalisation of trade and production, in combination with benchmarking practices, has intensified competition to a growing extent. Management regards shareholder value policies as a suitable means of withstanding this competition by focusing on the core business and introducing competition within the company. Foreign-based employees rose from 17% in 1986 to 27.6% in 1996 as a proportion of total employment in the 100 largest companies, while turnover abroad rose twice as sharply as domestic turnover during that same period (Höpner 2003, pp. 85 & 87). This internationalisation of production places companies under more intense pressure of competition, especially since this competition is shifting more and more from being complementary to being substitutive (see Hübner 1998); thus the traditional ability of Germany's exports to compete on quality can no longer be dissociated from competition on grounds of price. Cost and profitability goals have evidently been redefined as a result of the shareholder value approach.

Secondly, there are corresponding **changes in the financial strategies of shareholders in corporate enterprises**, which in fact - as rightly pointed out by Jürgens *et al.* (2002) - constitute only a comparatively small proportion of companies in Germany. In this regard the "Trojan horse" of the LME variant in Rhineland capitalism clearly takes the form of a dramatic transformation in the big banks' strategies concerning investment business on the one hand and, on the other, the growing importance of institutional investors (investment funds etc., as is emphasised in particular by Jürgens *et al.* 2002). Although there has been no fundamental shift in ownership, the big banks - which administer a sizeable part of the investment portfolio in Germany on account of their proxy voting powers - are relinquishing their holdings in order to release liquidity for investment business, and are managing their shares in "special funds". They therefore become "institutional investors" in the strict sense of the term: i.e. rather than investing strategically, they aim for short-term profitability and no longer show any loyalty towards companies. The proportion of similarly minded international institutional investors is rising simultaneously - several corporate entities now have over 20% of foreign holdings. The consequence of both these trends is that capital market orientation increases, the diversified companies typical of Germany's high-quality production come under pressure (suspicion of cross-subsidisation), and the goal of growth and employment is sidelined by that of short-term profitability. Along with growing capital market orientation and stock market capitalisation, with the big banks' loss of strategic direction and legislative simplifications (e.g. the law making it easier to raise capital), there is a growing likelihood of hostile take-overs: shareholder value policies are therefore increasingly regarded by company managers as a precondition for successfully rejecting take-over bids (on this point see Höpner 2003, p. 104 ff.). Another aspect of change, as yet impossible to assess, relates above all to small and medium-sized enterprises (SMEs), which employ approximately 80% of the workforce and produce just over 50% of GDP: the strategic changes made by the banks,

from local banks to investment banks, coupled with the Basle II Agreement, make it more difficult for chronically undercapitalised German SMEs to borrow funds. The co-operative relations which previously facilitated long-term profitability goals in this sector, as in others, are thus increasingly being overshadowed and rendered impossible by short-term commercial calculations.

Thirdly, the growing capital market orientation of companies not only necessitates short-term calculations of profitability at the expense of the classic trio - profitability, company growth and employment growth; it is apparent at the same time that **management personnel structures** are undergoing rapid change. Whereas it had been typical in large companies under Rhineland capitalism for top managers to come from within the company (internal promotion) and mostly to have completed a technical (higher) education, during the 1990s a dramatic transformation took place both in the composition of management and also in the ratio of technical staff to business economists and lawyers (see Höpner 2003, p. 123 ff.). First of all, the extent to which the top managers of large German firms sit on the supervisory boards of other large German firms halved during the 1990s in the fifteen companies most involved in this practice; the average period of office of management board chairmen has been falling sharply since the mid 1980s (p.131); there are now more business economists than technical staff presiding over management boards, and the external labour market (i.e. outside the company) is rapidly gaining in importance when it comes to recruiting senior managers (p. 130 ff.). The predominance of economists, with their interest in finance markets, over technical staff and old-style entrepreneurs in the managerial echelons of medium-sized businesses since the mid 1990s has partly been accelerated by the emergence of a new generation of proprietors. This trend, also detected by Dörre in a regional economic survey of the industrial region around Nuremberg (Dörre 1999, p. 198 ff.), goes hand in hand with the implementation of shareholder value policies - strict

pursuit of profit rather than growth, elimination of cross-subsidies, profit centres - sometimes resulting in the destruction of regional networks and undermining employee participation and co-management by trade unions and works councils.

The above-mentioned elements of change in the structures of Rhineland capitalism under pressure from market globalisation bring together a series of arguments which have been formulated in criticism of the Hall/Soskice thesis that pressure from globalisation would cause the different variants of capitalism to further heighten their comparative cost advantages. The following three points, by contrast, highlight social and economic transformations which are not directly connected with the process of economic globalisation.

Fourthly, the co-ordinated variants of capitalism are analysed by Hall/Soskice (2001), and the authors whose writings they edit, mainly on the basis of institutions in the *industrial sector*. Such an approach is justified to a certain extent, since this sector has been and still is the dominant one in many respects, and since it feeds many segments of the tertiary sector on account of its high productivity. However, all modern labour markets in developed capitalist societies - including under Rhineland capitalism in Germany - have long been determined by the **tertiary sector** which, even in Germany, well-known as a "latecomer" on this scene, accounts statistically for over 60% of employment relationships and over 75% of economic activity. (Manufacturing industry excluding construction accounted for just 22% of the workforce in Germany as a whole in 2002, according to the latest Statistical Handbook - Statistisches Taschenbuch 2003, 2.4, our calculations). In certain spheres, e.g. insurance, transport and the wholesale trade, Germany's tertiary sector does include some corporatist-style institutions which are altogether comparable with those in the industrial sector, yet for the most part it consists of small and medium-sized firms. The rise in the number of small businesses and micro-enterprises and the growth of knowledge-based production in the tertiary

sector, where certain segments of the labour market are highly mobile, and with individualised and increasingly unregulated employment relationships, flexible external labour markets are playing an ever more crucial role in the tertiary sector. Relevant catch-phrases here are the “emergence of labour entrepreneurs” (Pongratz/Voss 2003) and the “process of removing labour constraints” or of “eroding the borderlines of work” (*Entgrenzung*)” (Kratzer 2003). These job markets, as labour market researcher Günther Schmid puts it, are more akin to those of artists than to traditional industrial labour markets. It can even be posited for Germany (see Baethge 2000 on this point) that these modern service sectors have remained underdeveloped or have been unable to develop sufficiently, by comparison with the USA and the UK, *because* these services are either still organised along industrial lines or governed by a regulatory system redolent of industrialism and hence of the institutions of Rhineland capitalism itself! The strength of the current discourse about the flexibilisation of (external) labour markets in Germany - a debate which calls into question the very foundation of the institutions underpinning the German CME - lies in the fact that it can identify modern segments of the service sector which do not conform to the regulatory mechanisms governing the industrial sectors of CMEs.

Fifthly, EU policies, in the form of the prevailing “negative integration” of the EU countries’ economic and social systems, are likely in the long term to constitute another key precondition for the transformation of CME variants of capitalism in the European Union. Precisely because the EU encompasses both LME and CME types of capitalism, and because the CMEs for their part have no common structures but consist of Rhineland, statist and social-democratic models, as well as various hybrid systems, coordination and harmonisation policies normally amount not to positive forms of regulation but to the lowest common denominator, i.e. market freedom on the basis of minimum standards. Even though this is not universally the case, in many instances it

can justifiably be argued that such developments bolster a shift in the direction of an LME variant, as is easily demonstrated by the policy of liberalising public services (which in many CMEs are a mainstay of the institutional embedding of economic activity). What is more, eastward enlargement is likely to further strengthen the position of LME attitudes and the resultant policies in the EU: the transformation countries have not of course had an opportunity, since the downfall of state socialism, to shape their own institutional structures for a market economy, and so for the time being the majority of them are setting up new structures based on ownership and the market. These structures have much more in common with radical market economies of the Anglo-Saxon type than with continental European forms of capitalism. In many central and eastern European countries, for example, the industrial relations systems which have emerged bear more of a resemblance to the pluralist, voluntarist system in the United Kingdom than they do to the systems of western Europe.

Sixthly, one final aspect is to be found at the level of (national) **politics and politicians**. The political players themselves - no doubt under pressure from the primacy of neoliberal discourse and with one eye on European integration - have taken major strides towards altering Germany's variant of CME (but Hancké (2001) recounts similar moves in France too). The Red/Green government has implemented tax reforms (e.g. the scrapping of capital gains tax) and laws to deregulate the financial markets (see Jürgens *et al.* 2002) which in effect dissolve "Germany PLC" and encourage banks and enterprises to adopt a shareholder value approach to corporate governance. Moreover, one element of the "Agenda 2010" draft legislation currently in the pipeline is to make external labour markets more flexible: in Germany, as in other CME countries, a policy of privatisation has weakened the state as a player - in the production of public goods and as a participant in bargaining systems - or has reduced its role to one of external regulation. This weakening of the government as a political player is matched

by the weakening of employers' associations, in that some employers are departing from organisations and others are not joining in the first place (especially in eastern Germany and in the tertiary sector) and the weakening of trade unions as a result of economic and social modernisation. The main "Trojan horse" in this field - to remain with this image - is the economic and organisational structures in east Germany which, just like the central and eastern European countries referred to above, has been unable to develop its own institutional means of bedding down a capitalist economy and is at the same time under enormous pressure of competition from a west German economy which is more productive than its own by at least 35 percentage points on average. The attributes of west Germany's corporatist model have so far scarcely taken hold at all in the east, and the economic basis for legislative regulation is (still) too weak, so that for business leaders it makes more sense to refrain from joining associations and subjecting themselves to the binding effects of collective agreements (see on this point Müller-Jentsch/Weitbrecht 2003, p. 195, tables 4 and 5). As for workers, who initially had high hopes of the trade unions, they lost heart because those unions were unable to forestall unemployment, and/or as unemployed persons they see little point in joining a trade union. For these reasons the degree of organisation among both employers and employees is very low in eastern Germany. Even irrespective of these difficulties linked to reunification, however, structural changes in the economy (tertiarisation) and the process of social modernisation (pluralisation and individualisation) caused trade union membership figures in Germany as a whole to fall from over 30% to just over 20% during the 1990s (see Müller-Jentsch/Weitbrecht 2003, p. 193). The same trend is evident in almost all continental European countries with the exception of the Scandinavian countries (see Waddington/Hoffmann 2000, p. 54) and already occurred in the United Kingdom under Thatcher. The problem is that this weakening of organisations may well mean that the main players in the continental European model of corporatism will cut loose! The same negative trend applies to employers' associations because of the

increasing difference between SMEs and large enterprises due to the modernisation of the German economy: the organisational coverage of employers' associations has been decreasing steadily for the last two decades: in the west German metalworking industry, for example, the organisational coverage slumped from 65% (1965) to 56% (1984) and then further still to 35% (1998). What is more, there is a growing tendency among SMEs to leave these associations and thus to break up the alliance between firms of differing sizes within the German corporatist system (Schroeder/Silvia 2003, p. 261), a tendency which threatens the very core of the German corporatist model.

If we consider these six manifestations of change in the German model of capitalism all together, a process of convergence in the direction of an Anglo-Saxon-style "liberal market economy" would appear to be the obvious consequence. Yet, while not denying the changes, a more detailed analysis which embraces important pillars of the Rhineland model of capitalism, such as employee participation, arrives at different conclusions. Such an analysis will be conducted below, with the aid of various examples and at various levels.

V Change as a process of convergence between variants of capitalism?

The question we asked at the outset was whether or not Europe is adopting the market-based model of capitalism. In the light of the trends highlighted above, using "Rhineland capitalism" as a case study, the answer would appear to be clear-cut: rapid changes underway during the 1990s were leading in the direction of a form of capitalism geared to the capital market. This capitalism has gradually come to more closely resemble the LME variant, especially since both internally (development of the "knowledge society", government policy of liberalisation, loss of power by major players) and externally (EU negative integration) there were additional determinants making a change of course inevitable. At least from the point of view of the editors of "Varieties of Capitalism", who define institutions in functional terms, such a conclusion would seem empirically compelling, in contrast with the (optimistic) position

formulated in their introduction. However, such a narrow, functional vision not only ignores the socially and culturally determined "inertia" of institutions and the fact that it renders radical changes of course unlikely (the effects would moreover be disastrous), as Höpner argues. It likewise ignores the fact that institutional transformation is not necessarily tantamount to a radical change of course, but that mixed forms (described as "hybrids" by Höpner 2003, p. 210 ff.) can arise in certain places, altering the existing structures and/or equipping them with new or modified functions. This process can be illustrated by referring to the case of industrial relations, looking first of all at employee participation and then at collective labour relations.

It can in fact be asserted that both elements of industrial relations in Germany have survived the change as institutions, while having had to modify their functions: employee participation has been given an overwhelmingly positive verdict, even in recent surveys of company managers (see Frick *et al.* 1999); furthermore, large enterprises, portrayed here as the drivers of change, are not challenging the regional sectoral collective agreement, as became apparent from various statements made concerning the collapse of the IG Metall strike in east Germany. The function of both these elements has however altered: at crucial moments of decision-making in corporate enterprises about the transition to a shareholder value policy, the protagonists in employee participation - works councillors and members of the supervisory board - have come out in favour of this change, as shown by Höpner (2003, p. 150 ff.). In the Mannesmann case, for example (when vodaphone successfully made a hostile take-over bid for the mobile telephone branch of Mannesmann), employee participation was in no sense "a 'poison pill' to prevent the take over" (Jürgens *et al.* 2002, p. 55): what the worker representatives were keen to do was preserve and strengthen the company's core production, which often also represents the core workforce and hence the people responsible for electing employees to sit on works councils and supervisory boards. It could be said that we are seeing here elements of a selective corporatist policy, which were already regarded by Esser (1982) in the 1980s as typical of post-Fordism. What has also become apparent is that conflicts of

interest have often caused workforce representatives to ally themselves with shareholder representatives in opposition to management (for instance in respect of corporate transparency and determining profits). There are indications here that the role of employee participation is being modified into one of voluntarist representation. The regional sectoral collective agreement likewise still remains a component of Rhineland capitalism, one which does not in essence appear to be under threat even from developments in east Germany, as noted by Schroeder (2000) in his study - albeit before the dramatic collapse of the strike in the east German metalworking industry. It has however been adapted to the new *status quo* by means of extension clauses and has therefore retained its capability to effect regulation on a basis of co-operation in a changed environment (p. 389). In this sense the changes in Germany have mirrored those in the other continental European countries, which have been investigated empirically by Traxler *et al.* (2001, see also Hoffmann *et al.* 2002): pay settlements are rendered flexible and adapted to growing economic discrepancies thanks to extension clauses; in contrast to the market-based model, it is a matter here not of deregulation but of controlled decentralisation. In both cases the trade unions have been obliged to distance themselves to a certain extent from a strategy founded on solidarity; in both cases the institutions of the CME model have been preserved and have undergone functional change, without the UK or US model having been adopted.

In this respect - but other examples could be found in fields such as the dual training system and research policy - what emerges is that the CME variant "Rhineland capitalism" is indeed under pressure and undergoing a transformation, but that - for the time being - this change is leading neither to a reinforcement of "comparative advantages" nor to a convergence towards the Anglo-Saxon variant of LME capitalism. Similar conclusions are moreover reached by Jürgens *et al.* 2002, who observe a gradual and ambivalent process without a "big bang" effect in Germany (p. 54). The survival of institutions as important as the industrial relations referred to above could even prompt a completely different conclusion: precisely because

globalisation has significantly heightened market instability (causing Susan Strange to speak of “casino capitalism”), the institutions of co-ordinated market economies (CMEs) offer a degree of security³ and are not simply being sacrificed on the altar of the market. Even comparative empirical investigations of the “knowledge society” segment of the service sector (see Christopherson 2003) have demonstrated that, even though this sector does indeed require flexible labour markets, creativity and innovation can be fostered at the same time, as long as mobility does not mean that a person’s dismissal brings about his/her downfall; rather, an institutional network of social security - not protection against dismissal! - ensures that creativity can be preserved in the long term in a context of mobility or even within “unregulated” labour markets. The model of “transitional labour markets”, for which the labour market researcher Günther Schmid argues, would be one solution arising out of the system itself (see Schmid 2002). His surveys, funded by the BMBF, call for a new balance between modern service activity and modified forms of regulation (new and complementary welfare systems); similar findings emerge from the working party on developmental trends in Germany’s service sector (Arbeitskreis “Entwicklungstrends im Dienstleistungsbereich” 2000).

Thus the continued existence of institutions does not rule out changes in these institutions and the emergence of new hybrid forms. Höpner’s (2003) allusion to grey areas in the evaluation of change is apposite; although of course stark black and white images have never yet depicted reality, but have at most only helped to explain it.

³ It is no accident that where a similar degree of security is *not* provided through institutional involvement, namely in LME forms of capitalism, multinational enterprises are taking the initiative themselves and adopting codes of conduct or corporate social responsibility (CSR) standards as uniform, certified methods of embedding economic activity into society. In this way they gain a certain amount of security in unstable consumer markets (threats of consumer boycotts) and can guard against potential action by trade unions.

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