

## Europe: Cultural Adjustment to a New Kind of Capitalism?

Harold James

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Cultural explanations of economic performance are very popular but inherently problematical. Some analysts think that cultures never change, and hence they cannot explain any kind of alteration; while others see culture as shifting rapidly, but in response to economic change.<sup>1</sup> Such diverging approaches generate considerable confusion, when presuppositions about cultural determinants are translated into attempts to analyze. In consequence, economists are generally wary of cultural explanations. Two quite well known examples are: Margaret Thatcher was captivated by the thesis of the American historian Martin Wiener, who had described modern British culture as deeply anti-entrepreneurial and responsible for Britain's lethargic economic performance.<sup>2</sup> But then the culture (and as a result the performance?) changed and now an Anglo-Saxon legal culture is supposed to generate more effective corporate structures. Second, until relatively recently, the conventional thinking was that poor Asian economic progress could be explained in terms of Confucian values; for the past fifteen years, exactly the same values are said to cause exceptional dynamism.

Perhaps a more helpful way of tracing the impact of culture is to see it embodied in institutions that create specific incentives that affect the interactions of individuals. In particular, we should think about the interplay of three very powerful social constellations: families, states, and markets. Especially in the

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<sup>1</sup> See Eric L. Jones, *Cultures Merging: A Historical and Economic Critique of Culture*, Princeton: Princeton University Press, 2006.

<sup>2</sup> Martin J. Wiener, *English culture and the decline of the industrial spirit, 1850-1980*, Cambridge ; New York : Cambridge University Press, 1981.

European context, this relationship has been much misunderstood. Recently a great deal of literature has been devoted to demonstrating that there is no simple opposition between state and market: in particular, that a well-functioning market needs a secure institutional framework that can only be provided by well-functioning states. With a complete absence of a state, there is no way of enforcing contracts, which are at the heart of the market process. Where states become abusive, arbitrary, or corrupt, the scope for rent-seeking increases. Economic agents in the market instead of looking for technical improvements or innovations as a way of expanding their activity, try to capture the state.

The proposition that the state requires the market is perhaps more controversial: but it really should not be so. The extreme example of the malfunctioning of communist systems demonstrated how when states become arbitrary and seek to replace markets, they lose legitimacy because they have extended themselves into too many areas in which individuals have strong feelings.

A great deal of this discussion about the way in which an efficient and just operation of markets and states can proceed ignores the contribution of the family to the functioning of markets and states. This is surprising, because the family can be understood as providing a link across generations, and with this a perspective on time. The process of building institutions and markets is one that demands a long term, not a short term perspective, and become dysfunctional if there is no long term outlook. Economists are often looking for what they call inter-generational equity and for mechanisms for making inter-generational transfers that have the most acceptance and legitimacy. Children are an investment in the future, and societies that do not adequately reproduce themselves have great problems in other areas that demand equity and justice. Children are often the major rationale for individuals to accept sacrifices. Especially in largely immigrant societies such as the United States, there is a powerful tradition of enduring poverty in the belief that the next generation will

be better off. In current discussions about the effects of technology and global competition on middle-aged workers who have accumulated a particular and no longer-needed set of skills, such arguments are often the only honest consolation for “globalization losers”.

My presentation focuses on the diagnosis of Europe’s contemporary malaise as well as on the variety of Europe’s responses to apparent stagnation. It is striking how words such as “capitalism”, “market”, “enterprise”, or “globalization” which generally evoke positive associations in North America and Asia are negatively charged in western Europe (but less so in central Europe), as well as Latin America. It is not that Europe is a globalization loser: with powerful export economies, a tradition of innovation, and overwhelmingly prosperous societies, Europe might be thought of primarily as a winner. But Europeans are overwhelmingly worried.

First, I examine the political and public policy response to globalization, and why the current European reaction is so problematic (the domain of political culture). A political culture derived from Bismarck that mixed an idealization of the nation-state with a sense of insecurity that could only be countered by welfarism allowed the capture of the political system by particular interest. Then I look at what alternative sources of resilience may be offered by social structures, traditions and beliefs (and in particular by the family). The analysis thus moves to a broader concept of culture.

## I

The Lisbon agenda for transforming the European Union into a modern, technologically driven, knowledge-based economy is generally recognized to have failed. Most modern European states have become large, bureaucratized, inflexible and incapable of responding to the demands for change in a globalized world. They are not good at spreading technologies or ideas across national

frontiers. At the same time, these modern states are subject to great, and increasing, expectations about what they might provide: how they should make their citizens not only prosperous, but also happy.

Popular and political responses to globalization depend on many chance variables, such as the level of skill of a particular population (more skilled people are likely to be beneficiaries of globalization rather than losers), or the extent of the manufacturing sector (rich countries with a large share of their population employed in manufacturing are likely to find the job losses that accompany changing trade patterns unpleasant and unacceptable). But above all, the reaction to globalization is a function of the size of the state, and the assumptions about how politics operate that flow from the size of the state. One currently prevailing wisdom is that the main beneficiaries of globalization are large states, such as India or China, with a strong geopolitical position, as well as a nuclear potential. They may be, we are often told, about to rewrite the rules of the global order. In fact, much of this vision of a Chinese or Indian dominated world lies in the future: and, needless to say, China and India are not as successful at globalizing and developing their economies as the real champions like Singapore, South Korea, Taiwan, or Chile. Both giants have a great deal of entrepreneurial vigor, but also encounter enormous problems in reforming the public sector.

Large states in reality have a greater problem in responding to globalization; while the small states have characteristics that may make them the natural winners of globalization. They are better at the public policy adjustments, freeing up labor markets, establishing a solid framework for competition, facilitating cross-border takeovers and mergers. The urgency of such a program has been underlined in much recent writing.<sup>3</sup> Small states are also more likely to be successful in defending crucial aspects of the welfare state,

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<sup>3</sup> See for instance Jordi Gual (ed.), *Building a Dynamic Europe: the Key Policy Debates*, Cambridge: Cambridge University Press, 2004.

while at the same time promoting flexibility, a point made recently by André Sapir who developed a typology of different European reactions in which there was a specific “Nordic model” of capitalism.<sup>4</sup>

The most impressive and extensive economic and political reforms, allowing an opening up to the global economy, and a dismantling of domestic distortions, in the past twenty years have occurred in Chile, Ireland, and New Zealand. In each case, as well as regulatory reform and extensive privatization, the share of public spending in GDP was reduced by over ten percentage points: and the reduction contributed greatly to making a more flexible economy that could grow more quickly.

By contrast, the characteristic pathology of large states’ resistance to globalization is particularly evident on the European continent. The political and commentating classes (though not all the business elites) in France, Germany, Italy (and perhaps also Russia) feel that their nation’s days of economic strength – and perhaps also of political glory – lie in the past, and that the globalized world is becoming hostile and uncomfortable. They think of industrial policy in terms of national champions, from steel to automobiles but also even to yoghurt producers; and they treat any relocation of production following from changing competitive positions as a blow to national prestige. The result is that the former great powers become depressive, backward-looking, nostalgic and bewildered. The semi-large states in Europe (Poland and Spain) may face a similar political economy problem, with exaggerated expectations of what is politically do-able.

The most obvious “sick men” of the modern European Union are three of the four large countries, Germany, France and Italy. In each case, the malaise has produced a political blockage, with very narrow election and referendum results, and right and left wing parties that are both bitterly internally divided about liberalization and globalization. The new divisions on the left are *within* the

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<sup>4</sup> André Sapir, “Globalisation and the Reform of European Social Model”, 2005 paper, [www.bruegel.org/Repositories/Documents/Publications/working\\_papers/EN\\_SapirPaper080905.pdf](http://www.bruegel.org/Repositories/Documents/Publications/working_papers/EN_SapirPaper080905.pdf).

SPD, the French socialist movement, and the Olive Tree coalition: one part in each case is opposed to globalization, and to the European Union (the disputes came out especially in the course of the French referendum). An analogous dispute in Britain in the 1990s ended with the victory of a reformist wing of the Labour Party, but Blairism has become a term of abuse for most European socialists. Disputes between modernizers and reactionaries are mirrored on the right, where large business interests like the European Union, while traditionally minded voters and small businesses are worried about immigration, the effects of Basel II on lending to small businesses, and competition from Asian producers. The Northern League, or France's National Front are clearly anti-globalization parties; but such sentiments also exist within parts of the CDU/CSU.

The post-1949 Federal Republic was used to being regarded as the great economic success story of Europe, but since the post-unification recession of the early 1990s, it never really recovered, and growth was very sluggish. As Hans Werner Sinn has repeatedly pointed out, Germany proved fundamentally incapable of dealing with the aftermath of the East German revolution and the unification of 1990.<sup>5</sup> Chances for reform were repeatedly cast away, first by Helmut Kohl's Center-Right coalition, then by Gerhard Schröder's Red-Green Coalition, but now also unfortunately by the new Grand Coalition under Angela Merkel. The Schröder coalition fell apart prematurely because of the strain caused by a debate about the implementation of the 2010 reform agenda. Frau Merkel has drawn the lessons that prudence is the paramount political virtue. The promotion of new visions of national identity and national pride, such as the recent television campaign *Du bist Deutschland* looks like a classic response to economic failure, rather than as a really effective way of boosting economic

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<sup>5</sup> See Hans-Werner Sinn and Gerlinde Sinn, *Kaltstart : Volkswirtschaftliche Aspekte der deutschen Vereinigung*, Tübingen : J.C.B. Mohr, 1991; Hans-Werner Sinn, *Ist Deutschland noch zu retten?* Berlin: Ullstein, 2005.

performance.<sup>6</sup> And there is still a cultural obsession with decline: one example may suffice, the work of the German sculptor Magdalena Jetelová who won the 2006 Lovis-Corinth-Preis with her broken down and irregularly angled classical temple entitled: “Prozesse und Phänomene des Niedergangs, des Abschieds und der Perspektivlosigkeit” (Processes and Phenomena of Decline, Farewell and the Absence of a Vision).

At the same time as Germany became more like a Great Power in the geo-political sense, and its politicians talked about normalizing their national existence, it became less like an economic superpower. The consensus society that was at the center of the *Wirtschaftswunder* looks inflexible, and creates obstacles to change. Germany is surrounded by small states which all seem to be prospering more in the new geo-political and geo-economic environment: the rapidly growing central European formerly communist states, Poland and the Czech Republic, but also the other small neighbors on whom Germans traditionally looked down, but which are not necessarily low wage producers: Denmark, the Netherlands, Austria, or Switzerland. After years of German condescension on Austrians, there is even a new and paradoxical slogan, that Austria is “the better Germany”. Recently released statistics showing a faster growth rate in Switzerland than in Germany produced a new round of German breast-beating.

Many French writers such as Nicolas Baverez, the author of *La France qui tombe*, also express a vividly felt sense of national decline. France believes that the rules of the global economy work against French national interests. Policy makers deduce that they need to make up new rules, and plan for a world order that is more to their liking. Even pro-liberalization politicians tend to take up the radical rhetoric of globalization critics. The former socialist Prime Minister, Lionel Jospin, eloquently argued that “the need to take control in adapting to

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<sup>6</sup> See Henrik Müller, *Wirtschaftsfaktor Patriotismus. Vaterlandsliebe in Zeiten der Globalisierung*, Eichborn, 2006.

reality places a special responsibility on the state.” “We cannot let supposedly natural laws guide the evolution of our societies. This would be an abdication of our political responsibilities. On the contrary, we must seek to govern the forces that are at work in economic globalization.”<sup>7</sup> Jacques Chirac considers “ultra-liberalism” as “the new communism”, an enemy requiring complete ideological counter-mobilization.<sup>8</sup> In a widely quoted account, he is supposed to have recognized after the collapse of the Juppé government and its reform program in 1997: “France is an ungovernable country. She no longer wants us, or our reforms. I have drawn the consequences”.<sup>9</sup>

Italy is even more obviously sick. The centrist political establishment in the 1990s tried to implement reform by selling it as a necessary accompaniment of a process of European integration. The currency union reduced state borrowing costs. But it did not alter micro-economic behavior, and especially not the behavior of labor markets; and both the Berlusconi coalition and (apparently) the new government lack a solid enough political basis to introduce effective reforms. Governments of whatever political complexion are vulnerable to hold-ups by small coalition partners: the Liga Nord for the governments of the right, and now the anti-reform and fundamentalist Rifondazione Comunista for the left coalition. Coalitions can only be held together by the manipulation of old and odd cultural images: for Berlusconi the image involved the demonization of the “left” and “marxism”, for the left the only uniting vision is based on disdain for Berlusconi’s showmanship. The economic outcome is an increasing over-valuation and uncompetitive wage costs that could no longer be corrected by a parity alteration of the lira. Some members of the Berlusconi government began

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<sup>7</sup> Philip H. Gordon and Sophie Meunier, *The French Challenge: Adapting to Globalization*, Washington D.C.: Brookings, 2001, p. 100. “Gouverner des forces qui sont à l’oeuvre dans la mondialisation”, *Le Monde*, June 27, 2000.

<sup>8</sup> Quoted in “EU puts reforms on hold to avert French poll disaster”, *Agence France Presse*, March 23, 2005; also in “London’s Allure”, *Financial Times*, October 27, 2005

<sup>9</sup> Franz-Olivier Giesbert, *La Tragédie du président : Scènes de la vie politique (1986-2006)*, Paris : Flammarion, 2006 ; quoted in John Thornhill, « How Chirac Failed France », *Financial Times*, May 21, 2006.

to make comments suggesting that Italy would be better off without the currency union.

For post-Soviet Russia, the sense of faded imperial glory (and consequently of the particular duty of the state) is even stronger. The newly victorious capitalism looks as if it was simply a strategy to undermine Soviet strength and power. Even though there has been a substantial economic recovery since the crisis of 1998, capitalism is widely unpopular, not least because it has produced very wide discrepancies in income and wealth. The political clown Vladimir Zhirinovsky expressed the post-Soviet feeling well when he asked, rhetorically: "Why should we inflict pain and suffering on ourselves? We should inflict pain and suffering on other people."<sup>10</sup> By contrast, such an externalization of the costs of adjustment is not a very practical possibility as an expression of political sentiment by the inhabitants of small states.

Why is the nostalgic vision of past empire both so powerful and so paralyzing politically? There is an interplay between the possibilities for action and control that a large state offers, and a powerful series of historical arguments and associations that still continue to resonate.

Most obviously, a larger state can inevitably do more to control the economy. In a small state setting, an imposition of a dense network of controls is likely to lead to the loss of mobile factors of production, while in a large state it is harder for labor or capital to escape. Small states are thus likely to be quicker in liberalizing their labor markets, and reducing rates of taxation on capital. The difference is also noticeable when it comes to fiscal discipline. Large states can borrow freely on capital markets, and are subject to constant political pressures that lead to high fiscal deficits while the markets absorb their debt. Since the 1990s, fiscal discipline in the world as a whole, and also in the European Union

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<sup>10</sup> Quoted in Chrystia Freeland, "Blood, Sweat and Tears- For Others", *Financial Times*, Dec. 9, 1993.

countries, has improved. But since the late 1990s, deficits have increased dramatically in Japan (moving from a central government fiscal balance of -3.8 percent in 1998 to - 7.0 percent in 2005) and the United States (where the equivalent move is from + 0.5 percent to -3.4 percent). The EU countries were constrained at first by the stability and growth pact, but since 2001 there has been a dramatic deterioration in France and Italy, and a milder one in Germany). In the early twenty-first century, government deficits in the large states have soared. Smaller states (and of course poorer states) are forced to a more rapid adjustment.

There are also powerful political economy arguments about why smaller countries should be better at adapting.<sup>11</sup> In a globalized world, small states are able more easily to see where there is a comparative advantage, and to devote resources to that sector without a big competitive push and pull from other sectors for favors from the state. Thus, to take perhaps the best known examples, Taiwan can pursue the development of electronic goods, Finland mobile telephony, and Switzerland financial services. These all have developed into global leadership positions, and are acutely aware of the need to remain competitive, not in a national but in an international framework.

The difference in approach between small and large states is even more noticeable, and even more destructive, when it comes to international governance. Large states try to make international rules, and often build their domestic legitimacy on their claims to be able to shape a larger world: they think in terms of “mondialisation maîtrisée”. Instead of accepting the international system roughly as it is, with all its imperfections, they think that they can use their weight to alter the rules – to their favor. This is true in tussles over the commercial system. Aggressive trade policy is or can be used as an instrument of policy and can create new opportunities for the assertion of power and the

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<sup>11</sup> See Alberto Alesina and Enrico Spolaore, *The size of nations*, Cambridge, Mass. : MIT Press, 2003

development of economic muscle. The current trade order thus reflects the ability of the United States and to some extent also the European Union to impose its vision on the world. Political power can also be applied to serve national interests in issues of corporate governance or the design of the international monetary order.

In making the big state policies, all the aspirations and resentments engendered by a previous wave of globalization are still alive. In the late nineteenth century, faced with an earlier wave of integration of goods, capital and labor markets, many observers came to the conclusion that a strong state was needed to protect citizens against the consequences of globalization. The European welfare state was invented by Bismarck in Germany primarily as an exercise in domestic politics, and Bismarck's legacy still continues to shape expectations of what the nation-state is and what it can and should do. Bismarck was the master of interest politics, and understood how to assemble political coalitions around economic issues: workers, farmers, and businessmen inclined to demand tariff and quota protection.

The smokescreen behind which modern interest politics was created came from the idea or a geo-political necessity of the state. Some German politicians still present this rationale of why a large state needs to act. When challenged by the apparent success and prosperity of smaller neighbors, they will still explain that the large states have global responsibilities, and that smaller states have simply abdicated their role.

Small states are indeed less likely to wrap their politics in a Bismarckian way, with geopolitical activism cloaking domestic interest politics. A word of warning: the association of smallness and reform willingness is not an inevitable relation, and there are plenty of small states, from Greece to Cuba, with abysmal records as reformers. Traditionally, smaller states have emphasized their greater level of social solidarity. Hence there is less of a need to put together complex distributional coalitions. More importantly, small states realize much more

readily that they cannot go it alone. They are less likely to fall for the myths and temptations of empire.

As a result, they are likely to be more open to trade and more resistant to the dangers of protectionism. They are also more likely to have open capital markets. And immigration is less likely to be disruptive, because the economic aspects of cross-border migration (which are largely beneficial) will outweigh the temptation to see immigration in terms of a clash of values or of civilizations. The best modern analyses tend to argue for ways on institutionalizing the small scale vision on a general European scale, for instance by the promotion of regionalism, where the region is a focus of loyalty and a facilitator of adaptation, but cannot provide an alternative model of an overall economic and political framework. Growth thus often takes place in a decidedly regional, rather than national framework: in Bavaria, or Lombardy, or Catalonia. The best strategies for growth pick up what is beneficial in the small state tradition of adjusting to the world and seek to harness the paradoxical power of the petite.

Small state or regional approaches are obviously not the only ways of providing a mechanism for adjustment as well as a source of identity in a world which changes with bewildering rapidity. The literature on states rightly focuses on the macro-economic framework required for stability, on sound fiscal and monetary policies. But there is also a need for appropriate micro-economic incentives. These can be generated by a hands-off approach to regulation: but in general, state activism here means the imposition of obstacles, and for positive incentives we need to look elsewhere.

## II

The political roots of Europe's peculiar pathology of the state are worth further examination. The logic of a powerful state did not simply have its origins in Bismarckian power politics. One of the most powerful drivers of the idea of a

strong state and state planning in the second half of the twentieth century was the belief that the non-organized market had been inefficient, and in particular that growth had been restricted because of the prevalence of many family businesses. The state could plan markets in a rational way (while family capitalists could not). This interpretation was given a boost by the interwar Great Depression, as well as by a concomitant wave of writing about the characteristics of scientific management.

The concept of family capitalism is often used, particularly in the United States, to explain deviation from some notion of an ideal-typical American path, of the kind best described by Alfred Chandler.<sup>12</sup> Firms in this tradition should move smoothly from an entrepreneurial to a managerial type of organization, with the movement to the multi-divisional firm being taken as the key indicator that such a transition to business modernity has been achieved. The dominance of family business has historically been used, notably by David Landes, to explain poor French economic performance until the second half of the twentieth century, when the deficiencies of such organizations were overcome by a transition to planning in which technically trained business elites replaced dynastic control.<sup>13</sup> Charles Kindleberger repeated the accusation that the French family firm “sinned against economic efficiency”.<sup>14</sup> Many analysts immediately after the Second World War believed that the dominance of family firms accounted for inadequate investment: one consequence was inadequate capacity for production (such as specialty steels) required for France’s military security. Most recently, the under-capitalization of many German *Mittelstand*

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<sup>12</sup> Alfred D. Chandler, Jr., *The visible hand : the managerial revolution in American business*, Cambridge, Mass. : Belknap Press, 1977.

<sup>13</sup> David S. Landes, “French Entrepreneurship and Industrial Growth in the Nineteenth Century”, *Journal of Economic History*, 9, 1949, pp. 45-61. See also Daniel Henri, “Capitalisme familial et gestion industrielle au XIXe siècle”, *Revue Française de Gestion*, 70, Sept. 1988, pp. 141-50; Maurice Lévy-Leboyer, “Le patronat français a-t-il été malthusien?”, *Le mouvement social*, 88, 1974, pp. 3-50.

<sup>14</sup> Charles P. Kindleberger, *Economic Growth in France and Britain 1851-1950*, Oxford: Oxford University Press, 1964, p. 115.

firms has been a prominent issues as banks, stripped of former guarantees from the state, scramble to meet the capital adequacy requirements of Basel II and reduce their credit to the *Mittelstand* sector. The financial limitations which keep family firms small are also generally held to explain why Italian modernization remained incomplete and polarized in a dualism between a large and until recently state-dominated industry and myriad small producers.<sup>15</sup> Even recently, the *Economist* quoted the Italian economist Francesca Bettio of Siena, that the family is at the root of all Italian ills. “It is responsible for the fact that most Italian companies are small and privately owned; it has contributed to a low female participation rate in the workforce; and it is at least partly to blame for low social and labour mobility.”<sup>16</sup> The idea of the family firm is thus at the heart of a debate over the costs of the divergence of a continental European model of capitalism from the “Anglo-Saxon” one. According to this view, path dependence locked continental economies on a sub-optimal institutional track.

This model was also used to explain failure elsewhere. A perhaps idiosyncratic interpretation of the business experience reflects interwar criticism of the limited investment horizons of British firms. Alfred Chandler in *Scale and Scope* portrays Britain as still being in thrall to “personal capitalism” in which family relations played a big part. The term refers to a style of management, and not exclusively to the actual structure of ownership. William Lazonick uses a similar diagnosis for the ills of British capitalism.<sup>17</sup>

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<sup>15</sup> Robert Pavan, “Strategy and structure of the Italian enterprise”, Ann Arbor: University Microfilms, 1973.

<sup>16</sup> *Economist*, November 26, 2005, Survey of Italy, p. 6. The concept of Rhineland capitalism as a special path was popularized by Michel Albert, *Capitalism versus Capitalism*, London : Whurr, 1993 (original French edition 1991).

<sup>17</sup> Alfred D. Chandler, Jr., *Scale and Scope: The Dynamics of Industrial Capitalism*, Cambridge, Mass. : Belknap Press, 1990, especially pp. pp. 239-40. This interpretation was criticized by Roy Church, “The family firm in industrial comparison: international perspectives on hypothesis and history”, in (eds.) Geoffrey Jones and Mary Rose, *Family Capitalism*, London: Frank Cass, 1993, pp. 17-43. William Lazonick, “The cotton industry”, in (eds.) Bernard Elbaum and William Lazonick, *The Decline of the British Economy*, Oxford: Oxford University Press, 1986, pp. 18-50.

One variant of the gloomy depiction of family business holds that such firms may play a useful role in resolving the problems of trust that arise in small-scale local economies, but that large family firms still carry a heavy price.<sup>18</sup> The penalty of the family is thus far heavier for larger size enterprises. Such an interpretation escapes from the simple mechanism of Chandler's account of family firms being a child-like stage in the path to the mature managerial enterprise. It allows interpretations in which economies thrive on the interplay of a dualism between a small family-based sector and large modern enterprise.

The real historical picture is almost completely the reverse of the polemical caricature of family firms given by these twentieth century critical analysts. Rather than being responsible for backwardness, an enhanced importance of family firms was a response to uncertainty, and especially the arbitrariness of the state. In the European past, state inadequacy was compensated by the resilience of other institutions – notably the family. Family firms increased in importance at times of great political upheaval because they were able to provide a basis of trust in a setting when legal norms were in rapid flux: all over continental Europe at the time of the French Revolution and the Napoleonic wars, but again also in the aftermath of twentieth century conflicts. German families, for instance, were able to reconstruct businesses after Allied detrustification and decartelization, while new entrepreneurs created or recreated the dynamic *Mittelstand* enterprises that were at the heart of the German success story. In Italy, a special new bank, Mediobanca, allowed Italian family firms such as Pirelli, Fiat or Falck to reestablish themselves after 1945. The German and Italian postwar miracles were thus largely driven by family firms, and family business offered a bridge over a political chasm.

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<sup>18</sup> Peter Payne, "Family business in Britain: An historical and analytical survey", in (eds.) Akio Okochi, Shigeaki Yasuoka, *Family business in the era of industrial growth : its ownership and management : proceedings of the Fuji Conference. The International Conference on Business History, 10*, Tokyo: University of Tokyo Press, 1984.

By contrast, in the US and the UK, a more politically continuous and stable history meant a reduced demand or need for family firms. The superiority of family firms because of their association with higher levels of trust also characterizes some very dynamic parts of the world, notably in India and China, where the family firm plays a vital role in promoting innovation and entrepreneurship in a politically non-transparent and potentially unstable setting. These are large states, that are inefficiently managed, and innovation flows not from state initiatives but from alternative forms of social cooperation, in particular from extended families. These can provide a longer term and stable framework for expectations and calculations, and for investment decisions; they can convince both customers and their workforce of their stability, of being in business for the long run.

Actually, family businesses are quite common in most parts of the world, precisely because of their high degree of institutional resilience in the face of high levels of uncertainty. Over three quarters of registered companies in the industrialized world are family businesses, and - especially in continental Europe - they include some very large companies. Historians of the subject are often surprised by the extent that the phenomenon has survived into present day business existence.<sup>19</sup> According to one recent calculation, 17 of the largest hundred companies in Germany are in family hands, 26 in France, and 43 in Italy.<sup>20</sup> France and Italy still consider themselves to be the “champions of family capitalism”.<sup>21</sup> In France, at the beginning of the twenty-first century 33.8 percent of the total market value of listed corporate assets was controlled by just fifteen families (and 22.0 percent by five families). For Italy, the equivalent figures are 21.9 percent and 16.8 percent, and for Germany 25.0 percent and 15.7 percent. By

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<sup>19</sup> See for instance the session of the International Economic History in Budapest, 1982: (ed.) Leslie Hannah, *From Family Firm to Professional Management: Structure and Performance of Business Enterprise*, Budapest: Akadémiai Kiadó, 1982.

<sup>20</sup> *Financial Times*, Feb. 3, 2003: “The Complex Evolution of Family Affairs” (p. 6).

<sup>21</sup> Frédéric Lemaître, “La France: championne du capitalisme familial”, *Le Monde*, April 18, 2003.

contrast, in the United Kingdom, the equivalent figures are just 6.6 percent and 4.1 percent.<sup>22</sup> That is not to say that there are no long-lived family firms in the United States and Canada – the often eccentric Duponts and the highly secretive Cargills would be obvious examples. But many of the most North American outstanding family dynasties are relatively recent.

By the end of the twentieth century, there were new opportunities for all types of business, and hence a real and novel entrepreneurial challenge. Firms are much more unstable, and frequently change their locus of activity (Mannesmann, Siemens). Well-established corporate behemoths (ICI, Marconi) can collapse as a result of wrong strategies. Globalization can be seen as a new threat, with disruptions to established markets, massive legal changes. As in the past, family ties can provide a locus of stability. There are also new possibilities arising from:

1. The relative retreat of the state in European economies.
2. The greater activity of capital markets, which freed family businesses from their traditional fear of long term involvement with and hence dependence on banks. Banks are no longer the major source of business or industrial finance.
3. The internationalization of business activity added new possibilities for opening up markets, as well as potentially new sources of capital.

All three of these considerations enable the family firm to play a greater role than in the past. The most dynamic examples are cross-national and have a capacity for rapid innovation: the iconic Italian examples of fashion in textiles and clothing, Ermenegildo Zegna and Armani, or the German Hugo Boss; in automobiles (Porsche and the Quandt-owned BMW), publishing (Bertelsmann), as well as less specific conglomerates (Wendel or Haniel).

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<sup>22</sup> Mara Faccio, Larry H.P. Lang, The ultimate ownership of Western European corporations, *Journal of Financial Economics* 65, 2002, p. 393.

There is certainly no evidence for the model developed by David Landes and Alfred Chandler that dominated most analysis of this subject in the later twentieth century, in which there is a one way street called modernization which involves a transition from personalized capitalism to the multi-division publicly quoted corporation managed by a technocratic managerial elite for whom the question of ownership plays little or no role. The twentieth century rise of the brand, and the perception of an individual relationship required by a good brand, actually favors the family business. Ermenegildo Zegna is an embodiment of the virtues of his company in a way that chief executives of big corporations (for instance Hewlett Packard's Carla Fiorina) sometimes aspire to but in practice almost never can be.

This topic is the subject of my recent book, which attacks the Chandler/Landes hypothesis.<sup>23</sup> The case studies (one French, one German, and one Italian, chosen to be as nearly comparable as possible over the boundaries of specific national economic cultures) actually point in a different direction. Falck started out as a joint stock corporation, the Acciairie e Ferriere Lombarde, in which Giorgio Enrico Falck was a gifted technician with little capital of his own. By the 1930s he had turned it into a family business. From the 1870s to the 1950s, the major vehicles of the Wendel (France) and Haniel (Germany) interests were joint stock companies, Wendel SA and the Société des Petit-Fils de François de Wendel, and the Gutehoffnungshütte AG. Their fortunes started to revive with a turn after the 1960s or 1970s to different enterprise forms, non-quoted holding companies (in Germany, the form of the GmbH offered particular advantages). By the early twenty-first century, there is little surprise when even major companies want to "go private". The examples of the retreat from the publicly quoted joint stock company are not necessarily to be understood as "history reversing itself", but rather of a rational response to better developed capital markets.

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<sup>23</sup> Harold James, *Family Capitalism*, Cambridge Mass.: Harvard University Press, 2006.

Family ownership has the advantage of being visible and identifiable, in contrast to the anonymous capitalism of large numbers of individual investors or the facelessness of institutional investors. If ownership is an important or even the defining feature of the capitalist process, it may be desirable that it is transparent. The greater difficulties that arise when disposing of ownership in consequence offer a guarantee of continuity, and make property part of a stakeholding and relatively permanent pattern of institutional arrangements, in which there are higher levels of commitment. This means that it may be easier to motivate managers and workers than in a setting when they do not know whether tomorrow the (faceless) owners will walk away. Families in business recently responded to this sort of analysis by developing a concept of “professional ownership”. The family and its long-term vision thus offered a striking and reassuring alternative to the emphasis on “shareholder value” that had been so fashionable in the 1990s, and had been linked with the “Americanization” of business conduct. At the beginning of the twenty-first century, much European debate focused on whether “Anglo-Saxon capitalism” was not even a greater threat to national self-understandings than family capitalism had been. From a different angle, the CEO of IBM, Samuel Palmisano, recently announced the end of the traditional hierarchical multinational corporation, because of its impedance of information flows, its absence of rootedness and its tendency to generate anti-globalization backlashes.<sup>24</sup>

With the collapse of ideas about a “New Economy”, the end of the dot.com bubble, and the revelations of corporate corruption and scandal, some European businesses looked for a new model of responsible conduct. Family interests reasserted themselves in continental Europe, especially against managers and executives who seemed to have become too Americanized. The Mohn family ousted the leading manager of Bertelsmann, Thomas Middelhoff,

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<sup>24</sup> Samuel J. Palmisano, “The Globally Integrated Enterprise”, *Foreign Affairs* May-June 2006, pp. 127-136. (quote from p. 134)

who had wanted to turn a family company into an internationalized or even a denationalized enterprise. In France Jean-Marie Messier was similarly deposed from Vivendi Universal, and the Lagardère dynasty tried to regain control of Vivendi. Unlike Messier, the Lagardères were seen as deeply French. At the funeral of Jean-Luc Lagardère in 2003, the wife of the President of the Republic, the Prime Minister, and five ministers attended. The left wing newspaper *Le Monde* published a striking defense of a national form of capitalism: “at a time when the stock exchange keeps on falling, family capitalism, privileging long-term patrimonial interest over short-term operations, seems to have all the virtues.”<sup>25</sup> The head of the modern Wendel company (and incidentally long term president of the French employers’ association Medef), Ernest-Antoine Seillière, recently formulated his distinctive vision of a new French capitalism in a very striking way: “There is no capitalism that is not family. The anomaly of capitalism is the [stock] market.”<sup>26</sup>

It would be wrong to end on an excessively optimistic note. First, family firms are still the easy targets of blame: as in the contemporary discussion of what is wrong with Italy, or Germany, or in the complaints of the management of the steel-maker Arcelor in resisting a hostile takeover bid from Mittal.

Secondly, family firms also reflect strains and tensions in the family, and are not immune from general trends in society. A consequence of the expansion of the role of the state in Europe, and of the fact that for most of the second half of the twentieth century the etatist economy really seemed to run well, has been a devaluation of the family and a crisis of family values. It is this that might be interpreted as a break with a history in which family firms – small and large – and family values more generally played a crucial role in the economic development of modern Europe.

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<sup>25</sup> Lemaître, La France. “A l’heure où la Bourse n’en finit pas de chuter, le capitalisme familial, censé privilégier les intérêts patrimoniaux à long terme par rapport aux opérations à court terme, paraît même paré de toutes les vertus.”

<sup>26</sup> *Le Monde*, July 30, 2002

