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The Political Paradox of Finance Capitalism: Interests, Preferences, and Center-Left Party Politics in Corporate Governance Reform

JOHN W. CIOFFI AND MARTIN HÖPNER

A striking paradox underlies corporate governance reform during the past fifteen years: center-left political parties have pushed for pro-shareholder corporate governance reforms, while the historically pro-business right has generally resisted them to protect established forms of organized capitalism, concentrated corporate stock ownership, and managerialism. Case studies of Germany, France, Italy, and the United States reveal that center-left parties used corporate governance reform to attack the legitimacy of existing political economic elites, present themselves as pro-growth and pro-modernization, strike political alliances with segments of the financial sector, and appeal to middle-class voters. Conservative parties' established alliances with managers constrained them from endorsing corporate governance reform.

Keywords: *corporate governance; finance capitalism; center-left parties; economic reform; financial regulation*

I. INTRODUCTION: THE POLITICAL PUZZLE OF CORPORATE GOVERNANCE REFORM

The last two decades have witnessed rapid and substantial political economic change across the advanced industrial countries. Corporate governance reforms, which include the juridical restructuring of both the corporate firm and domestic securities markets, have gathered speed since the mid-1990s and assumed a central position in the politics of this broader transformation. Contrary to the rhetoric and ideology of deregulation, pro-shareholder corporate governance

reforms entail regulatory expansion and deepening. Political actors have intervened directly in the allocation and organizational structure of power within the private sphere at its institutional foundations: the corporate firm. In this article we show that political actors and center-left parties mattered decisively in this process.¹ 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 were the driving force behind corporate governance reform and the institutional adjustment to finance capitalism, while right-of-center parties resisted reform to protect established forms of managerialism and organized capitalism.*² We empirically confirm this general hypothesis and offer a number of explanations for this peculiar political dynamic. In doing so, we propose important qualifications to the “varieties of capitalism” literature and recent interest group analyses of the politics of corporate governance to better capture the political dynamics underlying structural and economic change.

Contrary to common understandings of corporate governance reform, political conservatives were seldom enthusiastic reformers and often resisted pro-shareholder laws, while the center-left has tended to champion the cause of shareholders, and thus finance capital, in opposition to managers. It is reasonable to hypothesize that the center-left should oppose, rather than support, corporate governance reform.³ At first glance, the distributional consequences of corporate governance reform would appear to conflict with traditional left-wing political commitments to working-class and low-income constituencies. Increased shareholder orientation is likely to sharpen incentives to increase short-term corporate profitability, reducing the role of stable financing through “patient capital” and cross-subsidization, and shifting income and wealth from wage earners to shareholders.⁴ Corporate governance reform also increases the likelihood of hostile takeovers that tend to shift rents to shareholders.⁵ Reform threatens to decrease the power and influence of employees 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 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. This paper speaks to a policy field that, so far, has not been systematically examined within the political parties literature and develops an argument that runs counter to the expectations of the mainstream of the political economy (and law and economics) literature on corporate governance.⁶ These accounts of politics, policy, and governance tend to identify the center-left and organized labor as inimical to corporate governance reform and hostile to shareholder interests. We find, to the

contrary, that center-left parties are not necessarily composed of those favoring “politics against markets,”⁷ but tend to favor—compared to the center-right—market-enabling and pro-shareholder legal reforms that mark a new and surprising turn in corporate governance policy and political economic development more generally. Rather than self-reinforcing institutional complementarities and business-supported path dependence common to the “varieties of capitalism” theory of Hall and Soskice,⁸ we find tensions within these national models that spill over into the political realm of policy making and threaten to destabilize and undermine their institutional complementarities.⁹

Finally, our findings diverge from the recent work of Mark Roe that argues that shareholder protections weaken and agency costs increase with the political strength of the labor movement and social democratic parties.¹⁰ In Roe’s model, managers—by definition—find themselves somewhere in between shareholders and employees, pressed to side with either one or the other group. In this analytic model, employees always increase agency costs. Our findings indicate that this theory does not recognize the non-liberal character of the center-right in most countries and fails to appreciate the role 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, but has also strengthened shareholders and other financial interests. It has re-established the balance among shareholders, managers, and employees in the shareholders’ favor.

All four country cases 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.¹¹ 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.¹² 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-controlled firms and conservative political elites.¹³ Compared with France and Germany, the Italian political economy was far less formally coordinated and organized for purposes of economic policy, while high levels of corruption accompanied undeveloped financial markets. Germany represents a classic case of a “coordinated market economy” (CME) with negotiated, strategic coordination among centralized peak associations, strong unions, and financial networks of corporations and banks, and including employee representation within the firm. While state ownership remained fairly low by French or Italian standards, the country’s capital markets remained undeveloped within a bank-centered financial system. The United States exemplifies the “liberal market economy” (LME), with a market-driven financial system, liquid and well-developed securities

markets, diffuse share ownership that separates corporate ownership from control, extremely weak unions, and negligible employee representation within the firm. These corporate governance characteristics gave rise to the American form of managerialism and have typically privileged managers over shareholders in corporate and political affairs.¹⁴

Although scholars often describe these national cases as falling within an LME-CME typology of political economic organization,¹⁵ we see both wider variation among them and an overarching political dynamic of economic crisis, political entrepreneurship and repositioning, coalition formation, and institutional and regulatory reform. Given the wide variations of law and institutional structures across these cases, the parallels in the processes and dynamics of corporate governance reform are all the more striking and significant.¹⁶ The following sections set out the basic contours and reform of the French, Italian, German, and American national corporate governance regimes. The analysis of each specifies the main drivers and political constellations of reform. The article concludes with a synthetic comparative section generalizing our main theoretical findings and their implications.

II. FRANCE: FROM STATISM, TO PRIVATIZATION, TO REGULATORY REFORM

Historically, of our four cases, France was the most highly centralized and statist. Not only did the French state wholly own or control a large number of the country's leading industrial and financial firms, but it also maintained tight control over the allocation of credit and thus over banks and corporate finance.¹⁷ 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 economic planning and industrial policy.

Prior to 1967, securities regulation was not even a recognized area of French law.¹⁸ In 1967, France's first securities law created a national securities markets regulator, the Commission des Opérations de Bourse (the COB), and a rudimentary framework for financial disclosure.¹⁹ But the intensely statist character of industrial policy limited actual transparency. Tightly knit political-bureaucratic-corporate elites decided policy and corporate strategy with minimal accountability. These state-firm relations fostered the corruption and corporate financial scandals that have long pervaded French politics and business.²⁰

French company law reinforced the insider domination of corporate firms by managers and fostered political-managerial relationships. French company law provides for a unitary board structure, but subordinates shareholder interests to "corporate interests" and the public interest embodied in state economic policies. There are few legal provisions for fiduciary duties to effectively protect shareholders.²¹ 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. In addition, a history of ideological labor militancy and uncooperative labor relations induced the exclusion of employees from firm governance.

The highly centralized and concentrated market structure of the French corporate economy depended on state finance, cross-subsidies, and credit allocation. Ownership structures were likewise centralized, either through state ownership or through the predominance of “blockholding” shareholders and family ownership of closely held firms.²² State administration of finance and widespread public ownership of enterprise displaced market-driven financial relations and constrained the broader development of financial markets and private shareholding.²³ Paradoxically, managerial power thrived in this statist environment. Shareholder rights, institutional investment, and labor 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 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.²⁴ 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.²⁵

This need to separate firm and government finances led to two waves of privatizations that set the stage for corporate governance reform in France.²⁶ The first wave, during 1986-1987, took place under the conservative Minister of Finance Édouard Balladur, and the second in 1993 under Balladur as prime minister.²⁷ However, upon returning to power in 1988, the Socialists did not reverse and, in fact, continued and accelerated the privatization process through sales of minority equity stakes in state-owned companies.

Led by state policy makers, by the late 1980s a general consensus emerged among the center-right and center-left that the development of capital markets in place of statist financial control was essential to improved corporate and macroeconomic performance.²⁸ The liberalization of financial markets eroded state control over finance. 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.

Major political and financial scandals heralded the fundamental reform of French securities markets regulation that came with the enactment of securities disclosure laws in 1988 and 1989.²⁹ The reforms targeted not only private abuses of the markets, but also the corruption and manipulation that emanated from the state's control over finance and the privatization process.³⁰ 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. 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 disengagement from direct control over finance. 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.³¹ 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.³²

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 voluntary "code of best practice" drafted by a private commission. These 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, Marc Viénot.

In July 1996, a *government* commission chaired by Senator Philippe Marini issued a parliamentary report proposing sweeping reforms in French company law.³³ 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. In keeping with the Anglo-American approach, the report pressed for company law reforms that avoided rigid mandatory rules and instead *enabled*, but did not require, firms to strengthen their boards and adopt more efficient corporate governance structures. Significantly, the Marini agenda largely stalled in the conservative-controlled Parliament.³⁴

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 2001.³⁵ 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. 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. 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 to reduce conflicts of interest in crucial matters such as auditing and compensation. There is no "one-share, one-vote" rule to enforce shareholder equality, thus leaving intact insider and government control of firms through "golden shares" or classes of stock with disproportionate voting rights.

Though French conservatives have resisted substantial changes to internal corporate structures and governance procedures, they 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), which merged the COB, the *Conseil des Marchés Financiers* (CMF), and a third regulatory body, the *Conseil de Discipline de la Gestion Financière* (CDGF).³⁶ The passage of this law under a conservative government indicates the broad consensus that had 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 limitations on the more fundamental reform of company law and the internal structure of the corporation.

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 percent of the French equity market, but the French government retained extensive powers to block control transactions and can intervene selectively in merger and acquisition activity.³⁷ In addition, the Ministry of Finance can block the acquisition of more than 20 percent of a French firm by a non-EU party. Hence, the state combined liberalizing and interventionist policies to ensure that French industry remains largely in the hands of French managers.³⁸

However, the French state under Socialist Prime Minister Lionel Jospin during the late 1990s and early 2000s 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 battles reminiscent of those in the United States.³⁹ The BNP-Paribas bank merger, along with other large-scale mergers and takeovers, 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 and industry. The insulated, self-protective elite networks that defined the post-war political economy are eroding rapidly along with the institutional arrangements that perpetuated it.

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. Under restored conservative rule following the 2002 elections, corporate governance reform is once again a marginalized policy area. Government policy towards corporate governance, ownership, and control 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 (now Interior Minister and conservative party head) Nicholas Sarkozy, the state increased its activism in controlling mergers and acquisitions and in bailing out troubled firms for political reasons, despite his pro-reform rhetoric. This suggests that the corporate governance debate will remain a trigger point in a new and still inchoate form of class politics in France—and with the center-left taking the side of shareholders against managers.

III. ITALY: THE AMBIVALENT REFORM OF AN INSIDERS' CORPORATE ECONOMY

Like France, until the early 1990s, Italian finance and corporate governance were 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, the economic, political, and social interconnections of a tightly knit group of elite families 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.⁴⁰ The extraordinary predominance of a number of families in corporate ownership and control has led to the Italian corporate governance regime being referred to as “family capitalism.”⁴¹

Case studies indicate that Italian corporate cross-shareholding and interlocking directorates are even more extensive and intensive than in Germany.⁴² The Italian board has provided weak oversight of the management board despite the existence of audit committees. Italian law also provided an extraordinarily low level of minority shareholder protection, reflected in the abnormally high control premium commanded by controlling holdings of stock compared with the market price of minority shares.⁴³ Italy also had one of the most bank-centered financial systems among the industrialized democracies.⁴⁴ But, unlike their German counterparts, 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. These legal and ownership structures gave rise to the insular *salotto buono*, a powerful interconnected clique of family capitalists that control many of Italy’s largest firms.⁴⁵

The relatively high level of state ownership of firms, especially in the financial sector, and the prolonged political dominance of the Christian Democratic Party profoundly shaped the Italian corporate governance regime in structure and its opaque—and frequently unsavory—practices. In the mid-1990s, eight out of the twenty largest Italian stock corporations were state controlled.⁴⁶ The deep entanglement of Italian business with the Christian Democratic Party defined Italian capitalism for most of the post-war period. Italian Christian Democrats dominated the political and economic systems more thoroughly than either the Christian Democratic Union–Christian Social Union (CDU-CSU) in Germany or the Gaulists in France. This 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 to bind networks of political and economic elites as sources of support and patronage. Corruption also pervaded the relations between Christian Democratic and Socialist politicians, and among major party politicians (excluding the Communist left) and private firms.⁴⁷

Italian reforms cannot be understood apart from the nearly wholesale collapse of this routinized corruption and with it the Italian party system in the wake of the Tangentopoli scandals of the early 1990s. The scandals, exposed and prosecuted by Italy’s independent judiciary, largely destroyed the legitimacy of the post-war political elite and supplied the political preconditions for the economic reforms that followed. The consequences of the scandals for Italian party politics were staggering. The center did not hold, on either the right or the left. The Christian Democrats and Socialists, Italy’s two dominant parties

collapsed in 1994. The Christian Democrats broke into three weak and feuding successor parties. The Socialists disbanded; their members absorbed into other parties on the left. 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.

Beginning in the mid-1980s, amid lagging macroeconomic and corporate performance, political elites embarked on a debate over Italy's competitiveness and economic woes.⁴⁸ The performance of state-owned corporations was notoriously poor. Italy's poor economic performance also threatened Italy's participation in European economic and monetary integration as those processes gathered political momentum in the European Community during the later 1980s and early 1990s. In the context of this debate, Italy's underdeveloped capital market posed an increasingly serious comparative economic disadvantage and political liability. By the early 1990s, EU integration through the European Monetary Union (EMU) and Single Market Program exerted direct and indirect pressures for reform of Italy's macroeconomic policies, state-owned firms, and undeveloped financial markets and regulatory framework. After the signing of the Maastricht Treaty and a humiliating devaluation of the lira in 1992, the Italian public supported EMU and the policies necessary to achieve the EMU's criteria of low inflation and budget discipline more strongly than any other large European electorate.⁴⁹ Privatization became a principal instrument of achieving fiscal discipline, public debt control, and therefore monetary stability while eliminating a principal channel of corruption.

The Italian privatization program, like its French counterpart, was one of the most extensive among the Organization for Economic Cooperation and Development (OECD) countries and constituted a profound transformation of the domestic political economy.⁵⁰ In 1997, the government sold off its entire equity stake in Telecom Italia and privatized the Borsa Italiana, the Italian stock exchange. 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."⁵¹ He lamented further that "we do not have guarantees for small shareholders, no rules for public companies."⁵² Tellingly, the left-wing government refused to sell shares to potential blockholders such as Mediobanca, remained critical of "golden shares," and instead favored the creation of companies with diffuse shareholders. Questions of minority shareholder protection and management accountability became salient political issues and

policy priorities.⁵³ 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. However, through much of the 1990s, the political right was in such disarray that it could not mount an effective defense against the reformers.

Filling the political vacuum created by the collapse of the Christian Democrats and Socialists, left-wing governments pushed through a succession of legislative changes during the 1990s. In 1990, a new antitrust law instituted a competition authority. The 1990 Amato law transformed banks into joint-stock corporations. In 1991, the Parliament passed a securities law prohibiting insider trading and imposed more stringent financial disclosure requirements on publicly traded companies. In 1992, following EC directives, the government passed additional securities laws mandating enhanced financial transparency and disclosure by mutual funds.⁵⁴ Reform legislation accompanied privatizations in the financial sector. A 1993 law 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 the exchange and publicly traded firms functioned efficiently and honestly.

Between 1996 and 1998, left-wing governments passed a series of major securities laws governing the behavior of mutual funds and financial intermediaries. 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 Treasury 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.⁵⁵ The main provisions of the Draghi reforms were as follows:

- Anti-takeover defenses must be approved by the shareholders' meeting.
- Minority shareholders' rights strengthened, reducing threshold to call a special shareholders' meeting to 10 percent.
- 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.

Looking to the Italian party system, the PDS was the driving force behind corporate governance liberalization, not only during the center-left "Olive Tree" coalition government (1996-2001) but also during the 1990s, when the weakness

of the conservative parties provided opportunities to reform. "Our Ex-Communists are the most economically liberal party round here," *The Economist* quoted an Italian businessman.⁵⁶ The right-wing parties, in government briefly during 1994 and from 2001 to 2006, have been divided over privatization and corporate governance issues, and the current conservative coalition government has largely stalled further reform. The privatization of Telecom Italia provides an important illustrative example of these tensions. Umberto Bossi's populist and regionalist Northern League regarded state holdings as contrary 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.⁵⁷ Berlusconi's Forza Italia, the strongest party on the Italian right, was (and still is) torn between neo-liberalism and the legacy of the protective Christian Democratic alliance with the managerial elite. Berlusconi, like former Christian Democratic premiers, enjoys close contacts with Italy's *salotto buono*—and is a prominent member of the country's business elite. Not surprisingly, all significant corporate governance reforms predated the Berlusconi government.⁵⁸

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 a central position within the Italian political economy. Ownership is still very concentrated in Italy and continues an entrenched tradition of insider control.⁵⁹ For all the legal and regulatory reforms of the 1990s, enforcement remains lax, and regulatory authority poorly institutionalized. Perhaps most important of all, the right-wing Berlusconi government appeared to embrace and embody the incestuous alliances and interrelationships between business and political elites.⁶⁰

However, the decade of reforms undertaken by the center-left significantly altered Italian capitalism. The post-privatization increase in the number of publicly held stock corporations and the increase in the stringency of legal protections for shareholders represent a substantial structural change in the Italian political economy. Between 1990 and 2000, the Italian stock market's capitalization rose from 14 to 72 percent of GDP.⁶¹ The years after 2000 witnessed a significant withdrawal of familial owners from the active control of industrial business. 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.

The partisan conflict over financial liberalization and corporate governance reform not only persists, but also has recently intensified over the role of Antonio Fazio, the governor of the Bank of Italy, in manipulating regulatory enforcement in favor of a domestic bidder to prevent a Dutch bank from taking

over an Italian bank. The scandal threw the conservative Berlusconi government on the political defensive against both the center-left opposition and the European Central Bank, and resulted in Fazio's resignation under pressure. Fazio's replacement at the head of the Bank of Italy: Mario Draghi, namesake of the center-left's Draghi reforms and fresh from four years as a vice chairman of Goldman Sachs in London. Fazio's ouster, and his replacement by Draghi, indicates the importance and depth of the realignment of political forces within Italy, and the European Union as a whole, with respect to financial sector regulation and corporate governance issues. If the Fazio scandal suggests an insular elite's continued influence, Draghi's return reveals a pro-shareholder shift in power and the parameters of legitimate policy making that the Berlusconi government could not withstand. Financial liberalization, corporate governance reform, and regulatory integrity are now enduring features of policy and societal expectations of the state.

IV. GERMANY: THE REFORM OF DEUTSCHLAND AG AND THE MICROCORPORATIST FIRM

The scholarly literature has treated the German political economy and corporate governance regime as a model case of a "coordinated market economy."⁶² 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 familial 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. Large private banks with their close personal ties with both industrial companies and public authorities established linkages of mutual influence between the private and the public spheres.⁶³ Unlike France, Italy, or the United States, the German corporate governance regime endowed both universal banks and employees with strong institutionalized forms of representation within the corporation.⁶⁴ The large banks established a dense network of interlocking 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.⁶⁵ These relationships and linkages, formed in the years of reconstruction after World War II, persisted through the following decades. Personal ties through interlocking supervisory board directorates deepened cooperative relationships between banks and industrial firms. For this reason, the debate over German corporate governance has been, to a large extent, a debate over the power of banks.⁶⁶ 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. Perhaps more importantly, German law enables employees to elect works councils with extensive statutory rights of consultation in a wide array of important corporate decisions.

This combined integration and institutionalization of financial and employee power has led commentators to describe the post-war German corporate governance regime as a consensual stakeholder model that incorporates managers, creditors, and employees within the firm. More broadly, the corporate governance regime and national financial system 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."). The institutionalized countervailing power of banks and employees within German corporate governance constrained and weakened managerial autonomy. Management boards had to coordinate with these stakeholder groups prior to taking major decisions to avoid potentially damaging conflict within the firm.

In Germany, general considerations of industrial and financial sector competitiveness drove financial market and corporate governance reforms.⁶⁷ In the 1980s, the rise of persistent mass unemployment and the growing political and economic pressures of European integration triggered a debate among German elites over German competitiveness and regulatory harmonization that raised the question of financial system reform. By the early 1990s, most large German universal banks, suffering from falling profit rates in a saturated banking market, began to shift their business strategies and policy preferences from the established relational banking model towards the development of new financial services capacities based on a more market-based financial system.⁶⁸ The banks and their peak association, the Association of German Banks (BDB), and political allies realigned in support of securities market reform. This change in orientation complemented German political support for European economic integration, which had been stymied, in part, by opposition from domestic financial institutions. Though managerial ranks remained divided, managers of some large German corporations backed much of the reform agenda to increase their access to foreign capital markets. By the early 1990s, the reform of securities law and regulation quickly became a consensual policy among German political and economic elites.

Taking advantage of the elite consensus that had formed in favor of financial market reform, the CDU-led 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.⁶⁹ The Second Financial Market Promotion Act of 1994 constituted a watershed of German financial market and securities law reform. The act created Germany's first national securities regulatory, the Federal Securities

Supervisory Office (Bundesaufsichtsamt für den Wertpapierhandel, or BAWe); banned insider trading; and established the legal and institutional basis for financial transparency and disclosure regulation under securities law.⁷⁰ These laws and the regulations subsequently drafted by the BAWe aimed to encourage the development of domestic securities markets, not to alter the power relations or structural features of the German corporate governance system.

This changed in the late 1990s when legal reforms advanced by the center-left Social Democratic Party (SPD) began to alter the core structures of the corporation and thus the basic logic of German corporate governance. Further fueling debate over corporate governance, a succession of spectacular corporate financial scandals that engulfed companies, such as the crises of Metallgesellschaft, Bremer Vulkan, Klöckner, and the Schneider real estate empire, stoked popular resentment towards corporate managers and financial elites. Stretching from the late 1980s through the late 1990s, these scandals, coupled with Germany's structural economic malaise, made corporate governance reform even more politically attractive. The center-left SPD saw pro-shareholder corporate governance reform as a means to garner support from the most powerful segments of the financial sector, broaden its appeal to the middle class, and exploit tensions within the CDU's managerialist coalition, all while maintaining its working-class base. What made this possible, at least initially, was the tacit support of German organized labor. Corporate governance reform presented a way to bridge the historically antagonistic interests of labor and finance capital.

While French and Italian unions neither welcomed nor opposed reform, German trade unions and their peak association, the Deutscher Gewerkschaftsbund (DGB), for the most part promoted the pro-shareholder orientation of corporate governance reform. Besides their historical preference for limiting the power of economic agglomerations and banks,⁷¹ three explanatory factors for the union's support of governance reform must be highlighted and distinguished. First, the presence of employee and union representatives on German supervisory boards gives organized labor an interest in empowering supervisory boards, increasing transparency, and improving management accountability. Every increase in supervisory board power buttresses the effectiveness of board codetermination.⁷² Second, unions have a broader interest in limiting managerial agency costs. The interests of both employees and shareholders align in favor of preventing opportunism and shirking by managers. 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.⁷³ 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. The addition of a private investment-based pillar to the German “solidaristic”

pension system, among other state policies, has encouraged the emergence of mass shareholding in Germany. Although the development of mass shareholding was and remains in its early stages, it has helped push corporate governance, once a preserve of technocrats, to the forefront of Germany's political debate over economic reform.

In contrast to the Financial Market Promotion Acts, the debate leading to the enactment of the 1998 Control and Transparency Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, or *KonTraG*)⁷⁴ 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. These 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.⁷⁵ Most provocatively, the SPD sought to prohibit banks from holding share blocks larger than 5 percent in industrial firms. SPD rhetoric targeted concentrated bank and managerial power, and framed reform in terms of protecting *shareholder interests*, rather than those of employees who formed its traditional base of electoral support. However, the SPD's policy agenda was not nearly as populist as the party's rhetoric. The major banks had already embraced policy positions favoring greater transparency and protection of minority shareholders through the development of securities regulation.⁷⁶

The SPD's proposed legislation forced the Kohl government onto the defensive and eventually to support compromise legislation that was enacted as the *KonTraG*. Nearing the 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 coalition, the small neo-liberal Free Democratic Party (FDP) supported reform in tension with the CDU's resistance. In contrast, historically left-wing parties and constituencies lined up behind the SPD as parliamentary representatives from the Green Party and even the post-Communist Party of Democratic Socialism (PDS) spoke in support of the SPD's company law and corporate governance reforms. With the governing CDU-FDP coalition divided and politically weakening, the Bundestag passed the *KonTraG* during the last months of the Kohl coalition government in 1998—shorn of its most severe anti-bank provisions. 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 managerial interests.

The *KonTraG* complemented the overhaul of securities law already well underway. Its most important reforms included the following:

- introducing shareholder democracy through a “one share, one vote rule” for the first time;

- requiring the supervisory board to hire and oversee the external auditors, and to meet four times a year (up from twice a year);
- prohibiting the voting of cross-shareholding stakes above 25 percent (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;
- authorizing share buybacks and stock options plans; and
- introducing stricter rules on risk management.

The SPD's embrace of corporate governance reform was not fleetingly opportunistic. Rather, reforms continued after Gerhard Schröder's SPD-Green coalition government came to power in September 1998. Most strikingly, the Schröder government surprised friend and foe alike 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 (locked in place by stiff capital gains tax liabilities). This "tax gift," especially for the large banks, triggered a 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.⁷⁷ The government went on to sponsor a governmental Corporate Governance Commission, its Code of Best Practices, and a series of less politically contentious corporate governance reforms.⁷⁸

The SPD's attempt to straddle the interests of labor and financial capital sparked conflict over the neo-liberal thrust of a proposed EU Takeover Directive designed to introduce hostile takeovers to Continental Europe. The SPD government had approved the directive, and was left vulnerable to a CDU attack. The CDU countered an SPD agenda that bridged the interests of labor and capital with one that appealed to an alliance of labor and management. The SPD beat an embarrassing retreat and joined the CDU to oppose the directive in the European Parliament, where it was defeated.⁷⁹ Immediately thereafter, however, the SPD government advanced its own domestic takeover law. The parties' negotiations over the German Takeover Act in November 2001 broke down into a divisive battle over financial and managerial power. Once again, the CDU defended German organized capitalism and managerialism. Perceiving takeovers as a threat to German managerial interests and the underpinnings of the post-war German economic model, CDU leaders argued for much greater managerial and supervisory board latitude in adopting anti-takeover defenses.⁸⁰ SPD and Greens argued that "the shareholders own the corporation and should have the final say,"⁸¹ and, holding a majority in the Bundestag, passed a takeover law that limited anti-takeover defenses to a surprising degree.⁸²

Conflicts within the SPD, and between the Party and the unions over takeovers, pointed to the tensions generated on the left by the corporate governance reform

agenda. As early as Schröder's 2002 reelection campaign, it was clear that his strategy of trying to pry off significant segments of the financial sector from the conservative coalition had failed. In the context of the SPD's broader pro-business agenda, tensions over the allocation of power within the national political economy and the corporate firm contributed to (though by no means caused) the eventual split in the ranks of the SPD and the formation of the new Left Party in 2005 by left-wing SPD dissidents and former Communists of the PDS. The division on the left hobbled the SPD and was a prime cause of his—and the party's—narrow electoral defeat in late 2005 that forced it into the junior position in a “grand coalition” with the CDU.

However, the corporate governance reforms of the past decade have produced lasting change in structural terms and, increasingly, in economic behavior and outcomes. The German company network has begun to dissolve. 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 indicate significant change at the company level.⁸³ The general question hanging over current German politics is whether the grand coalition will be willing or able to enact any significant economic reforms. The more specific question for our purposes is whether the center-left, in defeat and weakened by open revolt on its left, can politically reconcile the economic conflicts between workers and financial capital through a pro-shareholder corporate governance reform agenda.

V. THE UNITED STATES: SCANDAL, REFORM, AND THE PERILS OF NEO-LIBERALISM

The American case is the archetype of modern finance capitalism. But although it pioneered modern securities regulation, corporate governance reform came later to the United States than France, Italy, or Germany. The contemporary corporate governance debate in the United States began two decades ago amid economic crisis and instability. 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 since. Takeovers and the increased power of investment banks encouraged the adoption of new, financially driven management strategies. A business culture of short-term strategic planning horizons, excessive leverage, a focus on immediate returns to shareholders, successive booms in CEO empire building, and, ultimately, manipulation of earnings and disclosures would result in a corporate governance crisis. Coming approximately at the nadir of American “deindustrialization,” 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.

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. Yet the resulting explosion of legal activity failed to substantially reform the American corporate governance regime. The political battles over takeover law further strengthened management and diluted fiduciary duties to shareholders, as courts (most importantly in Delaware, the premier state of incorporation) sanctioned complex takeover defenses and many states (this time with the important exception of Delaware) adopted anti-takeover statutes.⁸⁴

The backlash against takeovers set the stage for an ongoing policy debate over corporate governance. Managers, unions, institutional investors, shareholder groups, financial institutions, and financiers sought to enshrine their policy preferences in law. However, the battles over takeovers turned on the content and adequacy of company law and fiduciary duties, not federal securities law and regulation. 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. The resulting dramatic option-driven rise in executive compensation intensified the conflicts of interest endemic to corporate governance and would play a prominent role in the massive and widespread corporate financial 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 securities litigation reform legislation designed to reduce the incidence of securities litigation.⁸⁵ Political motivations drove the conservatives’ legislative attack on securities litigation as much as, if not more than, economic considerations. They strengthened the position of managers, a predominantly Republican constituency, by weakening one of the most important enforcement mechanisms of transparency and managerial accountability, while attacking the financial base of a plaintiffs’ bar that overwhelmingly supported Democrats. However, throughout the 1990s, the SEC initiated a series of reforms to improve managerial accountability and financial transparency. In 1992, the SEC amended its proxy rules to encourage greater governance activism by institutional and other large shareholders.⁸⁶ But the SEC failed in its efforts to reform the regulation of accounting rules to require the expensing of stock options and to limit accountants’ provision of audit and non-audit consulting services to the same clients. The accounting firms and “new economy” technology firms enlisted congressional

allies in both parties to bring legislative pressure on the SEC until these proposals were withdrawn.⁸⁷ Finally, the SEC pushed through Regulation Fair Disclosure (“Regulation FD”) in August 2000, which prohibited selective disclosure of material information by corporations to favored analysts and financial institutions. 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. In this sense, Regulation FD conflicted with (and at least partially undid) the proxy reforms of 1992. Transparency regulation and institutional activism, the two dominant paradigms of corporate governance regulation and reform, were operating at structural, legal, and political cross-purposes.

The post-1990s scandals of 2001-2002 finally inflamed political support for more wide-ranging reform and disrupted the balance of power that had constrained federal corporate governance policy. With the passage of the Sarbanes-Oxley Act in mid-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 on publicly traded corporations, corporate managers, accountants, and attorneys. The act replaced the self-regulation of the accounting industry with the Public Company Accounting Oversight Board, appointed by and under the oversight of the SEC, to regulate accounting standards and the activities of accounting firms in auditing and consulting. The law also increased criminal and civil penalties on executives for failing to disclose material financial information to the public, and required the SEC to draft new regulations requiring heightened disclosure of the financial condition of corporations.⁸⁸

Sarbanes-Oxley represents an unprecedented intervention of federal law into the *internal* structure and affairs of the corporation—traditional subjects of state corporate law. Like the German KonTraG, Sarbanes-Oxley sought to strengthen the independence and auditing function of the board. The boards of public firms must now have a majority of independent directors and they must appoint an auditing committee composed *entirely* of independent directors.⁸⁹ Further, auditors must report directly to the audit committee, rather than management. Finally, Sarbanes-Oxley compelled CEOs and CFOs to certify the accuracy of corporate accounting and the adequacy of internal control procedures for collecting and disseminating financial information. This break with long-standing and politically entrenched traditions of American federalism suggests not only the extraordinary political potency of the scandals of 2001-2002 (after all, waves of corporate and financial market scandals are hardly new) but also a more fundamental change in the public perceptions of economic fairness that

privileges the interests of shareholders, a group that encompassed more than 50 percent of American households. As in our other country cases, the center-left seized on this opportunity against the resistance of managerialist conservatives.

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 an anti-regulation policy agenda.⁹⁰ 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 as an alternative to the Democrats' more substantial reforms. In the end, the continuing wave of corporate financial scandals, culminating with the spectacular collapse of WorldCom amid revelations of a multi-billion-dollar accounting fraud, sparked public outrage and broke political resistance to reform.⁹¹ Scandal and public anger gave Democrats in the Senate the opportunity to drive the politics of reform. 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 onto 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 lost prestige and political influence as the public began to perceive them as collectively corrupt and responsible for the looting of American corporations.⁹² The development of securities markets, mass shareholding, and the growth and diversity of investment funds in the United States meant that financial interests, ranging across a wide range of financial institutions, institutional investors, individual shareholders, and securities market operators, were divided in their preferences concerning the substance and extent of corporate governance reform. Financial institutions, such as investment banks, commercial banks, and brokerages, 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. Many were also weakened in the political process by their roles in numerous scandals. Accounting firms 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.

Institutional investors were a surprisingly impotent political force for reform. Since the 1980s, they were predominantly committed to a voluntaristic form of

corporate governance activism and were skeptical of, and often hostile to, increased regulation. Union pension funds were a partial exception to the peripheral role of institutional investors in the legislative politics of corporate governance reform. These funds have long been the most activist investors in corporate governance, with ideological and strategic commitments to constraining imperious managers. They are also closely tied to 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. Yet the political activism of even these well-organized funds had a marginal influence on the substance of reform. Overall, the breakdown of interest group politics as usual facilitated corporate governance reform, not the pressure from interest groups. Managers, accounting firms, corporate attorneys, and politicians (of both parties) antagonistic towards regulation were almost completely sidelined in the policy debates over corporate governance reform at the peak of the post-bubble scandals.

However, unlike the center-left political dynamic in our European cases, American corporate governance reform did not reflect a stable, long-term realignment of interest groups and partisan politics. The Democrats used the post-bubble scandals and the collapse of share prices to attack a deeply conservative and pro-manager Republican leadership and as a well-placed appeal to middle-class voters in a country where mass shareholding was well established. This political strategy was not the product of long-term interest group realignment or a shift in the Democrats' policy preferences. Rather, corporate governance reform fit well within the contours of the center-left ideology and the Democrats' historical support for the regulatory state. Indeed, the New Deal of the 1930s created modern securities regulation. However, the Democrats' enthusiasm for reform was tempered by their evolution into a purely centrist and largely pro-business party. Their capacity to push for reform was hobbled by the relative *absence* of class-based politics in the United States.⁹³ Further, the splits within and among influential interest groups proved to be a temporary condition that ended as the scandals receded in public memory. By 2005, a business backlash against corporate governance reform was fortified by the Republicans' 2004 general election victories and effectively ended the brief era of reform. Notwithstanding these differences between the American and European cases, the general point is valid: in the United States, as in France, Germany, and Italy, corporate governance reform was largely a project of the political left—not the ostensibly pro-business or neo-liberal right.

VI. DIFFERENT PATHS, PARALLEL POLICIES: THE PARTISAN POLITICAL DYNAMICS OF CORPORATE GOVERNANCE REFORM

Despite the considerable differences in structure and politics across them, a consistent political dynamic underlies reform in each of the country cases covered.

Political actors are crucial in driving the reform process, and those actors have come from the center-left and have pursued this agenda with the explicit or tacit support of their constituents. The pro-reform political constellation is opposite of what is expected. The parties with voter clienteles that have historically benefited from the distributional patterns of non-liberal capitalism are those that—in the policy domain of corporate governance—aim at liberalizing it. The emergence of finance capitalism relies on legal and regulatory infrastructure that receives political support primarily from the center-left. The consistency of this political dynamic reflects a deeper developmental trend. The countries analyzed here display very substantial political, economic, and juridical differences. Accordingly, their adoption of strikingly similar corporate governance reforms, and their consequent alteration of the structural allocation of economic power, reveals an epochal political economic change. Corporate governance reform, along with related capital market reforms, represents a broad, cross-national transformation of established national models of industrial capitalism into variants of finance capitalism.

These brief accounts of the historical development, substantive content, and political dynamics of corporate governance reforms in France, Italy, Germany, and the United States provide an empirical basis to describe common patterns across the cases. Despite the variation in political economic structures and party systems across the four cases, in each country the political center-left was the driving force behind corporate governance reforms, while the center-right tended to protect the status quo. Reform was situated in a common political dynamic in which center-left parties, scandals that undermined the political economic legitimacy of established elites, and changes in interest group politics and policy preferences played pivotal roles. Three sets of factors explain this political dynamic. First, a set of “functional” economic pressures on national political economies, firms, and interest groups created a context favorable to pro-shareholder reforms. Second, a set of “push” factors induced—or pushed—center-left parties to embrace corporate governance reform as part of their policy agenda. Lastly, a set of “pull” factors constrained—or pulled back—the center-right from endorsing reform. Together, this combination of political economic forces and constraints has informed a consistent dynamic of pro-shareholder corporate governance reform from the left. Substantively, this reform dynamic encompasses both regulatory reforms designed to address information asymmetries and securities market failures and legal interventions directed at *institutional governance failures of the corporate firm*.

By the 1980s, all four countries faced a combination 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 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, 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 existed independent of the specific political context and posed problems that *could* be addressed through financial system and corporate governance reform. Yet this by no way meant that reform was inevitable or indicates the identities of the political proponents of reform. The policy responses to these pressures were dependent on party composition and leadership, and the interest group alignments within national political economies. 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.

The center-right faced two closely related constraining *pull factors*. First, the legacy of class-based party formation embodied long-standing alliances between center-right parties and corporate managers, both as employers and as members of a managerial elite distinct from finance capital. Second, close personal and professional relations between center-right political elites and corporate managers led the politicians on the right to value managerial autonomy as matters of political expedience, personal economic interest, and ideological conviction. The political right became trapped by its own political economic legacies in a way that the center-left, faced with the decline of its ideological coherence and working-class base, was not. Although each of the center-right parties discussed here is a “catch-all” party, 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 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 Socialist and/or social democratic parties. The center-right was therefore more protective of traditional features of managerialism favored by their manager constituents.⁹⁴ In France, Italy, and particularly 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 effects of these close relations between the political right and corporate managers in the American case, in which the Republican Party maintains much closer ties to business interests and corporate

managers in terms of both policy orientation and electoral support than do the Democrats.⁹⁵

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. Thus, policy preferences in the area of corporate governance are not solely the product of the coordinated market economies' comparative economic advantages as suggested by the logic of the varieties of capitalism literature. Corporate governance regimes are also a forum in which reciprocal political support establishes tight linkages between the public and private spheres and among political economic elites. These relationships, facilitated by law and public policy, allowed the capture of vast rents produced by economic development and corporate activity. The center-right 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, where these party-management linkages were strongest, center-left support for corporate governance reform and center-right resistance are 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 with 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. However, in all four cases manager-party relations were and are asymmetrical: managerial elites have deeper and closer ties to parties on the right, which induced conservatives to defend the managerialist status quo.

In contrast to the intuitively predictable managerialism of the center-right, the center-left faced a more varied set of political and economic *push factors* that encouraged a surprising degree of support for corporate governance reform. First, to maintain and increase their electoral competitiveness, the center-left needed to develop agendas for economic reform that would cast it as a force of economic modernization, resonate with centrist middle-class voters, and still appeal to a left-wing and working-class electoral base. Second, shifting interest group preferences induced by structural economic changes and financial scandals enabled the center-left to align with groups favoring pro-shareholder policies, including significant segments of the financial sector. Governmental policies, dating from at least the early 1970s, facilitated the internationalization

of financial markets, services, and investment. By the 1990s, market-enabling and market-reinforcing regulation began to play an increasingly salient role in the development of financial internationalization, cross-national investment flows, and domestic economic restructuring. Third, an increase in shareholding among the public and the looming importance of securities market investments as a component of national retirement and pension systems gave the center-left an opportunity to fashion a corporate governance agenda consistent with more traditional anti-elite and pro-welfare state political appeals.

Conditions of poor economic performance, marked by rising unemployment, slow growth, and stagnating innovation and competitiveness, induced center-left parties to develop reform agendas that would appeal to both 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. Corporate governance reform also provided the center-left with a way to attack the opaque and 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 that broadened the appeal of corporate governance reform to centrist voters. 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 and networks among managerial and political elites. Financial market and corporate governance reform promised a way to reward innovative risk taking, reallocate capital, and facilitate corporate restructuring that would not depend on direct state intervention. Corporate governance reform reflects the withdrawal of the state from direct economic management, be it in the form of ownership of enterprise or allocation of credit, and the expansion of state regulatory capacities and structural interventions into the private sphere to promote welfare within the firm and the market.⁹⁶

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 reform. This factor was pivotal in Germany, but played a role in France and Italy as well. The internationalization of financial markets and services simultaneously opened more profitable market-based business strategies to financial institutions while also making them more vulnerable to foreign competitors entering their home markets. In France and Italy banks were cut loose from state supports and their roles in industrial policy, and would have to function competitively in increasingly internationalized markets. As financial institutions became more focused on and 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. 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 “investor confidence” in the efficiency, fundamental fairness, and thus legitimacy of financial markets and corporate governance practices and institutions. In the wake of stock market collapses across the advanced industrial countries in 2000-2001, 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.

Finally, the center-left developed an interest in pursuing shareholder-oriented policies and reforms as the importance and/or proportion of the general public holding shares began to rise.⁹⁷ This was a particularly prominent factor in the American case, where mass shareholding began earlier and advanced further than in Continental Europe. By the end of the 1990s, over 50 percent of households in the United States owned shares in some form. However, the expansion of shareholding also played an increasingly important role in Western Europe (though much more modest than in the United States) as an incipient shareholder culture began to develop. Faced with a decline in their traditional working class and the waning appeal of traditional left economic policies, pro-shareholder reforms not only appealed to a larger slice of the electorate, but also held the promise that the number and proportion of shareholders would rise. Moreover, policy makers looking ahead to a demography-driven crisis in public old age pension systems began to see the development of securities markets, institutional investment funds, and mass shareholding as essential to successful long-term pension reforms that would require alternative forms of savings that could generate higher rates of return.⁹⁸ Popular suspicion of financial elites has a long history on the left, in the United States as well as in Western Europe, as does advocacy for social welfare and pension policies. The growth of shareholding and securities as a channel of pension investment brought together these two consistent ideological and policy concerns, and prompted the center-left to support the rights of shareholders to a degree that would have been surprising twenty years ago.⁹⁹

Although the mix of push and pull factors varies across our cases, in the aggregate they lead to similar domestic political dynamics that shape the reform processes and outcomes in similar ways. Comparative analysis allows us to identify the salient factors in each country case, while showing how they produced cross-national commonalities in partisan politics and policy outcomes. Changing economic conditions introduced an inchoate conflict of policy interests between managerial and financial elites. The political right was constrained by the legacy of its elite supporters in both camps and fearful of opening the split within their ranks. The center-left had no such qualms and saw a strategic

opportunity in exploiting this conflict within the ranks of business to weaken their center-right opponents and appeal to the financial interests of additional coalitional constituencies.

In sum, economic developments altered the political terrain on which political parties maneuvered 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 operation of the corporate firm had always played central though often under-reported roles. The fiscal crisis of the state, the perceived need for more extensive and rapid corporate restructuring, and the evolving interests within the financial sector and organized labor presented the center-left parties with an opportunity to appeal to new constituencies as pro-growth economic modernizers and to distance themselves from backward-looking nostalgia for post-war economic policies and models that appeared to have run into chronic crisis.

VII. CONCLUSION

Corporate governance reform and the development of finance capitalism across the advanced industrial countries are frequently characterized as neo-liberal or right-wing political projects, and the center-left is represented as goaded by labor and as standing in opposition to the empowerment and protection of shareholders. 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 center-left has supported pro-shareholder corporate governance reforms while the right has consistently resisted them. This realization forces us to rethink how contemporary party politics functions and how class politics has been transformed over the course of a generation.

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 an evolving paradigm of finance capitalism in which the interests of investors have become far more important in terms of law, policy, and private economic decision making. One important catalyst of reform, in all the country cases save that of the United States, was the privatization of state-owned enterprises. This factor was especially prominent in France and Italy, but also present in Germany as well. Induced by chronically poor economic performance of state-owned firms and the resulting drain on public resources, European political economic integration under EU

auspices further exacerbated these fiscal pressures and impelled privatization. Corporate governance reform and associated minority shareholder protections provided a precondition for successful privatization programs. These reforms also reflected the political and practical difficulties in formulating and implementing alternatives to dispersion of shareholding through privatization. Leftist political resistance to allocations of shares that would directly benefit and reinforce the power of powerful financial institutions and blockholders, along with practical difficulties revealed by the French failure to establish a German-style stable cross-shareholding network, left the more regulatory, law-based variant of corporate governance reform as the most plausible policy course. 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. Corporate governance reform has expanded the scope and capacities of the regulatory state, just as it has reshaped the structure and power relations within the corporate firm. In each case, regulation has grown more stringent, extensive, and centralized, while penetrating into corporate form to favor shareholders and constrain managers. These common elements of corporate governance and cognate areas of securities regulation have become entrenched features of governmental policy and political economic organization, enduring in the face of subsequent electoral shifts and persistent conflicts.

Finally, and most central to this paper, corporate governance reform is 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 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 on the center-left initiated corporate governance reform in each country case and have been instrumental in fashioning new interest group alliances.

The center-left's corporate governance reforms reflected the "new middle" or "Third Way" strategies of the 1990s, but they are notably distinct from the bulk of the initiatives contained in these amorphous (and generally unsuccessful) policy agendas. Center-left policy agendas during the 1990s heyday of the "new middle" tended to embrace small-bore policies and, at best, incremental change. Corporate governance reform stands out in the muddled mass of center-left policies advanced during the past ten to fifteen years as an area of significant and systemic structural change that touches upon sensitive mechanisms of public

and private power. Moreover, the center-left's corporate governance reform agenda bore no relation to the arguable movement of these parties to the right on issues such as welfare state retrenchment and fiscal policy. The center-left did not outflank the right by appropriating its policy positions through some sort of tactical Clintonian "triangulation." The left pursued corporate governance policies that the right opposed and often actively resisted. Corporate governance reforms were, in part, an attempt to appeal to the middle-class core of the electorate (which now contains much of the working class) as current *savers* and potential *investors*, but this was the weakest part of the center-left's political appeal for reform. Shareholders are not a strong constituency where they exist in relatively small numbers (true of all our country cases except the United States)—and the status of shareholder is not a strong identity that shapes interests and political loyalties. The more potent appeals for reform revolved around the legitimacy of extant political economic elites and that of the emerging financially driven market order of contemporary capitalism.

A final note of caution must be added to this analysis. Looking at the recent politics of each of our country cases, the pro-shareholder stance of center-left parties did not reward them with electoral success. Rather, in each case the left has lost power. Indeed, the German SPD's pro-finance and pro-business—though not necessarily pro-shareholder—policies prompted a disastrous split on the left that led to defeat in 2005 and an uncertain future. A similar split contributed to the left's loss to Berlusconi's right-wing coalition in 2001 and still afflicts the fractious Italian left coalition government ushered in by the 2006 elections. In 2002, the French Socialist candidate did not even make it into the final round of the presidential election, the party's reforms alienating part of their electoral base and failing to enthuse the rest (though the party gained against the conservatives in the 2004 regional elections). The Democratic Party in the United States failed to achieve significant electoral gains in 2002 or 2004, following the Enron-era scandals and their spearheading of the Sarbanes-Oxley legislation—which is itself subject to continued attacks by the right. Corporate governance reforms and the constituencies they were designed to cultivate are no replacement for the programmatic politics of organized labor relations and welfare state expansion that mobilized the left's working-class base in the post-war era. The search for new and successful coalitions and policy agendas continues. However, corporate governance reforms have proved relatively popular and resilient. They are not sufficient to supply a foundation for center-left politics and policy, but they reflect important and enduring divisions among business elites and changes in both international and domestic financial markets to which the left has adapted. It appears that corporate governance reform and pro-shareholder policies will be part of the evolving political strategies of the center-left.

NOTES

1. The term “center-left,” as used here, refers to coalitions that exclude the large party on the right of each of the respective party systems, and to non-radical, non-Marxist parties only. The left-of-center parties in the countries we observe have very different origins (compare, for example, the German SPD with the Italian post-communist PDS). In general, Marxist and radical left parties do not behave in accordance with the “party paradox” of corporate governance reform. The puzzle we describe and the explanation we offer do not apply to them.

2. Our use of the term “finance capitalism” refers to an economic order characterized by increasing competition, the expansion and deepening of financial markets, and more extensive regulation of the corporate firm’s financial and governance practices consistent with the growth of market-driven finance. This conception of finance capitalism stands in sharp contrast to that developed by the German Socialist Rudolph Hilferding in the early twentieth century. Hilferding described a German economy dominated by monopolistic enterprises with strong financial linkages to major banks (and often to each other). In many ways, contemporary finance capitalism is the antithesis of Hilferding’s original conception. See Martin Höpner, “Corporate Governance Reform and the German Party Paradox,” *Comparative Politics* (forthcoming); and John W. Cioffi, “Building Finance Capitalism: The Regulatory Politics of Corporate Governance Reform in the United States and Germany,” in *The State after Statism: New State Activities in the Age of Globalization and Liberalization*, ed. Jonah Levy (Cambridge, Mass.: Harvard University Press, 2006), n. 2.

3. See Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford: Oxford University Press, 2003).

4. See, e.g., Henk Wouter de Jong, “The Governance Structure and Performance of Large European Corporations,” *Journal of Management and Governance* 1 (1997): 5-27.

5. As Shleifer and Summers 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. Andrei Shleifer and Lawrence H. Summers, “Breach of Trust in Hostile Takeovers,” in *Corporate Takeovers: Causes and Consequences*, ed. Alan J. Auerbach (Chicago: University of Chicago Press, 1988), 33-68.

6. For representative examples of the parties’ literature, see, e.g., James E. Alt, “Political Parties, World Demand, and Unemployment. Domestic and International Sources of Economic Activity,” *American Political Science Review* 79 (1985): 1016-40; Michael R. Alvarez, Geoffrey Garrett, and Peter Lange, “Government Partisanship, Labor Organization, and Macroeconomic Performance,” *American Political Science Review* 85 (1991): 539-56; Douglas Hibbs, “Political Parties and Macroeconomic Policies,” *American Political Science Review* 71 (1977): 467-87; and Manfred G. Schmidt, “The Impact of Political Parties, Constitutional Structures and Veto Players in Public Policy,” in *Comparative Democratic Politics*, ed. Hans Keman (London: Sage, 2002), 166-84. For leading volumes on comparative political economy, see Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001); and Wolfgang Streeck and Kozo Yamamura, eds., *The Origins of Nonliberal Capitalism. Germany and Japan in Comparison* (Ithaca, N.Y.: Cornell University Press, 2001).

7. Gösta Esping-Anderson, *Politics against Markets: The Social Democratic Road to Power* (Princeton, N.J.: Princeton University Press, 1985).

8. Peter A. Hall and David Soskice, "Introduction," in *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, ed. Peter A. Hall and David Soskice (Oxford: Oxford University Press, 2001)

9. Complementarity arises where the functionality of an institutional form is conditioned, at least in part, 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 has characterized the interplay of Japanese lifetime employment and monitoring by banks as an "unintended fit." Our analysis suggests that the destabilization of such complementarities may be equally unintended. Masahiko Aoki, "Unintended Fit: Organizational Evolution and Government Design of Institutions in Japan," in *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*, ed. Masahiko Aoki, Hyung-Ki Kim, and Masahiro Okuno-Fujiwara (Oxford: Clarendon, 1997), 233-53.

10. See, e.g., Roe, *Political Determinants of Corporate Governance*.

11. For classic general descriptions of these national post-war models, see Andrew Shonfield, *Modern Capitalism: The Changing Balance of Public and Private Power* (London: Oxford University Press, 1965), 239-97; and John Zysman, *Governments, Markets, and Growth* (Ithaca, N.Y.: Cornell University Press, 1983).

12. Bob Hancké, *Large Firms and Institutional Change: Industrial Renewal and Economic Restructuring in France* (Oxford: Oxford University Press, 2001); and Shonfield, *Modern Capitalism*, 71-87.

13. See Andrea Melis, "Corporate Governance in Italy," *Corporate Governance: An International Review* 8, no. 4 (2000): 347-55.

14. See Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies* (Princeton, N.J.: Princeton University Press, 2001), 123-69.

15. See David Soskice, "Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s," in *Continuity and Change in Contemporary Capitalism*, ed. Herbert Kitschelt, Peter Lange, Gary Marks, and John D. Stephens (Cambridge: Cambridge University Press, 1999); Peter A. Hall and David Soskice, "An Introduction to Varieties of Capitalism," in Hall and Soskice, *Varieties of Capitalism*; and cf. Peter A. Hall, "The Political Economy of Europe in an Era of Interdependence," in Kitschelt et al., *Continuity and Change in Contemporary Capitalism*.

16. Compare Soskice, "Divergent Production Regimes," 107-10 (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).

17. See generally, John Zysman, *Political Strategies for Industrial Order: State, Market, and Industry in France* (Berkeley: University of California Press, 1977); and Zysman, *Governments, Markets, and Growth*, ch. 3. By the early 1980s, the state owned 100 percent of thirteen of the twenty largest industrial firms, owned most of the country's leading banks (including Suez, Paribas, Cr dit Lyonnais, Soci t  G n rale, and BNP), and held controlling stakes, minority stakes, and substantial debt positions in numerous other firms. See Mary O'Sullivan, "Change and Continuity in the French System of Corporate Governance," INSEAD Working Paper (Fontainebleau Cedex, France: European Institute of Business Administration, 2001), 4-8.

18. See James A. Fanto, "The Role of Corporate Law in French Corporate Governance," *Cornell International Law Journal* 31 (1998): 31, 48; and James A. Fanto, "The Role of Corporate Law in the Adaptation of French Enterprises," *Columbia Business Law Review*, *Special Symposium Issue* (1998): 97-120.

19. Code des Sociétés, Ordonnance NE 67-833 du septembre 1967 (as amended), arts. 6, 7 (Fr.). For discussions of French securities law reforms, see Fanto, "The Role of Corporate Law in the Adaptation of French Enterprises," 111-12; and James A. Fanto, "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* 21 (1995): 41-44.

20. See, e.g., Leslie de Quillacq, "Where's the Breast-Beating?" *Breakingviews*, June 25, 2002, <http://www.breakingviews.com/examplecv.asp>; and Jon Henley, "Gigantic Sleaze Scandal Winds Up as Former Elf Oil Chiefs Are Jailed." *The Guardian*, November 13, 2003. See also International Securities Regulation Reporter, "Insider Trading Scandals: Parisians React with a Smirk and a Yawn," *International Securities Regulation Reporter*, October 11, 1989, 6; and Yves Meny, "Something Rotten in the Republic." *Financial Times*, January 28, 2001.

21. See Fanto, "The Transformation of French Corporate Governance," n. 115-17.

22. See Fanto, "The Role of Corporate Law in the Adaptation of French Enterprises," 106-7.

23. Jonah D. Levy, *Tocqueville's Revenge: State, Society, and Economy in Contemporary France* (Cambridge, Mass.: Harvard University Press, 1999). For analyses of French corporate governance in the context of statist economic policy, see, e.g., O'Sullivan, "Change and Continuity in the French System of Corporate Governance"; Fanto, "The Transformation of French Corporate Governance"; Jonathan P. Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries* (Oxford: Clarendon, 1994) 130-31; and Oxford Analytica, *Board Directors and Corporate Governance: Trends in the G7 Countries over the Next Ten Years* (Oxford: Oxford Analytica, 1992), 96.

24. See Richard Deeg and Sophia Perez, "International Capital Mobility and Domestic Institutions: Corporate Finance and Governance in Four European Cases," *Governance: An International Journal of Policy and Administration* 13, no. 2 (2000): 119-54.

25. *Ibid.* 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, *Tocqueville's Revenge*; Jonah D. Levy, "Activation through Thick and Thin: Progressive Strategies for Increasing Labor Force Participation" in *Trans-Atlantic Policymaking in an Age of Austerity*, ed. Martin Shapiro and Martin Levin (Washington, D.C.: Georgetown University Press, 2004).

26. For accounts of the complex, contentious, and ideological politics of French privatization and economic reform during the 1980s and 1990s, see Levy, *Tocqueville's Revenge*; see also Deeg and Perez, "International Capital Mobility and Domestic Institutions."

27. For discussions of French privatization, see O'Sullivan, "Change and Continuity in the French System of Corporate Governance"; F. Morin, "The Transformation of the French Model of Shareholding and Management," *Economy and Society* (February 2000): 36-53; Vivian Schmidt, *From State to Market? The Transformation of French Business and Government* (Cambridge: Cambridge University Press, 1996); and A. Goldstein, "Privatizations and Corporate Governance in France." *Banca Nazionale del Lavoro, Quarterly Review*, no. 199 (December 1996): 455-88.

28. See Fanto, "The Role of Corporate Law in the Adaptation of French Enterprises," n. 53.

29. See Loi NE 88-70 du 22 janvier 1988 ("Law on Security and Disclosure in the Financial Markets"); and Loi NE 89531 du 2 aout 1989 ("Security and Disclosure Law").

30. See Leslie Goldman, "The Modernization of the French Securities Markets: Making the EEC Connection." *Fordham Law Review* 60 (1992): 238-40.

31. See Loi 96-597 du 2 juillet 1996; Goldman, "The Modernization of the French Securities Markets," 238; and Fanto, "The Role of Corporate Law in the Adaptation of French Enterprises," 111.

32. See Goldman, "The Modernization of the French Securities Markets," 242-43. Following this strengthening of regulatory authority, the COB's enforcement powers arguably exceeded those of the SEC in some respects.

33. Senate, no. 124-1996-1997.

34. See Loi NE 97-277 du 25 mars 1997, §13. 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.

35. See Loi relative aux nouvelles régulations économiques, of May 15, 2001, no. 2001-420.

36. See Loi de sécurité financière, dated August 1, 2003, in *Official Journal of the French Republic*, no. 177 (August 2, 2003): 13220.

37. Along with its assertion of expansive regulatory powers, the state also held onto "golden shares" with disproportionate voting (or veto) power that conferred 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. Further, networks of government and financial elites reasserted themselves to retake control from the CEOs of France Telecom and Vivendi, whose disastrous forays into American-style corporate mergers and acquisitions nearly destroyed each company. See de Quillacq, "Where's the Breast-Beating?"; and Alan Cowell, "A Man Used to Moving in Elite Business Circles," *New York Times*, July 1, 2002 (French government instrumental in installing established member of elite as CEO of Vivendi after financial crisis).

38. Samer Iskandar, "Three Wiser Men: The French Government and the Business Community Can Learn Important Lessons from the Drawn-out Takeover Battle in the Banking Sector," *Financial Times*, August 30, 1999, 11. Cf. Tess Read, "Down with Dirigisme," *Worldlink*, September/October 1999, <http://backissues.worldlink.co.uk/articles/08091999111756/08.htm>.

39. See Hugo Dixon, "Sauter Pour Mieux Reculer," *Breaking Views*, September 4, 2003, <http://www.breakingviews.com/examplecv.asp>.

40. OECD, *Employment Protection and Labor Market Performance* (Paris: Organization for Economic Cooperation and Development, 1999), 18.

41. See, e.g., Ugo Pagano and Sandro Trento, "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, 2002).

42. Marcello Bianchi, Magda Bianco, and Luca Enriques, "Pyramidal Groups and the Separation between Ownership and Control in Italy," in *The Control of Corporate Europe*, ed. Fabrizio Barca and Marco Becht (Oxford: Oxford University Press, 2001): 154-87; and Mails, "Corporate Governance in Italy."

43. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny "Law and Finance," *Journal of Political Economy* 106 (1998): 1113-55; and I. J. Alexander Dyck and Luigi Zingales, "Private Benefits of Control: An International Comparison," CEPR Discussion Paper no. 3177 (London: Centre for Economic Policy Research, 2001), <http://ssrn.com/abstract=301200>, 16, 47.

44. OECD, *Economic Surveys: Italy*, July (Paris: Organization for Economic Cooperation and Development, 2003), 101.

45. This does not mean that economic coordination by banks was wholly absent. For example, Mediobanca, a merchant bank created in 1946, was at the center of the web of

the Italian company network. However, Mediobanca derived its power and influence primarily through its role as the country's preeminent investment bank, rather than as a major creditor and long-term shareholder of leading corporations (e.g., Deutsche Bank in Germany).

46. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny "Corporate Ownership around the World," NBER Working Paper 6625 (Cambridge, Mass.: National Bureau for Economic Research, 1998), 52.

47. The Italian Communist Party had been excluded from national political power and the political-corporate networks that fueled corruption, and was almost unscathed by the scandals. The party's history of pioneering "Eurocommunism" left its post-Cold War successor party well placed to pursue effective market reforms.

48. For economic statistics, see OECD, *Economic Outlook*, June (Paris: Organization for Economic Cooperation and Development, 2001).

49. 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 "A Survey on Italy," *Economist Supplement*, November 8, 1997 (data for the year 1997).

50. Privatization generated returns of nearly \$100 billion between 1990 and 2000, and equaled 8.2 percent of Italy's GDP in the year 2000. Only Portugal and Greece generated proportionally higher privatization returns during the 1990s. See Pagano and Sandro, "Continuity and Change in Italian Corporate Governance," 25; and Manfred Schneider, "Privatization in OECD Countries: Theoretical Reasons and Results Obtained" (University of Linz, 2003), 9.

51. Paul Betts and James Blitz, "At the Head of Italy's Table: The *Financial Times* Interview: Massimo D'Alema," *Financial Times*, London ed., December 22, 1997, 14.

52. *Ibid.*

53. *Ibid.*

54. See Alexander Aganin and Paolo Volpin, "History of Corporate Ownership in Italy," ECGI Finance Working Paper 17/2003 (Brussels: European Corporate Governance Institute, 2003), 24; Richard Deeg, "Change from Within: German and Italian Finance in the 1990s," in *Beyond Continuity: Institutional Change in Advanced Political Economics*, ed. Wolfgang Streeck and Kathleen Thelen (Oxford: Oxford University Press, 2005); and Pagano and Trento, "Continuity and Change in Italian Corporate Governance," 25.

55. Mario Draghi, "Corporate Governance and Competitiveness," *Review of Economic Conditions in Italy* 3 (1998): 341-57; and Bianchi, Bianco, and Enriques, "Pyramidal Groups and the Separation between Ownership and Control in Italy," 30-39.

56. "They're (Nearly) All Centrists Now," *The Economist*, July 5, 2001 (print edition, "Survey of Italy").

57. Robert Graham, "New Chairman Knows Iri from Inside: Differences within the Italian Coalition," *Financial Times*, London ed., August 8, 1994, 2.

58. These party dynamics also drove the Italian debate over the European Commission's failed draft Takeover Directive in 2001 and elucidate the ideological conflicts over Italian corporate governance regulation. The directive would have imposed uniform EU-wide regulation on corporate takeovers (both hostile and friendly) to encourage the development of a pan-European market for corporate control. 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, voted against. For discussion of the political controversy over the EU Takeover Directive, see John W. Cioffi, "The

Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration,” BRIE Discussion Paper (Berkeley, Calif.: Berkeley Roundtable on the International Economy, 2001); Helen Callaghan and Martin Höpner, “European Integration and the Clash of Capitalisms. Political Cleavages over Takeover Liberalization,” *Comparative European Politics* 3 (2005): 307-32.

59. “They’re (Nearly) All Centrists Now.”

60. Giuliana Amato, the independent first prime 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.” *Ibid.*

61. OECD, *Employment Protection and Labor Market Performance*, 18.

62. See, e.g., Soskice, “Divergent Production Regimes”; and Hall and Soskice, “An Introduction to Varieties of Capitalism.”

63. See Kenneth Dyson, “The State, Banks and Industry: The West German Case,” in *State, Finance and Industry: A Comparative Analysis of Post-war Trends in Six Advanced Industrial Economies*, ed. Andrew Cox (Brighton, UK: Wheatsheaf, 1986), 118-41 (noting that the banks’ intermediating relationships were especially important in the field of foreign trade).

64. See Shonfield, *Modern Capitalism*.

65. See Paul Windolf and Jürgen Beyer, “Co-operative Capitalism: Corporate Networks in Germany and Britain,” *British Journal of Sociology* 47, no. 2 (1996): 205-31; Jürgen Beyer and Martin Höpner, “Corporate Governance and the Disintegration of Organized Capitalism,” *West European Politics* 26, no. 4 (2003): 179-98; and Martin Höpner and Lothar Krempel, “The Politics of the German Company Network,” *Competition and Change* 8 (2004): 339-56.

66. Cf. John W. Cioffi, “Restructuring ‘Germany, Inc.’: The Corporate Governance Debate and the Politics of Company Law Reform,” *Law & Policy* 24, no. 4 (2002): 355-402; and J. Nicholas Ziegler, “Corporate Governance and the Politics of Property Rights in Germany,” *Politics and Society* 28, no. 2 (2000): 195-221, esp. 203.

67. However, privatization was a significant factor in the German case as well. See Ziegler, “Corporate Governance and the Politics of Property Rights in Germany” (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, “Corporate Governance and the Disintegration of Organized Capitalism”; and Cioffi, “Restructuring ‘Germany, Inc.’”

68. See Cioffi, “Restructuring ‘Germany, Inc.’”; and Cioffi, “Building Finance Capitalism.”

69. See Richard Deeg, “Institutional Change and the Uses and Limits of Path Dependency: The Case of German Finance,” MPIfG Discussion Paper 01/6 (Köln: Max-Planck-Institut für Gesellschaftsforschung, 2001); and Susanne Lütz, “From Managed to Market Capitalism? German Finance in Transition,” MPIfG Discussion Paper 2000-02 (Köln: Max-Planck-Institut für Gesellschaftsforschung, 2000).

70. The BAWe represented Germany’s appropriation of the “SEC model” of securities regulation through a strong centralized regulator with substantial rule-making and enforcement powers. See Cioffi, “Restructuring ‘Germany, Inc.’”

71. See Höpner, "Corporate Governance Reform and the German Party Paradox."

72. E.g., Ingrid Scheibe-Lange and Arno Prangenberg "Mehr Mitbestimmung via US-Börsenaufsicht," *Die Mitbestimmung* 43, no. 11 (1997): 45-49.

73. Hans-Detlev Küller, "Das Shareholder-Value-Konzept aus Gewerkschaftssicht," *Betriebswirtschaftliche Forschung und Praxis* 49 (1997): 529. There also may be situations, as in the takeover of Mannesmann by Vodafone, where both shareholders and labor (on the supervisory board and on works councils) prefer to split up the company, while the management board pursues its preference for running a large, powerful corporation. See Martin Höpner and Gregory Jackson, "An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance," MPIfG Discussion Paper 2001-4 (Köln: Max-Planck-Institut für Gesellschaftsforschung, 2001) (discussing Vodafone's hostile takeover of Mannesmann).

74. Corporate Control and Transparency Act (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, or KonTraG) of April 27, 1998, *Federal Law Gazette*, pt. I, 786 (Gesetz vom 27.4.1998, BGBl. I, S. 786 vom 30.4.1998).

75. See Cioffi, "Restructuring 'Germany, Inc.'"; see also Ziegler, "Corporate Governance and the Politics of Property Rights in Germany," 205, 216.

76. Cioffi, "Restructuring 'Germany, Inc.'"

77. Edmund Stoiber, the unsuccessful CDU-CSU candidate for chancellor in the 2002 election, used this issue in his election campaign and pledged to reintroduce the tax as chancellor.

78. See Transparency and Disclosure Act (Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizität, also known as the Transparenz- und Publizitätsgesetz, or "TransPuG"), v. July 19, 2002, BGBl. I S. 2681; and Law on Company Integrity and on the Modernization of the Stock Corporations Act (Gesetz zur Unternehmensintegrität und Modernisierung des Aktiengesetzes, or UMAG), BT-Drs. 15/5693, June 15, 2005 (effective November 1, 2005). The TransPuG requires, *inter alia*, listed companies to comply or explain their non-compliance with the governmental Corporate Governance Commission's Code of Best Practices. The government also signaled its approval of the EU European Company Directive creating a (so far seldom used) pan-European corporate form. See Council Regulation (EC) No 2157/2001 of 8. 10. 2001 on the Statute for a European Company (SE), OJ L 294/1, 10. 11. 2001, Art. 38 b). See also Marie Bolt, *Stellungnahme des DGB zum Fragenkatalog der Regierungskommission, "Corporate Governance—Unternehmensführung—Unternehmenskontrolle—Modernisierung des Aktienrechts"* (Berlin: Deutscher Gewerkschaftsbund, 2000); Roland Köstler, "Grundsätze der Unternehmensführung und -kontrolle in der Diskussion," *Die Mitbestimmung* 46, no. 5 (2000): 34-35; Roland Köstler and Matthias Müller, "Unternehmensführung—Unternehmenskontrolle—Modernisierung des Aktienrechts," *Arbeitshilfe* no. 15 für Arbeitnehmervertreter in Aufsichtsräten (Düsseldorf: Hans-Böckler-Stiftung, 2001); Heinz Putzhammer and Roland Köstler, "Eckpunkte für ein Übernahmegesetz," *Die Mitbestimmung* 46, no. 5 (2000): 22-23; Hubertus Schmoldt, "Shareholder Value und Mitbestimmung," *Die Mitbestimmung* 48, no. 6 (2002): 10-16; and Patrick Leyens, "German Company Law: Recent Developments and Future Challenges," *German Law Journal* 6, no. 10 (October 1, 2005): <http://www.germanlawjournal.com/article.php?id=645>.

79. The FDP, which was most likely to support the directive, had no representatives in the European Parliament.

80. See *Beschlussesempfehlung und Bericht des Finanzausschusses, Drucksache 14/7477*, November 14, 2001.

81. See remarks of Nina Hauer (SPD Bundestag Member) in the debate on the takeover law, minutes of the Bundestag 14/201, November 15, 2001.

82. Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz, or WpÜG), v. 20 December 2001 (BGBl. I.S. 3822).

83. Deeg, "Change from Within."

84. See Edward S. Adams and John H. Matheson, "A Statutory Model for Corporate Constituency Concerns," *Emory Law Journal* (Fall 2001): 1085; Mark J. Roe, "Takeover Politics," in *The Deal Decade: What Takeovers Mean for Corporate Governance*, ed. Margaret Blair (Washington, D.C.: Brookings Institution, 1993): 321-53; and John H. Matheson and Brent A. Olson, "Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation," *George Washington Law Review* (August 1991): 1425.

85. First, the Private Securities Litigation Reform Act of 1995 (PSLRA), passed over President Bill Clinton's veto, raised the pleading requirements for securities fraud suits and largely abolished "aiding and abetting" liability under which law and accounting firms could be held liable for fraudulent statements and omissions by publicly traded companies. The second law, the Securities Law Uniform Standards Act of 1998 (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.

86. Though nominally reducing disclosure, the amendments were designed to protect shareholders. The SEC's proxy reforms abolished a rule prohibiting shareholders collectively owning more than 5 percent of a corporation's stock from communicating among themselves without filing an expensive and time-consuming proxy statement. The rule was adopted to protect minority shareholders from unfair takeover tactics, but it effectively discouraged institutional investors from collaborating to pursue more activist corporate governance strategies.

87. This blunt use of political clout by the accounting industry and its legislative allies ultimately weakened their political position once the size, seriousness, and number of the accounting scandals of 2001-2002 became public.

88. The disclosures include "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.

89. 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, *20th Annual Board of Directors Study* (New York: Korn/Ferry International, 1993), 3, 7, 13; compare Investor Responsibility Research Center, *Board Practices 1996: The Structure and Compensation of Board of Directors in S&P 500 Companies* (Washington, D.C.: IRRRC, 1996), 3-6; and accord Charkham, *Keeping Good Company* 188-89 (in 1990, outside directors accounted for a majority on 86 percent of boards in the manufacturing sector and 91 percent of boards in all other sectors). However, managerial control over board nominations and elections casts doubt on the actual independence of directors and the practical import of this trend.

90. See John W. Cioffi, "Expansive Retrenchment: The Regulatory Politics of Corporate Governance Reform and the Foundations of Finance Capitalism in the United States and Germany," IES Conference Paper (Berkeley: Institute of European Studies, University of California, Berkeley, 2004), <http://ies.berkeley.edu/research/#sas>.

91. One senior Republican staffer said, "Congress didn't pass Sarbanes-Oxley, WorldCom did." Anonymous interview conducted by John W. Cioffi, Washington, D.C., March 2004.

92. 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 became the most effective meaning of managerial rent seeking and looting of the corporation ever devised.

93. The desire of Democratic Party politicians to cultivate the support of corporate managers constrained them from pressing for deeper reforms and, later, from supporting the SEC's attempt to give shareholders more power in board elections.

94. The strength of these pull factors varies to some extent with the 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, the French cases. A statistical test of this hypothesis, however, is beyond the scope of the current paper.

95. 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.

96. See also John W. Cioffi, "Building Finance Capitalism"; and Jonah D. Levy, "Introduction: The State Also Rises," in Levy, *The State after Statism*.

97. See Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton, N.J.: Princeton University Press, 2005); and John W. Cioffi, "The State of the Corporation: State Power, Politics, Policymaking and Corporate Governance in the United States, Germany, and France," in Levin and Shapiro, *Trans-Atlantic Policymaking in an Age of Austerity*.

98. 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 Sigurt Vitols, "The Origins of Bank-Based and Market-Based Financial Systems: Germany, Japan, and the United States," in Streeck and Yamamura, *The Origins of Nonliberal Capitalism*, 171-99. These issues have become important within recent and ongoing debates over pension reform in Europe. We find that, to date, shareholders and institutional investors, such as pension funds, have not wielded significant influence over corporate governance reform. Shareholders remain too diffuse to confer substantial political influence. Institutional investors, such as pension funds and mutual funds, have divergent interests with respect to financial regulation, pension policies, and corporate governance reforms. In most industrialized countries, including Germany, France, and Italy, the predominance of established public pension systems deprives private pension funds of financial and political power.

99. 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 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. Gourevitch and Shinn, *Political Power and Corporate Control*; and compare Roe, *Political Determinants of Corporate Governance* (arguing that employees and managers are more likely to forge intracorporate and political coalitions to curb transparency to protect themselves from shareholder and capital market pressures). German and American unions supported pro-shareholder demands for transparency and management accountability in keeping with their respective interests in union pension fund investments and codetermination. However, because shareholding remained undeveloped in our European cases and codetermination is far stronger in Germany than elsewhere, the "transparency coalition" thus

does not explain cross-national corporate governance reform. Even where labor supported corporate governance reform, as in the United States and Germany, it was not a driving force for change. Hence, we look to shifting partisan strategies, non-labor interest group preferences, and economic populism.

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