Do national financial systems still reflect national values?: The case of the US, Germany and France

prof.dr. Eelke de Jong

Radboud University

Nijmegen

This version: February 2019

very preliminary, do not quote

Abstract

An increasing awareness of the embeddeness of national institutions in deeper layers of values can be discerned. However, in the mean time internationalization and globalization have lead to a dominance of international and thus common standards. Consequently, chances are high that national influences are trumped by international ones. This certainly seems to hold for financial systems as these are designed according to international agreements. This paper describes the evolution of the financial systems in the United States, Germany and France with a view to investigate whether these systems still resemble the national characteristics which were so obvious during the first decades after World War II. It appears that some subsectors of the financial systems, such as the financing of residential housing still reflect differences in national attitudes.

prof.dr. Eelke de Jong
Department of Economics
Radboud University
P.O. Box 9108
6500 HK Nijmegen
T. + 31 24 36 11974 / 2379
E. e.dejong@fm.ru.nl

This research is part of the project "What Good Markets Are Good For: Towards a Moral Justification of Free Markets in Europe" financed by the Templeton World Charity Foundation. Research assistance by Merijn Jacobs and Annelie Kroese as well as comments on previous versions by Johan Graafland, and Tim van der Valk are highly appreciated.

1. Introduction

During the last decades economists have become increasingly aware of the importance of values and beliefs for the well-functioning of an economy. This awareness is witnessed by the many published papers on culture and economic phenomena (De Jong, 2009, Beugelsdijk and Maseland, 2011, Alesina and Guiliano, 2015). A topical issue has been whether cross-country differences can be attributed to differences in values. The latter are assumed to be formed over a long period by means of intergenerational transmission of values and behavior (Bisin and Verdier, 2011). Consequently, they are considered to be stable. In particular the relative position of countries is assumed and found to be stable (Hofstede 2001, and Beugelsdijk et al. 2015). In the meantime, many countries have reformed their institutions. Often these reforms are a reaction on the increasing globalization and internationalization. Moreover, the standards tend to be uniform as their principles are agreed upon within international committees, such as the Basel Committee on Banking Supervision and international organizations such as the Organizational for Economic Development (OECD). As a result the OECD countries' national institutions tend to converge towards a common standard. This raises the question whether the differences in nation institutional frameworks still resemble national differences in values and norms.

In this paper we investigate this question by describing the evolution of the financial system in three countries: the Unites States of America, Germany and France. These three countries have been selected as representatives of the three types of market economies distinguished with the Varieties of Capitalism literature. This literature makes a categorization into liberal (free) market economies, coordinated market economies and hierarchical market economies (Hall and Soskice 2001 and Schneider 2009). In the present study the United States represents the free market, Germany the coordinated market and France the hierarchical market tradition.

Compared to Asian economies, the individual is in high regard in Western societies. Nevertheless, the individual and in particular his or her freedom to act independently is more important in the free market economy than in the other two types of economies. Organizing economic exchange by means of competition is another feature of a free market economy. Competition is only fair and welfare improving if both the demand and supply side of the market are not dominated by one or a few agents. Hence, concentration by a few should be

avoided. Competition is good because it gives every individual an equal chance. A result can be an accumulation of power and wealth held by a few, but these inequalities are initially regarded as an award for individuals' talent or effort and thus are of no concern. Concentration of wealth and power becomes a concern when the accumulation of wealth is regarded to be too extreme. Then the government can set rules to restrict the accumulation of power and re-establish the arena for fair competition. This illustrates the government's role, namely to safeguard free competition between private agents. The government is expected not to own firms or banks. If the outcome of the economic process is unfavorable, sharp down turn in economic activity, then the government can step in and stimulate demand. Hence, the government's role is to correct unintended consequences of market activities, not to prevent these consequences to happen.

A coordinated market economy is also based on competition. However, in these societies competition is accepted along with other forms of coordinating economic activities. In particular cooperation is often used. This cooperation can be between producers, between employee organizations and trade unions, and between banks and firms or households. The ties between the different agents are relatively close and aim for a long term relationship. The degree of direct involved of the government in economic activities is higher than in a free market economy. For example, a (local) government can be the owner of a bank. In sum the institutional design of the economy aims at mitigating large differences in wealth and opportunities and smoothing the evolution of the economic process by means of a restrained (restricted) competition.

A hierarchical economy is characterized by a distinction between an elite and the rest of society. The elite is expected to act as a pater familias and to take care of the wellbeing of the other classes. This task goes with many responsibilities but as a trade off the elite is allowed to take an extra part of the economic pie as long as it protects the others against uncertainty and disaster among which are economic downturns. Consequently, the differences in wealth and political power can be large. Competition is one among many possible ways of coordinating activities but certainly not the naturally preferred one. The government can own a dominant share in private companies. Both this direct influence as well as the government's role as regulator are supposed to be used to protect citizens against the uncertainties resulting from the economic process.

This paper will investigate how before roughly the 1980s, the financial systems in the US, Germany and France reflected the characteristics of each type of economies. From the 1970s onwards the (inter) national financial system underwent many changes: the Bretton Woods system of fixed exchange rates collapsed, international financial capital flows were liberalized, and a movement towards common national standards (one level playing field) emerged. These international events along with changes in technology forced national governments to change the design of their national financial system. We investigate whether these changes and the resulting systems still reflect the corresponding archetypes as these have been developed in the Varieties of Capitalism literature. Some sectors of the financial system are less exposed to international influences than others. In particular the financing of small firms and residential housing remains to a great extent a national affair. We therefore pay especial attention to these sectors. Meanwhile, attention will be paid to the question whether the values associated with these type of economies are still relevant today or washed away by the forces of internationalization.

The rest of the paper is organized as follows.[1] The subsequent sections describe the evolution of the financial system of respectively the United States (free market economy), Germany (managed market economy), and France (hierarchical market economy). For each country we focus on the arguments and implicit values underlying each original structure. For Germany and France this original strucuture is the structure as it was duirng the decades after the Second World War. To a certain extent this also holds for the United States, however we go back until the beginning of the 19th century to find the system's cultural roots. After the country studies we systematically investigate how each system provides finances for housing and pensions The final section presents the conslusions.

2. **The free market economy:** ***The United States***

2.1 The period before Wordl War II

During a long period, distrust of concentration of power has been a dominant force in shaping the financial system in the United States. This distrust, often in form of populism, was already

[1] A description of the main functiosn and characteristics of financial systems can be found in a previous version of this paper entitled" Reform of financial systems in three different types of market economies" and in various textbooks on fiancial systems.

apparent at the end of the 18th and beginning of the 19th century. For example, in 1830 president Jackson announced that, in his view, the Second National Bank of the United States was a dangerous monopoly which only served the interests of the wealthy owners. This populist position helped him getting re-elected in 1832. In 1833 he decided to redistribute the federal deposits over different state banks en thus undermined the position of the Second National Bank, which in the end was not rechartered.

Of course the different state banks supported the president's position against the Second National Bank as the latter was a competitor and could control them. This illustrates another reason for the fragmented position of banking, namely the infighting by different groups and the power of local and state banks. Within the federal structure, each state has the power to charter banks. In practice, each state protected its own banks by excluding branches from other state's banks. Moreover, often own single-location banks were prevented from branching, so that a bank was restricted to a single office. This unit banking system hampered banks in diversifying their risks and limited their growth. Often these regulations were established in order to protect rural interests in the sense that locally collected deposits would not be invested in other communities (Berger et al., 1995, p. 185 and 186). As a result banks were small and by the beginning of the twentieth century, insurers were the largest financial institutions in the United States. Banks were confined to a single state and often to a single location (Roe, 1994, p. 59). The McFadden Act of 1927 consolidated this situation by imposing restrictions on interstate banking.

The 1929 Wall Street Crash and the resulting Great Depression of the 1930s lead to the Banking Act of 1933, better known as the Glass-Steagall Act. Once again populistic mood and distrust of the wealthy played an important role. During the financial crisis of the 1920s deposits were leaking from small middle-town banks to large, money center banks. In order to stem this outflow of deposits, the small banks wanted a deposit insurance system, which the large banks did not need and were not in favor of. At the same time, some were of the view that the 1929 crisis was also a result of commercial banks trading in stocks and other assets. Allegations made were that commercial banks had engaged in stock price manipulation and insider trading, which led to the bankruptcy of these banks. In this reasoning the losses due to stock market transactions had hurt thousands of small investors and depositors, who from then on, had to be protected against the consequences of these risky activities. One therefore thought it wise to separate the banks' commercial activities (taking deposits and providing loans) from their activities as investment banker. The latter activities were of more interest for

the large money center banks. Since these banks did not want a deposit insurance system, they agreed with the separation of investment banking from commercial banking in the hope that a deposit insurance fund would not be materialized. In the mean time on March 4, 1932 the United States Senate Committee on Banking and Currency started an investigation into the causes of the crisis. During these so-called Pecora Investigation a lot of information of abusive practices in the financial sector was revealed, amomng which that some rich bankers (the Morgans) had not paid income taxes since 1930. This was legal because they had incurred large losses on their portfolios of stocks. However, it fed the mistrust of the general public in the large money centre banks, which were thought to benefit the rich, far-away people. As a consequence these banks lost their battle against the smaller banks, and the Glass-Steagle act prohibited banks to have commercial banking, investment banking and insurance in one organization.[2] The motivation for this separation was the conflict of interest that can arise when banks are engaged in both commercial and investment banking. Such banks were also believed to have a tendency to engage in excessively speculative activity.

An other important view in the 1920s and 1930s was that the financial crisis and Great Depression were a result of excessive competition; "ruinous competition" (see e.g. Wheelock, 1992b, p. 326). Prices had declined too much, so that many companies (including banks) went bankrupt. In order to stem this 'excessive' competition, the Banking Act of 1933 introduced the prohibition for banks to pay interest on demand deposits and gave the Federal Reserve System (FED) the authority to introduce ceilings on interest rates of time and savings deposits. Regulation Q was the title of the regulation issued by the FED to exercise its authority.

---

[2] Tabarrok, 1998, 7 and 8 argues that Winthrop Aldrich, who was aligned with the Rockefellers, was instrumental in the separation of the proposal to separate banks' commercial from their investment division and to forbid any interlocking directorates between any type of bank and securities. In particular the last condition hit the Morgan banks much more severely than the Rockefellers. J.P. Morgan and Company had established a dense network of directors at several commercial banks by which they could mobilize money for financing large security issues. Consequenlty the new regulation raised the costs for the House of Morgan more than for the Rockefeller group, so that Aldrich's actions can be explained as gaining competitive strength by raising rivals' costs (ibid, p.10).

So after the crisis of the 1920s and 1930s. the USA's financial system was characterized by restrictiosn on interstate banking, a speration of commercial and investment banking and restrictions on interest rates. The first two were introduiced as a reaction on populistic mood and a distrust of large financial isntitutions. No in-depth investigation into the economic pros and cons were made.[3] The last measure (Regulation Q) aimed at mitigating the consequences of too severe competition. It is, however, strange to restrict competition by restricting prices in order to enable competition: a contradiction in terms, we woud say.

2.2 Reforms after World War II

After the Second World War these regulations were still in place. During the first decades after WWII these restrictions did not cause serious problems, because the international financial system itself was also tightly regulated.

From the beginning of the 1960s pressures were build up against the ceilings imposed by Regulation Q. The Eurodollar market began to flourish and offered an alternative for investing in US dollars at higher rates than were possible in the USA, where the deposit rates were still limited by Regualtion Q. As a reaction on the outflow of money, in 1966, Congress passed the Interest Rate Adjustment Act which authorized the Federal Reserve to set different rates ceilings on deposits of different sizes and extended interest rate ceilings to thrifts (Wheelock, 1992b p. 327). In the 1970s the situation worsened as inflation increased and nominal interest rates raised above the ceilings set by Regulation Q generating an outflow of funds from banks and thrifts. As a consequence, banks and thrifts saw declining profits and some went bankrupt. In 1980 and 1982 Congress reacted passing acts that started a process of eliminating interest rate ceilings and expanding the opportunities for thrifts to raise funds. Meanwhile, money market funds were created by other financial institutions. These funds pooled small investors' money to purchase commercial paper and were not restricted with respect to the interest to pay. As a consequence, small investors invested via money market

[3] In case of the separation of commercial and investment banking later studies found that many of the allegations in the 1930s of misconduct and increased financial risk of the securities trading activities were unfounded (White, 1986; Benston, 1990). Academic articles published in the 1980s and 1990s did not find empirical support fo the hypothesis that a universal bank could lead to conflicts of interest (Rheinholdson and Olson, 2012, Table Selected papers). A comparison of different financial systems revealed that only Japan and the USA still had a separation between commercial and investment banking (Barth et al. 1997).

funds in more attractive assets outside of banks and thrifts. These developments undermined the profitability of commercial banks. In the period 1980 to 1982 acts were passed in order to phase out interest ceilings (Sherman, 2009, p. 6) and to allow banks to offer money market deposits accounts that could compete with money market funds (Berger at al., 1995, p. 179). In conclusion, Regulation Q was abolished because the economic situation made it counterproductive, instead of protecting banks and thrifts against ruinous competition, it placed these institutions in an unfair position against newcomers such as money market funds and participants in the Eurodollar market. [4]

The restrictions on interstate banking were largely the result of the McFadden Act of 1927 and other laws (Medley, 1994). These restrictions were motivated by concerns about the power of concentrated financial institutions and about the possibility to adequately supervise banks operating in multiple states. Starting in the early 1980s some states made changes to their own laws that permitted out-of-state banks to enter their states under specific conditions (see Berger at al. 1995, pp. 185-190 for an overview). At that time small banks and insurance companies opposed allowing interstate banking out of fear for severe competition by large banking institutions.[5] However, by 1990, 46 states had laws which permitted out-of-state banks to acquire in-state banks under certain circumstances. The result was a patchwork of regulations. The Clinton administration made clear that it would like to move away from this patchwork and formulated a law which would suggest uniform rules for all states. Large banks were in favor, whereas the opposition by small banks was not as vocal as it had been before. This could be because the proposal allowed states to limit interstate entry and also set a minimum age requirement for the banks that could be acquired. Moreover, the law contained conditions aimed at restricting the power of individual institutions, such as ceilings on the percentage of nation's total deposits (10%) and an individual state's deposits (30%). On September 29, 1994 president Bill Clinton signed the Riegle-Neal Interstate Banking and Branching Efficiency Act, which allowed for different types of interstate banking. As the title suggests, at least according to the proponents of this law it would enhance the banks' efficiency and "help American banks better meet the needs of our people, our communities and our economy" (Clinton, 1994). The law contained criteria for out-of-state banks with

[4] Some US states still have usury laws, in particular Arkansas.

[5] Kroszner and Strahan (1999) perform an econometric study of the timing of bank regulation by US states and find that this deregulation is delayed, when the share of small banks is large, their financial health is strong and the number of Democrats in the state's government is relatively high. Deregulation is earlier if the small, bank-dependent firms are relatively numerous. They argue that technical developments diminished the competitive position of small banks (their knowledge of local firms), which set into motion a deregulation policy.

respect to their investments in favour of poor persons and poor neigbourhoods. These creteria came from the Community Reinvestment Act, to be discussed in Section 2.3.

Until 1970 the difference between commercial and investment banking remained intact. During the 1970s commercial banks and investment banks started activities traditionally belonging to the other type (Wheelock 1992a, p. 244 and Roe, 1994, p.). Commercial banks began to offer various kinds of securities services (assistance in buying stocks e.g.) and corporate finance services (advice on merger and acquisitions, e.g.). Investment banks encouraged companies to borrow money through the bond issuances rather than through loans with commercial banks. The securitization of mortgages, which was stimulated by the Government National Mortgage Association, meant that residential housing was financed through securities markets instead of deposits. The Money Market Mutual Funds (MMMF) enabled households to invest in deposit-like assets that offered a higher interest rate than that on deposits. Interest rates on the latter were still capped by Regulation Q. During the 1980s and 1990s this process of incursion in the other side's field continued.

Already from the 1970s commercial banks lobbied for a repeal of the Glass Steagall Act. Investment banks were less interested because they wanted to protect their activities and profits. By the end of the 1990s the commercial banks had broadened their activities to such an extent that investment banks gave in. Those in favor of allowing banks to execute both activities argued that in good times people invest, so that the money flows to investment banks, whereas in bad times there is a tendency to put the money on savings account, which are part of commercial banks. Allowing investment banks and commercial banks to merge would reduce the institutions' sensitivity to business cycles and hence make the financial system more stable. Actually, at the end of the 1990s, most financial institutions already offered both saving and investment accounts, and in some cases even insurance. These developments led to a reconsideration of the separation of the three financial activities. On November 12, 1999 president Bill Clinton signed the Gramm–Leach–Bliley Act (GLBA), also known as the Financial Services Modernization Act of 1999. The act allows financial institutions to offer commercial banking, investment banking and insurance. Some restrictions remained in place. An important one is that in case of a merger, each of the parties and affiliates should meet the criteria set by the regulatory bodies responsible for the Community Reinvestment Act. In practice this meant that each institution should lend enough money to minorities and the poor.

There were still opponents to a repeal of the Glass Steagal Act. Arguments were that holdings of commercial and investment banks would become too big to fail. Since bankruptcy is a crucial element of competition, such too big to fail institutions would undermine competition because these institutions know they cannot go bankrupt. At the end the Federal Government would have to bail out these institutions. John Dingell, a Democratic member of the House of Representatives voiced these concerns. A related argument is that these large institutions can acquire a monopoly in some fields and thus undermine competition. Others were of the opinion that new regulation of the newly created institutions would be needed in order for the American financial institutions to remain competitive. Senator Charles E. Schumer, Democrat of New York represented this view.

2.3 Pensions and Housing finance and pensions

The prevous sections illustrate hat populistic tendencies often have had a decisive influence on the way the fiancial system has been organized in the United States. How then is the structure of the finances of the people's own direct interests: pensions and housing?

A large part of the American pensions are funded. In 2016 the assets in private pension plans was equal to 134.9% of GDP and that in public plans to 15.4% of GDP (2015 figure, OECD, 2017). The United States, along with other Anglo-Saxon countries and The Netherlands, is one of the countries where funded pension schemes dominate. Consequently financial markest are well developed. This illustrates,once again, the pro-market attitude in the USA.

The finances of houses is characterized by a support for homeownership, since homeowners are assumed to look after their property and be more involved in measures to secure a clean neighborhood. Moreover, the number of houses available for rents against reduced rents is low. Homeownership is not stimulated by means of direct subsidies but by enhancing the avaliability of cheap financial instruments via financial markets. Since 1916 the federal government has created so-called Government Sponsored Enterprises (GSE) (see Pollin and Heintz, undated,Chapter 12). These are privately owned enterprises established by the federal government with a public mission. The purpose has been to create favorable conditions for credit in areas regarded of public importance such as agriculture, education and

housing finance.[6] The most important GSEs are in the area of housing finance and are Fannie Mae established in 1938, and Freddie Mac established in 1970. Both were created "to provide a stable source of funding for residential mortgages across the country, including loans on housing for low- and moderate-income families. Fannie Mae and Freddie Mac carry out that mission through their operations in the secondary mortgage markets." (US Congressional Budget Office, 2010, p. viii). Although the debt securities of these institutions were not officially backed by the federal government, the common opinion was that the government would not allow a default of their obligations. In September 2008 they were nationalized and are still (as of June 2018) owned by the federal government.[7] Between 1980 and 2006 these two institutions bought between 40 and 50% of all original mortgages (Fieldhouse at al. 2018, p. 1509). In the United States the secondary market of mortgages is larger than that in other countries (CESifo, 2008).

A typical mortgage contract has a term to maturity of 30 years. Homeowners can borrow against the current value of the asset and thus their ability to borrow is influenced by the development of the house prices. No early repayment fees are required and the loan to value ratio is about 80%. These characteristics imply that within a group of industrialized

---

[6] Besides these institutions initiated by the federal government, the state of North Dakota owns the Bank of North Dakota (BND), the only state-owned bank in the United States. The bank was founded in 1919. At that time most of the credit to companies (farmers) in the state were provided by financial institutions from other states. The farmers thought these institutions charged excessive rates and provided insufficient credit. The BND was founded as a bankers' bank to help increase private banks' lending power and it could purchase part or all of a loan after it had been issued. The BND has done very well during the subprime crisis (ibid, pp. 173, 174).

[7] Many argue for privatizing these firms again. The subprime credit crisis originated in the mortgage market and a large part of this market was held by Fannie and Freddie (27 percent in 2006 and 69 percent of new mortgages in 2012). This rose a debate about these institutions' role in originating the crisis. Opinions differ widely (ibid, pp. 168-170), but at least one can conclude that these institutions had not been that strict on their standards that they have prevented the crisis or signaled problems.

countries, US inhabitants can most easily acquire a mortgage for financing their home (CESifo, 2008).

2.4 Conclusions

This brief survey of the history of the American financial system reveals that for a long time, this system was very fragmented. A fragmentation which can be considered a result of the federal structure of the United States, in which both the federation and the individual states want to have a say. Often this led to a patchwork of institutions and a conflict between those who were in favor and those against concentration of institutions or rules favoring small or large banks.

From the start of the republic small banks could count on popular support. The inclination of many Americans was that large (financial) institutions would benefit the wealthy (often far away or even foreign) people. Small institutions should be protected against the power of the large ones. The support for small and medium-sized banks was based on the assumptions that these banks would best serve the interests of the people. Whereas in the 1930s this resulted in public support for small banks, in the 1980s and 1990s this meant that community and minority organizations wanted that the interests of minorities and persons with low and medium income were secured. Consequently, the opposition against large banks became less vocal and was replaced by public demand for banks adhering to the CRA criteria. That is, banks were demanded to finance mortgage for low and middle income and other projects related to disadvantaged groups.

The United States represents the free market economy. From that perspective, the introduction in the 1930s of restrictions on interest rate payments in order to protect (enable) competition and shield it against 'ruinous' competition is remarkable, to put it mildly. It sounds as a contradiction in terms. During the 1960s and 1970s the restrictions were undermined by the fact that market interest rates were rising above the ceilings set by law.

3. Coordinated market economies: Germany

3.1 Structure of the financial system

Germany's financial system has long been and is still dominated by banks, whereas markets played a minor role (see Welker, 1992, for a brief description of the history). After World War II the country was divided in four occupational zones. During the years immediately after the war three big private banks were each split into 10 regional institutions. From 1956 onwards the three banks were allowed to reestablish. The Deutsche Bank and the Dresdner Bank were reestablished in 1957 and the Commerz Bank in 1958. No restrictions apply to the activities banks are allowed to conduct, so that in principle, all banks can be universal banks. Traditionally, investment banking activities have been of minor importance. Four groups of banks can be distinguished, publicly owned savings banks, cooperative banks, commercial banks, and specialized banks.

The savings bank sector consists of the primary savings banks, the regional Landesbanken, and the Deka bank. The majority of these banks are owned by governmental bodies: municipalities, counties (Kreis) and *Land*. Six savings banks are guaranteed by charities and form the *Verband der Deutschen Freien Öffentlichen Sparkassen*. The primary savings banks, *Sparkassen* are required to serve the public interest in their community and are expected to avoid losses but are not required to maximize their profits.[8] Operations outside of their own territory are forbidden. Their clients are households and small and medium sized enterprises. The close relationship between local *Sparkassen* and small firms could be a reason why *Sparkassen* have been willing to provide credit in bad times to their clients (Detzer et al. 2013, p. 80). These banks have provided mortgages against low interest for a long period and funded these by deposits. According to some this makes these banks vulnerable for rises in the interest rate (Kahl et al., 2018). The regional *Landesbanken* are generally jointly owned by regional associations of the *Sparkassen* and the regional state governments *(Landesregierung*). As of 2008 there were 8 *Landesbanken*. Originally these *Landesbanken* acted as the banker of the regional state (*Land*) and the central bank of the

[8] The connection between the local government and the *Sparkassen* can be problematic in the sense that local politicians can use the revenues of these banks for investment in loss making activities. After some failures had occurred in the 1930s the savings banks have been separated from municipal administrations and were organized as autonomous bodies under public law (Welker, 1992, p.,231). But still local politicians can have a seat at the supervisory board. A recent study (Markgraf and Véron, 2018) for eight German federal states finds that between 16 and 18% of these board's members and more than 80% of their chairs are elected local politicians. A phenomenon unknown in other countries. Still so now and then allegations of misuse of power by local politicians pop up (see e.g. Kahl et al. 2018).

Sparkassen. Over time they developed activities in commercial and investment banking and this way became state-guaranteed competitors of commercial banks. This privileged position in the field of commercial and investment banking led to pressure from foreign private banks who appealed to the European Commission. This appeal was successful so that, as of 2005, the commercial activities of the *Landesbanken* are no longer guaranteed by the *Landesregierungen*. As a consequence, the *Landesbanken* started investments in foreign assets, in particular mortgage backed securities, and were severely hit by the subprime crisis. The last type of savings banks consists of one bank, the DEKA bank. It is owned jointly by the *Landesbanken* and the German Savings Banks Association (DSGV) and serves as the central asset manager of the savings bank sector.

The cooperative banking sector consists of two levels, the primary cooperative banks and two regional institutions. The primary cooperative banks (*Volksbanken*) are owned by their members and fulfill banking functions similar to the *Sparkassen.* The DZ bank and the WGZ bank act as the central banks for the primary cooperative banks. The WGZ bank, the *Westdeutsche Genossenschafts-Zentralbank* operates as the central institution for cooperative banks in the Rhineland and Westphalia regions of Germany. The DZ bank (the Deutsche *Zentral-Genossenschaftsbank*) based in Frankfurt fulfills this role for the other regions.

The private banks are big banks, regional banks and branches of foreign institutions. By 2010 there were four private banks. Deutsche Bank is by far the largest and the only major international player. The others are the Commerzbank, the Unicredit Bank and the Post Bank. By far the majority of the shares of the Post Bank are owned by Deutsche Bank. These banks have traditionally acted as house banks for the big industrial concerns. They provided long-term loans and were represented in the supervisory board of these firms. The second group consists of 168 as of 2010, small stock owned banks, which operate regionally. The third group consists of branches of foreign banks. There are many, but the total sum of their assets is relatively small.

The three previously described groups are universal banks. In addition to these banks Germany also has specialized banks which perform a specific function. These are mortgage banks, building and loan associations, and banks providing funds for investments in particular sectors. The largest are the *Kreditanstalt für Wiederafbau* (KfW) which provides loans for infrastructure and other government supported projects, and IKB (German Industrial Bank) which provides loans for small and medium sized enterprises.

Traditionally, security markets play a minor role in the German financial system. The largest stock exchange is in Frankfurt and five minor ones in different cities; Hamburg and Hannover, Berlin and Bremen, Dusseldorf, Munich, and Stuttgart. In the 1990s the stock exchanges grew due to the privatization of large state-owned enterprises such as Lufthansa and Deutsche Telekom, and of firms in former German Democratic Republic. But still the size of the equity market is small compared to the Anglo Saxon world. The same holds for the shadow banking sector. This sector is small, although German banks are connected with the global shadow banking sector, so that they can be vulnerable to foreign shocks in this sector (Deutsche Bank, 2012, p. 74).

3.2 Degree of competition and the government's role

The local *Sparkassen* and the *Volksbanken* are all independent legal entities. This implies that a national concentration index will reveal a very low level of banking concentration (Detzer et al., 2103, Ch 7). At the local level, however, concentration is much higher, as only one savings bank (the area a savings bank operates in is preset and restricted) and a few cooperative banks are active. These banks have close ties with the small and medium sized enterprises, which makes it difficult for other banks (foreign and the big German banks) to enter the market. The nonfinancial firms profit from these ties in that there are indications that the local banks are more willing to extent credit in bad times (Detzer et al., 2013, p. 80).

The lack of competition at the local level can lead to a relatively high interest rate spread of German banks. A comparison of interest rate spreads over the period 1979 to 2009 in different countries reveals that the German rate is slightly (0.25 to 0.50 per cent) higher than that in France and Japan. It is much lower than that in Italy (Detzer at al., 2013, Figure 7.2). Since 1995 money market funds are allowed in Germany. Almost immediately after this event the spread decreased, indicating that the competition from these funds has had an effect (ibid, p. 144).

Different layers of the government, municipalities, counties (Kreis) and the governments of the *Land*, own a share of the banks; the *Landesbanken* and the *Sparkassen*. One can argue that the resulting government guarantee gives these banks a competitive advantage. As far as we know, this has never been regarded a problem as long as these banks' potential competitors were German. It became a problem at the moment that the

Landesbanken entered into business where foreign banks were their competitors. These banks regarded the implicit government guarantee as unfair and illustrated that it resulted in lower spread for *Landesbanken* at international capital markets. After an appeal to the European Commission the *Landesbanken* had to separate their commercial business from their other activities. In sum, within Germany, banks compete but it is at the regional level and often the close ties between local banks and their costumers restrict this competition.

The aim of large parts of the banking system, in particular the *Sparkassen* and the *Volksbanken* is to provide relatively cheap credit to the small and medium sized enterprises and households. The *Sparkassen* have also an obligation to finance activities at the community level.

3.3 Reforms towards a market based system

Since Germany already had a universal banking system, no initiatives were taken to enlarge the scope of bank activities, except that nowadays insurance is also part of the all service banks. Restrictions on deposit interest rates were also lifted much earlier than in other countries. The abolishment of the Bretton Woods system of fixed exchange rates in March 1973 led to daily fluctuations in the exchange rates of the major currencies, so that banks and large international firms were confronted with the necessity to manage exchange rate risk. In 1974 the German Bankhaus Herstatt was the first major bank that went bankrupt due to mismanagement of exchange rate risks. The German government reacted by introducing the 1976 Second Amendment of the German Banking Act, which limited the open position in foreign currencies. At that time, German bank regulation still fitted the dominant position of banks. It allowed cross-shareholdings between firms and between banks and firms. Often banks had a dominant position in the Supervisory Board of large firms. Regulation did not require high standards of transparency or the prohibition of insider trading, which are crucial for the well-functioning of financial markets. From the 1980s onwards, pressure for reforms came from three sources: the large commercial banks, the German government and foreign actors. The foreign forces came from the wish to integrate the German financial sector in that of other industrialized, in particular European, countries. The European integration required a harmonization of national laws. All forces resulted in legal changes that improved the position of financial markets.

In the mid-1980s the big banks saw their profits declining due to a decrease of their services to the big industrial firms. The latter moved abroad and asked for listings on foreign equity markets, such as the New York Stock Exchange and Tokyo Stock Exchange. Moreover, the international bond market grew and new technology enabled long distance trading. In order to increase their competitiveness the big banks formed a consortium to promote the so-called *Finanzplatz Deutschland*; Germany as a financial center. A key element of this initiative was to expand the securities' markets. The banks hoped that an increase of securities' markets activities would increase their income from fees and investment banking activities. The Kohl government also wanted to strengthen Germany's role in international financial markets to support German financial institutions and to reduce the financing costs of the government's deficits (Mügge 2015, p. 184 and 185).

As a consequence of the desire to make the German financial system more market friendly, four financial market promotion acts have been legislated over the period 1990 to 2002. These acts broadened the products that could be traded and increased transparency. The act of 1990 was the first unified capital market law in German history, and was the first law to have investor protection as one of its objectives (Bradley and Sundaram, 2003). Over the course of a decade the laws allowed new activities such as money market funds, introduced a prohibition of insider trading (1994)[9], increased transparency, enhanced investor protection and improved supervision. In 2002 the Federal Financial Supervisory Authority was established as the single integrated financial markets supervisor, to supervise 'same businesses' with the 'same risks' and the 'same rules'. This was needed because of an increase in the type of activities by different institutions partly due to the establishment of large financial groups.

Besides a sound legal framework, enhancing investment bank activities also requires that banks and firms have no tight relations. If they do, then some banks could have prior information which sets them at a competitive advantage. However, until 2002 German banks still held large shares of equity of different industrials firms because selling it was unattractive due to a 50 percent capital gain tax they had to pay in case they sold their part. In 2002 the Social Democratic – Green government abolished this capital tax, which enhanced the divestment by large banks.

[9] Germany was the last country in the European Community to prohibit insider trading

In the 1990s stock markets obtained an important impetus by the privatization of a number of large state owned enterprises, such as Lufthansa and Deutsche Telekom. In addition in 1997 the *Neue Markt* was opened, which targeted at growth stocks much like the New York Nasdaq. In 1999 the SMAX for smaller firms was opened. Both markets were closed in 2003.

These reforms towards a more market oriented financial system have had only limited effect. First, despite the attempts to promote an 'equity culture', so that private persons would invest a larger share of their possessions in equity, private persons' investment in equity did not increase in a structural way. The amount invested by private persons increased during the 1990s but decreased again after the dot com bubble of 2000 (Detzer et al. 2013, pp. 85, 86, 89, and 245).

3.4 Pensions and the housing finance

In Germany pensions are to a large extent on a Pay-As-You-Go basis. The assets of private pension plans and public pension reserve funds are low, respectively 6.8 and 1.1 percent of GDP in 2016 (OECD, 2017). In order to increase their income relatively many Germans act as a landlord. In addition to these individuals, the group of private landlords consists of housing companies, institutional investors, and companies controlled by financial institutions. This group of private landlords owns 47% of all dwellings, which is very high according to international standards (Kofner, 2014, p. 264). 84 percent of the private rented dwellings in Germany and over 60 percent of all rental apartments are owned by private households, i.e. individuals, couples, estates or civil partnerships.

The *Bauspar* system is very popular for financing privately owned houses. Every second German household has at least one Bauspar contract. In 2012 there were about 26 million Bauspar savers with a total contract sum of about 763 billion euros (around 30% of German GDP) (Kofner, 2014, p. 272). A Bauspar contract consists of three phases: a savings phase (*Sparphase*), an eligible phase (*Zuteilungsphase*), and a loan phase (*Lenningsphase*). The idea is that all participants contribute to a fund that enables particpants to borrow in order to finance a house. During the savings phase, participants save and receive an interest. When the total amount saved is high enough the saver can use this amount as a down payment for buying a house and financing the additional amount needed by means of a mortgage. Before the credit crisis the savings had to be at least 50% of the amount the participants want to borrow. After this crisis conditions have become less strict. The Bauspar mortgage offers a fixed interest over

the entire time to maturity. As a consequence of this conservative attitude, the average age of first time buyers is high, about 40 years (Kofner 2014, p. 272), the average house-price-to-income (HPI) and loan-to-value (LTV) are low. Moreover, innovative products as adjustable rate mortgages, interest-only-mortgages are scarce. Subsidies for home-ownership are low and much lower than in other countries (Kofner, 2014, p. 263).

The mortgages are provided by banks whose funding is also conservative. The majority of the mortgages is financed by deposits and Pfandbriefe. These Pfandbriefe are covered bonds which remain on the balance sheet of the issuing banks. The amount of residential mortgage backed securities is small.

In sum, in Germany the financing of residential buildings is bank dominated and conservative. The Germans first save a large part of the money needed for buying a house and then obtain a mortgage which has a fixed rate for a long period of time. Both the mortgages and its funding are directed at a long horizon.

Conclusion

In summary, the German financial system was and still is a bank based system, with a large share of not for profit banks. Except for a few specialized banks, all banks are universal banks. Different layers of the government, most importantly municipalities and the governments of the *Land*, own a share of the banks; the *Landesbanken* and the *Sparkassen*. One can argue that the resulting government guarantee gives these banks a competitive advantage. As far as we know, this has never been regarded as a problem as long as these banks' potential competitors were German. International competitors forced Germany to separate the Landesbanken's commercial business from their other activities. In conclusion, within Germany, banks compete but it is at the regional level and often the close ties between local banks and their costumers restrict this competition. It is noteworthy that of the three countries studied, Germany has been the country which had the least restrictions on interest rates. Nevertheless, competition has not been very rough tough, which is most probably because of the close ties between the local banks and the small and medium sized enterprises.[10] These ties are also likely to hamper the entrance of large banks in these areas.[11]

[10] One could argue that for a long time a similar tight relationship existed between large banks and large companies.

[11] In a private conversation with the author, a German representative of a foreign bank complained that it was difficult to attract rich people for asset and wealth management, because they already conducted business with the local banks (*Sparkassen* and *Volksbanken*). They remained loyal to these banks when they had become rich.

The aim of large parts of the banking system, in particular the *Sparkassen* and the *Volksbanken* is to provide relatively cheap credit to small and medium sized enterprises and households. The *Sparkassen* also have an obligation to finance activities at the community level. The changes in legislation from 1990 aimed at increasing the competitive position of the German financial sector, in particular that of the large commercial banks. They reflected the dominant neoliberal view of that time, which expected that markets would discipline actors. These attempts had minor success.

Finally, regulation was always conservative; new products were allowed after they had been available in other countries. Mortgages have a fixed interest rate and along term to maturity. Often early repaymnets are not allowed. German investor also seem to dislike risk and hence market type investments. In short, they like a *Stabilitätskultur* (stability culture).

4. Hierarchical market economy: France

In France the government has always played a dominant role in many sectors of society. This also holds for the financial sector.[12] At the end of the 19th century the Paris Bourse was as important as the London Stock Exchange (Cerny, 1989, p. 170). In 1913 stock market capitalization to GDP was twice that of the United Sates (Rajan and Zingales, 2003, Table 3). The importance of financial markets declined due to the First World War, the depression of the 1930s, and the move towards regulation in and after World War II. After World War II the French financial system was dominated by banks under strict regulation of the government. It was an 'overdraft economy' instead of an 'auto economy' (a distinction made in Hicks,1974). "In an overdraft economy, deficit units do not borrow from the markets (which are non-existent or only residual), but they rely on bank credit" (De Bouissieu, 1992, p. 186). During the years many reforms were suggested and in some cases partly implemented. The final and largest move towards a deregulated system came after the U-turn of Mitterrand in March 1983. In this section we first describe the system as it was before the deregulation of the 1980s and then how it rapidly changed from mid 1980s onwards.

In 1945, three categories of banks were constructed: deposit banks, investment banks and medium and long-term lending banks. The competition between the different types of banks was low and each bank had its own preassigned field, objectives and instruments. The

[12] A brief description of the French financial systems history can be found in Metais (1996), pp. 364 and 365.

Treasury Circuit provided a good illustration of the high degree of regulation imposed by the French government. This circuit worked as follows (see Butzbach 2015, pp.1171-1172 for a schematic representation). The local savings banks (575 in 1945, ibid, p. 1161) collected private savings. Until 2007 these banks were the only providers of the Livret A,[13] a savings deposit of which the interest rate and conditions were set by the *Caisse des Dépôts et Consignations* (CDC), a specialized state affiliated /controlled financial institution. These conditions reflected the Treasury's priorities. The funds collected by savings banks were not invested by these banks themselves but transferred to the CDC. The latter in turn, converted these funds into medium and long-term financing (illiquid investments), granting loans directly to local authorities and financing social housing construction through the Crédit Foncier de France, a state-owned mortgage credit institution. The CDC also made productive investments through the Crédit National: a state-owned credit bank. The so-called 'Minjoz Law' passed in June 1951, authorized the savings bank to propose to the CDC loans to local authorities representing up to 50% of the annual increase in deposits (Butzbach, 2015, p. 1163). So, savings banks still were not allowed to invest these funds themselves. This nicely illustrates that at that time banks were very specialized and often held a state-endowed (partial) monopoly in a specific niche.

The first deregulation came in 1966 – 67. Banks' lending rates were deregulated although ceilings remained and branch banking was liberated which created an intense competition for market share (De Bouissieu, 1992, p. 186). During these years the government intended to end exchange controls and to move towards a more flexible monetary policy. However, these intentions were thwarted by the events of May 1986 (Cerny, 1989, p. 171).

French firms relied heavily on debt provided by banks. The French government controlled the allocations of loans from banks to firms through its control of Banque de France. In the early 1970s about 80 percent of all loans were directly controlled by the Banque de France (Loriaux, 1991). During the same period about 60 percent of the medium to long-term loans allocated to French companies were provided by government and semi-government agencies. These agencies' aim was to facilitate and subsidize lending to specific sectors. In 1973 the *encradement du credit* system was implemented. It was a system of credit ceilings for individual banks to control the quantity of money and the direction of financial

[13] The Livret A was established in 1818 by Louis XVIII to pay back the debts incurred during the Napoleonic wars. It has since been a popular savings instrument because of government guarantees and reasonable interest rates.

flows (Cerny, 1989, p. 172). Foreign influences were restricted by means of capital controls and financial markets were of minor importance. In 1977 IBM's market capitalization was about two times that of the Paris Bourse. Moreover, through different government institutions, such as CDC, the government owned about 55 percent of French shares (Cerny 1989, p. 174).

This system had various drawbacks. Firstly, efficiency was low due to an almost complete absence of competition. Secondly, since interest rates did not reflect market forces, they could be set too low so that too much credit was provided and inflation was created. Thirdly, over the years it appeared that the money market was too small so that it could not provide enough finance for French firms. From the beginning of the 1980s the financial system also had to be reformed in order to finance the government's deficits. Finally, the system of *encradement du credit* was very costly and complex because it sets limits to the credits to be provided by individual banks. Hence, the authorities had to oversee the behavior of individual banks in detail.

At the end of the 1970s and the beginning of the 1980s the disadvantages of this overregulated system emerged. The first disadvantage was triggered by international developments, such as floating exchange rates and the rise in foreign interest rates due to the strict monetary policy in the US and the UK. In the first instance, the French government tried to shield the French economy against these developments by means of capital controls. France had restrictions on international capital flows until 1989. However, these controls appeared to be unsustainable in the longer run and forced the authorities to structural changes so that the economy became more open to the outside world. These international developments put stress on the French banks. This sector appeared to be overregulated. The different segments introduced after WW II could not handle foreign pressure. In 1979 the Mayoux report recommended to introduce universal banking, so that an individual bank could diversify its portfolio.

Second, the system of *encradement du credit* had always been subject to exemptions for credits to low-cost housing, exports, agriculture and other investment projects favored by the government. In 1976 Raymond Barre, who at that time became Prime Minister and Minister of Finance and Economic Affairs, announced a target for the growth rate of M2 money. With the foundation of the European Monetary System (EMS) in March 1979, these monetary targets became of greater importance as they signaled the French willingness to stick to the agreed fixed exchange rates within the EMS. The *encradement du credit* was the main instrument to control M2. However, since the subsidized credits often exceeded M2

targets, the growth of the non-subsidized credits had to be set at an extremely low level. Adhering to the system would thus undermine the business of banks without access to subsidized credit. These banks were therefore allowed to provide bank credit with money acquired at financial markets, which led to an increase in bonds and equities issued by banks (Melitz, 1990, p. 396). The bond issues had a long term to maturity whereas the loans provided were short term. This maturity transformation is opposite to the normal one and in many cases not profitable as long-term interest rates are generally higher than short-term rates. The habit of providing exemptions to the rules for preferred credits gave a boost to institutions with privileged access to the socially expensive credits (Melitz 1990, p. 396). Concluding, during the 1970s it became clear that the French financial system was in need of a total overhaul.

In the first half of the 1980s the initiative of the reforms rested with the *Tresor*, and thus with the government (see for example Métais, 1996, p. 367). Two phases can be distinguished. First, the nationalization phase during the first years of President Mitterrand's government. In 1982, the socialist government nationalized the banks in order to direct the banks' policies towards financing small and medium-sized firms (De Bouissieu, 1992, p. 189). During these years his government followed a Keynesian policy in order to stimulate economic activity. Capital controls were used to limit capital flight.

The second phase started in March 1983 when the franc was devalued again, and the Mitterrand government changed course and aimed at a fixed peg between de French franc and the German mark and thus at a stability oriented policy. In 1982 the Socialist government nationalized banks in order to radically overhaul the French banking system so that it could withstand international pressures. It nationalized 36 deposit banks including large banks such as Paribas. As a result it controlled almost the entire banking sector. The government's aims were to finance priority investments, to improve control of credit and to reduce the costs of bank loans. Nationalized firms made huge losses in 1981-82. In addition, the former shareholders had to be compensated according to a ruling by the Constitutional Council (Cerny, 1989, p. 173). Both events required new funds. Moreover, since the second oil shock (1979) the French government's budget showed a deficit which had to be financed, whereas during previous years their budget had always been in balance (Melitz, 1990, p. 395). In 1984 the Minister of Finance started a process of deregulation which strived for a unified financial market where prices are set freely. The Banking Act of 1984 aimed at tearing down the barriers between the different segments and introducing competition between the different

financial institutions. This competition was still state-controlled (Mügge, 2015, p. 180). From 1986 onwards banks were gradually privatized again. At that time, the conservative government "justified the privatization by the pressures of competition and the need for French credit institutions to increase their capital." (De Bouissieu, 1992, p. 189). In 1988 the French state had still control over 69% of the commercial banks and 42% of the banking sector.

The French stock market was very small in the 1960s and 1970s. The trade was monopolized by the *agents de change*. From 1985 onwards these agents lost their monopoly (Cerny, 1989, p. 175). The nationalization in 1982 had an unintended stimulating effect on the Paris Bourse; the funds acquired through the compensation the government had to pay to the former shareholders of the nationalized companies, were invested in companies listed on the Bourse (Cerny, 1989, p. 178). In 1988 the French stock market was reformed; the *petit* Big Bang. The aim of the Stock Exchange Reform Act was to create a French investment banking industry that could compete with the banks in London. Ultimately, the overregulated financial system of the 1980s had to be replaced by a dynamic financial system which would much, more than before, rely on financial markets.

The establishment and further development of the French market for derivatives illustrates the declining influence of the state in favor of that of private participants (Mügge 2015, p. 182). The MATIF, the French market for derivatives, was introduced in 1986. The Tresor had played an important role in establishing this market. It immediately became a success, leading to high profits for those who were allowed to trade at MATIFF. These profits raised the jealousy of the banks that did not have a permit to trade. This conflict had to be settled by the Treasury. The conflict remained, however, as a consortium of French banks and a Swedish specialist set up a rival exchange, named OMF. Two, BNP and Paribas, of the three French banks had already established capital market operations in London.

In the meantime, from the end of 1983 onwards, the government also lifted restrictions on international capital flows. It started with the restriction that hurt the middle classes, the Socialist Party's constituency, most, namely the travel allowances and the *carnet de change* (liberalized in 1984). In 1985 other transactions were liberalized such as Eurobond[14] issues in

[14] Note Eurobonds refer here to the Eurocurrency market and not to the currency euro, which was created by the establishment of the Economic and Monetary Union.

French franc. In January 1990 France's capital account was fully liberalized (Abdelal, 2006, p. 8).[15]

Despite this trend towards a market based financial system, the ties between the French government and the financial and nonfinancial institutions are closer than in many other countries. The state still holds shares in large companies among which are financial isntitutes. Top managers are recruited from the students and alumni of the "Grand Ecoles" (Métais (1996, p. 369). In finance, the graduates of the specialization "Inspecteurs des Finances" of the 'Ecole National d'Adminstration' play a large role. They typically start their carreer at the Ministry of Finance and then move to top management roles in banking (among which is the central bank) and to top positions of industrial groups.

At least three reasons can be provided for the French move from an almost entirely regulated system towards a more liberal one. First, Mitterrand's experiment with Keynesian stimulation policy had failed. He made a U-turn in March 1983 when the French government decided to devalue the French franc and seek for structural changes so that the French franc - Deutsch mark peg could be maintained. Immediately after the devaluation, the capital controls were tightened even more by the introduction of the *carnet de change*, which restricted the allowance for foreign nonbusiness up to maximum of FF2000 per year per person. The use of personal credit cards abroad was also forbidden. These restrictions hurt the Socialist's party constituency, the middle class, the most and were very unpopular, so that already by the end of 1983 the *carnet de change* was withdrawn (Bakker, 1994, 225 of 170). Moreover, the restrictions led to a huge bureaucratic burden, attempts to evade the restrictions, and a diversion of banks' commercial activities towards foreign centers (Geneva, for example) (Bakker, 1994, p. 225). A second reason for accepting liberalization was, that it was part of European integration. Liberalizing capital flows and financial markets and the preparations for a monetary union were simultaneous processes. A third reason is that from the beginning of the 1980s, the French government was confronted with budget deficits. The old system was not able to finance these deficits, whereas allowing more parties through liberalization of financial markets would increase the possibilities to sell government bonds. Finally, there had always been a current in the Left which thought that liberal policies would serve the social

[15] It is noticeable that it were French leaders who as chair of international organizations, Camdessus (IMF), Delors (EC) and Chavranski (OECD), led the movement towards codifying liberal capital flows worldwide. An argument for the latter was according to Lamy "if you liberalize you must organize" (Lamy cited in Abdelal 2006, p. 7).

purposes. They saw inflation damaging long-term health of the economy. “This minority has always sought to modernize France to stabilize the currency; to fight inflation and to promote healthy growth and employment.” (Delors cited by Abdelal, 2006, p. 8) During the 1980s this minority won.

Pensions and housing finance

The French Pay-As-You-Go pensions system is relatively sober and funded pension schemes are small. In 2016 the assets in private pension plans amounted to only 9.8 percent of GDP, whereas in 2015 the public pensions reserve fund owns assets worth 2.5 percent of GDP (OECD, 2017, Table 8.4). The lack of funded schemes is reflection of the French aversion against Anglosaxon type of institutions (Chavannes, 2000, p. 189). Consequently, owning a house is a good way of increasing income (reducing costs) when old and thus of smoothing consumption over time.

Since World War II, the French government has had many schemes in place to subsidize housing loans and stimulate private savings for financing a house. In the 1960s over half of the housing loans were subsidized. This gave the French government the ability to control much of the terms on housing loans, including maturity and interest rates. From 1966 the Debré reforms were introduced which reduced the government sponsored circuit and introduced savings schemes to stimulate household savings for financing housing. Key were the introduction of the *compte d’erpargne logement* (CEL) and the *plan d’erpargne logement* (PEL). Both were savings products under favorable conditions. The PEL offered a higher interest rate but was also more binding. These savings products allowed households to reduce the housing debt and repay their housing loans relatively quickly and formed attractive means to create wealth without paying taxes. The PEL and CEL still exist but as of January 1, 2018 they do not provide the right for a subsidized loan anymore.

Until the mid-1980s, subsidized loans played an important role for financing housing. In 1985 about 67 percent of new housing credit was in the form of a subsidized loan (Van der Valk (2018, Table 4). A popular loan type was the *Prets en accession a la properiete* (PAP), introduced in 1977 as part of the Barre Reforms. In 1995, the PAP loan was replaced by the *Prets a toux zero* (PTZ). The PTZ is targeted at lower to middle income households, who

want to buy a house for the first time. It is still available and offers a loan without paying interest for a targeted group of first-owners.

In the second half of the 1980s a growing share of the population was confronted with an increase in debt. This led to a debate about over-indebtedness, which resulted in the law-Neiertz in 1989. According to this law the creditor should prevent over-indebtedness of consumers. In case of arrears, the newly installed committee should come with a solution. If after two months no solution was arrived, a judge could impose a reduction of the debt or reduce the interest rate (Van der Valk, 2018, p. 23). From 1985 onwards, the percentage of non-regulated credits for housing increased.

Nowadays housing finance is dominated by large universal banks from French origin. These banks are very cautious when providing housing credit. Loan to value is around 90 % for first buyers which is relatively high, whereas the percentage of the outstanding amount of guaranteed loans for house purchases is high namely 14 %. In The Netherlands it is 13 % and in the rest of the euro area 0, 4, or 5 % (see ECB, 2009, Table 2). Interest bands prescribe that interest rates cannot deviate more than one third of the average over the previous period. This is a measure to prevent large increases in interest payments and thus reduces chances that a private individual enters into debt service arrears. The Neiertz law (on over-indebtedness) has a similar aim. Since profits on mortgage loans are low, banks require an extensive set of insurance products. A consequence of this behavior is that low-income households, the elderly, and those without a steady employment are largely excluded from the market. The system of housing finance was hardly affected by the subprime crisis, probably due to the fact the French banks did not enter into the securitization products and the limited possibilities to experiment for credit providers.

In the 1960s the funding of mortgages were arranged via Crédit Foncier de France and the rediscounting facility of Banque de France (van der Valk, 2018, p. 14). In the mid 1960s monetary financing was restricted and by 1973 the main part of refinancing was halted. To compensate for the reduction in rediscounting, in 1966 the Banque de France allowed the banks to issue medium term covered bonds. The Crédit Foncier de France became the regulator of the mortgage bond market and set the interest rates. The French government strictly regulated the type of bonds that could be employed as collateral on this market. The maturity was set at 10 and 20 years and mortgages or a *privilège immobilier* served as the guarantee. A *privilège immobilier* is an alternative to a mortgage. It gives the creditor a

priority right in case the debtor fails to pay. No notary is required but the holder risks that other creditors are faster making a claim. The latter is not possible with a mortgage (Van der Valk 2018, note 21). Covered bonds and mortgages backed securities are of minor importance for financing housing loans. Over the period 2003-06 they counted for 1.6% respectively 1% of the residential loans outstanding (CESifo 2008).

5. Concluding remarks

During the 1980s capital controls have been lifted, so that since then capital can flow freely across borders. Since the 1990s the governments of the industrialized countries strive for a one level playing field in finance. As part of this process the Basle Committee of Banking Supervision, in which 28 jurisdictions are represented, designs supervisory guidelines which the most well-known have the acronym Basle I, Basle II and Basle III. Although these guidelines are not legally binding, they act as a mechanism for unifying the regulatory strucuture of the financial systems in the countries concerned. This raises the question whether for individual countries there still is some room to diverge from these unifying pressures. In particular whether the national traits stressed by Varieties of Capitalism and the corresponding value systems still can be observed. In order to answer this question, the present chapter describes the evolution of the financial systems of the United States of America, Germany and France as representatives of the liberal (free) market economy, the coordinated market economy and the hierarchical or state-led market economy. Here we summarize our findings by concentrating on the basic values of the original (that is immediately after World War II) financial systems, the role they played during the transition towards the present system, and the way they still are important fro explaining differences in pension systems and the way residential housing is financed.

In the USA the ideal person acts independently, and competition between individual (small) actors is assumed to be good. Another trait is that the public debate can be very populistic and the general public has a distrust in large financial institutions, which are often owned by 'foreigners' that is outside the persons' state. Banks and the financial system at large has to serve the people. In the 1930s these national traits led to three measures: a prohibition of interstate banking, a distinction between commerfial banking and investment banking, and a restriction on competition by caps ion interest rates (Regulation Q). In many

cases no valid economic rational was presented; the public mood dominated. In Section 2 we have argued that from the beginning of the 1960s the changes in circumstances have forced American authorities to abolish the restrictiosn of subsequently Regulation Q, the ban on interstate banking and finally that on universal banks. These three measures appeared to be counterproductive when circumstances had been changed. Nevertheless. They way the latter two bans were lifted still reflects the populistic tention in the the US. In 1974 Congress had passed the Community Reinvestment Act (CRA), whichj aimed at …. Based on this act some criteria were developed which indicated whether banks provided enough loans to the poor and minorities. These CRA-criteria were used as a benchmark for allowing interstatebanking and the merger of investment and commercial banking.

The trust in financial markets and distrust of direct governmenl polices also come to the fore when it comes to the financing of houses. The US government doesn't provide subsidies but enhances the working of the market nmechanisms. The federal government has stimulated financing of homeownership by establishing the Government Sponsered Private Enterprises Fenny Mae and Freddy Mac. These institutes buy mortages on the secondary market so that banks obtain liquidity for providing new mortgages.This illustrates again the preference for markets. Moreover, although mortgages can have a long term to maturity they can easily by replaced by new mortgages if conditions have changed so that a new contract is more profitable for a client. The costumer can hand over the ownership of the house to the banks in case the value of the house, the collateral in the mortgage contract, declines below the value of the loan. This hints at the importance of flexibility and short sightedness.

Germany is characterized by cooperation, long-term relations and stability; a *Stabiltätskultur* as they name it. Consequently, banks could have large stakes in private companies, using information acquired via different channels was acceptable. New financial products were allowed after they had already been introduced abroad. Germany was the last European countries that implemented alst country in E Local governments have a relatively large say in local banks, which have duty to provide finances fro local innitiatives, small and medium sized business and households. These banks' operational area is geopgrahically restricted and region. In order to obtain a mortgage via the *Bausparen*-system, a consumer has to save first. So that he or she shows a willingness to save and be trustworthy. The mortgage offered has a long term to maturity, a pre-set low interest rate and cannot easily be paid off prematurely. Once again these chracteristics illustrate a preference for long term orientation. Moreover, German private persons invest only a small share of their portfolio in equity and a

much larger part in fixed income assets. This once again hints at a preference for stability and an aversion of uncertainty.

The French government plays a dominant role in the economy both as a lawmaker and through direct intervention. In the first decades after World War II the French government had a firm grip on almost all aspects of the financial system, which resuted in many quasi-monopolies in different subfields. This tight regulation appeared to be too strict, too costly and led to inefficient use under the changing circumstance of the 1970s and 1980s. The reform of the 1980s was first led by the government in particular the Ministry of Finance. As part of the restructuring towards a more market oriented financial system, government nationalized almost the entire financial sector in order to restructure it. The French government still has a relatively large influence on the financial sector. The country has a wide range of preferred savings products such as *Livret A*, *Compe d'épargne logement*, and *Plan d'épargne logment*, and CODEVI. The government determines the interest rates offered and other specific conditions. As of 2016, about € 400bln is held in regulated deposits (Jones and Arnold, 2018). The banks are obliged to deposit a large share (about 65 percent) of the money collected via the *Livret A* with the state-owned *Caisse des Dépôts*. The latter uses the funds for investments in public housing and other projects. Another French peculiarity consists of the regulation on preventing over-indebtedness (the Loi Neiertz of 1989) and on restricting the change of interest rates. These rules illustrate the paternalistic attitude, according to which the French state should protect its citizens against abuse by market forces. In the words of Mitterand, the markets shoud be "responsibilized".

References

Abdelal, Rawi, 2006, Writing the rules of global finance: France, Europe and capital liberalization, Review of International Political Economy, 13(1), 1-27.

Alesina, A., & Giuliano, P. (2015). Culture and Institutions. *Journal of Economic Literature*, *53*(4), 898–944. https://doi.org/10.1257/jel.53.4.898

Atkins, Ralph, 2006, Lunch with the FT: The Main man, Financial Times October 27, 2006

Bakker, Age, F.P., 1994, The Liberalization of Capital Movements in Europe: The Monetary Committee and Financial Integration, PhD-thesis University of Amsterdam.

Barth, J.R., Nolle, D.E. and Rice, T.N, 1997, Commercial Banking Structure, Regulation, and Performance: An International Comparison, Office of the Comptroller of the Currency, Economics Working Paper, Washington.

Beck, Stefan and Christoph Scherrer, 2015, Varieties of capitalism: Beyond simple dichotomies, In Jessop, Bob, Brigitte Young, and Christoph Scherrer (Eds.), Financial Cultures and Crisis Dynamics. New York; Routledge. Pp. 162-175.

Berger, Allen N., Anil K Kashyap, Joseph M. Scalise, Mark Gertler and Benjamin M. Friedman, 1995, The Transformation of the U.S. Banking Industry: What a Long, Strange Trip It's Been
Brookings Papers on Economic Activity, No. 2 (1995), pp. 55-218

Bernanke, Ben S., 2007, *The Community Reinvestment Act: Its Evolution and New Challenges*, speech at the Community Affairs Research Conference, Washington, D.C. March 30, retrieved at April 18, 2018 from
https://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm

Beugelsdijk, Sjoerd and Robbert Maseland, 2011, Culture in Economics: History, methodological reflections, and comntemporary applications, Cambridge University Press; Cambridge

Beugelsdijk, S., Maseland, R., & van Hoorn, A., 2015, Are Scores on Hofstede's Dimensions

of National Culture Stable over Time? A Cohort Analysis. *Global Strategy Journal*, *5*(3),

223–240. https://doi.org/10.1002/gsj.1098

Bisin, A., & Verdier, T. (2011). The Economics of Cultural Transmission and Socialization.

In *Handbook of Social Economics* (Vol. 1, pp. 339–416). Elsevier.

https://doi.org/10.1016/B978-0-444-53187-2.00009-7

Blot, C., Creel, J., Delatte, A. L., Durand, K., Gallois, A., Hubert, P., ... & Viennot, M. (2013). *The French financial system, from past to present*. Financialisation, Economy, Society & Sustainable Development (FESSUD) Project.

Cerny, Philip G., 1989, The 'Little Big Bang"in Paris: financial deregulation in a *dirigiste* system, European Journal of Political research 17, 169-192.

CESifo, 2008, Institutional features of mortgage markets across countries, CESifo DICE Report, 2008 / 3, 70 and 71.

Chassany, Anne-Sylvaine, 2017, Macron plays corporate Meccano to make European champions Financial Times, September 28.

Chavannes, Marc, 2000, Frankrijk achter schermen: De stille revolutie van een trotse nation (France behind the scene: The silent revolution of a proud nation), Amsterdam: Prometheus.

Clinton, William J. "Statement on Senate Action on Banking Legislation, September 13, 1994." In *Public Papers of the Presidents of the United States: William J. Clinton (1994, Book II)*. Washington, DC: Government Printing Office, 1994.

De Boissieu, Christian, 1992, France monetary and financial system, In: J. Eatwell, M. Milgate and P. Newman, eds., The New Palgrave Dictionary on Money and Finance, Part 3, London: Macmillan, Volume 2, pp. 185-190.

De Jong, Eelke, 2009, Culture and economics: On values, economics and international business, Routledge, New York.

Detzer Daniel, Nina Dodig, Trevor Evans, Eckhard Hein, and Hansjörg Herr, 2013, The German Financial System, FESSUD, Studies in Financial Systems no. 3.

Deutsche Bundesbank, 2012, The shadow banking system: Small but internationally connected, Financial Stability Review 2012.

Dixon, Adam, D, 2012, Function before form: macro-institutional comparison and the geography of finance, Journal of Economic Geography 12(3), 579-600.

Dymski, Gary A., Gerald Epstein and Robert Pollin, eds., 1993, Transforming the US Financial System: Equity and efficiency for the 21st century, New York, M.E. Sharpe.

Eurofound, 2015, Vadafone's hostile takeover bid for Mannesmann highlights debate on the German capitalist model,

https://www.eurofound.europa.eu/fr/observatories/eurwork/articles/vodafones-hostile-takeover-bid-for-mannesmann-highlights-debate-on-the-german-capitalist-model, visited at July 7, 2018.

European Banking Authority, 2016, Guidelines Compliance Table, http://www.eba.europa.eu/documents/10180/1314839/EBA+Guideline+2015+22-Compliance+Table-GLs+on+sound+remuneration+policies.pdf

European Central Bank, 2009, Housing finance in the euro area, ECB, Occasional Paper 101.

Fieldhouse, Andrew J., Karel Mertens and Morten O Ravin, 2018, The macroeconomic effects of government asset purchases: Evidence from postwar US housing credit policy, The Quarterly Journal of Economics 133(3), 1503-1560.

Gordon, Jeffrey N., 2007, The Rise of Independent Directors in the United States, 1950-2005: Of shareholder value and stock prices, Stanford Law Review 59(6), 1465- 1567.

Guthrie, Jonathan, Michael Stothard and Alice Ross, 2014, Heseltine's view on foreign takeovers harks back to 1990s, Financial Times, MAY 2, 2014

Hall, Peter A. and David Soskice, eds. 2001, Varieties of Capitalism: The Institutional Foundations of Comparative Advantage, Cambridge University Press; New York.

Heukelom Floris, 2017, Good Markets, Ideational differences, mimeo, Radboud University, Nijmegen.

Hicks, J., 1974, The Crisis in Keynesian Economics, Oxford: Basil Blackwell.

Hofstede, Geert, 2001, On culture's consequences: Comparing values, behavior, institutions and organizationsa cross nations, Sage Publications, London.

Hofstede Geert, Cheryl A. van Deusen, Carolyn B. Mueller, and Thomas A. Charles, 2002? What Goals Do Business Leaders Pursue? A Study in Fifteen Countries, Journal of International Business Studies 33(4

James, Harold, 1996, International Monetary Cooperation since Bretton Woods, IMF & Oxford University Press, Washington DC and Oxford.

Johnston R.B., 1983, *The economics of the Euro-Market: History, theory and policy* MacMillan; London.

Jones, Clair and Martin Arnold, 2018, French banks win savings account case against ECB, Financial Times, July 13 2018.

Kahl, Stephan, Piotr Skolimowski, and Boris Groendahl, 2018, How Germany's little savings banks threaten big financial woes, Bloomberg Businessweek, October 5,.

Kofner, Stefan, 2014, The German housing system,: fundamentally resilient?, *Journal of Housing and the Built Environment*, 29, 255-275.

Kroszner, Randall, S. and Phillip E. Strahan, 1999, What drives deregulation?: economics and politics of the relaxation of bank branching restrictions, Quarterly Journal of Economics 114, 1437-1467.

Markgraf, Jonas and Niclas Vérnon, 2018, Germany's savings banks: uniquely intertwined with local politicians, blogpost at Breugel Institute, Brussels, http://bruegel.org/2018/07/germanys-savings-banks-uniquely-intertwined-with-local-politics/

Medley, Bill, 1994, Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Federal Reserve History, https://www.federalreservehistory.org/essays/riegle_neal_act_of_1994

Melitz, Jacques, 1990, Financial deregulation in France, European Economic Review 34, 394-402.

Métais, Joël, 1996, French Banks: The challenge of competition and globalization, in Schuster, Leo (Ed.) Banking Cultures Around te World, Frankfurt am Main, Fritz Knapp Verlag, 363-384

Morrison, A. D., & Wilhelm, W. J. (2008). The demise of investment banking partnerships: Theory and evidence. The Journal of Finance, 63(1), 311-350.

Mügge, Daniel, 2015, Competitive concern and imaginaries in the liberalization of European finance, In: Jessop, Bob, Brigitte Young, and Christoph Scherrer, Eds., Financial Cultures and Crisis Dynamics. New York; Routledge, pp. 176-188.

Nicoló, G. D., Bartholomew, P., Zaman, J., & Zephirin, M. (2004). Bank consolidation, internationalization, and conglomeration: Trends and implications for financial risk. Financial Markets, Institutions and Instruments, 13(4), 173-217.

OECD, 2017, Pensions at a Glance 2017, Paris.

O'Sullivan, Mary, 2007, Acting out institutional change: understanding the recent transformation of the French financial system, Socio-Economic Review 5, 389-436.

Perotti, Enrico and A. Schweinbacher (2009). The Political Origins of Pension Funding, Journal of Financial Intermediation, 18(3), 384-404.

Pollin, Robert and James Heintz, undated, Study of U.S. Financial System, FESSUD Studies in Financial Systems no. 10.

Quinn, Dennis P. and A. Maria Toyoda, 2008, Does capital account liberalization lead to growth?, The Review of Financial Studies, 21(3), 1403-1449.

Rajan, Raghuram G. and Luigi Zingales, 2003, The great reversals: The politics of financial development in the twentieth century, Journal of Financial Economics 69, 5-50.

Rheinholdson, Filip C.J. and Henrik S. Olson, 2012, The separation of commercial and investment banking: A literature review, Master Thesis, University of Gothenburg.

Roe, Mark, 1994, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance, Princeton; Princeton University Press.

Schmidt, Vivien, 2003, French capitalism transformed, yet still a third variety of capitalism, Economy and Society 32(5), 526-554.

Schneider, Ben Ross, 2009, Hierarchical Market Economies and Varieties of Capitalism in Latin America, Jornal of Latin American Studies 41, 553–575

Sherman, Matthew, 2009, A Short History of Financial Deregulation in the United States, Washington DC., Center for Economic and Policy Research (CEPR).

Shleifer, Andrei and Robert W. Vishny, 1997, A survey of corporate governance, The Journal of Finance, Vol LII (2, June), 737- 783.

Stephens, Mark, 2003, Globalisation and housing finance in advanced and transition countries, Urban Studies 40(5-6), 1011-1026.

Tabarrok, Alexander, 1998, The separation of commercial and investment banking: The Morgans vs. The Rockefellers, Quarterly Journal of Austrian Economics, Vol.1 (1), 1-18.

Thiemann, Matthias, 2014, In the shadow of Basel: Hoe competitive politics, bred the crisis, Review of International Political Economy 21(6), 1203-1239.

Valk, Tim van der, 2018, Housing finance, policy traditions and the pension system: the case of France and The Netherlands (1960-2018), mimeo University of Utrecht.

Van der Eyden, Ton, 2003, Public Management of Society: Rediscovering French institutional engineering in the European context, IOS Press, Amsterdam.

Welker, Johannes, 1992, Germany: Monetary and financial system, In: J. Eatwell, M. Milgate and P. Newman, eds., The New Palgrave Dictionary on Money and Finance, London: Macmillan, Volume 2, pp. 226-239.

Wheelock, David, C. 1992a, Glass-Steagall Act, In: J. Eatwell, M. Milgate and P. Newman, eds., The New Palgrave Dictionary on Money and Finance, Part 3, London: Macmillan, Volume 2, pp. 326, 327.

Wheelock, David, C., 1992b, Regulation Q, In: J. Eatwell, M. Milgate and P. Newman, eds., The New Palgrave Dictionary on Money and Finance, Part 3, London: Macmillan, , Volume 3, pp. 326, 327.

White, Eugene, N., 1986, Before the Glass-Steagal Act: an analysis of the investment banking activities of national banks, Explorations in Economic History 23, 33-55.

White Lawrence J., 2010, The Gramm-Leach-Bliley Act of 1999: A Bridge Too Far? Or Not Far Enough? Suffolk University Law Review XLIII, 937-956.