Rethinking Path Dependency: The Crooked Path of Institutional Change in Post-War Germany

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In: Glenn Morgan, Richard Whitley, Eli Moen, *Changing Capitalisms : Internationalization, Institutional Change, and Systems of Economic Organization*, New York : Oxford University Press, 2006, 480 p.

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6.1. **Introduction**

At the end of the Second World War, American occupying forces denounced the German tradition of cartelization and its contribution to the building up of Nazi power. While Germany was far from being the only European country with a tradition of cartelization, it was probably the country where the systematic organization of markets had gone furthest by the mid-1940s. Fifty years later, cartels have been all but formally outlawed from the German economy through, in particular, the double effect of a national anti-cartel act and of European competition law. At first sight, this suggests that, over a period of fifty years or so, the German regime governing competition has been radically reoriented. It has moved away from a deep mistrust of market competition (defined here as opposed to any form of collusion between competitors) and a marked preference for systematic inter-firm cooperation towards an overall endorsement of the liberal competition principle and a negative perception of cartelization.

A path dependency argument could see the mark here of one of those rare but critical junctures, where an institutional system or subsystem enters a radically new path, usually as a result of pressures external to the system itself. However, an analysis of the transformation of the German competition regime shows the limits of conventional path dependency approaches in trying to account for such an episode of institutional change. The end of Nazi Germany and

In alphabetical order. We thank the editors of this volume for highly helpful comments and suggestions on this chapter.

the Occupation period were indeed critical junctures—but with respect to the competition regime, they did not 'set into motion institutional patterns or event chains (with) deterministic properties' (Mahoney 2000: 507). Rather they marked the starting point of an ad hoc clearing process that would generate a crooked path. We follow that path, step by step, to propose an alternative theoretical frame to approach institutional change—what we call here path generation.

We look at the fate of the German competition regime by comparing what happened in product markets, on the one hand, and in the banking sector, on the other. The comparison of those two cases is interesting because, in spite of quite similar starting conditions, outcomes were different. This type of comparison has the potential—as we try to show in the last part of the chapter—to generate theoretical insights on institutional change in general. In both cases, the initial impulse for regime change was exogenous—the initiative coming from the Allied occupation government. This initial impulse was, in both cases, an attempt to increase competition where cooperation had been the dominant principle governing inter-firm relations. Struggles and confrontation evolved over a period of nearly ten years. Muddling through, give and take, negotiations, small steps forward followed by moments of backlash characterized the paths in both cases. In the end, in the case of product markets, the crooked path ultimately led to a significant transformation of formal institutions—away from cartelization and towards oligopolistic competition. With respect to the banking sector, however, drastic formal changes, originally introduced by the Allied occupation government, did not prove stable and disappeared.

This chapter has three main parts. First, we tell the story of the transformation of the competition regime in German product markets. We turn next to describe what happened in the German banking sector. A comparison of developments in those two cases illustrates and reveals the limits of conventional path dependency accounts. Finally, in the discussion section, we draw from this comparison a number of theoretical insights about institutional development and change.

6.2. **Transforming the Competition Regime in German Product Markets**

We first consider the reordering of product markets in Germany after the Second World War as an illustration of a process of path generation. This case is interesting because it reveals a tension between change and persistence, between a break with the historically dominant legacy of cartelization and the persistence of coordinated market behaviour, albeit in different forms—through mergers, for example, or through bank shareholding in firms. It also reveals the importance of foreign influences.

6.2.1. *The legacy of the past: organized capitalism in inter-war Germany*

When Hilferding 1923 wrote about 'organized capitalism' in Germany, he referred to a complex system of institutional mechanisms allowing German companies to control and stabilize their markets to a significant extent. The most important of such mechanisms were cartels, combines and the bank–industry nexus (see also Sorge, Chapter 5, this volume)—all of which had their origins in the last decades of the nineteenth century but had come into existence for different reasons.

A severe but relatively short slump following the industrial boom of the 1870s provided the impetus for the emergence of the first cartels as 'voluntary agreements between independent enterprises of a similar type to secure a monopoly of the market' (Liefmann 1938: 7). The cartelization movement, however, lasted well beyond this period, increasing in scale and scope in buoyant times as much as in more difficult ones (Djelic 1998: 54–5). The scope and stability of these cartels naturally differed considerably between sectors. Basic industries and raw materials were regulated by a few strongly organized and stable cartels. In the finished goods industries, on the other hand, cartels tended to involve larger numbers of firms and they usually proved more fragile. The collapse of a particular cartel agreement in those industries was usually followed by a period of cut-throat competition that itself triggered the crystallization of new cartel agreements.

From the end of the nineteenth century onwards, the development of horizontal cartels on a large scale was complemented by the emergence of ownership-based links between firms known as *Konzerne*. Liefman (1938: 225) defines the *Konzerne* as 'a merger of firms that remain juridically independent of one another into a single unit for the purposes of productive technique, administration, trading or (especially) finance'. A key difference between cartels and *Konzerne* was that whereas cartels were on the whole horizontal associations aiming to limit and control competition between firms operating in similar product markets, *Konzerne* had often a vertical dimension or would even bring together firms from unrelated industries to which financial and banking partners could be added. According to Kocka and Siegrist (1979: 91–4) the first *Konzerne* were created in order to overcome bottle-necks in the supply chain and to counterbalance deficits in the technical and financial infrastructure of Germany at that time. The economic disruptions following the First World War were fertile ground for the multiplication of such combines. By 1927, the top one hundred corporations in Germany were practically all *Konzerne* (Siegrist 1980: 87–8 as mentioned in Herrigel 1996: 95).

The bank–company nexus similarly increased in importance from the last quarter of the nineteenth century and changed its nature and form significantly. Up to the end of the nineteenth century, large private banks acted predominantly as commercial banks (Quack 2004) and sought to limit their lending risk by encouraging companies to obtain long-term finance on capital markets. Banks would hold a portion of the securities they underwrote but these holdings were generally seen as temporary, waiting for buyers that could offer a reasonable price. At that time, banks would only rarely transform frozen credit into shareholdings (Edwards and Olgivie 1996; Vitols 2001: 8).

Links between banks and companies became much tighter with the economic crises of 1923–4 and 1929–33. German banks increasingly turned to transforming frozen credits into long-term industrial shareholdings as a way to save and stabilize companies that had run into trouble (Höpner and Krempel 2003). At the end of the Weimar Republic, German banks had gained a central position as mainsprings of national industrial policy. This position reflected the multiplicity of their roles as 'supervisory board members, creditors, share owners, organizers of consortiums, and executors of the voting rights of dispersed share owners' (Höpner and Krempel 2003: 8). The combination of these roles made German banks important intermediaries in the market for corporate control. But German banks were not only owners and providers of capital. For many German firms, they were also a source of stability and a buffer against competition and its consequences. This stability was reinforced by the long-standing tradition within the German banking sector of regulating competition through gentlemen's agreements. Initiated by professional associations, a number of these agreements or cartels were in time to be made compulsory by the state.

By the end of the 1930s, cartels and combines had proliferated and the links between banks and industrial companies had become extremely dense. Faced with recurrent economic crisis, German politicians, lawyers, and economists had come increasingly to regard competition as potentially disruptive to the social order. They welcomed 'organized capitalism' as progress. While criticisms of cartels and their impact during the hyperinflation of 1923 led to a decree against abuses of cartels, this did not change the generally positive attitude in Germany to cartelization as a form of market coordination. Towards the end of the Weimar Republic, cartels increasingly became state regulated. Particularly during the Great Depression, the German government started to use compulsory cartels as a means of stabilizing industries facing crises—the banking sector being there an interesting illustration. Faced with the banking crisis of 1931, the Weimar government authorized the banking associations to set up a compulsory cartel on debit and credit interest rates.

During the Nazi period, a law on the formation of compulsory cartels was promulgated on 15 July 1933, becoming the basis for governmental intervention and state-led economic planning until the Second World War. Under the rigid centralized control put in place during the war, cartels were often not in the position to pursue and achieve their objectives. Voigt (1962: 187) states that at the end of the war the total number of cartels had declined to 650 'a large number of which were nothing more than mere shells'. Many of these shells, however, would become quickly revitalized, particularly in those industries that had been previously strongly cartelized. Attitudes towards the legitimacy of cartels as a means of economic coordination would prove deeply entrenched in a whole generation of business leaders that was soon to resume responsibility after the end of the war.

6.2.2. *The long post-war struggle for a German competition law*

A widely shared conviction that cartels and large combines had played an important role in the rise of the Nazi regime in Germany led the military governments at the Potsdam Conference to agree that German industry should be decartelized and deconcentrated after the war. Allied anti-cartel laws issued in 1947 prohibited cartels, combines, syndicates, or trusts (Damm 1958). On the American side, they grew out of the long-standing American antitrust tradition and reflected significant concerns about the role played by international cartels in undermining and even harming US security and defence before and during the Second World War (Berghahn 1986: 85; Djelic 1998: 82–3).

The British and French military governments followed the US policy of forbidding cartels as a means of destroying German war capacity. Their attitude towards cartel agreements—that were also common practice in Britain or France—was nevertheless much more lenient.

In 1949, the occupation statute was signed and Germany was allowed to return progressively to sovereignty. The American government insisted, however, that certain fields, among them decartelization and financial decentralization, would remain under the full control and scrutiny of the newly created Allied High Commission that took over at the end of the period of military government (Horstmann 1991: 192). In the treaty allowing Germany to return progressively to sovereignty, the American government demanded that German agencies prepare and submit their own competition law. This law, however, would replace the 1947 Allied legislation only after being fully validated and accepted by Allied authorities. The United States, and to a certain degree the United Kingdom, were thus in a position to exert significant influence on West German legislation, through political and economic coercion, including after the foundation of the Federal Republic of Germany in September 1949. This remained the case at least until the end of the occupation regime in 1954 (Djelic 1998: 81).

American policy makers were aware that radical transformations of the sort they were fostering would survive only if Germans actively appropriated them. From the beginning, the American military administration in Germany had tried to identify those Germans that would be sympathetic to their goals and thinking on and around competition. They found Eberhard Günther, who had been in charge of monitoring cartel agreements within the Ministry of Economics during the Weimar Republic. They also came to work with a number of 'ordo-liberal' economists, like Franz Böhm or Alfred Müller-Armack. The 'Freiburg school', with which those men were associated, had formulated in the 1930s an economic programme that was then highly heterodox in the German context. Ordo-liberals believed that competition, if nurtured and protected by a tight legal framework, was a basic precondition of political democracy. Early on, Americans had also identified Ludwig Erhard, at the time a relatively unknown professor of economics who had been in close contact with the Freiburg school for a number of years, as a potential local relay. In 1948, the Americans appointed Erhard chairman of the newly constituted German Economic Council (*Deutscher Wirtschaftsrat*).

As Economic Minister of the Federal Republic of Germany from 1949 onwards, he became a central figure in mediating between the demands of the American military government in Germany on one side and German resistance and opposition on the other. Erhard himself favoured a law that would combine strict opposition to cartels with a much more lenient approach to concentrations of economic power (Djelic 1998: 109–10). This, in fact, placed him close to the American antitrust tradition and to the position at the time of American occupation authorities.[1] His vision of a social market economy (*soziale Marktwirtschaft*) relied on a combination of large-scale firms and efficient competition that together would drive the German economy towards US-type consumer capitalism (Berghahn 1985: 185; Erhard 1958: 169–71).

During the early period of the drafting process, between 1949 and 1953, Erhard could count on the support of the Christian Democratic Party. He could also rely on representatives of the Liberal Party and, of course, he could turn if needed to the Allied High Commission. Within German industry, the retail trade sector and parts of the small and medium-sized business community—those represented in particular in the Association of Entrepreneurs (*Arbeitsgemeinschaft selbständiger Unternehmer*, AsU)—were in principle supportive of a ban on cartels. These actors hoped that such a ban could protect them against pressures from big business (Berghahn 1986). Nevertheless, even within those groups, the legitimacy of cartels was still deeply entrenched and it was acknowledged that there were necessary, or at least acceptable, exemptions (Hüttenberger 1976: 294; Robert 1976: 175).

Overall, though, support in Germany for Erhard's position was small and marginal. The majority of German business leaders were fiercely opposed to a ban on cartels (Hüttenberger 1976: 294; Robert 1976: 375–81). In spite of the 1947 Allied laws, there was informal coordination of market behaviour after the war that was quite reminiscent of inter-war cartelization. This was particularly so in those industries where pre-war cartels had been strong—raw materials, production, and investment goods industries. Opposition against any kind of cartel legislation was most likely to be found in these sectors (Voigt 1962: 188). But the opinion that cartels were necessary and

[1] This was the reason why a first German draft, written by a team of ordo-liberal experts and presented in 1949 to Erhard, was quickly filed away. This so-called 'Josten draft' was not only criticized by German business leaders who were against a strict prohibition of cartels. It was also in fact rejected by Erhard and the Americans on the grounds that it called for strong political and legal intervention in order to prevent concentrations of economic power (Robert 1976: 112–3).

legitimate ways to coordinate market strategies of firms was popular and widespread, well beyond those industries. Before the war, small and medium-sized firms in many industries, including mechanical engineering and consumer goods, had found protection behind cartel agreements. Price, term-fixing, and specialization agreements allowed weaker players to survive, protecting them in fact from the efficiency and productivity of larger firms. After the war, some of those smaller firms feared that a general prohibition of cartels would mean the end of such protection and trigger a process of concentration that would make it difficult for them to survive (Herrigel 1996: 172).

As soon as industry associations became re-established in the late 1940s and early 1950s they began to lobby fiercely. In particular, the Federal Association of German Industries (*Bundesverband Deutscher Industrien*, BDI) under the leadership of Fritz Berg became a vocal opponent of Erhard's project. The BDI argued that time was not yet ripe for a German economy fully based on the competition principle and that a prohibition of cartels would hamper economic reconstruction. Instead, the BDI favoured a legislation modelled on the double principle of abuse control and self-government by industry, as known from the Weimar Republic (Braunthal 1965; Damm 1958; Djelic 1998). On a more pragmatic level, the BDI and its sectoral member associations lobbied throughout the drafting process for exemptions and exceptions. Industry associations exerted constant pressure through direct contacts with specific ministries (i.e. finance or transport). They also lobbied elected representatives of the Parliament (*Bundestag*) and members of the upper house (*Bundesrat*). They pushed the idea that export, crises, rationalization, or specialization cartels were necessary and suggested that certain sectors should be fully exempted (Robert 1976: 181–5).[2] After long debates, the Economic Ministry finally submitted draft legislation to Parliament in 1952. The massive opposition stemming from business communities, however, and their active lobbying, meant that discussions of the bill were still pending at the time of the elections in October 1953.

Following the elections, a new attempt was made to reach an agreement. Ludwig Erhard created an ad hoc commission that brought together officials from the Ministry of Economic Affairs and a few

[2] In the pursuit of their aims, members of this camp did not hesitate to use rather crude methods of lobbying. For example, they threatened to reduce their campaign contributions for the 1953 elections and launched a virulent media campaign against Erhard, whom they accused of acting on American orders (Erhard 1963: Chapter 16).

members of the BDI. At the same time he attempted to tighten the links with those groups of industry (particularly the AsU and parts of the consumer goods industry) that did not benefit so much from cartels and were therefore more willing to accept a prohibition. Representatives of these groups became increasingly vocal from 1954 onwards, challenging the dominant position of the BDI and its leader Fritz Berg (Berghahn 1986; Braunthal 1965). In 1954, for example, a group of business leaders representing companies such as the Margarine-Verkaufs-Union, Württembergische Metallwarenfabrik, Krupp, Klöckner, or Mannesmann, sent an open letter to the Economic Minister where they argued that a prohibition of cartels was not necessarily negative for the German economy and that the BDI was far from representing the opinion of all its members (Robert 1976: 251–2).

The ad hoc commission finally agreed on a revised version in 1955. Erhard had insisted on the prohibition principle—the revised bill included a prohibition of cartels largely similar to the provisions of the Sherman Act—but had accepted a number of exceptions to the prohibition clause. Most of those exceptions had been proposed by industry representatives already during the first legislation period. The bill was presented to the Bundestag in 1955. Hostilities between the opposing camps were immediately reopened. Pressure now came not only from industry, but also from other ministries and politicians, in particular from some members of the Christian Democratic Party (Robert 1976: 371). With the end of the occupation regime in 1954, the threat of direct imposition of a law by the Americans was not so credible anymore. This allowed the opponents of a clear prohibition principle to exert more influence in the drafting process than before. Furthermore, in the course of the early 1950s, mergers between large companies brought the retail sector as well as small and medium-sized companies increasingly into opposition to a strict prohibition of cartels because they felt such legislation would be directed exclusively against them. In consequence, Erhard lost the support of a strong group that in the early 1950s had been an important ally (Hüttenberger 1976: 107). Hence, he had to accept a few more changes before the Law against Restraints on Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, GWB) was finally passed in 1957.[3]

[3] The German Law against Restraints on Competition (*Gesetz gegen Wettbewerbsbeschränkungen*) is cited in the following in the version of 27 July 1957, as reprinted in Lehnich (1958: 89–127).

6.2.3. *GWB: Magna Carta for change or a text hiding continuity?*

At the end of the seven year-long fight for a German antitrust act, the result appeared at first sight significant. The Law against Restraints on Competition (abbreviated in German to GWB (Gesetz gegen wettbewerbsbeschrängkungen)) represented, at least formally, a clear departure for the German product markets from the legacy of economic coordination through cartelization. Cartel agreements with restrictive effects on competition were declared null and void (S. 1) and a newly created Federal Cartel Office (*Bundeskartellamt*) was in charge of monitoring obedience and pursuing offences and behaviours illegal under the GWB frame (S. 48).

The law, however, included a number of exceptions. These were essentially of two types. First, certain types of agreements were excluded from the general ban (SS. 2 – 7 GWB). Among these were term-fixing, rebate, and specialization agreements that had merely to be notified to the Federal Cartel Office. This type of exceptions reflected a compromise with the small and medium-sized business community. Structural crisis cartels and export cartels were also exempted from the general ban. The latter not only had to be notified, though, they also had to be approved by the Federal Cartel Office. Furthermore, the law gave the Economics Ministry full authority to allow cartels in exceptional circumstances, when the national interest or public welfare called for limits to competition (S. 8, section 1 GWB). Second, industries in which full market competition was not considered as appropriate or possible, were excluded entirely from the area in which the law was operative. This included the public sector (S. 98 GWB), transport and communication (S. 99), agriculture and forestry (S. 100), the banking and insurance sector (S. 102) and utilities (S. 103) (Voigt 1962: 191).

Although GWB created a space for exceptions, the general prohibition of price and quota cartels, as well as the establishment of a federal agency in charge of monitoring and, if necessary, sanctioning violations of the law, did affect the business behaviour of German companies—even though with considerable delay in many cases. It prevented, in particular, the re-emergence of thousands of cartels that had structured the economy during the inter-war period (Nawrocki 1973: 105). The overall number of cartel agreements, as registered with the Federal Cartel Office, remained low during the following decades.[4]

[4] During the period 1958–60 the Federal Cartel Office received 189 applications for cartel agreements (Voigt 1962: 195). In 1972, 212 cartel agreements were registered with the Federal

According to contemporary observers—even those who were rather critical of the exemptions associated with the law—during the first years of its existence the German legislation led to more fairness in competition and freedom in decision-making in many industries. The investment and expansion strategies of most companies were no longer driven by the 'cartel rhythm' that had been so characteristic of inter-war Germany (Voigt 1962: 204).

At the same time, the German law could not prevent companies from searching for ways to bypass it. This was made easy in fact by the formulation of Section 1 that left informal cartel agreements and collusive behaviour outside the reach of the Federal Cartel Office. Neither was the law prepared to deal adequately with issues of misuse or abuse of economic power. Those issues arose in the late 1950s, together with increasing economic concentration (Nawrocki 1973; Voigt 1962).[5] During the 1960s, the Federal Cartel Office used information and persuasion to try and influence business attitudes. This was met with considerable reservation. In the early 1970s, cartel-friendly attitudes were still not exceptional within the German business community. This led the Federal Cartel Office in the 1970s to fine heavily a number of companies that had been shown to have violated the GWB (Nawrocki 1973: 103).

The impact of the GWB on company strategy and behaviour was therefore often not direct or immediate. Rather, it followed upon a long process of confrontation and contestation between different actors with opposing interests. Throughout this process, it was not always clear, who would have the upper hand. At critical points, the champions of cartel prohibition and in particular the Federal Cartel Office, were bolstered and helped by the development, in parallel, of a European competition regime. In some cases, the Federal Cartel Office even sought the active support of European competition institutions (Quack and Djelic 2005). The overall outcome of this more long-term process of normative and cognitive transformation was that cartel-like behaviour gradually and increasingly became regarded as inadequate and illegitimate by politicians, lawyers, and business leaders in Germany.

The slow move away from a legacy of cartelization in German product markets can be construed as a systematic break with the past. Whereas in the inter-war period product markets in Germany

Cartel Office in Germany the majority of which were export, term-fixing and specialization cartels (Nawrocki 1973: 119).

[5] The 1973 reform of the GWB dealt with those weaknesses. It extended the prohibition of cartels to collusive behaviour, improved the control of misuse of economic power and introduced a systematic control of mergers (Nawrocki 1973 : 111–2).

were predominantly governed by cartelization, the post-war period saw a significant move to a liberal market order in this area. Collusion between actual or potential competitors became not only prohibited by law but also increasingly regarded by a growing number of economic and societal actors as an inappropriate strategy to achieve a leading position in national and international markets. Among business leaders this reorientation was not only facilitated by a younger generation of managers taking over responsibility in the 1960s and 1970s (Berghahn 1986) but also by the strong impact of American management methods on German enterprise management (Djelic 1998).

Change, though, did not preclude continuities and the persistence of inter-firm coordination through other means in post-war Germany. One partial bridge with the past can be found in the growth of large German combines in the 1960s and 1970s, at this point often in the form of legally merged entities. Another element of partial continuity, at least up until the 1990s, was the stabilization, or even expansion, of the German company network linking German firms with financial institutions (Beyer 1998; Streeck and Höpner 2003; Windolf and Beyer 1995; Windolf and Schief 1999).

It would be misleading, however, to regard the evolution of the post-war company network in Germany as a modern substitute for the industrial cartels of the inter-war period (see also Shonfield 1977 [1965]: 254). Whereas cartels were directed at limiting the exposure of member firms to product market competition, the German company network can be seen as directed towards improving the competitiveness of its individual member firms in liberal (and increasingly internationalizing) product markets. It did so in a double sense: on the one hand, by providing flows of information on investment, technological development and market strategies it created opportunities for indirect coordination between firms of the same or related industries in Germany (Windolf and Beyer 1995: 24)—even though only rarely between direct competitors (Schönwitz and Weber 1982: 102). On the other hand, large blocs of cross-shareholding protected its member firms—at least well into the 1990s—from hostile takeovers and short-term capital market pressures (Höpner and Krempel 2003).

Hence, in our view, it is not sufficient to point to the continuities in structural financial and personal inter-firm linkages. Instead a qualitative analysis of which actors attempted to regulate which kinds of competition with what kinds of results during distinct periods would be necessary. Höpner and Krempel (2003) show that the motivations and logics behind apparent continuities in inter-firm linkages have changed considerably over the last century. Their results indicate that links between companies, like other institutions, can be used as tools for different objectives and can mean different things in different periods. In particular, the conditions of emergence of those links may have little to do with their contemporary functionalities. The idea here is that behind stable labels and formal *façade*, institutional arrangements may be drifting progressively, changing quite significantly through time both in meaning and impact (Streeck and Thelen 2005: 36).

Altogether, a progressive but clear break in the dominant order of product markets—away from cartelization and towards liberalization and competition—has combined in the post-war period in German product markets with continued and reinvented forms of social coordination (this was the case also in labour markets, see Sorge, Chapter 5, this volume). Ironically, this unique combination can be seen as highly structuring of what was identified in the 1970s as a specific German model of production. In this respect, the Law against Restraints on Competition fostered an early move of German firms towards modernized forms of inter-firm coordination in liberalized product markets which in other European countries did not take place before the 1990s (Lilja and Moen 2003: 158).

6.3. **The Post-War Reorganization of the Competition Regime in the Banking Sector**

Comparing the story of the German competition regime in product markets with what happened in the banking sector during the same period reveals both similarities and differences. In both cases, the initial impulse was exogenous—the initiative for change came from the Allied occupation government. In both cases, it is difficult to identify a moment or an event that could represent the type of critical juncture so important in path dependency arguments. Struggles and confrontations evolved over a period of nearly ten years and what appeared at one point in time as being a step in the direction of change could lead only a short time afterwards to severe backlash—and vice versa. In spite of similarities, however, outcomes in the longer run emerge as quite distinct.

In the case of product markets, the crooked path ultimately led to a significant transformation of formal institutions, that itself triggered and was reinforced by a progressive reorientation of economic actors away from cartelization and towards oligopolistic specialization. In the banking sector, on the other hand, quite drastic formal changes, originally introduced by the Allied occupation government, did not prove stable and were progressively displaced. The strength and coherence of German opposition combined with an evolving geopolitical context and a highly constrained and constraining local financial system to deflect and tame changes. Core actors of the German banking sector managed to defend and maintain cartelization in the financial sector well after the 1958 law prohibited cartelization in most industries and product markets.

6.3.1. *The allied banking project for Germany—a bone of contention*

The role and behaviour of German banks during the Nazi period was a sensitive issue after the Second World War—on a par with cartels and industrial concentration. The American government and its military administration in Germany wanted to severely punish German banks. They were also highly critical of the structure of the German banking system. Growing unrest, rumours about a currency reform and questions about the viability of the credit system made a reform of the banking system an urgent issue. When Joseph Dodge, an American banker, was put in charge of financial and banking policy within the American military government (OMGUS) in September 1945, it was high up on his agenda. Dodge favoured a far-reaching restructuring and decentralization of the German banking sector. OMGUS's programme for a 'democratic and demilitarized banking system' aimed at the introduction of more competition in the German banking sector through dissolution of the large private banks, the separation of investment from credit banking and a limitation of interlocking directorates between banks and industrial combines. Dodge viewed these measures as 'an integral part of our program to ensure that the German financial hierarchy will never play any part in disturbing the peace of the world' (cited in Horstmann 1991: 64). A novel banking structure should be established that was, here again, to be modelled upon the American experience (Holtfrerich 1995: 461).

The Dodge plan met considerable opposition in the Allied Control Council—the supreme allied authority body. The British military government was highly sceptical of a decentralization of the German banking system. It would not agree to any such measure as long as there was no mechanism set up allowing for a redistribution of financial flows between the different military zones. The Soviet military government opposed the American plans on the grounds that the currency reform should come before a reform of the banking system. In October 1946, the chairman of the Allied Control Council acknowledged that no agreement would be reached. Military governors were left to proceed as they wished in their respective zones of occupation (Holtfrerich 1995: 469; Horstmann 1991: 93).

Within the American zone, OMGUS sought German supporters of the Dodge plan. With very few exceptions, reactions among members of the Länder governments were quite negative.[6] Ludwig Erhard, then Economics Minister in the Land of Bavaria, rejected the Dodge plan uncompromisingly. The arguments advanced by German politicians were generally in line with the contents of a memorandum that had been prepared by representatives of the large German private banks. This memorandum had reached the Southern Länder governments already in October 1946—a sign that large German banks had early on begun to lobby German politicians with a view to prevent changes in the German banking system (Holtfrerich 1995: 472). The claim was that the German unified and universal banking system corresponded to the structure of the overall economy and therefore could not be dissolved into parts without endangering the stability and liquidity of that economy as a whole. Furthermore, a functioning system of banking credit was seen as crucial precondition for the reconstruction of the German economy (Horstmann 1991: 99).

Still, the threat that OMGUS would impose a law was real. Hence, governments of the Länder in the American zone prepared draft legislation for a decentralization of the banking system. In January 1947, central banks were set up in each Land within the American zone. Representatives of the private banks, however, objected to any cooperation with the Americans. In reaction, OMGUS issued an order in March 1946 launching decentralization for the private banks and making it clear that any informal contact across Land borders between branches of the same bank was illegal and would be punished (Horstmann 1991: 105). The governments of the Länder tried to

[6] The Land of Baden-Würrtemberg was the only one signalling cautious support of the Dodge plan. The Finance Minister, Dr Fritz Cahn-Garnier, himself a victim of persecution under the Nazi regime, and Otto Pfleiderer, head of department in the finance ministry, believed that decentralization of the banking system was an important dimension of political federalism. Pfleiderer also argued that a banking reform was a necessary 'complement to the policy of decartelization' (cited in Horstmann 1991: 107).

convince private banks to collaborate with OMGUS. Those attempts, however, were unsuccessful. In May 1947, the American military government came up with one more piece of legislation. Law no. 57 appointed state commissioners in charge of decentralization for each of the large private banks.

From 1947 onwards, Western occupying powers started talking about the possibility of having a bi- or trizonal central bank. The British military government was particularly convinced that this would be a mechanism facilitating the redistribution of financial flows across occupation zones. As a concrete result of these discussions, the Bank of German Counties (*Bank Deutscher Länder*) and the Allied banking commission started operating in Frankfurt in February 1948. As a counterpart, the British (and French) military governments agreed to a decentralization of private banks at the Land level in their zones also. Thus, by April 1948, it seemed as if key features of the Dodge plan were becoming reality in the three Western zones. The Reichsbank had been replaced by a federal system of central banks at the Land level. Out of the three large private German banks, thirty formally independent banks had been created. Both central and private banks could only operate within the borders of a Land. Apparently, the decentralization of the German banking sector had been achieved. The legal liquidation of the old private banks, however, proved difficult to implement because it required the cooperation of all four Allied governments. Opposition against a speedy liquidation did not only come from the Russian military government. There was resistance as well on the British side, and, of course within the German banking community.

6.3.2. *Reconcentration of the German banking sector*

In fact, there was hardly anybody within that community supporting the American decentralization plan. Top managers in large private banks had been suspended and often arrested by the Allied governments immediately after the war. Regional managers took over responsibility in the new local and decentralized banks and, in the American zone, state commissioners appointed by OMGUS had complete power. When they came back from captivity and de-nazification camps, however, the old German banking elites re-asserted their leadership. Soon, links and cooperation between banks across Land borders were re-established on an informal (and illegal) basis. At Deutsche Bank, for example, members of the pre-1945 board of directors started to meet again informally from 1947, sending out instructions on important issues to all decentralized units. One of those board members, Hermann J. Abs, had been in close contact since 1946 with the British military government. He became subsequently a key figure in the mobilization of private banks against a decentralization of the German banking sector (Holtfrerich 1995: 481–2).

At Dresdner Bank, the 'old circle' met regularly from mid-1948 onwards and secret messengers were circulating with information and money between the different Länder and military zones (Horstmann 1991: 178–9). Management through informal channels was made possible by the loyalty of regional managers to their previous 'mother bank'. Similarly, a number of the state commissioners appointed by the American military government had previously been active in the banking sector and sympathized openly or silently with a recentralization of private banks. Politicians as well as public opinion at the time were fully in agreement with the banking community. The decentralization of the banking sector was unpopular almost everywhere. Unlike in the competition field, where the ordo-liberals played a significant role, the Americans were unable to find supporters for their banking policy.

In 1950, the year when the Federal Republic of Germany was founded, Hermann J. Abs and Wilhelm Vocke, the president of the directorate of the *Bank Deutscher Länder*, presented their own propositions for the future of the German banking sector. A massive press campaign supported this German plan that opposed the American program and had the backing of German politicians, independent of party affiliation. A first victory for this German opposition came soon. The British military government sent a special memorandum to the financial committee of the Allied High Commission. This memorandum integrated in modified form the proposal of Hermann J. Abs for a revival of the large private German banks (Horstmann 1991: 211).

This led to heated controversies between the three Western powers that proved impossible to reconcile. As a result, Allied financial consultants formally called upon the German Minister of Finance, in March 1950, to develop a plan for the restructuring of the banking sector. In contrast to the equally unresolved reordering of the iron and steel industry, or of I. G. Farben, the initiative for future planning in the banking sector was handed over to the German side. This opportunity was quickly taken up by German bankers and politicians. In March 1952, a German law came into force that allowed a recombination of banking activities into three independent banks covering larger areas of the newly formed Federal Republic of Germany.[7] During parliamentary debates, members of the social-democratic and liberal parties argued for a full reconcentration of the banking sector. This was considered, however, politically unrealistic by the German government (Horstmann 1991: 281).

Of course, debates in Parliament did not go unnoticed amongst Allied representatives in Germany. When the draft legislation was submitted for approval in March 1952, the Allied High Commission formally demanded a reassurance that the three-banks model would not be immediately questioned itself. The government of the Federal Republic of Germany issued a secrete declaration of obligation (*Verpflichtungserklärung*). On 27 March 1952, in a letter to the Allied High Commission, Konrad Adenauer declared that the three-banks model would remain stable for the three years following enactment of the law. Geographical extension, in particular, of the domain of each bank was ruled out. Furthermore, the Finance Minister issued a declaration promising a reform of the right of banks to represent minority shareholders for whom they hold the shares (Horstmann 1991: 283).

Representatives from the private banks, however, were only waiting for the next opportunity to recombine further and to turn their three large banks into a single bank unified at the Federal level. When the Federal Republic of Germany regained full sovereignty in May 1955, this was immediately followed by calls from the private banks to remove the banking law. The drafting process for a new legislation started early in 1956, influenced by the suggestions of the German private banks. The law was passed rapidly without debates and with unanimous voting by the German parliament on 12 December 1956. It allowed for a recombination along the lines of the former banking groups starting in January 1957—the first possible date according to Adenauer's secrete declaration (Horstmann 1991: 294).

When compared to the original American plans for a reorganization of the German banking sector, the outcomes of the actual reform process appeared quite limited at the end of the 1950s. Instead, one finds significant evidence of continuity with respect to the structure and functioning of the German banking system across and beyond the Nazi period and the Second World War. The early American proposition to separate credit and investment banking had altogether disappeared

[7] *Gesetz über den Niederlassungsbereich von Kreditinstitutionen, Großbankengesetz.*

from the agenda. The same thing could be said of the plan to reduce and limit industrial shareholdings by German banks. Since the 1952 law, it was apparently accepted that the managers of large banks were the ones to be in charge of a reordering of the banking sector. This meant, in fact, that those who were making the decisions and planning 'reform' were the very men who had been ruling the industry before and during the Second World War. The 1956 legislation, finally, meant the full re-establishment of universal large private banking in Germany—nearly at the same time as the long-lasting struggle for a competition law came to an end with a significant impact there on formal rules of the game.

One important factor that could explain in part the failure of the ambitious American plan was the absence of liquid and large-scale stock markets. Banks were the only external providers of capital in post-war Germany. In that context, attempts to split banks into small units with little financial power and to detach them from their traditional ownership and personal links to industry were bound to be unpopular and to generate resistance. All the more so that, after 1948, the reconstruction of the German economy called for a joint mobilization of economic and financial resources. And this joint mobilization was in fact being encouraged by the United States for geopolitical reasons.

6.3.3. *Cooperation and competition in the German banking sector*

Overall, continuity defines the German banking sector in the period after the Second World War. Since the financial crisis of the 1930s, the German banking sector had been governed by cartel agreements that included recommendations on interest rates. Soon after the Second World War, banks and banking associations pleaded for a continuation of these sector-specific restrictions on competition. Their main argument was that free competition in the banking sector would quickly undermine the stability and security of the overall financial system. The authorities in charge of bank supervision in the different Länder generally accepted this argument and declared cartel agreements in that sector valid in principle (Hausleutner 1970: 47–8, 86–7).

The planned Law against Restraints on Competition loomed as a serious challenge to the existing coordination of interest rates and more generally to restrictions on competition within the German banking sector. Unsurprisingly, banks and banking associations became involved in the debate around the GWB from the start. They lobbied to have the financial sector exempted from the law. With the support of financial supervisory authorities, and of several Länder governments, they managed to obtain the insertion of a sectoral exception into the law against restraints on competition (GWB, see p. 146) (Hüttenberger 1976: 306; Robert 1976: 185, 341; Schmidt 1995: 22). As a consequence, banks and banking associations could officially continue their practice of negotiated and coordinated interest rates. In 1967, the Federal government declared the existing interest rate decree as invalid in order to generate more competition in the banking sector—with little effect. Several banking associations argued that individual banks needed help and orientation (*Orientierungshilfe*) during the transition period that would lead to more competition. Hence, they went on proposing and registering recommendations on credit interest rates with the Federal Cartel Office (Hausleutner 1970: 111–2).

The exemption of the banking (and insurance) sector from the Law against Restraints on Competition (GWB) would be removed only in 1990. Three developments preceded and prepared the 1990 reform of §102 GWB. From the mid-1970s, the Federal Cartel Office (FCO) had systematically gone after collusive behaviour. Increasingly, it was taking a much more critical position on the issue of interest rates recommendations in the banking sector (Schmidt 1995: 77). Then, during the 1980s, the FCO received support from the EC's Directorate General IV, which launched an increasing number of investigations into cases of anti-competitive behaviour in the European financial sector. The European Court of Justice also helped by confirming that the European competition law was applicable without sectoral exemption in all those cases.

The European layer of competition law began to penetrate more and more national administrative and legal decision-making and finally constrained the relevant German actors to adapt national legislation to European standards (Quack and Djelic 2005; Schmidt 1995: 26). Furthermore, since the mid-1980s large private banks in Germany were going through strategic reorientation from national to international (often European) markets and from universal to investment banking (Morgan and Quack 1999; Vitols 2001). Liberalization of financial markets as well as increasing international competition between

[8] A special law concerned with the regulation of the banking sector (*Kreditwesengesetz (KWG)*), was enacted in July 1961. It indicated the conditions under which banks would be allowed to operate but did not touch upon questions of competition in this sector (Hausleutner 1970: 137 ff.).

banks undermined the collective capabilities of large private banks with respect to sectoral self-organization and market coordination (Höpner and Krempel 2003; Lütz 2002; Deeg and Lane, Chapters 2 and 4, respectively, this volume).

6.4. How Institutions Change: Rethinking the Idea of Path

The two stories we have described and contrasted in this chapter give a sense of how processes of institutional change can be complex, dense, and somewhat messy in real life. We have looked in this chapter at an important institutional subsystem—the competition regime—and at its fate in two parts of the German economy—product markets and the banking sector. A comparison of evolutions in those two cases provides us with an illustration of the conditions and limits for institutional change. We now pull together the main theoretical claims we can make on the basis of the empirical material provided in this chapter.

6.4.1. *A pincer movement*

In the stories we told above, a critical factor influencing the shift in competition regime in German product markets was the significant pressure brought to bear by the United States, and the alternative model this country provided. Additionally, though, for this shift to stabilize, it was crucial that it was supported by a local group who became committed to the American ideas in order to gain leverage for their own, preexisting, German intellectual tradition. The ordo-liberals had been marginal in Germany—both intellectually and institutionally—until the end of the Second World War. But they were German seeds upon which the American antitrust pressure could be grafted. The support of American occupation authorities brought a number of ordo-liberals into key institutional positions from which they could influence the political and, later on, the business communities. Over time they were also able to engage in public discussions over the pros and cons of an economic constitution for the newly founded Federal Republic of Germany, linking the choice of a new competition regime with general political issues of democracy and social justice. Hence, the reordering of product markets in post-war Germany started from the collaboration between dominant foreign and peripheral domestic actors. Once local actors had obtained access to important positions of power and were able to champion their project to broad parts of society, dynamics internal to Germany gained momentum and proved quite significant for the long-term stabilization of change.

We argue that change is more likely when institutional systems or subsystems are being attacked from both inside and outside, and foreign as well as domestic actors are able to mobilize various resources in favour of a common project (for more examples of that see Djelic 1998; Djelic and Quack 2003). The case of the banking sector in Germany is in part a counterfactual illustration of our claim. The Dodge plan did not have the expected impact, nor were its consequences long lasting, partly because it lacked the support of significant domestic actors. The small number of groups willing to link the decentralization of banks to broader debates on economic democracy and Federalism (such as a few political representatives in Baden-Württemberg) were not able to mobilize any significant support.

The case of the banking sector, however, points also to structural limitations creating significant constraints for actors with the desire to mobilize in the direction of the envisioned project. The underdevelopment of stock markets in Germany meant that both American occupation authorities, as well as the very few domestic proponents of a decentralization of the banking sector, had difficulties in pointing to a viable alternative to universal banks—particularly in a situation in which financing was urgently needed for the economic reconstruction and financial markets were still predominantly national. Such structural limitations gave on the other hand the old banking elites significant leverage and the capacity to mobilize in their own interest.

6.4.2. *Layered dimensions of institutionalization*

The contrast of these processes of change in German product markets and banking sector highlights the multiple ways in which institutionalization occurs. When we think of institutions as collective, stabilizing or stabilized, rules of the game, we need to consider of at least three dimensions. First, we have to consider the formal institutions or rules of the game, whether they be structurally embedded or codified in 'hard' or 'soft' law regimes. Second, our empirical material also tells us, that we should pay attention to individual and collective behaviours and interactions that set themselves in a relation of coevolution with formal institutions. Finally, we have to take into consideration contextual rationalities (Djelic and Durand 2004), the background logics or principles in which institutional systems or rules of the game are inscribed. There can be more, or less, fit between those three levels or dimensions. A tight fit and articulation between all three dimensions reveals a strong and stable institutional regime—at least at the moment of observation. On the other hand, decoupling or loose fit reveal, we suggest, pressures for and greater potentiality of institutional change and recomposition.

Challenges to and attacks upon institutional regimes can happen at all three levels in succession or concomitantly. The story of the reordering of product markets in Germany shows that quite clearly. One could argue that the process started with a formal rewriting of the law when the occupying powers issued a decree in 1947 prohibiting cartels, combines, syndicates, or trusts. At the same time, and for ten years after that, we document a process of loose coevolution. The local German champions of the antitrust movement were busy elaborating their own version of the formal law—but the impact of that process on the behaviour of economic actors was at best indirect and in any case delayed. Behaviours were, in the meantime, changing within certain groups and the overall balance of power within the German economy was shifting in favour of those groups that had either internalized market regulation (through hierarchies) or developed patterns of regulation alternative to cartels. Those changes in logics of action were only partly related to changes in formal rules of the game. Furthermore, the direction of causalities was not so clear and changes in behaviours and market interactions influenced the process of transformation of formal institutions, at least as much as the latter had an impact on logics of action.

In the end, though, where we start from probably matters less than the fact that, in time, changes aggregate and combine on all three dimensions. Consequential and long-lasting institutional system change calls for a transformation of formal rules, behaviours and underlying principles. This is bound, however, to be step by step and to require time. It is likely to involve and reflect a multiplicity of cumulative pressures exerting themselves from many angles on a particular institutional regime.

6.4.3. *Nestedness and reinforcing pressures*

The importance of nested and reinforcing pressures at other levels of collective action is a further conclusion to be drawn from this comparison. In parallel to the reordering of markets in Germany, an antitrust regime was being developed at the European level. Antitrust provisions emerged as an important feature of both the European Coal and

Steel Community (ECSC) as it was being structured, starting in 1951, and the European Economic Community (EEC), which was born with the Treaty of Rome in 1957 (Djelic 2002; Quack and Djelic 2005). The two processes—one of institutional change at the national level in Germany and one of institution building at the European level—had originally emerged and were initiated independently from each other. Those two processes, however, soon collided, colluded, fed, and reinforced each other.

This concomitant and partly interconnected development of antitrust at the European level has, over the long run, been a stabilizing factor for the shift in competition regime in German product markets. A comparison with the post-war story of competition regime shift in Japan would tend to confirm that (Haley 2001). Although the Japanese story shared many features with the German one (Streeck and Yamamura 2003), the resulting institutional transformation in Japan was neither as significant nor as stable in the long run as it has been in Germany. One of the explanations, we propose, is that the shift in competition regime in German product markets was stabilized and reinforced through time by the development and emergence of another 'layer', as it were, of antitrust, at the transnational or European level. Such reinforcing pressure was entirely absent on the other hand in the Japanese story.

The story of the banking sector in Germany provides us with further evidence of the role and significance of reinforcing and nested pressures. The attempt at introducing more competitive logics within the German banking sector proved relatively short-lived and unsuccessful during the 1950s. We argued above that the relative lack of success of the change project in the German banking sector could be explained in part by the absence of local champions. The pincers had only one arm. At the same time, when we extend the banking story to look at more recent developments (the 1980s and 1990s), it becomes clear that the German banking sector has been experiencing major transformations (see also Lane, Chapter 4, this volume) after decades of stability and relative resistance to change. An important difference for this sector between then and now has been the emergence of reinforcing and nested pressures at the European and global level. European regulation has matured and progressively trickled down towards the German banking sector while the internationalization of financial markets has provided alternatives to industrial finance through domestic banks for many large corporate actors in Germany, and the political elite has become progressively reconciled to this.

6.4.4. *From path dependence to path generation*

This chapter suggests that the shift in competition regime in Germany since the end of the Second World War has emerged from a succession of critical junctures, and from a multi-step process of coevolution and hybridization of new rules of the game and preexisting practices. The path has been a crooked rather than a straight one and we argue that it could only be charted and ascertained a posteriori. Many of the stages and step-by-step evolutions could not have been fully anticipated or expected. We do not document a pattern of punctuated equilibrium—a single radical and abrupt jump from one competition regime to another. Nor do we give evidence, though, of evolutionary and inconsequential within path transformation. When we look at the period as a whole, the shift in competition regime was progressive and step by step and nevertheless highly consequential.

We propose that the idea of 'path generation' fits quite nicely with the process of institutional change we have described here and, more generally, suggest that the life and evolution of institutions may have more to do with processes of 'path generation' than with patterns of 'path dependence'. There are a number of key differences between the two concepts. The idea of 'path dependence' implies a focus on the past. The past constrains or even determines the present or the future. In contrast, the idea of 'path generation' suggests at least as much a projection towards an open-ended future.

Another major difference concerns the degree of openness implied by both terms. In the less deterministic variants of the path dependence argument, the process is open-ended for a short while only, during the periods that coincide with critical junctures. But then the process is closed off, precisely through what happens during those moments. In our idea of 'path generation', on the other hand, the process is open-ended throughout. The multiplicity of critical junctures together with their partly unexpected consequences means that both the path itself and its consequences can be fully recognized and mapped only post hoc.

A third important difference between the concepts of path dependence and path generation has to do with the articulation between structures and agency. Path dependence arguments tend to be associated with passive models of action where behavioural patterns and

[9] See Garud and Karnoe (2001: 6) for a parallel discussion of path creation and path dependencies in the field of entrepreneurship and technological innovation.

logics of action are merely constrained by and have to adapt to structural and institutional frames. Our idea of path generation reveals, on the other hand, a preoccupation with a process of coevolution and mutual interplay—where institutional frames constrain behaviours and agency, the latter in turn shaping, adapting and transforming the institutional and structural rules of the game in which they are embedded.

In contrast to the weak model of path dependence (Sewell 1996), the concept of path generation allows us to specify the conditions under which redirection of an existing path becomes likely. In our case study we have identified two such enabling conditions: a pincer movement of external and internal pressures for change and the ability of foreign and local actors to mobilize positional, relational, and discursive resources in favour of a planned change. Unlike in the strong variant of path dependence, on the other hand, a redirection of the path comes not from a single critical juncture but rather it emerges and is being constructed through a historical sequence of multiple junctures that cannot be fully anticipated. The path is a crooked one and it reflects long periods of struggle between countervailing pressures. This crooked path shows the historical interplay between pressures for continuity and stimuli for change—the reinforcing mechanisms identified by Mahoney (2000) and Pierson (2000) being challenged then by external and internal triggers for change.

The perspective on institutional change that emerges has been theorized elsewhere (Djelic and Quack 2003). We argue that the succession and combination, over a long period of time, of a series of incremental steps and junctures can lead in the end to consequential and significant change. Each single one of these incremental steps may appear in itself quite marginal and it may be absorbed and mitigated in part by the preexisting institutional frame. However, the succession, aggregation, and combination of multiple and multilayered steps ultimately and with a longer term view of the process adds to the significance and heightens the impact of each single transformation. We use the image of 'stalactite change' (Djelic and Quack 2003: 309) and we see it as more useful to describe the way in which most national institutional systems change than the image of the 'Big Bang' often associated with punctuated equilibria models.

[10] See also Thelen (2003: 210) for a discussion of the 'cumulative effects of ongoing and often subtle changes' and Streeck and Thelen (2005) for another thorough analysis of 'incremental change with transformative results'.

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