

**The Political Paradox of Finance Capitalism:  
Center-Left Party Politics in  
Corporate Governance Reform**

*John W. Cioffi (University of California, Riverside, USA)*

*Martin Höpner (Max Planck Institute for the Study of Societies, Germany)*

Paper for presentation at the Inaugural Workshop of the Amsterdam Research Centre for Corporate Governance Regulation, 17-18 December 2004, Vrije Universiteit Amsterdam.

## I. Introduction: The Political Puzzle of Corporate Governance Reform

The last two decades have witnessed substantial changes in the political economic structure and functioning of the advanced industrial countries. Despite the well-established existence of national “varieties” of capitalism, national political economies have experienced rapid and substantial change during the 1990s. Corporate governance reforms, which include the restructuring of both the corporate firm and domestic securities markets, have assumed a central position in the politics of structural change during the past decade. The provenance, significance, and implications of these reforms confound accounts of political economic change and policy-making voiced by many scholars and policy-makers. Through corporate governance reform, political actors have intervened directly in the organizational structure and allocation of power within the private sphere at its institutional foundations: the corporate firm. Yet, the politics of reform followed neither the logic of path dependence nor the neo-liberal trajectory towards unalloyed shareholder capitalism and a market-based financial system. The politics of corporate governance over the past decade reflects the persistence of established institutional arrangements, legal frameworks, and interest group politics. Yet, a detailed analysis of corporate governance reforms also reveals substantial changes in the policy positions of center-left political parties, financial institutions, and organized labor that provided the preconditions for structural change and the development national variants of an emerging international paradigm of finance capitalism.

In this paper we show that political actors and parties matter decisively in institutional and regulatory reform processes. By examining the country cases of the United States, Germany, France, and Italy, we seek to explain a striking political paradox of finance capitalism and corporate governance reform: *center-left political parties are the driving force behind corporate governance reform and the institutional adjustment to finance capitalism, while the right of center parties tend to protect managerialism and organized capitalism while resisting reform.* We empirically confirm this general hypothesis and offer a number of explanations for this peculiar political dynamic. In doing so, we combine theories of phases and varieties of capitalism with existing research on parties and interest groups to fashion a better understanding of the political dynamics underlying economic change.

It is reasonable to hypothesize that the center-left should oppose, rather than support, corporate governance reform and the institutionalization of finance capitalism.<sup>1</sup> First, at first glance, the distributional consequences of corporate governance reform and the rise of finance capitalism would appear to conflict with traditional left-wing political commitments to working class and low-income constituencies. Increased shareholder orientation limits the ability to transfer resources from shareholders to employees and from profitable sectors and/or corporate subsidiaries to financially weaker counterparts. As a consequence, increased shareholder orientation is likely to sharpen incentives to increase short-term corporate profitability and shareholder value, reduce the economic security provided by stable financing through “patient capital” and cross-subsidization (e.g., by means of diversification), and shift income and wealth from wage-earners to shareholders.<sup>2</sup> Second, finance capitalism and corporate governance reform increase the likelihood of hostile takeovers that tend to shift rents to shareholders.<sup>3</sup> This would be a particularly dramatic departure in Continental Europe where labor interests counterbalance shareholders and managers have largely relied on negotiated transfers of controlling blocks of stock for sector consolidation and relational bank finance to facilitate corporate restructuring. This points to the third reason why center-left support for corporate governance reform is counterintuitive: reform appears to conflict with the interests of employees and to decrease the power and influence of employees and organized labor within the firm and economy at large. Center-left parties should oppose a policy agenda that would harm one of their core constituencies.

In fact, the evidence indicates the reverse. Although our country cases represent different forms of political economic organization and nationally distinctive center-left parties, we find a clear and distinct pattern: Center-left parties have been more amenable to corporate governance reform and financial system liberalization than their political counterparts on the right. Indeed, center-left parties and politicians have often been instrumental proponents of reform while conservative parties and politicians have typically resisted reform and defended the interests of incumbent managers. We examine the manifestation of this political paradox of finance

---

<sup>1</sup> For an extended argument along these lines *see* Roe, 2003.

<sup>2</sup> *See, e.g.,* de Jong, 1997.

<sup>3</sup> As Shleifer and Summers (1988) argued long ago, shareholder gains from hostile takeovers tend to result not from increased efficiency, but from the breach of implicit contracts with employees and subcontractors. Hostile takeovers are likely to breach the trust inside companies and do not so much create value as shift rents. Labor, one might conclude, should therefore oppose the promotion of markets for corporate control.

capitalism across four country cases: France, Italy, Germany, and the United States. All four countries belong to the group of the seven largest and wealthiest industrial nations (G7), yet possessed divergent political economic structures with very different financial systems and corporate governance regimes during the post-war period.<sup>4</sup> In France, the state used ownership of industrial enterprises and banks along with tight governmental control over credit and finance as levers of statist economic planning and management. Major firms were situated in a hierarchical political economic structure in which markets remained stunted and managerial autonomy was constrained by state oversight and control. In sum, the state adopted coordination functions that belong to banks, family capitalists, and the capital market in the other three cases.<sup>5</sup> The Italian case, in partial contrast, combined high levels of state ownership of financial institutions with a “familial” form of capitalism defined by tight networks of family-owned firms and conservative political elites.<sup>6</sup> Compared with France and Germany the Italian political economy is far less formally coordinated and organized for purposes of economic policy, but these more informal network arrangements did reinforce elite relationships—but at the price of extraordinary levels of corruption and an undeveloped financial system. Germany represents a classic case of a “coordinated market economy” in which centralized peak associations, strong unions, financial networks of corporations and banks, and intra-firm representation of financial and employee interests institutionalize a high level of negotiation and strategic coordination within the economy and the corporate firm. While state ownership remained fairly low by French or Italian standards, the country’s capital markets remained undeveloped in a bank-centered financial system. The United States exemplifies the “liberal market economy,” with a market-driven financial system, liquid and well-developed securities markets, diffuse share ownership that separates ownership from corporate control, and extremely weak unions and employee representation within the firm. These characteristics made American corporate governance a power game between managers and shareholders with managers in the dominant position.<sup>7</sup>

Although these national political economies are often described as fitting within a broader typology of political economic models, such as the “coordinated market economies” and

---

<sup>4</sup> For classic general descriptions of these national post-war models see Shonfield, 1965: 239-297; Zysman, 1983.

<sup>5</sup> See Hancké, 2001, Shonfield, 1965: 71-87.

<sup>6</sup> See Melis, 2000.

<sup>7</sup> See Fligstein, 2001: 123-169.

“liberal market economies” theorized by Peter Hall and David Soskice<sup>8</sup>, we see an overarching political dynamic of economic change and crisis, political entrepreneurship and part repositioning, coalition formation, and institutional and regulatory reform. Given the wide variations of law and institutional structures across our cases, the parallels in the corporate governance reform processes and dynamics are all the more striking and significant. Notably, the political logic of reform that we set out below cuts across the liberal market economy (the United States) and the coordinated market economy (Germany, and to a lesser extent, France and Italy) paradigms.<sup>9</sup> The following sections will introduce the French, Italian, German, and American cases in greater illustrative, rather than exhaustive, detail in order to set out the basic contours of the national corporate governance regimes and their reform. After brief descriptions of the respective national corporate governance systems in their state until the early 1980s, the main causes for reforms and the political constellations will be specified. The main theoretical findings and implications then follow in a synthetic comparative section.

Our findings have implications for political science, sociology, political economy, and law. This paper speaks to a policy field that, so far, has not been systematically examined within the political parties literature.<sup>10</sup> Parties, we argue, do indeed matter in corporate governance reform. However, in the countries we observed, center-left parties pushed through corporate governance reform, not the center-right. Center-left parties are not necessarily comprised of those favoring “politics against markets,”<sup>11</sup> but tend to favor—compared to the center-right—market-enabling and enforcing law and regulation that marks a new and somewhat surprising turn in corporate governance and political economic development more generally. We call this the political or party paradox of corporate governance reform and financial capitalism, as it runs counter to the expectations of the mainstream political economy literature. Likewise, our findings contradict a large law and economics literature on corporate governance that identifies the center-left and organized labor as inimical to corporate governance reform and shareholder interests.

---

<sup>8</sup> See Soskice, 1999, Hall and Soskice, 2001; cf. Hall, 1999.

<sup>9</sup> Compare Soskice, 1999: 107-110 (arguing that divergent comparative economic advantages of the LME and CME models give rise to different institutional and interest group configurations that maintain path dependence).

<sup>10</sup> See, e.g., Alt, 1985; Alvarez, et al., 1991; Hibbs, 1977; Schmidt, 2002.

<sup>11</sup> Esping-Andersen, 1985.

Second, the paper speaks to the problem of institutional complementarity that is so central to the literature on national varieties of capitalism.<sup>12</sup> This literature presents a model of political economic organization in which stakeholder-oriented corporate governance, bank-centered financial systems, and highly coordinated labor relations systems form complementary institutional relations within coordinated market economies. Conversely, shareholder-centered corporate governance, market-driven financial systems, and market based employment relations are held to be complementary within the institutional paradigm of the liberal market economies. However, we find that labor movements across our country cases supported or at least acquiesced in pro-financial market and pro-shareholder reforms that would seem to run contrary to their economic interests and to disrupt the systemic institutional complementarities of the more coordinated economic models of the European cases. In fact, the center-left does not seem to care about institutional complementarities. We find tensions, rather than harmony, inside production regimes and national institutional arrangements that spill over into the political realm of policymaking and threaten to destabilize national political economic models and to undermine institutional complementarities.<sup>13</sup>

Finally, our findings diverge from the recent work of Mark Roe (2003) that argues that agency costs increase with the political strength of the labor movement and social democratic parties. Supervisory board and works council codetermination, in this view, allows managers to side with employees against shareholders. Supervisory board codetermination reduces shareholders' incentives to increase transparency because employees will appropriate the returns from better governance. This creates incentives for shareholders to pursue concentrated ownership to retain direct control in the firm, without need of transparency or disclosure regulations, in order to appropriate rents that would otherwise be divided among managers and employees. Concentrated ownership structures are therefore actually a counter-formation *against* organized labor and social democracy. In Roe's model, managers – by definition – find themselves somewhere in between shareholders and employees, pressed to side with either the one or the other group. In this analytic model, employees always increase agency costs. We insist

---

<sup>12</sup> Hall and Soskice, 2001; Streeck and Yamamura, 2001.

<sup>13</sup> Complementarity refers to a situation in which the functionality of an institutional form is conditioned by the existence of other institutional forms. The actors who participate in and benefit from the beneficial interaction effects of complementary institutions did not necessarily intend to create them. For example, Aoki (1993) characterized the interplay of Japanese lifetime employment and monitoring by banks as an "unintended fit." Our analysis suggests that the destabilization and destruction of such complementarity may be equally unintended.

that this fails to understand the role that the center-left has played in corporate governance reform. By pressing for substantial securities regulation and company law reforms, the left has not only benefited labor, it has also strengthened shareholders and other financial interests. It has re-established the balance among shareholders, managers, and employees in the shareholders' favor.

## II. France: From Statism, to Privatization, to Regulatory Reform

Historically, France was the most highly centralized and statist of the political economies among the four country cases analyzed here. Not only did the French state wholly own or control a large number of the country's leading industrial and financial firms,<sup>14</sup> but it also maintained tight control over the allocation of credit and thus over banks and corporate finance.<sup>15</sup> Law, regulation, and state policy did not tend to enable or serve as the foundation for markets and autonomous private economic activity. Rather, the regulatory structure reflected the centralization of the French state and maximized the discretionary authority and power of state actors to formulate and carry out governmental economic planning and industrial policy.

Prior to 1967, securities regulation—a crucial foundation of market finance and component of corporate governance—was not even a recognized area of French law.<sup>16</sup> Consequently, until the late-1980s, France possessed weak and poorly enforced transparency and disclosure rules governing public companies and securities markets. Instead of a law and regulation-based financial system that would allow and encourage the development of market finance and the formation of autonomous market relationships among private economic actors, administrative officials exercised extensive discretionary control over financial regulation, finance, and credit. The post-war state used the banks as pliant instruments of state policy and power within a highly centralized and concentrated bank-dominated financial system. The national financial system was designed to serve the interests of state actors and the ends of state policy.

---

<sup>14</sup> By the early 1980s, the state owned 100 per cent of thirteen of the twenty largest industrial firms, most of the country's leading banks (including Suez, Paribas, Crédit Lyonnais, Société Générale, and BNP), and controlling stakes, minority stakes, and substantial debt positions in numerous other firms. See O'Sullivan, 2001: pp. 4-8.

<sup>15</sup> See generally, Zysman, 1977; 1983, chapter 3.

<sup>16</sup> See Fanto, 1998a: pp. 31, 48 pp. 1998b: 97-120.

In 1967, France's first securities law created the first national securities markets regulator, the Commission des Operations de Bourse (the COB), and a rudimentary framework for financial disclosure.<sup>17</sup> The law required companies to issue a COB approved prospectus (“*note d'information*”) prior to an initial public offering or the listing of securities on an exchange.<sup>18</sup> The law also required the appointment of an official company auditor (the “*commissaire aux comptes*”) to assess and report on the corporation's financial results and internal controls.<sup>19</sup> But the intensely statist character of industrial policy and corporate finance and governance limited the actual transparency of corporate accounts and the accountability of managers to shareholders and other stakeholders. Firm finances remained opaque, corporate management highly centralized and hierarchical, and managerial power largely unchecked within the firm and its nominal governance structures. Tightly knit political-bureaucratic-corporate elites decided policy and corporate strategy with little or no transparency and regulatory enforcement, and thus minimal accountability. These state-firm relations fostered the corruption and corporate financial scandals that have long pervaded French politics and business.<sup>20</sup>

French company law reinforced the insider domination of corporate firms by managers and political-managerial relationships. French public corporations are typically organized as *societes anonymes* (SA) with a *unitary board* consisting of a board of directors (the “*conseil d'administration*”) chaired and dominated by the firm's CEO (the “*President Directeur General*,” or PDG).<sup>21</sup> At the most formal (and superficial) level, the typical French unitary board structure more closely resembles the American and British corporate structure than the German dual board structure. However, French company law subordinates shareholder interests to “corporate interests” and the public interest embodied in state economic policies. There are few

---

<sup>17</sup> Code des Societes, Ordonnance NE 67-833 du septembre 1967 (as amended), arts. 6, 7 (Fr.). For discussions of French securities law reforms, see Fanto, 1998b: pp. 111-112; 1995: pp. 41-44.

<sup>18</sup> See Code des Societes, Ordonnance NE 67-833 du septembre 1967 (as amended), arts. 6, 7 (Fr.); Fanto, 1998b: p. 111.

<sup>19</sup> Code des Societes, Loi NE 66-537 du 24 juillet 1966, arts. 218-35 (Fr.) (rules requiring the appointment of an official auditor and defining its independent role).

<sup>20</sup> See de Quillacq, 2002 (“The simultaneous crises at France Telecom and Vivendi, . . . ought to be prompting some deep soul-searching in France . . . As usual the old boy network is trying to solve things behind closed doors.”); Henley, 2003 (“Trial for huge kickbacks by publicly owned firm reveals years of corruption at top of French state”). See also, e.g., International Securities Regulation Reporter, 1989; Meny, 2001.

<sup>21</sup> Code des Societes, Loi NE 66-537 du 24 juillet 1966, arts. 89-117. A firm may choose a *dual structure*, *id.*: arts. 118-150, partially copied from the German dual board form, but this option is seldom adopted.

legal provisions for fiduciary duties to effectively protect shareholders.<sup>22</sup> Throughout the post-war period boards protected the interests of controlling shareholders and attended to the demands of state economic policy rather than the interests of minority shareholders. Further, the combination of French company and securities law, the state's administrative control over finance, and its substantial role in sectoral organization left no room for an active market for corporate control.

A history of ideological labor militancy and uncooperative labor relations has not only profoundly shaped the French labor relations system, but has also induced the exclusion of employees from firm governance. In part, the state organized labor relations through government-mediated collective agreements between weak and fragmented unions and weak employers' organizations. A history of chronic labor-management conflict led to the exclusion of employees from firm governance. A tradition of managerial paternalism toward employees took the place of formal employee participation and consultation within corporate decision-making. Job protection rights under national employment law, state mediated wage agreements, and national incomes policies defined labor relations both in more individualistic and more statist terms.

The highly centralized and concentrated market structure of the French corporate economy depended on state finance, cross-subsidies, and credit allocation, along with extensive state ownership. Ownership structures were likewise centralized, either through state ownership or through the predominance of "blockholding" shareholders and family ownership of closely held firms.<sup>23</sup> Unlike Germany, financial institutions historically have not themselves controlled corporate enterprise in France.<sup>24</sup> Indeed, financial institutions served as *conduits* of state control over the corporation and the industrial economy. State administration of finance and widespread public ownership of enterprise displaced market-driven financial relations and constrained the broader development of financial markets.<sup>25</sup> Markets remained truncated and the highly

---

<sup>22</sup> See Fanto, 1995: text accompanying nn. 115-117. Large French publicly traded companies also have strong anti-takeover protection, by law or through the corporate charter. *Id.* (citing Nunes, Keith D., *et al.*, *French & SEC Securities Regulation: The Search for Transparency and Openness in Decisionmaking*, *Vanderbilt Journal of Transnational Law*, vol. 26, p. 242 (1993)).

<sup>23</sup> See Fanto, 1998b: pp. 106-107.

<sup>24</sup> See *id.*: pp. 107-108 ("rather, they have served as proxies for the State or as financial advisors to a controlling shareholder, be it the State or a family").

<sup>25</sup> Levy, 1999. For analyses of French corporate governance in the context of statist economic policy, see, e.g., Fanto, 1995: p. 38; Charkham, 1994: pp. 130-131; Oxford Analytica, 1992: 96.

centralized management structure of the firm matched the centralization of the state.<sup>26</sup>

Paradoxically, managerial power thrived in this statist environment. Shareholder rights, institutional investment, and codetermination laws limit managerial dominance, but would have impaired state control over the corporation as a mechanism of economic policy. Accordingly, these legal mechanisms never developed under the *dirigiste* regime.

The transformation of corporate governance in France during the past fifteen years cannot be understood apart from the privatization of state-owned-enterprises during the 1980s and 1990s. The elimination of capital controls that ushered in the opening and internationalization of financial markets steadily eroded state capacity to control the allocation of finance as a mechanism of industrial policy. Further, as the “national champions” created and financed by the state proved increasingly uncompetitive in European and world markets, the political costs of statist economic governance rose throughout the 1970s and 1980s.<sup>27</sup> By the mid-1980s, state actors sought to escape the increasing burden of the declining firms’ financial demands by withdrawing from the allocation and rationing of credit as a component of industrial policy.

This need to separate firm and government finances led to two waves of privatizations that set the stage for corporate governance reform in France.<sup>28</sup> The first wave, during 1986-1987, took place under the conservative Minister of Finance Eduoard Balladur and the second in 1993 under Balladur as Prime Minister.<sup>29</sup> However, upon returning to power in 1988, the Socialists did not reverse and, in fact, continued the privatization process through the sales of minority equity stakes in state-owned companies. Despite campaigning on promises to halt the sale of state holdings, the Jospin government briefly *accelerated* the privatization program after the Socialists again took power in 1997. And the privatization continues at present.<sup>30</sup>

Privatization as a policy program had both ideological and pragmatic roots, but eventually became a matter of elite consensus among the center-right and the center-left. The privatizations of the 1986-1987 were largely a product of ideological politics in which the new conservative government sought to reverse the extensive 1982-1983 nationalization program of Mitterrand’s Socialist government. In doing so, the conservatives privatized the state’s better

---

<sup>26</sup> See generally Zysman, 1977.

<sup>27</sup> See Deeg and Perez, 1999.

<sup>28</sup> For accounts of the complex, contentious, and ideological politics of French privatization and economic reform during the 1980s and 1990s, see Levy, 1999; see also Deeg and Perez, 1999.

<sup>29</sup> For discussions of French privatization, see O’Sullivan, 2001; Morin, 2000; Schmidt, 1996; Goldstein, 1996.

<sup>30</sup> See, e.g., Mallet, 2002.

performing companies.<sup>31</sup> This privatization strategy intensified the incentives impelling the state's disengagement from economic and financial management. By the 1990s, poor performance of the remaining state-owned companies and financial demands by large French corporations sapped the state's fiscal position,<sup>32</sup> while the liberalization of financial markets eroded state control over finance that had underpinned the post-war French political economy and industrial policy. During the same period, disclosure of political corruption and successive corporate finance scandals undermined the legitimacy of established links between firms and the state financial bureaucracy. Under these conditions, privatization became a self-reinforcing policy that persisted through changes in government and party dominance. Privatization (sometimes under cover of EU obligations), financial system modernization, and corporate governance reform served the purpose of extracting the state from responsibilities for corporate and economic outcomes that taxed its capacities and resources while producing diminishing political and economic returns.<sup>33</sup>

Market developments drove financial liberalization even further than state actors initially intended. Government officials attempted to restructure the French corporate economy during the privatization process through the deliberate strategic allocation of equity into cross-shareholding networks in an attempt to replicate the self-protective and stable ownership structures of French industry. Known as "*les noyaux durs*" (the hard core) these cross-shareholding networks linked large banks, core industrial firms, and suppliers. In France, however, the network of cross-shareholding broke down during the mid to late-1990s firms found themselves dependent on capital markets for finance at the same time their share prices began collapsing and under increasing pressure to generate revenue, profits and greater financial liquidity. Because they were not locked into ownership networks by capital gains taxes like their German counterparts, the privatized French firms could and did seek to raise cash by selling off cross-shareholdings. This led to an unraveling of the state's meticulously crafted cross-shareholding networks, as firms and financial institutions sold off these assets. The result has been the emergence of a more active equity market with higher levels of "free float" (the

---

<sup>31</sup> O'Sullivan, 2001: pp. 6-7.

<sup>32</sup> *Id.*: 26-27.

<sup>33</sup> See Deeg and Perez, 1999. This did not mean that the French state withdrew into neo-liberalism. As Jonah Levy argues, the erosion of *dirigiste* policy was matched through the 1980s and 1990s by an expansion of welfare state programs and expenditures to cushion the blows of the market. See Levy, 1999, 2004 (forthcoming).

percentage of shares actively traded and not locked into immobile holdings) and greater market liquidity,<sup>34</sup> the growing presence of foreign shareholders in French firms, and a wave of consolidating takeovers that dramatically increased the practical importance of corporate governance in France.

This new market structure was reinforced by legal and regulatory reforms that transformed the institutional and juridical terrain of French corporate governance. Led by state policymakers, by the late-1980s a general consensus emerged that the development of capital markets in place of statist financial control was essential to improved corporate and macroeconomic performance.<sup>35</sup> Privatization through public share offerings forced state actors to confront the necessity of the financial system and corporate governance reforms in order to ensure that French firms could function and find financing once the state withdrew financing. More stringent securities regulation and shareholder protections under company law were pursued to assuage the doubts of a public unused to equity investment and foreign investors suspicious of underdeveloped, insider-dominated French markets. Corporate governance reform therefore followed proximately from the state policy of privatization and withdrawal disengagement from direct control over finance and economic planning.

French corporate governance reforms began in the area of securities markets regulation.<sup>36</sup> In 1987 brokers were allowed to trade in securities on their own account to increase the liquidity of French markets.<sup>37</sup> However, the critical juncture that heralded the fundamental reform of French securities markets regulation came with the enactment of the “Law on Security and Disclosure in the Financial Markets” of 1988 and the “Security and Disclosure Law” of 1989.<sup>38</sup> The reforms formed part of the historic “U-turn” away from orthodox socialist and Keynesian policies that began in the mid-1980s, but were also immediately motivated by two highly publicized, and highly politicized, financial market scandals. The first scandal involved insider trading involving Pechiney, SA, a state-owned French aluminum company, and a top contributor

---

<sup>34</sup> The development of the national equity market has been limited by the persistence of public pensions, and the inability of policymakers to institute a private pension scheme that could invest in, and generate higher demand for, corporate securities in the open market.

<sup>35</sup> See Fanto, 1998b: n. 53.

<sup>36</sup> Prior to the first wave of privatizations in 1986, the government substantially amended the law governing independent auditors in 1984 to expand their oversight and reporting functions and to ensure their independence from management. Fanto, 1998b: p. 112.

<sup>37</sup> See Fanto, 1995: pp. 42-43; cf. Goldman, 1992: pp. 232-233 (reforms beginning in 1985).

<sup>38</sup> See Loi NE 88-70 du 22 janvier 1988 (the “Law on Security and Disclosure in the Financial Markets”); Loi NE 89531 du 2 aout 1989 (“Security and Disclosure Law”).

to Mitterrand's Socialist Party. In the second, the new Socialist Minister of Finance orchestrated a hostile takeover attempt of Société Générale to pry it loose from the control of political conservatives installed by the former conservative government when the bank was privatized.<sup>39</sup> The reforms targeted not only private abuses of the markets, but the corruption and manipulation that emanated from the state's control over finance and the privatization process.<sup>40</sup> More importantly, however, the reforms created the legal and regulatory infrastructure for autonomous corporations and market finance in the private sphere while buttressing the shaky reputation of the scandal-tainted Socialist government.

The 1988 reforms substantially expanded the enforcement power of the COB and imposed stricter disclosure, market manipulation, and insider-trading rules. The law also established two largely self-regulatory bodies, the *Conseil des Bourses de Valeurs* ("CBV"), and the *Société des Bourses Françaises* ("SBF"), to oversee the stock exchanges in matters such as broker regulation, listing procedures and tender offers.<sup>41</sup> The Security and Disclosure Law of 1989 gave the COB sweeping investigative and punitive powers, including the authority to impose monetary and injunctive sanctions and to cooperate with foreign regulators.<sup>42</sup> As in securities regulation, French company law has changed with surprising swiftness and magnitude. Company law reforms have appropriated Anglo-American company law structures to a surprising degree, given the *dirigiste* tradition in French economic policy and governance. The most far-reaching reforms of internal governance structures and processes in France began not as legislation or regulation, but as a "code of best practice" drafted by a private commission. The Viénot Reports of 1995 and 1999 were the product of a commission established by France's two main employer bodies (the *Conseil National du Patronat Français* and the *Association Française des Entreprises Privées*) and named for its chair, Société Générale chairman Marc

---

<sup>39</sup> See Goldman, 1992: pp. 238-240.

<sup>40</sup> *Id.*

<sup>41</sup> The CBV is charged with drafting rules governing the stock exchange, subject to the approval of the Minister of Finance following consultation and advice of the COB. The CBV was renamed the *Conseil des Marchés Financiers* in 1996. See Loi 96-597 du 2 juillet 1996. The CBV delegated the SBF to supervise and control the securities market's administration, security, development, and promotion. Goldman, 1992: p. 238; see Fanto, 1998b: p. 111.

<sup>42</sup> The COB can impose fines up to the greater of 10,000 million francs or ten times the amount of unlawful profit, along with the authority to search any private or public premises, question suspects impound any documents relating to an investigation (with the approval of the Tribunal de Grande Instance and the assistance of a judicial police officer). The COB may also seek an order from the Tribunal to seize property, freeze assets, place funds in escrow, and issue injunctions, temporarily suspend persons from their professions. See Goldman, 1992: pp. 242-243. Following this extraordinary strengthening of regulatory authority, the COB's enforcement powers exceeded those of the SEC in many respects.

Viénot. The influential 1995 Report set forth a *voluntary* code of best practices, without formal legal force or regulatory enforcement, but nonetheless calling for substantial corporate governance reforms to protect and elevate the shareholder interests through restructuring of the board of directors, improved disclosure, and incentive compensation.<sup>43</sup>

In July 1996, a *government* commission chaired by Senator Philippe Marini issued a parliamentary report proposing sweeping reforms in French corporate law.<sup>44</sup> Just one year after the first Viénot Report rejected formal changes to French company law, the Marini Report proposed significant legal reforms in corporate governance—including a number of the Viénot recommendations. The Marini Report expressly advocated the embrace of Anglo-American corporate governance practices and norms in French finance and law in order to remain competitive in an increasingly international financial system.<sup>45</sup> In keeping with this Anglo-American approach, the Report pressed for company law reforms that avoided rigid mandatory rules and instead *enabled* firms to strengthen their boards and adopt more efficient corporate governance structures. Significantly, the Marini agenda largely stalled in the conservative controlled Parliament.<sup>46</sup>

---

<sup>43</sup> The Viénot Code recommended, *inter alia*, that:

- Boards should actively participate in strategically important corporate decisions;
- The board should have at least two independent directors;
- Cross-shareholding should be eliminated;
- Companies should not have interlocking directorates, and reciprocal directors should not serve on audit or compensation committees;
- Firms should disclose annually its decision making processes and the number of audit, compensation, and nomination committee meetings;
- The board should have audit, compensation and nomination committees, comprised of at least three members and at least one independent director
- Executive and employee representatives should not sit on the audit or compensation committees;
- At least one independent director and the board chairman should sit on the nomination committee;
- Directors should own a “significant” number of company shares.

<sup>44</sup> Senate, no. 124-1996-1997.

<sup>45</sup> Among other proposals, the Marini Report advocated the following company law reforms:

- Boards should be empowered to form committees and names their membership;
- Corporations should have the legal right (but not an obligation) to separate the offices of chief executive and board chair while maintaining a unitary board structure;
- Corporations should be obliged to disclose a list of owners to all shareholders;
- Shareholders should be given one month’s notice of a general meeting (up from 15 days);
- Shareholders should have the right to assign their proxy vote to an independent entity rather than management;
- Directors should not serve on more than five boards.

<sup>46</sup> Parliament did enact a law requiring pension funds to vote their shares to ensure some level of institutional activism. See Loi NE 97-277 du 25 mars 1997, § 13. This law emulated a 1988 American Department of Labor

Following the Socialists' 1997 election victory, the Socialist government, along with bureaucratic allies in the Ministry of Finance, pressed for legislation to carry out the Viénot and Marini recommendations. After a tortuous two-year battle in which conservatives in control of the *Senat* (the upper house of Parliament) repeatedly blocked and delayed the legislation, the Parliament passed the government's New Economic Regulations ("NRE") law in May 2001.<sup>47</sup> The law improved corporate disclosure of finances and managerial compensation, liberalized litigation rules for the enforcement of shareholder rights, and enabled firms to adopt more shareholder-friendly board and management structures (*i.e.*, the separation of the CEO and Board Chair). It also reformed tender offer and corporate takeover procedures to protect both minority shareholders and the interests of employees. However, the effect of conservative resistance to reform is indicated by what the NRE law *fails* to address. There is no "one-share, one-vote" rule to enforce shareholder equality (thus leaving intact inside and government control of firms through "golden shares" or classes of stock with disproportionate voting rights). France still has no legal rules defining director independence or mandating the appointment of independent directors, and no legal provisions requiring the formation of board committees (with or without a majority of independent directors) to reduce conflicts of interest in crucial matters such as auditing and compensation.

Though French conservatives have resisted substantial changes to internal corporate structures and governance procedures, they have supported continued reform and development of securities regulation. The strengthening and centralization of securities regulation continued under the conservative government of President Chirac and Prime Minister Raffarin that took office following the May 2002 elections. The Financial Security Act of August 1, 2003 established a new securities regulator, the *Autorité des marchés financiers* (AMF) that merged COB, the *Conseil des Marchés Financiers* (CMF), and a third regulatory body, the *Conseil de Discipline de la Gestion Financière* (CDGF).<sup>48</sup> The passage of this law under a conservative

---

ruling requiring pension funds under the Department's jurisdiction to vote their proxies. However, based on the American experience, the formal requirement of voting without more does not ensure activism, or even attentiveness. The effects of the French law are especially unlikely to alter governance practice, given that government policy has not yet resolved the intense conflicts over pension reform and private funds remain undeveloped.

<sup>47</sup> See *Loi relative aux nouvelles réglementations économiques*, of 15th May, 2001, no. 2001-420.

<sup>48</sup> See *Loi de sécurité financière* dated 1 August 2003, published in the Official Journal of the French Republic, issue 177 dated 2 August 2003 at p. 13220. This merger of regulators was particularly important in the area of corporate take-overs. Prior to the 2003 reform, regulatory oversight was inefficiently fragmented between the COB, which ruled

government indicates the broad consensus that has developed throughout the political elite favoring improved securities regulation and the development of French securities markets. The limits to this consensus, however, are reflected in the greater conflict and resulting limitations on the more fundamental reform of company law and the internal structure of the corporation. Though supported by centrist Socialists, corporate governance activists, and foreign institutional investors, the right generally resisted these reform proposals.

Corporate governance reform in France remains marked by political ambivalence, even on the pro-reform center-left. Although most French industry has been privatized, the state has not completely relinquished its grip upon industry and the economy. Foreign institutional investors hold 35% to 40% of the French equity market, but the French government retains extensive powers to block control transactions and can intervene selectively in merger and acquisition activity. The state holds a number of “golden shares” with disproportionate voting (or veto) power that give it control rights over some privatized companies—though this practice is now under attack in the European Court of Justice and is unlikely to withstand judicial scrutiny. In addition, the Ministry of Finance can block the acquisition of more than 20% of a French firm by a non-EU party. Hence, the state combined liberalizing and interventionist policies in overseeing sectoral consolidation to ensure that French industry remains largely in the hands of French managers.<sup>49</sup>

However, the French state under Prime Minister Lionel Jospin adopted a *deliberate policy* of allowing market forces to drive consolidation and adjustment if managers cannot come to voluntary agreements. 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

---

on whether a bid could proceed, and the CMF, which reviewed the adequacy of the compensation received by minority shareholders in a takeover.

<sup>49</sup> See Iskandar, 1999. A series of massive mergers involving the pairings of BNP and Paribas, Total-Fina and Elf Aquitaine, and Carrefour and Promodes represents 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. Likewise, other large cross-border mergers involving French corporations have left the French firm in the dominant position. The determination of government officials to maintain a large measure of French control over traditionally French firms is also seen in the government’s bailout of France Telecom and its appointment of a member of the established political elite to run Vivendi after its CEO pursued an American-style merger-driven expansion that drove the company bankruptcy financial crisis. However, the failure of the Ministry of Finance to resolve the hostile takeover battle among BNP, Paribas, and Societe General revealed the limits of the state’s willingness and capacity to guide the consolidation process or to impose acquisitions on private firms. Cf. Read, 1999.

battles reminiscent of the United States.<sup>50</sup> The BNP-Paribas bank merger that transformed the French financial sector also signaled the French government's policy choice to allow market forces, and in particular a new market for corporate control through hostile takeovers, to reshape French finance. The outcome of the BNP-Paribas-Societe General hostile takeover battle, in which BNP won control over Paribas through a hostile bid, exposed Societe General to acquisition by a foreign bank. The result was probably the least favorable outcome for all three banks and for economic nationalists. The French state could have blocked any of the bids and imposed a resolution, but *chose* not to. This outcome hinged on the victory of the COB and the Banque de France as champions of shareholder value over *dirigiste* traditionalists in the Trésor Public (within the Ministry of Finance) and the interests of incumbent managers.<sup>51</sup>

The emergence of hostile takeovers, restructuring and consolidation, and increased management turnover, reflects the profound shift in government policy and the growing power and influence of pro-shareholder officials, institutions, and ideology in France. The business and political culture of insulated, self-protective elite networks that defined the post-war political economy is eroding rapidly in the absence of the institutional arrangements that perpetuated it.<sup>52</sup> The most striking political aspect of this transformation, however, is the left's role in the reforms and changes in official policy. Pro-shareholder government policy reached its peak under the Socialist government, and has proved useful as a new rhetorical appeal to anti-managerial, anti-elite, and anti-hierarchical sentiments that have become more attractive on the left as traditional class cleavages and politics lose their political salience and utility.<sup>53</sup> Under restored conservative rule following the 2002 elections, corporate governance reforms are now once again marginalized but political corruption, financial scandal, and corporate performance remain vital issues. Government policy towards corporate governance, ownership, and control has resumed a more nationalistic tenor, evincing skepticism of foreign takeovers (though not of investment) and even refurbishing the idea of national champions. Under Finance Minister Nicholas Sarkozy, the

---

<sup>50</sup> See Dixon, 2003.

<sup>51</sup> See Read, 1999.

<sup>52</sup> However, networks of government and financial elites may be making a comeback as they retake control from CEOs of France Telecom and Vivendi whose disastrous forays into American-style corporate capitalism of mergers and acquisitions nearly destroyed each company. See de Quillacq, 2002; Cowell, 2002 (French government instrumental in installing established member of elite as CEO of Vivendi after financial crisis).

<sup>53</sup> Now that the conservatives control both the Presidency and the government, corporate governance reform has again receded on the political agenda, while the Socialists continue to demand further reforms. Cf. Cori, Nicolas, "Le PS veut durcir la loi sur les PDG," *Liberation*, December 11, 2003, available online at <http://www.liberation.fr/page.php?Article=164499>.

state has increased its activism in controlling mergers and acquisitions and in bailing out troubled firms for political reasons. This suggests that the corporate governance debate will remain a trigger point in a new and still inchoate form of class politics in France.

### III. Italy: The Ambivalent Reform of an Insiders' Corporate Economy

Like France, until the early 1990s, Italian finance and corporate governance was characterized by a high level of state ownership of enterprises, a bank-centered financial system, weak securities regulation and shareholder rights, undeveloped securities markets, and close—and often corrupt—relations between corporate elites and senior government and political party officials. Unlike France, a tightly knit group of elite families whose economic, political, and social interconnections defined and dominated the corporate economy and corporate governance without reinforcement by the state. With stock market capitalization worth only 14 percent of GDP in 1990, Italy had one of the most underdeveloped capital markets among Western industrialized nations (compared to 22 % in Germany, 26 % in France, 56 % in the US; *see* Table 1, below). Ownership was highly concentrated in the hands of family owners, the state, and other corporations.<sup>54</sup> The extraordinary predominance of a number of families in corporate ownership and control has led the Italian corporate governance regime being referred to as “family capitalism.”<sup>55</sup> Although political economy research still lacks a systematic comparison of company network structures in OECD countries, case studies indicate that Italian corporate cross-shareholding and interlocking directorates are even more extensive and intensive than in Germany.<sup>56</sup> These structures gave rise to the impervious “salotto buono”, the cultivated drawingroom clique of family capitalists. Italian law also provided an extraordinary low level of minority shareholder protection.<sup>57</sup> Consequently, majority equity stakes (or those controlling a majority of votes) command an abnormally high control premium compared with the price of minority shares.<sup>58</sup>

---

<sup>54</sup> *See* La Porta, et al., 1998b.

<sup>55</sup> *See, e.g.*, Pagano and Trento 2002.

<sup>56</sup> Bianchi, Bianco and Enriques, 2001; Melis, 2000.

<sup>57</sup> La Porta, et al., 1998a.

<sup>58</sup> Dyck and Zingales, 2001: 16, 47; *see also* the data in Table 1.

Italy also had one of the most bank-centered financial systems among the industrialized democracies.<sup>59</sup> But, unlike German banks, Italian credit institutes (until 1993) were not universal banks, and firms usually had credit relationships with a large number of banks at the same time. Accordingly, banks did not have substantial shareholdings in firms and had little incentive to monitor or wield substantial power over corporate managers. This does not indicate that economic coordination by banks was wholly absent. Mediobanca, a merchant bank created in 1946, was at the center of the web of the Italian company network. Led by the charismatic bank manager Enrico Cuccia, Mediobanca became an important intermediary in industrial governance in the 1970s. However, Mediobanca's influence derived its power and influence primarily through its role as the country's leading investment bank, rather than as a major creditor and long-term shareholder of leading corporations (as is a universal bank such as Deutsche Bank).

Two critical and interrelated characteristics of Italian capitalism were the relatively high level of state ownership of firms, especially in the financial sector, and the prolonged political dominance of the Christian Democratic Party throughout the post-war period until the 1990s. In the mid-1990s, eight out of the twenty largest Italian stock corporations were state controlled following post-war nationalization programs.<sup>60</sup> The deep entanglement of Italian business with the Christian Democratic Party defined Italian capitalism for most of the post-war period. With two short exceptional periods during the 1980s, *all* the prime ministers of the 51 Italian coalition governments between 1946 and 1992 belonged to the Christian Democratic Party.<sup>61</sup> The Italian Christian Democrats dominated the political and economic systems more thoroughly than either the CDU-CSU in Germany, or the Gaulists in France. This prolonged domination of the political system and Italy's chronically dysfunctional legal and regulatory institutions produced an ideal environment for the corrupt intertwining of political and corporate elites. The Christian Democrats used the state holdings and state-owned enterprises as patronage and financial vehicles for binding networks of political and economic leaders. The continuous lack of efficiency in the state-owned sector was perceived as especially an outcome of such interference of party interests into the matters of nationalized corporations. Corruption was also pervasive in the relations between Christian Democratic and Socialist politicians and private firms as well.

---

<sup>59</sup> OECD, 2003: 101.

<sup>60</sup> La Porta, et al., 1998b: 52.

<sup>61</sup> Kreppel, 2001.

The board structure of Italian stock corporations is a hybrid of a unitary board and a two-tier board. Both corporate managers and independent outsiders sit on the board of directors (as in an American corporation). The Italian internal audit committee incorporates attributes of a two-tiered board structure through its supervision of the management board. But the audit committee does not appoint senior managers or enjoy veto power over important financial and investment decisions. It therefore lacks the strength of the German supervisory board in the two-tier board structure. Nor does Italian law provide for employees or trade union representation on the management board (or on the internal audit committee) through codetermination or other company or labor relations laws.<sup>62</sup>

Beginning in the mid-1980s, like in other European countries, a discussion about the quality of Italy as a location for production occurred. In the context of this debate, Italy's underdeveloped capital market was perceived increasingly as a comparative disadvantage. In addition, overall macroeconomic performance, compared to other large Western European countries, was under-average. During the 1980s, the average unemployment rate was 8.4% (compared to 6.8% in Germany and 9.0% in France), the inflation rate averaged was 12% (Germany: 3%, France: 7.1%), and public debt as a ratio of GDP totaled 95.3% in 1989 (compared to 39.9% in both Germany and France).<sup>63</sup> In particular, the performance of state owned corporations was notoriously poor.

In this context of poor macroeconomic and microeconomic performance, internal political upheaval and disintegration—particularly on the right—and intense EU pressures for structural reform exerted by the European Monetary Union and the EU's Single Market program shifted domestic politics in favor of economic and corporate governance reform. Italy began a long and halting process of economic reform that included large-scale privatization of state owned enterprises, and the transformation of competition, securities, and company law. Ultimately, these reforms coalesced as a substantial, but still only partial, reform of corporate governance regulation.

These reforms cannot be understood apart from the nearly wholesale collapse of the Italian party system and loss of legitimacy of the post-war political elite in the wake of the "*Tangentopoli*"

---

<sup>62</sup> Bianco, 2001.

<sup>63</sup> Data source: OECD, 2001.

scandals of the early 1990s.<sup>64</sup> The collapse and subsequent transformation of the Italian party system in the early 1990s supplied the political preconditions of the economic reforms of the 1990s. The consequences for Italian party politics were staggering. The Christian Democrats and Socialists, Italy's two dominant parties, lost legitimacy and began to collapse as the Christian Democratic Party into three weak and feuding successor parties. The breakdown and disintegration of the Italian party system ushered in an unprecedented phase of center-left governments that broke the center-right's political and economic hegemony. With only the brief exception of Berlusconi's first term in 1994, a series of either leftist or independent prime ministers ruled Italy from 1992 through 2001 and, with the support of technocratic advisors, opened the way for economic reforms and an attempt to break the corrupt relationships between the political and managerial classes.

EU integration through European Monetary Union (EMU) and the Single Market Program was a second source of pressures for reform. After the devaluation of the Lira in 1992 and the negotiation of the Maastricht treaty, the prospect of joining EMU and abandoning inflation-plagued Lira created a wave of public euphoria in Italy. The Italian public strongly supported the idea of a single European currency and thus the policies necessary to achieve EMU criteria of low inflation and budget discipline.<sup>65</sup> Privatization became a principal instrument of achieving fiscal discipline, public debt control, and therefore monetary stability.

The Italian privatization program, like its French counterpart, was one of the most extensive among the OECD countries and constituted a profound transformation of the domestic political economy.<sup>66</sup> In 1997, the government sold off its entire equity stake in Telecom Italia. Referred to as "the mother of all privatizations," Telecom Italia became the country's largest publicly-held company with more than 1.5 million shareholders. The privatization of both

---

<sup>64</sup> The significant exception was the Italian Communist Party, which was almost unscathed by the scandals owing, no doubt, in part to the fact that the Communists had been excluded from national political power and the political-corporate networks that fueled corruption. The Communists had attained power over cities and districts in local elections, but had governed in an honest and competent fashion. The CPI had long been in tension with the USSR's authoritarian variant of communism, and with the collapse of the USSR and Warsaw Pact the Italian Party quickly reformed itself into the PDS, a left-wing but explicitly non-Leninist party that had substantial electoral and coalitional success during the 1990s.

<sup>65</sup> On a scale ranging from -100 to +100, Italian support for EMU was the largest in the whole EU (with a score of +55), compared to +31 in France and -7 in Germany. Data source: European Commission, reported in: Economist Supplement "A Survey on Italy", 8 November 1997 (data for the year 1997).

<sup>66</sup> Privatization generated returns of nearly \$100 billion between 1990 and 2000, and equaled 8.2 % of Italy's GDP in the year 2000. Only Portugal and Greece generated proportionally higher privatization returns during the 1990s. See Pagano and Trento, 2002: 25; Schneider, 2003: 9; see data in table 1, *infra*.

Telecom Italia and Borsa Italiana, the Italian stock exchange, in 1997 extended privatization to two of the most visible national economic institutions and raised the popular salience of governance issues and law, while increasing the practical importance of corporate governance reform.

Privatization put corporate governance reform on the political agenda. Massimo D'Alema, the leader of the Party of Democratic Socialism (the PDS, successor of the former Communist Party of Italy) became a fervent proponent of reform. After becoming Prime Minister in 1997, he commented that “[w]e are carrying out privatizations but we still have not done enough to create a proper financial market.<sup>67</sup> He lamented further, “we do not have guarantees for small shareholders, no rules for public companies.”<sup>68</sup> Tellingly, the left-wing governments government refused to sell shares to potential blockholders such as Mediobanca and, instead, favored the creation of companies with diffuse shareholders. As a result, questions of minority shareholder protection and management accountability became salient political issues and policy priorities for the first time. To a large extent, public debate and political conflicts over privatization and corporate governance focused on the Telecom Italia case. In January of 1997, Prime Minister Romano Prodi replaced the chairman and the managing director of Stet (the state holding vehicle to which Telecom Italia belonged) with Guido Rossi, a former independent leftwing senator, who was an outspoken supporter of small shareholder interest and an opponent of golden shares.<sup>69</sup>

The old alliances between former Christian Democratic politicians and industry marshaled resistance to these reforms and sought to protect the established government-business relationships and the insider-dominated model of Italian corporate governance.<sup>70</sup> However, through much of the 1990s, the political right was in such disarray (or under arrest or prosecution) that it could not mount an effective defense against the reformers.

As the left filled the political vacuum created by the collapse of the Christian Democrats and Socialists, the early 1990s witnessed a rapid succession of legislative changes. In 1990, a new antitrust law instituted a competition authority. The 1990 Amato law transformed banks

---

<sup>67</sup> Financial Times, 22 December 1997.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> This alliance and interpenetration between the Christian Democratic Party and business elites has been described as part of Italy's Catholic culture. See, for example, the address by Paolo Savano (1994), the Italian Minister of Industry.

into joint-stock corporations. In 1991, the Parliament passed a securities law barring insider trading and imposed more stringent financial disclosure requirements on publicly traded companies. New regulations for institutional investors also were passed in 1991. In 1992, following EC directives, the government passed additional securities laws mandating enhanced financial transparency and disclosure by mutual funds.<sup>71</sup>

Reform legislation accompanied privatizations in the financial sector. A 1993 law allowed credit banks to hold shares and to play an active role in industrial corporate governance and thus introduced universal banking in Italy. The privatization of the Italian Stock Exchange spurred further interest in both equity finance and corporate governance reform to ensure that these private organizations functioned efficiently and honestly. Between 1996 and 1998, left-wing governments passed a series of major securities laws and legislation governing the behavior of mutual funds and financial intermediaries as private investment and the channels through which this investment would flow became a more important component of economic policy.

The most dramatic and by far the most important corporate governance reforms, however, were the D'Alema government's "Draghi reforms" in 1998. Drafted by a commission headed by the Treasury's Director-General and former economics professor Mario Draghi, the reforms were designed to increase minority shareholder protection in order to further the development of Italian equity finance and securities markets.<sup>72</sup> The main provisions of the Draghi reform were:

- Anti-takeover defenses must be approved by the shareholders' meeting.
- Minority shareholders' rights strengthened, reducing threshold to call a special shareholders' meeting to 10%.
- A stronger role for the internal audit committee, with at least one member appointed by minority shareholders.
- Proxy voting reforms to facilitate shareholder voting (proxy voting had been virtually prohibited by strict regulation).
- Rules discouraging the building of control blocks.
- More stringent financial disclosure regulation, particularly with respect to the ownership and holdings of subsidiaries and corporate pyramids.<sup>73</sup>

A Code of Best Practice, drafted and released by an independent expert commission in 1999, followed the Draghi reforms but its provisions were voluntary and did not impose legal

---

<sup>71</sup> See Aganin and Volpin, 2003: 24; Deeg, 2003: 31; Pagaono and Trento, 2002: 25.

<sup>72</sup> Draghi 1998.

<sup>73</sup> Bianchi and Enriques, 2001: 30-39.

obligations on firms and managers and conferred no rights on shareholders. A 2003 successor act of the Draghi reform further strengthened shareholders protections, but did not have the substantial impact or practical significance of the Draghi laws. Neither the Code of Best Practice nor the subsequent legal reforms as far-reaching or politically contested as the Draghi reforms.

The combined effect of these reforms appreciably increased shareholder protections in Italian corporate governance (though the adequacy of their enforcement remains subject to skepticism). Comparative studies have found a general trend towards stronger shareholder rights across the OECD countries.<sup>74</sup> Pagano and Volpin report that, on a range of 0 to 6, the average national shareholder rights score climbed from 3.0 to 3.7 between the early 1990s and the early 2000s.<sup>75</sup> Italy's score increased from 1 to 5 as a result from the Draghi reforms—the largest increase in observed shareholder protection among the OECD countries during this period.

Looking at the Italian party system as a whole, it turns out the successor of the Communist Party of Italy, PDS, was the driving force behind corporate governance liberalization both in the “Olive Tree” center-left coalition government between 1996 and 2001 and in the entire 1990s period, along with a group of experts and technocrats, while the weakness of the former Christian Democrats provided the initial opportunity to reform. “Our Ex-Communists are the most economically liberal party round here,” *The Economist* quoted an Italian businessman.<sup>76</sup> The Refounded Communists (with a 8.6 percent share of votes in 1996), a second and more left-wing successor party of the Communist party, did not join the Olive Tree coalition and was more critical of economic liberalization and corporate governance reform. However, the RC enjoyed political influence because the survival of the center-left coalition depended on its tacit parliamentary support. In 1997, under the presidency of economic professor Romano Prodi, the RC actively slowed down the privatization of Telecom Italia and demanded that the Treasury keep a controlling block of “golden” shares to give the government veto power over management and thus prevent any hostile takeover of the privatized corporation.

The right-wing parties, in government briefly during 1994 and after 2001, have been divided and internally conflicted over privatization and corporate governance issues. The privatization of Telecom Italia provides an important illustrative example of these tensions.

---

<sup>74</sup> Pagano and Volpin, 2003: 41, Appendix B (updating the observations of La Porta, et al., 1998, for the early 2000s). For the original methodology and scoring, see La Porta et al. 1998.

<sup>75</sup> Pagano and Volpin, 2003: 41, Appendix B

<sup>76</sup> *Economist*, 2001.

Umberto Bossi's populist and separatist Northern League regarded the state holding as wholly irrelevant to a modern market economy and called for fast privatization without any golden shares. The neo-fascist National Alliance and its leader Gianfranco Fini were reluctant to see the state holdings disappear, especially in economically depressed southern Italy.<sup>77</sup> Berlusconi's Forza Italia, the strongest party on the Italian right with a 20.6 % share of the national vote in 1996, was (and still is) torn between neo-liberalism and the legacy of the protective Christian Democratic alliance with the managerial elite. On the one hand, Forza Italia shares Northern League's vision of economic liberalism. On the other, the Berlusconi government tended to slow down pro-shareholder corporate governance. Berlusconi, like former Christian Democratic premiers, enjoys close contacts with—and is actually a predominant member of—Italy's "salotto buono." Not surprisingly, all the significant corporate governance reform pre-dated the Berlusconi government.

Under Berlusconi, the right passed only one minor reform law in 2003, and it had that had no appreciable impact on Italian corporate governance or management. When the 2003 corporate governance reform act was negotiated, Giorgio La Malfa, the head of the Assembly's Finance Commission, insisted that Italian law after the Draghi reforms needed nothing more than "fine tuning," and emphasized the need to retain the "national character" of Italian industry. Although the OECD called the 2003 successor law of the Draghi reform "in a way revolutionary" (OECD 2003: 103-104) in its tightening of accounting standards, expansion of minority shareholders' power and imposing new regulation in the case of conflicts of interests, it was not a substantial reform and disappointed the financial community.<sup>78</sup>

The conflict over the European Commission's draft Takeover Directive in 2001 elucidates the ideological conflicts over Italian corporate governance regulation. The directive would have imposed uniform EU-wide regulation on corporate takeovers (both hostile and friendly) based on neo-liberal economic assumptions of shareholder primacy<sup>79</sup> and largely liberal legal rules constructed to encourage the development of a pan-European market for corporate

---

<sup>77</sup> Financial Times, 11 May 1994 and Financial Times, 8 August 1994.

<sup>78</sup> See also *Financial Times*, August 18, 2003.

<sup>79</sup> "Shareholder primacy" is the proposition that corporations should be managed in the exclusive interest of their shareholders as the means of ensuring the most efficient use of economic resources and maximizing economic innovation and growth. Given the short-term perspective of individual shareholders and well-known deficiencies in the actual use of hostile takeovers and the market for control, the normative and theoretical scholars and policymakers have fiercely debated the merits of shareholder primacy as the touchstone of corporate governance and its reform.

control.<sup>80</sup> Italian critics protested that the directive did not forbid golden shares, which are far more common in countries like the Netherlands and France than in Italy, and claimed that the directive would therefore asymmetrically threaten Italian companies with takeover by protected Dutch and French firms.<sup>81</sup> The PDS, however, welcomed the conciliation compromise that would have approved the Directive with only minor revisions. In the crucial European Parliament vote on July 4, 2001 the draft Takeover Directive was rejected in a tie vote of 273 to 273. The PDS and the Northern League voted *for* the directive. Berlusconi's Forza Italia, along with the Christian Democrats' successor parties, the Greens, the left-wing Refounded Communists, and the protectionist southern Italian National Alliance.

The strange and paradoxical political and ideological splits over the EU Takeover Directive replicated those over domestic economic and corporate governance reform. The Italian case, in sum, is characterized by clear and distinct party differences that make it the strongest case of political paradox of finance capitalism. These conflicts had been brewing for over a decade and reflect the extraordinary changes in economic interests, ideological frames of reference, and policy preferences across Italian political elites and interest groups. A decade of reform undertaken by the center-left significantly altered Italian capitalism and has created a hybrid form of capitalism that embodies neither a neo-liberal market model, nor the traditional Italian model of family capitalism. The increased number of publicly held stock corporations after privatization and, above all, the sharp increase in shareholder protection represent a substantial structural change in the Italian political economy. Between 1990 and 2000, the Italian stock market's capitalization as a percentage of GDP rose from 14 to 72 percent (*see* Table 1 below). The years after 2000 witnessed a series of withdrawals of famous family owners from the active control and operation of industrial business. With Fiat facing a severe financial crisis, the powerful Agnelli family's power declined within Italian capitalism. Firms have begun to increase the number of independent directors, publish quarterly reports, and set up investor relations departments and stock option programs. Mediobanca has lost influence over a number of major non-banking companies (including Montedison, Sai, Fondiara, Fiat, and Pirelli), overhauled its management, adopted a market oriented business model, and—in a striking illustration of its new role in the Italian economy—backed Olivetti's successful hostile takeover

---

<sup>80</sup> For discussion of the political controversy over the EU Takeover Directive, *see* Cioffi 2002; Callaghan, 2003.

<sup>81</sup> Cioffi, 2002. The Italians were particularly concerned about the takeover of privatized utilities by French firms then on acquisition sprees throughout Europe.

bid for Telecom Italia.<sup>82</sup> Hostile takeovers of leading Italian companies, including Telecom Italia, the insurance group Ina, and the Montedison conglomerate dramatically illustrate how much Italian business and the allocation and exercise of power within the economy have changed.

However, it is not clear whether the reforms of the 1990s will eradicate the insider control of Italy's "salotto buono" of family owners, or if the resurgence of the political right under Berlusconi will leave their remaining power intact or restore them to central position within the Italian political economy. Ownership is still very concentrated in Italy and continues an entrenched tradition of insider control.<sup>83</sup> Corporate and institutional finances remain opaque and disclosure less than forthcoming. For all the legal and regulatory reforms of the 1990s, enforcement remains the lax and regulatory authority poorly institutionalized. Perhaps most important of all, the right-wing Berlusconi government appears to embrace and embody the incestuous alliances and interrelationships between business and political elites than a neo-liberal ideal of structural reform of the traditional political economic model of the "family economy." Giuliana Amato, the independent first premier minister of the center-left Olive Tree coalition and yet another economist turned politician, criticizes Italians as "still loyal to the old system of a small group of shareholders close to management, and very aware of anyone who might come into the company ... Our culture of governance is still an elitist one, of closed companies and nearly closed shops."<sup>84</sup> Nothing so dramatically illustrates the continuing dysfunction of the Italian political economy and the limits of reform as the massive Parmalat scandal that became public in late 2003 and early 2004.

#### **IV. Germany: The Reform of Deutschland AG and the Microcorporatist Firm**

Much more than the French and Italian cases, the scholarly literature has treated the German political economy and corporate governance regime as a model case of a "coordinated market economy."<sup>85</sup> Prior to 1990, a set of distinctive and tightly intertwined institutional and informal relationships among corporate stakeholders distinguished German corporate governance from the Anglo-American neo-liberal market model, the statist French case, and Italian family

---

<sup>82</sup> See *Börsen-Zeitung*, March 19, 2003; *The Economist*, 2001; Melis, 2000: 32-33.

<sup>83</sup> *The Economist*, 2001.

<sup>84</sup> *Id.*

<sup>85</sup> See, e.g., Soskice, 1999; Hall and Soskice, 2001.

capitalism. The capacities for strategic economic coordination within German corporate (and sectoral) governance arrangements were not imposed by the exercise of discretionary state power, but were largely self-organized within a political economic environment of hierarchically organized interest groups and “social partners,” and intra-corporate relationships structured by, and in the shadow of, legal rules. State ownership of industrial and financial companies in Germany was lower than in Italy and France. Likewise, direct state intervention in finance and economic planning was less prominent and important than in France. However, the large private banks with their close personal ties with both industrial companies and public authorities<sup>86</sup> established linkages of mutual influence between the private and the public spheres. These relationships and linkages were especially strong in the years of reconstruction after World War II, but remained significant in the following decades.

Unlike France, Italy, or the United States, German corporate governance was characterized by the strong position of both universal banks and organized labor.<sup>87</sup> The large banks established a dense network of interlocking ownerships and enjoyed long-term credit relationships and ownership ties with large industrial companies from so many sectors that they adopted an interest in coordinating industrial policy as a whole.<sup>88</sup> For this reason, the debate over German corporate governance has been, to a large extent, a debate over the power of banks.<sup>89</sup> Personal ties through interlocking supervisory board directorates deepened cooperative relationships between banks and industrial firms. Also, supervisory board codetermination introduced by law in 1951 and 1952 and strengthened by 1976 legislation granted employees and unions a significant governance role in selecting managers and in important investment and financial decisions. The post-war German corporate governance regime has therefore been described as an inclusive and consensual stakeholder model that incorporated managers, creditors, and employees within the firm, and situated companies and financial institutions in the protective network of cross-shareholding, financial ties, board representation, and sectoral governance referred to as “Deutschland AG” (Germany Inc.).

Although the stock market was underdeveloped, the institutionalized countervailing power of banks and employees within German corporate governance constrained and weakened

---

<sup>86</sup> See Dyson, 1986 (noting that the banks’ intermediating relationships were especially important in the field of foreign trade).

<sup>87</sup> See Shonfield, 1965.

<sup>88</sup> See Windolf and Beyer, 1996; Beyer and Höpner, 2003; Höpner and Krempel, 2003.

<sup>89</sup> Cf. Cioffi, 2002; Ziegler, 2000: 203.

managerial autonomy. Management boards had to coordinate with these stakeholder groups prior to taking major decisions to avoid potentially damaging conflict within the firm. German corporations did not have a CEO in the American sense of the term. Companies typically had a “speaker” instead of a CEO as head of the management board, and until the 1980s, many management boards did not even have a speaker and were therefore purely based on consensual management decisions.

The political dynamics and sequence of financial market and corporate governance reforms in Germany between the mid-1980s and the mid-1990s were similar to those in Italy—with the exception that privatization played a less prominent role in driving the German reforms. In the Italian case, privatization could be identified as the main driver behind such reforms. In Germany, general considerations of economic competitiveness were far more important.<sup>90</sup> In the 1980s, the rise of persistent mass unemployment and the growing political and economic pressures of European integration triggered a debate among German political and economic elites over German competitiveness that expanded beyond issues of product and labor markets to encompass the reform of the financial system. Further, stretching from the late 1980s through the late 1990s, succession of spectacular corporate financial scandals, such as the crises of Metallgesellschaft, Bremer Vulkan, Klöckner, and the Schneider real estate empire, stoked popular resentment towards corporate managers and financial elites and made corporate governance reform even more politically attractive—to the party that was properly situated to exploit the opportunity.

Taking advantage of the elite consensus that had formed in favor of financial market reform, the Kohl government passed a succession of three major “Financial Market Promotion Acts” between 1990 and 1998 to stimulate the growth of equity markets, private investment, and domestic institutional investors.<sup>91</sup> The Second Financial Market Promotion Act of 1994 constituted the watershed of German financial market and securities law reform. The Act created Germany’s first national securities regulatory, the “Bundesaufsichtsamt für den Wertpapierhandel” (Federal Securities Supervisory Office or BAWe), banned insider trading,

---

<sup>90</sup> However, privatization was a significant factor in the German case as well. See Ziegler, 2000 (arguing that the privatization of East German state owned enterprises and the public offering of Deutsche Telekom shares spurred the government’s efforts to create a “shareholder culture” and to adopt shareholder friendly policies). In fact, the German government recovered its annual highest returns from privatization in 1998—which coincided with a major company law reform (see below) and a wave of regulatory expansion. See Beyer and Höpner, 2003; Cioffi, 2002.

<sup>91</sup> See Deeg, 2001; Lütz, 2000

and established the legal and institutional basis for financial transparency and disclosure regulation under securities law.<sup>92</sup> These laws and the regulations subsequently drafted by the BAWe aimed to encourage the development of a more active capital market, not to change the German corporate governance system in a fundamental way.

This changed in the late 1990s, when legal reforms began to alter the core structures of the corporation and thus the basic logic of German corporate governance. At this point, the reforms began to generate more intense political conflict and contestation from both the right and the left.<sup>93</sup> In contrast to the Financial Market Promotion Acts, the debate leading to the enactment of the 1998 Control and Transparency Act reform (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, or KonTraG) generated intense partisan and ideological debates.

In 1997, the SPD took advantage of shifting policy preferences among interest groups to engineer the first major overhaul of company law since 1965. The opposition Social Democrats in the Bundestag proposed a draft law by appealing to resentment of “bank power” among their popular base while simultaneously presenting themselves as pro-business economic pragmatists.<sup>94</sup> Most provocatively, the SPD sought to prohibit banks from holding share blocks larger than five percent in industrial firms. The SPD spoke out against bank and managerial power in order to frame its appeal to protect *shareholder interests*, not to tip the political economic balance of power in traditional class politics towards employees. However, the major banks had already embraced policy positions favoring greater transparency and protection of minority shareholders through the development of securities regulation. For much of the 1990s, German universal banks and large insurance companies had become increasingly supportive of pro-shareholder legal reforms as part of a broader financial market modernization program. Thus, the SPD’s policy agenda was not nearly so populist as the party’s rhetoric.<sup>95</sup>

---

<sup>92</sup> The BAWe represented Germany’s appropriation of the “SEC model” of securities regulation through a strong centralized regulator with substantial rulemaking powers and an increasingly important enforcement role in policing the financial markets. in order to prevent insider trading and to authorize the drafting and enforcement of new transparency and disclosure regulation. See Cioffi, 2002.

<sup>93</sup> Cioffi 2002, 2004a, 2004b; Höpner 2003. For example, political contestation was relatively modest when a 1998 legal reform allowed stock corporations to publish accounts prepared according to International Accounting Standards (IAS) or US GAAP instead of German Handelsgesetzbuch (Code of Commercial Law) accounting standards.

<sup>94</sup> For a detailed discussion of the SPD’s pseudo-populist strategy to gain left-wing support for governance reform, see Cioffi, 2002; see also Ziegler, 2001: 205, 216.

<sup>95</sup> See Cioffi, 2002.

The SPD's proposed legislation forced the Kohl government onto the defensive and eventually to support compromise legislation that was enacted as the Control and Transparency Act of 1998 ("KonTraG").<sup>96</sup> This strategic victory allowed the SPD leadership to portray itself as modernizing reformers, maintain their credibility with the SPD left wing, and characterize the CDU as resistant to reform and beholden to corporate interests. During the KonTraG's passage, Hans-Martin Bury, the SPD's expert on corporate governance issues in the Bundestag, argued that the German corporate sector was stifled by the power of banks, a lack of transparency, interlocking ownership structures, and an underdeveloped market for corporate control. He called the KonTraG draft a placebo law to appease the demands of the public without introducing any substantial change, a law to protect managers and banks.<sup>97</sup>

The KonTraG was passed during the last months of the Kohl coalition government in 1998. Nearing 1998 election, the SPD placed corporate governance reform at the center of the policy agenda both to stake out a reform agenda of its own and to provoke cleavages inside the Christian Democrat/Liberal coalition. Inside the government coalition, the small neo-liberal Free Democratic Party (FDP) supported the reform in tension with the CDU's resistance. When it was debated in the Bundestag, the FDP speaker Otto Graff Lambsdorff said that the law was only a partial success for the FDP, and he regretted that the FDP was not able to push the CDU towards further liberalization measures.<sup>98</sup> The CDU speakers Joachim Gres and Hartmut Schauerte exposed the tensions in the coalition when they insisted that significant restrictions on the power of banks were not necessary.<sup>99</sup> In contrast, historically left-wing parties and constituencies lined up behind the SPD as Parliamentary representatives from the Green Party and from post-communist Party of Democratic Socialism (PDS) spoke in support of the SPD's company law and corporate governance reforms.

The final version of the KonTraG dropped the anti-bank provisions while realizing more important corporate governance reforms. The KonTraG complemented the massive overhaul of securities law already well underway by:

- Introducing shareholder democracy through a "one share, one vote rule" for the first time;

---

<sup>96</sup> Corporate Control and Transparency Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, "KonTraG") of 27 April 1998, Federal Law Gazette, Part I, p. 786 (Gesetz vom 27.4.1998, BGBl. I, S. 786 vom 30.4.1998).

<sup>97</sup> See Remarks of Hans-Martin Bury, minutes of the Bundestag debate 13/220, 5 March 1998.

<sup>98</sup> See Otto Graf Lambsdorff in the debate over the KonTraG, minutes of the Bundestag debate 13/220, 5 March 1998.

<sup>99</sup> See Remarks of Joachim Gres and Hartmut Schauerte, minutes of the Bundestag debate 13/220, 5 March 1998.

- Requiring the supervisory board to hire and oversee the external auditors, and it to meet four times a year (up from twice a year);
- Prohibiting the voting of cross-shareholding stakes above 25% (a blocking minority under German company law) in supervisory board elections, and thus weakening defensive cross-ownership structures;
- Limiting the voting rights and supervisory board representation of universal banks while strengthening their disclosure and fiduciary obligations;<sup>100</sup>
- Limiting the number of supervisory board mandates per person to ten (supervisory board chairs count double);
- Authorizing share buybacks and stock options plans for managers;
- Introducing stricter rules on risk management.

The SPD's embrace of corporate governance reform was not merely fleetingly opportunistic. Rather, reforms continued after Gerhard Schroeder's SPD-Green coalition government came to power in September 1998. This continuation of the reform agenda shows that the policy differences between the SPD and the CDU regarding corporate governance went far beyond a simple government-opposition dynamic. Most strikingly, the Schröder government surprised the public when it introduced a tax reform in 2000 that abolished the capital gains tax on the sale of large share blocks and corporate cross-shareholdings in a deliberate effort to speed up the dissolution of the German company network. This "tax gift" especially for the large banks led to a sharp and somewhat bizarrely structured partisan conflict, in which the Christian Democrats on the right and the PDS on the left both opposed the government, with the FDP caught between the ideological positions.<sup>101</sup>

The government went on to sponsor or enact a series of less politically contentious corporate governance reforms. In 2001, the government appointed the Cromme Commission on Corporate Governance to draft an official corporate governance code of best practice. Shortly thereafter the Parliament passed the Transparency and Disclosure Act that imposed a "comply or explain" rule on listed firms requiring them to comply with the Code of Best Practice or disclose and explain any non-compliance.<sup>102</sup> The Parliament passed a Fourth Financial Market

---

<sup>100</sup> If the bank's holdings in a listed firm exceed 5% of the corporation's stock, it can vote their own equity stakes *or* vote the proxy votes of the shares deposited by its brokerage customers—but not both. *See* Cioffi, 2002, 2004b. The KonTraG also requires banks to disclose their representatives on supervisory boards, their shareholdings in firms, and alternative ways for their customers to vote their shares on deposit with the bank. (Cioffi, 2002)

<sup>101</sup> Edmund Stoiber, the CDU-CSU candidate for Chancellor in the 2002 election, used this issue in his election campaign and pledged to reintroduce the tax as Chancellor.

<sup>102</sup> *See* Transparency and Disclosure Act (Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizität (Transparenz- und Publizitätsgesetz, TransPuG), v. July 19, 2002, BGBl. I S. 2681.

Promotion Act in 2002, which strengthened securities regulation and the federal securities regulator.

In contrast, ideological and political conflicts over the issue of takeover regulation were intense. Although German parties came together to oppose the EU Takeover Directive,<sup>103</sup> the parties' positions in the negotiations over the German Takeover Act in November 2001 broke down in to a divisive battle over the future course of national economic development. The law allowed the target company's board to take defensive measures if it had sought the shareholders' authorization no earlier than 18 month *before* the bid, and it allowed supervisory boards to legitimize defensive measures after the bid. The FDP criticized the takeover law as not being liberal enough and called the 2001 act "provincial".<sup>104</sup> Once again, the CDU turned out to be the defender of German organized capitalism against financialization. Perceiving takeovers as a threat to German managerial interests and the underpinnings of the post-war German economic model, the CDU argued for much greater managerial and supervisory board latitude in adopting anti-takeover defenses.<sup>105</sup> SPD and Greens rejected this, arguing that "the shareholders own the corporation and should have the final say".<sup>106</sup>

Interestingly, one crucial pattern in the political constellations behind corporate governance liberalization differed from the French and Italian cases: while French and Italian trade unions neither welcomed nor opposed the reform acts in a noticeable way, German trade unions played a significant role in promoting corporate governance liberalization. The trade unions and their umbrella peak association, the DGB, welcomed the successive reforms of securities law and disclosure regulation from 1994 through 2002, the KonTraG (including its most important measure, the introduction of the "one share, one vote" rule), the government's Corporate Governance Code (written with participation of trade union experts), the act that allowed companies to publish their balance sheets according to international (IAS) or American

---

<sup>103</sup> The German Liberal Party FDP, which was most likely to support the conciliation compromised, was not a member of the European Parliament.

<sup>104</sup> See Rainer Funke in the debate on the takeover law, minutes of the Bundestag debate 14/192, October 11, 2001.

<sup>105</sup> In particular, the CDU contended that the 18-month-period allowed for shareholders' authorization resolutions was too short and should be replaced by a 36-month-period. The CDU also wanted to decrease the 75 percent threshold required for passage of defense resolutions by the shareholders' meeting. See *Beschlussempfehlung und Bericht des Finanzausschusses*, Drucksache 14/7477, November 14, 2001.

<sup>106</sup> See Nina Hauer (from the SPD) in the debate on the takeover law, minutes of the Bundestag debate 14/201, November 15, 2001.

(US GAAP) rules, and the “comply or explain” law that gave the Code some legal teeth.<sup>107</sup>

During the struggles over the German Takeover Act, trade unions supported the SPD position.

Why did the German unions come favor corporate governance reforms that typified a neo-liberal economic model otherwise so antagonistic to the interests of labor? Beside their historical preference for limiting the power of economic agglomerations and banks in particular<sup>108</sup>, three explanatory factors must be highlighted and distinguished. The first explanation for the union’s support of governance reform hinges on supervisory board codetermination. On the supervisory board, employee and trade union representatives participate in supervising managers. Therefore, employee representatives develop an interest in powerful supervisory boards, transparency, and management accountability. Every increase in supervisory board power increases the effectiveness of codetermination which is, of course, warmly welcomed by trade unions. Likewise, greater transparency gives shareholders and employees alike greater insight into the condition of the firm and empowers them in governance matters.

A second and related reason for the trade unions’ surprisingly supportive attitude towards corporate governance reform relates to a substantive dimension of corporate management: once trade unions gain influence over company decisions, they develop an interest in limiting managerial agency costs. The number of conflicts inside German companies in which both employees and shareholders are allied in opposition to managers should not be underestimated. One example is managerial pay. Another—and far more serious—set of problems is the managerial tendency to engage in value-destroying mergers and acquisitions, “empire building,” and other useless prestige investments. “If shareholder value helps to limit this risk potential, this must be in the interest of employees”, said one trade union expert.<sup>109</sup> In addition, not all conflicts over restructurings are insider-outsider conflicts (in which shareholders force insiders to restructure) or class conflicts (in which shareholder pressure helps managers to introduce restructurings that they would have preferred anyway). There are also situations, as in the Mannesmann case, where both shareholders and labor (on the supervisory board and on works

---

<sup>107</sup> See Bolt, 2000; Köstler, 2000; Köstler and Müller, 20001; Küller, 1997; Putzhammer and Köstler, 2002; Scheibe-Lange and Prangenberg, 1997; Schmoldt, 2002. German trade unions also called for legislation to make the provisions of the Corporate Governance Code mandatory.

<sup>108</sup> For details, see Höpner 2003.

<sup>109</sup> Küller, 1997: 529.

councils) prefer to split up the company, while the management board pursues its preference for running a large, powerful corporation.<sup>110</sup>

Third, the economic interests and identities of German union members have begun to blur with those of shareholders as an increasing proportion of employees holds shares. Changing saving preferences and the addition of a private investment-based pillar to the German “solidaristic” pension system, among other state policies, have encouraged the emergence of mass shareholding in Germany that has altered the terrain of economic interests, class identities, and policy preferences. As in the process of privatizations via stock offerings, trade unions start to care for shareholder protection when employees become shareholders. Although the development of mass shareholding has gone further in the US and Italian cases, it has become an increasingly significant feature of the German economy as well during the last decade.

Since the early 1990s, the German corporate governance regime has changed in a substantial, non-trivial way. The driving force behind reforms was the center-left, including trade unions, while the CDU tended to protect German organized capitalism. How far, compared to France and Italy, have changes in Germany gone? Measures on shareholder protection and on the rise of market capitalization (see Table 1) seem to indicate that changes in Italy and France went further than in Germany. However, due to its non-weighted design, the relatively modest LLSV index increase is likely to underestimate the extent of changes in Germany. As a result from the KonTraG reform, Germany was one of the precursors of the “one share, one vote” rule in Europe; the widely-known example of Volkswagen, protected by a Lower Saxony Bundesland law, is an exception to this rule. The Mannesmann takeover and especially the behavior of banks during the takeover battle indicate that the logic of German corporate governance has changed fundamentally. The dissolution of the German company network, the adoption of international accounting standards, stock options, American-style investor relations practices, profitability targets for subsidiaries, restructurings that aim to focus on core competencies and the adoption of investment banking strategies among the large private banks add indications for change at the company level. Deeg (2003: 37), by comparing German and Italian corporate governance reforms, comes to the conclusion that changes in Germany went even beyond Italian reforms. Altogether, we believe that financialization in Germany and Italy occurred to a similar extent.

---

<sup>110</sup> See Höpner and Jackson, 2001 (discussing Vodafone’s hostile takeover of Mannesmann).

## V. The United States: Scandal, Reform, and the Perils of Neo-Liberalism

We have placed the discussion of the American case last because, although it is the archetype of modern finance capitalism and pioneered modern securities regulation, corporate governance reform came after those of France, Italy, and Germany. The contemporary corporate governance debate in the United States began two decades ago amid economic crisis and instability but did not result in fundamental reform or change. The hostile takeover wave of the 1980s destabilized the American corporate governance regime and triggered a power struggle among managers, financial institutions, and shareholders that has waxed, waned, and waxed again over the past two decades. The takeover wave of the 1980s transformed the relationship between the corporate management and finance. Takeovers and the new power of investment banks encouraged the adoption of new financially-driven management strategies and techniques of financial engineering that led to the practices and business culture of short-term strategic planning horizons, excessive leverage, a focus on immediate returns to shareholders, successive booms in CEO empire building during the 1980s and 1990s, and—ultimately—manipulation of earnings and disclosure that would result in a corporate governance crisis following the collapse of the 1990s securities market bubble. Coming at approximately at the nadir of American “deindustrialization,” takeovers raised intense concerns over serious economic decline and social disruption caused by sudden and dramatic corporate restructuring, plant closings, and layoffs. The massive economic restructuring and redistribution of wealth driven by deindustrialization and the new era of shareholder capitalism galvanized political opposition to the disruption and perceived injustice of takeovers. The suspicion of concentrated financial power, the crisis in the industrial economy during the 1980s, and the mobilization of politically powerful managers and local populist interest groups generated a potent policy backlash.<sup>111</sup>

During the 1980s and early 1990s, managers, corporate raiders, and shareholders fought fierce legal battles over the fiduciary obligations of managers and directors in resisting hostile tender offers and adopting anti-takeover defenses. The result was explosion of legal activity, but that merely produced a stalemate between managers and shareholders, rather than substantial reform of the American corporate governance regime. Courts significantly weakened fiduciary duties (most importantly in Delaware, the premier state of incorporation) by sanctioning the use of a proliferation of complex and arcane takeover defenses. The political battles over takeover

---

<sup>111</sup> See Roe, 1993a.

law further strengthened management and diluted fiduciary duties to shareholders, as many states (this time with the important exception of Delaware) adopted “corporate constituency statutes.”<sup>112</sup> These statutes permitted directors responding to a hostile takeover attempt to consider and invoke the interests of other corporate stakeholders such as employees and local communities in opposition to those of shareholders. Yet these laws granted no enforceable rights to these stakeholders.<sup>113</sup> Legal recognition of their interests served to strengthen the position of incumbent management, not their own.<sup>114</sup>

The backlash against takeovers set the stage for the ongoing policy debate over corporate governance. Managers, unions, institutional investors, shareholder groups, financial institutions, and financiers sought to enshrine their policy preferences in the policy, statutory law, regulation, and legal doctrine. This politicization of the law and practice of American corporate governance during the 1980s marked the beginning of the contemporary international corporate governance movement. However, the battles over takeovers turned on the content and adequacy of company law and fiduciary duties, not federal securities law and regulation. In the absence of fundamental statutory and doctrinal reform, managers began to embrace contractual mechanisms to address perceived governance problems. In reaction to the takeover wave of the 1980s, managers and directors began to award themselves lucrative “golden parachute” severance payments in *de facto* exchange for their prospective approval of a takeover. Further, following the prescriptions of economic theory, firms began to adopt stock options as a form of compensation to align the economic interests of managers and directors with those of shareholders. Although this may be viewed as an efficient use of contracting to circumvent inefficient legal rules that entrench incumbent management, these payoffs also reveal the conflicts of interest inherent in takeover contexts and helped spark the dramatic rise in executive compensation that would play a prominent role in the scandals of the 1990s.

The politics of American corporate governance reform during the 1990s swerved between efforts to protect managerial interests and measures increasing shareholder protections. In 1995 and 1998, Congress enacted “tort reform” legislation designed to reduce the incidence of securities litigation. First, the Private Securities Litigation Reform Act of 1995 (“PSLRA”) raised the pleading requirements for securities fraud suits and largely abolished “aiding and

---

<sup>112</sup> See Matheson and Olson, 1991; Adams and Matheson, 2000.

<sup>113</sup> See Cioffi, 2002, chap. 6.

<sup>114</sup> See *id.*

abetting” liability under which law and accounting firms could be held liable for fraudulent statements and omissions by publicly traded companies. The PSLRA also authorized the appointment of a “lead plaintiff” in securities suits in hopes that the shareholder with the greatest alleged damages, almost always an institutional investor, could take charge of the litigation and thus press meritorious claims while quickly disposing of frivolous suits. The second law, the Securities Law Uniform Standards Act of 1998 (“SLUSA”), was even more sweeping. The SLUSA preempted state securities fraud laws that could have been used by plaintiffs’ attorneys to circumvent the new, more demanding restrictions on federal securities suits. At a time when conservatives in Congress lauded federalism, Republicans pushed through a bill that dramatically increased centralized federal control over securities regulation. The laws were politically as much as economically motivated. They strengthened the position of managers, a predominantly Republican constituency, by weakening one of the most important mechanisms of transparency enforcement and managerial accountability, while attacking the financial base of a plaintiffs’ bar that overwhelmingly supported Democrats.

However, throughout the 1990s, the SEC under Chairman Arthur Levitt initiated a series of reforms to improve managerial accountability and financial transparency. The first amended the SEC’s proxy rules to eliminate the cumbersome requirement of filing proxy statement whenever shareholders collectively owning more than 5% of a firm’s stock communicated about governance issues.<sup>115</sup> The 1992 proxy reforms expressly recognized the growing political power of institutional investors and their expanding role in corporate governance. The SEC failed in its efforts to reform the regulation of accounting rules and the activities of accounting firms. In particular, the SEC sought to require the expensing of stock options and to address auditors’ conflicts of interests when simultaneously acting as consultants. The accounting firms and “new economy” technology firms dependent on options enlisted allies in Congress to fight the regulatory proposals by bringing legislative pressure on the SEC until it was withdrawn.<sup>116</sup>

Finally, the SEC pushed through a regulatory change in direct tension with (and at least partially undid) the proxy reforms of 1992. Regulation “Fair Disclosure” (“Regulation FD”),

---

<sup>115</sup> The SEC’s proxy rules required that shareholders collectively owning more 5% of a corporation’s stock could not communicate among themselves without filing an expensive and time-consuming proxy statement with the agency. The rule had been adopted to protect minority shareholders from manipulation of firm governance and unfair takeover tactics. However, it effectively discouraged institutional investors from collaborating in pursuing more activist corporate governance strategies.

<sup>116</sup> This blunt use of political clout by the accounting industry and its legislative allies ultimately weakened its political position as once the size, seriousness, and number of the accounting scandals of 2001-2002 became public.

adopted in August 2000, prohibited selective disclosure of material information by corporations in order to prevent favored analysts, financial institutions, and institutional investors from receiving information not released to the general public. While addressing the problem of informational asymmetries that disadvantage individual investors vis-à-vis large institutions, Regulation FD once again impeded the ability of institutional investors to pursue corporate governance activism by limiting their ability to communicate in private with managers about their concerns and demands.<sup>117</sup> By the end of 2000, it had become increasingly clear that transparency regulation and institutional activism, the two dominant paradigms of corporate governance regulation and reform, were operating at structural, legal, and political cross-purposes.

Only the post-1990s scandals of 2001-2002 would finally implicate the adequacy and legitimacy of the entire American corporate governance regime, including securities regulation, and inflame political support for more wide-ranging reform. With the enactment of the Sarbanes-Oxley Act in late-2002, following the Enron, WorldCom, Global Crossing, and other massive corporate scandals, the federal government instituted the most comprehensive corporate governance reform in the United States since the 1930s. Sarbanes-Oxley imposed a host of new regulatory requirements and measures on publicly traded corporations, corporate managers, accountants, and attorneys. Sarbanes-Oxley created an entirely new regulatory body appointed by and under the oversight of the SEC, the Public Company Accounting Oversight Board, to enforce a new set of regulations governing accounting standards and the activities of accounting firms in auditing and consulting. The law also required the SEC to draft new regulations requiring heightened disclosure of the financial condition of corporations that included off-balance sheet transactions, codes of ethics (and their waiver by the board), the reconciliation of “pro forma” financial results with generally accepted accounting standards (US GAAP), non-audit services performed by the firm’s auditor, and real time disclosure of material financial information and developments.<sup>118</sup>

---

<sup>117</sup> Although institutional investors could continue to apply public pressure on poorly performing and autocratic management (as in the case of the CalPERS blacklist), these were largely disfavored methods of activism. These funds, with tens or hundreds of millions of dollars invested in target firms, did not want to take public actions against management that might diminish the value of their holdings.

<sup>118</sup> The law also increased criminal and civil penalties on executives for failing to disclose material financial information to the public and compelled CEOs and CFOs to certify the firm’s accounts and internal control procedures for collecting and disseminating financial information. These provisions are likely to be of more symbolic than practical importance, however.

Under the Act, federal law in the United States began *for the first time* to encompass the *internal* structure and affairs of the corporation—traditional subjects of state corporate law. Similar to German law (see below), Sarbanes-Oxley strengthens the auditing function of the board and its independence from management. Public firms are now required to appoint an auditing committee comprised *entirely* of independent directors, and the SEC is charged with writing and enforcing rules defining directorial independence.<sup>119</sup> To ensure the effectiveness of the committee, at least one member must be qualified as a financial expert under standards to be promulgated by the SEC, and the audit committee has direct responsibility for the appointment, compensation, and oversight of the outside auditors, resolving disputes between management and the auditors concerning financial reporting, and approval of all auditor services. Further, auditors must report directly to the audit committee, rather than management. This unprecedented—and underreported—centralization of corporate governance regulation represented a sharp break with traditions of American federalism that suggests the extraordinary political potency of the financial and governance scandals of 2001-2002.

The law was the product of political struggle between Democrats using financial scandals against the Republicans, and Republicans seeking to dilute the reform legislation in keeping with their long-standing alliance with corporate managers and their anti-regulation policy agenda.<sup>120</sup> The Bush Administration was firmly, if quietly hostile to major legislative and regulatory reform. Congressional Republicans, especially in the House of Representatives, were likewise antagonistic and advocated the Administration's policy position by proposing mild legislation that would effect little practical change. In the end, the continuing wave of corporate financial scandals culminated with the spectacular collapse of World.Com amid revelations of a multi-billion dollar accounting fraud. One senior Republican staffer said, "Congress didn't pass Sarbanes-Oxley, World.Com did."<sup>121</sup> While this contains an element of truth concerning the impact of the scandals, this statement downplays the fact that Congressional Democrats were

---

<sup>119</sup> There has been a pronounced trend toward the appointment of "outside" directors (*i.e.*—individuals not part of management), beginning with a 1978 New York Stock Exchange listing rule requiring an audit committee of outside directors. See Korn/Ferry International, 1993: 3, 7, 13; compare Investor Responsibility Research Center, 1996: 3-6; accord Charkham, 1994: 188-189 (in 1990, outside directors accounted for a majority on 86% of boards in the manufacturing sector and 91% for those in all other sectors). However, managerial control over their nomination casts their independence in doubt.

<sup>120</sup> For a more extended discussion of the politics surrounding the passage of the Sarbanes-Oxley Act, see Cioffi 2004b.

<sup>121</sup> Anonymous interview conducted by John W. Cioffi, Washington DC, March 2004.

responsible for drafting and pushing through the law, and that this was only possible because of the Democratic Party's short-lived control of the Senate prior to the November 2002 elections. Incessant and massive scandals led moderate Republicans to follow the Democrats' lead and support a more substantial reform agenda. Faced with crumbling Party unity and fearful of the electoral and economic consequences if they continued to block reform, the Bush Administration and congressional Republicans ended their resistance and signed on to a largely unchanged Democratic bill.

The interest group politics surrounding the passage of the Sarbanes-Oxley Act were even more fractious and disrupted by scandal. Corporate managers remained peripheral to the legislative process as result of their loss of prestige and influence in the wake of successive corporate scandals and the popular perception that they, as a class, had looted American corporations and their shareholders that comprised over 50% of American households.<sup>122</sup> The development of securities markets, mass shareholding, and the growth and diversity of investment funds in the United States meant that financial interests were divided in their interests and preferences concerning the proper extent of corporate governance reform and government regulation of business and markets. Accounting firms, having perhaps the most to answer for and the most to lose, fought strenuously against the Sarbanes-Oxley reforms—even at the risk of further antagonizing public opinion—but were in no position to stem the tide of popular opinion and political pressures for reform. Financial institutions, such as investment banks, were split over the reforms. They are dependent on public faith in the integrity of the securities markets, but are also privileged insiders that benefited from the status quo and stood to lose from reform. Financial institutions and service providers were also weakened in the political process by their role in numerous scandals of their own—in addition to aiding and abetting dishonest corporate executives.

Institutional investors were a surprisingly impotent political force for reform. They were long committed to an essentially voluntaristic form of corporate governance activism, and the majority of them (particularly mutual funds) espoused a neo-liberal policy stance that was skeptical of, and often hostile to, increased regulation of their affairs. Further, because they are

---

<sup>122</sup> The only issue managers fought fiercely was, perhaps revealingly but not surprisingly, the regulation and more stringent accounting treatment of stock options—the mechanism that was supposed to align the interests of managers and shareholders, but which became the most effective meaning of managerial rent-seeking and looting of the corporation ever devised.

legally barred from contributing to political campaigns and cannot mobilize voters, institutional investors have less political influence than their economic power would predict. An important partial exception to the marginal political status of institutional investors was the active role played by union pension funds. These funds have long been the most activist investors in corporate governance, with ideological and strategic commitments to constraining imperious managers. They were also closely tied to the political operations of their founding unions and the AFL-CIO, which—despite the weakness of American organized labor—remain core contributors and voting constituencies of the Democratic Party.

Similar to the center-left political dynamic in our European cases, the Democratic Party drove the reform process. First, under the pressures of economic crisis and an eroding working class base, center-left policymakers came to embrace corporate governance reform as a means of appealing to voters resentful of economic elites while claiming the banner of reform and economic justice. The Democrats used the post-bubble scandals and the collapse of share prices to attack the Republican party's most conservative and pro-manager leadership since the 1920s and as a well-placed appeal to middle class voters (with significant savings invested in stocks) who believed in free but *fair* markets. Second, in each case, scandal and crisis weakened opponents of reform. In the United States, managers, accounting firms, corporate attorneys, and politicians (of both parties) antagonistic towards regulation were almost completely sidelined from active political participation during policy debates over corporate governance reform at the peak of the post-bubble scandals. Third, corporate governance reform fit surprisingly well within the contours of the center-left ideology and the Democrats' historical support for the regulatory state. The Democratic Party has long been committed to the development of the regulatory state as a counterweight to concentrated managerial and corporate power, and as a corrective for market distortions. Indeed, the Party's New Deal of the 1930s brought modern securities regulation into existence. In the post-war period, the Democrats formed a practical and ideological interest in shoring up the perceived fairness of financial markets that absorbed increasing shares of working and middle class pension and retirement savings. Governance and securities law reform thus appealed to both the egalitarian and welfare state components of center-left ideology and policy agendas. This is a highly simplified sketch of complex inter-party and intra-party dynamics, yet the general point is valid. In the US, as well as in France,

Germany and Italy, corporate governance reform is largely a project of the political left—not the ostensibly pro-business or neo-liberal right.

## VI. Common Patterns Across Divergent Cases

In the last two decades, national financial systems and corporate governance regimes across the advanced industrial countries have undergone substantial reforms designed to buttress and encourage the development of financial markets through increased minority shareholder protection, corporate transparency and financial disclosure, and management accountability. We have provided sketches of the historical development, substantive content, and political dynamics of these reforms in France, Italy, Germany, and the US to determine whether there are common patterns across the cases. Despite the variation in political economic structures across the four cases and the substantial differences among their respective party systems, in each country the political center-left turned out to be the driving force behind corporate governance reforms, while the center-right tended to protect established forms of managerialism against reform and the threatened destabilization of financial capitalism. Our findings suggest a common (though not necessarily universal) political dynamic implicating the central roles of center-left parties and changing interest group alignments and policy preferences in corporate governance and financial system reform. We explain this political dynamic with reference to a set of “functional” economic pressures on national political economies, firms, and interest groups; a set of “push” factors that induced—or pushed—center-left parties to embrace corporate governance reform as part of their policy agenda; and a set of “pull” factors that restrained—or pulled back—the center-right from endorsing reform. Together, these factors have shaped a consistent two-stage process of corporate governance reform that proceeds from securities market regulation to the deeper reform of the internal structural characteristics and governance processes of the corporation itself. Reform and the development of finance capitalism thus involve a movement from regulation designed to address information asymmetries and market failures to legal intervention directed at *institutional failures* of the corporate firm.

### A. The Political Dynamics of Corporate Governance Reform: Functional Economic Pressures and Political Push and Pull Factors

By the 1980s, all four countries faced a combination of sets of destabilizing economic developments and forces that spurred reform and restructuring at the levels of both the state and the firm. Most relevant to our subject of corporate governance reform were (and are): (1) the internationalization of financial markets, services, and investment; (2) the intensification of international competition that gave rise to increased pressures for corporate adjustment and restructuring; (3) economic stagnation contributing to state fiscal crises and rising structural unemployment; (4) growth in individual and institutional shareholding as a form of savings and pension provision; and (5) successive corporate finance scandals, at times implicating political as well as managerial and financial elites. Finally, but not least, with the exception of the United States, the privatization of state owned enterprises—driven in large part by the economic pressures described above—provided an extra incentive for reform in France, Italy, and (to a lesser extent) Germany.

However, these contextual factors do not themselves explain the content or timing of reform. These economic forces constituted “functional” pressures in that they posed problems that *could* be addressed through financial system and corporate governance reform. Yet this by no means leads to the conclusion that reform was inevitable or indicates the identities of the political proponents of reform. These functional pressures existed independently of the political context. The policy responses to these pressures were dependent on the party composition and the interest group alignments within specific national governments. Political actors drive policy reform, not broad economic forces; and the more fundamental the legal or institutional reform, the more political the process. This can be seen from the sequence and pattern of reforms.

To analyze the political dynamics of reform, we distinguish sets of “pull” factors (that pulled the center-right back from promoting reforms) from “push” factors (that pushed the center-left towards reform) that existed in each of our four country cases. The *center-right* faced two closely related “*pull factors*”: (1) the legacy of class-based party formation embodied in the long-standing alliance between center-right parties and corporate employers, and (2) the close personal and professional relations between center-right political elites and corporate managers. The *center-left* faced a more varied set of “*push factors*”: (1) the need for an economic reform agenda that would still appeal to a left-wing and working class electoral base, (2) shifting interest group preferences that enabled the center-left to align with major financial institutions, (3) an

increase in shareholding among the public and the increasing importance of securities market investment to the future of pension reform.

In large measure, the center-right became trapped by its own political economic legacies in a way that the center-left, with the decline of its ideological coherence and working class base, was not. First, although each of the center-right parties discussed here are “catch-all” parties, modern European party systems developed in response to, or at least in the shadow of, class politics framed by the conflict between labor and capital. An important legacy of this post-war class conflict and party formation was the center-right’s close political alliances with employers (*i.e.*, corporations and their managers) and its ideological affinity with employer interests in opposition to the working class and their socialist and/or social democratic champions. The center-right was therefore more protective of traditional features of managerialism favored by their manager constituents.<sup>123</sup> The German *CDU-Wirtschaftsrat* (Economic Affairs Council of the Christian Democratic Party), a group of employers lobbying for industrialist interests inside the CDU, is a good example for this; nothing comparable ever existed in the other large German “catch-all” party, the SPD. In France, Italy, and particularly in Germany, this preservationist impulse on the center-right extended to the institutions and arrangements of the coordinated market economies to which the fortunes of large business enterprises and their managers were so closely tied. However, we also see the existence and effects of these close relations between the political right and corporate managers in the American case where the Republican Party maintains much closer ties to business interests and corporate managers both in terms of policy orientation and electoral support.<sup>124</sup>

Second, the established post-war political economic institutions and corporate governance regimes were largely, and in the Italian and French cases almost entirely, the creation of the right. This led to close and mutually reinforcing business-party relationships between managerial and party elites that persisted over decades and became extremely valuable politically and financially for managers and politicians alike. We expect this effect to vary with the degree of dominance of the center-right in the respective countries (see Table 1). Thus, policy

---

<sup>123</sup> The strength of these pull factors varies to some extent with degree and character of the entanglement between business and the center-right party. The number of years in office of the center-right might be a quantifiable proxy for this party-business relationship. This factor was particularly important in the Italian and, to a lesser degree, in the French cases. A statistical test of this hypothesis, however, is beyond the scope of the current paper.

<sup>124</sup> In fact, the pro-business orientation of the Republican Party appears to have intensified as the working class character of the opposition Democratic Party has deteriorated.

preferences in the area of corporate governance is not solely the product of the coordinated market economies' comparative economic advantages identified by the varieties of capitalism literature, but also a form of political exchange in which political support and rents passed back and forth between the public and private spheres. These relationships allowed the capture of vast rents produced by economic development and corporate activity, often with the aid of favorable public policies. The center-right therefore had an enormous stake in preserving these relationships—and the legal frameworks that sustained them—from erosion and destabilization by financial system and corporate governance reform. In Italy, followed by Germany, these party-management linkages were strongest, center-left support for corporate governance reform and center-right resistance is most evident. French managers had links to both the Socialist and conservative parties and this explains, in part, why evidence of a right-left party split over the center-left reform agenda is more ambiguous: although still more supportive of reform than the right, the left was “pulled” back from shareholder-friendly reforms to a greater degree than its counterparts in other countries. Similarly, the Democratic Party in the United States relies on and has extensive relationships with managerial elites, which blunted calls for corporate governance reform until the post-bubble scandals overrode the constraints of pluralist interest group politics.<sup>125</sup>

In contrast to the experience and situation of the center-right, a set of distinct “push” factors induced center-left parties to endorse and pursue corporate governance reform. In the absence of the same sort of pull factors constraining the policy positions and strategic repositioning of the center-right, the economic and political incentives encouraged center-left support for corporate governance reform. First, under conditions of poor economic performance marked by rising unemployment, slow growth, and stagnating innovation and competitiveness, center-left parties needed a reform agenda that would appeal to their centrist and left-leaning constituents. The center-left saw corporate governance reform as a way of promoting economic restructuring, dynamism, and fairness without increasing managerial autonomy and power at employees' expense. Particularly during the zenith of neo-liberal ideology and neo-classical

---

<sup>125</sup> However, even now, the desire of Democratic Party politicians and leaders to cultivate the support of tech industry managers has induced the congressional Democrats from unequivocally supporting the expensing of stock options, which is fiercely opposed by Silicon Valley and other high tech business interests. Conversely, the reliance of American financial and professional firms on securities markets and related services meant that there has long been a managerial elite within the financial sector that is both a key pillar of Republican Party support but also somewhat more amenable to pro-shareholder reforms to buttress the functioning and legitimacy of these markets.

economic theories at the height of the American technology boom and bubble market, financial market and corporate governance reform promised a way to reward innovative risk taking while providing mechanisms of capital reallocation and corporate restructuring that would not depend on state intervention. In addition, corporate governance reform posed a threat to the opaque but strategically important relationships between conservative politicians and corporate managers, while appealing to the resentment of their left-wing constituents towards these incestuous elites. This political opportunity structure became more powerful in the wake of large-scale corporate financial crises and political corruption scandals in each of our country cases. The new reform agenda did not impose any additional significant fiscal demands on the state, while it appealed to the historical antagonism of the left towards the political economic hierarchies, cozy relations, and frequently corrupt networks among managerial and political elites.

Second, center-left parties took advantage of shifting economic interests and policy preferences of national financial elites by appealing to their interest in financial modernization through financial market and later through corporate governance reform. This factor was pivotal in Germany, but played a role in France and Italy as well where banks were cut loose from their state supports and responsibilities and would have to function competitively in increasingly internationalized markets. As financial institutions became more adapted to a market-driven form of finance and financial services their interests departed from those that underpinned the established bank-centered models of long-term, stable relationships and came to favor pro-shareholder reforms. In France and Italy this shift in interests extended to a new variety of corporate managers willing to abandon the old system to engage in hostile takeovers and extensive merger and acquisition activities reminiscent of American variant of financial capitalism that has taken root since the early 1980s. Even in the United States, where market-based finance and financial institutions had been long established, investment banks, commercial banks developing investment banking and securities arms, and institutional investors all depended on the confidence of the public in the efficiency, fundamental fairness, and thus the legitimacy of financial markets and corporate governance practices and institutions. In the wake of stock market collapses across the advanced industrial countries in 2000, this concern spurred at least limited support for corporate governance and regulatory reform even among many of the firms that would bear the brunt and burden of increased regulation.

Third, the center-left developed an interest pursuing shareholder-oriented policies and reforms as the importance and/or proportion of the general public holding shares began to rise.<sup>126</sup> This was a particularly prominent factor in the American case, where mass shareholding began earlier and advanced further than in Continental Europe to the extent that, by the end of the 1990s, fifty per cent of households owned shares in some form. However, the expansion of shareholding also played an increasingly important role in Western Europe as the incidence began to increase (though much more modestly than in the United States) and an incipient shareholder culture began to develop. Even more important, policymakers looking ahead to a demography-driven crisis in public old age pension systems began to see the development of securities markets and mass shareholding as essential to successful long-term pension reforms that require alternative forms of savings that generated higher returns.<sup>127</sup> Popular suspicion of financial elites has a long history on the left, in the United States as well as in Western Europe, as does concern for social welfare and pension policy. The growth of shareholding and securities as a channel of pension investment brought together two consistent ideological and policy concerns of the left and prompted the center-left to support the rights of shareholders to a degree that would have been surprising twenty years ago.<sup>128</sup>

In sum, economic developments altered the political terrain on which political parties maneuver for strategic advantage, but in ways that constrained the center-right to a greater degree than the left. As a result, in some important ways center-right parties became truly conservative in their policy positions, rather than neo-liberal. Their opposition to corporate governance reforms that would threaten the power and autonomy of corporate managers was an effort to preserve a broader form of economic organization in which the internal structure and

---

<sup>126</sup> See Gourevitch and Shinn, 2004; Cioffi, 2004a.

<sup>127</sup> The amount of shareholdings among employees varies with savings preferences, with the organization of the pension system, and with the degree to which employees enjoy stock options. See Vitols, 2001. These issues have become important within recent and ongoing debates over pension reform in Europe.

<sup>128</sup> The policy shift by center-left parties in favor of corporate governance reform, and the support of organized labor in particular, is similar to what Gourevitch and Shinn (2004) describe as a “transparency coalition”: employees and unions shift their preferences in favor of the protection of shareholder rights to give them an informational advantage over management and as they become shareholders themselves. Compare Roe, 2003 (arguing that employees and managers are more likely to forge intra-corporate and political coalitions to curb transparency to protect themselves from shareholder and capital market pressures). We find a functional equivalent to this “push factor” in German codetermination. Supervisory board codetermination benefits employees – in their role as employees engaged in collective bargaining, not solely as shareholders – who therefore have an interest in increasing management accountability and corporate financial transparency. Such shareholder oriented reforms increase the effectiveness of codetermination. It is therefore not surprising that German trade unions support shareholders’ demands for transparency and management accountability.

operation of the corporate firm had always played a central though often underreported role. The fiscal crisis of the state, the perceived need for more extensive and rapid corporate restructuring, and the evolving interests of financial institutions presented the center-left parties with an opportunity to present themselves as pro-growth economic modernizers, rather than backward looking and nostalgic for economic policies and models that appeared to have run into chronic crisis.

### **B. Two Phases of Corporate Governance Reform**

Nationally distinctive combinations of these pull and push factors help explain both the “paradox” of corporate governance reform, and why we find two phases of reforms in each of our country cases.<sup>129</sup> The first reform phase emphasized the financial system and securities regulation reform. Because the development of securities law and regulation had occurred decades earlier in the United States, this phase of reform during the 1990s was comparatively limited and ambiguous. In our three European cases, where bank centered financial systems were the norm, this phase of the development and institutionalization of securities regulation was far more dramatic and significant. From the late-1980s to the mid-1990s, France, Italy, and Germany transformed their securities law and regulation in terms of stringency of substantive transparency norms, state commitment to regulatory enforcement, and institutionalization of regulatory authority. Despite the significance of these episodes of lawmaking and institution building in the area of securities regulation, these reforms were not attended by intense partisan or interest groups conflict or ideological debate.

Generally, a consensus of economic and political elites supported securities market reforms.<sup>130</sup> They were designed to promote the development of more active and liquid securities markets, rather than fundamentally alter the logic of national corporate governance regimes. Securities law reforms were closely tied to European legal and regulatory harmonization as part of the EU’s Single Market Program. Yet EU integration alone does not explain the underlying consensus in support of more expansive and centralized securities regulation. The reform narrative indicates that where national-level consensus was lacking, EU legal harmonization stalled. Securities regulation throughout most of Europe during the 1990s did embody such a

---

<sup>129</sup> See also Cioffi 2004a (describing variations on the two phase reform process in the United States and Germany).

<sup>130</sup> For example, the 1988 French Law on Security and Disclosure in the Financial Markets and the 1989 Security and Disclosure Law, the 1991 Italian law on banning insider trading, and the enabling law creating the German BAWe in 1994.

consensus of industry, the financial sector, and government in favor of expanding the financial repertoire available to both business and investors. This first phase of reform reflected a new alignment of state officials, political parties, bankers, and industrial managers favoring the cultivation of a more dynamic and innovative financial system. In each case, regulatory centralization and increasingly stringent transparency and disclosure rules characterized institutional development and legal reform—in some ways even exceeding the centralization and transparency requirements long-established in the United States. Ironically, through much of the 1990s, political conflict over securities regulation in the United States precluded any further reforms even as the need for legal intervention in dysfunctional markets and firm governance processes became increasingly obvious. In general, however, corporate governance reform began with these first phase reforms of securities regulation because they were politically more palatable to powerful interest groups and ideological commitments by political parties than later changes to company law. The effect of securities regulation reform on the balance of power among managers, shareholders and other financial interests, and labor was attenuated and, in some cases moderated, by creating financial options for managers to escape reliance on and the scrutiny of bankers.<sup>131</sup>

The second phase of reforms, however, did alter the basic structures, power relations, and internal governance of the corporate firm. These reforms substantially altered the fundamental logic of national corporate governance regimes and, not surprisingly, generated considerable political conflict. Prior reforms seeking to encourage the development of market-driven financial systems largely elided underlying conflicts over the future organizational form of national economic organization and, ultimately, of the corporation itself. Tensions between established forms of managerialism and organized capitalism, on the one hand, and policy reforms intended to stimulate the development of securities markets and a market model of finance, on the other, became inescapable as reformers turned their attention towards company law and the core of corporate governance. The reform of company law entailed the modification of institutional and legal structure of the corporate form—from the allocation of power within the firm's component organs, such as the board, board committees, and shareholders' meeting, and the legal rights and obligations of corporate actors, from managers, to directors, to majority and

---

<sup>131</sup> For this reason, organized labor was more passive and peripheral in the first phase reform process that instituted modern securities regulation in Europe.

minority shareholders. These reforms therefore threatened to fundamentally reallocate and alter the structure of corporate power. At this point, corporate governance reform implicated the core interests of powerful political economic elites and actors. Not surprisingly, this second phase of generated far more intense political conflict than the first.

The reform of company law became a zero-sum game. Increased shareholder rights and protections corresponded to the expansion of obligations owed by managers, directors, and controlling shareholders, and the consequent diminution of their power and autonomy. Where minority shareholders and employees benefit from increased transparency, managers and majority shareholders lose the benefits of informational asymmetries and insulation from accountability. Where unequal voting rights are abolished to protect diffuse shareholders, controlling stockholders lose a critical mechanism of their power. Would-be reformers found themselves in an increasingly intense conflict between the modernization of financial systems and the protection and preservation of established forms of managerialism and political economic organization. Under these circumstances, the corporate governance reform agenda could no longer be advanced through consensus. The strategic maneuverings of party politics became central to corporate governance reform and political conflict characteristic of the legislative process.

## **VII. Conclusion**

Corporate governance reform and the development of finance capitalism across the advanced industrial countries is frequently characterized as a neo-liberal or right-wing political project and that the center-left, goaded by labor, stands in opposition to the empowerment and protection of shareholders. However, this understanding does not withstand closer scrutiny of the political dynamics of reform. In countries with such varied political economies as France, Italy, Germany, and the United States, the left has supported pro-shareholder corporate governance reforms while the right has consistently resisted it. This realization forces us to rethink how contemporary party politics functions and how class politics has been transformed over the course of a generation. A superficial view of the political dynamics of corporate governance reform and the development of the institutional foundations of financial capitalism obscures the true significance of these changes and the central role of politics and political actors in fostering them.

The analysis developed here illuminates several critical aspects of contemporary political economic development. First, political economic change over the past fifteen years has provided the foundations for a new paradigm of finance capitalism in which the interests of capital are far more important and empowered in terms of law, policy, and private economic decision-making. The regulatory state and newly activated conflicts among between managers, capital, and labor are central to this new form of political economic organization. Second, structural change is both widespread and deep. It goes to the foundations of political and economic governance institutions, from the scope and organization of the regulatory state to the structure and power relations within the corporate firm. In each case, regulation has grown more stringent, extensive, and centralized as policy has favored shareholders and constrained managers.

Third, and most central to this paper, corporate governance reform and these political economic changes are inseparable from a historic shift in national party politics and interest group preferences that has induced center-left parties to advance pro-shareholder and pro-reform policy agendas. Center-left political actors orchestrated have taken the lead in advancing corporate governance reform, rather than unions, shareholders, or other interest groups. Shareholders are too poorly organized (as in the United States) or too few in number (in Continental Europe) to constitute an effective coalition partner, while labor remains somewhat ambivalent and peripheral to the politics of financial system and corporate reform. Though private interests may have been favorably disposed to pro-shareholder legislation and regulation, state actors initiated corporate governance reform in each country case we analyzed. From this perspective, politics and the institutional environment of political and corporate governance are constitutive. Political actors have been instrumental and essential in fashioning new interest groups alliances and ultimately new interest groups with a stake in the governance of the corporation. Although the United States, Germany, France, and Italy have faced similar economic constraints and pressures, the development of finance capitalism is driven by domestic economic trends and political calculations. As a consequence alongside parallel legislative and regulatory developments, the emerging general form of finance capitalism is diverging along national lines just as the post-war political economic order characterized by Fordism and Keynesianism once did.

## References

- Adams, Edward S. and Matheson, John H. (2000): A Statutory Model for Corporate Constituency Concerns. In: *Emory Law Journal*. Fall 2001, p. 1085.
- Aganin, Alexander; Volpin, Paolo (2003): History of Corporate Ownership in Italy. ECGI Finance Working Paper 17/2003. Brussels: European Corporate Governance Institute.
- Alt, James E. (1985): Political Parties, World Demand, and Unemployment. Domestic and International Sources of Economic Activity. In: *American Political Science Review* 79, 1016–1040.
- Alvarez, Michael R.; Garrett, Geoffrey; Lange Peter (1991): Government Partisanship, Labor Organization, and Macroeconomic Performance. In: *American Political Science Review* 85, 539–556.
- Altmeyer, Werner (2002): Druck auf die deutsche Mitbestimmung. In: *Die Mitbestimmung* 48, 12, 62-65.
- Barca, Fabrizio; Iwai, Katsuhito; Pagano, Ugo; Trento, Sandro (1998): Post-War Institutional Shocks. The Divergence of Italian and Japanese Corporate Governance Models. Università degli Studi di Siena Dipartimento di Economia Politica Working Paper No. 234. Siena: Dipartimento di Economia Politica.
- Berle, Adolph A.; Means, Gardiner C. (1932): *The Modern Corporation and Private Property*. New York: Macmillan.
- Beyer, Jürgen; Höpner, Martin (2003): Corporate Governance and the Disintegration of Organized Capitalism. In: *West European Politics*, 26: 4, 179-198.
- Bianchi, Marcello; Bianco, Magda; Enriques, Luca (2001): Pyramidal Groups and the Separation between Ownership and Control in Italy. In: Fabrizio Barca, Marco Becht (eds.), *The Control of Corporate Europe*. Oxford: Oxford University Press, pp. 154-187.
- Bianchi, Marcello; Enriques, Luca (2001): Corporate Governance in Italy after the 1998 Reform: What Role for Institutional Investors? *Consob Studi e Ricerche Paper 43*. Rome: Commissione Nazionale per le Società e la Borsa.
- Bianco, Magda (2001): Italy. In: Klaus Gugler (ed.), *Corporate Governance and Economic Performance*. Oxford: Oxford University Press, pp. 130-138.
- Bolt, Marie (2000): Stellungnahme des DGB zum Fragenkatalog der Regierungskommission "Corporate Governance - Unternehmensführung - Unternehmenskontrolle - Modernisierung des Aktienrechts". Berlin: Deutscher Gewerkschaftsbund.
- Castles, Francis G. (Ed.) (1993): *Families of Nations: Patterns of Public Policy in Western Democracies*. Aldershot: Gower.
- Chandler, Alfred D., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge: Belknap, 1980)
- Charkham, Jonathan P. (1994): *Keeping Good Company: A Study of Corporate Governance in Five Countries*. Oxford: Clarendon Press.

- Cioffi, John W. (2001): The Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration. BRIE Discussion Paper, Berkeley, CA: Berkeley Roundtable on the International Economy.
- Cioffi, John W. (2002): Restructuring 'Germany, Inc.': The Corporate Governance Debate and the Politics of Company Law Reform. In: *Law & Policy* 24, 4, 355-402.
- Cioffi, John W. (2004a): "The State of the Corporation: State Power, Politics, Policymaking and Corporate Governance in the United States, Germany, and France," in: Martin Levin and Martin Shapiro (eds.), *Trans-Atlantic Policymaking in an Age of Austerity*. Washington, DC: Georgetown University Press (in press).
- Cioffi, John W. (2004b): "Expansive Retrenchment: The Regulatory Politics of Corporate Governance Reform and the Foundations of Finance Capitalism in the United States and Germany." In: (forthcoming in Jonah Levy, ed., *The State After Statism: New State Activities in the Age of Globalization and Liberalization*. Cambridge, MA: Harvard University Press, 2005 (under contract). Prior version available from: Institute of European Studies, University of California, Berkeley, Conference Paper, posted at <http://ies.berkeley.edu/research/#sas>.
- Colli, Andrea (2003): Convergence Lost. Finance, Governance and Industry in Italy at the beginning of the new Millennium. Paper presented at the 2003 BHC/EBHA Meeting, Lowell, MA.
- Cori, Nicolas (2003): "Le PS veut durcir la loi sur les PDG." *Liberation*, December 11, 2003. Available online at <http://www.liberation.fr/page.php?Article=164499>.
- Cowell, Alan (2002): "A Man Used to Moving in Elite Business Circles." *New York Times*, July 1, 2002.
- de Jong, Henk Wouter (1997): The Governance Structure and Performance of Large European Corporations. In: *Journal of Management and Governance*, vol. 1, 5-27.
- de Quillacq, Leslie (2002): "Where's the breast-beating?" *Breakingviews*, June 25, 2002. Available online at <http://www.breakingviews.com/examplecv.asp>.
- Deeg, Richard (2003): Institutional Change and Path Dependency: The Transformation of German and Italian Finance. Unpublished Manuscript.
- Deeg, Richard, 2001: Institutional Change and the Uses and Limits of Path Dependency: The Case of German Finance. MPIfG Discussion Paper 01/6. Köln: Max-Planck-Institute for the Study of Societies.
- Deeg, Richard (1999): *Finance Capitalism Unveiled. Banks and the German Political Economy*. Ann Arbor: University of Michigan Press.
- Deeg, Richard and Sophia Perez (1999): *International Capital Mobility and Domestic Institutions: Corporate Finance and Governance in Four European Cases*, Unpublished paper presented at the Conference on the Political Economy of Corporate Governance in Europe and Japan, Robert Schulman Center, Europe University Institute, June 10-11, 1999.
- Deutsches Aktieninstitut (2000): DAI-Factbook 2000. Statistiken, Analysen und Graphiken zu Aktionären, Aktiengesellschaften und Börsen. Frankfurt: Deutsches Aktieninstitut.

- Dixon, Hugo (2003): "Sauter Pour Mieux Reculer." *Breaking Views*, September 4, 2003. Available online at <http://www.breakingviews.com/examplecv.asp>.
- Draghi, Mario (1998): Corporate Governance and Competitiveness. In: Review of Economic Conditions in Italy 3/1998, 341-357.
- DWS (2001): DWS Corporate Governance Survey 2001. European Corporate Governance Ranking Report – Euro Stoxx 50. Frankfurt: DWS.
- Dyck, I.J. Alexander; Zingales, Luigi (2001) : Private Benefits of Control: An International Comparison. CRSP Working Paper 535. Cambridge: Harvard University.
- Dyson, Kenneth (1986): The State, Banks and Industry: The West German Case. In: Andrew Cox (ed.), *State, Finance and Industry. A Comparative Analysis of Post-War Trends in Six Advanced Industrial Economies*. Brighton: Wheatsheaf, 118-141.
- The Economist* (1997): "A Survey on Italy." Supplement, November 8, 1997.
- Esping-Anderson, Gøsta (1985), *Politics Against Markets: The Social Democratic Road to Power*. Princeton: Princeton University Press.
- Fanto, James A. (1998a): *The Role of Corporate Law in French Corporate Governance*, Cornell International Law Journal, vol. 31, pp. 31-91.
- Fanto, James A. (1998b): *The Role of Corporate Law in the Adaptation of French Enterprises*, Columbia Business Law Review, Special Symposium Issue, pp. 97-120.
- Fanto, James A. (1995): *The Transformation of French Corporate Governance and United States Institutional Investors*, in "Symposium: Comparative Models of Privatization: Paradigms and Politics," Brooklyn Journal of International Law, vol. 21, pp. 1-77.
- Fligstein, Neil (2001): *The Architecture of Markets. An Economic Sociology of Twenty-First-Century Capitalist Societies*. Princeton: Princeton University Press.
- Galbraith, John Kenneth, (1967): Die moderne Industriegesellschaft. München: Droemersch Verlaganstalt.
- Goldman, Leslie (1992): "The Modernization of the French Securities Markets: Making the EEC Connection." *Fordham Law Review*, vol. 60, pp. 227-253.
- Goldstein, A. (1996): "Privatizations and Corporate Governance in France." *Banca Nazionale del Lavoro, Quarterly Review*, no. 199, pp. 455-488 (December 1996).
- Gourevitch, Peter; Shinn, James (forthcoming 2005): *The Politics of Corporate Governance Regulation*. Princeton, NJ: Princeton University Press.
- Goyer, Michel (2003): Corporate Governance, Employees, and the Focus on Core Competencies in France and Germany, in: Curtis J. Milhaupt (ed.), *Global Markets, Domestic Institutions. Corporate Law and Governance in a New Era of Cross-Border Deals*. New York: Columbia University Press, 183-213.
- Hancké, Bob (2001): *Large Firms and Institutional Change: Industrial Renewal and Economic Restructuring in France*. Oxford: Oxford University Press.
- Henley, Jon (2003): "Gigantic Sleaze Scandal Winds Up As Former Elf Oil Chiefs Are Jailed." *The Guardian*, Thursday, November 13, 2003.

- Hibbs, Douglas (1977): Political Parties and Macroeconomic Policies. In: *American Political Science Review* 71, 467–487.
- Höpner, Martin, 2003: European Corporate Governance Reform and the German Party Paradox. MPIfG Discussion Paper 2003-4. Köln: Max-Planck-Institut für Gesellschaftsforschung.
- Höpner, Martin; Jackson, Gregory (2001): An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance. MPIfG Discussion Paper 2001-4. Köln: Max-Planck-Institut für Gesellschaftsforschung.
- Höpner, Martin; Krempel, Lothar (2003): The Politics of the German Company Network. MPIfG Working Paper 2003-9. Köln: Max-Planck-Institut für Gesellschaftsforschung.
- International Securities Regulation Reporter (1989): *Insider Trading Scandals: Parisians React With a Smirk and a Yawn*, International Securities Regulation Reporter, October 11, 1989, p. 6.
- Investor Responsibility Research Center (1996): *Board Practices 1996: The Structure and Compensation of Board of Directors in S&P 500 Companies*. Washington, DC: IRRC.
- Iskandar, Samer (1999): “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*, August 30, 1999, p. 11.
- Köstler, Roland (2000): Grundsätze der Unternehmensführung und -kontrolle in der Diskussion. In: *Die Mitbestimmung* 46/5, 34-35.
- Köstler, Roland/Matthias Müller (2001): Unternehmensführung - Unternehmenskontrolle - Modernisierung des Aktienrechts. Arbeitshilfe Nr. 15 für Arbeitnehmervertreter in Aufsichtsräten. Düsseldorf: Hans-Böckler-Stiftung.
- Korn/Ferry International, *20th Annual Board of Directors Study* (New York: Korn/Ferry International, 1993)
- Kreppel, Amie (1997): The Impact of Parties in Government on Legislative Output in Italy. In: *European Journal of Political Research* 31, 327-350.
- Küller, Hans-Detlev (1997): Das Shareholder-Value-Konzept aus Gewerkschaftssicht. In: *Betriebswirtschaftliche Forschung und Praxis* 49, 517-531.
- La Porta, Rafael; Lopez-de-Silanes, Florencio; Shleifer, Andrei; Vishny, Robert (1998a): Law and Finance. In: *Journal of Political Economy* 106, 1113-1155.
- La Porta, Rafael; Lopez-de-Silanes, Florencio; Shleifer, Andrei; Vishny, Robert (1998b): Corporate Ownership around the World. NBER Working Paper 6625. Cambridge, MA: National Bureau for Economic Research.
- Levy, Jonah D. (1999): *Tocqueville’s Revenge: State, Society, and Economy in Contemporary France*. Cambridge, MA: Harvard University Press.
- Levy, Jonah D. (2004) (forthcoming): “Activation Through Thick and Thin: Progressive Strategies for Increasing Labor Force Participation.” In: Martin Shapiro and Martin Levin, eds. (2004): *Trans-Atlantic Policymaking in an Age of Austerity*. Washington, DC: Georgetown University Press.

- Lijphart, Arend (1999): *Patterns of Democracy. Government Forms and Performance in Thirty-Six Countries*. New Haven and London: Yale University Press.
- Lütz, Susanne (2000): From Managed to Market Capitalism? German Finance in Transition. MPIfG Discussion Paper 2000-02. Cologne: Max Planck Institute for the Study of Societies.
- Mallet, Victor (2002): "France Goes on Sale," *Financial Times*, June 17, 2002.
- Matheson, John H. and Olson, Brent A. (1991): Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation. In: *George Washington Law Review*. August, 1991, p. 1425.
- Melis, Andrea (2000): Corporate Governance in Italy. In: *Corporate Governance: An International Review*, vol. 8, no. 4, 347-355.
- Meny, Yves (2001): "Something Rotten in the Republic." *Financial Times*, January 28 2001.
- Morin, F. (2000): "The Transformation of the French Model of Shareholding and Management." *Economy and Society*, February 2000
- Nunes, Keith D., et al., (1993): *French & SEC Securities Regulation: The Search for Transparency and Openness in Decisionmaking*. Vanderbilt Journal of Transnational Law, vol. 26, p. 242.
- OECD (1994): *Employment Outlook*, July 1994. Paris: OECD.
- OECD (1999): *Employment Protection and Labor Market Performance*. Paris: OECD.
- OECD (2001): *Economic Outlook*, June 2001. Paris: OECD.
- OECD (2003): *Economic Surveys: Italy*. July 2003. Paris: OECD.
- O'Sullivan, Mary (February 2001): "Change and Continuity in the French System of Corporate Governance," INSEAD Working Paper, European Institute of Business Administration.
- Oxford Analytica (1992): *Board Directors and Corporate Governance: Trends in the G7 Countries Over the Next Ten Years*. Oxford: Oxford Analytica.
- Pagano, Marco; Volpin, Paolo (2003): *The Political Economy of Corporate Governance*. Unpublished Manuscript. London: London Business School.
- Pagano, Ugo; Trento, Sandro (2002): Continuity and Change in Italian Corporate Governance: The Institutional Stability of One Variety of Capitalism. Università degli Studi di Siena Dipartimento di Economia Politica Working Paper No. 366. Siena: Dipartimento di Economia Politica.
- Putzhammer, Heinz; Köstler, Roland (2000): Eckpunkte für ein Übernahmegesetz. In: *Die Mitbestimmung* 46/5, 22-23.
- Read, Tess (1999): "Down with Dirigisme." *Worldlink*, September/October 1999. Available online at: <http://backissues.worldlink.co.uk/articles/08091999111756/08.htm>.
- Roe, Mark J. (2003): *Political Determinants of Corporate Governance. Political Context, Corporate Impact*. Oxford: Oxford University Press.
- Roe, Mark J. (1994): *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*. Princeton, NJ: Princeton University Press.

- Roe, Mark J. (1993a): "Takeover Politics," pp. 321-353, in Margaret Blair, ed., *The Deal Decade: What Takeovers Mean for Corporate Governance*. Washington, D.C.: Brookings Institution.
- Roe, Mark J. (1993b): *Some Differences in Corporate Structure in Germany, Japan, and the United States*, Yale Law Journal, vol. 102, p. 1927
- Savona, Paolo (1994): Privatization in Italy: Roundtable Discussion with Paolo Savona, Italian Minister of Industry. In: Columbia Journal of World Business 29, 1, 72ff.
- Scheibe-Lange, Ingrid; Prangenberg, Arno (1997): Mehr Mitbestimmung via US-Börsenaufsicht. In: Die Mitbestimmung 43/11, 45-49.
- Schmidt, Manfred G. (2002): The Impact of Political Parties, Constitutional Structures and Veto Players in Public Policy. In: Hans Keman (ed.), *Comparative Democratic Politics*. London: Sage, 166–184.
- Schmidt, Manfred G. et al. (2003): Party compositions of OECD governments, 1945-2002. Unpublished Dataset.
- Schmidt, Vivian (1996): *From State to Market? The Transformation of French Business and Government*. Cambridge and New York: Cambridge University Press.
- Schmoltdt, Hubertus (2002): Shareholder Value und Mitbestimmung. In: Die Mitbestimmung 48, 6, 10-16.
- Schneider, Manfred (2003): Privatization in OECD Countries: Theoretical Reasons and Results Obtained. Unpublished Manuscript. Linz: University of Linz.
- Schumpeter, Joseph A. (1942/1950): *Kapitalismus, Sozialismus und Demokratie. Einleitung von Edgar Salin*. Zweite, erweiterte Auflage. Bern: A. Francke AG Verlag. English edition (1950): *Capitalism, Socialism and Democracy, 3d edition*. New York: Harper & Row Publishers.
- Shleifer, Andrei; Summers, Lawrence H. (1988): Breach of Trust in Hostile Takeovers. In: Alan J. Auerbach (Ed.), *Corporate Takeovers: Causes and Consequences*. Chicago: University of Chicago Press, 33-68.
- Shonfield, Andrew (1965): *Modern Capitalism: The Changing Balance of Public and Private Power*. London: Oxford University Press.
- Sombart, Werner, (1987): Sombarts „*Moderner Kapitalismus*“: *Materialien zur Kritik und Rezeption*. Herausgegeben von Bernhard von Brocke. München: DTV. Darin: Die Zukunft des Kapitalismus (1932), 394-418.
- Soskice, David (1999): Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s. In: Herbert Kitschelt, Peter Lange, Gary Marks, John D. Stephens (Eds.), *Continuity and Change in Contemporary Capitalism*. Cambridge: Cambridge University Press, 101-134.
- Streeck, Wolfgang; Yamamura, Kozo (Eds.) (2001): *The Origins of Nonliberal Capitalism. Germany and Japan in Comparison*. Ithaca and London: Cornell University Press.
- Vitols, Sigurt (2001): The Origins of Bank-based and Market-based Financial Systems: Germany, Japan, and the United States. In: Wolfgang Streeck; Kozo Yamamura (Eds.):

*The Origins of Nonliberal Capitalism. Germany and Japan in Comparison.* Ithaca and London: Cornell University Press, 171-199.

Windolf, Paul; Beyer, Jürgen (1996): Co-operative Capitalism: Corporate Networks in Germany and Britain. In: *British Journal of Sociology* 47, 2, 205-231.

Ziegler, J. Nicholas (2000): "Corporate Governance and the Politics of Property Rights in Germany," *Politics and Society*, vol. 28, no. 2, pp. 195-221 (June 2000).

Zysman, John, *Governments, Markets, and Growth*, (Ithaca: Cornell University Press, 1983)

Zysman, John, *Political Strategies for Industrial Order: State, Market, and Industry in France*, (Berkeley: University of California Press, 1977)

<b>Table: Comparative Data</b>				
	<b>Italy</b>	<b>Germany</b>	<b>France</b>	<b>US</b>
<b>Market Capitalization (percent of GDP), 1990</b>	14	22	26	56
<b>Market Capitalization (percent of GDP), 1999</b>	72	68	112	181
<b>Minority Shareholder Protection, early 1990s</b>	1	1	3	5
<b>Minority Shareholder Protection, early 2000s</b>	5	3	5	5
<b>Block Premium, 1990s</b>	0.37	0.10	0.02	0.02
<b>Returns from Privatization (percent of one-year GDP), 1990s</b>	8.2	1.1	4.2	-
<b>Employees' Representation Rights</b>	0	2	1	0
<b>Deviations from "one share, one vote"</b>	-	2	22	0
<b>Spread of Shareholding (shareholders as percent of habitants), late 1990s</b>	-	17.7	9.8	48.2
<b>Years of center-right party dominance, 1949-2002</b>	38	34	35	30

**Definitions and Sources of Variables:**

Market Capitalization: Market Capitalization of listed shares as a percentage of GDP. Data source: OECD (1999: 18).

Minority Shareholder Protection, early 1990s: LLSV index on shareholders' anti-director rights. Sum of six dummy variables (0=low shareholder protection, 6=high shareholder protection). Indicates if (a) proxy by mail is allowed; (b) shares are not blocked before a shareholders' meeting; (c) cumulative voting for directors is allowed; (d) oppressed minorities are protected; (e) the share capital required to call an extraordinary shareholder meeting is less than 10 percent; (f) shareholders have pre-emptive rights at new equity offerings. Source: La Porta et al. (1998a: 43).

Minority Shareholder Protection, early 2000s: Update of the LLSV index for the early 2000s. Source: Pagano/Volpin (2003: 41).

Block Premium: Averages from country based company samples. Difference between the prices per share paid for control blocks and the exchange prices two days after the announcement of the control transactions, divided by the exchange prices two days after the announcements and multiplied by the proportion of cash flow rights represented in the controlling blocks. Source: Dyck and Zingales (2001: 45).

Returns from Privatization: Amount raised by privatization of state-owned enterprises as a percentage of 2000 GDP, 1990-2000. Source: Schneider (2003: 9).

Employees' Representation Rights: 2=strong representation, 1=moderate representation, 0=low or no representation. Source: OECD (1994: 154).

Deviations from "one share, one vote": Percentage of firms among the Top 120 with voting rights or ownership ceilings in 1999. Source: Goyer (2003: 197).

Spread of Shareholding: Shareholders as percent of habitants, late 1990s. Source: Deutsches Aktieninstitut (2000: 08.6-1)

Years of Center-Right Party Dominance, 1949-2002: Numbers of years with center-right or right party dominance were counted. Grand coalitions were not counted as center-right dominance. In the US case, the number refers to the years of Republican presidencies. In the case of government or presidency changes, the government or president with the longer time in office was counted. Source: Schmidt et al. (2003).