The Anglo-Saxon vs. the Rhine Model of Capitalism

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Abstract: Two models of capitalism are the Rhine model (so-called because Germany and France, two of its practitioners, lie on either side of the Rhine) and the Anglo-Saxon or Anglo-American model (mostly associated with the U.S. and the U.K.) . The Rhine model is characterized by the sharing information and building consensus among stakeholders, then taking coordinated action in pursuit of long-term economic AND social goals. The Anglo-Saxon model is characterized by individuals and firms pursuing their interests, ideally with minimal government interference. In this system the interests of labor and other stakeholders are subordinate to the interests of shareholders and management , asymmetric information is a source of speculation and profits, and macro policy is focused on managing the short run business cycle.

The financial crises, which has more negatively impacted countries using the Anglo-Saxon model, highlights two of its weaknesses: market failure due to imperfect information, and macroeconomic instability in the absence of a long run national agenda. If the U.S., in particular were to improve information and embark on longer term macroeconomic policy, the recurring cycles of speculative mania might be broken and a more efficient use of resources would emerge.

Broad Differences in the Rhine and Anglo-Saxon Models of Capitalism

Since the demise of central planning in the former Soviet Union, comparative systems has become a study of variants in capitalist systems, for example crony capitalism in post war South Korea and Russia today, khaki capitalism in Indonesia in the 70's and Nigeria today, and the new mercantilism in Japan and the Asian Tigers. But one of the most enduring (and endearing) are the social market systems of Western Europe—or the Rhine model of capitalism. Enduring for over 60 years and endearing for its emphasis on the greatest good for the greatest number.

Each Rhine country differs in its particulars, and policies have been modified over time in adjusting to globalization and European integration. (The U.K. has actually changed models: from WWII until the 1980's, the U.K. was solidly in the Rhine camp, but since Thatcherism, both the U.K. (and Canada) have moved toward the Anglo-Saxon model even while retaining some remnants of the old system such universal health care and heavily unionized workforces.)

The Anglo American model has also been modified over time. In the U.S., social security, deposit insurance and the Clean Air Act has endured despite the last 30 years of Supply side hegemony. But even now, with the large scale public involvement (bailout) of the financial sector, the bedrock values of the model are evident: the preference for private ownership and management of resources, limiting government economic intervention to short term crises or cyclical management (long term planning is socialism) and large income disparities accepted --even celebrated--as necessary to keep the system innovative and strong. There have been times when income inequality was less than it is now, but

there has never been a will to make it as equal as in some of the Rhine countries. There have also been times when government has taken a lead role in managing key infrastructure industries like finance today or the railroads during WWI, but only temporarily , in cases of national emergency. And there have been times when we actually engaged in economic planning and suspended market rules (government setting prices during WWI or providing make-work employment during the New Dear) but again only in times of emergency. The U.S. safety net is downright stingy for the poor and minimal for the working poor and middle class. Macro policy is designed to promote growth, full employment and price stability. The planning horizon is the short run business cycle. So, despite changes around the edges, the U.S. still belongs in the Anglo-Saxon column—indeed it is the paradigm of the model.

By way of contrast, the social market economies of Western Europe have some well-known characteristics: The most generous welfare systems on earth (the safety net has been reduced in some countries in recent years, but is still more substantial and wide ranging than ours in the U.S. Their post transfer poverty rates, for example, are much lower than in the U.S., even when the underlying poverty rate is higher (Mishel, et al.:418) typical benefits include substantial subsidies for households with children, the unemployed, child care, health care, and post secondary education); high rates of unionization and a significant for workers in policy discussions at the level of the firm, the industry and the nation; and macroeconomic policy which tends to take a longer view, explicitly pursues social justice, and considers the interests of a broad range of stakeholders.

The contrast with the United States is stark. The U.S. seems to pride itself on its “winner take all” economy and until now—only since the taxpayer bailout of Wall Street--have the obscene earnings going to Wall St bankers, brokers, and CEOs --regardless of their performance-- never caused outrage. In the U.S. anger is more often directed at the poor for the pittance they receive in public assistance.

The U.S. lags behind the Rhine countries in human welfare measures like infant mortality rates, child poverty rates, and poverty rates in general. (Middle class resentment toward the poor would be alleviated if the middle class—whose taxes pay for everything—could access the health, food and tuition assistance you can only get in this country if you are poor.)

This is a fundamental character difference in the societies of people living in the two systems. In the Rhine countries the commitment to social equity has been taken independently and at different times in each of the countries. (This doesn’t mean incomes are perfectly equal: CEO pay is 20 times greater than average worker pay, in the Rhine countries, while in the U.S. it is 300 times greater. (Apparently the prospect of being 20 times richer than most people is incentive enough.) One reason the European Union is successful is because the participating countries share these values. By way of contrast, in the U.S.—perhaps because of the frontier experience—individuals consider it their basic right to be “free” to pursue their individual interests. In a system like this, you wouldn’t trust your government to look out for your interests anymore than you can trust anybody else.

If the Rhine economies were in ruins there wouldn’t be much to talk about. (And too often on this side of the Atlantic, it has been suggested that this is so, that “Graying Europe”, “Old Europe”, “Fortress

Europe" is on its last legs. Their higher rates of taxation and unemployment, in this view, means that work incentives have been taxed away and everyone just lays around collecting welfare.)

But consider this: among the world's 27 richest countries, 16 are in western Europe(Kennett: 31). Yes, despite their big governments, strong unions and generous welfare systems, the Rhine countries are affluent. And they have maintained their strong economic positions even while adjusting to globalization, the consolidation of markets into the EU, and subsidizing the poorer countries now coming in from eastern Europe.

Case Studies

Getting down to particulars, following is short case studies of three of the Rhine countries: Sweden, Germany and France. It shows the variety of ways in which the Rhine model operates. The focus is on how macroeconomic policy is formulated to promote long run stability and general well-being.

Sweden:

It might be tempting to dismiss Sweden because how hard could it be to devise successful macroeconomic policy in a politically and culturally homogenous society of just 9 million people? But consider that before WWI Sweden was one of the poorest, least developed countries in Europe. Since then it has become the paradigm of a welfare state with the most equal distribution of any nation anywhere (even during the Soviet years, income distribution was as equal in Sweden as in the former Soviet Union.) and high scores on human welfare indices reflect not only a sharing of the economic pie, but also a big pie. Its large, highly concentrated industries (just one company—Investor AB—controls 40% of the Swedish stock market) are very competitive internationally. They have to be, because the domestic market isn't that big. One fourth of national output is destined for export markets. One might think that where consumption subsidies are so high rates of unemployment would also be high, but the government aggressively uses monetary, fiscal and exchange rate measures to maintain high levels of employment. (One of the paradoxes of this hefty safety net in Sweden, is that labor force participation rates among single mothers was always much higher in Sweden than in the U.S. (Goldberg and Kremen: 145) The U.S. had always justified stingy welfare benefits as a way to increase work incentives. But in Sweden the opposite was proven: generous benefits made it POSSIBLE and BENEFICIAL for single moms to work.) In addition, firms are offered incentives to move to regions with labor surpluses and away from areas with labor shortages, when practicable. Centralized wage bargaining (since the 1930's) has coincided with decades of labor peace and Sweden's economic emergence as one of the world's most affluent societies : 11th out of the richest 27. (Kennett: 31)

Centralized wage bargaining is at the core of Sweden's long run macro economic goals, which are social cohesion and export-led growth. Wages are negotiated at the national level between business and labor under the stewardship of the national government. First the firms in the "exposed" industries present their case. (Exposed industries must compete in global markets). The wage settlement reached in the exposed sector is then extended to the "protected" sectors (those not competing outside the country). The power of business in wage determination is significant, but so is the power of labor (85% unionized) and government (responsible for more than half of GDP and national

employment). Wage solidarity-- uniform compensation nationally based on skill, training, occupational status, etc. promotes the social cohesion so important in Swedish culture. If the wage levels necessary to maintain competitiveness in the exposed sector are not satisfactory to meet consumption goals, then government subsidies make up the difference. The process provides three major stakeholders – comprising most of the adult population—with information with which a common vision of economic circumstances and a forecast for the coming period is developed. Agreement is reached among the major stakeholders which is intended to promote the nation's long run macro economic goals of social cohesion and export-led growth.

Germany

The German Constitution explicitly lays out the economic AND social goals the government is required to pursue: price stability, stable currency, full employment, steady growth, and social equity, security and progress. The German experience with hyperinflation after the two World Wars has made it extremely concerned with price stability, and it is hard to imagine the government idly watching while housing and stock prices began showing trending upward significantly without any discernable justification. Co-determination is evident in many facets of the German economy. The idea is that society's various groups are partners rather than rivals or competitors.

German banks, for example, are "universal banks" (there being no distinction between commercial banks, investment banks, or stock brokerages). German banking is a model of stability, suggesting no inherent reason why banks cannot handle these multiple functions under the right conditions. (The German central bank—Bundesbank—is thought to be the world's most conservative. With adoption of the Euro the Rhine countries are all passing their monetary policy onto the European Central Bank—which is proving to be as conservative as the Bundesbank). In fact the universal banks and the firms they finance develop close/multifaceted relationships. The banks are able to exert a strong influence on governance of the firm, giving it financial advice , in some instances voting on shares the banks have purchased or shares they hold in deposit. This is thought to limit the tendency of debtor firms to divert borrowed money to riskier investments.

Co-determination between labor and management is the most noted feature of the German system. Workers are guaranteed say in the operation of companies . Workers must, by law, occupy at least half the seats on the supervisory boards of companies (which determine the broad direction of the enterprise). Workers also sit with management on work councils (required in all but the smallest firms) which have deciding roles in hiring and firing decisions. Beyond the workplace, co-determination involves wage determination through collective bargaining on an industry wide basis (under government supervision).

The German system, like the other Rhine countries concentrated in the European Union, is organized on market principles but subject to extensive social regulation. The social regulation "is intended to ensure that the impersonal workings of markets do not interfere with or undermine basic needs ranging from adequate income and healthcare to organized representation in the workplace. " (Turner:3) The struggle to reconcile the profit imperative with the well-being of the general population is evident in

Germany in the 1880's, under Bismark, when the world's first social security system was set up. Fifty years later, Hitler rose to power by pandering to the unease accompanying social dislocation as market relations continued to spread . The post WWII system of co-determination reflects this ongoing desire to simultaneously benefit from markets but also achieve broader social improvement. (Once the workers are seen to, you are more than half way there.)

Co-determination might also apply to the practice of encouraging competing firms to confer on matters such as resolving a technological bottleneck, or how to share a shrinking market during recession (illegal in the U.S.) so as to avoid business failures/bankruptcies.

Regardless of the level at which codetermination is taking place, the process is infused with information sharing and a commitment to social progress. This commitment endures despite the pressures of having to digest the much poorer East German provinces in the 1990s, and making outsize contributions/transfers –fully one quarter of the total EU budget in 2000 (Kennett: 277) -- to improve the performances of other countries in the EU, and despite having to compete globally. And still Germany remains one of the world's premier economies (10th among the riches 27).

(How many times have American workers been told they have to take huge cuts in compensation or face unemployment due to global competition? And how often have federal, state or local governments responded by showering the companies--not the workers--with subsidies. And how often, in the end, did the firms walk away with the taxpayer handouts, and the workers lose their jobs (and retirement benefits) anyway? These Rhine models show that it doesn't have to be this way.

Again in the German as in the Swedish case, we see a process. sharing information, then building consensus among stakeholders in order to pursue long run economic as well as social goals.

France

France is noted for indicative planning (IP), Practiced formally for 30 years after WWII and more informally since, IP aims to "improve the performance of the economy by the provision of better economic information: forecasts or targets are published but compliance is voluntary…The plan, via collective action, can supply economically valuable information which, as a public good, the market mechanism does not disseminate." (Holmes: 781)

The five-year plans developed from 1945-1975 are generally credited with France's strong economic recovery during this period. The common vision and shared market research are thought to have promoted investment and growth. Informed investment choices required knowledge about a wide range of macroeconomic variables (availability of inputs, expected future prices, currency value, etc) which firms must estimate based on experience or purchase. IP is an attempt to close this information gap and, by drawing the actors in the economy into a dialogue about their plans and needs, put it in a strong position to compile a comprehensive and consistent set of forecasts about the future direction of the economy. If these projections are accepted by the economic actors, the forecasts are more likely to be realized because then both buyers and sellers are confident that demand for the products and supplies of materials will be forthcoming. Early identification of surpluses or shortages can result in

investment behavior that is modified in time to reduce such disequilibria. Hence, ideally, both business and consumers benefit from such collective exercises. (Kennett: 141).

IP proponents stress the advantages arising from sharing a common view of the future due to an ongoing exchange of information and dialogue between firms, unions, government, business organizations and the public. The process wasn't perfect (accurate information is critical, but incentives to mislead for private gain exist), the system can't anticipate external shocks, and some suggest the plan can never work without public ownership of the so-called "network" or infrastructure industries (energy, transportation, finance, and communications, in particular). On this last point, indeed, in recent years, re-privatization proceeded (at one point during the 30 formal planning years the French government controlled 25% of productive resources) but stopped short of privatizing these network industries (perhaps an acknowledgement of their strategic importance in realizing the plan's macroeconomic goals?).

IP was most formally realized as a plan in France, but both the U.K. (from the 60's -80's) and Japan (beginning in the late 50's) practiced variants. Consider the following list of macroeconomic variables in Franc for the 5 year plans between l954 to l965: National income, investment, private consumption, industrial production, agricultural production, machine tools, textiles, steel, coal, oil, electricity, gas, motor vehicles, meat and milk. The nationalized industries tended to come in close to target. But in the private sector results were more varied: motor vehicles overshot the target output by 47% and investment by 1000% in 1957, while machine tools reached just 75% of target in '57, and private consumption showed such a thoroughly dismal performance in 1961 it is hard to believe it isn't a typo. (Lutz: '69) As can be see, the list is by industry, so individual firms are targets if the targets are met. But in the next planning period, directed investment might be achieved through the financial markets—especially if they are in the public sector.

IP was most successful in the three decades immediately following WWII. By the late 60's planning was becoming more complicated pressure emerged to address specific social issues—like incomes policy. Meanwhile, in the United States, anathema to anything which could be even vaguely construed as a plan set in hard. Planning became associated with socialism/communism in these cold war years. (It is odd: no self respecting capitalist firm would operate without a plan-- a one year, two year, maybe even a five year or a 10 year plan--but here we are, the largest economy on earth, and our policy makers still will not formally consider where we might want to be in, say 10 years, with respect to a variety of issues.

Conclusion:

It could be argued that the crises in American financial markets was market failure due to imperfect information compounded by a culture where, in the absence of a share long run vision for the macroeconomy, the pursuit of short run speculative gains prevailed.

There really was perfect storm leading to information failure: investors (ordinary people like firefighters, teachers, civil service workers) , lacking information about how to invest, trust their portfolios to large institutional investors or even individual brokers with the assumption these people had the information necessary to make informed investment choices with these other people's money

(after all that was their field). Most investors felt reasonably safe because there were safeguards: the SEC was supposed to be watching over Wall Street and the Fed was supposed to be wisely managing the money supply.

But rating agencies had become seriously compromised in their roles as independent assessors. The regulatory agencies were asleep at the wheel. How could the Feds have not noticed when standard underwriting rules were being ignored to make subprime mortgages ? How could the SEC have not protested when new financial instruments emerging on Wall St were allowed to get a pass on normal regulatory oversight?

The market failure and speculative mania that infected U.S. financial markets was unlikely to occur in the Rhine countries because sharing information—transparency— and building consensus over long run economic goals is their process. Probably not everyone behaves perfectly in this process, but experience suggests that, on the whole, the various stakeholders are motivated to behave and cooperate . Perhaps it is because they are satisfied with long run growth and stability, and aren't as seduced as gulliable Americans over the thrill of short run, more fleeting pursuits. (And famously, European businesses are not as dependent on financial markets as American businesses—they are more likely to finance out of their own retained earnings so, like their governments, they can focus on the long term rather than on short term, quarterly returns)

The long run focus in the Rhine countries minimizes speculative mania and focuses investment on activities in line with long term objectives for the general stability and well being of the nation. What happened in the U.S. was the equivalent of the parents blowing the rent and grocery money at the track.

By 2008, market speculation had become a major activity in the U.S. economy (exactly the situation in 1929 as explained by J. K. Galbraith: why do the hard work of actually building or inventing something , if you can make money by just buying stocks and sitting back while their prices rise?) And what were we purchasing with these investments?

What if, as a nation, we had been financing government borrowing to reverse global warming and eliminate child poverty by the year 2015. Gov't securities are low yielding, but there are people who will choose safety over risk-- especially if they agree with the content of the investment.

But to even have that investment option would have required a national plan, and we don't do plans. That would have required doing the hard work of consensus building—not an attractive thought right now in our very divided national family. But people can put aside their differences to work for a common good.

Perhaps the Rhine model could never be practiced in the U.S. It isn't part of our culture. Would more perfect information have helped, or would it just have helped some of us jump to safety before the crash? Could we ever develop a taste for taking the long rather than the short view (delayed vs. instant gratification) and have the patience to use a map to get there rather than just winging it? Are we

doomed to forever be like naughty children, trying to get something for nothing while the grown-ups, across the way in Europe, concern themselves with more serious, lasting pursuits.?

The Anglo-Saxon model reflects our culture and values and history. As Marx suggested, capitalism is very good at adapting to and exploiting the culture in which it is embedded.

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