

The Politics of Corporate Governance Regulation

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Political Determinants of Corporate Governance: Political Context, Corporate Impact. By Mark J. Roe.* *New York: Oxford University Press, 2003. Pp. 250. \$29.95.*

Why do corporate governance systems differ quite substantially around the world? The American model supervises managers through a board representing a diffuse mass of external shareholders whose rights are defended by a variety of institutional rules (such as those governing insider trading, antitrust, and an open market for corporate control) and by watchdog “reputational intermediaries” (such as accountants, securities analysts, and bond-rating agencies). The claims of employers, suppliers, and buyers are subordinated to shareholder rights. The German model, in contrast, supervises managers by concentrating ownership in blockholders, permitting insider relationships, allowing substantial horizontal coordination among producers, and accepting a variety of “stakeholder” claims on the firm besides those of the shareholders. Japan, as well as Sweden, Austria, and other continental European countries, resembles the German model to varying degrees, while the United Kingdom, Canada, Australia, Ireland, and New Zealand bear closer resemblance to the

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American system. Just why these differences exist has been the object of vigorous debate both in the legal academy¹ and across many other fields.

Mark Roe's new book, *Political Determinants of Corporate Governance*, vigorously presents the "politics school," of which he is the pioneer and an important leader. Political forces, he argues, account for the difference in choice of corporate governance models among advanced industrial countries. Researchers ask: What are the "legal and institutional preconditions for strong securities markets"?² Roe adds *politics* to the list and puts it in first place. Corporate governance arrangements inside the firm, Roe argues, interact deeply with a nation's politics. Political forces—party systems, political institutions, political orientations of governments and coalitions, ideologies, and interest groups—are the primary determinants of the degree of shareholder diffusion and the relationships among managers, owners, workers, and other stakeholders of the firm. Whatever the formal specifications of corporate law, politics shapes daily the calculations made by all players.

Roe argues that where social democracy is strong, shareholder rights are weak, and shareholder diffusion is low.³ Social democracy gives voice to claims on the firm in addition to those of the shareholders: employee job security, income distribution, regional or national development, social welfare and social stability, and nationalism, to name a few. To counter these competing claims, blockholders resist diffusion of shares in order to maintain leverage in the boardroom, and investors shy away from a system in which they lack protection or dominance.

To test this theory, Roe first correlates the degree of shareholder concentration with various indicators of social democratic power, such as partisan composition of governments, employee protection in labor law, and income equality. He finds strong evidence that weak labor correlates with strong diffusion. He then provides qualitative process-tracings (country case studies of the historical evolution of governance patterns) that show how strong labor power inhibits diffusion, and examines the impact of other economic variables—the degree of economic competition and monopoly power—on the degree of shareholder diffusion.

Finally, Roe uses his political argument to confront directly a very influential alternative interpretation—the Quality of Corporate Law (QCL) argument, developed by Rafael La Porta, Florencio López-de-Silanes,

1. For a recent statement in this publication, see John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 *YALE L.J.* 1 (2001).

2. Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 *UCLA L. REV.* 781 (2001).

3. MARK J. ROE, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT* 1-5 (2003).

Andrei Shleifer, and Robert Vishny (LLS&V).⁴ Countries with similar levels of QCL, Roe observes, differ in the degree of shareholder diffusion. Therefore, other variables must be in play. The critical one is politics. He demonstrates that for his sample of countries, the political account correlates more strongly than QCL with shareholder diffusion. Advanced industrial countries with high QCL vary considerably in the degree of shareholder diffusion; thus, something else must be at work. That something is the degree of social democratic influence. Roe tests LLS&V's impressive data collection with his own substantial data on political variables, and concludes, in my view convincingly, that politics does better than QCL. QCL can matter, Roe argues, when politics enables it to matter—that is, when property rights are assured, when enforcement and independent judges are allowed to work, and when the political balance in society gives it a place. Even then, the consequences for corporate governance of any given set of laws are driven by politics. Roe's is the only account in the law-and-economics tradition that makes politics explicitly central to an explanation of corporate governance in a comparative and international perspective. For him, political forces not only define the law—they also determine how the law actually operates.

In stressing politics, Roe directly challenges other leading interpretations that stress the primacy, and autonomy, of economics, law, and private processes of reputational bonding. Roe's book provides an important opportunity to examine the status of politics in the conflicting interpretations of corporate governance. No one really doubts that politics has something to do with corporate governance, but theorists vary considerably in the status they give to politics in a causal model. Roe is unique among major authors in seeing politics as continuous, ongoing, and primary. For other theorists, politics operates in the distant past, or indirectly, or barely at all.

Specifically, Roe's book allows us to examine a contest between his political theory and LLS&V's version of QCL. Although the essays contained in *Political Determinants of Corporate Governance* are not intended to confront QCL directly—Roe's concern with politics, dating

4. See, e.g., Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999) (showing that diffusion of shareholding has been limited); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000) [hereinafter La Porta et al., *Investor Protection*] (arguing that legal differences, which correlate with distinct legal families, influence corporate governance outcomes); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (linking corporate governance in forty-nine countries to their legal families); Rafael La Porta et al., *The Quality of Government*, 15 J.L. ECON. & ORG. 222 (1999) [hereinafter La Porta et al., *Quality of Government*] (comparing as many as 152 countries on a number of dimensions concerning geography, religion, ethnicity, legal family, and strength of socialism to assess government performance using measures of government intervention, public-sector efficiency, public-good provision, size of government, and political freedom).

back to the late 1980s,⁵ precedes the LLS&V publications that emerged in the late 1990s—they in fact do so. In LLS&V's argumentation, the difference between governance systems arises from the effects of common-versus civil-law legal traditions; politics exists only in the initial choice of legal system in a given jurisdiction. LLS&V then focus on the consequence of this initial act upon the development of corporate governance systems and shareholder diffusion. Yet what a country does with its legal tradition and system turns on politics: the rules that determine the extent of economic competition within and between countries; the laws and decrees that structure banking, corporate finance, and the securities industry; the rules that shape the markets for capital and labor; and the degree of state involvement in the economy. LLS&V make allusions to politics in their analyses of QCL, referring to rule of law, judicial efficiency, and corruption.⁶ But politics has no distinct causal status in their argument and, after the initial choice of systems, no longer plays a role in shaping the actual content or use of law.

Roe's political theory and the QCL theory are themselves criticisms of an important literature in economics that argues that the efficacy of the market makes regulation unnecessary and renders variation among governance forms unimportant or nonexistent. Competition in product and capital markets forces firms to adopt "rules, including corporate governance mechanisms,"⁷ that minimize costs in the drive to efficiency. In situations of vigorous competition, the remaining details of corporate governance are irrelevant.⁸ The logic of risk diversification will lead to shareholder diffusion. Securities regulation is unnecessary and possibly harmful.⁹ An open world economy will lead to convergence. Observed variance in systems among countries would reflect differences in economic competition, shaped by objective characteristics such as size or factor endowments. The empirical critique of this approach, made by Roe and

5. See, e.g., MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE GOVERNANCE* (1994) [hereinafter ROE, *STRONG MANAGERS, WEAK OWNERS*] (arguing that the emergence of the Berle-Means diffusion model in the United States was derived from populism's political power to weaken financial institutions and to assure competition); Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469 (1991) (discussing the effects of politics on the mutual fund industry, particularly with respect to its limited role in corporate governance).

6. See La Porta et al., *Investor Protection*, *supra* note 4, at 8-10. An earlier article raises a number of political questions in conceptual and historical terms. See La Porta et al., *Quality of Government*, *supra* note 4; see also Rafael La Porta et al., *What Works in Securities Laws?* (Oct. 2002) (unpublished manuscript, on file with author) (extending the analysis of legal families to securities regulation).

7. Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 738 (1997).

8. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

9. For a summary of the issues, see La Porta et al., *supra* note 6, at 1-7.

LLS&V, notes that despite increasing international competition, the Berle-Means¹⁰ separation of owners from managers by no means has become universal, and thus other forces must be at work.¹¹

Another interpretation of diffusion, developed by Brian Cheffins¹² and John Coffee,¹³ argues for the private capacity of markets to develop mechanisms of reputation without state intervention, thus implicitly without politics. John Coffee groups Roe with LLS&V and Lucian Bebchuk¹⁴ as sharing the view that “[o]wnership and control cannot easily [be] separate[d] when managerial agency costs are high.”¹⁵ Although they disagree “about the causes of high agency costs—i.e., weak legal standards versus political pressures that cause firms sometimes to subordinate the interests of shareholders—they implicitly concur that the emergence of deep, liquid markets requires that the agency cost problem first be adequately resolved by state action.”¹⁶ In disagreement, Coffee quite persuasively argues that the Berle-Means model emerged from the behavior of private actors in the United States—bankers such as J.P. Morgan seeking to reassure foreign investors and the leaders of the New York Stock Exchange seeking to attract a particular kind of listing—and out of a particular situation in which state authority was absent.¹⁷ The legal protections came afterward, as shareholders created a constituency seeking the aid of state authority. It is not the law that causes corporate governance, but the reverse. I read Coffee as agreeing that there was a managerial agency problem—investors sought protections—but believing that state regulation was not required to solve it.

Coffee rejects Roe’s version of a political account,¹⁸ but politics does appear in his analyses in two ways. First, the shareholders lobby for regulation after diffusion has occurred, working through politics to generate

10. See ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

11. See Shleifer & Vishny, *supra* note 7, at 738, 769-73.

12. See Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2001) [hereinafter Cheffins, *Does Law Matter?*]; Brian R. Cheffins, *Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom*, in *CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY* 147 (Joseph A. McCahery et al. eds., 2002) [hereinafter Cheffins, *Britain on the Roe Map*].

13. See Coffee, *supra* note 1.

14. See LUCIAN ARYE BEBCHUK, *A RENT-PROTECTION THEORY OF CORPORATE OWNERSHIP AND CONTROL* (Nat’l Bureau of Econ. Research, Working Paper No. 7203, 1999); Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999).

15. Coffee, *supra* note 1, at 6 (emphasis omitted).

16. *Id.*

17. Coffee’s argument resonates well with Paul R. Milgrom et al., *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1 (1990).

18. Coffee, *supra* note 1, at 25.

QCL.¹⁹ Second, politics is central to Coffee's key variable—the presence or absence of state involvement in economic life—in shaping whether the private mechanisms of investor assurance develop.²⁰

Arguments using norms and culture generally discount politics. Amir Licht makes an argument stressing culture, path dependence, and norms, while Coffee and Roe have both explored the role of norms in shaping behavior, holding law constant.²¹ It is not clear what these arguments make of politics: Does politics shape norms by altering the law and its enforcement in what is acceptable convention, or do norms shape politics and the law? Analyses of social movements and of corporate networks by sociologists and legal scholars explore linkages to politics and public policy.²²

Another important body of literature on corporate governance examines competition among securities regulation and markets. The disagreement between Roberta Romano and Bebchuk on convergence for or against shareholders turns substantially on assumptions about the utility function of politicians: Do they actually seek to attract incorporation, or are they responding to other political calculi, pressures, and interests? That literature recognizes that politics matters, but does not appear to have a substantive

19. *Id.* at 40–46.

20. *Id.* at 52–72 (describing the processes that led to state activism in France and Germany, which inhibited private development of investor assurance mechanisms). But the level of state action is a political variable: What shapes the degree of state involvement in the economy, if not political forces that, for various purposes, want or do not want state intervention? The real issue thus may not be with the degree of state activism, but with the nature of political accountability. In England, for example, the state was not at all inactive. But after the Crown's defeat in the Civil War, state activity was supervised through Parliament by interests that steered it toward some interventions and away from others. See JOHN BREWER, *THE SINEWS OF POWER: WAR, MONEY, AND THE ENGLISH STATE, 1688–1783* (1988); BARRINGTON MOORE, JR., *SOCIAL ORIGINS OF DICTATORSHIP AND DEMOCRACY: LORD AND PEASANT IN THE MAKING OF THE MODERN WORLD* (1966); Douglass C. North & Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England*, 49 J. ECON. HIST. 803, 805–06 (1989).

21. See Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001); JOHN C. COFFEE, JR., *DO NORMS MATTER?: A CROSS-COUNTRY EXAMINATION OF THE PRIVATE BENEFITS OF CONTROL* (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 183, 2001); MARK J. ROE, *CAN CULTURE EVER CONSTRAIN THE ECONOMIC MODEL OF CORPORATE LAW?* (John M. Olin Ctr. for Law, Econ. & Bus., Harvard Law Sch., Discussion Paper No. 381, 2002).

22. See, e.g., FRANK DOBBIN, *FORGING INDUSTRIAL POLICY: THE UNITED STATES, BRITAIN, AND FRANCE IN THE RAILWAY AGE* (1994); ROBERT F. FREELAND, *THE STRUGGLE FOR CONTROL OF THE MODERN CORPORATION: ORGANIZATIONAL CHANGE AT GENERAL MOTORS, 1924–1970* (2001); MICHAEL USEEM, *EXECUTIVE DEFENSE: SHAREHOLDER POWER AND CORPORATE REORGANIZATION* (1993); Gerald F. Davis & Henrich R. Greve, *Corporate Elite Networks and Governance Changes in the 1980s*, 103 AM. J. SOC. 1 (1997); Gerald F. Davis & Tracy A. Thompson, *A Social Movement Perspective on Corporate Control*, 39 ADMIN. SCI. Q. 141 (1994); Mark C. Suchman, *The Contract as Social Artifact*, 37 LAW & SOC'Y REV. (forthcoming 2003); Mark C. Suchman & Mia L. Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 LAW & SOC. INQUIRY 679 (1996).

theory of politics.²³ The issues about the consequences of U.S. federalism reappear in analyses of the potential for “functional convergence”²⁴ in international competition among securities markets.

Roe’s political theory of corporate governance directly confronts these alternative explanations. Whereas his first book explores the U.S. case,²⁵ the new book combines, integrates, and extends into a comprehensive statement a series of articles, stretching back a decade, that sets the American experience in a comparative framework with other advanced industrial democracies.

Roe’s argument has become the foundation of the “political theory” of corporate law.²⁶ Articles that refer to political explanations generally refer to Roe. His particular account is quite powerful, and he has advanced our understanding in developing it. The chapter on what constitutes a political interpretation, however, is by no means closed: *There is not one political interpretation, but several.* In this regard, Roe opens wider the door for exploration of political influences on corporate law and behavior.

A careful reading of Roe’s book helps us to evaluate the status of politics in interpretations of corporate governance and to examine the different meanings that can be given to political explanations. There are, thus, two steps to such a discussion. First, how does politics compare to other arguments? Second, which among several political arguments is the most convincing? Roe’s admirable account is, in my view, very powerful, indeed superior, in taking the first step: Politics dominates explanations about corporate governance. In taking the second step, however, Roe’s position, while still strong, is neither completely convincing nor exhaustive of the political forces at work.

Roe’s political account is incomplete. He does not consider two significant alternative political analyses. The first is an alternative political preferences and interest group model. Roe stresses the relative power of left versus right, and labor versus capital. But he does not consider issues and interest groups—stressed by Raghuram Rajan and Luigi Zingales²⁷—that cut across the class divide, such as industrial sectors, agriculture, religion, and constitutional disputes. The second alternative political model looks at political institutions: Divergence in outcomes reflects differences not in

23. See, e.g., ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993); Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 *YALE L.J.* 553 (2002); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 *STAN. L. REV.* 679 (2002).

24. JOHN C. COFFEE, JR., *COMPETITION AMONG SECURITIES MARKETS: A PATH DEPENDENT PERSPECTIVE* (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 192, 2002).

25. ROE, *STRONG MANAGERS, WEAK OWNERS*, *supra* note 5.

26. Coffee, *supra* note 1, at 6.

27. See RAGHURAM G. RAJAN & LUIGI ZINGALES, *THE GREAT REVERSALS: THE POLITICS OF FINANCIAL DEVELOPMENT IN THE 20TH CENTURY 12-19* (Nat’l Bureau of Econ. Research, Working Paper No. 8178, 2002).

preferences but in the mechanisms of preference aggregation, such as electoral laws, federalism, legislative-executive relations, and party systems. Corporate governance outcomes may reflect, as Marco Pagano and Paolo Volpin argue, the degree to which institutions favor specific coalition formation.²⁸

Roe simplifies for the purpose of research. His argument is parsimonious. His account of specific country cases, as opposed to the statistical tests, is quite nuanced, subtle, complex, and astute. In fact, in his work I can find passages that demonstrate his complete awareness of most of my objections. He does not, however, consider how these nuances could be integrated into alternative political variables that need examination on their own terms.

As a political scientist, my criticisms focus on the political account. This seems appropriate, as politics is the center of his argument. A law professor or economist might pay more attention to Roe's presentation of those arguments.²⁹ I choose only to summarize his interpretations of the legal and economic issues, and instead focus my comments on his particular version of the political argument.

Part I of this Review lays out Roe's political argument and his empirical test of it. Part II explores the contest between Roe's political argument and LLS&V's QCL. Part III situates Roe's political argument in relationship to other political interpretations.³⁰ Part IV probes the implications of Roe's argument for public policy issues. Part V categorizes the various meanings given to politics in arguments about corporate governance.

I. THE ORIGINS OF DIFFUSE SHARE OWNERSHIP

Why do the original owners of a firm sell shares to the public? The deductive version of this process postulates two motives: a preference by owners to diversify their assets so as to reduce risk and the necessity for firms to seek more capital. Both motives lead to the selling of stock, and

28. See MARCO PAGANO & PAOLO VOLPIN, *THE POLITICAL ECONOMY OF CORPORATE GOVERNANCE* (Ctr. for Studies in Econ. & Fin., Working Paper No. 29, 2001) [hereinafter PAGANO & VOLPIN, *POLITICAL ECONOMY OF CORPORATE GOVERNANCE*] (laying out a model of potential alliances among managers and workers against shareholders, and arguing that certain institutions, such as corporatism, facilitate such coalitions); see also Marco Pagano & Paolo Volpin, *The Political Economy of Finance*, 17 OXFORD REV. ECON. POL'Y 502 (2001) [hereinafter Pagano & Volpin, *Political Economy of Finance*] (exploring the literature applying the concepts of political economy to issues of corporate governance).

29. The current Wall Street scandals strengthen open disclosure norms; I am a political scientist, with strong priors that Roe is absolutely correct in stressing politics. I am myself writing on political interpretations of corporate governance patterns.

30. This Review does not strictly follow the order of presentation in Roe's book.

thus to share dispersion.³¹ This creates a problem of managerial agency costs. As owners step away from active management, they need to hire agents to run the firm. Who will make sure that those managers do not exploit their positions at the expense of shareholders? Potential investors realize this risk. Without protection against insider abuses, the founding family will have trouble selling shares, and the firm will have trouble raising capital through the sale of equity. The solution is a regulatory structure that protects shareholders from managerial agency costs: vigorous accounting, full disclosure of information, financial regulation, antitrust, and other instruments associated in the United States with the SEC. Where regulation is of high quality, diffusion will occur; if the protections are not there, blockholding will remain.

This dynamic claims to explain the pattern that developed in the United States, which led to the separation of ownership from management that was famously analyzed by Adolf Berle and Gardiner Means.³² Ownership separates from control when managerial agency costs (abuse by managers) are low. If these costs are high, diffusion will not happen. In the United States and the United Kingdom, for example, the high degree of separation is marked by deep equity markets and substantial diffusion of shareholding in public firms. Yet, this process has not happened to the same degree in many other countries such as Germany and others on the European continent. What explains the divergence? The agency-costs logic imputes it to the quality of regulation: Effective regulation in the United States and the United Kingdom keeps managerial agency costs low so diffusion can occur. By implication, regulation in much of continental Europe must be less effective, allowing for higher agency costs and less extensive diffusion.

Roe's political interpretation collides with the QCL theory in explaining this important difference. For QCL adherents, the "protection of shareholders . . . by the legal system is central to understanding the patterns of corporate finance in different countries."³³ Roe cites numerous law professors, business school experts, and economists—including Nobel laureate Franco Modigliani—who articulate, develop, or analyze this argument.³⁴ The QCL story is, as Roe notes, straightforward: If a nation's law poorly protects minority stockholders, a potential buyer may fear that the majority stockholder will shift value to himself and away from the buyer. The prospective buyer therefore "does not pay pro rata value for the

31. Alternatively, the motives could lead to the use of loans. The choice of bonds versus equity has been one of the major distinctions to be explored in this literature, but here has given way to examining shareholder diffusion. See generally RAJAN & ZINGALES, *supra* note 27 (developing an "interest group" theory highlighting the importance of political forces in explaining time series and cross-sectional variations in financial development).

32. BERLE & MEANS, *supra* note 10.

33. ROE, *supra* note 3, at 165 (quoting La Porta et al., *Investor Protection*, *supra* note 4, at 4).

34. *Id.* at 165 nn.1-2.

stock. If the discount is deep enough, the majority stockholder decides not to sell, concentrated ownership persists, and stock markets do not develop."³⁵ The seller may wish to fragment ownership to prevent a controller from diverting value. But the buyers would still have reason to fear that an outside raider could capture control and divert value to himself, so again the sale price is depressed.³⁶

Good corporate law protects both buyer and seller. Rules on the structure of boards, proxy rights, legal rights toward directors, the right to call meetings, and full information disclosure are among the variables that LLS&V look at.³⁷ James Shinn examines accounting, audit procedures, disclosure, insider trading, the market for control, the composition of boards, standards setting and third-party analysis, and other rules shaping the composition and duties of boards.³⁸ QCL includes not only "law-on-the-books," but the "quality of the regulators and judges, the efficiency, accuracy and honesty of the regulators and the judiciary, the capacity of the stock exchanges to manage the most egregious diversions, and so on."³⁹ If these protections are of high quality, buyers and sellers will consider the managerial agency problem as under control, and share trading will occur. The quality of corporate law is thus the main driver of the type of corporate governance system and the degree to which we have Berle-Means firms.

Where do we find high-quality corporate law? LLS&V argue that we are more likely to have it in common-law countries than in civil-law ones. They have classified countries around the world into different legal families, then classified the corporate law protections in each, and ultimately compared these to the data on patterns of control. They find strong correlations between shareholder diffusion and common law. Why this is so remains a subject of lively debate.

Roe notes the appeal of the QCL argument: It makes the problem technical, and thus susceptible to technical solutions. Roe explains:

Technical institutions are to blame, we can conclude, for Russia's and the transition nations' economic problems. The fixes, if they are technical, are within our grasp. Human beings can control and influence the results. Progress is possible if we can just get the technical institutions right. . . . If it turns out that deeper features of

35. *Id.* at 165.

36. *Id.* at 166.

37. In a recent work, LLS&V also examine the closely related provisions concerning securities law. See La Porta et al., *supra* note 6.

38. See James Shinn, *Globalization, Governance, and the State* (2001) (unpublished Ph.D. dissertation, Woodrow Wilson School of Public and International Affairs, Princeton University) (on file with author) [hereinafter Shinn, *Globalization*]; James Shinn, *Private Profit or Public Purpose?: Shallow Convergence on the Shareholder Model* (2001) (unpublished manuscript, on file with author).

39. ROE, *supra* note 3, at 167 (internal quotation marks omitted).

society—industrial organization and competition, politics, conditions of social regularity, or norms that support shareholder value—are more fundamental, we would feel ill at ease because these institutions are much harder to control.⁴⁰

Roe provides three sets of criticisms of the QCL position: deductive, economic, and political. The deductive criticism questions the logic of the reasoning that derives diffusion from QCL. The economic criticism points out the neglect of a key variable, the degree of economic competition. The political criticism argues for the superior explanatory power of political factors over the purely legal ones of QCL.

A. *Deductive Flaws*

Roe's first criticism argues that high-quality corporate law is, in incentive terms, compatible with various corporate governance forms. Specifically, high QCL does not lead inexorably to a diffuse ownership model because there are other incentives at work that may reward movement to the strong blockholder model; better corporate law may simply make distant shareholders more confident in blockholders.

For example, the regulatory system in the United States focuses primarily on *personal abuse* by insiders. In particular, it seeks to prevent the diversion of shareholder resources for the insiders' personal gain—looting the firm through loans and gifts, improper assignment of resources, and padding the payroll, to name a few. But shareholders can lose as much or even more money from *bad management*, argues Roe, and about that the American law of fiduciary duties is silent. In fact, the business judgment rule, which Roe calls “nearly insurmountable in America,”⁴¹ shields directors and managers from legal inquiries regarding the quality of management, and judges have rejected efforts aimed at punishing bad managerial decisions. One case that did support such a suit, *Smith v. Van Gorkom*,⁴² was “a decision excoriated by managers and their lawyers, and promptly overturned by the state legislature.”⁴³ Yet, as Roe explains,

agency costs come from stealing *and* from shirking. It is correct to lump them together in economic analyses *as a cost to shareholders*, because both costs are visited upon the shareholders. But it is incorrect to think that law affects each cost to shareholders equally well.

40. *Id.* at 166-67.

41. *Id.* at 172.

42. 488 A.2d 858 (Del. 1985).

43. ROE, *supra* note 3, at 172.

The standard that corporate law applies to managerial decisions is, realistically, no liability at all for mistakes, absent fraud or conflict of interest. *But this is where the big costs to shareholders of having managerial agents lie, exactly where the core of corporate law falls into an abyss of silence.*⁴⁴

It is just here that the blockholder system provides advantages. Large blockholders have the incentive and the means to deal with “shirking, mistakes, and bad business decisions that squander shareholder value.”⁴⁵ With big stakes, they have the power to replace or discipline managers.⁴⁶ In the Berle-Means firm, collective action problems face diffuse shareholders; they have little incentive to pay the transactions costs of organizing pressure on directors to move against managers. Shareholders can sell, though this depresses stock price further. The major mechanism for managerial discipline in the U.S. system is the market for corporate control: A badly run firm becomes a target for takeover. But this will happen only after considerable loss of shareholder value creates that attraction. Mergers appear to be costly to the shareholders of the acquiring firm, so mergers and acquisitions may themselves become vulnerable to costs of managerial agency, where the deal makers make the money, not the shareholders.

Deductively, then, the quality of corporate law argument cannot specify which set of incentives—the fear of managerial agency costs from personal corruption versus the fear of managerial agency costs from poor management—will determine the form of corporate governance. The former may encourage shareholder diffusion models, but the latter may encourage concentrated blockholding.

It is also not clear that the QCL argument can adequately specify why the two legal traditions provide different protections to shareholders. Many interpretations have been proposed, but none is wholly convincing. LLS&V note a judicial explanation, suggesting that judges in common-law countries, relying on precedent and experience in a “smell test,” have stronger fiduciary duty principles than do civil-law judges applying general principles further removed from specific cases.⁴⁷ As civil law is more detailed, it specifies and prohibits, rather than allowing individuals to evolve with more freedom. Civil-law countries may be more involved in regulating business than are common-law ones. But, as LLS&V note,

44. *Id.* at 171-72 (footnotes omitted).

45. *Id.* at 172.

46. For a discussion on the attractions of blockholding, see Shleifer & Vishny, *supra* note 7. In his comments to me, Patrick Bolton suggests that tax evasion may also motivate the reluctance to list shares in order to avoid scrutiny by tax authorities.

47. La Porta et al., *Investor Protection*, *supra* note 4, at 9 (citing JOHN COFFEE, PRIVATIZATION AND CORPORATE GOVERNANCE: THE LESSONS FROM SECURITIES MARKET FAILURE (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 158, 1999) and S. Johnson et al., *Tunneling*, 90 AM. ECON. REV. PAPERS & PROC. 22, 22-27 (2000)).

judges could apply their discretion in different ways to protect insiders as much as outsiders, or to bar all intervention. It is therefore not enough “to focus on judicial power; a political and historical analysis of judicial objectives is required.”⁴⁸ From the seventeenth century onward, for example, the British Crown lost influence over the courts to Parliament and the property owners who dominated it, so common law evolved to protect property against the Crown.⁴⁹ In our era, common-law countries can pass interventionist legislation (as happened in Britain under a Labour government in 1945) and civil-law countries can move toward less regulation (as happened in France after 1985). Legal tradition can evolve in different directions, depending on the politics that shapes legislation and enforcement. LLS&V note that while it may be true that “political factors affect corporate governance through channels other than the law itself[,] . . . the law remains a crucial channel through which politics affects corporate governance.”⁵⁰ Indeed, law is a channel, but this confirms Roe’s point about the centrality of politics: Politics picks the law and shapes its enforcement.⁵¹ Politics therefore must become central to the QCL argumentation, and it must be specified, clarified, and operationalized before the theory is complete as an explanation.

B. *Economic Forces: Competition*

Roe’s second critique of QCL turns to the economics of the market. He asserts that it is market conditions, not the law itself, that shape the demand for protection against managerial agency costs. Where there are vigorous product and capital markets, there are fewer opportunities to accrue monopoly rents and thus lower agency costs. It is where such rents are high that we find struggle within the firm over who gets the “monopolist’s rectangle,” the surplus captured from the consumers as a result of restraint on competition.⁵² Roe explains:

48. *Id.* at 12.

49. See generally BREWER, *supra* note 20 (describing various aspects of emerging parliamentary supremacy in Britain); MOORE, *supra* note 20 (analyzing the economic cleavages that influenced the English Civil War). While many observers classify the English state as weak in comparison to highly bureaucratized French and Prussian examples, Brewer argues that the English state was in fact stronger because Parliamentary supervision of the executive reassured social groups the state was being used as they desired, and not at the monarch’s whim. See also North & Weingast, *supra* note 20 (showing that England paid lower interest rates on loans because investors had confidence in a supervised executive).

50. La Porta et al., *Investor Protection*, *supra* note 4, at 12 n.3.

51. Daniel Berkowitz et al., *Economic Development, Legality, and the Transplant Effect*, 47 EUR. ECON. REV. 165, 165-68, 181-86 (2003).

52. See ROE, *supra* note 3, at 127.

Firms can be decomposed. They are made up of shareholder-owners, managers, employees, and customers. *These* players *also* compete for the rents. Competition for rents and that monopoly rectangle is not just *between* firms but also *inside* firms as the players *inside* the firm—shareholders, managers, employees—compete to grab a piece of that rectangle. (And outside the firm, consumers seek to prevent the monopolist from extracting that rent for the inside-the-firm players.) The way the players compete for those rents is reflected in corporate governance institutions inside the firm and political organizations inside the polity.⁵³

In such situations, owners have an incentive to retain direct control in the firm in order to make effective claims on the distribution of those rents. They will shy away from the diffuse ownership model for fear someone else will capture the rent, either other players in the firm, or external investors seizing block control. All the players in a situation of low competition—workers, managers, owners—have an incentive to protect their situation. Thus, the QCL theory has an omitted variable: competition.⁵⁴ Where competition is vigorous, whether from internal market conditions of a country or foreign trade, there is less surplus and less value to contest inside the firm for control, thereby creating greater capacity to move down the Berle-Means path.

Thus, we can observe that the “world’s wealthy democracies have two broad packages: (1) competitive product markets, dispersed ownership, and conservative results for labor; and (2) concentrated product markets, concentrated ownership, and pro labor results. The three elements in each package mutually reinforce each other.”⁵⁵ This is a very powerful statement, for it shows a deep relationship among, as well as a causal structure to the interconnection of, these domains of economic life. Roe’s treatment resonates strongly with the “Varieties of Capitalism” (VOC) literature, which sees two alternative equilibriums in market economies that are very much like Roe’s two “packages.” The VOC authors add to the packages education, training, welfare systems, price-setting mechanisms, and labor-market policy, for which there are similarly paired contrasting patterns.⁵⁶

53. *Id.* at 128. On the specific dynamics of player interactions, Martin Höpner models three sets of alliances and conflicts in the firm: shareholders and managers against workers, workers and managers against shareholders, and shareholders and workers against managers. Martin Hoepner, *European Corporate Governance Reform and the German Party Paradox* (Nov. 2002) (unpublished manuscript, on file with author).

54. ROE, *supra* note 3, at 142-43.

55. *Id.* at 140.

56. See VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (Peter A. Hall & David Soskice eds., 2000) [hereinafter VARIETIES OF CAPITALISM]. The book’s introductory essay provides an excellent statement of the VOC approach, Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, in VARIETIES OF CAPITALISM,

Globalization and competition threaten the second package. Here, Roe provides a structural theory for the rise of the QCL theory itself. When competition was relatively low, as in much of the twentieth century, social, economic, and political aspects of firm life actually shaped the incentives that structured corporate governance. Relationships among the players within the firm and economic system thus obscured issues about the relationship between managers and owners. As globalization and competition have spread, the monopoly rent is squeezed, the older relationships decline in impact, and the historically “less important” issue—the distribution of benefits between controllers and shareholders—rises in impact.⁵⁷ Thus, the “technical issues” of the private benefits of control have become more important because greater competition in product markets has made the distributional issues inside the firm less important.

C. Politics

Markets drive governance, and markets are politically determined; thus, politics drives corporate governance. This leads to Roe’s third critique of QCL—the major thrust of the book—and its positive claim as a distinctive theory. It is politics, Roe argues, that best explains ownership separation. All the major variables that shape the incentives structuring corporate governance derive from conditions set by politics. The characteristics of competition, and of QCL itself, are all expressions of political decisions. Struggles inside the firm are connected to struggles outside of it. Power in the boardroom connects to power in the polity. Claims to the profits of the firm derive from obligations defined by a country’s political processes.

That is a general point about politics. It needs one more step—specifically, a positive theory about which political variables structure political life. The central political variable for Roe is social democracy. Where social democracy is strong, shareholder diffusion does not take place; where it is weak, diffusion occurs.⁵⁸

Roe develops this point deductively and empirically. Deductively, he models the incentives that cause owners not to sell when faced with labor and other strong claimants on the firm. Job protection, social insurance charges, union bargaining on wages and working conditions, German

supra, at 1, and various other chapters provide access to American, German, and British research. For an extension of the concept of “institutional complementarities,” see Peter A. Hall & Daniel W. Gingerich, *Varieties of Capitalism and Institutional Complementarities in the Macroeconomy: An Empirical Analysis* (Aug. 12, 2001) (unpublished manuscript, on file with author).

57. ROE, *supra* note 3, at 145.

58. Roe’s definition of social democracy is not that of a specific political party, but, more loosely, the use of government to restrict capital for a wide variety of purposes (such as to benefit labor). This definition has strengths (parsimony for research) but also problems (confusion on the political location of critics of the market).

codetermination, and a variety of other regulations all obligate managers to include concerns other than shareholder value, thereby depreciating the value of the firm to shareholders. Owners therefore have an incentive to preserve power through large, concentrated blockholding in order to better confront labor and to steer the firm through the complexities of political life both inside and outside the firm. Blockholders appoint agents to the governing council of the firm. Owning large percentages, they have both the incentive to pay close attention to performance and the means to do something about their dissatisfactions.⁵⁹

There are, Roe argues, alternative models of efficient firms. Roe rejects the triumphalist claim of many U.S. analysts that the American model is the most efficient and is destined to sweep away all other alternatives. Rather than one form of governance being superior, it may be that each type has offsetting advantages and disadvantages. In fact, the concentrated stakeholder model does some things quite well, often better than the diffuse model. As W. Carl Kester puts it, blockholding reduces transactions costs at the expense of moral hazard problems, as opposed to the Berle-Means model, which reduces moral hazard costs at the expense of transactions costs.⁶⁰ The blockholder system allows a long-term relationship to develop between capital and management, and between the firm and the many participants, in a system of production with investment in "specific asset" strategies of production.⁶¹ The production system that emerges out of that model of corporate governance seems to have advantages for some kinds of activity: for example, very high quality engineering and low product-defect rate—virtues popularly associated with Germany and Japan.

American diffusely held firms looked good in the 1990s, but less so in the 1980s. Measured over several decades, blockholder firms and Berle-Means firms perform at about the same level, whether the performance is evaluated using shareholder rate of return, profits, growth, or size. In the long run, the economies of countries characterized by different systems do about the same in terms of price stability and growth. Countries and firms do better in some years and worse in others, but they average out.⁶² There

59. An implication of this analysis is that the absence of insider-trading laws, while making outsider-owners vulnerable, may preserve blockholders' incentives to sustain the firm's long-run health.

60. See W. Carl Kester, *American and Japanese Corporate Governance: Convergence to Best Practice?*, in NATIONAL DIVERSITY AND GLOBAL CAPITALISM 107, 118-23 (Suzanne Berger & Ronald Dore eds., 1996); W. Carl Kester, *Industrial Groups as Systems of Contractual Governance*, 8 OXFORD REV. ECON. POL'Y 24, 26-27 (1992).

61. See generally VARIETIES OF CAPITALISM, *supra* note 56 (examining the advantages and drawbacks of various economic and corporate governance arrangements).

62. For firm comparisons, see MARCO BECHT ET AL., CORPORATE GOVERNANCE AND CONTROL (Nat'l Bureau of Econ. Research, Working Paper No. 9371, 2002). For country comparisons, see JOHN STEPHENS & EVELYN HUBER STEPHENS, DEVELOPMENT AND CRISIS OF THE WELFARE STATES: PARTIES AND POLICIES IN GLOBAL MARKETS (2001); and VARIETIES OF CAPITALISM, *supra* note 56.

are important differences across firms and among countries—income distribution, welfare systems, education and training, and unemployment patterns—to which I shall return below in a more general discussion of the relationship of Roe's book to the comparative capitalism literature.

The logic of strong labor power, then, is to discourage shareholder diffusion and reinforce stakeholder controls. Is this borne out by the evidence? Roe presents substantial empirical material to confirm his hypotheses. First, he measures political coloration of governments and correlates this with governance models and shareholder diffusion. Then he provides qualitative process tracing for an important set of countries. Finally, he sets up tests pitting the political coloration-of-governments argument against the QCL argument. Let us turn to each of these.

1. *Partisan Political Conflict and Ownership Separation*

Roe's first step is to regress degrees of left-right political party control of governments in highly industrialized democracies on degrees of ownership concentration. The former indicates labor power, so the higher the left score, the greater the disincentive to disperse shares and the higher the expected degree of concentration. This is indeed what the data show. Table 6.1 places various governments from 1980 to 1991 on a left-right political spectrum.⁶³ To measure shareholder concentration/diffusion, table 6.2 looks at the portion of mid-sized firms in those countries without a twenty-percent blockholder in 1995.⁶⁴ The correlation between the two variables is quite high: The more the country is to the left politically, the less the shareholder diffusion.⁶⁵

The time period chosen by Roe could have affected these results; the eleven-year period for table 6.1 was followed by some notable partisan shifts within various countries.⁶⁶ These changes, however, like partisan variance in earlier years, do not appear to alter the results in any important

63. ROE, *supra* note 3, at 50. Roe places Sweden on the farthest left, followed by Austria, Australia, Norway, Finland, Italy, France, the Netherlands, Belgium, Denmark, Switzerland, Canada, Germany, the United States, Japan, and the United Kingdom.

64. *Id.* Percentages range from 0% for Austria, France, and Italy, to 60% for the United Kingdom and 90% for the United States. The most striking outlier is Germany, whose diffusion level, at 10%, is quite low given its political placement on the right.

65. *Id.* at 51 graph 6.1.

66. The 1990s marked a general shift of several countries to the left: Margaret Thatcher and John Major were replaced by Tony Blair in 1997, Ronald Reagan and George H.W. Bush by Bill Clinton in 1993, Helmut Kohl by Gerhardt Schröder in 1998, and the Liberal Democrats in Japan by more complex coalition politics. But at the same time, Italy moved to the right with Silvio Berlusconi (briefly in 1994 and again since 2001), as did Spain with Jose Marie Aznar (in 1996 and again since 2002), France with conservatives gaining control of both the presidency and the National Assembly in 2002, and the United States with George W. Bush winning the presidency in 2000 and the Republican Party controlling both houses of Congress in 2003.

way.⁶⁷ Commenting on the absence of data at a certain point in the discussion, Roe makes an important observation, the meaning of which he should have explored more deeply: “[P]olitical coalitions come and go; corporate structures are the result of long-term expectations of governmental orientation.”⁶⁸ He is right, but this undermines the importance of the left-versus-right indicator that he selected and suggests the role of other political variables that influence policy positions over the long run: political institutions, cross-class alliances, and corporatism.

Seeking further tests of the relationship between politics and shareholder diffusion, Roe sensibly turns to indicators aside from partisanship that would suggest the importance of the social democracy variable. First, he regresses employment security on ownership. Where labor is strong, employment protection should be high and ownership not diffuse. Indeed, Roe’s empirical data support this. The United States has the weakest employment protection and the highest diffusion; Italy has the strongest protection and is among the countries with the least diffusion.⁶⁹ Next, Roe looks at income inequality, which he takes as a proxy for social democratic strength as these parties would be major forces demanding policies that reduce such inequality. Again, Roe does find weaker stock markets and less ownership diffusion in countries with greater income equality.⁷⁰

At this point, Roe concludes that a strong *prima facie* case exists that politics plays a substantial role in explaining variance in systems of corporate governance. He remains cautious, though, as the evidence shows correlation, not causation. The data do not, at this point in Roe’s book, provide a test to compare politics and alternative explanations such as QCL; this comes later. The data also do not, I would add, test the strength of this political explanation (social democratic strength) against alternative political theories.

Roe then turns to another form of evidence: country case studies with qualitative process tracing of the patterns of policy, politics, and shareholder diffusion. He uses them to provide corroborative evidence for his argument. The cases do that, but they also provide evidence for

67. Roe partially controlled for partisan shifts in an earlier period by employing a forty-year political index, 1951-1991, and obtained similar results. ROE, *supra* note 3, at 53. Doing the analysis by decade (concentration and politics in each period) would be better, but the data on concentration do not appear to be available. Calculating the correlation for the years after Roe’s data set (1991-2002) appears to weaken the result somewhat, but not substantially. See Peter Gourevitch & Michael Hawes, *Corporate Governance Systems, Political Institutions, and Partisan Politics: Preliminary Data Analysis* (Nov. 2002) (unpublished manuscript, on file with author).

68. ROE, *supra* note 3, at 53.

69. *Id.* at 52 graph 6.2.

70. *Id.* at 54 graph 6.3.

alternative political accounts dealing with cross-party coalitions and political institutions, as I shall discuss in Part III.

2. *Other Political Processes*

Before getting to the final step of directly confronting the politics and QCL theories, Roe probes other conceptualizations of social processes that may be at work.

a. *Rent-Seeking*

Rather than viewing policy as only a political struggle between alternative visions of the public good (say, social democracy versus free markets), Roe notes that "one could see the results in conservative nations as financial interests' successful rent-seeking," as opposed to the rent-seeking of labor in social democracies.⁷¹ Indeed, a comparison of alternative rent-seeking strategies would be very valuable, but Roe chose instead to highlight the social democratic version. That simplifies the research strategy, but makes it more difficult to evaluate the causes of country outcomes. If other groups besides labor seek regulation that has the effect of inhibiting shareholder diffusion, then their demands are central to the result, and require analysis.

b. *Historical Sequence*

It may be that politics reflects elements of business structure, not the reverse. As Roe notes, concentrated ownership in Germany preceded historically the emergence of social democracy, and may in fact have caused it. Indeed, concentrated power and big trusts tend to provoke resentment and hardship among consumers, small businesses, labor, and farmers, forming a target of attack and contributing to the evolution of countervailing power. Roe sees this relationship clearly, but he does not balance the exploration of the role of social democracy with a study of business and other nonlabor interests that prefer the blockholder model.

c. *The Efficiency of Stability*

Roe provides an economic and political analysis of how a regulatory world with social democratic features could contribute to an efficient economy. The Berle-Means firm is not necessarily the best for the political economy of capitalism. The efficiency of a corporate governance structure

71. *Id.* at 111.

lies not only in its internal productive prowess, but also in its connection to social stability. Social turmoil—rioting, strikes, civil war, unrest, political chaos, and unpredictable or unstable government—is catastrophic for a market economy. Investors, managers, workers, and other individuals making decisions prefer some degree of predictability; without it, economies operate at a lower level. Some regulations, in cyclical industries such as oil, arise to handle market failure.⁷² But, Roe argues, some interventions in the economy produce systemic efficiencies rather than microeconomic ones, and these interventions can create social stability that reassures populations facing stress. “[S]ome corporate rules and supporting institutions cannot succeed and prosper because they would induce strong backlash. There is reason to think that strong shareholder-based institutions in many nations would often have induced that kind of backlash.”⁷³ The United States is no exception.⁷⁴

The dampening rules (that reduce takeovers and bankruptcy auctions) may enhance a system’s political stability, preserving the *core* efficiency tendencies of capitalism, private property, and competitive markets, by *conceding* a few economically dubious but politically astute regulations here and there. One could believe a set of legal institutions to be inefficient one by one—anti-takeover rules, slow chapter 11 reorganizations, Glass-Steagall, old-style antitrust, and a list to which we could all add—and still one cannot conclude that the whole set is inefficient, because the inefficient *fringe* may preserve that efficient *core* of private property, mobility, and competition.⁷⁵

This is a shrewd point, well crafted, with a finely constructed metaphor on the political economy of “latifundia.” By emphasizing the benefits of stability, Roe challenges the assumption of economic efficiency as the sole driver of firm structure, and reinforces the overall theory that politics matters. Some interventions may be valuable for stability, but may be resisted nonetheless. Do the latifundia owners think that they need to make concessions to get stability, or that they can prevail without them? The history of political development repeatedly shows that the powerful and privileged too often underestimate the degree of trouble they confront, overestimate the cost of concessions to them, and prefer force over compromises. The Whig approach—modest reforms to stave off a more costly process of change—that characterizes British political development

72. See generally DANIEL YERGIN, *THE PRIZE* (1991) (describing the boom-and-bust character of the oil industry that leads to centralization and regulation).

73. ROE, *supra* note 3, at 120.

74. *Id.* at 119.

75. *Id.* at 121.

is rather rare. Even in democracies, reforms often require some sort of catastrophe like a depression to overcome resistance—witness the current struggles over corporate governance issues in the United States. Therefore, politics, according to Roe, shapes the social compromise needed to articulate an efficiency/stability balance.

II. QCL VERSUS POLITICS: EVALUATING COMPETING EXPLANATIONS

Roe now addresses the most influential rival argument to his “political determinants”—QCL. This allows us to explore which model better explains a country’s choice of corporate governance forms.

Roe wants to solve the problem of apparent covariance of law and politics to establish a hierarchy or sequence of causality. Four competing social processes tend empirically to correlate: the relative strength of social democratic politics, the degree of product-market competition, the quality of legal institutions, and a country’s economic size.⁷⁶ All of them, he notes, appear to be moving together at the present time. The European Union is seeking to strengthen corporate law, and countries are building stronger stock exchanges. The social democratic parties have moved rightward toward “new labor” views, and election results in several cases have strengthened more conservative parties. Greater competition arising from European integration and the World Trade Organization is squeezing out rents, privatizing firms, creating demand for public firms, forming better ways of raising capital, and increasing the level of wealth and technological change. Roe notes that these events are possibly interconnected; each pulls and pushes the other. But correlations do not prove causality. Even if we find diffuse shareholding to be correlated with high-quality corporate law, this relationship may have occurred simultaneously with or after, not before, diffusion.

Roe makes a strong effort to untangle this web of causality. Chapter 22 provides the most direct and concise empirical confrontation of the QCL theory with Roe’s political argument. Tables 22.1 through 22.3 summarize the findings.⁷⁷ Table 22.1 is a correlation matrix, examining the interactions of the following:

- a. Three political indicators of labor power: political place (left-versus-right orientation of government), the degree of employment protection,⁷⁸ and the degree of inequality;

76. *Id.* at 154.

77. *Id.* at 157-58.

78. For data showing that greater employment protection is associated with greater ownership concentration, see *id.* at 137 tbl.19.1.

- b. Three measures of quality of corporate law: a La Porta qualitative indicator and two quantitative measures dealing with a control premium obtained by blockholders and the premium between voting and nonvoting stock;⁷⁹
- c. An indicator of the degree of competition in industry,⁸⁰ and
- d. Two indicators of diffusion: degree of stock market capitalization divided by GNP, and breadth of holdings in mid-size firms.⁸¹

Roe finds that politics correlates with degree of dispersion, but so does the quality of corporate law.⁸² He then works to separate the effect of politics and QCL. Table 22.2 shows what degree of variance is further explained by adding a variable.⁸³ First, indicators of QCL are positively correlated with diffusion. But when politics is added to the QCL index, explanatory power increases dramatically. Table 22.3 reverses the sequence. When QCL is added to the model after politics, explanatory power improves, but to a lesser degree than when politics is added to the model after QCL.⁸⁴ Roe concludes that this finding confirms the importance of politics. Each model explains some variance in diffusion, and the two variables together explain more than either alone. When used alone, politics is more powerful than law. In several side-by-side comparisons, politics dominates corporate law as an argument. But in no case does corporate law dominate politics. As a result, Roe builds a strong case for the dominance of politics as an explanation—a convincing one in my view.

The final step in the evidentiary presentation strikes at the empirical heart of the QCL argument. If we take the set of wealthy industrial countries with satisfactory corporate law, we find some of them have diffuse Berle-Means firms and some of them do not. QCL cannot explain that divergence, but politics can.⁸⁵ Some countries with high-quality corporate law (such as Sweden) do not have substantial ownership diffusion, but they do have the political indicators noted by Roe's theory.

There are, Roe notes, measurement problems in this analysis, as massive efforts to codify rules outrun careful evaluations of whether these

79. *Id.* at 157-58.

80. *Id.* at 149 tbl.20.1. In chapter 20, graph 20.1 and table 20.1 show that ownership concentration increases with monopoly power. *Id.* at 149 graph 20.1 & tbl.20.1.

81. *Id.* at 157-58.

82. *Id.* at 156.

83. *Id.* at 158.

84. *Id.*

85. *Id.* at 191. For developing countries, Roe argues (convincingly I think) that QCL debates obscure a concealed variable—the quality of property rights.

rules are enforced or in other ways consequential.⁸⁶ Since the sample size of QCL countries with functioning democracies and assured property rights is small, Roe provides a qualitative analysis of those countries and some suggestive but not statistically significant numbers.

One qualitative indicator of corporate law, Roe suggests, is the premium for control—how much will an investor pay to get control of the firm and how much will the minority stockholders have left? If quality of law were the principal determinant, “nations with high gaps between the value of control and the value of the minority stock would have more concentrated ownership than nations where that gap is weak.”⁸⁷ The evidence, Roe argues, does not support this. It is true that in the United States, the premium is 4%, and in Italy it is 25%; these percentages correlate with the QCL coding of these countries. In Germany, however, although the premium is also about 4%, ownership concentration is high. So if control blocks trade at no higher premium in Germany than in the United States, something other than QCL must be driving concentration. That something is codetermination: No one can ever buy full control of German boards because codetermination gives half of the supervisory board seats to labor.

Roe then offers another measure of QCL. Dual class voting (where, for example, Class A shares carry a right to vote, while Class B shares do not) is held as an indicator of weak QCL. This has been researched by, among others, Modigliani to prove that the “dual class premium varie[s] with the quality of a nation’s security market.”⁸⁸ Drawing on unpublished data, Roe argues that this finding does not hold up. Granted, Italy and France do have such a premium and the United States does not, which fits the coding on low and high QCL. Germany and the four Scandinavian countries all have dual class systems without much of a premium, however. Sweden and her neighbors have high-quality corporate law and concentrated ownership.⁸⁹ Germany is held to have mediocre protection, although some researchers contest this description.⁹⁰

86. See La Porta et al., *supra* note 6 (suggesting that the existence of high-quality securities law has an impact even without measuring enforcement). Despite the title, the paper measures securities law and regulations in forty-nine countries through interviews of experts in each country, rather than measuring how the laws and regulations are actually applied.

87. ROE, *supra* note 3, at 185.

88. *Id.* at 188 n.14 (citing Franco Modigliani & Enrico Perotti, *Protection of Minority Interest and the Development of Security Markets*, 18 *MANAGERIAL & DECISION ECON.* 519 (1997)).

89. *Id.* at 189, 193. In Sweden, ownership by outsiders is high—with 55% of the population owning shares and 35% of the shares held by foreigners—but blockholding is quite strong and expropriation by controllers apparently low. Roe summarizes this and other findings in tables 25.1 and 25.2 of his book to show that there is no correlation between voting premium and ownership concentration. *Id.* at 189 tbl.25.1, 193 tbl.25.2.

90. See, e.g., Detlev Vagts, *Comparative Company Law—the New Wave*, in *FESTSCHRIFT FÜR JEAN NICOLAS DRUEY ZUM 65. GEBURTSTAG 595* (Rainer J. Schweizer et al. eds., 2002).

In the world's rich nations, then, some countries have good minority shareholder rights, including quality structures for contract protection, but still have concentrated ownership. QCL is not irrelevant to economic life, but it does not explain variance in concentration between countries that have similar levels of QCL.

In one important way, Roe and LLS&V's analyses do not directly confront each other. Roe looks only at advanced industrial countries with democracies and strong property rights. Only in democracies can the impact of voting as a measure of politics be evaluated; only in advanced industrial countries are markets deep enough for differences in governance systems to be significant. On the other hand, LLS&V look at the whole world—wherever variables about markets and governance can be measured. Their claims are thus different. To Roe, LLS&V cannot explain variance within the subset of wealthy countries. Even for the poorer developing countries, QCL is not the most essential factor shaping their economic development. Ownership separation in large firms is, for these countries, simply not the core economic problem that needs solution. A more important issue is the absence of basic property rights, political stability, and accountable political institutions; legal culture matters less than the political institutions that guarantee property and the rule of law. In short, Roe stresses the role of politics as the precondition for effective high-quality law, while LLS&V stress quality of law in itself.

III. ALTERNATIVE POLITICAL ACCOUNTS

Roe asserts the importance of politics compared to other explanatory variables in accounting for the degree of shareholder diffusion in corporate governance. As mentioned previously, Roe's argumentation is convincing on this first step of discussion. The second step compares Roe's version of a political argument to other political arguments. While Roe is persuasive in asserting the primacy of politics, this issue of which political variables matter is open to dispute and needs some careful parsing.

Roe uses labor power to drive his argument. This makes his theory parsimonious and testable, but at some cost. He sees the nuances—the factors that run against the grain of his position—but does not openly mobilize them into an alternative logic. It is important to develop political arguments of various kinds to capture these differences, so that a criticism of "Roe's political argument" is not necessarily a rejection of all "political arguments," but rather a widening of the channels of political mechanisms at work that affect corporate ownership and governance. To accomplish this, I develop a classification of political arguments so as to locate Roe's position more precisely:

Interest group preferences and powers: Policy expresses the outcome of a clash among interest groups, with their various preferences and relative power resources. Differences in policy among countries thus express differences in the strengths of alternative groups. Within this category, different principles of cleavage can be found, among them:

- Class-based, left-versus-right divide: Roe uses a version of this principle.
- Sectors-based, cross-class coalitions: Roe often notes the existence of such coalitions and how they might influence the political processes examined here, but does not theorize about them.

Institutional mechanisms of interest aggregation: Institutional analysis criticizes preference-based analysis on the grounds that it is underdeterminative: Preferences can be combined in different ways, so preferences alone cannot explain outcomes. Institutions shape the way preferences are aggregated; they structure the consideration of alternatives, and the mode of structuring influences the result. Alter the institutions, and a different outcome results. An important institutional difference relevant to this debate is:

- Consensus versus majoritarian political systems: These systems combine electoral laws, the number of political parties, and legislative-executive relations in different ways.

Examining these perspectives allows us to clarify the various meanings of alternative political arguments.

A. *Interest Group Preferences: Cleavage Structures in Modern Politics*

Roe's argument rests on the assumption of a left-right structure of politics and issues based upon social classes that are economically defined. His players are employees and owners. They struggle in both the firm and the polity: in the firm to capture greater returns, and in the polity to shape the rules and conditions of the struggle within the firm and over the larger social pie.⁹¹ The goals of the players are primarily economic gain. But the

91. In this respect, Pagano and Volpin misread Roe in saying he provides an ideology model. PAGANO & VOLPIN, *POLITICAL ECONOMY OF CORPORATE GOVERNANCE*, *supra* note 28, at 3. I read them as all being in agreement on a political economy model. Ideology is one explanation for the left-versus-right division. But in this book, Roe does not provide an explanation for why the left and the right are divided, or why one or the other has power. He seeks to show that the division has consequences, which is what also interests Pagano and Volpin. In his first book, Roe

major concern of Roe's book is to nestle another struggle within this larger one—the struggle among stockholders, boards of directors, and senior managers. The essential proposition is that the class struggle of left-versus-right in the whole polity shapes the boardroom struggle of the firm itself.⁹²

This political conception, however, does not fit the way many political analysts see the cleavage structure of contemporary political life. Roe's approach draws on a factors model of economic interest—like the Stolper-Samuelson trade model—in which land, labor, and capital in each country are either abundant or scarce compared to other countries. This approach has been used very effectively by researchers to explain the politics of trade preferences around the world⁹³ and continues as one type of interpretation in vigorous debates over how to understand the cleavages and public policy issues caused by economic globalization.⁹⁴

An alternative economic argument looks at sectoral conflict between industries, rather than class conflict within them. In analyses of trade politics, this approach is represented by the Ricardo-Viner model. Whereas Stolper-Samuelson assumes perfect factor mobility and an easy transfer from one use to another, Ricardo-Viner asks what happens if factors are sticky in their use. Under those conditions, workers and owners will both be concerned about protecting the specific asset of their investment. Workers may join their bosses and owners in sheltering their firm. For example, steelworkers may join their bosses and shareholders in supporting tariff restrictions, producing a political coalition that cuts across class. As Michael Hiscox explains, either the Stolper-Samuelson or the Ricardo-Viner model could be accurate depending on historical circumstances.⁹⁵

This “sectoral cleavages” approach has been extensively explored by the “Varieties of Capitalism” (VOC) literature.⁹⁶ These authors examine ways in which market economies differ not only in corporate governance, but also across a range of other characteristics, including labor markets, price setting, welfare systems, education and training, strategies of production, income distribution, employment rates, and macroeconomic policy. They find substantial clustering along these dimensions. Being

does speak at length about ideology as an explanation for populism. In this book, the political division arises over economic differences based on class. Roe does not evaluate why the political balance may differ among countries.

92. See ROE, *supra* note 3, at vi, 2-3.

93. See, e.g., Douglas A. Hibbs, Jr., *Political Parties and Macroeconomic Policy*, 71 AM. POL. SCI. REV. 1467, 1467 (1977). On the impact of globalization on workers and others who pay the costs of adjustment, see DANI RODRIK, HAS GLOBALIZATION GONE TOO FAR? (1997).

94. See, e.g., GEOFFREY GARRETT, PARTISAN POLITICS IN THE GLOBAL ECONOMY 1 (1998); Geoffrey Garrett & Peter Lange, *Internationalization, Institutions, and Political Change*, 49 INT'L ORG. 627 (1995).

95. Michael J. Hiscox, *Class Versus Industry Cleavages: Inter-Industry Factor Mobility and the Politics of Trade*, 55 INT'L ORG. 1 (2001) (exploring variance in asset specificity from one time period to another, as well as its corresponding shift in political cleavages).

96. VARIETIES OF CAPITALISM, *supra* note 56.

located at one end of a continuum on education and training predicts where that country will be situated on the other dimensions. These features combine to allow these researchers to speak of “national production systems” (NPS).

Like Roe, VOC scholars broaden the scope of inquiry concerning corporate governance, seeing connections between it and other aspects of society.⁹⁷ While these authors and corporate governance scholars such as Roe, LLS&V, and Coffee do not significantly cross-reference each other, they do interact intellectually in important ways. The VOC literature uses a different terminology from the corporate governance literature; it differentiates between Liberal Market Economies (LME) and Organized Market Economies (OME)—sometimes also referred to as Coordinated Market Economies (CME).⁹⁸ Such categorization overlaps substantially with Roe’s diffusion-versus-blockholder paradigm, albeit not perfectly.⁹⁹

Roe and the VOC school agree on the importance of politics. The difference between them lies in how they talk about interests and preferences. For Roe’s statistical tests, interests are primarily defined as labor versus capital. On the other hand, many of the VOC authors (although not all) follow the Ricardo-Viner logic: Interests and preferences follow the investment in specific assets and are therefore different for members of the same social class. In OME systems, as workers, managers, owners of capital, professionals, and other actors invest deeply in the specific assets of their situation, their interests and preferences are altered: While they do have some conflicting interests over wages and power, they also hold common interests, such as preserving the production system of their firm and product group. In OMEs, managers support welfare systems as ways of sustaining worker commitment to the firm and accept unions as instruments for managing labor conflict. They accept regulation in order to stabilize markets and prices and to reduce uncertainty. With these protections against risk, firms are able to invest in production strategies that require very high

97. For example, Peter Hall and Robert Franzese argue that the effects of central bank independence, another “technological solution” popular among economists, cannot be modeled in isolation from the system of wage and price determination, which rests upon law, society, and politics. Peter A. Hall & Robert J. Franzese, Jr., *Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union*, 52 INT’L ORG. 505, 512-24 (1998) (discussing the German case and providing cross-national comparisons).

98. Other writers use different labels, but they describe the same thing. See, e.g., MICHEL ALBERT, *CAPITALISM AGAINST CAPITALISM* (Paul Haviland trans., Whurr Publishers 1993) (1991) (contrasting the Rhine model, such as that in Germany or Japan, with the Anglo-American one). While vivid, this classification has the disadvantage of being nationally specific rather than analytic. See generally RONALD DORE, *STOCK MARKET CAPITALISM: WELFARE CAPITALISM: JAPAN AND GERMANY VERSUS THE ANGLO-SAXONS* (2000) (using country labels).

99. Some countries classified in the VOC literature as LMEs have more concentrated ownership than a perfect correlation between NPS and diffusion would predict, while others in the OME category are somewhat more diffuse. Gourevitch & Hawes, *supra* note 67.

levels of specific assets, such as high-quality precision tooling and low-defect manufacturing.

In LME countries, firms and employees invest in more general assets—assets that are not committed to specific uses. Firms build strategies that allow them to add or release workers, open or close factories, and make or fail to renew contracts as needed. This is a flexible system, but an arm's length one. Thus, in LME countries, workers and owners have much lower structures of reciprocal obligation both inside and outside the firm, reflecting a Stolper-Samuelson world of factor-based class struggle. In OME countries, by contrast, the structures of interests reflect shared preferences of actors on both sides of the class divide within their firm, factory, or enterprise, thereby presenting different structures of solidarity.

On the political left, workers in efficient, export-oriented industries have different views from those in weak, protected, or nontradable industries. Some analysts see these differences as accounting for tensions inside the social democratic camp and its movement toward the center.¹⁰⁰ The solidarities that supported collective action in the past are weakening as economic change redefines situation and experience. A left-versus-right conceptualization of politics can thus obscure not only the movement of each camp—which Roe analyzes—but also the coalitions that form within and between camps.

On the political right, there are different goals and interests among owners as well. Speculators or managers may want to drive up share price and cash out, while other sorts of investors, such as pension funds and endowments, want stability or a lower-risk existence. These owners will seek quite different rules. There are also conflicts among “reputational intermediaries”: accounting and consulting within one firm, and stock analysis and banking within another. Some owners want blockholding, while others prefer diffuse shareholding.¹⁰¹ Individuals can do well at the expense of the whole, which presents a classic collective action problem; stronger rules could reduce the profits of some subset of players while increasing return to the whole by bringing investors back into the market. In sum, we can see the potential for disagreement among members of the “owning class” about strategy and interests, and, accordingly, about policy and politics.

If we focus on owners and workers alone as coherent political groups in conflict with each other, we will not get an understanding of the politics that leads to the Berle-Means firm. Roe's account of what happens in his country cases, as opposed to his stylized political model used for the

100. See, e.g., GOSTA ESPING-ANDERSON, *SOCIAL FOUNDATIONS OF POSTINDUSTRIAL ECONOMIES* 101-03 (1999).

101. See Shleifer & Vishny, *supra* note 7, at 769.

statistical analysis, provides good reasons why. Owners and managers not only fight each other, but also among themselves. They seek allies from labor, farmers, or other groups. Which coalition of owners and managers and their related “intermediaries” prevails can only be explained by relating the struggle between them to other conflicts and processes.

The advantage of a cross-class coalitions approach emerges in a close reading of Roe’s impressive individual country case studies.¹⁰² Country profiles are the bane of comparativists. They irritate the country specialists, who, in some respects, always know more about each case and are less enchanted by the generalizations and simplifications comparative profiles necessarily entail. At the same time, quantitative macro-researchers are skeptical about the validity of separate “stories.” Roe does an impressive job with national case histories, revealing wide knowledge and providing enough material to inform the readers. Inevitably, the material seems, at times, to have been selected and presented to fit his priors. Yet Roe is consistently aware of the nuances and the complexities of the country cases, as well as the points where other readings are possible; he knows the price he pays for parsimony.

The cases show the tension between empirical country trajectories and Roe’s left-right argument. While the country stories support the claim that politics matters, they could also fit, at times, a left-right story or sectoral and institutional interpretations. To rescue the paradigm from such contradictions, Roe uses the concept of path dependence—previous decisions are locked into institutions, ideas, and interests, shaping events long after their original causes have faded. But this obscures precisely the cross-class dynamics that are at work. The labor explanation suggests that labor power is an ongoing force. Path dependence suggests it need not be; labor can have influence today because of its impact on institutions and investments in the past, even if its political resources have diminished.

The strong labor argument works well for some countries, notably the Scandinavian ones. Sweden pioneered the social democratic, full employment welfare state in the 1930s. The Social Democratic Party has dominated the government for most of the past seventy years. Sweden has, as predicted by Roe’s theory, few diffusely owned public firms of the Berle-Means kind. And yet, all the more interesting to Roe, Sweden has rather high QCL.¹⁰³

What Roe’s account of Sweden underplays is the coalitional politics that brought the Social Democrats to power and sustained the bargains for all these years. They took the reins of government in a “cow-trade,” a bargain with the farmer-based Agrarian Party. In so doing they followed the

102. ROE, *supra* note 3, at 63-105.

103. *Id.* at 94-97.

example of Denmark, which put such a coalition in office the very day in January 1933 on which Hitler took power, marking the failure of a comparable coalition in Germany. The Swedish Agrarians agreed to support unemployment compensation for workers in exchange for price supports for farmers. When the coalition fared well in the 1936 elections, business groups also made their accommodation to this bargain. A famous agreement was signed in 1938 in Saltsjobaden, in which labor agreed to contain wildcat strikes and not to contest managerial authority over firms in exchange for owners' recognition of union rights, unemployment compensation, and public welfare policies.¹⁰⁴ This perfectly supports Roe's core argument: Politics in society drives power relations within the firm, including corporate governance. It also shows the cross-class, cross-sector coalitional nature of what drives the politics and the bargains.

If Sweden fits ideally the model of strong unions and a leftist government, Japan is the ideal example of the opposite. Since the late 1940s, the Japanese left, except for a brief moment in the 1990s, has played no role in governing coalitions; the conservative Liberal Democratic Party has controlled the government for decades. Social welfare benefits are low in Japan. Unions are quite weak and are mostly in-house organs of firms. All this has led some scholars to describe Japan as "corporatism without labor."¹⁰⁵

Roe is certainly correct in emphasizing the importance of politics in shaping Japanese corporate governance patterns. In the early part of the twentieth century, Japan, like France, had emerging equity markets.¹⁰⁶ It shifted to a bank-centered model with more centralized control after World War I, a movement accelerated by military governments during World War II and continued after the war.¹⁰⁷

104. See, e.g., PETER GOUREVITCH, *POLITICS IN HARD TIMES: COMPARATIVE RESPONSES TO INTERNATIONAL ECONOMIC CRISES* (1986); PETER A. SWENSON, *CAPITALISTS AGAINST MARKETS: THE MAKING OF LABOR MARKETS AND WELFARE STATES IN THE UNITED STATES AND SWEDEN* (2002); Peter Swenson, *Bringing Capital Back in, or Social Democracy Reconsidered: Employer Power, Cross-Class Alliances, and Centralization of Industrial Relations in Denmark and Sweden*, 43 *WORLD POL.* 513 (1991).

105. T.J. Pempel & Keiichi Tsunekawa, *Corporatism Without Labor? The Japanese Anomaly*, in *TRENDS TOWARD CORPORATIST INTERMEDIATION* 231 (Philippe C. Schmitter & Gerhard Lehmbruch eds., 1979).

106. RAJAN & ZINGALES, *supra* note 27; see also Richard Carney, *The Political Economy of Financial Systems: Explaining Varieties of Capitalism* (2003) (unpublished manuscript, on file with author) (exploring the shift from equities to bank financing in France and Japan by evaluating the impact of the rising power of labor and small farmers on policy).

107. See generally DORE, *supra* note 98 (analyzing the origins and dynamics of the Japanese production system); TAKEO HOSHI & ANIL K. KASHYAP, *CORPORATE FINANCING AND GOVERNANCE IN JAPAN* (2001) (exploring the changing role of banking in the Japanese system, and noting the decline in recent years of banks as the core for the *keiretsu* model); CHALMERS JOHNSON, *MITI AND THE JAPANESE MIRACLE* (1982) (describing the Japanese bureaucratic state as the driving force behind the Japanese growth model); J. MARK RAMSEYER & FRANCES MCCALL ROSENBLUTH, *JAPAN'S POLITICAL MARKETPLACE* (1993) (challenging Johnson's assertion of bureaucratic primacy by arguing that politics drives the politicians who monitor the

Roe uses path dependence to establish a role for labor in Japan. For a few years after World War II, labor power was considerable. Intense conflicts, extensive strikes, and factory seizures put pressure on Japanese managers, who were hard-pressed for credits, raw materials, and other production resources. With the U.S. Army present, the managers could not turn to open repression. Instead, they settled labor grievances with an understanding that in exchange for labor peace, managers would provide full-time employment. This was not so much law as strategic collaborative understanding. Roe is completely correct in showing that such well-known aspects of the Japanese system are not permanent features of Japanese culture, but are rather political creations arising out of a specific historical moment. Once the bargain was struck, it perpetuated itself. It became institutionalized in a set of vested interests that reinforced themselves over time to form the Japanese production system.¹⁰⁸ The Liberal Democratic Party manages a complex coalition, combining inefficient sectors such as farmers, the construction industry, small shopkeepers, and small businesses with efficient ones such as automobile and electronics manufacturing. Roe's analysis makes complete sense, but it is not really an argument about the strength of social democracy. Rather, it is one about cross-class coalitions and political institutions.

Germany poses a similar challenge to Roe's account. Social democracy has been influential since World War II, but it does not dominate the country. A bargain was struck in the post-World War II years, out of which arose *Mitbestimmung*, or codetermination of labor and capital owners. Again, Roe's astuteness overcomes the aggressive parsimony:

One might argue that the analysis here gets the structural sequence backwards. *Blockholding* came first and resisted change. Hence, blockholding plausibly induced codetermination, and not codetermination that initially induced blockholders.

That kind of response is just true enough to mislead us in analyzing the German corporation. Blockholding *did* come first, resisted change (in contrast to American direct financial influence, which populist pressure broke up early), and codetermination then came forth as a political and social *reaction* to blockholding. . . .

But a focus on the historical sequence misses the point. *Once the two were in place*, neither could change easily without changing

bureaucracy); ULRIKE SCHAEDE, COOPERATIVE CAPITALISM: SELF-REGULATION, TRADE ASSOCIATIONS, AND THE ANTIMONOPOLY LAW IN JAPAN (2000) (stressing the role of trade associations as key links between state action and the private sector).

108. See JOHN WOMACK ET AL., THE MACHINE THAT CHANGED THE WORLD (1990).

the other. . . . Evolution was harder, and maybe still is because the two complementary institutions must move in unison.¹⁰⁹

Roe is right to say that what caused something is not the same as what keeps it in place.¹¹⁰ Codetermination has a background in Germany that long precedes World War II. Unions had been actively involved in the management of unemployment insurance funds, for example, since the Bismarck era.¹¹¹ But as in other countries, labor and the political left were not the only source of demand for state action and intervention. German business, as in most of Europe and elsewhere, had long relied on state assistance in such forms as tariffs, contracts, and loans. Farmers also sought, and received, assistance. Politically, the Christian Democratic Party, which dominated German politics for much of this period, had a strong tradition of public intervention for social programs and criticism of free markets. Ideological currents in Germany and much of Europe generated antimarket ideas from the far right and from nationalist groups. Thus, the bargain that formed the German model can be seen as a cross-class, cross-sectoral one, influenced by ideological and religious currents; the postwar bargain was institutionalized, but it is misleading to rest the argument on left power. If both sides of a bargain develop a strong interest in the agreement, it is the bargain and the interaction that need analysis, not the strength of one side alone.¹¹²

As a specific example, Roe's model is not congruent with the support of the German Social Democratic Party for, and the opposition from the Christian Democrats against, the 2001 repeal of capital gains tax on the sale of shares.¹¹³ Martin Höpner provides a stronger explanation by

109. ROE, *supra* note 3, at 78.

110. See, e.g., Bebchuk & Roe, *supra* note 14; Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1995).

111. Philip Manow, *Social Protection, Capitalist Production: The German Political Economy and the Bismarckian Welfare State from the 1880s to the 1990s*, at 24-33 (2002) (unpublished manuscript, on file with author).

112. For valuable comparisons of Japan, Germany, and other cases, see DORE, *supra* note 98.

113. The conventional wisdom on the repeal is that it weakens the incentives for blockholding, as banks are now free of the "tax-loss" reason not to unwind their positions. Roe argues that the opposite could be true: The tax was a disincentive to take block positions in anticipation of the tax, and thus its absence could make it easier to buy blocks if there were good reasons to do so. If banks do unwind their cross-holding, will that in turn lead to an erosion of the whole German system? That question goes to the core of the institutional complementarities discussion developed by ROE, *supra* note 3, at 80, VARIETIES OF CAPITALISM, *supra* note 56, and Hall & Gingerich, *supra* note 56. See also PAUL WINDOLF, CORPORATE NETWORKS IN EUROPE AND THE UNITED STATES (2002); Martin Höpner et al., *The Battle over the Takeovers Directive*, MITBESTIMMUNG, Aug. 2002, at 22 (providing a concise overview of disagreements among European countries on EU takeover rules and the relationship of such rules to German tax law); MARTIN HÖPNER & GREGORY JACKSON, AN EMERGING MARKET FOR CORPORATE CONTROL? THE MANNESMAN TAKEOVER AND GERMAN CORPORATE GOVERNANCE (Max Planck Inst. for the Study of Soc'y's, Discussion Paper No. 01/4, 2001), at <http://www.mpi-fg-koeln.mpg.de/>

reconceptualizing the potential alliances and conflicts in the firm. He models three combinations: shareholders and managers against workers, workers and managers against shareholders, and shareholders and workers against managers. Workers, Höpner argues, support transparency in order to make codetermination more effective. This may help explain the involvement in many countries of public and union-based pension funds in shareholder rights movements.¹¹⁴

France appears to fit Roe's model, as it is generally classified as having a strong left and weak capital markets. As with Japan, this classification results from a shift in French patterns. Before World War I, despite the predominance of family firms, France had a growing equities market,¹¹⁵ a fact that casts doubt on the legal cultures argument. But in the mid-twentieth century, it moved to the political left and toward greater bank dominance. Ownership separation was weak. As French politics have moved rightward in recent years, privatization and regulatory changes have increased the number of publicly held firms. All this fits quite well with Roe's stress on politics as the driver. But the nature of French politics, again, evokes complex coalition formation. The French left has indeed been vigorous in the twentieth century, but France can hardly be classified as a strong social democratic country. Its unions, dispersed among Communist-, Socialist-, and Christian-Democratic-affiliated institutions, are seen as fragmented and weak. As in Japan, small property owners are politically quite important. So are civil servants—a major component of the left wing electorate. Christian Democracy is not particularly strong in the party system, but it is important as an element in French electoral and coalition politics. Pro-Republican-versus-anti-Republican conflicts, and church-versus-state ones, all have played a large role in defining left and right in French politics. These are all elements of a system in which it is hard to sort out the specific role of social democracy and labor.¹¹⁶

pu/mpifg_dp/dp01-4.pdf (examining the implications of an active market for control for the German model of governance and industrial relations).

114. Hoepner, *supra* note 53. Like Höpner, John Cioffi disputes Roe's two claims about codetermination: that it arises from left power, and that it shapes the dynamics of shareholder diffusion. John W. Cioffi, *Governing Globalization?: The State, Law, and Structural Change in Corporate Governance*, 27 J.L. & SOC'Y 572, 594-95 (2000); John W. Cioffi, *Restructuring Germany, Inc.? The Corporate Governance Debate and the Politics of Company Law Reform*, 24 LAW & POL'Y (forthcoming 2003); John Cioffi, *State of the Art*, 48 AM. J. COMP. L. 501, 524-30 (2000) (book review); see also Dwight B. Crane & Ulrike Schaede, *Functional Change and Bank Strategy in German Corporate Governance* (Dec. 2002) (unpublished manuscript, on file with author) (examining the role of financial globalization, European Union legislation, and domestic demands for change in shifting the business strategy of German banks, as well as their role in corporate governance).

115. See RAJAN & ZINGALES, *supra* note 27, at 1; Carney, *supra* note 106 (manuscript at chs. 3-4).

116. See generally Stanley Hoffmann, *Paradoxes of the French Political Community*, in IN SEARCH OF FRANCE I (Stanley Hoffmann ed., 1963) (showing the way ideological currents since the French Revolution have shaped French political life).

Italy can also provide support for either a left-versus-right or a coalitionist argument to explain the low quality of Italian QCL and low shareholder diffusion. It displays key features of Roe's political argument: a strong Communist party, militant labor unions, and strong government regulation. For example, many Italian labor-market regulations apply only to firms above a certain size threshold. As a result, many firms stay small and private.¹¹⁷ Yet, like France, these policies arise out of coalition dynamics in which there are many sources of opposition to free-market ideas: small firms, family farms, Christian Democracy, social conservatism, nationalism, and neofascism. As in France, Italian politics has over the past dozen years shifted toward the center-right, and with that shift has come greater acceptance of the market.¹¹⁸

For Roe, politics explains the United Kingdom's distinctiveness: high-ranking QCL like that of the United States but, until recent years, weak shareholder diffusion.¹¹⁹ The left, he argues, was not strong enough to prevent or undermine high QCL, but was strong enough to inhibit its full application. As an alternative explanation, Brian Cheffins argues that the lack of diffusion was caused primarily by norms among financial interests that thought buying shares was too risky.¹²⁰ Cheffins also challenges the social democracy thesis by noting that diffusion did increase during the strongest years of labor influence, from 1945 to 1979. Roe counters by noting that the rate of diffusion increases even more dramatically after U.K. politics shifted rightward under Margaret Thatcher.

What really helps clarify the British case, however, is path dependence. As Alexander Gerschenkron noted in his famous discussion of "early and late" development, the United Kingdom had a unique trajectory as the first industrial nation. Its firms were small, its banking system was decentralized, and its labor movement was weak. It developed securities markets and shareholder protection early on.¹²¹ Finance became a vital economic sector and a politically influential one. Securities markets and shareholder protection emerged early in the development process, when British politics favored property and markets. Institutions were built and they persisted. Britain was also the first country to turn to free trade, as well as the first to expose agriculture to world-market forces. Overall, the

117. See SUZANNE BERGER & MICHAEL J. PIRE, DUALISM AND DISCONTINUITY IN INDUSTRIAL SOCIETIES 88-131 (1980).

118. See Shinn, Globalization, *supra* note 38, at 44-45.

119. Analysts disagree on precisely when full separation occurred in the United Kingdom, but seem to agree that it occurred much later than in the United States. See generally Cheffins, *Does Law Matter?*, *supra* note 12, at 472-76 (arguing that shareholding in the United Kingdom developed from assurances given by the London Stock Exchange and financial intermediaries like banks and brokerages, not by law and regulation).

120. See Cheffins, *Britain on the Roe Map*, *supra* note 12, at 158-60.

121. See ALEXANDER GERSCHENKRON, ECONOMIC BACKWARDNESS IN HISTORICAL PERSPECTIVE 14 (1962).

economic situation of a wide range of British groups favored a decentralized market economy. High QCL locked in early. When politics turned leftward, this policy area was not challenged.

Roe turns last to the United States, about which he wrote extensively in his first book. The case is interesting here because he can deepen our understanding of the United States by putting it in comparative perspective. Why does the United States have the most extensive Berle-Means firms in the advanced industrial world? At first blush, following the logic Roe uses, the answer is simple. The United States has the weakest social democratic influence of any of the countries: unions with limited power; a very moderate Democratic party, strongly influenced by farmers and, until recently, by Southern landowners; and the least developed welfare state relative to other industrial countries. But weak labor cannot fully explain the U.S. pattern in two striking aspects: the decentralized character of financial institutions and the abandonment of the trust model since the end of the nineteenth century. Left entirely to themselves, conservative capitalist interests might well have developed strong instruments of private market control, as they did in Europe. Indeed, there were signs this was happening—J.P. Morgan created a bank-trust system that made the United States look rather like Germany at the turn of the last century. What happened? Politics—American politics—attacked concentration of power in finance and industry. A long string of well-known legislation, from the National Bank Act of the 1860s and the Sherman Antitrust Act in 1890 to Glass-Steagall and the Securities Acts of the 1930s, institutionalized shareholder protection and, most importantly, forbade concentrated ownership and bank control.¹²²

What was the politics that produced this? In his first book, Roe found the answer in populism. This would work if populism is integrated into a broader coalitional argument. Like the European social democrats of later years, the American populists got little of what they wanted unless they found allies. Farmers, free traders, workers, small businessmen, ethnic groups, regional tension, investors, and small savers all interacted to produce coalitions against the aggregation of economic power. Jim Fisk and Jay Gould made money by manipulating gold prices, while Morgan made money by reassuring investors.¹²³ But none of them wanted regulatory changes that led to the Berle-Means model. The lobby for that, instead, came from shareholders who were unwilling to rely on either type of titan.¹²⁴ This process was powerfully aided by the immense size of the U.S.

122. See ROE, *STRONG MANAGERS, WEAK OWNERS*, *supra* note 5, at 51-101, 104-05.

123. See generally JEAN STROUSE, *MORGAN: AMERICAN FINANCIER 196* (1999) (showing Morgan's strategy of commitment to investors as a way of encouraging British capital exports to the United States).

124. Coffee, *supra* note 1, at 8.

economy, which helped create vigorous product and capital markets despite periods of tariff protection and regulation. Roe notes the relevance of political institutions: American federalism and the separation of powers gave populist voices and its allies a mechanism for influencing policy formation. The fragmentation of finance in the United States, Roe suggests, may have reduced the target for a labor reaction, in contrast to continental Europe.¹²⁵

This is quite a plausible account, vividly driving home the importance of politics in shaping corporate governance, in creating the substance and quality of corporate law, and in shaping its application.¹²⁶ Law is not an autonomous force. Even after law is created, applications, enforcement, and substantive interpretations turn on politics. We see this in the current Enron-induced crisis. Politics has undermined the quality of U.S. corporate governance regulation by changing the laws, eroding definitions, and loosening standards. Enforcement institutions such as the SEC were “captured” by the people they were supposed to regulate.¹²⁷ Reputational intermediaries colluded with managers at the expense of shareholders. The current controversies in the United States thus demonstrate the diversity of “owner” interests and preferences among shareholders, managers, board members, accountants, and reputational intermediaries. The quarrels over regulation among legal and economics scholars are mirrored in the political marketplace: Some want more regulation to reassure investors; others make money from its absence.¹²⁸

All the country case studies show the influence of noneconomic forces in political conflicts. These deserve attention as well. Roe is interested in criticisms of the market. But these criticisms can come from many sources: religion, culture, region, nationalism, emotions, and attachments of various kinds.¹²⁹ In Europe, “Social Christian views” have been strongly represented in political life, particularly after World War II, either directly in Christian Democratic parties or indirectly through other political parties

125. ROE, *supra* note 3, at 105.

126. *See id.* at 113 (noting the importance of cultural patterns of regulation).

127. For discussion of the dynamics of capture, see Roger Noll, *Economic Perspectives on the Politics of Regulation*, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 1253 (Richard Schmalensee & Robert D. Willig eds., 1989).

128. Because there are always collective action problems within class categories, it becomes difficult to explain behavior by tracing back to a collective preference: Who will undertake the transaction costs for organizing the collective benefit? Some group with a particular reward needs to be found that will pay the transaction costs to organize in the “general” good. *See generally* BERRY EICHENGREEN, *GOLDEN FETTERS: THE GOLD STANDARD AND THE GREAT DEPRESSION, 1919-1939* (1992) (exploring the drive for the gold standard and its impact on the great crisis of the interwar years); BETH A. SIMMONS, *WHO ADJUSTS? DOMESTIC SOURCES OF FOREIGN ECONOMIC POLICY DURING THE INTERWAR YEARS* (1994) (exploring the role of partisan politics and labor in shaping investor behavior toward governmental policy).

129. A classic analysis of party cleavages is PARTY SYSTEMS AND VOTER ALIGNMENTS: CROSS-NATIONAL PERSPECTIVES (Seymour M. Lipset & Stein Rokkan eds., 1967).

and through community, labor, and social organizations. Christian unions, for example, organized workers and kept them separate from socialist or Communist unions. These Social Christian views strongly supported state promotion of families, expansion of the welfare state, job security, and other policies that Roe characterizes as social democratic.¹³⁰

Other sorts of criticism of the market come from social conservatives who, drawing on various ideological currents, are skeptical of free-market views: Benjamin Disraeli's Tory socialism in Britain and Bismarckian thinking in Germany are well-known examples. Interestingly, one of the oldest differences between the United States and Europe is the absence of such antimarket traditions among the American propertied classes, with the partial exception of agriculture. The weak labor threat in the United States, Roe implies, explains this difference. Intellectual historians view a belief in markets as key, while Louis Hartz pins the cause on the absence of a feudal social structure.¹³¹ It is distorting, therefore, to collapse criticisms of the market into a bifurcated labor-versus-capital divide.¹³²

Taken together, the country cases suggest the need for more theorizing on the role of path dependence, about which Roe has clearly reflected deeply.¹³³ There is a logic at work that compels more attention: Gerschenkron's "advantage of backwardness" model.¹³⁴ After Britain's first move toward industrialization, late-developing countries faced competition and ever larger capital requirements to overcome their larger relative technical gap. These late developers needed more centralized forms of economic life, for which they used either banks or the state. As a result, the United Kingdom developed diffuse shareholding, while Germany and Scandinavia developed blockholding. Once formed, these initial patterns were locked into place, though Gerschenkron does not explain why.

Investigating path dependence also helps us sharpen our understanding of the processes of change. There is nothing inevitable about a country's

130. ROE, *supra* note 3, at 85-86. Roe notes the antimarket sentiment of Christian Democracy in Italy, but neither generalizes the point to the rest of Europe nor develops it toward a coalitional argument.

131. See LOUIS HARTZ, *THE LIBERAL TRADITION IN AMERICA* (1955). Hartz's view is itself contested. In the South and elsewhere, traditions were far from liberal. Some Southerners imagined a slave empire including much of the Caribbean basin. See GEORGE M. FREDRICKSON, *THE BLACK IMAGE IN THE WHITE MIND* 320-32 (1971); JAMES M. MCPHERSON, *BATTLE CRY OF FREEDOM: THE CIVIL WAR ERA* 115-16 (1988).

132. Torben Iversen and Anne Wren note some strong differences in policy and outcomes among "Christian democratic," "social democratic," and "neoliberal" advanced industrial countries: Christian democratic governments stress equality and budgetary restraint over growth, social democratic governments pick equality and growth over budgetary restraint, and neoliberal governments pick high employment and budgetary restraint over equality. Torben Iversen & Anne Wren, *Equality, Employment, and Budgetary Restraint: The Trilemma of the Service Economy*, 50 *WORLD POL.* 507, 513-15 (1998).

133. Bebchuk & Roe, *supra* note 14; Roe, *supra* note 110.

134. GERSCHENKRON, *supra* note 121.

“path,” nor is it locked in forever. Its trajectory is sustained by interests, ideology, and institutions—each of which can change. The United States shifted from a late-developer pattern to the U.K. approach, while France and Japan both shifted from equity to bank-centered patterns. As these countries debate their governance systems today, the outcomes will be shaped by coalitional dynamics, the alliances among groups (along class lines or cutting across them), and the way these intersect with noneconomic elements of political life.

Roe understands these objections. His first book gave attention to many nonclass and noneconomic elements of political life, such as ideology and populism. But to make a comparativist argument in this book, he conflates a variety of antimarket views into the label “social democracy” and then characterizes this as left-wing political power and labor influence. An alternative view looks at coalitions: Labor, itself fragmented, is one of several players interacting with other social fragments to produce political outcomes. This coalitional model fits better with Roe’s actual accounts of the countries than does his more stylized social democracy model. It fits his account of the United States quite well—labor weakness did not produce Berle-Means, but rather labor was a participant in a process that produced an outcome. The same is true for Europe and Japan. In his qualitative analysis, Roe discusses coalitions and undermines the left-versus-right divide. In his statistical analysis, his “political argument” dominates the coalitional one. To some degree, the different emphases reflect research needs. A nonnarrative statistical test requires simplifications. Roe has measured the left-right divide and found support for it. Comparable measures and tests for coalitional arguments have yet to be applied to this issue area; a full comparison of the two arguments requires such additional research.

B. *Institutions*

The first two criticisms of Roe’s specific version of a political account focus on his treatment of interest groups and their preferences: The flatness of the two-class model facilitates statistical tests, but is able neither to account for the diversity of preferences nor to model the coalitions that produce policy outputs.

The next set of criticisms focuses on the need to analyze political institutions—the mechanisms of preference aggregation. The sort of coalition that comes together to prevail in policy decisions cannot be fully understood by looking at preferences alone. Coalition formation also requires an analysis of power resources and aggregation mechanisms that

link preferences to power. Institutions can have a powerful impact on which political resources matter and how they are combined.¹³⁵ Indeed, they are central to all the theories: Which political institutions sustain property rights, accountable government, honest and effective regulation, and quality law enforcement?¹³⁶ Recent databases developed by Arend Lijphart,¹³⁷ the World Bank,¹³⁸ and others¹³⁹ allow us to explore these relationships further.

Several institutional arguments, discussed in the following Subsections, are relevant.

1. *Political Structure: Voting Laws, Legislative-Executive Relations, and Political Parties*

The VOC researchers call attention to the impact institutions have on the policy “requirements” of the two systems.¹⁴⁰ In so doing, they resonate well with Pagano and Volpin’s intuition that political institutions favor or hinder different sorts of coalitions among owners, workers, and managers. The VOC authors focus on the capacity of political systems to make credible commitments to a line of policy. Because the OME model invests deeply in specific assets, participants in that system must have confidence that the rules and regulations will not change sharply and that they will have an important voice in shaping changes that may occur. Conversely, if policy swings are substantial, economic actors will pursue strategies that lead to an LME system, with easily transferable investment and less-binding commitments. Sharp swings of policy make specific asset investments risky, while stable policies protect them.

This leads to a prediction: Where we find political systems that constrain policy swings, we are more likely to find OMEs; where political systems allow wide policy swings, we should find LMEs. Which political system can make a “credible commitment” to society that it will limit policy swings?

135. PAGANO & VOLPIN, POLITICAL ECONOMY OF CORPORATE GOVERNANCE, *supra* note 28, at 2 (exploring the impact of institutions on the emergence of manager-worker alliances). James Shinn provides support for their argument. Shinn, Globalization, *supra* note 38, at 25-60.

136. Political institutions do not appear in Bernard Black’s list of requirements for effective securities markets. Black, *supra* note 2.

137. See AREND LIJPHART, PATTERNS OF DEMOCRACY: GOVERNMENT FORMS AND PERFORMANCE IN THIRTY-SIX COUNTRIES (1999).

138. See THORSTEN BECK ET AL., NEW TOOLS AND NEW TESTS IN COMPARATIVE POLITICAL ECONOMY: THE DATABASE OF POLITICAL INSTITUTIONS (World Bank Dev. Res. Group, Policy Research Working Paper No. 2283, 2000).

139. See, e.g., Peter Gourevitch & Michael Hawes, *The Politics of Choice Among National Production Systems*, 6 L’ANNÉE DE LA RÉGULATION 241 (2002).

140. The overlap between OME and blockholder models on the one hand, and LME and diffused shareholder models on the other, is not perfect. But it is substantial. See Gourevitch & Hawes, *supra* note 67.

Institutionalists have developed ideas that contrast two models of political systems: consensus and majoritarian.¹⁴¹ Majoritarian systems magnify the impact of small shifts of votes, thus allowing large swings of policy; consensus systems reduce the impact of vote shifts by giving leverage to a wide range of players through coalitions, thus resulting in minimal policy swings. Consensus systems have many “veto players,” while majoritarian ones have few.¹⁴² In Lijphart’s classification, the United Kingdom is closest to a pure majoritarian model,¹⁴³ where a single party controls a cabinet that controls the legislature. Consensus systems (in Scandinavia and Austria, for example) also have cabinet dominance over the legislature, but within the context of a multiparty system, induced by proportional representation and resulting in broad coalition majorities within the government.

In the credible commitment argument, majoritarian systems have a low probability of committing to an OME system.¹⁴⁴ OME systems correlate with proportional representation electoral laws, multiparty systems, and multiparty coalition governments. LME systems correlate with single-member-plurality-winner laws, two-party systems, and one-party control of government.¹⁴⁵

141. See LIJPHART, *supra* note 137, at 9-47; see also BECK ET AL., *supra* note 138 (providing systematic measurement of political institutions around the world).

142. A veto player is any political actor or group that can block policy. This concept is different from the more frequently used concepts of “veto gate” (a formal institutional point where legislation can be blocked) and “veto point” (any point where legislation can be blocked, including veto gates and veto players). While majoritarian and consensus systems could both have any number of veto gates, consensus systems have many veto players (members of the multiparty coalitions) and majoritarian ones have few veto players. Presidential systems create the possibility of divided government (one party controlling the legislature, the other the executive) and greater intraparty discord. See GEORGE TSEBELIS & JEANNETTE MONEY, *BICAMERALISM* (1997); GEORGE TSEBELIS ET AL., *LEGISLATIVE PROCEDURES IN THE EUROPEAN UNION: AN EMPIRICAL ANALYSIS* (Centro de Estudios Avanzados en Ciencias Sociales, Instituto Juan March, Working Paper No. 2001-165, 2001); Gourevitch & Hawes, *supra* note 139; Allen Dee Hicken, *Party Systems, Political Institutions and Policy: Policymaking in Developing Democracies 174-79* (2002) (unpublished Ph.D. dissertation, University of California, San Diego) (on file with author).

143. LIJPHART, *supra* note 137, at 10-21. Lijphart specifies the archetypical majoritarian (Westminster) system as having these ten characteristics: (1) concentration of the executive in one-party and bare-majority cabinets, (2) cabinet dominance over the legislature, (3) a rigid two-party system, (4) a majoritarian and disproportional system of elections, (5) interest group pluralism, (6) a unitary and centralized government, (7) a unicameral legislature, (8) constitutional flexibility, (9) absence of judicial review, and (10) a central bank controlled by the executive. *Id.*

144. Electoral laws play an important role in shaping the system. See GARY W. COX, *MAKING VOTES COUNT: STRATEGIC COORDINATION IN THE WORLD’S ELECTORAL SYSTEMS* 37-150 (1997). Torben Iversen and David Soskice make an original contribution to this discussion by linking individual voter attributes, as they relate to specific assets and to choice of party. Torben Iversen & David Soskice, *An Asset Theory of Social Policy Preferences*, 95 *AM. POL. SCI. REV.* 875 (2001); see also MATTHEW SOBERG SHUGART & JOHN M. CAREY, *PRESIDENTS AND ASSEMBLIES* (1992) (exploring the interaction of electoral laws and constitutional relationship between presidential and parliamentary constitutions).

145. All the countries with plurality systems, with the exception of France, are LME systems (the United States, the United Kingdom, Australia, Canada, and New Zealand). When measured by party control of government, the LMEs cluster toward the single-party control end, while the

Similar tests using Roe's categories (degree of diffusion of share ownership) with institutional variables produce similar, though not identical, results.¹⁴⁶ Consensus systems correlate with concentrated share ownership, while majoritarian systems correlate with diffuse shareholding. Note that this effect is independent of the partisan and labor/capital balances, Roe's key variables. In an institutionalist account, what matters is the ability of left and right to come to an understanding on policy approaches. Labor strength is transmuted into bargains in consensus systems, but produces combat in majoritarian systems. Pagano and Volpin support this finding in their correlation of coalition governments, weak shareholder protection, and high employment protection.¹⁴⁷ Institutional variance in political systems, then, correlates substantially with differences in national production systems and with corporate governance as a subsystem.¹⁴⁸

Roe is far from unaware of these institutional dimensions. He makes frequent reference to bargaining among actors in blockholder countries. This is most telling in his treatment of "corporatism"—the system of institutionalizing representation of social groups (unions, business associations, and professional groups) into decisionmaking boards to which significant authority is delegated by government. "Concerted arrangements via tripartite bargaining characterize some nations, as the three players—labor, owners, and the government—negotiate corporatist deals. . . . This is not exactly social democracy, but it is government often taking labor's or its ally's side in negotiations inside and outside the firm."¹⁴⁹ Roe does not evaluate, as he should have, this rather important assessment, which actually is the source of much contention among the specialists on corporatism. Some authors see corporatism as a bargain among groups, not as a victory of one over the others; they then compare countries according

OMEs spread across the whole range of possibilities. Regime type (presidential versus parliamentary) also does not correlate with production systems. See Gourevitch & Hawes, *supra* note 139, at 245-52.

146. See Gourevitch & Hawes, *supra* note 67. Adding a veto-player indicator of institutions (political cohesion) to a partisan-position measure increases the measure of adjusted R^2 from 0.53 to 0.73. The small number of cases limits the R^2 these analyses can yield. More work needs to be done to find ways of expanding the number of cases, such as making more observations over specified time intervals. Of course, Roe notes these difficulties in his treatment. ROE, *supra* note 3, at 52.

147. Pagano & Volpin, *Political Economy of Finance*, *supra* note 28, at 516.

148. For further discussion, see Hall & Soskice, *supra* note 56; Ronald Rogowski & Mark Andreas Kayser, *Majoritarian Electoral Systems and Consumer Power: Price-Level Evidence from the OECD Countries*, 46 AM. J. POL. SCI. 526 (2002) (showing that majoritarian systems have lower consumer prices than consensus ones); Hall & Gingerich, *supra* note 56 (developing and testing the notion of institutional complementarities); and Torben Iversen & David Soskice, *Insurance and Representation: Why Do Some Democracies Redistribute More than Others* (2002) (unpublished manuscript, on file with author) (exploring the impact on policy of a politics based on commitment to specific assets rather than general ones).

149. ROE, *supra* note 3, at 111.

to the balance of forces among groups in the bargain.¹⁵⁰ Roe sees that corporatism cuts across the left-versus-right divide. But then corporatism should not be seen as “taking labor’s side,” which risks equating it with social democracy. Roe is right to see that corporatism institutionalizes a voice for labor, but it is one voice among several. Other players are participants in the bargain. Roe asserts that labor dominates because of the outcomes—equality and job protection. But these conditions may have other causes. This key point risks being made true by definition and thus tautological—if the diffuse model means weak labor, then the nondiffuse model and anything that contributes to it must be symptoms of labor strength.

Roe’s more accurate assessment is that “[c]orporatism is another way to reduce . . . conflict; centralized associations of employers, employees, and the government meet to hammer out bargains on wages, employment levels, and monetary policy. The corporatist associations thereby divide up those monopoly and oligopoly rectangles.”¹⁵¹ Corporatism arose out of the bargaining of depression, fascism, Communism, and disruptions from World War II, though it has many antecedents and a variety of intellectual and political sources. The confusion is in causality: Is corporatism a cause of group power, or a symptom of it? It is both: It creates power, but it also reflects it. The political system creates the institutions of corporatism—they are acts of delegation—so their existence expresses power realities. If those power relationships in politics change, the political system could rescind that delegation. Corporatism extends group power beyond the formal institutions of the political system. Its existence in OMEs thus contributes to the credible commitment of those systems not to change policy in sharp ways. It is important not to use corporatism as an independent causal variable in explaining the choice between OMEs and LMEs when it is also an important attribute of the OMEs themselves.

2. *Consumers Versus Producers*

At the end of chapter 18 in his book, Roe makes the interesting suggestion that the difference between policies that favor diffuse shareholding and those that favor blockholding resonates strongly with the distinction between policies that favor consumers and those that favor producers.¹⁵² If we could explain the politics of pro-consumer and pro-

150. See, e.g., Christoph Kunkel & Jonas Pontusson, *Corporatism Versus Social Democracy: Divergent Fortunes of the Austrian and Swedish Labour Movements*, 21 W. EUR. POL. 1 (1998); Philippe C. Schmitter, *Still the Century of Corporatism?*, 36 REV. POL. 85 (1974).

151. ROE, *supra* note 3, at 135.

152. *Id.* at 133.

producer interests, he observes, we would gain greater insight into the corporate governance debate.

The institutionalists offer just that. Ronald Rogowski and Mark Kayser find that while majoritarian electoral systems reward consumers, proportional representation arrangements reward producers. Countries with majoritarian systems have low product prices, while countries with proportional representation have “high voter turnout; less strategic voting; less political violence, greater cabinet instability and shorter lived governments; higher governmental expenditures and budgetary deficits; more welfare spending; greater dependence on trade; and greater equality of income.”¹⁵³ Studying the interaction of institutions with interests and preferences has rich potential for understanding political influences on corporate governance.

IV. PUBLIC POLICY ISSUES

Roe’s analysis raises important questions about public policy toward corporate governance. It is particularly relevant to the ongoing controversy over the proper balance between markets and regulation. Can public policy create strong protections for external shareholders? Can it do so without suffocating initiative and undermining efficiency? Can it escape “capture” by the very interests it tries to regulate? Alternatively, can markets themselves reward those who wish to pay the costs of monitoring and let those who do not want to pay the costs go elsewhere with their savings?

A. *The “Autonomous State” and “Capture” Models*

One traditional view in law and economics suggests that regulation in areas such as securities is “irrelevant or damaging.”¹⁵⁴ The QCL view, in contrast, argues that regulation can have a positive effect. Properly structured, institutions can generate and enforce rules that advance a utility function autonomous from specialized interests—a regulatory apparatus that preserves a public objective of diffuse shareholder rights (or other desired objectives). But specialists disagree on whether the role of regulation is to reduce the costs of private enforcement through litigation, or to provide benefits that private actions cannot.

Capture models challenge both arguments for regulation. James Buchanan and Gordon Tullock wrote that the utility function of elected officials and their agents is never identical to that of the public because

153. Rogowski & Kayser, *supra* note 148 (citing extensively works on the consequences of institutional differences).

154. For a clear summary of the debates, see La Porta et al., *supra* note 6, at 1-18.

elected officials have private interests of their own.¹⁵⁵ Roger Noll argued that regulation is always captured: Those being regulated manage to work through politics to push regulation toward their goals.¹⁵⁶ It cannot be assumed that the SEC or any other agency actually works to achieve the goals stated in its charter or authorizing legislation. Whether an agency acts according to its mandate turns on politics: on the relationship between groups seeking regulation and the political system that passes the laws and appoints the judges and the regulators. This line of reasoning points to the centrality of politics and the impossibility of separating politics from law and regulation.

The issue of separating politics from law and regulation arises forcefully in discussion of developing countries generally, most recently in Asian economic development studies. Does economic development require high-quality corporate law? Indeed, how good was American corporate law at the end of the nineteenth century? Rapid growth in several Asian countries seems also to suggest otherwise. This phenomenon gave rise to a literature on the developmental state,¹⁵⁷ whose bureaucracy has enough distance from political pressures to pick developmentally oriented policies that are market conforming, rather than redistributive.¹⁵⁸ This argument echoes debates in European countries, such as France, in which bureaucracies play a critical role in economic life.¹⁵⁹

The Asian financial crisis of 1997-1998 challenged this interpretation. Rather than a neutral public-regarding policy process, the system in place looked more like "crony capitalism." Analysts following principal-agent theories challenged the theoretical foundations of the autonomous state argument and its most noted example for the Asian cases—the bureaucracy-centered school developed by Johnson.¹⁶⁰ The civil service needs a utility function that determines how to use its power. It gets that function from the political system. Politics and politicians shape the parameters within which the civil service operates. Authority is delegated and monitored by

155. JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 20-30, 286-95 (1962).

156. Noll, *supra* note 127; see also Matthew D. McCubbins et al., *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431 (1989) (arguing that Congress structures the executive branch of the United States to attain policy objectives).

157. *E.g.*, STEPHAN HAGGARD, *PATHWAYS FROM THE PERIPHERY: THE POLITICS OF GROWTH IN THE NEWLY INDUSTRIALIZED COUNTRIES* (1990); RICHARD ROSECRANCE, *THE RISE OF THE TRADING STATE* (1986); ROBERT WADE, *GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION* (1990).

158. *See, e.g.*, JOHNSON, *supra* note 107.

159. JOHN ZYSMAN, *GOVERNMENTS, MARKETS, AND GROWTH: FINANCIAL SYSTEMS AND THE POLITICS OF INDUSTRIAL CHANGE* 99-170 (1983).

160. *See, e.g.*, JOHNSON, *supra* note 107.

politicians. If bureaucrats appeared to have autonomy, this was because the politicians agreed with their actions.¹⁶¹

The capture model provides an intellectual challenge to the QCL position. It undermines assumptions that governance arrangements reflect the response of “efficient institutions” to competitive forces. What we see may instead reflect the ability of political forces to create a rent through laws and regulations. The possibility of capture compels treatment of regulation, corporate law, and markets in the framework of political systems. Effective regulation cannot be modeled without attention to the structure of the political system that rewards certain kinds of laws, regulation, and enforcement, and undermines others. The regulators, the politicians, the legal community, and the investors all have utility functions that push in various directions, and these need to be analyzed.

The capture model for regulation also challenges political arguments—both those that focus on preferences and those that look at institutions. If regulation is captured, does either left-versus-right or cross-class coalitional control of government matter? The logic of Noll’s position is to undermine the relevance of party and alliances: Whoever is in charge, the regulatory instruments are captured. But Noll’s argument brushes past possible variance in the direction of capture. Conservative, pro-business parties will run a labor-relations board differently than a pro-union party. A government dependent on environmentalist votes will manage the forests, water supply, and parklands differently than one reliant on business developers. The SEC will swing for or against the securities industry, investors, workers, or managers, depending on the importance of each group in the core constituency of the party in power. So will public pension funds swing—as a function of who appoints their boards.¹⁶²

The corporate governance and securities regulation field links up well with concerns about “governability” and “effective” public policy. The World Bank and other agencies are interested in what makes countries able to generate growth, absorb investment, provide public goods, secure property rights, and, recently, resist terrorism and provide public order. Some researchers also raise the issue of distribution—who gets the benefits and who pays the costs. Interest in distributive issues encouraged the development of the World Bank database on institutions noted in the previous Part, a database that could be mobilized for research on corporate

161. See RAMSEYER & ROSENBLUTH, *supra* note 107, at 121-41. This book sharply contrasts with Johnson’s, which treats the bureaucracy as more dominant than political parties and the legislature.

162. See, e.g., Mary Williams Walsh, *Calpers Wears a Party, or Union, Label*, N.Y. TIMES, Oct. 13, 2002, at C1.

governance. It would have to be supplemented by research on political parties, social movements, interest groups, and social structures.¹⁶³

The U.S. experience of the past year provides another arena for these arguments. Reformers divide on analysis of cause and remedy. A norms approach looks for the spread of better standards among individuals, generated perhaps by a norm entrepreneur.¹⁶⁴ Private enforcement looks to the deterrence benefit of stiffer penalties and vigorous prosecution. A public regulatory approach seeks to restore a system of reputational intermediaries. A more systemic analysis calls for greater activism by institutional investors as “blockholders” to overcome the inherent collective action problems of the American model.¹⁶⁵ Roe correctly directs our attention toward politics in order to understand Sarbanes-Oxley and these debates. Solutions cannot abstract from the political issues of institutional design. Norms without enforcement, enforcement without quality law and regulations, law enforcement without political support, politics without a structure of preferences and institutional mechanisms—these elements are all pieces of an interacting system. Each piece can be analyzed separately, but they don’t operate separately. Roe’s argument compels more research on interactions and comparisons among these elements.

B. *The Market for Regulation*

If regulation can be captured, can markets operate to protect investors through competition among regulatory jurisdictions? The well-known debate on competition among the U.S. states leads to conflicting conclusions. Romano argues that competition leads to upward convergence—to high standards for shareholder protection;¹⁶⁶ Bebchuk argues that it leads to downward convergence.¹⁶⁷ Kahan and Kamar argue that states do not really compete for tax revenues or for incorporation.¹⁶⁸ Central to the disagreements are assumptions about the utility functions of politicians and the leverage of different players in the firm (managers, shareholders). Do states actually compete for incorporation, seeking

163. See, e.g., PRESIDENTS, PARLIAMENTS, AND POLICY (Stephan Haggard & Mathew D. McCubbins eds., 2001).

164. Robert C. Ellickson, *The Evolution of Social Norms: A Perspective from the Legal Community*, in SOCIAL NORMS 35 (Michael Hechter & Karl-Dieter Opp eds., 2001); Robert C. Ellickson, *The Market for Social Norms*, 3 AM. L. & ECON. REV. 1 (2001).

165. Roberta Romano argues that institutional investors have been ineffective because they have not picked the right strategies. ROBERTA ROMANO, LESS IS MORE: MAKING SHAREHOLDER ACTIVISM A VALUED MECHANISM OF CORPORATE GOVERNANCE (Yale Int’l Ctr. for Fin., Working Paper No. 241, 2000). Should the pension funds focus only on managerial honesty or look also at firm strategy and social responsibility? See, e.g., Walsh, *supra* note 162.

166. ROMANO, *supra* note 23, at 14-24.

167. See BEBCHUK, *supra* note 14.

168. Kahan & Kamar, *supra* note 23.

revenue or other benefits? Or are lawmakers responding to a variety of constituents' goals, such as local businessmen who want protection from hostile takeovers? The supply of regulation will thus follow the incentives of politicians and regulators, rather than the demands of firms, managers, or shareholders. The implications, argue Kahan and Kamar, provide support for both contrasting arguments: Delaware and the noncompeting states will bias their laws in favor of managers, while Delaware's particular rewards from incorporation tilt it somewhat closer to shareholders than the other states. Progress in this argument requires, they suggest, better models of the incentives of all players—politicians, interest groups, and firms.

This argument resonates with international debates. The U.S. regulatory model competes with others. Could the market cause convergence around shareholder protection, a kind of functional convergence?¹⁶⁹ This process is at work, it is argued, because some investors prefer firms that protect external shareholders. These investors demand a premium for firms that do not offer such protections, estimated as up to twenty percent.¹⁷⁰ Firms in countries that have such protections thus have access to cheaper capital, giving them a competitive advantage. Managers will therefore have to demand reforms of this kind, becoming the lobby in each country for adopting the other system. Countries are experimenting with this model by allowing rival securities markets to compete within their borders. The Novo Mercado in Brazil, for example, specifies different listing requirements than the regular Brazilian Bourse in conformity with shareholder protections. The advantage of this approach to reform is that it appears gradual and less politically confronting: Those who do not wish to change would not have to. Germany tried the Neue Market; its collapse this year shows the difficulty of making this method work.

Are market forces actually causing change in regulatory and corporate governance practices? Observers disagree on this issue.¹⁷¹ Measurement can be difficult because the impact may be indirect. In analyzing reform processes around the world, James Shinn finds little evidence of direct lobbying by managers and owners for regulatory change. Instead, he notes a more indirect process, by which managers and owners work through political institutions.¹⁷² Governments face budgetary pressures to balance their budgets—from EU rules following Maastricht to fears of taxpayers and investors over ballooning state deficits. To balance the books, governments privatize. This brings in immediate cash, lowers claims on the public purse, and creates growing numbers of shareholders. As the class of shareholders grows, it demands governance reforms to protect itself. At the

169. See COFFEE, *supra* note 24, at 1-12.

170. Shinn, *Globalization*, *supra* note 38, at 32-34.

171. For example, John Coffee says "yes," while James Shinn says "no."

172. Shinn, *Globalization*, *supra* note 38, at 99-120.

same time, long-run concerns about aging populations and dwindling retirement funds lead to partial privatization of those retirement funds and a growing interest in securities-based pension funds.

While the Berle-Means mechanism located the drive for shareholder dispersion in the goals of founder-owners, Shinn's argument locates it in a structure in which a variety of players work through the political system. Trade-oriented groups support the European Union and economic integration and, thus, the requirements for managing deficits; fiscal conservatives worry about public debt and subsidies to public firms. The resulting impact on corporate governance is indirect: It creates a class of new shareholders who then, as in the case of the United States, may seek regulatory protections.

Another indirect mechanism for regulatory change, which links competing jurisdictions together, is the desire for firms to increase market capitalization in order to carry out mergers. This is particularly relevant in Europe where, for example, Germany's decision to repeal capital gains taxes on the sale of shares may have had that objective. Yet market capitalization reforms may not lead to significant change in the system of shareholder rights.¹⁷³ Furthermore, jurisdictional competition can lead to conflicts between countries. For example, European firms seek to raise capital by listing in the United States. Yet, they do not wish to follow U.S. securities rules. The SEC has allowed exemptions for such cases, apparently responding to demands by foreign firms that Sarbanes-Oxley should not be applied to them. But such exemptions burden U.S. firms with a competitive disadvantage, thereby creating interjurisdictional conflicts.

The international context adds complexity to political explanations, as it requires integrating international influences into modes of national politics,¹⁷⁴ but the analytic issues are nonetheless similar. Competing jurisdictions and rival markets all influence the incentives of the various players, both within the firm and within society. International agreements create a field of decisionmaking in which the domestic and international dimensions interact, thereby influencing domestic preferences and processes;¹⁷⁵ domestic political players evaluate preferences and strategy according to incentive structures shaped by strategic interaction with players in other countries.¹⁷⁶ Domestic politics remains central in these

173. See Höpner et al., *supra* note 113.

174. See JAMES SHINN & PETER GOUREVITCH, *HOW SHAREHOLDER REFORMS CAN PAY FOREIGN POLICY DIVIDENDS* (2002).

175. Peter Gourevitch, *The Second Image Reversed: The International Sources of Domestic Politics*, 32 INT'L ORG. 881 (1978); Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 INT'L ORG. 427 (1988).

176. See LEGALIZATION AND WORLD POLITICS (Judith L. Goldstein et al. eds., 2001); ANDREW MORAVCSIK, *THE CHOICE FOR EUROPE: SOCIAL PURPOSE AND STATE POWER FROM MESSINA TO MAASTRICHT* (1998); David Lake & Robert Powell, *International Relations: A*

processes because it is the states that decide whether to accept and comply with international agreements and institutions.

VI. CONCLUSION

In examining Roe's important new book, this Review has explored two sets of disagreements about corporate governance patterns. The first is over the status of politics in an interpretation of corporate governance. Roe has successfully argued that politics matters in an explanation of corporate governance patterns. This makes his position distinct from other theories. LLS&V recognize the role of politics in their discussion, but they do not privilege it in either their data or at the level of theory. To them, politics was involved in an original choice among legal systems—common versus civil—but not in the actual functioning of the legal systems and their impact on corporate governance. Recent work by LLS&V examines the effects of legislation, the rule of law, and judicial efficiency; these all *imply* a role for politics, but politics itself remains unspecified in their arguments.¹⁷⁷

For Roe, diffusion will not happen, even with high QCL, if politics inhibits it either by strengthening the claims of nonshareholders or by instituting unfavorable policies on competition, labor markets, and equality of income distribution. Coffee, in contrast, rejects Roe's particular version of a political account, but does analyze the impact of politics. He emphasizes the importance of politics both in the constituency for QCL—the shareholders—and in his major comparative variable, the role of the state in economic life. Nonetheless, Roe is the only one, in my opinion, to see politics as having continuous importance to corporate governance. It works daily, defining the relationships inside the boardroom and the polity that encourage or inhibit diffusion.

Roe's position both extends and challenges the finance theory that drives the law-and-economics literature on corporate governance. He extends it by showing the ways politics shapes the laws and the conditions in which it operates. He challenges it by showing that corporate and securities law does not fully specify all the incentives that shape the way managers and owners calculate their strategies. Faced with identical bodies of law, even of high quality, actors will behave differently depending on the various claims, derived from politics, that can be made on the firm. These are important insights that should induce new directions for research.

Strategic-Choice Approach, in STRATEGIC CHOICE AND INTERNATIONAL RELATIONS 3 (David Lake & Robert Powell eds., 1999).

177. A recent paper offers a rebuttal of Roe's theory by including a left government with an interest group variable. But Roe focuses on advanced industrial countries, while the paper looks at a larger international sample. See Juan Botero et al., *The Regulation of Labor* (Nov. 2002) (unpublished manuscript, on file with author).

The second debate concerns the attributes of politics that produce outputs. Here, Roe's argument is both important and incomplete. Leftist political power does matter; he has shown this convincingly. But its effects can be better understood when placed in the framework of coalitions and institutions. While alternative models examined in this Review share Roe's emphasis on the importance of politics, coalitions and institutions provide alternative political channels to the forces that constrain or expand the primacy of shareholder rights and the degree of shareholding diffusion. Instead of seeing "stakeholder claims" in terms of "social democracy," as Roe does, such claims could be recast as "coordinated" or "organized" market-economy principles. Labeling them this way suggests that different mechanisms are at work, with different implications for refuting and testing theories. In Roe's model, if a researcher shows the left is not the vital player in shareholder diffusion, the finding would disconfirm his argument. But in a "coordinated economy" model of politics, such a finding does not constitute a full rebuttal, as a weaker left could nonetheless be an important participant in coalitions that bring other sources of support to the table and could be reinforced by the impact of political institutions. Roe solves the puzzle of weak leftist presence in low-diffusion countries with "path dependence." Another related way to solve the same problem, though, is to talk more about cross-class coalitions, bargains, and institutions.

The various authors in this debate know too much to deny altogether the relevance of each others' variables: Politics, law, judges, the role of the state, norms, private mechanisms, and path dependence appear in all of their writings. They differ in how these variables act in a causal sequence, and how they are privileged relatively in a model. All of the models discussed here make some contribution to our understanding. How can we choose among them? The answer will vary according to what sorts of reasoning each reader finds compelling. Possible considerations include:

- *Other Data:* Are there other political dimensions of countries that correlate with the governance patterns? I have suggested two political indicators—cross-class coalitions and political institutions. On the second, I provide some crude measurement suggestions. But these are not full challenges to Roe or LLS&V unless they are more completely measured.
- *Mechanisms:* What are the mechanisms of causality at work in these arguments? In his statistical work, Roe measures power through elections. His qualitative works implies a more deeply structural model of the balances of forces at work, but does not fully specify or measure them (union concentration or party organization, for example). While LLS&V correlate civil and

common law with QCL and diffusion, the actual mechanism of the alleged relationship is continually being debated and challenged. It would be useful to clarify the connections that link legal tradition to legislation and regulation, legislation to judges and regulators, judicial enforcement to politics and political institutions, and all of these back to the incentives and objectives of the players in a firm.

- *Country Cases*: Roe provides a qualitative test—the country profiles. While quite valuable, these can be, and have been, challenged. Country specialists at times dismiss the whole because they find a weakness in one of the parts. Outliers or exceptions do not disprove a general statement; they suggest that other influences, to be identified by country specialists, are at work. But critics who pursue specific cases need an alternative argument that covers a set of countries in a comparative framework. It is possible that each country does have a unique trajectory, but that goes against the evidence that there are cross-country patterns on outcomes and on other variables explored by Roe and LLS&V. Roe has explored the analytic issues in his treatment of chaos theory and path dependence, but an integrated account has yet to be fashioned. At the same time, the qualitative country cases do pose a challenge of completeness the generalists must address.
- *Theory*: The models could be reframed, broadening the variables at play in shaping corporate governance. Roe shows that the incentives to managers and owners cannot be modeled just by looking at the regulations on corporate governance and securities alone. Other rules, and other forms of power, also matter. Roe shows, for example, the impact of employee protection. Other research could also examine the relationships with suppliers, retailers, the education system, price-setting mechanisms, and other variables that shape claims on the firm.¹⁷⁸ Another promising line of research can build on the lead of Höpner, Pagano-Volpin, and Rajan-Zingales to explore

178. For examples of current research, see MASAHIKO AOKI, INFORMATION CORPORATE GOVERNANCE, AND INSTITUTIONAL DIVERSITY: COMPETITIVENESS IN JAPAN, THE USA, AND THE TRANSITIONAL ECONOMIES (Stacey Jehlik trans., Oxford Univ. Press 2000) (1995); MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS (2001); Takeo Hoshi, *Japanese Corporate Governance as a System*, in COMPARATIVE CORPORATE GOVERNANCE 847 (Klaus J. Hopt et al. eds., 1998); and Jean Tirole, *Corporate Governance*, 69 ECONOMETRICA 1 (2001).

the various coalitions that can emerge among shareholders, managers, workers, and reputational intermediaries.

Roe and LLS&V have set an impressive standard of systematic cross-national comparison. They have built up databases, developed theory, proposed hypotheses, generated tests, and presented the evidence. They have raised the bar for research. Challenges cannot be ad hoc or anecdotal; they cannot succeed by showing only that a particular event does not fit well with the overall pattern. It is important to explore each country case, to find flaws with this or that event or piece of data, but this is not the same as having a general theory. Those who contest their conclusions will need to build alternative data, theories, tests, and evidence. Those who proffer general theories will have to confront the challenges of the country specialists.

In that light, Roe's book is a substantial and welcome contribution, as well as a challenge, to all the disciplines involved: law, economics, business, politics, and sociology. Politics, Roe persuades us, is involved in every aspect of explaining corporate governance. It should not be plausible after reading Roe to offer an explanation without considering the impact of politics. Politics must therefore become integrated into the way these disciplines explain governance. That in turn compels more communication across them. Reading Roe is a rewarding step in that direction.