

Varieties of Privatization:

Informal Networks, Trust and State Control of the Commanding Heights

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Abstract

Why did ordoliberal Germany unconditionally privatize its aerospace and defense industries in the 1980s, whereas the neoliberal government in the United Kingdom established significant state control? To shed light on this puzzle, this article builds on the Varieties of Capitalism (VoC) and theorizes how different production regimes – complemented by distinct legal traditions – shape governments' decisions about how to privatize state-owned industries. I argue that Germany's coordinated market economy included *informal networks* between state and business actors that were based on *trust*. These relationships enabled the government to transfer ownership of the defense industries to the private sector without retaining any formal control. The United Kingdom's liberal market economy, by contrast, lacked such informal trust-based networks. That explains why the British government maintained formal control instruments and thus intervened more forcefully in its aerospace and defense sector. The comparative process-tracing analysis draws on original sources, such as formerly secret archival files and interviews with decision-makers. The article's contribution lies not only in extending the firm-centered logic of VoC to coordination between corporate actors and the *state*, but also in institutionalist theory-building: Trust-based coordination within informal networks systematically reduces vulnerabilities and can thus substitute for the arguably constant need of formal control.

1. Introduction

Most governments of advanced industrialized countries have turned toward privatizing state-owned enterprises (SOEs) in past decades.¹ They thus shifted vital responsibilities for the provision of public goods to the private sector (Mercille & Murphy, 2016). The indirect regulation of markets rather than the direct exercise of state control was supposed to ensure not only welfare, but even national security (Markusen, 2003). Beyond this gradual convergence among advanced democracies (Peters, 2012), however, the *design* of privatization, and thus how governments influence former SOEs once privatization has taken place, has varied greatly: from retention of formal decision-making powers by the state to granting unconditional private freedom of action (Obinger, Schmitt, & Traub, 2016, pp. 2–3). These design choices have, in turn, made a significant difference, as they ultimately decided over whether the new national champions strived for monetary profits or served political purposes. Without considering the government's veto power provided by golden share arrangements, for instance, one 'would have substantially understated the power of the state in privatized firms' (Bortolotti & Faccio, 2009, p. 2909).

Among scholars of International Political Economy (IPE), there is widespread agreement that variations in ideology combined with party politics primarily explain national differences in privatization policies (Appel, 2000; Obinger et al., 2016). Therefore, center-right protagonists in liberal countries like the United States (US) and the United Kingdom (UK) have, arguably, been in the vanguard of privatizing SOEs, whereas their counterparts in continental European countries such as France and Germany have been much more hesitant. Yet, if we compare the privatization of a key economic sector – the aerospace and defense industries – in the UK and Germany in the 1980s, we encounter a puzzling phenomenon: Despite the fact that '[p]rivatization was one of the key elements of what became known as Thatcherism' (Mercille

& Murphy, 2016, p. 1042; Zohlnhöfer, Obinger, & Wolf, 2008, p. 96), the neoliberal UK government preserved state control in the form of a golden share in its privatization of British Aerospace (BAe) (Parker, 2009). By contrast, Germany's ordoliberal government under Chancellor Helmut Kohl gave up residual control and fully privatized *all* shares of the counterpart company, Messerschmitt-Bölkow-Blohm (MBB), in 1989 (Huck, 1989). This raises the question of *why the two governments privatized their state-owned aerospace and defense corporations in such contradictory ways*.

This anomaly matters for two main reasons: It can shed light on the conditions under which neoliberal governments are prepared to stay involved in the *commanding heights of the economy*, i.e., private industries essential for the national economy as a whole. It may also help us to explain under which circumstances ordoliberal governments are willing to give up state control and promote full privatization. In contrast to the literature's predominant emphasis on ideological beliefs held by political parties, this article builds on the Varieties of Capitalism (VoC) approach (Soskice, 1999) by focusing on the suggested 'modes of capitalist coordination' (Hay, 2019, p. 4).

However, I refine VoC as 'a firm-centered political economy' (Hall, P. A. & Soskice, D., 2001, p. 6; Howell, 2003, p. 105) in two main ways: First, the original framework has theorized distinct modes of firm-to-firm coordination (e.g. formal vs. informal). I extend this perspective to also include the coordination between firms and *state* actors in order to shed light on the opportunities and constraints that governments face when they design the privatization of SOEs.² Second, I incorporate a new causal mechanism into the VoC approach that has hitherto been neglected: the role of *trust* as a distinct mode of coordination that translates institutional opportunities into political choices.³ Trust is understood as mutual confidence in the adherence to agreed-upon commitments beyond short-term self-interest. Despite all actors'

constant concerns about others' future behavior, relationships of trust allow governments to relinquish formal control over SOEs.

I argue that a trust-based explanation, focusing on the opportunities provided by the prevailing production regime and complemented by legal traditions, accounts for the contradictory ways in which the two governments privatized their aerospace and defense industries. In coordinated market economies (CMEs), strategic and often informal coordination shapes interactions between the government and firms in the form of networks. In turn, this coordinating capacity provides additional strategic options for state actors. Trust relationships within these networks function as a substitute for formal state control and may thus result in institutional designs without any safeguards despite actors with a strong preference for control. Liberal market economies (LMEs), on the other hand, do not depend on informal networks or trust relationships between state and corporate actors. Instead, formal contracts and market competition shape coordination between them. In the absence of informal networks and the operation of trust, governments merely have formal design options to retain control over its privatized enterprises.

The empirical analysis in this article traces how the UK's and Germany's different production regimes constrained or enabled state actors in designing the privatization of aerospace and defense industries. The two governments had analogous preferences: They strived for efficiency gains in civilian and military aircraft production, but both sought to establish a design that would avoid foreign ownership of the privatized corporations. Which opportunities and constraints were, then, provided by the two countries' institutional frameworks to achieve the preferred outcomes? While the UK's constellation of LME and common law did not result in trust relations between state and corporate actors, Germany's CME, complemented by civil law, required strong coordinating capacity. This took shape in

trust-based exchanges within informal networks such as the so-called 'Deutschland AG'. The UK's options were limited to contractual control instruments such as formalized veto power in the form of the so-called 'golden share.' By contrast, Germany had additional strategic options at its disposal. Core members of Deutschland AG – Daimler-Benz and Deutsche Bank – were regarded as trustworthy actors with a reliable reputation for knowing how to respond *informally* to the threat of foreign takeover. Hence, Germany's government was less vulnerable and would exercise future informal influence on the basis of trust rather than requiring legal control instruments such as those employed in the UK. These critical differences are traced and compared by causal process observations of the context, the decision-making process, and the outcome itself.

This article contributes to institutionalist theorizing in general, and the privatization of the state's core functions in particular. First, I suggest micro-foundations for how the opportunities provided by *informal networks* lead to outcomes beyond the formalized rules of the game (Streeck & Thelen, 2005, p. 10). Given that informality is an inherent part of political life (Stone, 2011), the article's theory-building is applicable to those manifold instances where political outcomes hardly reflect formal agreements. I specify how informal networks connect to the chosen designs of governance arrangements. The causal mechanism is trust that substitutes for the establishment of formal control.⁴ In the absence of informal networks and trust, however, only formal instruments remain. The most significant implication is that integral building blocks of institutionalist theories, such as concerns about opportunism and enforcement problems (Fioretos, 2011; Hall, P. A. & Soskice, D., 2001; Scharpf, 1997), are no longer to be treated as constant obstacles to cooperation, but – under the condition of trust – as variables. As a consequence, actors' concerns over cheating need to be empirically investigated rather than theoretically assumed.

Second, the article shows that selling defense contractors is not a unique political process, but part of the large universe of privatizing former core state functions (e.g. utilities, telecommunications, arms production) (James, 2002, pp. 130–132; Kim, 2007, p. 173; Markusen, 2003, pp. 473–474). Given that the choices of privatization designs have constituted distinct power balances between state and corporate actors on the commanding heights of the economy, they also shaped different pathways of transforming the modern state (Leibfried & Zürn, 2005; Genschel & Zangl, 2014). The article thus contributes to the body of literature that theorizes the causes and effects of how governments retreat from their entrepreneurial role in governing the commons (Graham & Prosser, 1987; Toninelli, 2000; Howell, 2003; Peters, 2012; Colli, Mariotti, & Piscitello, 2014). By drawing on previously disclosed and formerly secret information from archives, personal notes from decision-makers, and semi-structured interviews with contemporary witnesses (Beach & Pedersen, 2013, pp. 132–143), I demonstrate that my trust-based VoC-explanation is able to resolve the puzzle of why liberal, arm’s-length coordination resulted in a more direct power position of the UK’s government within the aerospace and defense sector than the more indirect, *laissez-faire* position of the German government.

The remainder of this article proceeds as follows: First, I explore the two privatizations and flesh out their startling nature against the backdrop of prevailing theoretical approaches. Then, I draw on VoC and develop an institutionalist framework to show how state and private actors coordinate with each other, before I propose trust as a causal mechanism and spell out the observable manifestations. Next, I explain my methodological approach and employ process-tracing techniques to compare the empirical record of the privatization trajectories in the UK and Germany. The conclusion discusses the implications of the analysis and addresses the theoretical scope of the article’s argument.

2. Contradictory varieties of privatization?

What is the design of privatization? I conceive of it as a governance arrangement between the state and private actors that prescribes the degree of the new firm's corporate independence. The key question is the extent of future governmental control of the new entity (Fligstein, 2016, p. 959; Obinger et al., 2016, pp. 2–3), and therefore I suggest two dimensions to distinguish privatization designs *with* ex post state control from those *without*. First, the governance arrangement may grant state actors formalized access to a firm's internal decision-making processes (e.g., reporting arrangements, board meetings), or the government may be fully excluded from internal corporate processes (Scharpf, 1997, pp. 174–175). While having information and participating in decision-making processes may help to persuade and *softly* shape the behavior of the new board, 'teeth' are ultimately lacking. Thus, I introduce a second, *hard* dimension: blocking power that allows state actors to critically shape the corporation. Either there are legal provisions preserving the state's veto power with regard to future decisions taken by the privatized entity (e.g., a blocking minority of shares, special shares), or there are none of these provisions and thus no blocking power (Graham & Prosser, 1987; Toninelli, 2000).

Why do these political choices with regards to the future privatization design matter? Admittedly, governments have other options to exercise influence over the aerospace and defense industries. They can procure weapons systems (Weiss, 2019), they can regulate arms exports and private service providers (De Vore, 2014; Krahnemann, 2010), and they may engage in 'defense diplomacy' abroad (Rüchardt & Weiss, 2018). In other words, governments spend money, authoritatively set rules, and engage in foreign policy in order to shape corporate behavior of aerospace and defense contractors. Yet, the effects of these policies are *indirect*.

By contrast, ownership of firms allows for *direct* interference into corporate strategies and decision-making (e.g. by nominated board members). If a government thus privatizes a firm *and* abstains from any formal veto power, it does not merely reduce its influence, but it moves from direct toward *indirect governance* (Colli et al., 2014, p. 487; Genschel & Zangl, 2014; Abbott, Genschel, Snidal, & Zangl, 2016). Now, the new firm's executive board unilaterally decides over the closure of plants, the relocation of jobs, the investment in specific technologies, and the company's ownership structure itself. The government may have influence, but it has no longer a *direct* say in these decisions. This extent of directness differentiates ownership from other important policy instruments, such as procurements or regulations.

Privatization with ex post control in the United Kingdom

In 1979, the election manifesto of the then-leader of the opposition in the UK, Margaret Thatcher, stressed the political objective of 'sell[ing] back to private ownership the recently nationalised aerospace' industries (Conservative Party, 1979). This committed her government to launching the privatization of British Aerospace (BAe) from 1981 onwards. The Secretary of State for Industry, Keith Joseph, who was Thatcher's neoliberal mastermind and the primary designer of privatizations (Bosanquet, 1981), stressed that the government's 'wish is to establish an *arms length* [sic] *relationship* with the new company, and to make clear that the government will not intervene in the company's commercial decisions' (Joseph, 1979a, p. 1). Yet, the key question was how to politically control corporate decisions once privatization had taken place (see also, Fligstein, 2016, p. 954)?

BAe's first flotation on the stock market in 1981, when shares worth about half of the company's value were sold, needs to be distinguished from the second one in 1985. Given the expectation of reduced gains (Parker, 2009, p. 114), industrial takeovers were ruled out in 1981, and a private bank, Kleinwort, acted as the government's financial advisor in preparing the flotation on the stock market. It suggested a state shareholding of between 40 and 60 per cent, which served as an effective safeguard even under private law (Hayward, 1989, p. 173; Parker, 2009, p. 115). Thus, this first flotation was dominated less by concerns over control than by a desire to signal to investors the private and therefore attractive nature of the new corporation, BAe (Joseph, 1979a, p. 2). Nevertheless, the actual privatization design in the form of 'articles of association' stressed the 'cardinal principle' of UK control and essentially prevented foreign acquisition of more than 15 per cent of BAe's shares (British Aerospace, 1981; HC Deb, 1979, 222, 223). Another important instrument of government control was the right of the Secretary of State for Industry to appoint two British citizens as directors. In short, this privatization design guaranteed the government's veto power by allotting it the majority of shares and providing it with access to corporate decision-making processes by appointing two board members.

Different scenarios were on the agenda of the second flotation in 1985. First of all, an industrial takeover came into consideration as the electronics group Thorn-EMI and the General Electric Company (GEC) both showed an interest in BAe's shares. By mid-1984, however, negotiations with both corporations had failed (The Financial Times, 1984b, The Financial Times, 1984c). A second stock market flotation re-emerged as the most viable option and the government – now advised by the City firm of Lazard – announced its decision to sell the remainder of the shares in January 1985 (Parker, 2009, p. 123). In order to preserve state control *without* ownership, however, the Thatcher government put forward the golden (or

special) share solution. This privatization design was, again, reflected in the articles of association, which reinforced UK control (Art. 40) (Hayward, 1989, p. 173). Art. 72 was amended to stipulate only one director (and one alternate). In clear contrast to the past, however, Art. 13 introduced the 'Special Share' arrangement, by which the articles of association themselves could not be amended without the consent of the British government. '[T]he special share [...] will have the same blocking effect' (HC Deb, 1985, p. 185; Parker, 2009, p. 427) as the government's former ownership of more than 25 per cent of the shares.

In sum, BAe's shares were almost fully privatized on the stock market by 1985, but political prerogatives and thus *ex post* rights had not been abandoned. Control was formally safeguarded by the government's direct access to corporate decision-making processes and, in particular, by its veto power.

Privatization without ex post control in Germany

At the beginning of the 1980s, three German *Länder* – Bavaria, Hamburg, and Bremen – had become majority shareholders of the *de jure* centralized, but *de facto* fragmented, corporation Messerschmitt-Bölkow-Blohm (MBB). MBB was not only Germany's largest defense contractor, but also represented the German part (i.e., 37 per cent) of the European Airbus consortium for civilian aircraft (Huck, 1989). At the same time, automotive manufacturer Daimler-Benz had diversified its business and increasingly moved into aerospace by acquiring majority shares in the engine producer MTU, defense electronics from AEG, and the aerospace company Dornier. Although MBB's privatization was repeatedly on the political agenda, the precise terms were far from clear (Eglau, 1991, pp. 145–184). How, then, did German policy-makers seek to control corporate decisions after privatization?

The notion of 'industrial leadership' was meant to be the solution for Germany's aerospace sector. Whereas privatization should relieve the federal government from budgetary pressures, it sought to prevent a foreign takeover in the future. In addition, two of the *Länder*, Bavaria and Hamburg, also aimed to impose particular terms to protect production sites located on their respective territories (Der Spiegel, 1989c; Voscherau, 1989d; Reuter, 2016). In the spring of 1987, the government approached Daimler-Benz, which favored an *unconditional* takeover (Daimler-Benz AG, Bavaria, Bremen, & Hamburg, 1989, p. 1; Der Spiegel, 1987a, Der Spiegel, 1987b; Voscherau, Krupp, & Rahlfs, 1988). After the Federal Minister of Economic Affairs' exceptional approval, which outweighed the initial prohibition by the Antitrust Authority (Der Spiegel, 1989b; Reuter, 1998, p. 369), Daimler-Benz eventually acquired MBB in 1989 without any reservations and fully integrated it into its aerospace division, DASA (Eglau, 1991, pp. 165–184).

In sum, neither the federal government nor the *Länder* preserved any veto with regard to future decisions by DASA or Daimler-Benz, and political representatives did not have direct access to corporate policy making within Daimler-Benz as they were no longer *ex officio* board members.

How to approach the varieties of privatization?

At first glance, the two governments' choice of a design for the privatization of their aerospace and defense industries appears contradictory. Standard approaches would have predicted precisely the opposite outcome. Political Economy scholars would typically focus on the role of partisanship and expect right-wing and neoliberal parties to be more prone to promote privatization than left-wing governments (Zohlnhöfer et al., 2008; Obinger et al., 2016).

Explanations of this kind often also take into account the role of the different ideologies held by the elite in shaping variation in privatization outcomes (Appel, 2000). Yet, while the combination of partisanship and ideology would lead one similarly to expect privatization, it would clearly foresee more control in Germany than in the UK.

Scholars from Security Studies, on the other hand, would combine the perception of a threat to national security with domestic variables in their approach to the restructuring of defense industries (Gholz & Sapolsky, 1999/2000; Weiss, 2018). The closer and more immediate military dangers faced by Germany in the 1980s from the Soviet Union would have suggested control instruments being retained on the continent rather than in the UK. This contrasts with the actually observed outcome. Another strand of scholarship on the privatization of national security (Markusen, 2003) would similarly expect the neoliberal UK to replace 'direct state ownership of the defence industry [...] by hands-off steering' (Krahmann, 2010, p. 41).

Historical-institutionalist (HI) approaches, widely applied by both sub-disciplines, face similar difficulties. The HI notion 'that the timing and sequence of events shape political processes' (Fioretos, 2011, p. 371; see also, Krotz, 2011) does not provide a promising starting point either. State ownership of the British aerospace and defense industries was, in fact, merely a brief interlude following the Labour government's nationalization of certain sectors in the second half of the 1970s. In contrast to Germany's trajectory of public shareholding in this sector, British firms had been *fully* private before.

Likewise, when we integrate veto players into our analysis (Tsebelis, 2002, p. 74), we find that Germany's federal state structure, which required close coordination between the government and the *Länder* in the design of privatization, meant that it had more than double the number of veto players compared to the UK with its centralized system of government

(Bortolotti & Pinotti, 2008, p. 14). This constellation would, again, have suggested more *ex post* control instruments in Germany than in the UK (Zohlnhöfer et al., 2008).

Finally, vested interests and the varying salience of the aerospace industries in the national economy might account for the UK's insistence on formal control, whereas the German government might have had more freedom of action in this regard (Dunne & Sköns, 2010, pp. 282–285). A comparison between BAe's and MBB's relative economic and export importance suggests that the relative salience was, indeed, more extensive in the UK. Yet, this shaped neither an exceptional preference for political control instruments nor special means of influence by organized interest groups. The process-tracing analysis highlights the very similar degree to which decision-makers in both Germany and the UK were keen to prevent foreign ownership of their aerospace companies (Bischoff, 2017; Kim, 2007; Krupp, 2017).

In sum, standard approaches have difficulties explaining the contrast between Germany's unconditional privatization and the establishment of significant control instruments by the UK. Therefore, the following section develops an alternative account of how to approach these varieties of privatization.

3. Production Regimes, Legal Traditions, and Trust

To explain why one privatization design is chosen rather than another, I build on the VoC literature (Hall, P. A. & Soskice, D., 2001; Soskice, 1999) and expand its firm-centered logic to cooperation between private actors and the *state* in three steps. First, I theorize how the opportunities and constraints provided by the wider production regimes shape either strategic or non-strategic forms of coordination between the government and firms. Second, I introduce legal traditions as institutional complementarities. The resulting institutional

frameworks provide varying opportunities for the emergence of a relationship of trust as a mode of coordination between the state and corporate actors. Therefore, in a third step, I develop trust as a hitherto omitted causal mechanism, i.e. I spell out the pathway whereby X – a national production regime complemented by a legal tradition – contributes to producing Y – the choice of privatization design (Beach & Pedersen, 2013, p. 12). The evolving trust relationships provide the government with *additional* strategic options and thus make a privatization design without *ex post* control instruments more salient than one based on formal safeguards.

The institutional framework

The original VoC approach focused on how ‘the organization of production through markets and market-related institutions’ (Soskice, 1999, p. 101) shapes firm-to-firm coordination. For instance, CMEs tend to encourage long-term cooperative relationships between companies much more than LMEs do. These wider production regimes are conceptualized as institutional frameworks that vary according to the capacity of business (and labor) to coordinate among themselves (Lane, 1997). This coordinating capacity depends on a combination of ownership, links with financial institutions, as well as both formal and informal networks (Hall, P. A. & Soskice, D. W., 2001; Farrell, 2009).

In contrast to this firm-centered approach (Howell, 2003, pp. 105–106), recent studies have applied VoC to investigate *government-to-firm* coordination around the commanding heights of the economy (Colli et al., 2014; De Vore & Weiss, 2014; see already, Albert, 1993). Extending beyond the original framework, scholars argue that the prevailing production regime also helps to resolve problems of *government-to-firm* coordination by providing

opportunities and constraints to their interactions. Coordinating capacity depends on ownership structures, connections to financial institutions, and the networks that organize coordination within, for instance, the aerospace and defense industries. The primary effect of the production regime's institutional framework lies in its capacity to provide information about future behavior and thus to make one governance arrangement more attractive than another. In a nutshell, institutions induce coordination as 'the beliefs instantiated in institutions will be compelling focal points' (Farrell, 2009, p. 50).

Liberal market economies, such as the UK, organize coordination via market mechanisms and adversarial contracts, which are the primary source of information for the actors involved (De Vore & Weiss, 2014). Neither informal networks nor banks' domination of supervisory boards within manufacturing industries play a pivotal role in coordination. Both state and corporate actors seek to avoid flexible interpretations of rules. Instead, the predominance of formal institutions requires that these contracts are relatively specific in the sense of shaping a focal point that predefines actors' future behavior (Farrell, 2009, p. 106).

By contrast, exchanges between government and firms shape strategic coordination and mutual commitments in coordinated market economies like Germany's (Coates, 2000; Hall, P. A. & Soskice, D., 2001, p. 8). Financial institutions not only provide patient capital (Culpepper, 2005), but simultaneously shape the corporate strategies of manufacturing industries through supervisory boards (Streeck & Höpner, 2003). Beyond formalized rules of the game, such as associational networks, informal institutions help to address coordination problems and the challenges raised by moral hazard. They are understood as 'socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels' (Helmke & Levitsky, 2004, p. 727). Informal institutions convey unwritten understandings and allow for more flexible future behavior (Stone, 2011). Most significantly,

informal rules offer incentives that may either complement or compete with the opportunities provided by formal institutions (Helmke & Levitsky, 2004). The more complementary this interrelationship is, the more stable focal points evolve that actors *additionally* have at their disposal.

Despite the fact that these wider production regimes provide opportunities and constraints for all the actors involved, they hardly *impose* one specific form of government-firm coordination within an uncertain environment. Instead, LMEs or CMEs are complemented by other institutional frameworks, such as legal traditions, that contribute to the coordination between state and corporate actors (Lane, 1997; Bortolotti & Faccio, 2009; Rosenthal & Voeten, 2007).

In common law countries, economic exchanges between actors are institutionally formalized by terms of contract that aim to anticipate uncertain situations (La Porta, Lopez-de-Silanes, & Shleifer, 2008, pp. 288–290). The coordinative challenge is to agree on contracts that are as complete as possible (Casper, 2001, pp. 391–392). By contrast, civil law countries fill the inevitable gaps in incomplete contracts by taking into consideration the social nature of economic exchanges and thus their intention and the reputation of the actors involved in them (Rosenthal & Voeten, 2007). Here the coordinative challenge is to meet the extensive information requirements for understanding the true nature of business relationships (Casper, 2001, pp. 389–391). While common law has furthered adversarial contracting as the predominant form of exchange, the civil law tradition has given rise to ‘socially conditioned private contracting’ (Beck, 2012, p. 61).

How do these two distinct legal traditions, in turn, relate to the wider production regimes? On the one hand, common law hardly complements coordinated market economies as it does not contribute to the creation either of strong institutions beyond the contract or,

consequently, of coordinating capacity. Likewise, there is little in the way of a complementary relationship between liberal market economies and civil law. Market transactions are an inherently inadequate means of providing information that can be translated into strategic forms of coordination. This has been described as the ‘trust problem of markets’ (van Waarden, 2012, pp. 356–358).

On the other hand, common law does complement liberal market economies as adversarial contracts and market competition mutually reinforce each other. Formal institutions are the predominant sources of information for all actors involved, so that these rules of the game help to overcome coordination problems. This applies not only to firm-to-firm interactions (Lane, 1997), but also to the relationship between state and corporate actors. Golden shares, for instance, serve as widespread instruments of governmental control in common law countries (Lovell, 1985, p. 2; Bortolotti & Faccio, 2009). They imply that the government preserves a formal veto right over future company behavior in imperfectly anticipated situations.

By the same token, civil law complements coordinated market economies as both involve the strong institutions needed to meet the wide-ranging informational requirements. While the provision of information is costly in civil law exchanges, CMEs have developed complementary – formal and informal – institutions to allow for socially conditioned contracting. For instance, standardized contractual structures and industry frameworks significantly lower information costs (Casper, 2001, p. 415). Beyond these formal institutions, however, CMEs have established informal networks and communication channels between corporations and the government so that bargaining positions can be mutually adjusted (Coates, 2000, pp. 64–74; Casper, 2001, pp. 393–396). This has shaped a particular mode of

strategic coordination that clearly reaches beyond contractual duties and regularly includes stable informal agreements.

In sum, the wider production regime – complemented by legal traditions – shapes a structure of opportunities and constraints that both state and corporate actors draw on to satisfy their interests. The resulting institutional frameworks support specific forms of coordination. The complementary combination of LME and common law strongly encourages adversarial contracting as the predominant mode. Coordinating capacity beyond contracts is useless and thus not required. Only formal rules can establish *ex post* control to some extent. By contrast, the complementary linkages between CME and civil law further strong coordinating capacity. These complementarities shape a strategic mode of coordination that allows for *informal* agreements and influence beyond formalized control instruments. In other words, this constellation involves more coordinating capacity and thus produces *additional strategic options* for all actors, but without imposing one particular design. The question thus arises *how* these informal agreements can potentially substitute for contractual guarantees. What is the causal mechanism that translates them into the choice of a privatization design without *ex post* state control, thus taking advantage of the additional strategic options?

Trust as a causal mechanism

The concept of trust provides this omitted causal link (Cook et al., 2005): ‘where there is trust there should be less need for detailed and formal contracting’ (Parker & Hartley, 2003, p. 101). The mechanism is that trust relationships prolong the shadow of the future and thus reduce the contracting parties’ risks from opportunism in two critical ways (Coates, 2000; Bachmann & Inkpen, 2011): First, the presence of trust implies that actors will take each other’s future

interests into account, *even if this is costly*. ‘To say that I trust someone is to say that I believe that this person will cooperate by engaging in a costly action to my benefit should this prove necessary’ (Farrell, 2009, p. 25; Hoffmann, 2002, pp. 376–384). This reduces mutual fears of cheating and exploitation. Second, the presence of mutual trust goes beyond the notion of information that institutions provide, but refers to having *confidence* in a partner’s actions (Lane, 1997). This reduces uncertainty about future behavior and thus vulnerability (Scharpf, 1997, p. 137), allowing governments to engage in coordination beyond the confines of formalized state control.

This notion of trust as encapsulated interest builds on Hardin (Hardin, 2006), but it also takes into account the possibility that informal networks – not exclusively personal exchanges – contribute to the effectiveness of trust relationships (Farrell, 2009, pp. 29, 42).⁵ Networks help to establish stable beliefs about the reputation of other actors; they provide information on precedents; and they institutionalize diffuse, rather than tit-for-tat, reciprocity (Scharpf, 1997, p. 137). For instance, a ‘reputation for “fair dealing” [...] can substitute for detailed contractual controls’ (Parker & Hartley, 2003, p. 101). This implies that trust relationships reduce fears of exploitation and thus enable the design of governance arrangements with fewer formal control (Farrell, 2009, pp. 24, 51-54; Hoffmann, 2002, p. 394). Trust evolves as an active form of coordination.

Although informal institutions like networks and trust are closely linked to each other, they are distinct. Unlike institutions that merely shape *expectations* about future compliance, the presence of trust stipulates that compliance is likely even under the condition of divergent preferences in the future. Potential agency slack is not completely removed, but considerably mitigated (Bachmann & Inkpen, 2011). Trust may thus substitute for formalized state control.

Figure 1 gives an overview of this theoretical framework:

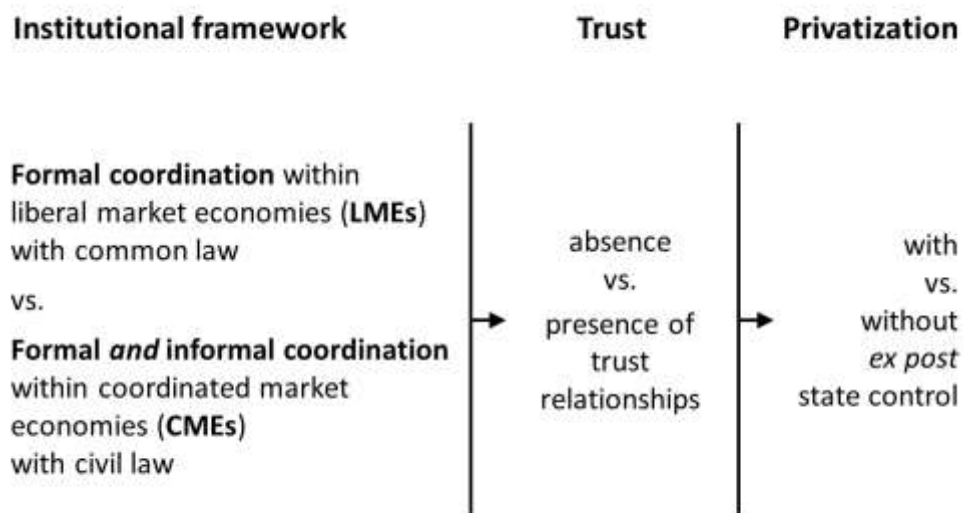


Figure 1: Institutions, trust, and varieties of privatization

The next section spells out what has to be observed empirically in order to confirm or refute this theoretical pathway. I will distinguish between three main domains of observation: context, process, and outcome (Hoffmann, 2002, p. 386; Rathbun, 2012, p. 53).

Observable manifestations

Trust is inherently difficult to measure (Hoffmann, 2002, p. 394), so it is vital to provide linkages that are as transparent as possible between theoretical expectations and empirical observations. The first manifestation has to do with the institutional framework and the opportunities and constraints it puts in the way of state and corporate actors. I seek to explore the *context of decision-making* in order to find out the salience of trust as part of formal and informal coordination. If we observe formal interactions primarily in the shape of (adversarial) contracting, this suggests a narrow range of options for privatizing SOEs. Coordinating capacity and trust are moderate or even low. By contrast, if informal networks complement formal coordination and unwritten rules of the game govern the interactions between state and corporate actors, the range of available options for privatization designs is significantly broader. This requires a more extensive coordinating capacity and thus allows for relationships of trust. For instance, the functioning of a network and initial indications of trust can be observed through members' interactions on a number of similar occasions when *precedents* were set for the decision-making process under investigation (Farrell, 2009, 53, 62).

The second observable manifestation refers to the *decision-making process* and investigates how trust relationships unfold and exert their effects in the form of informal agreements. Here, I focus on formal vs. informal networks and whether actors share beliefs about the

trustworthiness of other actors. This would significantly enhance coordinating capacity. Most significantly, informal agreements on parts of the ultimate privatization design would be a strong indication of the presence of trust. 'All things being equal, rules that provide actors the most leeway indicate trusting relationships' (Hoffmann, 2002, p. 391). Given that informal agreements are not formally enforceable, they imply confidence in the credibility of commitments. As a consequence, the shadow of the future is prolonged and there are additional options on the agenda of the decision-making process: formal contracts for sure – yet complemented by unwritten and informal agreements. By contrast, if informal agreements do not play a role, this will indicate a lack of coordinating capacity and trust. The shadow of the future is short and formal rules will predominate as the exclusive recipe for addressing potential slack of the privatized firm.

The third observable manifestation moves on to the *outcome of the decision-making process*, that is the ultimate choice of one of the options (Hoffmann, 2002, pp. 388–393). The inherent incompleteness of the privatization contract suggests a time lag between the exchange of benefits (Rathbun, 2012, p. 11). This, in turn, makes actors vulnerable and enhances uncertainty, because tit-for-tat strategies cannot cover opportunistic options. Under these circumstances, we can conceive of two pathways to designing the privatization outcome: First, the absence of contractual safeguards indicates a high coordinating capacity and the presence of trust, because cooperation partners are confident that each will take the other's interests into account. Second, the presence of contractual safeguards implies lower coordinating capacity and the absence of trust as the safeguards aim to decrease incentives for non-compliance in the future.

It is important to stress that inferences drawn from the outcome alone are insufficient to validate the theoretical pathway and to identify trust as a causal mechanism. Instead, they

need to be combined with both the context and the decision-making process itself (Beach & Pedersen, 2013, pp. 29–32). This approach to empirical analysis helps us to move beyond a generalized notion of trust in, for instance, democracy. Instead, it allows us to investigate the manifestation of *trust as an active mode of coordination* between actors with both converging and diverging interests.

To sum up, this section has theorized the causal pathway that connects the institutional framework of the wider production regime with a government's choice of privatization design. The higher a production regime's coordinating capacity, the more useful complementary informal networks will become and the more opportunities will evolve for the emergence, reproduction, and effectiveness of trusting relationships. A mutually shared belief in trustworthiness can eventually substitute for formal control as part of the privatization design.

4. Mechanismic process-tracing across two different paths

Having specified the observable manifestations of the theorized pathway from a national production regime to privatization, some methodological remarks are in order. This article tests the proposed theoretical framework in two within-case analyses and compares their findings, which will allow to reflect on its contingent generalizability. The point of departure is the contradictory and, hence, puzzling privatization designs in the UK and Germany. Yet, how 'can we make inferences from the explanation of individual historical cases to the general explanatory power and scope conditions of the underlying theories that explanations of cases draw upon?' (Bennett, 2008, p. 702). The answer is process-tracing, as the analysis systematically compares within-case inferences about the coordinating capacity of a production regime and the operation of trust as a causal mechanism.

The purposeful selection of cases helps to enhance the explanatory power of this theoretical framework. I combine a typical with a deviant case to trace not only a generalizable pathway, but also an omitted causal mechanism (Beach & Pedersen, 2016, pp. 281–292). The UK is typical in the sense that common law countries with governments that prefer control over privatized entities frequently establish golden shares (Bortolotti & Faccio, 2009, p. 2925). By contrast, the German case is deviant in the sense that standard approaches would have expected the establishment of state control (see section 2). The article’s structured, focused comparison seeks to demonstrate across both cases that the production regime – complemented by legal traditions – *similarly* induced the governments’ *distinct* privatization designs.

However, case selection does not merely allow for a *test* of this theoretical framework, but it also enables *theory-building*. Given that trust has so far mostly escaped the scholarly attention (for two exceptions see, Farrell, 2009; Rathbun, 2012), I contrast the operation of trust as a causal mechanism in the deviant case with its non-operation in the typical case (Beach & Pedersen, 2013, pp. 16–18; Bennett, 2008). This allows theorizing trust as an active form of coordination that, if present, magnifies the effects of informal networks at the commanding heights of the economy.

This mechanistic pathway can be structured according to a sequential logic: First, actors draw on the opportunities and constraints produced by the prevailing institutional framework (i.e. the wider production regime complemented by a legal tradition). Second, the resulting coordinating capacity enables or constrains the workings of trust relationships as actors proceed through negotiating and contracting phases. Finally, actors have different sets of strategic options at their disposal and choose the most salient privatization design. In other words, trust translates the opportunities provided by informal networks that make

governance arrangements with fewer control instruments more salient (Beach & Pedersen, 2013, pp. 38–39). Conversely, a lack of trust constrains the actors' options and paves the way for a governance arrangement that has formalized control instruments in place.

The empirical evidence required to trace this sequence is based on a diversity of data, which are triangulated to draw inferences by comparing the workings of institutional frameworks and the operation of trust as a mechanism across two cases. The starting point was historiography and secondary literature on defense-industrial policies in Germany and the UK. Empirical data was easier to access in the latter instance and stemmed from three different sources. First, the Margaret Thatcher Foundation and the National Archives provided a large compilation of cabinet memoranda, minutes, and letters. Second, *Hansard* gave access to a complete collection of parliamentary debates in the House of Commons and the House of Lords. Third, these data were supplemented by the historical archives of the *Financial Times* and the database *Nexis*[®]. With regard to the German case study, the analysis builds on the extensive coverage provided by the weekly news magazine *Der Spiegel*, memoirs of protagonists and semi-structured interviews with corporate as well as political decision-makers. Most significantly, I inspected formerly confidential and secret material from the Airbus and Daimler corporate archives as well as from the Bundesarchiv and, in particular, the Staatsarchiv Hamburg. This analysis is the first scholarly contribution to draw on these primary sources.

5. A question of trust? Explaining the varieties of privatization

This section traces the diverging designs of the UK and Germany privatizing their defense and aerospace industries in the 1980s. Each case is structured according to observations made on the context, the process, and the outcome respectively. The 'whys' of both privatizations strongly resembled each other. In addition to center-right governments in power, existing inefficiencies and the reduction of the financial burden of military as well as civilian aircraft development were the predominant triggers in both countries. Yet, the 'hows', or the design, strongly differed.

Neoliberal privatization without trust in the United Kingdom

The UK's liberal market economy, which was complemented by common law, shaped a decision-making context with a predominant emphasis on formal contracting. Coordinating capacity was low. Informal rules of the game or networks had hardly any effect during the negotiation process. Trust relationships did not develop. This constrained the provision of any strategic options beyond formalized control instruments. The ultimate outcome of privatization thus reflected the government's concerns about a potential foreign takeover of BAe so that decision-makers integrated a golden share to guarantee the government director's veto power.

First, the analysis of the *context* of BAe's privatization shows that, in the beginning, full privatization without safeguards was on the agenda. BAe's leadership strongly opposed the 15 per cent limitation on foreign ownership for financial reasons as it held down the price of the shares (Maulny, Taylor, Schmitt, & Caillaud, 2000, p. 155). Furthermore, the government's 'financial advisers [...] prefer[red] the Government directors to have no power of veto'

(Joseph, 1979b, p. 4; The Financial Times, 1984a). Also the British government itself highlighted its 'general approach of standing back from industrial decision taking' (Joseph, 1979a, p. 1) and declared that there was 'no reason why the company [i.e., BAe] should not be classified as being in the private sector' (Joseph, 1979b, p. 1). Although one could argue that military security was at stake, Secretary of State for Industry, Keith Joseph, stated in the same – previously confidential – memo that national security considerations did *not* justify any state interference: 'The Government will be able to obtain what it wants as a customer – as it did before nationalisation, and as it now does from private sector companies whose products are of strategic importance' (Joseph, 1979b, p. 3).

The available evidence thus suggests that national security concerns did not primarily account for the UK's privatization design, so that a threat-based explanation for the insertion of control instruments faces difficulties (Gholz & Sapolsky, 1999/2000; Michell, 1985, p. 1). At the same time, this indicates that the sector's historical legacy would have explicitly allowed full privatization; yet this was ultimately overruled by competing dynamics. If a governance arrangement without state control was, accordingly, considered, the question arises as to why it was ultimately rejected. Which strategic options did the wider production regime and common law provide?

The analysis of the context reveals a lack of coordinating capacity and trust in the willingness of BAe's future leadership to take the government's interests into account. Joseph's approach was inherently contradictory. While he had initially stressed the government's power position as a customer, he simultaneously argued that informal exchanges would be insufficient means of control. BAe's future chairman and the board would supposedly not know how to weigh economic against political rationales. Therefore, privatization was to be designed in such a way that directors appointed by the government would – formally – introduce the political

point of view into future company affairs (HC Deb, 1979, p. 222; Lovell, 1985, p. iii). Formal contracting that is typical for common law rather than an informal agreement was complementary to the UK's institutional framework. As a result, British decision makers insisted on the appointment of government directors, because this was arguably 'the only way for the Government to assess directly the quality of the direction and management of the company' (Joseph, 1979b, p. 5). In other words, the UK's institutional framework and its lack of coordinating capacity created a context of constraints for informal rules, thus inducing the government to maintain contractual safeguards for the time after privatization (Michell, 1985, p. 1; Graham & Prosser, 1987, p. 34).

Second, strategic coordination and informal networks were scarcely available during the *decision-making process*. This was, however, not a sector-specific phenomenon (Lovell, 1985, p. 1; see also, De Vore & Weiss, 2014, pp. 510–511). In contrast to more corporatist countries, 'government agencies did not have the strong links to manufacturing corporations or banks that would enable them to manipulate private sector actors in the pursuit of industrial policy goals' (Vogel, 1998, p. 47). Rather than by informal relationships, the government's influence was brought to bear – if necessary – by law and formal contracts. The UK had eventually resorted to golden shares in more than 80 per cent of privatized companies by the end of 2000 (Bortolotti & Faccio, 2009, p. 2924).

In the midst of the privatization process, the Society of British Aerospace Companies (SBAC) complained about a lack of coordination (The Financial Times, 1982). Trust relationships remained the exception rather than the rule (Joseph, 1981, p. 2; McCarthy, 1979, p. 2; The Financial Times, 1981). Tony Edwards, then-president of the SBAC, stated that, at the time, he 'was shocked at the lack of relationships between industry and the Government and between industry and the Ministry of Defence' (cited from Winn, 31 July - 6 August). This was reflected

in the testimony of state representatives (HC Deb, 1985; Joseph, 1980). From the perspective of the wider production regime and the common law tradition, however, the provision of information beyond the contract was neither customary nor necessary. Effective informal networks were scarce. Yet, this lack of networks and informal pre-agreements reduced the number of options open to the government for designing the privatization of BAe. Instead, these opportunities and constraints reinforced a single focal point of formal state control.

Third, the *outcome* of the governance arrangement itself implied an exchange of benefits with a substantial time lag. 'Over a long period there is bound to be conflict and tension between the director's role and responsibility in a Companies Act framework and the Government's need to control the company for broader public sector reasons' (Howe, 1980, p. 2; Lovell, 1985, 1, 4). The available evidence indicates that this long time horizon hampered informal agreements and trust relationships so that formal control increasingly became the default option.

Counterfactually, the golden share could have been understood as a short-term assurance against any unanticipated repercussions from turning to the stock market rather than as a preference for maintaining government control indefinitely. Yet, BAe's articles of association were of *indefinite* duration and could only be terminated by a unilateral decision of the government. This contractual safeguard was regarded as the only adequate means of preventing foreign ownership of BAe (House of Commons Standing Committee 'G', 1979, pp. 555–556).

Retrospectively, it turned out that the government was strongly committed to enforcing the compliance with the formal limitation of foreign ownership. Again, informal agreements could not substitute for adversarial contracting. A precedent was set in March 1989, when BAe announced that its 15 per cent limit had been breached and around 2.5 million shares would

have to be sold off. According to common law traditions, the last buyers to appear on the share register, who accounted for the over-subscription, were encouraged (i.e., indirectly forced) to dispose of their holdings (The Independent, 1989). In April 1989, BAe declared that foreign shareholding had dropped below the advised 15 per cent level (The Financial Times, 1989). In fact, there was no leeway with respect to the literal terms of contract.

In sum, the UK's choice of privatization design reflected the substantive aim of preventing foreign ownership in the future, an aim that could only be achieved by formal state control. The existing institutional framework did *not* provide for additional strategic options such as relying on informal networks. Thus, the establishment of an indefinite and strictly enforced veto indicated the government's lack of trust in its corporate partners. Neither informal access to company decision-making nor a time-limited golden share was regarded as sufficient once BAe was privatized. The long time lag could only be overcome by formal safeguards, which essentially evolved as the only focal point available that allowed for 'cooperation without trust' (Cook et al., 2005).

Coordinated and trust-based privatization in Germany

Germany's coordinated market economy, which was complemented by civil law, provided a decision-making context that allowed for extensive coordination and even trust relationships between state and corporate actors. Informal networks, such as the Deutschland AG, served as a central hub for coordination beyond the written terms of contracts, which, in turn, created trust. There have been several historical precedents to prevent foreign ownership of large manufacturing companies by informal means. In contrast to the opportunities provided by the UK's production regime, Germany's coordinating capacity thus allowed the government

to consider a wider range of – informal – strategic options within the privatization process. Trust relationships materialized in several informal agreements that were extensive in scope and had a long time horizon, culminating in the outcome of the MBB case: privatization without any formal safeguards.

First, the *context* of privatization was primarily characterized by the opportunities provided by the wider production regime and the civil law tradition. Given the importance of MBB to the economy and as an exporter, German decision-makers were as concerned about the future of the national aerospace and defense industries as their counterparts in the UK. Yet Germany's coordinating capacity was considerable due to the salience of informal networks, of which the so-called Deutschland AG was the most prominent (Streeck & Höpner, 2003, pp. 16–28; Voscherau, 1989b). Its nucleus was made up of financial institutions, such as Allianz and Deutsche Bank, which provided both equity and credit capital to industrial firms. Historically this had resulted in extensive crossholdings so that Germany's financial institutions have had the capacity to effectively steer manufacturing industries via capital provision and holding leading positions on supervisory boards. However, it was arguably 'not a club of domination, but of coordination, which was ultimately based on mutual trust' (Reuter, 2016, own translation).

Most significantly, the omnipresence of Deutschland AG made trust relationships conceivable (Andres, Betzer, & van den Bongard, 2011, pp. 205–207; Voscherau, 1989b). For instance, the CEO of Deutsche Bank was not simply a highly influential manager, but a representative of Germany's economy who would, supposedly, take national interests into account, even if this was costly for his own business in the short term. Historically, Deutschland AG organized coordination and carried out numerous functions, such as acting as a defense against foreign ownership. The government repeatedly issued informal requests

and, in return, provided incentives such as tax reductions (Streeck & Höpner, 2003, p. 18). These informal rules of the game prevailed in Germany, but not in the United Kingdom.

An important precedent was set in 1975, when the Shah of Persia considered acquiring about 30 per cent of Daimler-Benz's shares from the industrialist, Friedrich Karl Flick (Priemel, 2009, pp. 14–20; Bischoff, 2017). The German government strongly opposed foreign takeovers, in particular, by oil-producing states and – *informally* – approached members of Deutschland AG, such as the executive board of Daimler-Benz and Deutsche Bank. The latter ultimately acquired the majority of Flick's shares and created a complex legal construction, the Mercedes-Holding with two sub-units, in order to resell them to a selected group of eight shareholders, who were themselves part of the wider Deutschland AG. The overly complex legal construction helped the new investors to claim tax reductions, tolerated by the Treasury (Der Spiegel, 1975). As a result, the Shah's acquisition of shares was prevented; and informal agreements with the government were even reconfirmed officially:

On the basis of their traditionally friendly relationship, Friedrich Flick KG has offered 29 per cent of Daimler-Benz AG shares to Deutsche Bank. After consulting the federal government and with the agreement of Daimler-Benz AG, Deutsche Bank has declared its willingness to acquire the shares in order to avoid foreign ownership and to guarantee the entrepreneurial independence of Daimler-Benz AG (Daimler-Benz AG, 1974, p. 18, own translation).

The Deutschland AG served not simply as a safeguard against foreign takeovers but provided all the actors involved with confidence that partners of this informal network would take Germany's national interests into account in spite of short-term costs and uncertain future benefits (Streeck & Höpner, 2003, 19-20, 24). Therefore, both the federal government and the *Länder* had firmly established beliefs, built on informal exchanges and actual precedents, with

respect to how political influence on the defense industries could be maintained after privatization. Additional strategic options on how to design privatization evolved. This gives rise to the question of how precisely these opportunities provided by the context translated into the specific bargaining of divesting MBB?

Second, informal – often trust-based – exchanges were predominant in the *decision-making process* from the outset until the contracts were signed. High coordinating capacity was not only required, but, in turn, reinforced strategic options beyond formal state control. Already in a cabinet meeting in the mid-1980s, several federal ministers stressed that the private sector should invest and increase its shareholding in MBB. To endorse these plans, Chancellor Kohl was willing to promote this idea on the occasion of an *informal* meeting with industrial representatives (German Federal Government, 1984). While the negotiations with Daimler-Benz were subsequently carried out by the Ministry of Economics, Kohl informally supported them (Reuter, 2016). Even at the peak of hard bargaining in 1989, informal – often oral – promises played a crucial role. In particular, Hamburg trusted Daimler-Benz' promises with respect to the future engagement with the European Airbus consortium and the allocation of working packages, which eventually led its mayor, Henning Voscherau, to waive any legal safeguards (Ehlers, 1989; Mittelbach, 1989a).

Trust relationships translated into informal agreements between the federal government, the *Länder*, and Daimler-Benz between 1986 and 1988. The official negotiations only started in June 1988, by which time many contested issues had basically been resolved (Reuter, 1998, pp. 356–361; Tandler, 1989, p. 7). While this might have been no more than cheap talk, the available empirical evidence suggests that these informal agreements were significant in scope and of long duration.

The federal government offered two specific incentives to Daimler-Benz on an informal basis. One was a secret promise – not a contractual guarantee – of the exceptional approval of the Minister of Economics. This promise was a *sine qua non* for Daimler-Benz entering a formal bargaining process at a later stage. The corporate actor not only trusted the particular government, but Germany's leadership as such. In contrast to the UK, a change of government was not perceived as a potential threat to these promises, even though the Social Democrats were much more critical of the potential takeover (Reuter, 2016). Most protagonists expected the Federal Antitrust Authority to initially prohibit the acquisition because Daimler-Benz would emerge as a monopolist supplier in various sectors (Der Spiegel, 1988a). But when the government engaged in 'socially conditioned contracting' (Beck, 2012, p. 61) and gave a long-term promise of exceptional approval, it was a substantial one rather than cheap talk (Der Spiegel, 1989a; Mittelbach, 1989b).

In addition to available evidence on beliefs, this can be inferred from observable actions by Daimler-Benz (Der Spiegel, 1988d; Reuter, 1998, p. 360). More than six months before signing the final contracts, Daimler-Benz established a new holding for aerospace activities, DASA, whose core was to become MBB (Der Spiegel, 1988b). These were inherently costly processes in which Daimler-Benz would only have invested if it had trusted that it would obtain the government's exceptional approval. While the informal agreement was initially a valuable promise, extensive media coverage had in the meantime produced an atmosphere of protest that made it politically costly for both the government and Daimler-Benz (Der Spiegel, 1988c; Mittelbach, 1989b). Yet, trust relationships between the federal government, the *Länder*, and Daimler-Benz turned out to be sufficiently stable to enable corporate restructuring to proceed (Der Spiegel, 1989b; Huck, 1989, pp. 12–14).

The second incentive that the government offered to Daimler-Benz was to act as a broker between it and the *Länder* during the negotiation process (Der Spiegel, 1988c, p. 29; Tandler, 1989, p. 9). A key challenge was the divergence of interests between the federal government and Daimler-Benz on the one side, and the *Länder* on the other. One of the parameters – particularly promoted by the Bavarian leader Franz-Josef Strauß – was to insist that ‘foreign parent firms not be allowed to raid the fruits of German scientific research’ (Milosch, 2006, p. 157). Hence, the negotiations with Daimler-Benz received his general support as they promised a privatization design of the kind he desired. After all, protagonists of Deutschland AG had previously demonstrated that they would act in accordance with this objective. To further accommodate the concerns of the *Länder*, the most important meetings were not only attended by Daimler-Benz executives, but also by the chairman of its supervisory board, the Deutsche Bank CEO, Alfred Herrhausen. Precedents had proven that politicians could ultimately trust representatives of Deutschland AG to prevent foreign takeovers (Daimler-Benz AG et al., Tandler, 1989, pp. 11–12; Voscherau, 1989b; 1989; Reuter, 2016). As a result, the empirical evidence suggests that the bargaining process was not a one-way street with the government providing incentives to bring about the desired takeover by Daimler-Benz. Instead, there was mutual trust (Kiener, 1989).

Third, the *outcome* of the governance arrangement itself suggested a time lag between the exchange of benefits. This form of incompleteness was addressed by socially conditioned contracting. The preliminary framework agreement between Daimler-Benz and the three *Länder* ended with a severability clause, which is widespread in civil law countries and which stressed the importance of the contract parties’ basic intentions (Daimler-Benz AG et al., 1989). This indicated that concerns about opportunism were, indeed, present. Contractual safeguards were one response, as previously endorsed in the UK’s privatization of BAe; trust

suggested another – less complete and more informal – focal point without state control. Yet, each actor faced vulnerabilities once privatization was in place.

Daimler-Benz was confronted with the government's purchasing power, which it had painfully experienced after its acquisition of Dornier in the 1980s (Reuter, 2016). Given that MBB's military production runs were almost completely dependent on the Tornado and its potential successor, the Jäger 90 (known today as the Eurofighter), the private acquisition of MBB would only pay off if the successor materialized. Daimler-Benz's leadership was uncertain about the government's preferences in this respect. In a confidential conversation, Daimler-Benz CEO Edzard Reuter asked Kohl whether he could credibly expect the future combat aircraft to be funded. Kohl nodded and, in turn, Reuter accepted this informal commitment (Reuter, 1998, p. 363). Again, this was an informal agreement of extensive scope and with an extremely long time horizon, which could only overcome concerns about opportunism, if there was mutual trust.

By contrast, the *Länder* were primarily concerned with jobs in their constituencies (Der Spiegel, 1989c; Kiener, 1989; Social Democratic Party, 1989; Eglau, 1991, pp. 175–182;). Given that Daimler-Benz insisted on entrepreneurial freedom to create technological synergies with its core competencies (Der Spiegel, 1985), MBB had to be integrated into its DASA holding and the former's fragmented structure had to be rationalized. DASA was to be empowered to take corporate decisions on economic – rather than political – principles. As Bavaria and Bremen were *promised* – not legally guaranteed (Social Democratic Party, 1989; Bischoff, 2017) – vital concessions, it was Hamburg in particular that was opposed to selling all of its shares (Voscherau et al., 1988; Krupp, 2017). For instance, it attempted to strengthen the supervisory board of Airbus in order to be able to delegate politicians as members. Again, Daimler-Benz rejected political interference, weakened the role of the board, accepted merely a corporate

representative proposed by politicians and offered annual consultation meetings. Except for the state's purchasing power, its formal levers and direct access to future corporate policy were minimal (Daimler-Benz AG et al., 1989; Voscherau, 1989a; Bischoff, 2017).

Most significantly, Hamburg was concerned with the potential relocation of manufacturing sites to Bavaria. Thus, its mayor Voscherau insisted on preserving control rights within MBB's subsidiary, Airbus (Daimler-Benz AG et al., 1989; Voscherau, 1989c). Daimler-Benz fundamentally opposed political control and merely offered a commitment to manufacture civilian jets carrying more than 100 passengers in Hamburg. It declared to allocate work shares within Airbus according to economic principles, which represented an advantage for Hamburg's existing assembly lines. This settled some of the most serious concerns but provided *no legal guarantees* for the future (Tandler, 1989, p. 11; Bischoff, 2017). Production lines could still be closed down or, in a more likely scenario, be relocated to the South (Der Spiegel, 1989c; Eglau, 1991, pp. 175–182; Voscherau, 1989a; Reuter, 2016). Two potential readings can be inferred: either the privatization was imposed on Hamburg, or Voscherau and his treasurer Hans-Jürgen Krupp viewed Daimler-Benz as a trustworthy actor that would take its responsibilities seriously and, in future, delegate the larger civilian aircraft projects to the North. The available evidence suggests the latter reading. Hamburg eventually exchanged a formalized right against a lucrative, but informal promise (Daimler-Benz AG & Senate of Hamburg, 1989; Gellert, 1989; Krupp, 2017; Mittelbach, 1989b; Schirner, 1989; Tandler, 1989, pp. 12–15; Voscherau et al., 1988; Voscherau, 1989c).

Finally, the federal government took a long-term perspective in disposing of Airbus's liabilities, yet it was, at the same time, concerned about a potential foreign takeover in the future. However, Daimler-Benz was regarded as a sufficiently trustworthy partner not to sell DASA to foreign interests; and, in turn, Deutsche Bank continued to guarantee that Daimler-

Benz itself would remain German (Gellert, 1989; Huck, 1989, p. 9; MBB, 1989; Reuter, 2016; Voscherau, 1989b). There was a sense of trust that, as in the past, Deutschland AG would always find an effective response, should such a scenario arise. This expectation was not only based on reputation and precedent, but created additional strategic options for Germany's government. Ultimately, it was the trust relationship between state and corporate actors that evolved as focal point and allowed for a privatization design beyond formal state control (Daimler-Benz AG & Senate of Hamburg, 1989; Gellert, 1989; Voscherau, 1989d; Reuter, 2016; Bischoff, 2017).

In sum, the process-tracing analysis reveals differences in coordinating capacity based on the opportunities provided by wider production regimes and complemented by legal traditions. In contrast to what happened in the UK, this constellation gave rise to trust relationships between the German government and private actors. First, Deutsche Bank and Daimler-Benz, which comprised the core of Deutschland AG, were seen as trustworthy actors with a reliable reputation. Second, this informal network had previously set vital precedents with respect to one of the most contested matters in the privatization, that is, whether to respond to the threat of foreign takeovers in accordance with political objectives. This constellation of factors exercised causal power over the course of the bargaining process and ultimately developed into a focal point for the German government that was lacking in the UK: informal influence on the basis of trust rather than a legal right of state control.

6. Conclusion

This article began by contrasting two arguably contradictory privatizations that challenged the predominant ideologies of the time. Neoliberals preserved state control in the UK, while

Germany's state-interventionists gave up all forms of formal safeguards in the aerospace and defense industries of the 1980s. Far from paradoxical, however, I demonstrated that the two privatization designs were fully consistent with the opportunities and constraints provided by the prevailing production regimes and complementary legal traditions.

The combination of the government's preference against foreign ownership and the institutional opportunities that did not allow for trust relationships and thus informal influence accounts for the UK's privatization design. The shadow of the future was short. By contrast and despite identical preferences, Germany's prevailing production regime, complemented by civil law, shaped strong informal institutions. Networks, such as the Deutschland AG, allowed for strategic coordination between the government and private business on the commanding heights of the economy. I suggested trust as the causal mechanism that effectively prolonged the shadow of the future within these informal networks. The empirical analysis showed how trust as an active form of coordination constituted the oil that fueled those strategic interactions available in CMEs. This oil reduced the German government's fears of cheating and further vulnerabilities it faced. I thus identified varying levels of trust to explain the differences between the UK's design of state control and Germany's unconditional privatization.

This article has resolved the puzzle of these contradictory varieties of privatization, but its theoretical implications reach beyond that. To what extent does the theoretical explanation of two historical case studies hold today (Beach & Pedersen, 2016, pp. 281–293; Bennett, 2008)? To what extent may we generalize from the article's *explanandum*, on the one hand, and its *explanans*, on the other?

First, beyond the case studies' potentially unique situation of the 1980s, the UK's approach has largely remained stable. While Germany's more recent political choices amount to change,

they provide, in fact, additional confirmation for the suggested causal pathway and the underlying arguments put forward. When the government initiated structural economic reforms in the 2000s (Streeck & Höpner, 2003), Germany's extensive coordinating capacity in general and its informal networks in particular were challenged. Most significantly, the relatively rapid dissolution of Deutschland AG (Andres et al., 2011) implied that the informal fence of trust relationships that had guarded Germany's champions against foreign ownership no longer worked. These institutional changes have required new rules of the game. Despite global norms for the protection of foreign investments, Germany has meanwhile established far-reaching regulations that are essentially generalized golden shares (German Bundestag, 2008). Today, the government may – formally – prohibit a foreign takeover rather than – informally – requesting trusted partners from Deutschland AG to do the job. The loss of informal options makes formal solutions mandatory.

Second, the article's *explanandum* – the design of privatization – is an instance of an indirect governance arrangement where governors grant specific tasks to intermediaries that are potentially hard to control in the future (Abbott et al., 2016). Therefore, the findings are not only applicable to economic governance of the commanding heights (e.g. utilities, telecommunications), but to the much broader population of cases where governments have retreated from the hierarchical provision of public goods. These delegations to private or international actors range from managing healthcare (Eckl, 2013) and education (Coates, 2000) to regulating financial services (Vogel, 1998) and securing cyberspace (Weiss & Jankauskas, 2019).

Finally, the article's theory-building of a novel *explanans* has sought to contribute to IPE in general and to clarify the effects of informal institutions in particular. With regards to the former, I have challenged standard approaches of why governments retreated from their

involvement in national economies. Ideologies, party politics, or path dependence would have suggested distinct privatization designs in both the UK and Germany. Building on prior efforts to utilize VoC for investigating state-to-firm coordination (Krotz, 2011; De Vore & Weiss, 2014; Weiss, 2019), I argued that the opportunities provided by the domestic institutional framework offered governments a set of strategic options. The presence of trust ultimately shaped the extent of future control. Whereas Farrell introduced this reasoning to IPE for a classical VoC study of firm-to-firm interactions (Farrell, 2009), I exploited the (less confidential) data access to privatization policies in order to show how trust as an active form of coordination has similarly operated in state-to-firm coordination.

What is, then, the suggested effect of informal rules of the game? I specify one potential mechanistic pathway of *how* informal institutions – a widespread phenomenon in political life – are transmitted into political choices. In the absence of trust, formal safeguards against uncertainty and concerns about cheating become necessary. Conversely, trust relationships substitute for the insertion of state control into governance designs as trust reduces vulnerabilities and allows for the future exercise of informal influence. The demonstrated effect of this variation implies for institutionalist theorizing to move from theoretical assumption toward empirical analysis: concerns about cheating should no longer be treated as a theoretically constant obstacle to cooperation (Abbott et al., 2016), but – under the condition of potential trust – as an empirical variable to be analyzed.

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² Several scholars who have studied the political economy of the commanding heights have incorporated state institutions into their analyses (e.g. Albert, 1993; De Vore & Weiss, 2014). Unlike these exceptions, however, the original VoC has remained a firm-centered political economy ever since (Hall, P. A. & Soskice, D. 2001; Howell, 2003).

³ While some scholars have analyzed the role of trust in insightful ways (e.g. Coates, 2000; Cook, Hardin, & Levi, 2005; Rathbun, 2012; Farrell, 2009), trust has not been theorized as a causal mechanism that magnifies the effects of informal networks. This conceptualization seeks to contribute to institutionalist theories in political science, more broadly.

⁴ I conceive of trust as an active form of coordination (Farrell, 2009), rather than an abstract attitude towards a broad phenomenon such as democracy.

⁵ By contrast, Hardin and like-minded scholars have argued that the role of trust is one of 'a *complement* to (not substitute for) organizational arrangements that make cooperation

possible' (Cook et al., 2005, p. 2). This paper, nevertheless, follows Farrell, who explicitly theorizes the link between (non-personal) institutions and trust.