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# Workshops

## Proceedings of OeNB Workshops

# *The Transformation of the European Financial System Where Do We Go? Where Should We Go?*

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# Editorial

Over recent years the transformation of financial systems has been the subject of many economic, legal and political science studies. In the past, most of the theoretical and empirical literature concentrated on a separate analysis of efficiency aspects, policies and institutions. Meanwhile, an alternative view has gained importance, namely to consider economic systems as a set of complementary institutions (Hall and Soskice 2001). In this view, financial structures are but one subset of institutions governing economic activity. They are significant to the extent that considerable changes in financial structure are often alleged to set off adjustments in other institutional areas such as labor and product market institutions, affecting the degree of corporatism, industrial relations and the distribution of income, wealth and risk in the society.

This volume puts together papers discussing the positive and normative aspects of the convergence of financial systems.[1] The financial systems of many European countries have experienced some changes during the past two decades. The most obvious trends are the diffusion of financial market-based corporate governance criteria, a decrease in state ownership as well as a growing role of institutional investors. However, those changes have contrary to expectations not yet spurred a major convergence towards a financial market-based system.

In his introductory overview of the literature, *Peter Mooslechner* reviews the main findings of the recent research on the impact of financial structure on economic efficiency and discusses two broad issues: first, whether convergence towards the U.S. model will take place, and, second, whether this is desirable. The answer to both questions, he concludes, is highly uncertain depending on one's view regarding the interaction of markets and institutions. *Bruno Amable* provides an overview of financial systems' diversity. He investigates not only indicators of financial structure, but also the pattern of control (internal versus external control) and its implications for corporate governance. Looking at cross-country differences in some indicators of financial structure, he finds that the trend towards increased disintermediation - observed since the mid 1990s - can almost entirely be accounted for by the rise in share prices. Furthermore, *Amable* studies the links between financial systems and characteristics of

[1] Workshop of the Oesterreichische Nationalbank on "The Transformation of the European Financial System. Where Do We Go – Where Should We Go?", held on June 20th 2003.

political systems. He shows that partisan politics are correlated with financial systems, and he presents evidence that the political system (majoritarian versus consensus-based) is also related to the financial system. *Markus Knell* notes that the paper of Amable is part of a strand of literature that considers many determinants (law, politics, …) of financial systems' diversity. But in principle, he adds, one could also argue that neither law nor politics may be regarded as the fundamental cause, but that culture shapes both the legal and the political structures of an economy.

*Ekkehard Ernst* studies the interaction of the labor and the financial markets. Cross-country differences in policies and institutions on labor and financial markets are more and more acknowledged as key drivers behind countries' performance divergence. His paper offers an empirical investigation of industry growth among OECD economies. He considers industry growth as a function of complementarities that may exist between financial and labor market institutions. Various measures of financial and labor market characteristics in 19 OECD countries are used to construct interaction terms to measure the impact of these characteristics - and their combinations - on industrial activity. A systematic relation between certain institutional combinations and the type of industry that prospers in a particular country can be found: Industries showing more needs in flexible relations with stock- and stakeholders are significantly more active in countries with a combination of dispersed ownership and flexible labor relations. On the other hand, industries in need of stable relations between various financial investors, management and the workforce can prosper better in countries displaying a combination of stable labor relations and concentrated ownership. *Jürgen Janger* comments that Ernst's finding is important, because approaches focusing on institutional complementarities have up to now provided little econometric evidence in favour of their claims, while approaches focusing on the impact of only one set of institutions on growth have provided a lot of yet inconclusive evidence. Further research is needed to link Ernst's findings on industry growth to aggregate economic growth.

Two contributions remain that are rather cautious towards the notion of institutional complementarity. One paper studies the concept from a theoretical perspective and the other one examines it by looking at a case study. *Wolfgang Streeck* argues that the concept of institutional complementarity makes demanding assumptions on the rationality of the actors and that it suggests too static a view of institutions. His point is that the extent to which one institution complements another is fundamentally uncertain. The institutions thought to be made complementary by design are themselves only vaguely defined. The environmental demands on the performance of social and economic systems are not static and in fact change in often unpredictable ways. But complementarity is not just an uncertain but also a moving target, because long-time lags make their elements less tightly coupled than functionalist theories suggest. And institutions also depend for their performance on an unpredictably changing environment that is the ultimate arbiter as to whether or not and to what extent their institutions are complementary. Mostly actors do not have enough information to pursue institutional complementarity, and therefore tend to pursue other objectives that are less demanding on their cognitive capacities.

*Helene Schuberth* and *Martin Schürz* share Streeck's sceptical view about the notion of complementarity. They investigate whether financial governance modes within the U.S. financial system are coherent by studying governance mechanisms for groups of society with different resources, namely chief executive officers (CEOs) and the poor. The governance mechanisms for CEOs aim to align the interests of shareholders and managers. Rent seeking by managers is combated by efforts to strengthen social responsibility. Governance relies on fostering individualistic rent seeking behavior and on restricting such behavior by a specific social value system, which may be seen as a conflicting set of governance modes. The governance mechanisms for the poor aim at increasing the knowledge of the financial illiterate. This neither ensures sound financial behavior nor the integrity of financial institutions. Knowledge as a substitute for consumer regulation shifts the responsibility to the individual and creates the paradox of informed but powerless consumers.

These proceedings are the first among others to follow, publishing contributions to our regular workshops that bring together academics and policy makers addressing key policy challenges. The workshop on "The Transformation of the European Financial System" is the fourth of a series of workshops dealing with issues of financial markets and the macroeconomy.[2] We hope these proceedings will contribute to a better understanding of the mechanisms linking financial structures to other institutional features of economies. With this broader interdisciplinary perspective going beyond the narrow research focus of the economics profession we also hope to have provided some new insights regarding convergence of financial systems in Europe.

Helene Schuberth
Martin Schürz

Hall, P.A. and D.W. Soskice (eds.) (2001), 'Varieties of Capitalism. The Institutional Foundations of Comparative Advantage', Oxford: Oxford University Press.

[2] 'Aspects of the Transmission of Monetary Policy', November 9, 2001 (published in OeNB Focus on Austria 3-4/2001); 'Pension Finance Reform: From Public to Financial Economics', December 6, 2002 (published in OeNB Focus on Austria 2/2003) and 'Finance for Growth', January, 27, 2003 (published in OeNB Focus on Austria 1/2003).