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Introduction

1. Understanding the structural pathologies of the current model of capitalism

The history of capitalism is abundant in agonizing fluctuations. The intellectual nemesis of capitalism, Karl Marx, in his theory of cyclical growth posited that the phenomenon of recurring periods of prosperity and crisis is congenital with the functioning of a capitalist system, given that economic downturns serve a rejuvenating function for capital stock. This is the idea that recessions constitute an essential regulating device of the capitalist edifice, in the sense that they weed out unproductive segments of the market and bring about the seed of future economic growth. This idea is not confined to Marxian theory, but reemerges in other foundational texts of economic thought.

However, in Marx’s view every new period of economic growth following a contraction is less likely to restore the socioeconomic damage caused by the latter and therefore every new recession leaves an indelible mark on the system with the result being that in the long run capitalism will have lost its capacity to recover from a downturn. According to Marx, capitalism is thus wasteful and inefficient and should be replaced by a more rational system: socialism.

But focusing on the traditionally critical to capitalism Marxian theory could be deemed a biased approach. Therefore, it is worth looking at what a proponent of capitalism said about economic downturns: Joseph Schumpeter. Schumpeter saw capitalism’s secret of success lying in a process that takes place during recession periods. His theory on the capitalist order is epitomized in his axiom of ‘creative destruction’ that postulates that economic contraction nurtures new consumer goods, new methods of production and new forms of industrial organization that, functioning as capitalism’s engines, destroy the old technological edifice and reallocate property rights, thus securing a new era of economic growth.

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1 Joseph Schumpeter, The Instability of Capitalism, 38 THE ECONOMIC JOURNAL 361, 363
4 Yanis Varoufakis, Foundations of Economics: A Beginner’s Companion, 308
7 Varoufakis, supra note 4, 28
8 Joseph Schumpeter, Capitalism, Socialism and Democracy (1942), 83
Therefore, both a polemicist and a sympathizer of capitalism taught us that crises are a crucial source of vitality for a capitalist system and that we should be expecting them\(^9\). There is no doubt that such times of contraction are associated with a lot of suffering. This suffering, however, could well be Socratic birth-pangs, i.e. the painful puzzlement that is congenital to the process of discovering the truth\(^10\). What I mean is that the economic misery and the societal damage that we experience after the 2008 financial meltdown have also triggered a worldwide self-examination about what went wrong and how we are going to prevent such calamity from happening again in the future.

To the majority of participants in the debate on the causes and the remedies of the crisis, the chain of events leading to the post-2008 collapse came as a bombshell. The element of surprise pertains not to the mid-September 2008 stock market crash or to the immediately preceding problem of the run on the shadow banking system, but predominantly to the formation of a bubble in the US housing market and in Eurozone’s sovereign debt. As it will be discussed later on (Section 5.3. of Chapter One), according to the neoclassical economics’ orthodoxy firms and individuals cannot err regarding the price of an asset in an efficient market; that means that a bubble cannot occur\(^11\).

In my opinion, what should worry us the most about this crisis is exactly the fact that we were surprised; that we weren’t expecting it. This means that we have put so much faith in our capitalist system and to the functionality of our markets’ regulation that we’ve turned a blind eye to past events, such as the dotcom bubble of 2000 or the stock market crash of 1987, but also to the fact that the major Western economies have in essence been in a stagnation mode since at least the oil spikes of the 1970s. It seems that we fail to identify that beyond the coincidental reasons for this economic crash lies a structural pathology in the way capitalism is reproducing itself and in the way our markets are regulated.

The post-2008 period has been marked by an unprecedented production of law-and-economics scholarship bearing on the crisis. Most papers focus only on the immediate causes of the crisis by undertaking an in-depth analysis of the subprime mortgage meltdown or of the sovereign debt crisis. The objective of those papers is to identify, which market failures emerged during these crisis years, so as to promote the regulatory changes that will fix exactly these problems. In this respect, these papers fail to view beyond the incidental reasons for this crisis, so as to help address the more deeply rooted anomalies that have emerged by the ‘financialization’ of capitalism that over the past four decades

\(^9\) CURTIS MILHAUPT & KATHARINA PISTOR, LAW & CAPITALISM: WHAT CORPORATE CRISSES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD (2008), 27

\(^10\) See PLATO’S THEAETETUS, 1500-d (Francis MacDonald Cornford, transl.) (1985)

\(^11\) The skepticism against bubbles is founded on the belief that markets are efficient mechanisms for aggregating and processing information and thus prices are supposed to reflect assets’ fundamental intrinsic value. This skepticism is epitomized in Eugene Fama’s statement ‘The word “bubble” drives me nuts’; see Interview with Eugene Fama, Nov. 2, 2007, The Region (Federal Reserve Bank of Minneapolis). Available at: http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=1134
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has contributed to the aforementioned state of stagnation and to a heightened cyclicality of the economy that has produced numerous economic bubbles during the same period\textsuperscript{12}.

Nevertheless, given that the analysis employed in these papers is akin to the fundamentals of mainstream economics, their approach easily came to be seen as providing a roadmap to regulatory authorities and governments worldwide as to the legal responses that should be produced. As a consequence, the regulatory reforms we’ve seen so far and those that are currently planned can be characterized as short-sighted; \textit{they do not address the structural pathologies of capitalism}. By ‘structural pathologies’ here, I mean mainly the inability that capitalism has shown since the collapse of the Bretton Woods system in the early 1970s to produce high and sustainable rates of economic growth that would help unemployment go down and sovereign debt levels to be viable.

Accordingly, this study aspires to trace these structural pathologies and look beyond what happened in the years immediately preceding the current recession. It uses the events surrounding the recent US housing bubble and the ongoing European sovereign debt crisis only as a starting point in order to trace the roots of the problem that are to be found in the global institutional environment that gradually emerged after the collapse of the Bretton Woods Agreement in the 1970s. From the vast array of institutions comprising the post-Bretton Woods institutional setting, this study focuses on the institutions of corporate governance and seeks more specifically to show how the corporate apparatus shares the blame for the persistent stagnation that does not allow investors to gain confidence again in the markets and that does not allow states to improve their debt-to-GDP ratios.

2. Should corporate governance be fixed in the post-2008 world?

As mentioned above, this study looks upon corporate governance as one of the contributory factors to the persistence of the crisis. Thus, first of all this study takes issue with those approaches that view the post-2008 meltdown as not having exposed a failure in the institutions of corporate governance\textsuperscript{13}. Moreover, it takes issue with the more conventional approach, which posits that corporate governance needs to be fixed only in relation to financial institutions and perhaps only in so far as the issue of risk management is concerned. Indeed, a quick look at the academic literature and the press after the 2008 crash will reveal that there is one broad area of corporate governance that has been mainly

\textsuperscript{12} The Japanese asset price bubble of the 1980s, the dotcom bubble of the 1990s and the global real estate bubble of the 2000s, to name but a few of the bubbles that have burst over the past decades.

\textsuperscript{13} See John Coates’s IV Testimony at the U.S. Senate Committee on Banking, Housing and Urban Affairs within the scope of the Hearing: Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance (Jul. 29, 2009). Available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=c754606c-0b95-4139-a38a-63e63b4b3fa9&Witness_ID=49f23bd3ae69-42a8-af65-82d7b82502a
put on trial: defective risk management\textsuperscript{14}. The larger part of this critical approach to the pre-crisis corporate governance failures relates specifically to the governance of financial institutions, i.e. banks (investment and commercial), insurance companies, mutual funds, pension funds etc., and to their insufficient risk management systems that allowed collateralized debt obligations and credit default swaps to flood their balance sheets. General corporate law has largely escaped criticism and hence the view has been developed that we only need to repair prudent regulation or the \textit{suis generis} governance of financial institutions.

A focus on the governance problems of financial corporations is \textit{prima facie} justified, as much of the failed bets, whose consequences spilled over to the real economy emanated from speculation within this type of firms. However, I would argue again that this viewpoint is short-sighted and unduly constrains the scope of the positive and normative discussion on corporate governance that should be done.

Focusing exclusively on the failures and the necessary reforms in the governance of firms of the financial sector is again a stance that ignores the pathology of the ‘financialization’ of capitalism. As this term has been given many definitions in literature\textsuperscript{15}, what I mean by using it in this context is the fact that over the last decades financial-like motives have been dominant in non-financial (industrial) corporations (‘\textbf{NFCs}’) as well\textsuperscript{16} and that the latter have increasingly been seeking to profit through financial channels (e.g. through the use of financial derivatives) rather than through trade or commodities production\textsuperscript{17}. The graph in Figure 1 below shows how the ratio of financial assets to real assets has been growing within US NFCs in the years 1952-2003 (i.e. before the financial bets in the US housing market surged). To a certain extent, it could be noted that financial investment has been replacing physical


\textsuperscript{15} See James Crotty, \textit{The Neoliberal Paradox: The Impact of Destructive Product Market Competition and ‘Modern Financial Markets on Nonfinancial Corporation Performance in the Neoliberal Era}, in \textit{FINANCIALIZATION AND THE WORLD ECONOMY} (G. Epstein, ed.) (2005), 77 (defining financialization as the rise of financial investment and incomes from such investment); Julie Froud et al., \textit{Shareholder value and financialization: consultancy promises, management moves}, 29 ECONOMY AND SOCIETY 80 (viewing financialization as the growing importance of shareholder value in economic decisions)


\textsuperscript{17} Greta Krippner, \textit{The Financialization of the American Economy}, 3 SOCIO-ECONOMIC REVIEW 173, 174
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Investment\textsuperscript{18}, apart from the implications that this has for the risk gearing of NFCs’ balance sheets, it is also a proxy for reduced physical capital accumulation, which is traditionally one of the foremost engines of economic growth. At the same time statistical evidence indicates that the profits of US NFCs from financial investments increased from 15% in the 1950s to around 50% in 2001\textsuperscript{19} and these are correlations that also hold true for non-US NFCs\textsuperscript{20}.

In light of the above, it is logical to assume that because of the increasing engagement of NFCs in financial markets much of the speculation in financial instruments, to which the current crisis is conventionally causally linked, has taken place within NFCs, so that many of the governance problems that are thought to have tolerated, encouraged or directly caused these irresponsible speculative practices are also problems of NFCs. In addition to this, since NFCs have been increasingly divesting from real assets, it is logical to assume that the persistent low rates of economic growth that are currently blamed for not allowing states to improve their debt-to-GDP ratios may be partly attributable to the reduced capital accumulation that takes place inside NFCs, which are not subject to some special form of regulation, but to general corporate law.

Therefore, since a legal field is normally thought to be -by virtue of its imperfections- abetting the observed irregularities that its subjects are committing, corporate law, which regulates the behavior of NFCs, purports to share the blame for the economic crisis and thus a reform in corporate governance is needed that goes beyond mere changes in the \textit{suis generis}\textsuperscript{21} governance of financial institutions. After all, since recent empirical studies show that on average financial institutions are no worse governed than NFCs\textsuperscript{22} it follows that if a case is made about reforming the former’s governance then as a matter of principle the latter’s governance should be reformed as well.

\begin{flushright}
\textsuperscript{18} Engelbert Stockhammer, \textit{Financialization and the Slowdown of Accumulation}, 28 Cambridge Journal of Economics 719, 719 \\
\textsuperscript{19} See Crotty, \textit{supra} note 15 \\
\textsuperscript{20} Stockhammer, \textit{supra} note 18, 730 \\
\end{flushright}
Nevertheless, the argumentation above is only intended to convince those that are focused on the immediate causes of the post-2008 crisis that there is merit in a study, which grapples with the failures of corporate law and governance and which thus implicitly calls for their reform. Those few that were worried even before 2008 on the route that the ‘New Economy’s’ institutions had taken understand that since the corporate apparatus lies at the heart of the capitalist system, the crisis of capitalism signals a crisis in corporate law and governance.

3. Outline of the study

3.1. Outline of Chapter One: The Great Reversal in Corporate Governance and the Great Reversal in Shareholdership

Chapter One introduces this study’s foundational hypothesis: the shift in the institutional logics of corporate governance towards shareholder value (‘Great Reversal in Corporate Governance’) coupled with shareholdership’s increasing short-termism (‘Great Reversal in Shareholdership’) have cumulatively contributed to the low rates of GDP growth that are observed in the major Western economies since the breakdown of the Bretton Woods system in the early 1970s (‘First Hypothesis’).

The unraveling of the thread of the causality links between the two Great Reversals and the low rates of economic growth in the post-Bretton Woods era is reserved for the final section of Chapter One (Section 7). Sections 1-6 explore the international political economy of the shareholder value orientation in corporate governance and of shareholder short-termism and through a timeline story starting from the late 1940s and ending in the late 2000s.
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present the wide array of legal and extra-legal institutions that gradually brought about these two great reversals.

Sections 1-2 analyze the institutions of macroeconomic policymaking in the major Western economies from the end of World War II up to the early 1970s, when the Bretton Woods system of fixed exchange rates broke down. In these two sections the Keynesian foundations of these institutions are emphasized and the intensive use of capital controls by states is underlined. The latter was an arrangement that contributed to relatively weak capital markets, which were thus not in a position to influence corporate governance significantly.

Section 3 moves on in time and focuses on the stage of the deconstruction of the post-War institutions during the 1970s. The political economy of this decade indicates that there is a series of successive causality links between the breakdown of the Bretton Woods agreement, the oil spikes, the high inflation rates and the demise of the capital controls in the major Western economies.

While this general causality analysis on the capital decontrol movement is valid for most OECD countries, in Section 4 I choose to specifically refer to the politics and economics of the capital account liberalization efforts in the US, the UK, Germany and France, in order to illustrate my argument that the stagflation and the monetary chaos of the 1970s effectively forced the ‘financialization’ of the economy. Additionally, special allusion is made to the birth of the European Monetary Union as a response to the fall of the Bretton Woods arrangements and to the liberalization of the capital movements at the EU level that this monetary union required.

The reason why I devote so much attention in Sections 3-4 to the capital account liberalization movement of the 1970s and the 1980s is because the free movement of capital gave rise to a competition between states to attract funds into their capital markets. Within the scope of this race states lowered the brokerage commissions for stock exchange transactions; this made the secondary sales of stocks cheaper for shareholders and thus widened the margin to profit from short-term fluctuations in the share price, contributing to one of the two great reversals: the Great Reversal in Shareholdership.

After having alleged that the capital account liberalization movement of the 1970s and the 1980s is one of the reasons that contributed to the unlocking of the impatience gene in the shareholder community, I move on in Section 5 to argue that there is a causal link between the inflation of the 1970s and the rise to dominance in the intellectual sphere of neoclassical economics. This provides me with the opportunity to present the intellectual substructure of the post-Bretton Woods era and further explain how the neoclassical ideology provided input legitimacy to the commercial banking deregulation movement in the US that allowed US banks to enter the securities business for the first time since the Great Depression, thus contributing to the burgeoning of capital markets in the post-Bretton Woods world. The growth of the capital markets is a point of special interest for the purposes of my analysis because it is identified as one of
the reasons why firms reoriented towards shareholder value and thus why the Great Reversal in Corporate Governance occurred.

With the basic tenets of neoclassical economics in mind, I then present in Section 6 the development within the niche of (neoclassical) financial economics of the agency theory that revolutionized the institutional logics23 of corporate governance and became the catalyst force behind the Great Reversal in Corporate Governance. Simultaneously, I show how the theoretical shareholder value construct of the agency theory penetrated the minds of the managers of the real world with the help of the leveraged buy-out frenzy of the 1980s in the US and with the increasing presence of US institutional investors in foreign jurisdictions.

Once the presentation of the legal and extra-legal institutions that brought about the two great reversals is complete through Sections 1-6 (see Figures 9-10 for an overview), Section 7, the final part of Chapter One, attempts to document with the use of numerical data the causation chain of the First Hypothesis, i.e. the causality links between the Great Reversals in Corporate Governance and Shareholdership and the low rates of economic growth observed in the post-Bretton Woods era (Figure 2).

The unraveling of the (causality) thread of the First Hypothesis starts with a table comparing the rates of economic growth during the post-War and the post-Bretton Woods era in the major Western economies; the table exposes the slowdown in the rates of GDP growth during the latter period. The justification that the First Hypothesis offers for this slowdown is the slower rates of growth of (business) capital accumulation during the post-Bretton Woods era, a trend, which implies that corporations have been retaining less of their profits for reinvestment and have been distributing more of them to their shareholders. To back this, I present numerical data exposing the slower rates of growth of capital accumulation and the lower retention ratios and higher equity payout ratios for NFCs in the post-Bretton Woods period.

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The final part of Section 7 is reserved for the presentation of additional empirical data that back Chapter One’s foundational assertion about the advent of the Great Reversal of Shareholdership. Firstly, I show through graphs the decreasing significance of equity as a net source of finance of fixed capital formation and treat this as a proxy of the fact that shareholders have increasingly become short-termists, as they do not allow the time for their funds to turn into fixed investments and return to them as profits. Secondly, I present three trend lines that show that in the Western world’s largest stock exchanges the average holding period of stock has been reducing over the past decades.

3.2. Outline of Chapter Two: The Post-Keynesian theory of the firm

Chapter Two reinforces the First Hypothesis by attempting to back the causal connection between the two great reversals and the increase in NFCs’ equity payout ratios. Section 7 (7.1-7.4) of Chapter One explains the causal connection between high equity payout ratios and low retention ratios (by indicating that the retention ratio is always inversely related to the payout ratio) as well as the causal connection between lower retention ratios and reduced rates of capital accumulation. The only causal connection of the First Hypothesis’s causality chain that is loosely documented in Chapter One is the one between the two great reversals and high equity payout ratios (see Figure 2). Chapter Two fills in this gap by having recourse to the Post-Keynesian theory of the firm and by offering a simplified model of short-termist shareholdership’s influence on the corporation’s distribution patterns (Figure 3).

The Post-Keynesian theory is an alternative to the neoclassical theory of the firm and purports to be better equipped to explain the mechanics inside those big listed corporations that matter for overall capital accumulation in an economy. The Post-Keynesian theory of the firm starts with the more realistic assumption, verified by business history, that the objective of a corporation is to
grow (rather than profit) and is based on the more realistic (Keynesian) assumption about rationality, i.e. the fundamental uncertainty.

Figure 3 – Chapter’s Two addition to the First Hypothesis

3.3. Outline of Chapter Three: Corporate law and the Great Reversal in Corporate Governance

Chapter Three puts forward the assumption that corporate law has been an accomplice for the reorientation of corporate governance towards shareholder value and thus that it indirectly shares the blame for the low rates of capital accumulation that have thrown the major Western economies in a stagnation mode over the past decades (‘Second Hypothesis’). In other words, the Second Hypothesis seeks to expand the First Hypothesis’s causality chain by adding corporate law as a contributing factor to the chain reaction that ultimately led to low rates of GDP growth in the post-Bretton Woods era. The Second Hypothesis is only concerned with the impact that corporate law had on the Great Reversal in Corporate Governance (Figure 4); corporate law’s relationship to the Great Reversal in Shareholdership is an issue touched upon by the Third Hypothesis, which is developed in Chapter Four.

Chapter Three’s scope exposes the limitations of this study’s legal part, as it focuses on the impact of only one niche of business law on the Great Reversal in Corporate Governance. A discourse on the influence that developments in other crucial business law areas, such as in securities and investment funds regulation, had on the priorities that managers set is excluded from this study, as the latter strives to expose corporate law’s impact on the priorities that managers set (see Sections 1 and 2 above). Nevertheless, especially through Chapter One (see Figures 9-10) this study does acknowledge that there indeed are several legal institutions other than corporate law that have contributed to the rise of shareholder value (see also Introduction, 4.2.2. on the institutional complementarity concept that this study espouses); it chooses
though not to analyze them, as it seeks to make a contribution to the field of corporate law specifically.

For the Second Hypothesis to appear plausible, the relationship of developments in corporate law to the Great Reversal in Corporate Governance must be established. Scientifically though, it would be a mistake in this case to claim the existence of a relationship that amounts to the degree of causation; the impact that a legal reform has on the behavior of organizations cannot be measured with precision with the exception perhaps of reforms in the field of tax law. The task though of providing at least some indications that such a linkage between corporate law and the Great Reversal in Corporate Governance may exist is taken seriously in Chapter Three that responds to this challenge by introducing the post-Bretton Woods shareholder value index (‘PBWSV’). This is an index that shows the progress that the corporate laws of the five Western jurisdictions, whose capital accumulation rates are presented in Section 7.2 of Chapter One (France, Germany, The Netherlands, UK, US), have made at the shareholder value level during the post-Bretton Woods era.

The PBWSV is built in three steps. Firstly, I identify the criteria according to which a type of rule belonging to the niche of corporate law would be classified as relevant for shareholder value. There is one theoretical criterion, i.e. whether a certain type of corporate law rule can theoretically contribute in the reduction of what the agency theory of the firm calls ‘residual loss’, and one empirical criterion, i.e. whether the rights offered by a certain type of corporate law rule are used by shareholder activists to promote their interests inside the firm. Once these types of corporate law rules have been identified, I turn them into the PBWSV’s variables and I quantify them. Without going into detail here regarding the exact rating methodology that I use, a jurisdiction scores points on the PBWSV if it has the aforesaid rules in place and does not score if it does not have them. This index is ‘dynamic’, in the sense that it identifies what the relevant scores were for each jurisdiction every single year from 1973 to 2007.
Therefore, the PBWSV shows how each jurisdiction’s corporate law scored from a shareholder value perspective at the time of the collapse of the Bretton Woods arrangements in 1973 and then how this score changed over the years until 2007, the year before the ongoing crisis officially started.

Eventually, out of the index a trend line emerges illustrating the incremental move of each of these jurisdictions’ corporate law towards shareholder value. This trend line functions as an indication that there is merit in the Second Hypothesis.

3.4. Outline of Chapter Four: Corporate Law and the Great Reversal in Shareholdership

Developments in the field of corporate law may have a more obvious effect on the orientation of corporations towards shareholder value, but it is difficult to conceive of corporate law reforms that can be described as something more than a mere ‘nudge’ to shareholders, when the issue discussed is the reforms’ impact on the time-horizons of shareholders. While Chapter Three proves that it is feasible to construct an index that quantifies corporate rules with regard to their shareholder value-friendliness, it is impossible to draw an accurate index quantifying the impact that corporate rules have on shareholders’ myopia; that would require to estimate the exact time, by which shareholdership’s horizons are shortened, as a result of the introduction, abolition or amendment of a certain corporate law provision.

In fact, Chapter Four does not contend that corporate law has been one of the initiators of (or even contributing factors to) the Great Reversal in Shareholdership. It asserts that corporate law reforms that were intended to merely help this legal niche adjust to the era of ‘financialization’ have escalated the divestment of structurally long-termist institutional investors from equity positions and have preserved the trend towards shareholder short-termism that other institutions have directly caused (‘Third Hypothesis’). In other words, the Third Hypothesis does not contend that corporate law has caused equity’s short-termism, but that it has made the latter more acute and has prevented corporations from engaging in shareholder eugenics and crafting their shareholder base so as to attract more long-termist shareholders.

Chapter Three starts with a brief presentation of the contribution that other niches of business law, such as pension funds regulation and accounting rules, have had to the Great Reversal in Shareholdership. Then the discourse grapples with the attempt to back the Third Hypothesis. This is done by ‘cherry picking’ legal developments generating bias in favor of short-termism in the five Western jurisdictions (France, Germany, The Netherlands, UK, US), whose capital accumulation rates and movement towards shareholder value were studied in Chapters One and Three respectively. As far as the four EU jurisdictions of the sample are concerned, this time instead of studying corporate

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law developments that took place at the national level, reforms that took place at the EU level are studied.

3.5. Outline of Chapter Five: The path towards Long Governance

In the final chapter I attempt to structure a new normative doctrine for corporate law and governance: Long Governance. The three hypotheses introduced by this study, and particularly the First Hypothesis, function as the ratio legis for this new doctrine. Of the two 'stagnation-generating' factors identified in the framework of the First Hypothesis, i.e. shareholder value and short-termism, Long Governance aspires to overturn the latter and therefore contribute to an amelioration of the business capital accumulation dynamics in the Western economies.

Long Governance aspires to represent an intermediate ‘third way’ in the fundamental debate of corporate governance, i.e. the shareholder value vs. stakeholder value debate, and thus Chapter Five begins by a presentation of the shareholder value/stakeholder value dichotomy.

Like the shareholder value and the stakeholder value approaches, Long Governance may be viewed both as a management theory and as a legal concept. As a management theory, Long Governance calls management to set as a benchmark for its actions the long-run interests of all the shareholders who hold, have held or will hold stock in the firm. This is an approach that in practice will require managers to take at the same time under account the interests of other stakeholders as well, since in the long-term shareholders as a class benefit from the protection of other stakeholders. As a legal concept, Long Governance attempts to answer two normative questions: (i) to whom ought directors owe their duties; and (ii) how should the powers inside the corporation be distributed.

With regard to the former question Long Governance suggests that in the ordinary course of business directors should focus on the maximization of long-term corporate welfare, while in the framework of change-in-control transactions it advances the discharge of directorial duties to the benefit of the firm’s existing non-arbitrageur shareholders. With regard to the latter question Long Governance advocates that shareholders should be divided into classes on the basis of their time-horizons, so that more powers are distributed to the class of long-termist investors; but in order for that to happen Long Governance acknowledges that first the pool of long-termist shareholders, which will represent that class, should overall be enlarged.

Finally, Chapter Five drawing on the Third Hypothesis and the various legal rules that were identified there as sustaining short-termism in corporate governance summarizes the regulatory agenda of Long Governance and makes suggestions as to the legal reforms that should be promoted in order for the negative business accumulation dynamics to be reversed.
4. Embedding the study in the corporate governance literature

4.1. An overview of the comparative corporate governance literature

As it becomes evident from the outline of the study, the latter discusses corporate governance in several jurisdictions; it is, therefore, comparative in nature. In addition to this, it approaches corporate governance from more than one viewpoint; while Chapter One approaches corporate governance from an international political economy perspective, Chapter Two analyzes it from the viewpoint of (micro)economics, while Chapters Three and Four focus on corporate governance’s legal aspects. This study, therefore, commits to a view of corporate governance that is holistic, interdisciplinary, historical and international in its scope. Thus, analytically it comes close to an emerging school of thought in social sciences called ‘Comparative Institutional Analysis’ [25]. Within this school of thought there is a cohort of papers on comparative corporate governance, which has developed into a separate niche and draws on insights from law, economics, sociology, organizational studies and political economy. The current study aspires to be part of this niche and consequently it is necessary to identify how it relates to the literature that has been produced within this sub-field so far.

I view comparative corporate governance literature to date to be consisting of four sub-groups.

The first sub-group attempts in an outright way to provide a taxonomy of the corporate governance systems around the world. Depending on the dimension of the analysis the two typologies that are more commonly offered for corporate governance systems are: outsider vs. insider systems [26] and market-oriented vs. bank-oriented systems [27].

Outsider systems are usually also market-oriented and are thus characterized by developed securities markets. Equity is provided by dispersed and uncommitted shareholders with the result being the separation of ownership and control in listed corporations, while managers are disciplined by the damoclean sword of an active market for corporate control and by a well-embedded in the corporate culture shareholder value orientation. The influence of dispersed equity capital in firms of outsider systems is effectuated through the market mechanism of exit, whose threat can be particularly acute in the case of a

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[26] See Julian Franks & Colin Mayer, Corporate Ownership and Control in the UK, Germany and France, 9 JOURNAL OF APPLIED CORPORATE FINANCE 30

[27] See Ross Levine, Bank-based or Market-based Financial Systems: Which is Better?, NBER Working Paper 9138 (2002). Available at SSRN: http://ssrn.com/abstract=307096; To be sure the market-oriented vs. bank-oriented typology is introduced to classify financial systems around the world, but given the impact of corporate finance patterns on corporate governance structures it is used as a taxonomy for corporate governance purposes as well.
hostile takeover. The US and the UK are viewed as the paradigm outsider systems.

Insider systems, on the other hand, are usually also bank- oriented and characterized by weak or unimportant securities markets. Equity finance is provided mainly by a dominant shareholder with the result being the prevalence of concentrated ownership. Banks take an active role in the corporate governance of listed corporations by closely monitoring the firms, to which they have lent funds, while managers have to respond to the concerns of various stakeholders, particularly of the employees, whose influence on corporate affairs may be secured by their mandatory presence on the firm’s board. Equity capital’s influence in insider systems’ firms is effectuated through ‘voice’, particularly by the dominant shareholders. Continental Europe, mainly Germany and The Netherlands, and Japan are viewed as the paradigm insider systems.

The second strand of comparative corporate governance literature puts forward the ‘convergence claim’, i.e. the assertion that corporate governance systems around the world gradually – or eventually will – converge to the outsider/market-oriented model. The convergence theorists posit that despite the differences in corporate systems around the world there is a clear universal tendency towards the dominance of a shareholder-centered ideology in corporate law. In other words, the competitive pressure generated by the globalization of trade and finance is thought of as inspiring institutional convergence in the field of corporate governance.

The third sub-group emerged from the ‘varieties of capitalism’ approach that by drawing on the new economics of organization sets a new framework in the study of comparative capitalism that helps explain the institutional variation of the different economic systems. The corporate governance literature within the ‘varieties of capitalism’ approach views the corporation as the crucial actor in a capitalist economy. The fundamental distinction of economic systems here that also leads to an implicit corporate governance taxonomy is between ‘liberal market economies’ (LMEs) and ‘coordinated market economies’ (CMEs). If we were to draw an analogy with the outsider vs. insider taxonomy, LMEs would equate to outsider systems of corporate governance, while CMEs to insider systems.

External corporate finance in CMEs is thought of as not being entirely dependent on current profitability and publicly available financial data; therefore, network embeddedness, expressed through board interlocks and other

28 Patrick Bolton & Ernst-Ludwig von Thadden, Blocks, Liquidity, and Corporate Control, 53 The Journal of Finance 1, 2
32 Id., at 6
types of inter-firm networks, has developed into a governance mechanism that allows investors to monitor the firms, to which they commit their funds. This allows capital—mainly debt—in CMEs to be more patient and thus more conducive to finance long-term projects. The absence of an obligation of firms to sustain current profits in the face of a fluctuating economy renders them more able to make credible commitments to their employees about job security. Moreover, due to the prevalence of concentrated ownership in CMEs’ firms, the latter are largely immune from hostile takeovers, which could bring about abrupt changes in the firm’s workforce. Consequently, labor markets tend to be less fluid in CMEs and therefore employment is more long-term and secure.

The institutional structure of CMEs endows corporations in these countries with the capacity to develop incremental innovation strategies that are marked by continuous small-scale improvements to existing product lines. Secure employment allows employees to risk suggesting changes to products or processes that would otherwise alter their job situation in case of failure and long-term tenures encourage the development of synergies between the employees that provide a fertile soil for incremental innovation. In turn, incremental innovation capacity confers upon CMEs’ firms the comparative advantage to produce capital-intensive goods, such as machine tools, engines, consumer durables etc. This assumption of the ‘varieties of capitalism’ approach is empirically backed by the industrial profile of CMEs, such as Germany or Japan, whose output is of great physical weight.

In LMEs external corporate finance is traditionally obtained more from the securities markets and less from bank lending. Rentiers of finance rely more on publicly available information and current earnings, while they contract with firms on an arm’s length basis due to the lack of networks that would signal inside information. Focusing on the share price is more important for managers

See Walter Powell, Neither Market Nor Hierarchy: Network Forms of Organization, 12 Research in Organizational Behavior 295
34 Hall & Soskice, supra note 31, 22-23
35 While this view seems to have been traditionally valid for Germany, the paradigm CME, it purports not to hold equally true for The Netherlands, the other main CME country of the ‘Rhenish’ model of capitalism, as Dutch banks have in the past been reluctant to participate in the long-term financing of the industry; Eelke Heemskerk, Decline of the Corporate Community: Network Dynamics of the Dutch Business Elite (2007), 49-50
36 Peter Hall & Daniel Gingerich, Varieties of Capitalism and Institutional Complementarities in the Macroeconomy: An Empirical Analysis, MPIG Discussion Paper, 04/5, 23
37 Hall & Soskice, supra note 31, 38
39 Hall & Soskice, supra note 31, 38
40 Sigurt Vitols, Varieties of Corporate Governance: Comparing Germany and the UK, in Varieties of Capitalism, supra note 20, 350ff.
41 Measuring the physical weight of an economy’s output, although certainly not a formal way to evaluate an economy’s growth or productivity, can tell us a lot about this economy’s industrial profile and innovation capacity; see David Wessel, From Greenspan, a (Truly) Weighty Idea, Wall St. Journal, May 20, 1999, p. B1
42 Hall & Soskice, supra note 31, 28-29
since dispersed ownership renders the firm vulnerable to hostile takeovers; the cheaper your equity is the easier it is for a corporate raider to launch a successful takeover bid. Therefore, shareholder value emerges as the principal concern for managers in LMEs that results in them being less responsive to stakeholders’ and especially employees’ concerns. Shareholder value orientation and frequent changes in corporate control give rise to fluid labor markets that allow LMEs’ firms to hire and fire more easily in order to grasp new opportunities. This confers upon firms in these countries the capacity to be more open to radical innovation that brings ‘new to the world’ or ‘new to the industry’ products – rather than merely ‘new to the business’ products that is what incremental innovation brings about. The institutional structure of LMEs, therefore, endows them with the comparative advantage to be more productive in the high-tech and services sectors. This assumption is backed empirically by the industrial profile of the paradigm LMEs, the US and the UK, whose GDP output is ‘lighter’ compared to CMES.

The fourth strand of comparative corporate governance literature, more commonly known as the ‘law and finance’ approach, starts from the Schumpeterian assumption that strong financial markets are indispensable for economic growth. It then postulates that strong legal protection of investors and particularly of shareholders is indispensable for a country to attract private investment in its securities markets, which would then get to develop and function as the engine of economic growth. In light of this approach, the ‘law and finance’ line of literature engages in a comparative statistical analysis of the legal underpinnings of corporate finance and identifies that poor legal protection for investors is correlated with high ownership concentration – i.e. the holding of large blocks of shares by a relatively small number of shareholders – while strong legal protection leads to dispersed shareholder structures in firms. Countries are for the purposes of the comparative analysis classified according to their ‘legal origin’ into common law and civil law countries. Once the legal indicators are regressed against economic outcome variables, common law countries that have strong investor protection norms, dispersed shareholdership and strong securities markets are found to be having higher growth rates, while civil law countries with weak investor protection, concentrated ownership and weak securities markets are identified as lagging

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44 See Wessel, supra note 41
45 See JOSEPH SCHUMPETER, THEORIE DER WIRTSCHAFTLICHEN ENTWICKLUNG (1911)
46 See Robert King & Ross Levine, Finance and Growth: Schumpeter Might be Right, 108 QUARTERLY JOURNAL OF ECONOMICS 717
47 See Raphael LaPorta et al., Legal Determinants of External Finance, 52 JOURNAL OF FINANCE 1131
48 Rafael LaPorta et al., Law and Finance, 106 JOURNAL OF POLITICAL ECONOMY 1113, 1114
49 See Andrei Shleifer & Robert Vishny, A Survey of Corporate Governance, 52 JOURNAL OF FINANCE 737
50 MILHAUPT & PISTOR, supra note 9, 18
behind in growth. Thus, the ‘law and finance’ line of literature backs by means of a different line of argumentation Friedrich Hayek’s old claim that common law countries have a superior performance to civil law countries.

### 4.2. The study’s novelties in relation to the existing comparative corporate governance literature

As mentioned under 3.1. above, this study’s First Hypothesis is that the shift in the institutional logics of corporate governance towards shareholder value coupled with shareholdership’s short-termism have cumulatively contributed to the low rates of growth that have been observed in the major Western economies since the breakdown of the Bretton Woods system in the early 1970s. In the process of backing the First Hypothesis – but also the Second one- I introduce a series of ancillary arguments that relate to the corporate governance systems we observe around the world. My argumentation buttresses the assumptions of some of the aforementioned sub-groups of comparative corporate governance literature, but takes issue with others. Identifying the complementarities of the study’s arguments with prior scholarship in this field is of paramount importance, as it will help establish the study’s limitations, novelties and in general its scientific identity.

In this sub-section I explain how my study relates to each sub-field of the niche of comparative corporate governance. The textboxes convey the novel arguments that my study (derivatively) spires to introduce into the respective line of comparative corporate governance literature. For readers familiar with the basic tenets of comparative corporate governance the textboxes offer the possibility of quickly understanding what this study adds to the existing literature.

#### 4.2.1. An additional point of intersection between outsider and insider systems

The current study does not in principle intend to interfere with the classical distinction of outsider vs. insider corporate governance systems. While as I explain below, it may offer some support to the convergence claim, it observes that the differentiating features of the insider corporate governance systems remain unaltered. A large percentage of listed corporations in insider systems still have a controlling shareholder rather than dispersed owners. This retention of control on behalf of a dominant shareholder is effectuated either through the offering to outside shareholders within initial public offerings.

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52 See FRIEDRICH HAYEK, *THE ROAD TO SERFDOM* (1944)
53 For the position this study takes on the fundamental debate of corporate governance, i.e. the shareholder value vs. stakeholder value debate, see Chapter Five.
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(‘IPOs’) of less than the majority of stock outstanding or through the introduction of control-enhancing mechanisms, i.e. structures that deviate from the one-share/one-vote principle such as multiple voting shares, voting caps, pyramidal holding and cross-holdings. This study does not offer a novel argument regarding the holdings of controllers. It identifies, however, a common feature regarding publicly traded non-controlling stock in both outsider and insider corporate governance systems; this stock is predominantly short-termist.

Again, however, there is another limitation in the remark I am making, since I refer to all publicly traded non-controlling stock except stock held by equity index funds.

Indexing or index tracking is the investment strategy of tying your portfolio to the performance of the market as a whole. The ideal vehicle for indexing is the index fund. An equity index fund is a collective investment vehicle, which holds a small percentage of shares in all or almost all companies that constitute an index, i.e. an imaginary portfolio of securities representing a particular market or a portion of it that is used as a benchmark to track targeted stock market activity. The most popular index for equity index funds is the S&P 500, which represents about 75% of the total market value of the NYSE, and shows how the stock of 500 US corporations that have a large market capitalization has traded during a specific trading session. Equity index funds that follow the S&P 500 gain exposure to the vast majority of the companies that form the components of the index or to companies that are deemed to be representative of the index composition, so as to mirror or replicate the index’s movements rather than outperform the index.

These clearly defined rules of share ownership of fixed predetermined holding weights, by which equity index funds abide, has turned equity index

54 In a survey conducted in firms that went public between January 1994 and December 2004 in several insider system countries (Austria, Belgium, France, Germany, Greece, Italy, The Netherlands, Portugal, Spain, Switzerland) it was identified that post-IPO the pre-IPO controlling shareholder retains on average 52% of the shares; see Franck Bancel & Usha Mittoo, Why Do European Firms Go Public?, 15 EUROPEAN FINANCIAL MANAGEMENT 844, 869. In some insider systems countries, such as Italy, the percentage of shares retained by the controller post-IPO can be much higher; see Silvia Rigamonti, Evolution of Ownership and Control in Italian IPO Firms, Borsa Italiana (BIt) Notes, N. 17 – May 2007, 21, who finds that in Italian IPOs that took place from 1985 to 2005 the stake offered to outside shareholders within the scope of an IPO was on average 30%.
57 This remark reflects author’s conversations with Robert A.G. Monks.
58 Kathryn Montgomery, The Role of Institutional Investors in Corporate Governance, 26 CANADIAN BUSINESS LAW JOURNAL 189, 192
59 MARTIN GOLD, FIDUCIARY FINANCE: INVESTMENT FUNDS AND THE CRISIS IN FINANCIAL MARKETS (2011), 97
60 ROBERT A.G. MONKS ET AL., CORPORATE VALUATION FOR PORTFOLIO INVESTMENT: ANALYZING ASSETS, EARNINGS, CASH FLOW, STOCK PRICE, GOVERNANCE, AND SPECIAL SITUATIONS (2010), 227
funds into a class of ‘permanent’ shareholders with long-term horizons regarding the performance of their index’s companies. Although a series of more active management techniques has emerged lately for equity index funds that require them to rebalance their holdings from time to time, traditional indexing only requires them to modify their holdings when a company enters or leaves an index. This contributes to the relative permanence of their shareholder positions.

Investments by equity index funds are on the rise in both outsider and insider systems. At the end of 2009 assets invested in equity index funds represented 13.7% of all equity mutual funds’ assets in the US, while their shareholdings accounted for about 11% of the capitalization of the S&P 500 index. Accordingly, this is more or less on average the percentage of an S&P 500 firm’s outstanding stock that is held by permanent shareholders. Equity index funds based on other indexes, such as S&P Europe 350 that represents 70% of the European equity market capitalization, have collectively a smaller stake in the companies consisting the index, since it is the S&P 500 attracts most of index funds existing.

However, this new class of permanent shareholders does not seem to be able to imprint its long-term horizons on the firms’ strategies. Influencing corporate governance would require equity index funds to take a more activist stance within the corporations, in which they hold stock, and that would result in them having to increase their management fees that due to their ‘free rider style’ of passive management are half the fees that other types of collective investment vehicles charge to investors. Therefore, although they are by nature long-term shareholders, they should not be accounted for long-termist governance players. Still though, I am obliged to leave them out of the general remark I am making, which in light of the above should be rephrased as follows:

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**The Time-horizons of Public Non-controlling Stock**

Publicly traded non-controlling stock except for the stock held by equity index funds is short-termist in both outsider and insider systems of corporate governance.

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61 Montgomery, supra note 58, 192
62 MONKS ET AL., supra note 60, 227
66 MONKS ET AL., supra note 60, 228
4.2.2. Nominal divergence, but functional and formal convergence between insider and outsider systems

The claim that corporate governance systems around the world converge or will eventually converge to the outsider model has two variations. There are those who claim that convergence is or will be formal, in the sense that corporate law—statutory or case law—will realign firms in insider countries towards shareholder value \(^{67}\) and those who claim that convergence will be functional \(^{68}\), meaning that, although formal rules won’t change, corporate governance mechanisms will in practice promote shareholder value.

I am of the opinion that we currently have both formal and functional convergence of the two systems of corporate governance without though having at the same time nominal convergence. Functional convergence is the one caused by extra-legal institutions; extra-legal forces and arrangements produce the result of shareholder value orientation among corporate managers. Formal convergence is the one caused by legal institutions, belonging to the field of corporate law or financial regulation. The legal rules distribute rights and assign obligations to the various corporate constituents that in aggregate have the result of orienting the firm’s management more towards the interests of the shareholders, rather than towards the interests of other stakeholders. Nominal convergence would require that the corporate legal systems of both insider and outsider countries provide to the most determinative question of corporate governance the same explicit answer, i.e. that the firm ought to be managed in the shareholders’ interests ('shareholder primacy norm').

If one looks at the corporate laws of representative insider countries, one would understand why it cannot be asserted that there is nominal convergence. The German Constitutional Court seems to have indirectly rejected a contractual theory of the firm, out of which a shareholder orientation for corporate law could eventually emerge, since it has adjudicated that the economic view of the firm should be complemented with a social approach, which would conceive the firm as the joint undertaking of labor and capital \(^{69}\). In addition to this, recently in the other main representative country of the Rhenish model of capitalism \(^{70}\), The Netherlands, the Supreme Court within the scope of a multibillion takeover battle explicitly rejected the shareholder value maximization approach that is followed in such cases in outsider systems (e.g. in Delaware), which indicates that when a company is up for sale then the duty of the board is to maximize the proceeds from the takeover bid for the benefit of

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67 See Hansmann & Kraakman, supra note 29
68 See John Coffee, The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications, 93 NORTHWESTERN UNIVERSITY LAW REVIEW 641
70 The ‘Rhenish model of capitalism’ is a term that originates from the French term ‘capitalisme rhénan’ that was introduced in MICHEL ALBERT, CAPITALISME CONTRE CAPITALISME (1991), 119, a precursory work to the varieties of capitalism line of literature.
the shareholders. While Amsterdam’s Enterprise Chamber, a specialized court for corporate disputes, had in the same case adjudicated that when a company is clearly the target of a takeover contest, the board’s duty is to create for the benefit of the shareholders the best possible conditions for the bidding process to unravel, the Dutch Supreme Court overturned this adjudication by stating that the foundations of Dutch company law, as exemplified by the Dutch Corporate Governance Code, require the board to take under account the interests of all stakeholders even in ‘bidding war’ situations. Thus, The Netherlands’ ultimate judicial authority refused to accept the introduction into Dutch company law of the so-called ‘Revlon’ duty, a standard of review for managerial actions introduced by the most sophisticated judicial forum for corporate disputes of the outsider countries, the Delaware Supreme Court, that mandates the board within takeover battles to run a fair auction, so as to maximize the price received by the shareholders. Thus, the Dutch Supreme Court resisted the acceptance of the shareholder primacy norm that the Amsterdam Enterprise Chamber attempted to introduce.

While in light of the above it may be clear that there is no nominal divergence, a prima facie reading of insider countries’ corporate law could lead one to assert that there is no formal convergence either. Germany still has in place the co-determination law (‘Mitbestimmungsgesetz’) that requires half of the seats of the supervisory boards of German corporations that employ more than 2,000 persons to be occupied by employee representatives and also an act that requires companies that employ more than 500 persons to have one-third of the members of the supervisory board elected by the employees. The Netherlands has a rigid law regarding employee representation on supervisory boards as well, as in principle one third of the seats of the latter are reserved for persons proposed by the firm’s works council.

This study though shows in Chapter Three through the construction of the post-Bretton Woods shareholder value index that reforms in corporate law have reoriented corporate governance in insider countries towards the maximization of shareholder value despite the residual existence of

71 BA7970, Hoge Raad, R07/102HR (OK 137); For an overview of the Dutch Supreme Court’s decision on this case that pertained to the takeover battle between Barclay’s and a consortium led by RBS for the acquisition of ABN AMRO see Wilco Oostwouder, Can You Trust the Dutch (Company Law System)?, 4 EUROPEAN COMPANY LAW 211
72 BA4395, Ondernemingskamer Gerechtshof Amsterdam, 451/2007; For an overview of the Enterprise Chamber decision see Cornelis de Groot, The ABN AMRO Ruling: Some Commentaries, 4 EUROPEAN COMPANY LAW 168
73 See HR, supra note 65, at 4.5 (‘Ook hier geldt dat het bestuur bij de vervulling van zijn bij wet of statuten opgedragen taken het belang van de vennootschap en de daaraan verbonden onderneming behoort voorop te stellen en de belangen van alle betrokkenen, waaronder die van de aandeelhouders, bij zijn besluitvorming in aanmerking behoort te nemen’)
75 Gesetz über die Mitbestimmung der Arbeitnehmer vom 4. Mai 1976 (BGBl. I S. 1153) (‘MitbestG’)
76 §§1 and 7 MitbestG
77 § Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat vom 18. Mai 2004 (BGBl. I S. 974)
78 Art. 2:158 of the Dutch Civil Code (‘BW’)
stakeholderist rules. These reforms appear on their face to have helped corporate law adapt to the era of financial markets, but at the same time some of them have had the unintended consequence of promoting shareholder value. I am not necessarily implying that the new rules have allowed shareholders to increase their explicit influence over corporations, i.e. by means of direct intervention into management. They have mostly allowed them to increase their implicit influence, i.e. through market mechanisms that eventually induce managers to cater for shareholders’ interests. Thus, in Chapter Three through the Second Hypothesis this study endorses the formal convergence claim.

As well as this, this study implicitly accedes to the claim that there is functional convergence in corporate governance between outsider and insider systems. In Chapter One I present a series of structural changes in international political economy and particularly a (formal) convergence of countries in their approach to issues of monetary policy and current and capital account openness that have had the unintended consequence of spurring convergence in the functioning of corporations in both outsider and insider systems. The increased mobility of capital that followed from capital account liberalizations provided firms of insider countries with the opportunity to raise capital by listing their securities in the more developed stock exchanges of the outsider countries, but this meant that through the listing agreement with the self-regulatory organization that provides the stock exchange facility (e.g. NYSE, LSE) the firm had to introduce some more ‘outsider-like’ corporate governance arrangements. This has also been called ‘convergence by contract’. In addition to this, the freedom of establishment for corporations in the EU (Art. 54 TFEU) as interpreted by a trilogy of rulings delivered by the ECJ (Centros, Uberseering, Inspire Art) had an effect on the corporate mobility of small and medium sized enterprises (‘SMEs’) within the EU, as a number of SMEs operating in insider countries of continental Europe are now registered in the UK and thus subject to an outsider system of corporate governance. This has been called ‘hybrid convergence through regulatory competition’ and although

79 Martin Gelter, The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance, 50 HARVARD INTERNATIONAL LAW JOURNAL 129, 147
80 See Coffee, supra note 68
81 Ronald Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 AMERICAN JOURNAL OF COMPARATIVE LAW 329, 346, 349
82 ECJ 9 March 1999, Case C-212/97, Centros Ltd. V. Erhvervsog Selskabstyrelsen
83 ECJ 30 September 2003, Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.
84 GERT-JAN VOSSESTEIN, MODERNIZATION OF EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE: SOME CONSIDERATIONS ON ITS LEGAL LIMITS (2010), 124ff.
85 See Marco Becht et al., Where Do Firms Incorporate? Deregulation and the Cost of Entry, 14 JOURNAL OF CORPORATE FINANCE 241
86 Gilson, supra note 81, 350
it is currently relevant only for SMEs\textsuperscript{88}, which remain outside the scope of this study, it is a convergence indicative of the dynamics that regulatory competition in corporate law might eventually develop in the future with regard to large listed corporations as well, as it has happened in the framework of regulatory competition in the US.

To be sure, an ancillary distinctive attribute of the outsider system of corporate governance is believed to be short-termism or myopic horizons\textsuperscript{89}. The constant takeover threat caused by the dispersed ownership of outsider systems’ corporations has been claimed to induce managers to sacrifice long-term interests in order to boost current profits, so as to keep the firm’s quoted stock price up and thus render it expensive for a corporate raider to launch a takeover bid\textsuperscript{90}. The arm’s length character of corporate finance in outsider countries that relies on publicly available information on earnings is also prone to spur short-termism to managers, as the stock markets’ rational forecast of firm value is epitomized in the belief that higher earnings today means higher earnings in the future and this eventually traps managers into behaving myopically\textsuperscript{91}.

On the other hand, the stereotypical view of insider systems, as it was implied above under 4.1, is that they are long-term oriented\textsuperscript{92} particularly because of the inside information regarding a firm’s financial condition that rentiers of finance are able to get through vertical firm networks and cross-shareholdings within industrial groups, as is the case with the Japanese keiretsu\textsuperscript{93}. However, the reforms discussed in Chapters One, Three and Four have indirectly unrooted the long-term character of corporate governance in insider systems, since among the firm’s financiers they have disproportionately empowered -in terms of implicit influence- the holders of non-controlling equity that according to the empirical data presented in Chapter One have short-term investment horizons.

Therefore, the current study enriches the convergence claim, by adding one more dimension, in which systems of corporate governance converge:

\textsuperscript{88} Peter-Christian Müller-Graff & Christoph Teichmann, Europäisches Gesellschaftsrecht auf neuen Wegen (2010), 43ff.
\textsuperscript{89} See Shleifer & Vishny, supra note 49
\textsuperscript{90} See Jeremy Stein, Takeover Threats and Managerial Myopia, 96 Journal of Political Economy 61
\textsuperscript{91} Jeremy Stein, Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior, 104 The Quarterly Journal of Economics 655, 656
\textsuperscript{92} See Michael Porter, Capital Disadvantages: America’s Failing Capital Investment System, 70 Harvard Business Review 65
4.2.3. Equity’s new role in the finance-dominated model of development

A study related to corporate governance cannot escape its duty to make a contribution to the political economy of contemporary capitalism. As it has been mentioned:

Corporate governance lies at the core of comparative and international political economy […] Patterns in corporate governance […] affect the rates of economic growth and adjustment […] They mingle with trade disputes and international economic coordination. Corporate governance is not the sole driver in these areas of policy, but it is an important component…

No other approach in the comparative corporate governance literature has been more integrated with political economy, as the ‘varieties of capitalism’ intellectual framework. The latter provides a firm-centered political economy, where corporations are viewed as the key agents of economic adjustment, whose ‘activities aggregate into overall levels of economic performance’95. The ‘varieties of capitalism’ analysis is built on the concept of institutional complementarity that views institutions in an economy as interacting to give a coherent outcome. Each institution introduces a set of constraints, incentives and possibilities that determine agents’ behavior96, but often the influence of one institution is reinforced by the existence of another institution97. These two ‘reinforcing’ institutions then are said to be complementary.

In this study, I accede to the ‘varieties of capitalism’ institutional complementarity concept in the sense that although I focus on the impact of legal institutions on shareholders’ and corporate managers’ time-horizons, I do not deny that short-termism is cumulatively caused by the simultaneous existence of other institutions particularly of the macroeconomic sphere. This is

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94 Peter Gourevitch & James Shinn, Political Power and Corporate Control (2005), xiv
95 Hall & Soskice, supra note 31, 6
96 Bruno Amable, Institutional Complementarity and Diversity of Social Systems of Innovation and Production, 7 Review of International Political Economy 645, 656
97 Bruno Amable et al., How Do Financial Markets Affect Industrial Relations: An Institutional Complementarity Approach, 3 Socio-Economic Review 311, 313
the reason why I put corporate governance in the international political economy context in Chapter One, so as to fend off against potential criticism that I have not given due attention to other institutional factors that affect corporate constituents’ time horizons.

However, to identify how this study exactly relates to the political economy dimension of existing comparative corporate governance literature, an overview of the so-called ‘Regulation School’ (‘école de régulation’), one of the institutional economics approaches on which the ‘varieties of capitalism’ framework was founded, is necessary.

The ‘Regulation School’ is a heterodox approach to political economy that insists on the variability of capitalisms [sic] across time. Within this approach capitalist economies are seen as having some generic features that are differently configured in successive stages of capitalism.

Regulationists coined the mode of economic growth that prevailed in the world’s industrialized nations until the 1970s as ‘Fordism’. Fordism is seen as a model of development based on economic and extra-economic conditions that favored mass production and mass consumption. Fordist firms were relying on economies of scale and by a technical division of labor they were able to introduce a model of mass production that increased their productivity. The firms’ increased output was absorbed by mass demand, which was becoming possible due to the fact that wages were linked to productivity and thus they were also simultaneously increasing. The virtuous circle was completed through the reinvestment of profits back into the business, which improved mass production equipment and led to a further rise in productivity and hence wages.

The Fordist regime is commonly acknowledged to have contributed to the high rates of growth that were marked during the ‘Golden Age of Capitalism’ (late 1940s – early 1970s) in the world’s industrialized nations. However, the great transformations that occurred during the 1970s – on which I elaborate in Chapter One- marked the end of the Fordist regime and prompted.

98 Bob Jessop, Survey Article: The Regulation Approach, 5 THE JOURNAL OF POLITICAL PHILOSOPHY 287, 289
99 Id., at 290
100 See MICHEL AGLIETTA, REGULATION ET CRISSES DU CAPITALISME : L’ EXPERIENCE DES ETATS-UNIS (1976)
101 BOB JESSOP, BEYOND THE REGULATION APPROACH: PUTTING CAPITALIST ECONOMIES IN THEIR PLACE (2006), 58
102 Id., at 59-60
103 Henry Ford himself had declared his firm’s settled policy ‘My ambition is to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes. To do this, we are putting the greatest share of our profits back into the business’. He explicitly invoked this policy in a dispute he had with certain minority shareholders (the Dodge brothers), who challenged Ford Motor Company’s board decision not to declare a dividend out of a large pool of earnings that had been retained to fund new projects. Coincidentally, this case was the one that introduced in the US the shareholder primacy norm, since Ford’s policy was not accepted by the court on the basis that ‘it is not within the lawful powers of a board to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others ’; see Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919)
regulationists to analyze the new structures of the capitalist economy in order to identify Fordism’s successor. While the ‘varieties of capitalism’ approach is right in suggesting that CMEs/insider systems are more resilient to change and thus one could suggest that they haven’t yet abolished all of their Fordist attributes, my view is that the finance-led regime that has emerged in LMEs/outsider systems as the strongest candidate to succeed Fordism\(^{104}\) has also affected the structure of the CMEs. Hence, again I attempt to balance my contribution to the comparative corporate governance literature between the ‘varieties of capitalism’ approach and some variation of the convergence claim.

A finance-led capitalist model is viewed as an institutional setting that, apart from carrying the characteristics of ‘financialization’ that were discussed under Section 2 above, is governed by an accumulation regime, i.e. the complementary pattern of production and consumption that is reproducible over a long period\(^{105}\), that is dominated by finance\(^{106}\). While in Fordist economies consumption was financed by the increasing wages of employees, in the finance-led regime adjusted wage shares have fallen\(^{107}\) and thus consumption is increasingly financed by consumer’s access to financial gains and credit\(^{108}\). Concerns arising from the ageing population in Western countries led to the privatization of many aspects of social security from 1980s onwards. Institutional investors, such as pension funds, undertook the privatized savings function by providing wage earners with an indirect access to the stock market. Additionally, the falling adjusted wage shares are also partly offset by the massive employee stock-option programs. Thus, the stock market has an increasing wealth effect on the savings/consumption all\(^{109}\). At the same time, the expansion of the importance of the stock market along with the deregulation of the commercial banking industry from the 1980s onwards allowed consumers to post their financial wealth as collateral in order to borrow from banks\(^{110}\). Facilitated access to private credit in turn stimulated consumption.

In light of these observations, I would claim that in the finance-led model of capitalism the stock market transformed from a mechanism to finance the supply side of the economy (i.e. the industry) into a mechanism that finances the consumption side. This negative net contribution of equity to the financing of industry from the 1970s onwards is evident in the analysis of Section 7 of Chapter One (see Figures 21–24).


\(^{105}\) Jessop, _supra_ note 98, 291

\(^{106}\) Robert Boyer, _Is a Finance-led Growth Regime a Viable Alternative to Fordism? A Preliminary Analysis_, 29 ECONOMY AND SOCIETY 111, 112

\(^{107}\) Engelbert Stockhammer, _Wage Moderation Does Not Work: Unemployment in Europe_, 39 REVIEW OF RADICAL POLITICAL ECONOMICS 391, 394-395

\(^{108}\) Boyer, _supra_ note 106, 120; Marc Lavoie, _Introduction to Post-Keynesian Economics_ (2009), 151


\(^{110}\) Boyer, _supra_ note 106, 121
The shareholder value orientation of firms that I claim that prevailed in both LMEs and CMEs was a precondition for the transition from a Fordist model of accumulation to a finance-dominated regime, as it helped divert the firm’s profits out of the firm’s reinvestment program and into the shareholders’ pockets. The shareholder value approach, thus, did nothing more but to ensure that stock would increasingly get to serve consumption rather than production.

Consequently, the current study by blending corporate governance analysis with heterodox political economy’s analysis of the current finance-led or finance-dominated model of development suggests that:

**Equity: From Financing Supply to Financing Demand**

In the finance-led model of capitalism the stock market transformed from a mechanism to finance the supply side of the economy (i.e. the industry) into a mechanism that finances the consumption side. This marked a transformation in the role of equity as well, which might also explain the gradual transformation of shareholders’ time horizons. When stock is needed to finance consumption it has to provide returns more rapidly than when it is needed to finance production, since financing production would require the stockholder to be more patient, as industry projects might last for several years.

4.2.4. Corporate law’s new desideratum and equity’s share of blame in the crisis

The final strand of the comparative corporate governance niche, the ‘law and finance’ line of literature, is a very influential set of articles written by leading financial economists and legal commentators, who within the general framework of a ‘law matters’ thesis have developed a series of arguments, each of which carries its own value. From this series I have disaggregated two arguments that deserve special attention and that I find to be relevant for the purposes of the current study. Identifying how this study relates to each of these two arguments is essential in order to reveal how it views the normative role of the legal institutions of corporate governance in the post-2008 world.

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111 Engelbert Stockhammer, Some Stylized Facts on the Finance-dominated Accumulation Regime, 12 COMPETITION & CHANGE 184, 185

112 The ideas developed within the scope of these studies influenced the World Bank ‘legal technical assistance programs’ that saw the transplantation of law, which has worked well in the case of developed countries, as the secret of economic success for an emerging economy.
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4.2.4.1. Can corporate law restore trust in the economy?

The first argument that emerges from the ‘law and finance’ strand of comparative corporate governance is the one that depicts corporate law as a kind of technology that can be inserted into an economy and propel the growth of securities markets. This argument, which has been duly called the ‘technical corporate law theory’, flows from empirical data that show that deep securities markets correlate with an index of shareholder legal protections. An implicit tenet that is found within this argument is that the quality of corporate law can arouse trust among potential investors, so that they can decide to take the risk associated with the holding of a security and thus infuse the financial markets with additional liquidity.

Although corporate law is not the only and most likely not the most crucial mobilizing force behind strong securities markets, its capacity at least to infuse the investor community with trust should not be contested. Thus, corporate law although a second-order phenomenon in the creation of securities markets can become one of the main weapons for fighting the confidential crisis that has thrown the post-2008 global economy into a stagnation-persisting liquidity trap. While I leave the explanation of the Keynesian concept of liquidity trap for Chapter One (Section 1.2), I confine myself to stating here that a preference for hoarding over spending is the main characteristic of this phenomenon.

113 MARK ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2006), 165-166
114 There have indeed been several studies that show that countries that have or have had at a certain point in time deep securities markets were able to develop them in the absence of corporate law or securities regulation. For instance, the Japanese equity market of the early 20th century, which played a major role in the financing of Japanese industry and agriculture, developed due to the presence of prominent directors on Japanese firms’ boards, who in the absence of business regulation were fulfilling a signaling intermediary role between firms and investors; see Yoshiro Miwa & Mark Ramseyer, The Value of Prominent Directors: Corporate Governance and Bank Access in Traditional Japan, 31 JOURNAL OF LEGAL STUDIES 273. Investment bankers were developing similar bonding mechanisms in the nascent US securities markets of the early 20th century; see John C. Coffee, The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control, 111 YALE LAW JOURNAL 1. Other studies have shown the importance of private ordering and self-regulation in the development of securities markets by referring to the contribution of the NYSE stock exchange rules in enforcing crucial governance obligations on firms in the pre-New Deal US; see Mark Roe, Political Preconditions to Separating Ownership from Corporate Control, 53 STANFORD LAW REVIEW 1463. Finally, the technical theory of corporate law is contested by the fact that civil law countries that within the ‘law and finance’ literature are shown to have poor quality of corporate laws had very developed securities markets before World War I; see Raghuram Rajan & Luigi Zingales, The Great Reversal: The Politics of Financial Development in the 20th Century, 69 JOURNAL OF FINANCIAL ECONOMICS 5
115 Signs of hoarding among firms and investors seem to be present in the post-2008 world as it becomes evident from the ratio of cash assets to loans outstanding on banks’ balance sheets and the ratio of cash assets to total assets on non-financial corporations’ balance sheets. US companies have boosted their liquid assets by 26% in the first quarter of 2010, which is the highest level since 1952; see Aki Ito, Japan Companies Join US in Hoarding Cash on Europe, BLOOMBERG BUSINESSWEEK, JUNE 17, 2010. These numbers are too high to infer that corporate America is just trying to deleverage or that banks prepare for the implementation of the ‘Basel III’ accord that mandates larger liquid reserves; See Adrian Blundell-Wignall & Paul Atkinson, Thinking Beyond Basel III: Necessary Solutions for Capital and Liquidity, OECD JOURNAL: FINANCIAL MARKET TRENDS (2010), Iss. 1. Evidence that the US economy is in a liquidity trap is further reinforced by facts about consumer spending. Consumers in the US are also hoarding, since the personal savings rate has risen after the 2008 crash [see RICHARD POSNER, THE CRISIS OF CAPITALIST DEMOCRACY (2009), 300], while the 2008 $80bn tax rebate program of the US
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The positive correlation between public trust and economic growth has been documented in several studies. The investment decision is not only the outcome of a rational calculus, but also an act of faith in the overall market system. It follows that the greater the faith one has in the institutional infrastructure of the financial system, the more likely it is for her to invest part of her wealth in securities.

But, how exactly can corporate law infuse the market players with faith? According to a modern taxonomy in behavioral economics there are two types of trust that are crucial for economic growth. The first one is utterly subjective and is called benevolent trust. Benevolent trust arises from culture and is due to social norms rather than rules. The second type of trust is based on objective characteristics of the financial system, such as the quality of investor protection, the enforcement of the legal rules governing capital markets etc. and is called deterrent trust. In other words, deterrent trust is the trust that arises from reliance on the law.

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116 See e.g. Luigi Guiso et al., Trusting the Stock Market, 6 THE JOURNAL OF FINANCE 2557; Paul Zak & Stephen Knack, Trust and Growth, 111 THE ECONOMIC JOURNAL 295
117 Guiso et al., supra note 116, 2557
118 See Toshio Yamagishi & Midori Yamagishi, Trust and Commitment in the United States and Japan, 18 MOTIVATION AND EMOTION 129
120 Guiso, supra note 116, 2557-2558
121 ‘The bonds of words are too weak to bridle men's ambition, avarice, anger, and other Passions, without the fear of some coercive Power’ [see THOMAS HOBBES, LEVIATHAN OR THE MATTER, FORME AND POWER OF A COMMONWELATH ECCLESIASTICA AND CIVILL, (A.R.WALLER, ED.) (1904) [1651], 92]. This Hobbesian dictum shows that between the two types of trust it is deterrent trust that carries more weight in the equation leading to economic growth. Of course, social norms that increase benevolent trust have in the past functioned as efficient non-legal devices for governing economic activity; there are indeed economies, such as the South Korean and Japanese one, that in the 1960s and 1970s are thought to have grown due to a reliance on extralegal mechanisms rather than the rule of law. But as we move from domestic-oriented economies to a global market for capital with firms’ cross-listings in foreign stock exchanges and funds’ products being marketed across several jurisdictions, benevolent trust is likely to reduce. The social glue that allows people to interact in low transaction costs is somewhat less strong...
Max Weber, whose economic sociology actually sew the seed of the conceptualization of trust as the link between the sphere of economy and the sphere of law\textsuperscript{123}, identified ‘calculability’ as the foremost virtue that law should possess in order to spur deterrent trust and foster the development of a market economy\textsuperscript{124}. Calculable is the law that can foster a stable and predictable atmosphere within a system of competitive capitalism. In a free market economy the interaction of selfish profit-seekers, who while pursuing the maximization of their own individual welfare might theoretically cause damage to the economic comfort of others, creates a business environment of radical uncertainty\textsuperscript{125}. Thus, according to Weber the organized coercion of law should nurture the belief among market participants that detrimental egoistic tendencies in the market will be constrained\textsuperscript{126}. Law should have the capacity to foster such conditions in the market, so as to induce economic agents to make a psychological commitment not to further their own self-interest if this would be done to the detriment of others or of the system as a whole. In the world of modern finance a legal system can be deemed calculable if it reduces the possibility that economic agents will generate negative externalities by means of their market behavior.

This study’s three hypotheses focus on corporate law’s orientation towards shareholder value and fostering of short-termist shareholderhip that together have a negative influence on economic growth. Thus, if any normative conclusions are to be drawn from this study the focus should be on how corporate law can create to market players the faith that it won’t have any more a ‘stagnation-generating’ character. In other words, the type of calculability I envision for corporate law in the post-2008 world is one that will result in the markets believing that the corporate apparatus can become again the engine of rapid economic growth. This is the desideratum of the normative concept of Long Governance, which is introduced in Chapter Five.

If corporate law re-emerges as a device able to cure the structural pathology of capitalism, i.e. the economic stagnation, it is not only the markets that will start functioning in a counter-cyclical way, but labor as well, since employees will be induced to make more firm-specific investments that will increase its productivity. At the moment, short-termist pressures on corporations generated by shareholders expose the employees to a holdup problem that when cross-border transactions take place. Therefore, in today’s world deterrent trust is what is more crucial for a vibrant economy.

}\textsuperscript{122}\textsuperscript{ The fact that a malfunctioning legal system can be a source of ‘confidential crisis’ is an idea that can be traced back to Henry Thornton, who in 1802 wrote that ‘in a society in which law and the sense of moral duty are weak, and property is consequently insecure, there will of course, be little confidence or credit, and there will also be little commerce’; \textsc{Henry Thornton}, \textit{An Enquiry into the Nature and Effects of the Paper Credit of Great Britain} (1802), 14
\textsuperscript{123} \textsc{Kenneth Morrison, Marx, Durkheim, Weber: Formations of Modern Social Thought} (2006), 291
\textsuperscript{124} \textsc{Max Weber, General Economic History} (F. Knight, transl.) (2003), 271
\textsuperscript{125} David Trubek, \textit{Max Weber on Law and Capitalism}, 3 \textsc{Wisconsin Law Review} 720, 740-741
\textsuperscript{126} David Trubek, \textit{Toward a Social Theory of Law: An Essay on the Study of Law and Development}, 82 \textsc{Yale Law Journal} 1, 13

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discourages them from making a firm-specific investment\(^{127}\). In the presence of a ‘downsize and distribute’ pressure on behalf of the shareholders, employees, who have invested in acquiring skills specifically deployable in the corporations they work, are likely to be threatened with opportunistic renegotiation of their employment contract that will result in a loss of part of the rent on the investment\(^{128}\). This threat is thought to reduce their incentives to make a welfare maximizing firm-specific investment on the first place.

### The Calculability of Corporate Law and Short-termism

For corporate law to become calculable and thus conducive to restore trust in the economy in the post-2008 world, a set of reforms must be undertaken that will allow the corporate apparatus to act in a counter-cyclical and “non-stagnation-generating” way. Since short-termism is identified as one of the causes of economic stagnation, corporate law, in order to become calculable, should stop sustaining short-termism. This will eventually induce the markets to overcome their appetite for hoarding and be incentivized to lend out funds to corporations again, while employees will be induced to make more firm-specific investments, which will result in labor’s increased productivity in the economy.

#### 4.2.4.2. Does financial development promote economic growth or increase macroeconomic fragility?

As it was mentioned in sub-section 4.1 above, the second basic argument in the ‘law and finance’ line of literature is that developed financial markets are linked to economic growth (‘the finance for growth argument’). Given the many comprehensive papers bearing on the finance for growth argument\(^{129}\), I will restrain myself here from dealing in detail with the topic. In the face though of the heterodox economic approach to corporate law that this study takes, it is necessary for reasons of analytical coherence to identify very briefly how the relationship of finance to growth is viewed by the Keynesian and Post-Keynesian schools of thought, from which this study largely draws inspiration.

Financial markets do have multiple functions, but the one that is important for the macroeconomic setting and for economic growth is the

\(^{127}\) See Gelter, supra note 79

\(^{128}\) Id., at 130

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financing of real investment. The extent, to which financial markets manage to translate the savings of households into corporate business investment, characterizes the degree of the financial system’s ‘functional efficiency’. In Chapter One I present evidence that equity markets at least are not functionally efficient (see Figures 21-24), as the stock market through the shareholder value orientation that it introduces for quoted corporations has given rise to a ‘coupon pool capitalism’, where corporations first return their earnings to financial markets through dividends and stock buybacks and then compete to re-acquire those funds. In heterodox macroeconomic thought investment spending is the prime mover of the economy, so if financial markets negatively affect it then prospects for growth are impaired.

This functional inefficiency of the equity markets is stylized in Chapter Two through my analysis of the Post-Keynesian theory of the firm, by which it is shown that it is theoretically sound to claim that there is a causal link between shareholder influence on public corporations and the negative capital accumulation that is marked in the last four decades.

Apart from the seemingly negative influence of financial markets on capital accumulation, capital may actually increase macroeconomic fragility by acting as a rapid destabilizer in times of uncertainty. One of the foundations of the design of modern financial systems is the reversibility of investment. This means that after funds have been invested in a particular market, field or corporation they should always be allowed to be withdrawn rapidly and at a minimum cost; the financial system is concerned with building these technological and regulatory institutions that will secure the effectiveness of this right to enter and exit from an investment rapidly. As it has been noted in respect of the pro-cyclical character of finance capital:

There is an obvious contradiction between the necessary lasting investment in production, with its specific risks, and this absolute freedom of movement demanded by finance. Non-financial firms must confront the structural crises following from […] the recurrent recessions of the business cycle, and adapt to the constant pressure of

131 See James Tobin, On the Efficiency of the Financial System, 153 LLOYDS BANK REVIEW 1
135 Gérard Dumênil & Dominique Lévy, Costs and Benefits of Neoliberalism - A Class Analysis, 8 REVIEW OF INTERNATIONAL POLITICAL ECONOMY 578, 602
competition. Finance attempts to use its own institutions to obtain protection against these risks, thanks to its ability to withdraw, attempting to impose the consequences of these movements on others. Doing so, it can considerably deepen the crises or even create new crises and, therefore, jeopardize growth and employment.\textsuperscript{136}

This destabilizing character of finance capital becomes more acute, when the investor worries unduly about short-term market losses. It is the short-termist investor who will predominantly feel the urge in the face of a recession to move her money out of the illiquid and risky markets. A long-term investor that can overlook the near-term financial impact of a crisis and instead focus on the long-term opportunities coming out of it, will instead act as a countercyclical force providing businesses with liquidity at the times when it is most needed.\textsuperscript{137}

It follows, then, from the above analysis that:

\begin{center}
\textbf{The Pro-cyclicality of Short-term Equity and the Counter-cyclicality of Long-term Equity}
\end{center}

Short-term equity –as well as short-term capital in general- is of pro-cyclical nature and can act as a destabilizing force that can deepen crises, while long-term equity –as well as long-term capital in general- is of countercyclical nature and acts as a stabilizer.

\textsuperscript{136} Id.