CHAPTER 2

POLITICS AND FINANCIAL MARKETS

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Over the past generation, financial markets have conquered the world. The number of countries with a local stock market doubled after 1985, and the market capitalization in emerging markets (formerly known as the "Third World") topped $5 trillion by 2006. The fall of the Berlin Wall was followed by the creation of thousands of new public corporations in Eastern Europe. Hundreds of millions of new investors began buying and selling company shares from Chile to China to the United States, and financial news became pervasive. The range of things traded on financial markets also expanded from stocks and bonds to mortgage-backed securities, collateralized debt obligations, and life insurance contracts for the terminally ill. Households found themselves participating in global financial markets as buyers (through pension plans and mutual funds) and sellers (through securitized mortgages, credit card debt, auto loans, college loans, and insurance). Homeowners in Poland took out mortgages denominated in euros to take advantage of lower interest rates, and car buyers in Hungary took on loans in Swiss francs to buy Italian cars, giving them an immediate financial interest in central bank policies. The surprising interconnections created by global finance became evident during the financial crisis that began in 2008, when pensioners in Australia and Norway learned that their financial security depended on the mortgage payments of delinquent property speculators in Florida, and taxpayers in the UK learned that the banks they had bailed out might be responsible for repaying defrauded investors in the United States.

Finance was at the center of the global economic crisis. Yet the impacts of the crisis were distributed in peculiar ways. Why was the United States devastated and not Canada? Why Iceland and not Denmark? Why Greece and not Turkey? Why the UK and not France? Why Ireland? The political reactions to the crisis also varied widely. The United States initially elected a substantially more liberal government, followed by an immediate right-wing backlash against "big government"; the UK went more

conservative and implemented vast budget cuts in education and social welfare, followed by its own backlash; and the Greeks took to the streets to protest government austerity measures. Finance and politics were connected in deep yet unpredictable ways across different economies.

The central argument of this chapter is that the structural organization of finance within a country reflects and shapes the organization of business and politics. By "structural organization of finance" I mean the ways that savings are channeled from households to businesses and other borrowers. This includes questions such as what are the mechanisms (e.g., markets, banks), who are the intermediaries, how is the banking industry organized, and what are the characteristic ways for corporations to raise financing. The structural organization of finance inherently implicates politics. One of the main stakes of politics is control of business, that is, who gets to control the decisions businesses make and how the fruits of business activity are divided. This is the domain of corporate governance—"the structures, processes, and institutions within and around organizations that allocate power and resource control among participants" (Davis 2005: 143). Although traditionally an obscure term of art used in law and business schools, corporate governance has recently become a central concern of scholars across many disciplines, including sociology, political science, economics, law, and business (Aguilera and Jackson 2010).

This chapter seeks to integrate some of the theoretical threads that have emerged from disciplinary studies of finance and politics. I first describe how finance varies around the world and some of the efforts to create typologies of national systems. Finance is organized in starkly divergent ways, even among the largest and most successful economies (e.g., the United States, China, Japan, and Germany), with banks, markets, firms, and the state taking on characteristically different roles (Zysman 1983). I then review research from several disciplines on how law and domestic politics shape finance, and how finance creates interests within the polity. Contributions in this area have come from diverse academic domains, from sociology and political science to law and finance, and researchers have put forward theories proposing rather different dynamics to explain the interaction of finance and politics (e.g., Carruthers 1996; Gourevitch and Shinn 2005; Hall and Soskice 2001; La Porta et al. 1998; Roe 1994).

I then shift to a discussion of how the practice of finance has changed with globalization over the past generation, and how the increasing size, scope, and reach of financial markets has altered some of the traditional "varieties of capitalism." The balance among different institutional elements—product markets, labor markets, education systems, social welfare provision—has shifted due to the expansive spread of financial markets across geographic and social space. Hypertrophied finance created policy challenges that were resolved (or not) in diverse ways around the world. Finally, I conclude with a brief discussion of the financial crisis that began in 2008 and its implications for how researchers should think about finance and politics.

Variation in finance around the world

In spite of the homogenizing pressures of globalization, finance is organized in quite diverse ways around the world. Businesses can raise funds through wealthy families, through markets, through banks, through interfirm networks, through retained earnings, and in many other ways. Some countries, including most industrialized nations, have substantial stock markets and well-developed banking sectors to channel savings to business. Yet even among the wealthiest economies there are stark differences in how finance is organized. Consider the three largest economies in the OECD. The United States has traditionally had vast capital markets, and the bulk of its corporations are publicly traded. In 2009, the market capitalization of public corporations in the United States totaled over $15 trillion—slightly higher than GDP that year, albeit one-quarter lower than it had been two years earlier. Corporate ownership is typically dispersed in the United States, with the largest single shareholder often owning less than 10 percent of a company's shares. Germany, on the other hand, has fewer public corporations than Pakistan—roughly 600—and large banks have traditionally held substantial stakes in even the largest public corporations. And Japan has many public corporations, like the United States, but their ownership was traditionally intertwined through cross-shareholding arrangements with other corporations.

The organization of finance correlates with many other aspects of a nation's economy and polity. Social democracies often have relatively large and concentrated banks, less prominent capital markets, and their corporations tend to have concentrated ownership structures in which a single family or group might own a dominant stake. They also have lower levels of inequality, and their leading industries often include manufacturing firms that require a specially trained workforce. English-speaking countries tend to have more dispersed corporate ownership and a greater reliance on markets for financing rather than banks. Vanguard industries might include biotech, software, and other innovative industries that rely on venture capital, and the high payoffs to entrepreneurs and financiers contribute to relatively higher inequality.

Scholars have proposed a variety of typologies to capture this correspondence. Among the largest economies, a simple dichotomy distinguishes between bank-based and market-based financing, exemplified by Germany and the United States (Zysman 1983). Political scientists drawing on a more extended set of dimensions distinguish between coordinated market economies and liberal market economies, with Germany and the United States again providing the paradigm cases (Hall and Soskice 2001). Yet another polarity that yields similar categories is the distinction between legal families, that is, countries whose legal systems were based on common law (primarily English-speaking countries and those that had been colonized by Great Britain) and countries whose legal systems were based on civil law (including most of Continental Europe and countries that had been colonized by France). The former have characteristically larger financial markets and stronger legal protections for small shareholders, while the latter

frequently have small or nonexistent financial markets and weaker shareholder protections. Such typologies often rely on a relatively truncated set of countries, most often rich Western countries, Japan, and Korea. Often left out of the analysis are Africa, Latin America, the Middle East, and much of Asia. But they do point to a set of dimensions that covary with finance.

As these typologies suggest, the connection between finance and politics implicates broader national economic systems. The organization of finance is a *consequence* of political decisions, a *stake* of political struggles, and a *source* of political interests and conflicts. It is a *consequence* because political struggles often result in constraints on finance (e.g., limits on the size, reach, and activities of banks) or in new possibilities (e.g., eliminating constraints on foreign investment). It is a *stake* because the organization of finance creates some of the basic ground rules over how the proceeds from business are distributed (e.g., in profits to shareholders vs. investments in worker training). And it is a *source of political interests* because actors' position in the system of business and finance shape who benefits and who has a voice in economic choices (e.g., capital gains taxes arouse different interests in a country with widely distributed stock ownership than one without). As we will see, political outcomes reflect not just finance but broader economic systems in which finance is embedded.

Finance and national economic systems

Financial markets have long played a critical but mercurial role in mediating between states and economies—"mercurial" because many aspects of financial markets elude direct control. In the late seventeenth century, England—with a limited monarch dependent on parliament for funds—developed financial markets, while France—with an absolutist monarch who could levy taxes at will—did not. Military technology had become costly at this point, and thus "War had become as much a test of financial strength as military power" (Carruthers 1996: 90). Because financial markets could raise the huge sums necessary for war quickly, Britain's military power was enhanced by its financial markets, while France was weakened by their absence. State power, in short, depended on systems of finance, and financial markets were enhanced by limits in state power. Within a few decades Britain had become a global hegemon, projecting military power around the world and extended its empire and laws to far-flung colonies. Moreover, it had developed a set of institutions to support financial markets that comported well with its system of common law (Carruthers 1996).

The organization of finance also had direct implications for the state's ability to guide the economy. In *Imperialism: The Highest Stage of Capitalism*, Lenin ([1916] 1939) surveyed a set of wealthy economies and concluded that industrialization and industry consolidation had led to a situation in which a few banks, through their control of critical oligopolies, occupied the commanding heights of the economy. Concentrated finance created concentrated economic power, particularly within Germany and the

United States. Thus, taking control of a nation's largest banks was tantamount to taking control of the economy—at least in the most advanced industrial economies. The format of finance, in short, shaped the capacities of states to intervene in the economy.

Subsequent political theorists built on this basic insight to unpack the links between states, finance, and business in different economies. Zysman (1983) argued that the organization of the financial system determined what levers government officials had over business, and thus how states might guide responses to industrial crises. He distinguished three main types of financial systems corresponding to the three largest economies at the time. Each format implied a different repertoire of policy strategies available to the state. In the United States the financial system was organized around financial markets with competitively established prices. In this situation, state and industry had an arms' length relation. Companies led the process of industrial adjustment, while the state had very little leverage to guide industrial policy through finance. Japan had a credit-based financial system with government-administered prices that allowed government intervention in industry, and thus the state led industrial adjustment. Germany featured a credit-based system in which autonomous financial institutions had a preponderant influence on industry. This created a style of industrial adjustment that entailed negotiation among major social partners, including government, banks, companies, and often labor.

This argument also suggested a potential model of national economic development. Countries that industrialized late—in this case, Germany and Japan—tended to have credit-based systems rather than market-based systems. Late development reduces some of the uncertainty around industrial planning: when the path to industrial development is already known and the best technologies and practices have emerged, it is more feasible for policymakers to seed the development of firms in critical industries that meet global standards. That is, a developmental state can guide industry through targeted finance through banks, acting as a surrogate for undeveloped financial markets. Thus, Evans (1995) describes how Korea, following the lead of Japan, rapidly industrialized by channeling finance to companies in keystone industries such as steel, shipbuilding, autos, and electronics, reinforcing dense links among the state and industry (and earning the nickname "Korea Inc."). By the 1990s, Korea had become one of the dozen largest economies in the world and participated in a variety of vanguard industries, while the former "developmental state" had substantially stepped back from its directive role in the economy.

The configuration of finance shapes the policy repertoire available to states to influence the economy. But late development alone cannot explain why finance looks the way it does around the world. During the decades after Zysman wrote, dozens of countries have opened stock exchanges. In 1990 China reopened its first stock market since the 1949 revolution, and by 2006 it was among the world's largest—in a country still communist in name. Where did these configurations come from? And how do they change, if at all?

One influential perspective came out of the "law and economics" school. In an important series of articles published in the late 1990s, four financial economists claimed that a

country's system of law had a permanent effect on its financial system, largely through its influence on the legal protections available to "minority" (noncontrolling) shareholders (La Porta et al. 1997, 1998, 2000). Legal systems can be classified along many dimensions, but a broad distinction applicable to most advanced economies is between civil law and common law systems. In civil law, codes of law are created by statutes and interpreted by judges, with relatively modest reference to precedent. In common law systems, prior court decisions create more or less binding precedents, and thus law as applied in practice can draw as much on precedent (case law) as on statute. Common law countries tend to have better-articulated protections for minority shareholders, and such protections tend to be a precondition for widespread stock ownership: few investors are willing to risk an investment in a firm in which a large shareholder can dominate corporate decision-making in ways that harm their interests.

Financial markets and patterns of ownership differ in characteristic ways between common law and civil law countries. A basic dimension is size: common law countries generally have significantly larger financial markets relative to the size of the real economy (as measured by market capitalization/GDP). A second dimension is ownership concentration within particular firms: ownership tends to be much more dispersed in corporations domiciled in common law countries compared to those in civil law countries. Thus, market-based finance and corporate governance are much more prevalent in common law countries than in civil law countries (Clayton, Jorgenson, and Kavajecz 2006).

An implication of this argument is that historical events long ago—whether a European country had been invaded by Napoleon in the early nineteenth century, or whether an African nation had been colonized by the British rather than the French—set nations on paths of financial organization that are still in place today. Former French colonies were stuck with small or nonexistent financial markets and concentrated corporate ownership, regardless of the helpful advice of the IMF on the benefits of creating domestic stock exchanges. Indeed, with the exceptions of Vietnam and Lebanon, stock exchanges are almost entirely absent from former French colonies, whereas they are widespread among former British colonies (Weber, Davis, and Lounsbury 2009). Moreover, the presence and vibrancy of financial markets is associated with subsequent economic growth, indicating that countries unable to sustain a financial market (such as former French colonies) are doomed to a permanently weaker economic trajectory (Levine and Zervos 1998).

Yet historical comparisons show that finance waxes and wanes over time and thus cannot be fully determined by legal family. In the early part of the twentieth century, France and Japan both had vibrant equity markets. After World War I, however, France experienced a "great reversal" as its economy became more detached from trade with its neighbors and its financial markets retrenched (Rajan and Zingales 2004). In contrast, Germany and the United States could both be characterized as having bank-controlled "finance capitalism" on the verge of World War I. Many industries had become relatively concentrated in the United States (Chandler 1977), and three New York banks had each placed their officers on the boards of dozens of major corporations, often including the

largest competitors in the same industry (Brandeis 1914). This was the situation that had piqued Lenin's interest: the concentrated economic power of early finance capitalism was a small step from state control. Yet a generation later, the United States was the prototype of "managerial capitalism" in which financial institutions had been neutered and a new class of autonomous professional managers was in control of industry thanks to the broad dispersion of corporate ownership (Berle and Means 1932). This transition could not be attributed to a change in legal systems, as the United States was still firmly in the grip of Anglo-Saxon common law. We therefore need to find another explanation.

Domestic politics provides one explanation for the expansion and contraction of finance and the relative power of different kinds of financial institutions. In the United States, populists have repeatedly mobilized to prevent the concentration of finance since the founding of the republic (Roe 1994). Banks were purposely kept relatively small and weak in the United States compared to other industrialized countries. Moreover, when banks grew large and powerful, as in the early twentieth century, policymakers intervened to limit their control of industry. By the time *Other Peoples' Money* appeared in print in 1914, Congress had outlawed board interlocks among competitors and the biggest banks had recalled their executives from most corporate boards (Davis 2008). Within a decade, finance capitalism was merely a memory in the United States, and the famous "separation of ownership and control" was underway. This regime was reinforced by the 1933 passage of the Glass-Steagall Act, which formally separated commercial banking (making loans) from investment banking (underwriting and dealing in securities).

For most of the twentieth century, the United States had a bizarrely fragmented financial system due to a series of political restrictions on financial institutions. Commercial banks were prohibited from operating branches in more than one state, so that New York, California, Illinois, and every other state had their own separate banking sectors with their own set of regulations. Commercial banks and investment banks were strictly separate, so that making a loan and underwriting a bond had to be done through different institutions that were in implicit competition. Moreover, commercial banks were banned from owning shares in companies, which severely limited their influence (Neuman, Davis, and Mizruchi 2008). The contrast between Spain and Italy after World War II also demonstrates how domestic politics can shape the format of finance and banking. In Italy during the early 1930s, commercial and investment banking were legally separated, as in the United States, thereby pushing Italian firms toward self-financing and their characteristic form of ownership pyramids. By contrast, the Spanish state facilitated ownership and lending ties between big banks and industrial corporations, thus encouraging a kind of Mediterranean finance capitalism (Aguilera 2003).

The link between domestic politics and finance is evident among the broader set of OECD countries, where neoliberal countries have systematically larger and more dispersed finance than social democracies. Mark Roe (2003) argues that there is a causal relation between corporate ownership structures and the degree of social democracy. Powerful organized labor corresponds to strong owners; weak labor corresponds to dispersed owners and large financial markets. Thus, ownership is dispersed in the UK

and the United States, where labor is relatively weak, while it is relatively concentrated in Germany and the Nordic countries, where labor is strong. His interpretation of this regularity is that concentrated ownership acts as a countervailing force for the political struggles within firms among managers, owners, and labor. Large shareholders have the incentives and the ability to govern the firm directly, and their position of power in the governance system strengthens their hand with respect to labor. Moreover, their incentives to sell (i.e., to disperse ownership) are dampened by the fact that outside investors would undervalue a firm with powerful (and legally protected) stakeholders.

The organization of finance and the organization of labor are clearly linked. But capital and labor are implicated in a larger matrix of interdependent institutions at a national level, and thus understanding the politics of finance requires a more comprehensive view of the economy and the polity. Political scientists have taken a comparative approach to this question by seeking to organize national economic systems into more-or-less coherent "varieties of capitalism." The best-known typology distinguishes two main forms among advanced economies, each exemplified by a prototype: liberal market economies (LMEs), represented by the United States, and coordinated market economies (CMEs), represented by Germany (Hall and Soskice 2001). Hall and Soskice's approach is distinguished by several factors. The first is that firms and their strategies are the leading elements in the economy, and different varieties of capitalism facilitate different kinds of firms and strategies. That is, configurations at the national level imply what are the most fruitful firm-level strategies. In LMEs, firms interact primarily via arms' length market-based relations, while in CMEs networks of firms have more collaborative and nonmarket-based relations.

A second distinguishing feature of this approach is that firms engage with five institutional spheres, each of which shapes their feasible strategies and therefore the kinds of industries that thrive. The spheres include: (1) industrial relations (bargaining over wages and working conditions); (2) vocational training and education (recruiting a workforce with suitable skills); (3) corporate governance (how firms relate to suppliers of finance); (4) interfirm relations; and (5) their own employees. These five spheres line up into more or less coherent configurations of complementary elements that encourage firms to specialize in particular kinds of strategies. CMEs have characteristically stronger employment protections, while LMEs have more developed financial markets. Thus, in CMEs, firms and workers should be more willing to invest in specialized assets, while in LMEs they should prefer investing in switchable assets (Hall and Soskice 2001: 17). This is reflected in the characteristic leading industries in an economy: in the United States, information technology, medical engineering, and biotechnology (typically funded via the stock market) are among the leading industries, while in Germany civil engineering, nuclear engineering, and machinery (which require a highly skilled and specialized workforce) are among the leading industries.

Although the idea of a dichotomy (or even a continuum) of formats of capitalism is conceptually pleasing, it fits uneasily with the data, even among OECD countries. Hall and Soskice (2001) classify six countries as LMEs (the United States, UK, Australia, New Zealand, Canada, and Ireland), ten as CMEs (Germany, Japan, Switzerland, the

Netherlands, Belgium, Sweden, Denmark, Norway, Finland, and Austria), and six as ambiguous (France, Italy, Spain, Portugal, Turkey, and Greece). Such typologies often seem to reflect the two or three exemplars chosen as the "poles" or ideal types—for example, the United States and Germany (Hall and Soskice 2001), or these two and Japan (Zysman 1983). Yet even among the OECD countries, two or three types seem inadequate to capture the diversity of institutional configurations (cf. Aguilera and Jackson 2010).

One approach to this problem is to work inductively from the data rather than beginning with the ideal types. Bruno Amable (2003) accomplishes just this, with a series of cluster analyses that distinguish no fewer than five varieties of capitalism among 21 OECD countries. His analysis begins with five "fundamental institutional areas" that implicate firms: product markets; labor markets; financial intermediation; social protection and welfare provision; and education. Again, these institutional areas display strong complementarities—what Amable describes as "specific architectures of complementary institutions" (20). For instance, strong employment protections and social welfare guarantees encourage workers to invest in training that might be specific to a particular employer; vigorous product market competition, on the other hand, encourages flexible (less-protected) employment practices, which discourage worker investment in specific skills and promotes competition within the education sector. Using detailed cross-national data on each of the five domains for the late 1990s, Amable finds slightly different clusterings across each of the five domains (e.g., six clusters for product market competition; four clusters for employment protection). These clusters are in turn aggregated into five main models of capitalism: market-based economies (the Anglo-Saxon model); social democratic economies (the Scandinavian model); Asian capitalism (including Korea and Japan); Continental European capitalism; and south European (or Mediterranean) capitalism. Each model underlies a distinct "social system of innovation and production" that provides an environment that is conducive to some kinds of economic activities and less attractive for others.

> Market-based economies specialize in activities where fast adaptation and good industry-university links matter: biotechnologies, computer science, and electronics. Social-democratic countries have a comparative advantage in health-related activities as well as industries linked to their natural resources (paper and printing). Countries on the Mediterranean model specialize in light industries and low-tech activities. Asian-capitalism countries have a comparative advantage in computers, electronics, and machines. The only model which does not seem to exhibit a strong pattern of specialization is the Continental European model. (Amable 2003: 22)

Politics enters this account at the level of institutional design: "Rather than optimal solutions to a given problem, institutions represent a compromise resulting from the social conflict originating in the heterogeneity of interests among agents. What we consider to be different economic 'models' are therefore based on specific social compromises over institutions. The question of institutional change is basically a question of political economy" (Amable 2003: 10). This provides a morphology. How, then, might they change—that is, what could provide a theory of evolution for models of capitalism?

The prospects for change depend on a country's political institutions. The feasible set of governance formats is constrained by how political decisions are made: who are the players, what are their interests, and what are the specific mechanisms of preference aggregation (Gourevitch 2003). Gourevitch and Shinn (2005) provide a systematic model for linking politics to corporate governance systems. In contemporary economies, firms create wealth, and corporate governance shapes how the spoils are divided among different players (owners, managers, workers). Thus, claims on profits within the firm depend on politics outside the firm; participants in the firm will therefore seek allies in the polity to promote the institutions of corporate governance they prefer, such as greater or lesser protection of minority shareholder rights, which in turn pushes toward lesser or greater ownership concentration. The three main players each have characteristic interests that influence their prospects for forming political coalitions.

> Workers seek good wages, job stability in the face of layoffs, even at the expense of profitability, and protection of their pension claims on the firm . . . Managers seek income, job security, and managerial autonomy. They want high payments of various kinds, from salary to options, and the greatest autonomy in directing the resources of the firm—which also gives them the greatest leeway to shirk . . . Owners prefer to minimize all the forms of agency costs paid to managers and workers, fearing that each of these groups is able to divert resources from profits, requiring the firm to pay above market prices to them. (Gourevitch and Shinn 2005: 59)

Gourevitch and Shinn propose three possible coalitional struggles (owners and managers vs. workers; workers and managers vs. owners; owners and workers vs. managers), each of which has two possible outcomes. When owners and managers win over workers, it is an investor coalition and promotes ownership diffusion; when workers win, it is a labor coalition and promotes blockholding. When managers and workers win over owners, it is a corporate compromise and accords with blockholding; when owners win, it is an oligarchy and also promotes blockholding. Finally, when owners and workers prevail over managers, it is a transparency coalition, while when managers win it is a managerism coalition; in either case, shareholding is likely to be diffuse.

What determines which coalition wins? Gourevitch (2003) notes that above and beyond distinctions such as common law vs. civil law, national political systems within democracies can systematically shape the prospects for changes in corporate governance and systems of production. Consensus systems, as among many of the parliamentary systems of Europe, commonly require the creation of political coalitions to get things done, and thus policy swings are relatively minimal. But in majoritarian systems such as the UK and the United States, small shifts in votes can lead to large swings in policy as a new dominant party sweeps out the policies of the old, creating an uncertain climate for investment in firm-specific assets. Once again, we find a systematic difference between Anglo-Saxon countries (which commonly have majoritarian systems) and the coordinated market economies, which in turn corresponds to levels of ownership concentration or dispersion.

The clean distinction between managers, owners, and workers, each with clear political interests, can become quite muddled through changes in the structure of the economy and the organization of finance. Systems of production create different political interests and give different prospects for financial control, thereby creating a feedback loop to domestic politics. This suggests that changes in the organization of production—for example, the shift from an industrial to a postindustrial economy—can lead to shifts in perceived political interests and new forms of political coalitions, which can in turn change the organization of finance. In the United States, for instance, the wave of finance-driven hostile takeovers of manufacturing conglomerates in the 1980s and the outsourcing movement of the 1990s led to the disaggregation of production and the end of traditional forms of job security (Davis 2009). This was accompanied by a shift from company-sponsored retirement pensions to individual, portable pension plans (typically "401(k)" plans, named for the section of the tax code that enabled them). Because of the rise of individual pension plans and the increased accessibility of mutual funds for college savings, most American households had invested in the stock market by the turn of the twenty-first century. Although the amounts involved were often small—the median shareholding household had under $30,000 invested in the market, hardly enough to retire on—the psychological impact of stock ownership can be substantial. Due in part to targeted recruiting efforts by the administration of George W. Bush, shareholders came to identify with the Republican party at astonishing rates during the first decade of the twenty-first century, increasing from 30 percent to 40 percent between 2000 and 2004 (compared with a flat 18 percent among non-shareholders). This in turn helped assure the (re)election of Bush in 2004, who spent the first years of his second term pressing for the privatization of the national pension system in the United States in order to create a "nation of shareholders" who would (presumably) vote Republican (Davis and Cotton 2007). By contrast, in nations with more generous state-sponsored pension systems such as traditional social democracies, private pensions are of relatively little consequence and provide little push toward market-oriented voting (Jackson and Vitols 2001). Similarly, state-funded higher education lessens the need for private savings through vehicles such as mutual funds, again muting the connection between household decision-making and financial markets.

In short, the organization of finance is shaped in part by whether individuals identify politically as workers, managers, or owners, which in turn depends on the structure of the economy, which is shaped by the organization of finance. Endogenous forces can lead to changed relations between politics and finance.

Change and crisis in finance

By the turn of the millennium, it was clear that financial markets were becoming ever more central to global political economy. The collapse of the Soviet Union and the disintegration of Yugoslavia set in motion an array of disparate new approaches to capitalism

in Eurasia, often prominently featuring financial markets. Mass privatization of former state-owned enterprises created thousands of new public corporations. By 2000, Azerbaijan had two publicly traded corporations, Bulgaria had 500, and Romania had over 5,500 (behind only the United States and India). While the economic trajectories of former communist countries varied widely, most included stock markets as a means to transfer state ownership, with varying levels of success (cf. Kogut and Spicer 2002). Outside Eastern Europe, dozens of other countries opened their first stock exchange during the 1980s and 1990s, doubling the number of countries in the world with a domestic stock market. New exchanges opened in Iceland (1985), Barbados (1987), Guatemala (1989), Mongolia (1992), Latvia (1993), Lebanon (1996), Tanzania (1998), Papua New Guinea (2000), and scores of other countries now dubbed "emerging markets." The neoliberal dream of Western economists appeared to be coming true, as new outlets for portfolio investment spread across nearly every continent.

Finance became increasingly unconstrained by state control as the effortless flow of funds through electronic means enabled a new placelessness. This challenged the coherence of the varieties of capitalism we have reviewed, which tend to assume that states preside over porous but meaningfully bounded economies. Corporations had long been somewhat strategic in their financing, but now nationality itself had become more a matter of choice than circumstance. The opportunity to list shares in New York or London or Hong Kong attracted businesses from around the world. Hundreds of non-US companies created secondary share listings in the United States, and by the end of the 1990s there were more foreign companies traded on American markets than there were German companies traded on the Deutsche Böerse.

As finance increasingly detached from place, it became possible for companies to opt out of their domestic financial system entirely. Dozens of companies domiciled in Israel bypassed the Tel Aviv stock market and went straight to NASDAQ; many were funded by American venture capitalists, advised by American law firms, and incorporated in the United States. On the stock market, only their mailing address distinguished these firms from typical Silicon Valley startups (Davis and Marquis 2005). This development fitted uneasily with the premise of varieties of capitalism: If whole institutional sectors can be bypassed, then what becomes of the complementarities assumed by this approach?

In retrospect, it is clear that the late 1990s represented the high-water mark of the neoliberal consensus on the role of finance in economic growth. Enthusiasts seemed to believe that installing a financial market was the economic equivalent of providing vaccinations, clean water, and universal literacy—an unambiguously positive step on the path to economic growth and development in the contemporary global economy. True believers were rapturous about the benefits of financial markets. Treasury Secretary Larry Summers stated in 1997 that "Financial markets don't just oil the wheels of economic growth—they *are* the wheels" (Murray 1997). A handful of economic studies provided evidence consistent with the claim that vibrant financial markets encouraged economic growth (e.g., Levine and Zervos 1998), and policymakers and the punditry popularized this idea. Thomas Friedman (1999) described the "golden straitjacket" that

embraced emerging economies who availed themselves of the benefits of financial markets. The path to economic growth was clear but narrow and required acceding to the demands of faceless global investors.

This was, of course, a rather different model of development than the familiar developmental state (Evans 1995). What had changed? A Whiggish account would run like this: reductions in the transaction costs of market-based finance relative to other forms of financing created an irresistible attraction for both issuers and investors. Entrepreneurs were attracted by the opportunity to get rich quick via a public stock offering; global investors were attracted by the high potential growth rates in emerging markets. Old models of state-directed investment—the ones that guided developmental states such as Japan and Korea—would be replaced by an entrepreneurial model in which Western investors would fund the entrepreneurial visions of local businesses around the world. States would no longer be in the business of "picking winners": markets would do that. Instead, the proper role of the state in finance was to create a legal infrastructure for financial markets and the protection of shareholder rights (drawing on the well-documented architecture of the American system), reduce restrictions on the flow of finance, and watch the economy grow (Davis 2010).

The new model was not without trade-offs. Technological changes expanding market-based finance created clear winners and losers, both within the polity and in society at large. Within the United States, the manager/worker coalition was replaced by a manager/owner coalition, resulting in a corresponding loss in power by labor. The precipitating event was the takeover wave of the 1980s, in which one-third of the largest US industrial corporations were taken over and often split up in the name of "creating shareholder value" (Davis, Diekmann, and Tinsley 1994). Corporate managers were increasingly compensated according to their ability to increase share price, thus aligning their interests with those of their shareholders. By the 1990s there was consensus among those who owned and those who managed that corporations existed to create shareholder value, not to provide steady employment, and a wave of downsizing shrank the largest US firms down to their core, creating a spike in income inequality (Davis and Cobb 2010).

Even within banking, the hyper-expansion of financial markets created both winners and losers. The increasing availability to businesses of market-based debt meant that commercial banks in the United States lost much of the primary market for their lending; on the other side of the balance sheet, savers found market-based vehicles such as mutual funds offered a more remunerative alternative to traditional savings accounts, leaving banks increasingly irrelevant (Davis and Mizruchi 1999). A long-delayed wave of consolidation in the industry during the 1990s and 2000s created a small handful of national giants (JP Morgan Chase, Bank of America, Citigroup) but left most major cities without a locally based bank. Investment banks, on the other hand, grew increasingly large and powerful, as they were the primary conduits to market-based finance. Both in terms of compensation and political influence, investment bankers became a potent force in American society, as witnessed by the market-friendly staffing of the Clinton Administration in the 1990s.

Due to the reorganization of finance, new categories of players emerged and gained political influence. Mortgage finance, for instance, had traditionally been a simple affair in the United States: depositors put their savings in local banks, and the banks made mortgage loans to local borrowers. Widespread securitization of mortgage loans fundamentally reshaped the value chain for housing finance, creating new industries of free-standing mortgage brokers (who replaced bank loan officers), loan originators such as Countrywide and New Century (who made the initial loans and then sold them to investment banks for packaging into mortgage-backed securities), and loan servicers (who took in payments from home buyers and distributed them to investors). And lightly regulated hedge funds and private equity firms grew into a "shadow banking system" outside the traditional categories of finance.

Even among advanced economies with long-standing traditions of corporate governance, the growing scope and influence of financial markets challenged the internal coherence of the varieties of capitalism in which market-based finance had featured less prominently. In Germany, the prototyical coordinated market economy, public corporations in the 1990s began proclaiming their newfound commitment to "shareholder value," in part to enhance their allure to foreign investors (Fiss and Zajac 2004). Meanwhile, Japanese companies began to abandon the traditional model of lifetime employment security, encouraged in part by the influence of foreign investors (Ahmadjian and Robinson 2001). It appeared that emerging markets were not alone in experiencing the effects of the golden straitjacket.

Some argued that mobile finance threatened the power of the nation-state. When the bargaining power of states is weakened by increasingly mobile capital, it has a direct impact on the bargaining power of labor (Arrighi and Silver 1999). Martin Wolf (2004: 243–4) stated, "The interests of a transnational company are not the same as those of the country from which it originates or of the workers it has historically employed. It has become, to coin a phrase, a 'rootless cosmopolitan.' " The traditional national coalitions between workers and firms (or managers) are undermined when corporations and investors have little fixed attachment to place. Thus, states may find themselves increasingly attentive to the demands of investors, particularly when they are backed by a seemingly coherent theory of economic growth. This dynamic played out in countries around the world during the 1990s, from the Phillippines to Bill Clinton's America, where investment banking veterans such as Robert Rubin provided a Greek chorus for the markets.

But the economic crisis that began in 2008 created an inflection point for global finance. If the decade that ended in 2000 represented the high-water mark for finance-based neoliberalism, then the decade that ended in 2010 demonstrated the dangers of tying the well-being of society too closely to financial markets. What began with a few thousand American homeowners falling behind in their mortgage payments ended up creating a global crisis that brought the world to the precipice of a second Great Depression. In September 2008, the United States saw the biggest bank failure and business bankruptcy in its history (Washington Mutual and Lehman Brothers), the seizure of the two institutions behind half of its mortgage market (Fannie Mae and Freddie Mac), the near-implosion of the world's largest insurance company (AIG), and the disappearance

of two of its four biggest independent investment banks (Lehman and Merrill Lynch)—all within three weeks. Only massive and unprecedented intervention by the Federal government prevented the world's financial system from seizing up. As housing prices declined, homeowners stopped paying their mortgages, and many global investors discovered that the mortgage-backed bonds peddled to them by Wall Street were nearly worthless. Meanwhile, exporters who relied on debt-loving Americans to buy their wares found demand drying up overnight as consumers rediscovered the virtues of thrift. A contagion of financial crises spread to unlikely places—Iceland, Greece, Ireland, Spain—calling into question the integrity of European financial union. Moreover, at the beginning of 2010, the S&P 500 market index stood one-quarter lower than it had a decade before, and the United States had half as many public corporations as it did in 1997. Even in its home and native land, finance-centered capitalism appeared increasingly untenable. Meanwhile, China—which defies all of the varieties of capitalism we have reviewed—surpassed Japan to become the world's second-largest economy. Ten years hence, we may be seeking to explain a rather different league table of global economic success.

Conclusion

The study of finance and politics has become a vibrant and highly interdisciplinary domain over the past generation. Important contributions have come from many scholarly quarters. We have reviewed financial economists writing about the law (La Porta et al. 1998); legal scholars writing about political dynamics (Roe 2003); political scientists writing about corporate management and strategy (Hall and Soskice 2001); and management scholars writing about finance (Davis 2009). Every few years a previously overlooked construct becomes a central topic for scholarship (e.g., bank vs. market-based finance; civil law vs. common law; majoritarian vs. consensus political systems). New data collection efforts seek to compile cross-national time-series information on topics from the average level of ownership concentration in public companies to the death rates of European colonists.

Yet more and better data do not seem to resolve the debates within the field. Indeed, new data often serve to undermine existing interpretations shortly after they are established. Legal family seems to correlate highly with financial market development and corporate ownership, yet both show substantial change over time even within prototypes (the United States, France, and Germany). Comparative information suggests that simple dichotomies (e.g., market-based vs. bank-based financial systems) can obscure more than they reveal, and expanding the sample beyond one or two dozen countries leads to the realization that, for instance, Latin America does not fit readily into the category of "Mediterranean capitalism," and Africa has a diversity of economic formats from north to south. Moreover, models seem to rise and fall over time in ways that seem inconsistent with theory. China's rapid economic expansion is a puzzle from almost any perspective we have examined.

Even the collection of lavish time-series data has failed to plausibly establish causality. Many core aspects of countries are relatively fixed. Nations rarely change their legal family, their language, the point in history when they industrialized, or their dominant religion, and changes in political systems are only slightly less infrequent. (There are, of course, "exogenous" shocks such as the collapse of the Soviet Union that occasionally create rapid shifts in political systems, but these were not designed with an experimental handbook.) In addition, many of the elements hypothesized to shape finance and politics frequently occur together—common law, a majoritarian political system, Protestantism, and the English language are broadly shared among neoliberal economies, for instance, so distinguishing the effective ingredient is difficult.

One conclusion from our review is that typologies of capitalism should be held lightly. The most empirically grounded typology, from Amable (2003), distinguishes five models of capitalism among 21 OECD countries, but notes that the Netherlands and Switzerland may form yet a sixth distinct type. The addition of other areas of the world—Latin America, Africa, the Middle East, China, Southeast Asia—suggests that the final typology may have at least a dozen models. And even within the identified types, a determined skeptic would find reason to quibble. Consider the differences between close neighbors and model-mates Denmark and Sweden, or Korea and Japan, or Chile and Argentina. Even the United States and Canada are quite different on several relevant dimensions. In contrast to the United States, Canada has four major political parties, state-funded higher education, universal healthcare, low income inequality, and a financial sector that has seen only two bank failures since the 1920s—and none during the Great Depression or the recent financial crisis (which helps explain its 2008 ranking by the World Economic Forum as the best banking system in the world). Of course, to claim that every country is utterly unique would be hostile to the enterprise of social science—but the evidence suggests that typologies of capitalism should be considered provisional at best.

A second conclusion, borne out by the financial crisis, is that states are still central actors in the global economy. Capital may be internationally mobile, but in a crisis it is ultimately left to the state to sort things out, bail out the players deemed to be indispensable, and create reforms sufficient to coax participants back in to the market. Ultimately, the state is inextricable from the economy, and finance and politics are inseparable (Block 1994).

A third conclusion is that the microlevel dynamics of finance and politics have received very little attention relative to cross-national comparisons. Tectonic shifts in the organization of production have been matched by equally massive changes in the organization of finance and property. Securitization has done for homes, cars, and college educations what the dispersion of shareholding did for the large corporation, "splitting the atom of property" (in Berle and Means' phrase) and changing the meaning of ownership and control. The mortgage crisis in the United States revealed just how Byzantine finance could be. Mortgages were pooled and sliced into bonds (mortgage-backed securities), which were in turn pooled and turned into second-generation bonds (collateralized debt obligations), which were sold to investors around the world. Efforts to foreclose on

delinquent homeowners were hampered by the fact that it was in many cases impossible to prove who owned what. And efforts at intervention at the policy level were hampered by the fact that the interests of homeowners, borrowers, financial institutions, and bondholders formed no clear coherent coalition: for instance, while delinquent homeowners and the bank that nominally owned the mortgage might have an interest in reducing the principal owed, this might come at the expense of the bondholder or neighboring homeowners. Property ownership is a fundamental source of political interest, yet we have surprisingly little research on how participation in finance—as buyer or seller—affects microlevel politics (e.g., party identification or political activism).

Finally, the evolution of the technologies of finance suggests that finance can be a flywheel of historical change. The idea of technology as an engine of economic change is commonplace, but the vast expansion of finance over the past generation—enabled by advanced information and communication technologies (ICTs)—indicates that finance has its own relatively autonomous developmental path. The sociological study of finance is still at a relatively early stage, but it is hard to imagine a more suitable topic for ongoing inquiry.

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