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Governing Globalization? The State, Law, and Structural Change in Corporate Governance

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Current analysis of the 'globalization' of the activity of capitalist corporations tends to argue that the legal institutional frameworks of the nation state are of little importance in determining the governance of those corporations, and that the regulation of those corporations therefore is impossible. This view simply ignores the role that those frameworks do in fact play. In this paper, various styles of corporate governance are analysed in terms of the influence of the company law, financial market regulation, and employment law promulgated by nations or nation state groupings. Rather than the globalization of corporate governance reflecting the unimportance of the nation state, it reflects a change in the style of regulation.

INTRODUCTION

During the 1980s and gathering strength throughout the 1990s, the development of the set of norms and policies identified with dominant contemporary conceptions of 'corporate governance' has become an increasingly important area of economic rhetoric, regulatory politics, and institutional reform.[1] Driven by the alleged overpowering force exerted by

1 See M. Roe, 'From Antitrust to Corporate Governance? The Corporation and the Law' in *The American Corporation Today,* ed. C. Kaysen (1996).

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international capital markets, belief in which is an article of faith in the most important policy making fora, the concept of 'shareholder value' has become both talisman and agenda for the reform of economic governance and corporate management alike.[2] Certainly, we no longer live in a world of stable and predominantly self-contained national political economic systems identified with the 'golden age' of post-war capitalism.[3] Just as assuredly, however, we do not live in a world in which the state has withered away under the relentless, intense competitive pressures of international markets identified as globalization.[4] National distinctiveness and divergent developmental paths remain facts of the political economic landscape, and this applies to state institutions and corporate organizations alike. Multinational corporations are thought to effect globalization through their scale, reach, and investment, and restructuring decisions may be growing in importance within national and international economies alike, but the nation state remains the geographical and organizational base of the corporate firm.[5] This article examines cross-national trends in the development of corporate governance regimes in the United States of America, the United Kingdom, Germany, France, and Japan by analysing patterns of change in law and regulatory institutions. The laws propounded by the state formally constitute corporate governance institutions that mediate the opposing interests and the power relations within the corporation. It is this continued and close relationship between the nation state, law, and the corporate firm under conditions of globalization that concerns us here.[6]

2 See, generally, I. Millstein, OECD Business Sector Advisory Group on Corporate Governance, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets, A Report to the OECD by the Business Advisory Group on Corporate Governance* (1998); compare S. Strange, *Mad Money: When Markets Outgrow Governments* (1998); S. Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (1996); S. Saskia, *Globalization and its Discontents: Essays on the New Mobility of People and Money* (1998).

3 See, for example, A. Shonfield, *Modern Capitalism: The Changing Balance of Public and Private Power* (1969, 2nd edn.).

4 See L. Weiss, *The Myth of the Powerless State* (1998); S. Berger, S. Dore, and R. Dore (eds.), *National Diversity and Global Capitalism* (1996); S. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (1996).

5 See, for example, P. Doremus et al., *The Myth of the Global Corporation* (1998); J. Zysman, 'How Institutions Create Historically-Rooted Trajectories of Growth' (1996) 3 *Industrial and Corporate Change* 243; J. Zysman, 'National Roots of a ''Global'' Economy' (1995) *La Revue d-Economie Industrielle, un numero special de 1995: Renouveau des Politiques Industelles dans le contexte des economies globales* 107–21.

6 For earlier articulations of arguments presented herein, see J.W. Cioffi, *Governing Globalization? The State, Law, and Structural Change in Corporate Governance*, BRIE Conference Paper no. 2 (2000); J.W. Cioffi and S.S. Cohen, 'The Advantages of Forwardness: The Interdependence of the State, Law, and Corporate Governance in an Age of Globalization' in *Corporate Governance and Globalization*, eds. S.S. Cohen and G. Boyd (2000).

Corporate governance is conceived here as a 'nexus of institutions' defined by company law, financial market regulation, and labour law. This theoretical approach emphasizes the political and juridical character of corporate governance, and departs from the dominant neo-classical economic theory of the firm as a 'nexus of contracts' and corporate governance as institutional mechanisms defining the relationship between managers as agents and shareholder as owners and principals.[7] Comparative analysis reveals that the theoretical models of neo-classical economics, however elegant, entirely fail to describe or explain the structure and development of the more statist political economies such as Japan or France and the neo-corporatist systems of Germany, the Netherlands, and Scandinavia.[8] Not only does the agency theory of the firm and its governance poorly comprehend non-Anglo-Saxon firm and governance structures, this failure indicates more fundamental weaknesses. Although contracting and the capacity to contract are certainly critical to the existence and functioning of the corporation, the firm has a social and institutional existence separate from these contractual agreements. Agency theory ignores (when it does not expressly repudiate) the *constitutional and hierarchical character* of the corporate firm. Formal contract or reciprocal quasi-contractual agreements do not define the organizational structure of the firm; they are largely hypothetical abstractions posited by an economic theory. Mandatory legal rules, the articles of incorporation, and corporate by-laws play a central role in defining the corporate firm.[9] In addition to these more

7 See, for example, M. Jensen and W. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure' (1976) 3 *J. of Financial Economics* 305; F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law* (1991).

8 See, for example, E. Wymeersch, 'Status Report on Corporate Governance Rules and Practices in Some European Countries' in *Comparative Corporate Governance*, eds. K. Hopt et al. (1998) 1045–199; P. Gourevitch, 'The Macropolitics of Microinstitutional Differences in the Analysis of Comparative Capitalism' in *National Diversity and Global Capitalism*, eds. S. Berger and R. Dore (1996) 239–59; J. Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries* (1994); compare R. La Porta et al., 'Legal Determinants of External Finance' (1997) 52 *J. of Finance* 1131; R. La Porta et al., *Law and Finance*, Working Paper no. 5661 (1996). US-centric analyses also tend to accept the American institutional framework as given and eschew significant critical assessment. Compare W. Lazonick and M. O'Sullivan, *Corporate Governance and Corporate Employment: Is Prosperity Sustainable in the United States?*, Jerome Levy Economics Institute, Working Paper no. 183 (1997); see, also, M. Roe, 'Path Dependency, Political Options, and Governance Systems' in *Comparative Corporate Governance: Essays and Materials*, eds. K. Hopt and E. Wymeersch (1997); M. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (1994); M. Roe, 'Some Differences in Corporate Structure in Germany, Japan, and the United States' (1993) 102 *Yale Law J.* 1927; M. Roe, 'A Political Theory of American Corporate Finance' (1991) 91 *Columbia Law Rev.* 10.

9 See M. Eisenberg, 'The Conception that the Firm is a Nexus of Contracts' (1999) 24 *J. of Corporation Law* 818, at 827–31.

formal structures, a profusion of less formal norms, including bureaucratic or otherwise hierarchical authority relations, are critically important in the functional operation and social reality of the firm, as in any complex organization.[10] Indeed, in agency theory's acid bath of abstractions, the firm as a bounded entity dissolves entirely.[11]

The use of law and regulation to structure markets and firms (in other words, markets and hierarchies) is becoming an increasingly important, and perhaps dominant, mode of state intervention in the advanced industrial economies. Structuring economic institutions and relations through law has the potential to satisfy both political and economic demands on policy makers and managers, while avoiding more direct modes of intervention such as state ownership, bureaucratic control over finance and credit, and broad discretionary regulatory powers. The governance structures and bargaining fora created by corporate governance law have this function. The legal mechanisms of corporate governance *restructure* markets and the organizational hierarchies within them.[12] They do not *supplant* markets. However, these reconfigured institutional arrangements take distinctive forms in different countries and among the most resilient of these institutional arrangements are those of national corporate governance regimes. These legal frameworks and regulatory policies have provided the institutional foundation necessary for the development of large, complex corporations and the domestic and international markets within which they are situated. Hence, the emerging international economic order and domestic politics remain highly interdependent, even as the forms of economic regulation and governance evolve.

Corporate governance regimes are the product of intense political and economic pressures ultimately embodied in legal relations, processes, and institutions. To the extent that corporate governance institutions occupy a core position within political economic organization, law and regulation play a central role in structuring the political economy. Increasing political competition over the 'rules of the game' of governance indicates the centrality of law and regulation as political actors seek advantage through the modification of the legal rules defining the fundamental institutions of

10 See M. Eisenberg, op. cit., n. 9, pp. 835–6; D. Campbell, 'The Role of Monitoring and Morality in Company Law: A Criticism of the Direction of Present Regulation' (1997) 7 *Australian J. of Company Law* 343, at 354–7; L. Mitchell, 'Trust and Team Production in Post-Capitalist Society' (1999) 24 *J. of Corporation Law* 869; see, generally, R. Kramer and T. Tyler (eds.), *Trust in Organizations: Frontiers of Theory and Research* (1996); A. Fox, *Beyond Contract: Work, Power, and Trust Relations* (1974).

11 See Campbell, id., pp. 357–61; Eisenberg, id., p. 832 (both criticizing Jensen and Meckling, op. cit., n. 7).

12 Compare K. Hopt and G. Teubner (eds.), *Corporate Governance and Directors' Liabilities: Legal, Economic, and Sociological Analyses on Corporate Social Responsibility* (1985).

economic governance. Political analysis of recent formal changes across the neo-liberal, neo-corporatist, and statist corporate governance regimes reveal significant cross-systemic parallels and variations in corporate governance reforms. Substantial trends towards *increasingly stringent and centralized state regulation* of financial markets suggests convergence on the American model. Yet, national bodies of company and labour law remain distinct and combine with financial market regulation to produce continued divergence in corporate governance regimes. These findings suggest significant change in corporate governance cross-nationally, but towards new varieties of systemic hybrids, not convergence on the neo-liberal market model associated with the United States of America.

NATIONAL POLITICAL ECONOMIES AND LEGAL CHANGE

Given the absence of a global legal and regulatory framework, the relation of corporate governance to globalization must be sought at the level of the national political economy and the degree and nature of change viewed cross-nationally. The analysis focuses on the formal institutional and legal changes in corporate governance regimes because they indicate the depth of political economic change, the strength of the forces inducing it, and are also likely the most enduring form of change because of the path dependent effects of institutional structures.

Legal and regulatory changes in corporate governance have varied substantially across countries and across the different institutional components of corporate governance regimes. Two categories of variables describe these dynamics. The tripartite institutional structure of corporate governance regimes provides one set: the structural components comprised of (i) corporate law, (ii) financial market regulation, and (iii) labour law. Different types of political economic systems provide a second set of variables. Political economic regimes fall into three basic types: (i) neo-liberal, (ii) neo-corporatist, and (iii) statist. Together, these bodies of law allocate and structure the power relations among managers, shareholders, and employees - the principal interest groups in firm governance. These sets combine to form a 3×3 table that correlates distinct political economic models with structural features of corporate governance regimes construct. The resulting Table 1 describes the characteristic features of these systems during the late 1970s and early 1980s, prior to the ascendance of liberal reform agendas and the burst of globalization in the later 1980s and 1990s.

By focusing specifically on the five most important countries illustrative of the political economic typology in Table 1, Tables 2 to 4 show recent developments in each of the core the institutional components of their governance systems. This raises the analysis from the level of typology to that of a more concrete – and contemporary – analysis of structural composition and change in corporate governance regimes broken down into the categories of financial market regulation, company law, and labour law. A comparison of these tables gives us a reasonably good idea of the cross-national trends of legal and institutional change in corporate governance regimes.

Tables 2 to 4 show the variation and degree of change across and within these corporate governance regimes. Of each of the components of the tripartite governance model presented here, the financial markets and financial market regulation have changed most substantially under the pressure of globalization. Labour law has changed very little and demonstrates striking stability and resilience in the face of economic change and pressures from globalizing markets. Company law shows a moderate degree of change and thus occupies an intermediate position between the dynamism of financial market law and the relative anchor supplied by labour law.

This consistent variation in the degree of change across political economic models and areas of law reveals the relationship of corporate governance to both globalization and resilient national political economic institutions. Financial system reforms and international financial flows have driven globalization. As the most important juncture between national economies and international markets, domestic financial systems are most susceptible to change in response to international market pressures.[13] The institutional arrangements integrating labour into the political and economic system are fundamental to the structure and political stability of national political economies and thus most resistant to exogenously induced change. Company law mediates between the capital and labour market structures and should thus display an intermediate degree of change in response to the globalization of capital markets. The following analysis treats each of these parts in turn.

1. *Financial markets, regulation, and the new finance capitalism*

Recent changes in financial market regulation reveal a pronounced trend in favour of increased formal regulation and codification, improved transparency and disclosure,[14] and regulatory oversight of securities markets

13 Liberalized trade has a negligible impact on cross-national capital flows, while liberalization of capital controls, financial services, and capital accounts substantially increase them. See N. Tamirisa, *Trade in Financial Services and Capital Movements*, IMF Working Paper, WP/99/89 (1999).

14 Although Germany at first appears to be lagging somewhat in improving transparency, one consultancy has recently commented that German firms had been waiting for passage of legislation that permitted them to adopt US GAAP or IAS without filing a second set of financial statements using German accounting rules before switching to more stringent accounting standards. See Davis Global Advisors, *Corporate Governance 1998: An International Comparison* (1998) (proprietary consultancy report). In addition, the German *Neue Markt*, the ‘new market’ for small cap high tech stocks, requires use of IAS as a listing requirement.

Table 1: Traditional character of corporate governance by type of political economy

	Financial market regulation	Corporate/company law	Labour law
Neo-liberal (United States and United Kingdom)	• Strong transparency and disclosure rules designed to correct market failures and protect minority shareholders. • Strong legal prohibitions on insider trading. • Fragmentation of equity ownership stakes and financial services (in United States by law). • Pension and tax laws encouraged development of large equity holding pension funds.	• Corporate law is permissive with few mandatory rules (wide latitude for contractual and charter-defined corporate governance structures and processes). • Shareholder primacy enshrined in fiduciary duties enforceable by private rights of action. • Vertically integrated firms rely on short-term contractual relations externally; law limits cross-shareholding, director interlocks, and business associations as sectoral coordinating bodies. • Well-developed market for corporate control underpinned by fiduciary duty and disclosure rules.	• Strict separation of labour relations and firm management (sharp distinction between corporate and labour law); no form of board or works council codetermination. • Fragmented labour organization with no sectoral or peak bargaining between employers and unions. • Weak protection for labour organizing (and strict restrictions on strikes in United Kingdom).
Neo-corporatist (Germany)	• Moderately to weak transparency and disclosure regulations. • Regulation institutionalizes bargaining among insiders. • ‘Universal banks’ combine banking and securities business at core of financial system; substantial number of smaller peripheral local and regional financial institutions. • Public pensions predominate; private pensions insignificant and not encouraged by policy.	• Mandatory rules structure the corporation and governance processes. • Corporate interests legally superior to shareholder interests, corporation responsible for stakeholder employees, few effective privately enforceable legal protections for shareholders. • Corporate networks underpinned by cross-shareholding, interlocking directorships, and strong employers and sectoral business associations. • Weak market for corporate control.	• Interpenetration of labour relations and firm management through board and works councils codetermination (blurred boundaries between company and labour law). • Centralized labour organizations and employer associations; legal facilitation of sectoral/industry level bargaining. • Strong protection for labour organization and bargaining power (but not necessarily for strike activity).

Statist (France and Japan)	● Weak transparency and disclosure rules. ● Administrative officials vested with extensive discretion over financial regulation (including discretionary allocation of capital). ● Highly centralized and concentrated bank-dominated financial systems. ● Public pensions predominate; private pensions insignificant and not encouraged by policy.	● More mandatory rules than neo-liberal systems, but regulatory and inter-firm relationships have most powerful impact on corporate governance structures. ● Shareholder interests subordinate to 'corporate interests' and state policies; few legal provisions for autonomous organization and representation of stakeholder interests or for effective protection of shareholders. ● Hierarchical, vertically structured corporate networks linking large banks, core industrial firms, and suppliers (for example, *Keiretsu*). ● Virtually no market for corporate control and substantial state role in industrial and sectoral organization through administrative power and control over finance.	● *De facto*, if not *de jure*, separation of labour and strategic management of firm, and firm paternalism toward employees displaces employees' formal consultation and veto rights. ● Fragmented organized labour limits co-ordination in bargaining; state mandated labour and incomes policies more important than collective bargaining and partially implemented by more centralized employer associations. ● Substantial legal employment rights combined with weak protection for autonomous labour organizing and bargaining.

Table 2: Major changes in financial market law and regulation (1985–2000)

United States	United Kingdom	Germany	France	Japan
• Institutional investors given more power and influence by 1992 reform of SEC proxy rules and 1995 legislation granting allow greater communication and co-operation in governance activism, grants institutional shareholders 'lead shareholder' status to curb alleged excesses in shareholder litigation (ineffective). • 1988 Treasury Department ruling requires ERISA pension funds to vote their shares as a fiduciary duty. • Federal Reserve and Treasury Department sanction erosion of Glass-Steagal separation of banking and securities business, ending in law's repeal.	• 'Big Bang' of 1986 deregulates financial services and opens securities brokerage and trading to greater market competition. • 1986 Financial Services Act re-regulated financial services sector through increased codification of rules focusing on fraud. • In 1997, government proposed creation of a single regulatory body, the Financial Services Authority, overseeing securities markets. • Increasing harmonization of United Kingdom financial law with EU Financial Services and Capital Adequacy Directives further increases codification of securities law but substantive change not substantial.	• Disclosure law passed in 1998 to increase transparency by allowing firms to issue financial statements using IAS or US GAAP only. • Securities Trading Law of 1995 requires disclosure of parties owning or controlling 5 per cent of stock, but has limited effect because of loopholes. • KonTraG proxy voting rules more protective of shareholders, induce banks to create voting procedures and offices to reduce conflicts of interest. • Frankfurt Stock Exchange increases stringency of internal disclosure and listing rules; its *Neue Markt* for small cap and high tech securities issues requires use of IAS reporting standards.	• French government reforms financial regulation to give up most discretionary power over allocation of finance. • EU increasingly restricts state's ability to finance and bail out firms. • 1988 and 1989 legal reforms expand COB power to oversee and enforce disclosure and reporting requirements. • 1988 law establishes stock exchange authorities, the CMF and SBF, whose powers expand to include regulation of listing, brokerage, and tender offers.	• 1998 'Big Bang' sets stage for modernization and consolidation of financial services, but, to date, very little disclosure and transparency reform. • Steady reduction in state control over credit and finance, but Ministry of Finance has used discretionary control over lending to small and medium sized firms to maintain employment despite recession and excess capacity. • New financial services regulatory body created in 1999 and required use of IAS financial reporting rules starting in 2000, but too early to judge effect.

(see Table 2). This is consistent with the hypothesis that the primary impact of globalization has been on the financial system and the mechanism through which it influences national economies has been the capital markets. Globalization is often described as eroding the significance of law and regulation by compelling countries to engage in competitive deregulation and inducing a shift to market-driven contractual forms of governance. Table 2 reveals a striking pattern of re-regulation and juridification, even in the most neo-liberal countries. Indeed, the neo-liberal systems appear most inclined to pursue what Steven Vogel has described as 'juridical re-regulation.'[15]

(a) More rules for liberalizing markets

The dominant trends in substantive regulation outside the United States favour increasingly stringent transparency and disclosure requirements to increase the liquidity of and confidence in securities markets. In Germany and Japan, legal reforms allow or require the use of International Accounting Standards rather than the more opaque traditional accounting rules. In France, Germany, the United Kingdom, and Japan regulatory agencies have been created or substantially reformed to police securities markets – largely with respect to disclosure by corporate issuers of securities and the policing of insider trading.

There is a strikingly paradoxical aspect to this increase in regulation. The increase in state regulatory power has been accompanied by the increasing privatization of regulation. Increased competition among European securities exchanges brought about by EU integration and globalization has prompted more stringent exchange self-regulation, accounting, and disclosure standards. This trend is most advanced in Britain where 'codes of best practice', drafted by the privately convened and constituted Cadbury, Hampel, and Greenbury commissions, were incorporated in substantial part

15 Vogel, op. cit., n. 4; see, also, R. Buxbaum and K. Hopt, *Legal Harmonization and the Business Enterprise: Corporate and Capital Market Law, Harmonization Policy in Europe and the U.S.A.* (1988); R. Buxbaum, 'Juridification and Legitimation Problems in American Enterprise Law' and F. Kubler, 'Juridification of Corporate Structures', both in *Juridification of Social Spheres: A Comparative Analysis in the Areas of Labour, Corporate, Antitrust and Social Welfare Law*, ed. G. Teubner (1987). Although the European Union has been a substantial cause of the juridification trends in Europe, the broad trend towards increased regulatory oversight of capital markets cannot be explained solely by EU legislation. EU directives and legal harmonization do not require the development of new administrative and regulatory capacities now common across Europe. Even Japan has put an (arguably) independent securities regulator in place. Finally, prior to the EU's financial services harmonization, Britain's experience with financial services deregulation and the 1986 Financial Services Act indicates that the increasing regulatory stringency and legalism in the securities markets has sources independent of the EU's integration and harmonization programme. See Vogel, op. cit., n. 4, pp. 93–119; see, also, S. Woolcock et al., *Britain, Germany, and 1992: The Limits of Deregulation* (1991).

into the listing rules of the London Stock Exchange – thereby rendering them mandatory and quasi-legal in character. Though not as advanced as in the British case, similar trends in increased stringency of self-regulation by stock exchanges can be discerned in Frankfurt and Paris.

Intriguingly, the United States is something of an outlier. The Securities and Exchange Commission (SEC) and New York Stock Exchange, in a questionable sanction of self-regulation, endorsed exchange rules that allow the adoption of a wide range of stock option plans without shareholder approval despite growing criticism of their benefits and propriety. This is less protective of shareholder value than emerging trends in Europe where suspicion of managerial enrichment and a tradition of far more egalitarian pay policies remains strong. In addition, the Private Securities Litigation Reform Act of 1995 sought to reduce the power of private shareholder litigants, traditionally a primary enforcement mechanism of American securities market regulation.[16] Though both these developments may reflect the higher level of capital market regulation in the United States from the beginning, they appear to be the product of the growing political strength of management interests.

(b) Financial concentration and institutional activism

Consolidation and concentration of the financial sector is a global phenomenon, sweeping not only the historically fragmented American financial industry, but the traditionally more concentrated financial sectors of Europe and more recently in Japan. Two trends predominate in the United States of America: the increasing concentration of the financial sector and the rise of activist institutional investors. In turn, regulatory politics and legal changes have advanced these developments. The United States has witnessed a far-reaching concentration of finance through bank mergers. Banks seek to reverse the eroding profit margins in their core lending business, to realize the greater economies of scale made possible by new information technologies, and to exploit synergies among a full range of financial services, from retail and commercial banking, to brokerage and investment banking, to insurance services. American financial institutions are thus not only seeking to expand the *scale* of their operations, but also to increase the *scope* of their services by acquiring or forming subsidiaries to provide brokerage services in the belief that these strategies will enable them to better compete in global markets.[17] Banks have pursued this strategy with

16 Private Securities Litigation Reform Act of 1995 (1995) *Public Law* 104–67, amending Title I of the Securities Act of 1933, 15 U.S.C. 77a, and following.

17 The formation of Citigroup, the mergers of Bank of America and NationsBank and of Chemical Bank and Manufactures Hanover, to mention only a few of these groundbreaking transactions, reveal a financial sector in search of economies of scale and volume of assets and transactions. Whether the assumed benefits of scale economies driving this movement are in fact real or realizable is another matter.

increasing intensity since 1988 when a Federal Reserve Board decision permitted them to form investment subsidiaries to circumvent the long standing separation of banking and brokerage under the Glass-Steagal Act.[18] This process was formalized and dramatically advanced by the passage of the Gramm-Leach-Bliley Act of 1999 which repealed Glass-Steagal and sanctions the combination of commercial banks, insurers and securities firms under one ‘financial holding company.’[19] Thus, the United States appears to be converging on the universal-banking model exemplified by Germany.

German banks seeking higher returns on capital have begun to move aggressively into investment banking. The ‘big three’ German universal banks are increasingly interested in the growth of securitized finance in Germany and the financial sector profits that go with it. Dresdner Bank’s purchased Kleinwort Benson, a London-based investment bank. Deutsche Bank followed an even more ambitious programme and acquired Morgan Grenfell in Britain and Bankers’ Trust in the United States. That both Deutsche Bank and Dresdner were compelled to seek investment banking expertise in the United States and the United Kingdom testifies to the comparative advantages acquired in different institutional settings and the difficulty of recreating such complex competencies under different institutional conditions.[20] The formation of Hypovereinsbank, now

18 A. Gande et al., ‘Bank Entry, Competition, and the Market for Corporate Securities Underwriting,’ (1999) 54 *J. of Financial Economics* 165; D.G. Litt et al., ‘Politics, Bureaucracies, and Financial Markets: Bank Entry into Commercial Paper Underwriting in the United States and Japan’ (1990) 139 *University of Pennsylvania Law Rev.* 369.

19 For years, repeal of Glass-Steagal has been on the congressional agenda. At first repeal was resisted by the financial institutions seeking to preserve their protected markets. In recent years, the fight has been over who will regulate the new universal financial institutions: the Federal Reserve or the Treasury Department. In the end, the law was repealed once a deal over regulatory jurisdiction was brokered between Treasury and the Fed. ‘Functional regulation’ provides the overarching conceptual framework and it continues pre-existing regulatory responsibilities under the supervisory ‘umbrella’ of the Federal Reserve. In the case of the SEC, the Act expands pre-existing regulatory authority.

20 This difficulty is further underscored by the fact that Deutsche Bank’s British venture is widely regarded as a failure and the scepticism commentators have voiced about the success of its acquisition of Bankers Trust. Likewise Dresdner Bank’s acquisition of the United Kingdom investment bank, Kleinwort Benson, was fraught with problems of staff retention and integration. Finally, the failed merger attempt between Deutsche and Dresdner Banks in March-April 2000 was a public humiliation for both banks as both appeared inept in the new world of transaction-driven finance. Both the strategies and problems of these banks testify to the power of path-dependence at the level of the firm. See T. Major, et al., ‘Dispute Ends Plan to Create World’s Biggest Bank: Disagreement Over Dresdner Bank’s London Arm Thwarts $32bn Merger with Deutsche Bank’ *Financial Times*, 6 April 2000, 1; W. Lewis et al., ‘Merger Collapses after Fierce Dispute over DrKB: How Distrust over Investment Banking Division Led to Dresdner Bank Pulling Out of Deal with Deutsche Bank’ *Financial Times*, 6 April 2000, 18.

Germany's second largest, also indicates a broad restructuring and increased concentration of the financial sector. In France, the hostile takeover of the Paribas investment bank by BNP, a larger commercial bank, also reflects the European trend towards integrated financial services emphasizing securities dealing and investment banking. However, as a structural and governance issue, consolidation is less a transformation in the already concentrated European and Japanese financial systems than it is for the historically – and intentionally – fragmented American financial system.

The neo-liberal economies of the United States and Britain are experiencing a second, and potentially more far-reaching, form of financial concentration through the rise of institutional investment funds. Pension funds and mutual funds have changed the financial and landscape of the United States. The percentage of equity of the 1,000 largest public corporations held by institutions in the United States has gone from approximately 25 per cent in the early 1970s, to 46.6 per cent in 1987, to 58.8 per cent in 1996. More important for corporate governance, over 25 per cent of equity in the 1,000 largest public corporations is held by large, and generally public, pension funds with longer time horizons, lower portfolio turnover, and thus greater incentives to become active in firm governance.[21] Some observers believe that the increasing size and, in some cases, activism of institutional funds herald a new form of corporate governance that could replace the dispersed shareholding characteristic of the Berle and Means corporation and the established paradigms of managerial and shareholder capitalism in the neo-liberal economies.

The market power of these vast institutional holdings is double-edged because their very size makes them increasingly illiquid. Indexed funds, by definition, remain limited in their ability to liquidate ownership positions because they must keep their portfolios weighted in accordance with the market. The scaling up of investment funds intensifies this lock-in effect because the disposition of large holdings tends to erode the price of shares a fund might wish to sell. The likelihood of even greater losses through liquidation therefore create an incentive for large funds to holds positions they otherwise might sell. The reduced liquidity of large holdings, even in a well-developed securities market, therefore raises the incentives for governance activism as a strategy to improve financial performance.[22]

This increasingly concentrated pooling of investment capital and the governance power that goes with it carry potentially profound international

21 The Conference Board, 1 *Institutional Investor Report*, tables 8 and 19 (July 1997).
22 See J. Hawley and A. Williams, 'Corporate Governance in the United States: The Rise of Fiduciary Capitalism, A Review of the Literature' (1996) (paper prepared for the OECD); J. Hawley et al., 'Getting the Herd to Run: Shareholder Activism at the California Public Employees Retirement System (CalPERS)' (1994) 6 *Business and the Contemporary World* 4.

consequences.[23] Anglo-American institutions own between 35 per cent and 45 per cent of equity traded on the Paris Stock Exchange and have been repeatedly credited with pushing French managers to focus on shareholder value through corporate restructuring and into a wave of major corporate mergers and hostile takeover activity that has shaken the French economic élite.[24] Likewise, foreign institutional investors holding approximately one half of Mannesmann's stock played a pivotal role in Germany's first cross-border hostile takeover – the hostile acquisition of Mannesmann by Vodafone of the United Kingdom. It would be inaccurate to attribute the transformation in governance taking place in France and Germany to the general phenomenon of globalization. The power of institutional investors derives from their *organizational form and governance capacities* as large-scale equity holders, and national legal structures and institutional arrangements determine both characteristics in the first instance. The globalization of capital markets is thus a necessary, but not a sufficient, condition to account for changes wrought by the international activities of Anglo-American institutional investors.

In the United States of America, the increasing power of institutional investors is not solely a matter of scale and type of investment, but also a consequence of government policy expressed through legal reforms. First, under the Department of Labor's 'Avon Letter' ruling of 1988, pension funds now have a legal *duty* to remain knowledgeable and reasonably active in corporate governance and to vote their shares at the annual general meeting.[25] This imposition of legal duties to engage with governance issues and processes enabled institutional investors to gain expertise and a self-conscious role in corporate affairs. Second, changes in SEC proxy rules in the early 1990s have encouraged funds to co-operate with one another in corporate governance activism and allowed institutional investors to communicate their concerns and demands among one another and to management without triggering cumbersome and expensive SEC proxy disclosure rules and reporting requirements.[26] These reforms built on the incentives created by the Avon

23 See R.M. Buxbaum,'Comparative Aspects of Institutional Investment and Corporate Governance' in *Institutional Investors and Corporate Governance*, eds. T. Baums, R.M. Buxbaum, and K.J. Hopt (1994).

24 In 1999, foreign shareholders owned 61 per cent of Total and 51 per cent of Elf Aquitaine. J. Tagliabue, 'Embracing la Nouvelle Economie: A String of Big Deals Elevates France in Europe and the World' *New York Times*, 1 September 1999, p. C-1. See, also, Davis Global Advisors, op. cit., n. 14, pp. 52–4.

25 US Department of Labor, *Opinion Letter to Helmuth Fandl, Avon Products, Inc*. (Feb. 29, 1988) (giving notice to pension fund trustees that their fiduciary duties require the diligent exercise of share voting rights); see, also, DOL Interpretive Bulletin 94–1 (July 1994) (fiduciary duties of pension fund trustees include ' . . . activities intended to monitor or influence corporate management').

26 See SEC Rules 14a–1(1)(2)(iv) & 14a–2(b), 17 CFR ss. 240, 14a–1(1)(2)(iv) & 14a–2(b), promulgated under s. 15(a), Securities and Exchange Act of 1934, 15 U.S.C. s. 78n.

Letter by creating an avenue for institutions to apply private pressure on managers without raising public concerns over the excessive financial power or depressing stock prices in the near to medium term. Thus, the proxy reforms sanctioned informal tactics likely to be more effective than resort to formal governance mechanisms such as proxy voting battles or derivative litigation to enforce fiduciary duties. Third, the Private Securities Litigation Reform Act of 1995 gave institutional investors greater power over shareholder litigation pursuant to a 'lead litigant' provision.[27] Though they have not taken up this role with any frequency for fear of incurring their own potential fiduciary and negligence liability,[28] recent developments in securities litigation indicate that institutional investors are increasingly intervening in order to increase recoveries and prevent arguably collusive settlements between defendant-corporations and class counsel.[29] Thus the Act has indeed increased the power of the funds, but not in a way that curbs securities litigation. The failure of these policies to effect substantial change in corporate governance is not surprising, given the institutional bias favouring liquidity over control in the United States.[30] However, the consistent and distinctive policy initiatives to empower institutional investors are striking in their attempts to foster and use concentrated financial power within a 'political model' of corporate governance.[31]

To date, the increasing size, activism, and international investments of institutional investors represents a set of legal and historical developments unique to the United States and, to a lesser degree, Britain. Yet the rise of institutional investors may substantially transform the institutions and dynamics of governance around the world as industrialized countries seek to meet the dual challenge of improving governance and pension provisions for graying populations. The emergence of institutional investors as a significant economic and governance force in the non-Anglo-Saxon countries turns not on the regulatory politics of corporate governance, but on the even more politically explosive issue of pension reform. The outcome of these battles, looming throughout the industrialized world, remains undetermined in extent

27 Ss. 27(a)(3)(A) & (B), 15 U.S.C.A. ss. 77z–1(a)(3)(A) & (B); 78u–4(a)(3) (A) & (B).

28 See J. Grundfest and M. Perino, *Securities Litigation Reform: The First Year's Experience: A Statistical and Legal Analysis of Class Action Securities Fraud Litigation Under the Private Securities Litigation Reform Act of 1995* (1997a); J. Grundfest and M. Perino, 'Securities Litigation Reform: The First Year's Experience' (1997b) 29 *Annual Institute on Securities Regulation* 241.

29 See *In re: Cendant Corporation Litigation*, 182 F.R.D. 144; 1998 U.S. Dist. LEXIS 13989 (D.N.J. 1998) (the California, New York State, and New York City public employee pension funds combined to intervene as lead plaintiff in a major securities class action that recovered $2.8 billion and led to court ordered corporate governance reforms). Other fund-led lawsuits are now pending.

30 Compare J. Coffee, 'Liquidity Versus Control: The Institutional Investor as Corporate Monitor' (1991) 91 *Columbia Law Rev.* 1277.

31 Compare J. Pound, 'The Rise of the Political Model of Corporate Governance and Corporate Control' (1993) 68 *New York University Law Rev.* 1003.

and form. Nonetheless, with the advent of institutional investors in the United States and the United Kingdom and their increasingly activist global investment strategies, shareholder capitalism has taken on an identifiable institutional form.

(c) The crisis of the statist political economies

In the statist political economies, globalization and the elimination of capital controls that preceded it have eroded the capacity of the state to control the allocation of finance as a mechanism of industrial policy. Neither France nor Japan can utilize their ministries of finance for the highly interventionist industrial policies of the past. France gave up the capacity to allocate and ration credit in the mid-1980s as the political costs of choosing economic winners and losers began to rise throughout the 1970s and 1980s and as the 'national champions' created with these financial mechanisms of policy proved increasingly uncompetitive.[32] The stunning growth of the Japanese economy and the success of its export oriented industrial firms reduced the relative power of the state's control over credit and finance in an economy awash with cash and rapidly inflating asset prices. The Japanese government therefore abandoned capital controls in the early 1980s.

However, the state remains a powerful actor in both these economies and the legacy of statist institutional arrangements has been a profound influence on subsequent reforms. The French state substantially structured the governance arrangements of state enterprises during their privatization.[33] Yet, thereafter, government policy has left these newly private firms dependent on capital markets for their own financing. The BNP-Paribas merger that transformed the French financial sector also signalled the French government's policy choice to allow market forces, and in particular a new market for corporate control, to reshape French finance. As the BNP-Paribas-Societé General hostile takeover battle revealed, the French state has arrived at a *deliberate policy* of allowing market forces to compel consolidation and adjustment if managers cannot come to voluntary agreements. The outcome, in which BNP won control over Paribas through a hostile bid, exposes Société Général to acquisition by a foreign bank. The French state could have blocked any of the bids and imposed a resolution, but *chose* not to.[34] The result was probably the least favourable outcome for all three banks.

32 See R. Deeg and S. Perez, 'International Capital Mobility and Domestic Institutions: Corporate Finance and Governance in Four European Cases' (1999, unpublished paper on file with author).

33 See J. Levy, *Tocqueville's Revenge: State, Society, and Economy in Contemporary France* (1999).

34 See 'Down with Dirigisme' *Worldlink*, September/October 1999 (describing limits on state authority and splits among state institutional actors over state intervention in the market for control); compare P. Ford, 'Europe Answers Walmart Threat' *Christian Science Monitor*, 1 September 1999, 1.

Japan presents a non-trivial special case, yet one that illustrates the central importance of domestic politics in a globalizing economy. Japan's belated and rather limited financial consolidation began in mid- to late-1999 after a decade of economic stagnation and financial crisis. Given the size of Japan's debt crisis (possibly as much as $1 trillion in bad debts), resolving it would have taken enormous political and bureaucratic will and strength. Japan in the 1990s possessed neither. A political crisis initiated by the crash of the bubble economy and pervasive corruption scandals shattered both the legitimacy and virtual power monopoly of the long-ruling Liberal Democratic Party.[35] A succession of weak and unstable coalition governments were unwilling and/or unable to take difficult and divisive policy decisions. The crash, economic crisis, and recurrent corruption scandals also weakened the esteem and authority of the powerful bureaucracies. Under these conditions, no political resolution could be found to unwind the banking crisis and restore the financial system to health. As a consequence of this political failure, Japan has not been capable of undertaking the kind of financial reforms to improve transparency, disclosure, and accounting for fear of exposing and intensifying the severity and breadth of the crisis. The result has been political and economic stagnation.

2. *The equivocal case of company law*

Comparative analysis of company law reveals a moderate but surprisingly variable degree of cross-national change (see Table 3). In the neo-liberal economies of the United States and Britain, this moderate change is unsurprising because they are supposed to supply the model for convergence induced by globalization. However, the substance of the changes that have occurred in these countries confounds the mainstream convergence theories. In the United States, the political and legal reaction to the hostile takeover boom of the 1980s generated anti-takeover laws and judicially sanctioned anti-takeover devices that effectively restored much of the managerial power of the *status quo ante*.[36] Conversely, the rise of institutional investors after

35 See Vogel, op. cit., n. 4.

36 The current merger and acquisition wave in the United States is almost entirely comprised of friendly deals. There is a vibrant market for *companies* in the United States today, but this should not be confused with the harsh market for *control* of the 1980s. For an overview of the American hostile takeover movement and political and legal responses thereto, see R. Alcalay, 'The Golden Age of Junk' *New York Rev. of Books*, 26 May 1994, 28–34; S. Wallman, 'The Proper Interpretation of Corporate Constituency Statutes and Formulation of Directors' Duties' (1991) 21 *Stetson Law Rev.* 163; S. Wallman, 'Corporate Constituency Statutes: Placing the Corporation's Interests First' *Business Law Update* (1990); see, also, essays collected in M. Blair, ed., *The Deal Decade: What Takeovers Mean for Corporate Governance* (1993); S. Bhagat et al., *Hostile Takeovers in the 1980s: The Return to Specialization*, (1990); A. Schleifer and R. Vishny, 'The Takeover Wave of the 1980s' *Science*, August 1990, 745. For a comparison with the European conception of 'corporate constituencies' see A. Conard, 'Corporate Constituencies in Western Europe' (1991) 21 *Stetson Law Rev.* 73.

the end of the takeover boom has driven extra-legal changes in corporate governance by increasing the use of independent board members, independent board committees, and direct dealings between investment funds and managers that has reinforced managerial sensitivity to shareholder values. At the same time, however, the American governance regime has allowed – or encouraged – the use of stock options as executive compensation that has effected a vast redistribution of wealth to managers.[37] Despite attacks on these compensation schemes as excessive and vulnerable to managerial conflicts of interests, the politics and economics of the American corporate governance regime have been incapable to restrain this flow of money. Rather, the New York Stock Exchange, with the SEC's blessing, reduced transparency and shareholder control by exempting a wide range of options plans from shareholder approval. In contrast, Germany began an incremental, but apparently sustained, process of company law reform with the enactment of the Control and Transparency Act (KonTraG) in 1998. This legislation required, among other things, that the supervisory board, rather than the managing board, appoint and receive the report of the external auditor; forced banks must choose between voting their own shares or voting deposited proxies where the bank's stake exceeds 5 per cent; instituted a one-share, one-vote rule; and allowed for stock repurchases for the first time in Germany.

The comparison between France and Japan is the most startling. As in securities regulation, French company law has changed with surprising swiftness and magnitude.[38] Company law reforms have appropriated Anglo-American company law structures to a surprising degree, given the *dirigiste* tradition in French economic policy and governance. Most surprisingly of all, these changes in law and state policy have triggered a dynamic market for corporate control, including tender offers and hostile takeover battles reminiscent of the United States.[39] The French government transformed the political economy by privatizing large numbers of public firms. However, it also deliberately structured the ownership stakes and governance relationships among these privatized firms so as to reorganize entire sectors of the French

37 'Cutting the Cookie' *Economist*, 11 September 1999, 26.

38 Technically speaking, there is no distinction in French law between securities and company law, see J. Fanto, 'The Role of Corporate Law in French Corporate Governance' (1998) 31 *Cornell International Law J.* 31; J. Fanto, 'The Role of Corporate Law in the Adaptation of French Enterprises' (paper prepared for the Cross-Border Conference on Corporate Governance, Center for Law and Economics, Columbia Law School, March 17–18, 1997), whereas Germany separates takeover law from company law.

39 These developments challenge cultural theories of political economic behavior. The rapidity with which the formerly closed and mutually supporting French political and economic élite has embraced adversarial relations and tactics obliterate the image of the French political economy as overdetermined by a shared and ingrained culture of élitism.

Table 3: Major changes in company law (1985–2000)

United States	United Kingdom	Germany	France	Japan
• Wave of anti-takeover statutes in the late-1980s and early-1990s, and judicial sanction of anti-takeover devices weaken shareholder primacy and market for corporate control. • Takeover litigation during 1980s generates contradictory and ambiguous fiduciary duty rulings re: shareholder rights. • 1999 NYSE and SEC rule amendments exempt most stock option plans from shareholder approval, continuing pattern of United States law giving shareholders comparatively few rights to vote on important corporate decisions.	• 'Super Code' of corporate governance 'voluntary' best practices issued as an appendix to the London Stock Exchange listing rules and as a LSE disclosure rule that has induced significant board reform by large firms. • Increased use of non-executive and independent directors and independent board committees. • Greenbury Report recommends greater disclosure and shareholder approval of executive and board compensation (too soon to determine impact). • Government and FAS commit to thorough review of company law to determine need for legislative changes. • Fiduciary duties remain undeveloped: shareholder litigation rare, Super Code silent on conflicts of interest, and United Kingdom Companies Act silent on duties and role of directors (though obligation is to shareholders as group).	• Courts inferred existence of fiduciary duties to shareholders, but law remains undeveloped and conceptions of corporate interest distinct from share-holder interest persist. • KonTraG statute (only major company law reform since 1965) reforms: (1) external audit rules; (2) voting of bank shares and proxies; (3) stronger fiduciary obligations of custodian bank in voting proxies; (4) one share, one vote rule; (5) prohibition on voting cross-shareholding stakes in board elections; (6) stock repurchases allowed for first time. • Legislative progress towards implementing draft EU Takeover Directive.	• 1989 COB and exchange rules create bidding and disclosure procedures for tender offers. • Introduction of freezeout and appraisal rules to protect minority shareholders. • Law requires shareholder vote on wide range of corporate decisions. • Proxy voting reform to facilitate shareholder voting and weaken management control over voting (too early to discern impact). • Private litigation enforcement mechanisms for shareholder rights considered but either rejected (e.g., class action) or not yet enacted. • Market for corporate control becomes very active (particularly in domestic market).	• Liberalization of law on bringing of lawsuits for mismanagement, stock option plans, share buybacks, and formation of holding companies, but little impact on litigation rates and on governance of public firms; legal institutions and procedural rules still discourage litigation. • No policy action on the Keidaren's policy statement endorsing corporate govern-ance practices favouring shareholder interests. • Despite creation of independent securities regulatory body and government pledge of more stringent securities and banking regulation, bank and *keiretsu* group finances remain opaque and tightly interwoven. • Government's 1999 pledge to eliminate constraints on market for corporate control, including acquisitions by foreign buyers, not fulfilled; still no market for corporate control.

economy and to protect firms from takeover.[40] This strategy proved ineffective as firms found themselves dependent on capital markets for finance at the same time as their share prices began collapsing and sought to raise cash by selling off stock holdings. This led to an unraveling of cross-shareholdings, the growing presence of foreign shareholders in French firms, and a wave of consolidating takeovers that is still continuing. This takeover wave dramatically increased the practical importance of corporate governance in France. However, the state has not completely relinquished its grip upon industry and the economy. Foreign institutional investors hold 35-40 per cent of the French equity market, but the French government retains extensive powers to block control transactions and intervenes selectively in merger and acquisition activity. Hence, the state has combined liberalizing and interventionist policies in overseeing the process of sectoral consolidation to ensure that French industry remains largely in the hands of French managers as a deliberate policy choice.[41] The BNP-Paribas, Total-Fina-Elf Aquitaine, and Carrefour-Promodes mergers represent a new breed of nationally-based firms shaped more by market forces than state fiat and oriented towards European and international competition rather than national markets and state economic management.[42]

In contrast, Japanese company law and corporate governance has remained largely unchanged through an economically disastrous decade. The market for corporate control is flat. Friendly acquisitions are exceptional; and hostile takeovers are non-existent. Legal protection for shareholders remains feeble and the procedural and institutional mechanisms to protect the nominal rights that do exist virtually preclude bringing claims against management. Cross-shareholdings within *keiretsu* groups remain common and account for up to 60-70 per cent of shares.[43] Informal practices have not evolved to compensate for the absence of legal change. Board composition, structure, and practices continue to be dominated by management and interlocking directorates among *keiretsu* insiders. Prospects for substantial change and reform in the near- to medium-term are remote.[44]

40 Levy, op. cit., n. 31.

41 S. Iskandar, ‘Three Wiser Men: The French Government and the Business Community Can Learn Important Lessons from the Drawn-out Takeover Battle in the Banking Sector’ *Financial Times*, 30 August 1999, 11. Recent events reveal the limits of state control in this restructuring, however. See *Worldlink*, op cit., n. 34.

42 This was especially clear in the consolidation of the French petroleum sector as French government officials oversaw the cross-national merger of Total with Belgium’s Petrofina and as the resultant entity, Total-Fina, took over the much larger (and traditional ‘national champion’) Elf Aquitaine. Likewise, other large cross-border mergers by French firms have left the French acquirer in the dominant position. However, the failure of the French Ministry of Finance to negotiate or impose a resolution to the BNP-Paribas-Société Général hostile takeover battle revealed the limits of the state’s willingness and capacity to guide the consolidation process or to impose acquisitions on private firms. See *Worldlink*, id.

43 Davis Global Advisors, op. cit., n. 14.

44 id.

Of the juridical components of corporate governance, labour law[45] remains the most stable. Table 4 reveals the striking resilience of labour relations law as it pertains to corporate governance. In Europe, where organized labour has far more power than in the United States and Japan, labour interests continue to exercise substantial influence over the dynamics of national politics and economic policy. The core interest of labour is the manner in which labour law structurally constitutes and integrates labour interests and organized labour into the political economy. Globalization has certainly altered the balance of power between capital and management on one side and labour on the other. Europe's basic labour laws and labour market institutions, such as centralized and sectoral bargaining, forms of codetermination, and job protection, were almost all developed from the 1950s through the 1970s. These institutional developments endowed labour with substantial political and economic clout. Changes in labour law and labour relations during the 1980s and 1990s have generally been concerned with marginal incremental measures concerning the flexibility of internal labour markets and wage bargaining structures.[46]

Prior to the EU's Works Council Directive, codetermination had been closely correlated to neo-corporatist modes of political economic organization. Just as the 'business unionism' and absence of labour representation in firm governance in the United States reflect the fragmented institutions and market-based organization of the American political economy, the institutions of firm governance bear the stamp of their development within neo-corporatist regimes of continental Europe. Indeed, these institutions of codetermination may be accurately labeled as 'micro-corporatism.'[47] These micro-corporatist arrangements are held in place by a

45 Only those changes in labour relations law that relate to corporate governance and the representation of labour within the firm are identified. Other changes and reforms affecting rights of collective bargaining, rights to strike and other forms of self-help, and developments in the cognate areas of employment and employee benefits (for example, pensions) law.

46 A critical exception was the anti-labour legislative programme pursued by the Thatcher government in the United Kingdom in the early 1980s. However, this radical retrenchment of liberalism was driven by domestic political economic considerations and institutional constraints in response to the economic crises of the 1970s, not to globalization trends emerging after the mid-1980s. See J. Levy, R. Kagan, and J. Zysman, 'The Twin Restorations: The Political Economy of the Reagan and Thatcher ''Revolutions'' ' in *Ten Paradigms of Market Economies and Land Systems*, eds. L.J Cho and Y.H. Kim (1999).

47 See H. Assmann, 'Microcorporatist Structures in German Law on Groups of Companies' and W. Streeck, 'Status and Contract: Basic Categories of a Sociological Theory of Industrial Relations', both in *Regulating Corporate Groups in Europe*, eds. D. Sugarman and G. Teubner (1990); W. Streeck, 'Co-determination: The Fourth Decade' in *International Perspectives on Organizational Democracy, Vol. II*, eds. B. Wilpert and A. Sorge (1984).

Table 4: Major changes in labour relations and labour law (1985–2000)

United States	United Kingdom	Germany	France	Japan
• No significant legislative changes. • Continued debate over the legality of employee teams and 'quality circles' under the NLRA § 8(a) prohibition on 'company unions'.	• No substantial legal change. • 1997 accession to the EU Social Policy Agreement extends Works Councils Directive to United Kingdom. • Increasing juridification and codification of labour relations under EU pressure.	• No substantial legal change. • Court rulings strike down attempts to circumvent board codetermination. • Maintenance of board codetermination precludes proposed reduction of board size.	• No substantial legal change, despite continued employer criticism of job-protection legislation and litigation. • EU Works Council Directive introduces a weakened form of the institution to France (after Arroux laws of 1982 break unions' monopoly on labour representation in policymaking and introduce weak works councils).	• No significant change in law, labour relations remain largely non-legalistic. • State makes emergency credits available to distressed firms on condition of retaining employees.

Table 5: Degree of change in corporate governance law by country and category

	Financial Market Regulation	**Corporate/Company Law**	**Labour Law**
United States	Moderate/Low	Moderate/Low	Low
United Kingdom	High (form of law and regulatory institutions) Moderate (substantive law)	Low (formal change) Moderate (informal/self-regulatory change)	Low (High during the confrontation between Thatcher and unions during the early 1980s)
Germany	Moderate High /Moderate (stock exchange self-regulation)	Moderate/Low	Low
France	High	High/Moderate	Low (Moderate during early 1980s, but with little practical effect)
Japan	Low	Low	Low

distribution of political power that favours labour to a far greater degree than in the United States and the United Kingdom.

However, neo-corporatist polities are not distinguished by the relative power of organized labour and social democratic parties alone. Centre-right Christian Democrat parties built neo-corporatist political economies to ensure the social and political stability necessary for long-term economic growth and to prevent the pathological politics of the past. The social democratic left did not impose these institutional arrangements, though, as in the case of German codetermination, it did extend them.[48] Further, the development and perpetuation of divergent corporate governance regimes under both right- and left-of-centre governments indicates that they have broader support than that of the unions and the political left. The economic success of these substantially varying economies and the broad base of political support and social legitimacy they have enjoyed through much of the post-World War II period indicates that these are politically and economically functional and self-reinforcing institutional arrangements.

48 See K. Thelen, *Union of Parts: Labour Politics in Postwar Germany* (1991).

In this respect the analysis here differs from Mark Roe's recent work arguing that social democracy is the primary determinant of national governance regimes and the resultant patterns of ownership and control. There is certainly a correlation, indeed a causal relationship, between the presence of significant social democratic parties and neo-corporatist governance institutions.[49] The 'Rhenish model' of capitalism, broadly conceived as encompassing both the neo-corporatist and statist economies discussed here, emerged from traumatic social strife, often characterized by intense class conflict, as a means of stabilizing political and economic affairs in the post-war era.[50] However, for most of the post-war period and almost the entire period of post-war reconstruction and institution building, the centre-right was in power in continental Europe. Social democratic parties were consistently in power only in the Scandinavian countries. Likewise, centre-right coalitions devoted to developmental policies constructed the statist political economics of Japan and France to protect economic sovereignty, channel finance to industry, ensure wage restraint, and curtail class conflict.

Likewise, Roe's argument that supervisory board codetermination has discouraged financial transparency and thus the development of securitized finance should be viewed with substantial scepticism.[51] He argues that workers representatives on the board discourage information flows to the board because the workers will use this information to extract additional rents from the firm in wage bargaining. The theory is questionable on historical and analytical grounds. The United States once had a powerful labour movement with approximately the same union density as Germany today and considerably less wage restraint. Yet this did not prevent the United States from achieving financial transparency through stricter disclosure rules and accounting standards than in other countries. Further, German codetermination and company law binds the employee representatives to a duty of confidentiality, arguably mitigating the variety of opportunism assumed in Roe's analysis. Finally, *sectoral* level wage bargaining, such as that characteristic of the German labour relations system, tends to sharply reduce the extraction of *firm specific* rents.

Labour politics have been at the core of the contemporary politics of corporate governance in Germany and Europe as a whole. Most striking, amid the predominantly neo-liberal rhetoric of the globalization debate, is

49 See M. Roe, 'Political Preconditions to Separation of Ownership From Control: The Incompatibility of the American Public Firm with Social Democracy' (1999, unpublished draft on file with author).

50 The term 'Rhenish model' is taken from M. Albert, *Capitalism Against Capitalism: How America's Obsession with Individual Achievement and Short-Term Profit has Led it to the Brink of Collapse* (1993).

51 See M. Roe, 'Codetermination and German Securities Markets' in *Comparative Corporate Governance: The State of the Art and Current Research*, eds. K. Hopt et al. (1998).

the stability of codetermination in Germany[52] and the expansion of works councils codetermination in Europe through the EU itself. The interests represented in the German corporate governance regime – management, banks, and labour – are powerful actors within the political process and easily can thwart political initiatives to increase their accountability to, and therefore the power of, shareholders. The interests of each of these factional beneficiaries of the German governance regime have interlocked in mutually reinforcing ways. Banks maintain control over the domestic capital markets, even as they now attempt to balance between traditional long-term perspectives of 'patient capital' and attempts to foster a German 'equity culture.' Labour remained shielded from competition over wages in large swaths of the economy, especially in the core export oriented industries, through the continuation of sectoral collective bargaining between strong industrial unions and employers associations. Likewise, labour's role in firm governance reduces the attractiveness of some takeovers and restructuring strategies by limiting the costs of firm and sectoral restructuring that managers and financiers can impose on employees. Management has remained substantially shielded from takeover threats and shareholder pressures by long-term relations with banks, cross-shareholding with other firms, and the ability of labour to reduce the short-term rents that can be appropriated from post-takeover restructuring. The result is an informal 'governance coalition' that embraces the principal actors and interests in the German governance debate and straddles the political divide between the CDU-CSU and the SPD. In addition, unions aligned with the CDU further underpin this governance coalition by inhibiting the adoption of neo-liberal policies by the centre-right. This *de facto* coalition provides an ideal example of the sort of quasi-public institutional arrangements that underpin Germany's exceptionally stable consensus politics and the deadlock that often results from them.[53]

More broadly, proposals for an EU directive on harmonizing company law and corporate structure have been blocked over the role of labour within the firm. For over twenty-five years, the EU has debated, and failed to promulgate, its draft Fifth Directive adopting a pan-European company law amid conflicts over mandatory works councils and labour codetermination.[54]

52 See M. Rhodes and B. van Appeldoorn, 'Capitalism Unbound? The Transformation of European Corporate Governance' (1998) 5 *J. of European of Public Policy* 406; Roe, op. cit., n. 43.

53 Compare P. Katzenstein, *Policy and Politics in West Germany: The Growth of a Semisovereign State* (1987) 58–80.

54 See Rhodes and van Apeldoorn, op. cit., n. 50; U. Schaede, 'Toward a New System of Corporate Governance in the European Union: An Integrative Model of the Anglo-American and Germanic Systems' in *Politics and Institutions in a Integrated Europe*, eds. B. Eichengreen et al. (1995); R. Buxbaum and K. Hopt, *Legal Harmonization and the Business Enterprise: Corporate and Capital Market Law, Harmonization Policy in Europe and the U.S.A.* (1988) 259–69.

Further confounding the theory that globalization is driving convergent liberalization is the EU's adoption of the Works Council Directive requiring that member nations adopt works council legislation giving employees a direct voice in the management of firms. While not nearly as protective of worker interests as Germany's Works Council Act,[55] the Works Council Directive does introduce another dimension to the governance of European firms. The introduction of works councils devolves power and legal authority within the corporation downward to the employees and their representatives. This reallocation of authority effectively circumscribes the power of the management, the board of directors, and shareholders. The proliferation of works councils thus alters the structure of governance in precisely the opposite direction predicted by bald globalization theories.

Even in the United States and Japan, where labour is not nearly so powerful and entrenched, labour has played a role in shaping the development of corporate governance and cushioning the harshness of market forces. In the United States, labour interests mobilized in resistance against corporate takeover activity joined with managerial interests in pressing for protective anti-takeover legislation – though labour's political weakness was clearly reflected in the statutes' expansion of managerial powers without any grant of power to employee representatives. Japanese law does not mandate any formal employee representation in corporate governance; nor does Japanese politics notably empower labour. The continued economic slump has revealed the weakness of juridical labour relations as some firms have laid-off 'lifetime' employees and middle managers. Yet, despite a decade of economic stagnation and industrial overcapacity, management has been extremely resistant to mass layoffs. In part, this resistance reflects state policies discouraging firings in order to prevent political instability and further erosion of aggregate demand. In one of the last vestiges of state control over credit and finance, the Japanese government has conditioned emergency credits to struggling firms on retention of employees. However, the absence of layoffs and downsizing as prevalent restructuring and adjustment strategies also reflects the ingrained 'stakeholder' norms of the post-war corporate governance system in which insider and employee interests were paramount in the organization and operation of the corporate firm.

In Japan and throughout the industrialized countries, the striking lack of change in the legal structures of labour law and labour relations indicates the extremely sensitive political character of these institutions and their

55 In Germany, works councils are a more significant institution in the governance of firms than the codetermined Supervisory Board. See M. Lutter, 'The German System of Worker Participation in Practice' (1982) *J. of Business Law* 154; compare K. Thelen, 'Western European Labour in Transition: Sweden and Germany Compared' (1993) 46 *World Politics* 23; Thelen, op. cit., n. 48; L. Turner, *Democracy at Work: Changing World Markets and the Future of Labour Unions* (1991).

connection to corporate governance regimes. This absence of formal change certainly does not imply that labour relations and the relative strength of labour, management, and capital has not changed since the 1970s. Obviously they have. Yet this absence of formal change indicates that states, politicians, and policy makers have been unwilling to incur the political costs of such a course or have found fundamental labour market reform neither necessary nor desirable. Thus, for both economic and political reasons, labour market institutions and their interrelationships with corporate governance have proved strikingly resilient.

CONCLUSION

This comparison of corporate governance regimes under the pressures of globalization reveals patterns of institutional development that support some preliminary and conjectural conclusions about the relationship between national political economies and globalization. First, significant financial market reforms and increasing securities market regulation have driven the development of more transparent and liquid investment flows and ownership structures both domestically and internationally. The construction of the institutional framework for increasingly marketized and securitized finance appears well under way across a wide range of political economies. These market facilitating institutional arrangements form the channels through which signals and shocks from the global capital markets feed into national economies. Through these markets and the domestic institutions that constitute them, national economies are becoming increasingly integrated into a global economy. By and large, this development of securities markets and securities regulation reflects a convergence on the American financial and regulatory model.

Turning to company and labour law, the picture becomes substantially more complex. Minimal changes in domestic labour law have ensured substantial continuity and institutional resilience in labour relations. If anything, recent legal changes, such as the 35-hour week in France, the reinforcement of codetermination rights by German courts, and the EU Works Council Directive, have tended to reinforce existing labour market structures and relations. Company law displays an intermediate level of transformation characterized by marginal changes. Legislative and regulatory change has focused on those rules and areas most closely related to the functioning of the securities markets but has left the most basic structural features of the corporate firm intact. Company law, like labour relations law, thus has maintained significant national divergence. Political actors have been unwilling or unable to alter these fundamental arrangements at the base of their political and economic orders – even as the changes in financial markets strip the statist and neo-corporatist political economies of the complementarities between financial and labour relations systems. Hence, these corporate governance systems can be expected to go through a period of significant strain and increasing political unrest.

These differences among areas of law leads to the conclusion that the impact of globalization has not and will not produce convergence but a new set of differentiated political economic systems integrated into global capital markets. Among these divergent systems, the patterns of change and stability revealed here suggest two potential outcomes in the form of two divergent hybrids of the neo-liberal economic model and the neo-corporatist model.[56] The neo-liberal model appears to be evolving more concentrated financial systems through the pressure of unmediated market forces that favour the development and interests of strong financial actors, particularly *vis-à-vis* labour. This form of political economic organization is adjusting to global markets in which the deliberate fragmentation of markets, investments, and ownership interests as a point of policy is no longer appropriate. Whether this change in the structure of neo-liberal shareholder capitalism has any significant effect on the governance and functioning of these economies remains to be seen.

The development of the neo-corporatist model suggests that shareholder interests are gaining in marginal power and importance, but in an institutional setting in which the forces of global capital markets are mediated by firm and labour market structures. This micro-corporatist institutional structure balances the interests of key political economic interests and actors *at the level of the firm* where flexible adjustments to changing market conditions are more efficient than at the level of state policies and institutions. Thus, there is greater flexibility and adjustment capacity in the neo-corporate model than is usually recognized. This flexibility, in addition to the political resilience of these institutions, accounts for the relative stability of neo-corporate regimes.

The evolution of the statist political economies remains subject to great uncertainty and presents a contradictory and puzzling picture of regime development. Of each of the three broad models of political economy considered here, the statist mode of organization appears most at odds with globalization. Statist policies of planning and targeted financing have become liabilities in economic adjustment at the same time that global financial markets and the elimination of capital controls have effectively forced the abandonment of state-channelled finance as a mechanism of industrial policy in both Japan and France. The similarity ends there. In France, the state pushed through financial liberalization and has successfully

56 D. Soskice, 'Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s' in *Continuity and Change in Contemporary Capitalism*, eds. H. Kitschelt et al. (1999) has also speculated that globalization is inducing convergence on the dual equilibria represented by market-centered neo-liberalism and neo-corporatist co-ordination. Compare P. Hall, 'The Political Economy of Europe in an Era of Interdependence,' in Kitschelt et al., id.

reformed much of its securities and company law along Anglo-American lines. This would suggest that the developmental path of the statist political economies, once deprived of their statist policy mechanisms and lacking the dense networks of institutional structures that have developed in neo-corporatist systems, 'tip' towards minimalist, neo-liberal organizational forms. Yet the French state, for all its legal liberalization, retains very substantial discretionary power over industrial organization and the market for corporate control – though the limits of this power and the will to use it has been severely tested. Japan, for its part, has been prevented by the depth of its financial crisis, the legacy of its government institutions, and its political disarray from pursuing effective reforms in any direction.

In short, the evolution of the statist political economies to date reveals an equivocal and ambiguous picture of the recent development of economic and corporate governance regimes. And in this ambiguity lies the unsettled and unsettling character of our age. To date, no clear theoretical or political alternative has emerged to the stark logical and substantive austerity of neo-liberalism and deregulation. Vague nostrums like the 'Third Way' and the '*Neue Mitte*' do not rise to this level of intellectual or programmatic clarity and the ongoing policy vacillations and indeterminate ideological commitments of contemporary centre-left governments in the United States and Europe amply testify to this fact. However, as the above analysis suggests, national political institutions remain powerful and distinctive determinants of political economic adjustment. Globalization does not determine the form of national institutions any more than nations govern globalization.