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Where Should We Go?*

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# Comment on: Bruno Amable, “An Overview of Financial Systems’ Diversity”

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*Markus Knell (OeNB)*

## 1. Introduction

The paper by Bruno Amable sets itself the task to give an „overview of financial systems’ diversity“. Rather than offering a mere survey of the existing literature, it goes beyond such a more “enumerating orientation” and adds interesting facets to the established wisdom in this area. Since it is notoriously difficult to discuss an overview paper in a satisfying manner (and rather uninspiring to point to the inevitably missing pieces and underemphasized aspects) I will concentrate my short remarks on the genuine contributions of the paper. Before turning to these issues in section 3 I want to briefly summarize the main results of the article in the following section.

## 2. Summary of the Main Results

Bruno Amable focuses primarily on two dimensions along which financial systems differ: sources of finance (bank-based vs. market based systems) and corporate governance (internal vs. external control). In the first part of the paper Bruno Amable presents some empirical evidence about cross-country differences and the development over time. Generally one could not observe a trend towards disintermediation over the 1990s (and even less so if the measures are corrected for increases in share prices).<sup>1</sup>

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<sup>1</sup> As an aside – given the place of this publication – it is interesting to note that the data

In order to analyze the second dimension of financial system diversity—corporate governance – Bruno Amable undertakes a principle component analysis (PCA) based on various indicators that were collected and developed by La Porta et al. (1998). The first factor that comes out of this analysis clearly represents the dichotomy between internal and external control (or concentrated vs. diffuse ownership). The second factor is (less clearly and somewhat more multifariously) related to transparency, enforcement etc.

The PCA identifies – implicitly – three clusters of countries, where the first one represents insider-control (or market based) systems (Anglo-Saxon countries and Japan), while the third cluster comprises outsider control economies (Southern European countries, Germany and Austria). The second cluster (Scandinavian countries, France, Switzerland and Ireland) lies somewhere in-between although it is closer to the outsider control group.

In the second part of the paper Amable tries to assess what lies behind the diversity. First it is shown that the clustering broadly corresponds to legal traditions (in the spirit of La Porta et al.). He goes, however, beyond this comparison and also analyses whether politics and characteristics of the political system might be associated with the financial systems that emerge in different countries. In a first step it is shown that partisan politics are in fact correlated with financial system diversity (diffuse ownership is associated with right-wing political forces). In a second step the author presents evidence that also the political system (majoritarian vs. consensus based) is related to the financial system (although more to the second factor of the PCA than to the first).

### 3. Comments and Discussion

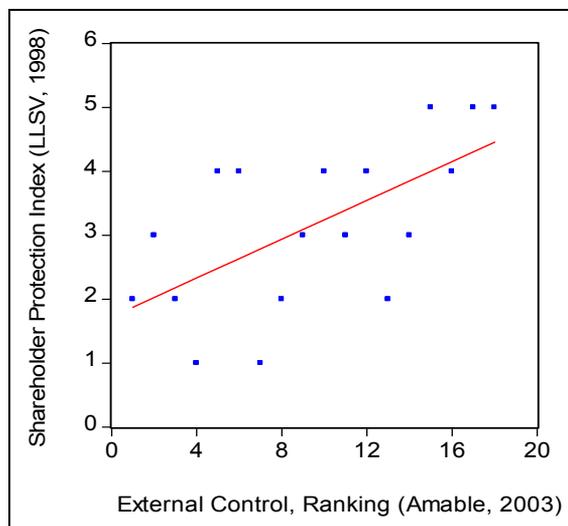
The starting point for my brief comments on the paper is the observation that over the recent years a large and growing body of literature was produced that deals with issues of financial system diversity. In this

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indicate that among all countries analyzed Austria is the one with the highest degree of intermediation.

literature many factors and dimensions are mentioned and analyzed that could be responsible for or at least contribute to this diversity: sources of finance (bank-based vs. market-based), corporate governance (internal vs. external control, shareholder rights, ownership structure), regulation and supervision, openness to international financial flows etc. In a way there is a *diversity of diversities* and it would be interesting to have a more extensive discussion of whether and why the two dimensions singled out in the paper are the most important ones. Even more interesting would be to offer some comparisons of the evidence and conclusions presented in the paper and the established (and sometimes conflicting) results of the widespread literature. This could be helpful in assessing whether the different methods, focuses and data sources lead to similar results, thus contributing to the emergence of “stylized models” of financial systems. I have undertaken a tentative analysis along these lines by contrasting the results of Bruno Amable with the famous shareholder protection index (SPI) by La Porta et al. (1998).

Chart1 is a scatter plot of the rank that countries hold with respect to the first factor of the PCA (the external vs. internal control dimension) versus the SPI. As is evident from the picture (and shown by the regression line) there is a clear positive relation between the two measures thus confirming the results of the PCA. Furthermore, one can calculate the average SPI for the three clusters of countries. Again the results are broadly in line with each other since the SPI is highest for cluster 1 (4.6), followed by cluster 2 (3.0) and cluster 3 (2.16). Of course these results are not particularly surprising (especially since similar data sources are used) but it is nevertheless comforting that different methods and approaches lead to compatible results.

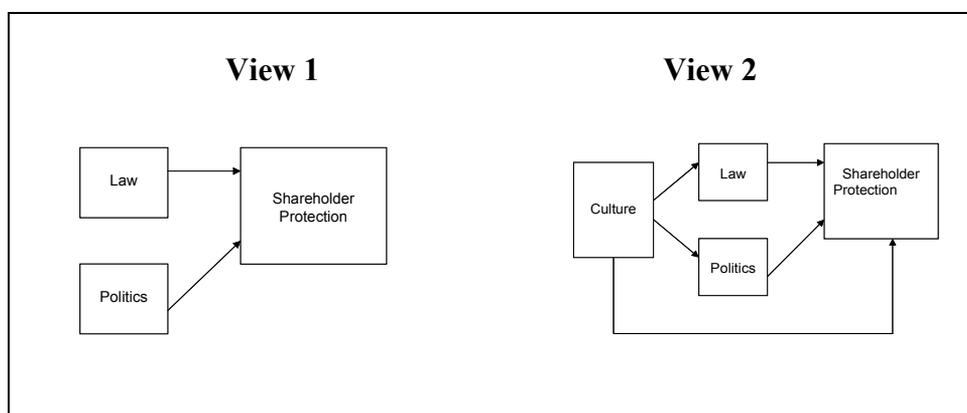
*Chart 1: External Control vs. Shareholder Protection*

The topic of the second part of the paper touches on various deep and difficult questions: What lies behind the diversity of financial systems (or even behind the diversity of diversities)? Why do we observe one constellation of institutions in country A and another one in country B? What are possible explanations for the diverse patterns? Bruno Amable broadens the traditional focus on issues of legal origin and turns the attention to aspects of the political system. This is a highly interesting extension of the existing approaches and delivers new results about the connection between partisan politics, political structure and the financial system. Nevertheless the findings of the paper should probably be regarded as only a first pass on this topic and it would be rewarding to have more research along these lines. I want to list some of the open question in this area as I see them.

- The paper is rather mute on the question of whether politics is the basic, moving force behind the main economic and social developments that lead to the emergence of differentiated financial systems or whether legal origin (perhaps together with the political system) shapes the institutional structure of a country. Put differently it is not clear in the article whether the assumption is made that there is a *causa prima institution*, a first institution or factor to which all other

institutional features can be reduced and on which a hierarchy of institutions can be built. In principle one could also argue that neither law nor politics is this *causa prima* institution but that rather a third factor – something like “culture” (comprising social preferences, “national characteristics”, historic specificities etc.) – shapes both the legal and the political structures of a country and its position on shareholder protection. These two alternative views are illustrated in a highly stylized form in Chart 2.

*Chart 2: Two Alternative Views on the “Hierarchy of Institutions”*



- Related to these aspects is the ever-present issue of simultaneity, endogeneity and reverse causality. It could, e.g., well be that it is not only politics that influence shareholder protection but that – the other way round – the existing legislation on shareholder protection has an effect (e.g., via lobbyist activities) on the political processes and outcomes. In the field of institutional analysis, where cumulative causation and complementarities abound, it is particularly important to take such possibilities into consideration.
- PCA does not seem to be well suited to deal with these aspects, since the groups of potentially explanatory variables are considered one at a time. I also have some difficulties in interpreting the results of these projections as “causal”, rather than as a representation of correlations. Altogether, I would find it interesting to supplement the results of the PCA with an empirical investigation that uses a multivariate framework. This could be helpful to deal with issue of simultaneous

influence of the legal and the political process (and of other possible factors) and to approach the topic of complementarities (although this is probably the subject of a separate paper or even an entire research project).

## References

- Amable, B. (2003). Workshop on The Transformation of the European Financial System Where Do We Go – Where Should We Go?
- La Porta, R., F. Lopez-de-Silanes, A. Shleifer and R. Vishny. 1998. Law and Finance. *Journal of Political Economy* 107. 1113-1155.