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# THE LABOR MARKET DETERMINANTS OF CORPORATE GOVERNANCE REFORM

Abstract: A theoretical framework is presented that connects change in the organization of labor with change in corporate governance and financial system development. Building on work by Rueda (2005, 2006, 2007), the paper considers labor change in terms of reduced "insiderness" and examines how this might impact on the orientation of corporate governance vis-à-vis blockholders and minority shareholders. The proposed relationship is investigated utilizing a panel of data for the advanced industrialized democracies.

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# LABOR MARKET DETERMINANTS OF CORPORATE GOVERNANCE REFORM

**Roger Barker and David Rueda**

## I. INTRODUCTION

The joint stock company is one of the most successful socioeconomic institutions of modern society. Along with markets, firms serve to mobilize and coordinate the use of capital in the generation of economic growth (Roberts 2004: 74). However, unlike markets, firms organize production in terms of hierarchical authority relations between economic agents (Coase 1937). Their pervasiveness in modern economic life is arguably even greater than that of markets: according to McMillan, 70% of transactions in the US economy occur within firms, as compared to only 30% in markets (McMillan 2002:168).

The dangers inherent in the concept of the limited liability company received an early treatment from Adam Smith in *The Wealth of Nations* (1776). Two and a half centuries later, the underlying problem remains the same: the distinctive legal structure of the corporation offers corporate insiders an opportunity to enrich themselves at the expense of other stakeholders. Such a moral hazard problem creates significant dangers for overall societal welfare and stability, given the central role played by firms in the production structure of most political economies. Societies wishing to enjoy the firm's economic benefits have to decide, either explicitly or implicitly, which actors can be trusted to exercise power over the firm, and how that power will be restricted and held accountable.

The authority structure of a firm can be organized in a variety of ways. The possible range of permutations has been reflected in the post-war diversity of national corporate governance practices, which appear to have defied the harmonizing effects of economic globalization (Stulz 2005; Dyck and Zingales 2004; Nenova 2003).

For example, a distinctive approach to corporate governance has underpinned the non-liberal economic models of continental Europe. European corporations have operated within a framework of incentives that have shielded them from engagement in short-term earnings and share-price maximization. This has facilitated their cooperation with other social actors in fulfillment of the post-war "corporatist compromise". More stable corporate behavior has also given rise to an environment in which economic actors are more willing to engage in long-term commitments and non-market forms of cooperation (e.g. in training, R&D, industrial relations, etc). This proved to be a particularly efficient form of economic organization in the post-war era of "diversified quality production" (Streeck 1992).

There is, however, evidence of significant change underway in European corporate governance, particularly since the mid-1990s. Most European countries have introduced national codes of corporate governance for the first time, along with a range of regulatory changes to improve company disclosure, board accountability and minority shareholder rights. At the micro-level, more and more companies are seeking to project an image of "good" corporate governance, in order to secure cheaper finance and a higher share price. In addition, supranational institutions, such as the European Commission, have been active in promoting some degree of harmonization in corporate governance regulations, for example through passage of the 2003 Takeover Directive.

With respect to Europe's largest economy - Germany—Beyer and Höpner (2003) also argue that significant change is underway in corporate governance (in contrast to the "Reformstau" in other policy areas). At the company level, shareholder orientation is being increased through the use of profitability goals, measures to increase financial transparency, investor relations activities and the increased use of stock options (Beyer and Höpner 2003: 179). The amendment of German corporate law in 1998 to include the "protection of shareholder value" as a valid corporate objective for

the first time in German history is praised by Espen Eckbo as "a giant step forward for German corporate governance. Adam Smith would have approved" (Eckbo 2005: 3).

The objective of this paper is to explain both the diversity that exists in corporate governance regimes, and account for why it may be changing.

## II. WHAT ARE WE TRYING TO EXPLAIN? CORPORATE GOVERNANCE CHANGE IN INDUSTRIALIZED DEMOCRACIES.

Corporate governance is an attribute of political economies that varies significantly across countries (La Porta et al 1999; Morck and Steier 2005). It also varies significantly across time (Rajan and Zingales 2003; Becht and Delong 2004; Morck at al 2004), although it is argued that there is also a high level of path dependence in the short-to-medium term.

In the previous section we have hinted at some of the reasons why corporate governance matters to the political economy of industrialized democracies. Let us be a little more systematic about these reasons. First, the fact that the structure of firms differs significantly among different countries affects their response to common external challenges (Morck and Steier 2005; Roe 2003; Hall and Soskice 2001; Knetter 1989). Numerous authors have argued convincingly that corporate governance is, in fact, a key factor in determining the style of capitalism that prevails in a country (Hollingsworth and Boyer 1997; Aoki 1988; Hall and Soskice 2001). Second, corporate governance is not only a fundamental part of a political economy system, it has also been related to a plethora of economic and political outcomes. Corporate governance is used in the economic literature to explain a range of other outcomes: levels of economic growth and efficiency (Carlin and Mayer 2000, 2003; Mueller 2005); innovation capability (Allen and Gale 1999; Huang and Xu 1999); levels of competition (Fulghieri and Suominen 2005);

financial openness (Stulz 2005); relative prevalence of public and private companies; levels of control premia (Dyck and Zingales 2004); and the emergence of social democracy (Belloc and Pagano 2005).

There are several ways of categorizing corporate governance systems. One of the key distinctions is between shareholder and stakeholder systems of corporate governance (Letza et al 2004). However, this characteristic is difficult to quantify and, arguably, all corporate governance systems are stakeholder systems to some degree (what varies is the distribution of power amongst stakeholders). In the economics literature, corporate governance is also measured in terms of blockholding and minority shareholder orientation. While a blockholding orientation is not entirely synonymous with stakeholder corporate governance, it is arguably a necessary condition for it to occur.

Given its multifaceted nature (as well as its conceptual complexity), the operationalization of corporate governance in empirical studies displays great variance. As we will make clear below, this paper's theoretical claims are fundamentally concerned with capturing the extent to which the monitoring, oversight and control of the management of public companies is oriented towards external minority shareholders. This theoretical goal guides our choice of dependent variables.

The variable which is most commonly used in cross-section analyses of corporate governance (ownership concentration) is not available as a time series. The cross-sectional work in the literature has been done with data relating to the early/mid-1990s (La Porta et al 1998; Faccio and Lang 2002). Although a team of researchers has recently published a more up-to-date snapshot of ownership concentration—relating to 2004 (Kho et al 2006) - this is still not a measure of corporate governance that can be employed in an in-depth analysis of corporate governance change employing panel

data econometric techniques. We utilize four alternative proxies for minority shareholder strength.

The first is stock market capitalization divided by GDP, also known as "equity share". A higher equity share is taken to imply a greater orientation towards external minority shareholders. The issue of publicly traded equity (i.e. equity listed and traded on a stock exchange) requires that firms submit themselves to an increased level of external accountability. In order to buy and hold the equity of publicly traded companies, external investors need to be persuaded that companies are being operated in their interests (and not only the interests of other stakeholders, such as blockholders or employees). Consequently, a high proportion of publicly issued equity in the financing of corporate activity may be taken to imply that firms have been successful in orienting their governance to the needs of such external minority stakeholders.

There are several possible limitations for using this measure as a proxy for outsider corporate governance. Firstly, much of an economy's public equity market may be held by blockholders. Although a firm may go public as a means of gaining additional investment resources from external investors, controlling stakes may be held by incumbent blockholders. An indeterminate proportion of national equity markets may thus represent the sunk investment of insider capital. Secondly, the relative size of an economy's equity market may be driven by institutional factors unrelated to corporate governance. For example, the Netherlands has a significant private pension sector, which has promoted the channeling of savings into equity investment (giving rise to a high equity share). This does not necessarily imply, however, that Dutch firms are governed with a high minority shareholder orientation. Similarly, Switzerland has achieved a high equity share due to the pool of savings arising from its status as an offshore banking centre.

We argue, however, that change in equity share, rather than its absolute level, may still provide a useful indication of changing patterns of corporate governance. Change is likely to be primarily driven by the activities of external minority investors; in contrast, blockholder ownership stakes are likely to be relatively unchanging (given their strategic rather than short-term profit maximizing rationale). Consequently changes in equity share, rather than their levels, should say something useful about changes in minority shareholder orientation.

Our second proxy is the total value of shares traded on the stock market divided by GDP. The rationale of this measure is similar to that of change in equity share. The variable is commonly used as a measure of the activity or liquidity of equity markets. However, its level is likely to be more reflective of the minority shareholder nature of corporate governance than equity share, as blockholder equity stakes are much less traded (due to their strategic nature) than those of short-term profit-maximizing portfolio investors. Consequently, blockholder activities are less likely to distort the level of this measure.

The third proxy is the value of international equity issuance as a share of GDP. This is data that is collated by the Bank for International Settlements (BIS), and relates to equity issuance that is specifically targeted towards non-domestic investors. It consists of equity issues falling into three categories: Equity issuance from domestic corporations in foreign markets; equity issuance from domestic corporations in foreign currency in the domestic market; and equity issuance from domestic corporations in domestic currency in the domestic market targeted at non-domestic investors. Data refers to both initial public offerings and secondary equity issuance from existing public companies.

Unlike Equity Share, the level of this proxy is not distorted by the equity ownership activities of blockholders. It does not include, for example, issues of equity that are entirely oriented towards

domestic incumbent ownership groups. The rationale of this proxy is that companies will have to exhibit outsider friendly governance if they are to raise significant funds in the market through the issuance of such stock. Its main limitation is that equity issuance activity—both IPOs and secondary issues - occurs in cycles, depending on the current state of market sentiment. Issuance boomed in the late 1990s, and then more or less dried-up in most markets in 2000 and 2001. These cyclical movements did not reflect underlying structural changes in corporate governance, but rather the volatilities of the credit cycle.

Our final proxy for corporate governance is an index of shareholder protection that was originally developed by La Porta et al (1998) in respect of shareholder protections prevailing in the mid-1990s, but which has been updated up to 2002 by Pagano and Volpin (2005). It is a summary index of six possible legal protections available to external shareholders vis-à-vis company management. Each individual protection is evaluated as a dummy variable (1 = protection exists, 0 = protection does not exist). Consequently the score for each country ranges between 0 and 6.

The categories of minority shareholder protections are as follows: (1) vote by mail, equals one if the law explicitly mandates or sets as a default rule that the company must provide a proxy form allowing shareholders to vote on the items on the agenda of a general shareholders' meeting by mail; (2) shares not deposited, equals 1 if the law does not require, nor explicitly permits companies to require, shareholders to deposit with the company or another firm any of their shares prior to a general shareholders meeting; (3) cumulative voting, equals one if the law explicitly mandates or sets as a default rule that shareholders owning 10% or less of the capital may cast all their votes for one board of directors or supervisory board candidate (cumulative voting) or if the law explicitly mandates or sets as a default rule a mechanism of proportional representation in the board of directors or supervisory board by which shareholders owning 10% or less of the capital

stock may name a proportional number of directors to the board; (4) oppressed minority, equals one if (minority) shareholders owning 10% or less of the capital stock can challenge (i.e. by either seeking damages or having the transaction rescinded) resolutions that benefit controlling shareholders and damage the company; (5) pre-emptive rights, equals one when the law or listing rules explicitly mandate or set as a default rule that shareholders hold the first opportunity to buy new issues of stock; (6) capital to call a meeting, equals one when capital needed to call a shareholders' meeting (directly or through the courts) is less than or equal to 10 percent.

Table 1 presents the data for all our dependent variables: international equity issuance, equity market capitalization, value of equity traded, and the shareholder protection index. The table lists the values for all countries included in the analysis in a range of years. The table makes clear that there is a great degree of cross-country and temporal variance in our analysis. We will explain in the following section, why we think that insider labor is an important explanation of this variation.

[Table 1]

The above table summarizes how our measures for the dependent variable have changed since the early 1980s. International equity issuance, equity market capitalization and the value of equity traded have substantially increased their share of GDP in each of the countries in our database, suggesting an overall trend towards more outsider-oriented corporate governance practices at the level of the firm. These increases have been apparent in both liberal market economies and coordinated market economies. However, as the latter have generally started from a much lower base, the percentage increases in many cases have been significantly higher.

International equity issuance is a more volatile series than equity share and value traded, due to the more "lumpy" nature of

primary (rather than secondary) market transactions. In fact, in the early 1980s, there was very little international equity issuance being undertaken in many countries. All three series also reflect the impact of a strong upswing in equity market valuations, issuance and trading at the end of the 1990s—the so-called "technology bubble" - which ended with a significant downturn in equity markets in 2000. However, by 2003/2004 the measures had, in many countries, started to increase again, although remaining below the cyclical peaks attained in 1999/2000.

Our regulatory measure of corporate governance change has exhibited less change over the period for which we have data. However, the overall trend is, once again, in favor of greater minority shareholder protections in most countries. One country in which significant change has been recorded by our regulatory measure is Italy. Italy has reformed its outsider-hostile regulatory framework into a system offering similar levels of minority protections as available to shareholders in liberal market economies. However, Belgium, Netherlands, Denmark and Switzerland still appear to offer a poor level of protection to outsider shareholders, at least as of 2002.

Regardless of the extent of change of individual series, the level of all of the measures reveals the tendency of liberal market economies (UK, US, Ireland, Canada, Australia, New Zealand) to exhibit a stronger outsider-orientation, whilst the coordinated market and Mediterranean economies exhibit a weaker outsider-orientation. The main exceptions to this pattern arise from equity market data relating to the Netherlands, Luxembourg and Switzerland. The latter two countries are offshore banking centres, and therefore benefit from "artificially" high inflows into their domestic capital markets from foreign capital. Netherlands—in contrast to other coordinated market economies—has a developed a significant privately-funded pensions sector, which has caused its equity market to develop significantly relative to its domestic economy.

# III. THE ARGUMENT: INSIDER LABOR AND INSIDER CAPITAL

## A. WHAT IS INSIDER LABOR?

The traditional conception of social democracy rests on the assumption that there is a connection between Left government and labor as a whole. In other work, however, Rueda (2005, 2006 and 2007) has argued that labor is divided into two segments: those with secure employment (insiders) and those without (outsiders). Since the early 1970s, insiders have become insulated from unemployment. Not only do they enjoy high levels of protection, they also benefit from the fact that outsiders act as a buffer bearing the brunt of fluctuations in the business cycle.

The starting point for our analysis is that the interests of labor market insiders and outsiders are fundamentally different and, in some circumstances, contradictory. In terms of labor market protection, insiders care about their own job security while outsiders care about unemployment and job precariousness much more than about the employment protection of insiders.

The division between insiders and outsiders, therefore, is essentially related to the unemployment vulnerability of different actors in the labor market. Insiders are workers with highly protected jobs. Factors like the nature of employment protection legislation, a company's firing and job search costs, insiders' production process skills and attained levels of company investment, and the behavior of unions contribute to the level of protection that characterizes "insiderness." Insiders are sufficiently protected by the level of security in their jobs not to feel significantly threatened by increases in unemployment. Outsiders, on the other hand, are either unemployed or hold jobs characterized by low levels of protection and employment rights, lower salaries, and precarious levels of benefits and social security

regulations. The unemployed, the involuntary fixed-term employed and the involuntary part-time employed are outsiders.[1]

The differences in the interests of insiders and outsiders have dramatic consequences for the preferences of both groups regarding corporate governance. In this paper's framework, there are two dimensions in which labor insiders and outsiders diverge: the levels protection of labor insiders and the openness of the corporate governance system. Outsiders are not benefited by high job insider labor protection since it represents a shelter for insiders from competition from outsiders. In their role as consumers, outsiders are also not benefited by the limitation in competition represented by a blockholder-centered corporate governance system. Labor outsiders, therefore, do support competition in the labor market and in the corporate governance system. Insiders, on the other hand, are obviously benefited from high job protection limiting the competition from outsiders. They are also in favor of a blockholder-centered corporate governance system since, as we will make clear below, it represents a system in which both insider labor and insider capital mutually benefit from limiting competition.

## B. WHAT IS INSIDER CAPITAL?

The distinction between insider and outsider capital is relatively well established in the corporate governance literature (Franks and Mayer 1995; Hellwig 2000; Pagano and Volpin 2001). Insider capital is a category of owner that seeks to establish a significant degree of direct control over the management of individual public companies, normally through ownership of a large proportion of the company's equity capital. Unlike in a company with a diversified ownership base, such an ownership strategy reduces the

[1] See Rueda (2007: chapter 2), for a more detailed explanation of the differences between insiders and outsiders.

scope for a separation of the functions of ownership and control. In such circumstances, both management and the dominant blockholder can be viewed as company "insiders" in the sense that they are able to exert direct control over the company's assets and activities.

A public company whose ownership is dominated by insider capital occupies, in effect, an intermediate position between a private company and a public company with diffuse ownership. In the former case, the owner (for example, the founding entrepreneur) often enjoys full control of the company through ownership of a large proportion of the company's equity. However, the lack of a public listing restricts access to external capital. In the case of a public company with diffuse ownership, a stockmarket listing facilitates access to external equity financing from capital markets, however there are no longer control rights enjoyed by any single investor (Hellwig 2000).

By securing control rights over a public company, therefore, insider capital seeks to achieve the best of both the private and public corporate worlds: access to the increased financing opportunities associated with a public listing, and retention of the control rights typically enjoyed by the owners of private companies (Hellwig 2000: 101). Such an ownership structure has been characteristic of many public companies in the post-war corporate sectors of coordinated market economies, particularly in continental Europe (Becht and Mayer 2001).

In contrast, outsider capital describes those owners with relatively small equity participations in individual companies. Such minority shareholders tend to be passive holders of a company's stock. Their ownership participation is focused on financial returns - through receipt of dividends and an increased share price. Outsider capital does not generally seek to influence company performance directly, e.g. by exerting pressure on company management. In the case of management underperformance, their main sanction is to sell the

shares, i.e. to exercise a policy of "exit" rather than "voice" (Hirschman 1970). Such an ownership policy has been typical of institutional investors—such as pension funds, mutual funds and insurance companies—which are the predominant class of investors in Liberal Market Economies.

In order to acquire control rights, it is necessary for insider-oriented investors to take substantial positions in the equity securities of individual companies. Although equity participation in excess of 50% of the votable stock ensures control, it is often possible to achieve effective control with significantly smaller blockholdings, e.g. 15-20% or less. This might be possible if the blockholder is able to coordinate the voting activities of smaller shareholders. Alternatively, the firm may permit issuance of different classes of share, some of which may provide multiple votes at company general meetings. Owners of the latter category of share may, therefore, be able to attain control whist owning only a relatively small proportion of the total equity capital.

Smaller blockholdings may also be sufficient for effective control due to the collective action problem faced by minority shareholders, who may not be able to mobilize and coordinate the support of their fellow minority shareholders against the wishes of a large blockholder. This is likely to be a particular problem if the ownership stakes of individual minority shareholders are low, e.g. below 1% of a firm's total market capitalization, as is typical of an institutional investor in a Liberal Market Economy.

The portfolio diversification strategy of an outsider-oriented investor is fundamentally different to that of insider capital. Outsider investors seek to avoid the high levels of concentration risk that arise from taking large positions in individual firms. By investing in the equity of a large number of companies, outsider capital seeks to benefit from the diversification benefits identified by modern portfolio theory (Markowitz 1952). However, the price that is paid for such a diffuse ownership strategy is an inability to

exert direct control over the management of individual companies. Unless explicit legal or regulatory safeguards exist to safeguard their interests (described in the literature as quality corporate law or minority shareholder protection), minority shareholders' main channel of influence over company management is via the effect of aggregate buying and selling decisions on the company share price, which plays a role in determining the vulnerability of the firm to hostile takeover bids (Manne 1965), and the access of the firm to external financing from equity capital markets.

The cleavage between insider and outsider capital is defined here in terms of ownership strategy rather than institutional form. However, within the major industrialized democracies it is possible to identify categories of organization that are frequently associated with insider or outsider investment strategies. For example, an insider capital strategy is generally employed by pyramidal business groups, which are ubiquitous players in the corporate sectors of many countries (Morck and Steier 2005; La Porta et al 1999). In such a structure an apex shareholder (often a wealthy family) directly controls a single company (which may or may not be publicly listed), which in turn controls large blockholdings in other companies. A complex web of cross-shareholdings may exist across the corporate sector, although ultimate control may ultimately reside with an opaque group of elite actors.

Blockholding has also been pursued in many post-war coordinated market economies by industrial corporations (through cross-shareholdings in other corporations), universal banks (particularly in Germany and Japan), family networks (e.g. the Wallenberg family empire in Sweden), the state (e.g. via nationalization or public investment in "strategic" industries), and a complex mixture of each of these institutional types. In contrast, outsider capital behavior is characteristic of institutional investors, such as pension funds, insurance companies, mutual funds and hedge funds, which dominate the ownership structure of liberal market economies.

Acquiring direct hierarchical control of management is one way of mitigating potential principal-agent problems between owners and managers (Stiglitz 1985; Allen and Gale 2000). Rather than relying on incentives provided by capital market signals, owners can control more directly the extent to which managers are administering the firm in their interests. In particular, the information asymmetries that plague principal-agent relationships (Jensen and Meckling 1976), e.g. concerning the firm's technology, business environment or earning's prospects, can be minimized without recourse to a complex institutional framework of financial contracting vis-à-vis external shareholders. However, once they have acquired control, there will remain little incentive for insider capital to support the introduction of corporate governance safeguards for minority shareholders, e.g. strong non-executive boards, financial reporting requirements, laws to secure the voting rights of minorities, etc. The potential agency costs generated by a weak corporate governance framework are no longer something to which they are exposed (Rajan and Zingales 2003).

Indeed, in the absence of regulatory safeguards, blockholders may seek to exploit their position of control to expropriate resources from minority shareholders via a variety of mechanisms. These could take the form of directing management to favor chosen suppliers, choosing management based on non-meritocratic or dynastic considerations, or requiring management to pursue a business strategy based on personal objectives rather than profit or value maximization. At worst, control rights may facilitate the blockholder's ability to undertake outright theft of the company's assets, or to indulge in insider trading. Each of these (and many other) forms of self-dealing may ultimately result in insiders benefiting disproportionately from their investment in a firm—either in financial or non-financial terms - in relation to minority shareholders.

In a similar way to the position enjoyed by insider labor, insider capital is ultimately representative of incumbent ownership interests in a political economy. A major concern of any incumbent is likely to be its ability to sustain that position of incumbency against potential competition (Morck and Steier 2005: 40). Incumbents are unlikely to take a positive view of any policy—such as law and regulation safeguarding the rights of minority shareholders—that reduces the barriers to entry faced by non-incumbents, and thereby increases the competitive pressure on their enterprises. Such a perspective is also likely to color their attitude towards the development of capital markets. Whereas insider capital has already sunk the capital to finance its existing operations, and may be able to finance incremental investment from retained earnings or insider networks, capital markets offer the potential for non-incumbents to raise funds, and subsequently threaten the position of existing players. In short, insider capital may not only view corporate governance reform and the encouragement of capital markets as unnecessary for its ownership strategy, but also as a threat to its position of incumbency in the domestic corporate sector (Rajan and Zingales 2003).

A second major difference between the preferences of insider capital and outsider capital relates to the way in which they may operate as political actors. The ownership of control rights in corporations of strategic national importance by a relatively small number of influential investors may facilitate their ability to exercise influence over the political process. As Mancur Olson has argued, interest groups that can organize themselves—for example, due to their relatively small size and commonality of interest—will have a greater chance of becoming significant political actors than diffusely organized interests, and will bargain with other organized interest groups at the expense of those interests that are not able to organize themselves (Olson 1982: 37). As a small and cohesive group of elite actors, insider capital is potentially able to acquire political leverage that can be used to protect its incumbent position

and block the lobbying demands of minority shareholders for law and regulation to protect their interests relative to blockholders.

In contrast, individual minority shareholders may find it more difficult to achieve a similar level of direct political influence. The low level of their investment positions in individual companies will not accord them the status of major strategic players in a domestic political economy. Furthermore, their lack of long-term commitment to individual companies and, more generally, to national economies is not conducive to a high level of domestic political legitimacy.

Within individual political economies, outsider capital tends to be composed of a larger number of individual investors, with a wide diversity of styles and strategies. Furthermore, many are non-domestic investment institutions, which have no interest in political involvement in foreign contexts. Just as they are faced with a collective action problem in exerting control over individual companies, outsider investors face similar difficulties in unifying their interests for the purpose of political lobbying. Their main influence over the political process is likely to result from their aggregate investment decisions—transmitted via the price signaling mechanisms of capital markets. The ultimate impact of such market signals on political outcomes may well be significant. However, it will be difficult for outsider capital to operate as a cohesive political actor capable of determining corporate governance outcomes through participation in domestic distributional coalitions with other organized social actors.

## C. THE RELATIONSHIP BETWEEN INSIDER LABOR AND INSIDER CAPITAL.

Our argument is driven by the preferences of four social actors: insider labor, outsider labor, insider capital and outsider capital. As suggested above, insider labor and outsider labor are assumed to have opposing preferences in respect of the labor market. Insider

labor favors policies and practices that provide a high level job security and favorable conditions of employment for its own constituents, i.e. those employees already in secure and well-paid jobs. Outsider labor favors a competitive labor market, offering a level playing field for all types of employee.

Analogously, insider capital and outsider capital have opposing preferences in terms of capital markets and corporate governance. Insider capital wishes to discourage the entry of new competitors into domestic product markets, and therefore opposes liberalization of capital markets and the enhancement of minority shareholder protections. In contrast, outsider capital wishes to participate in domestic product markets on equal terms with insider capital, and therefore favors measures that encourage new market entrants, such as the development of capital markets and the protection of minority shareholders.

The preferences of capital and labor actors overlap in respect of product market competition. Both insider capital and insider labor would like to see limitations on the competitiveness of domestic product markets, resulting in the generation of product market rents. Insider capital benefits from these rents directly.[2] However, insider labor also benefits from these rents through higher wages and improved job security, which are offered to them by insider capital. Consequently, both insider actors benefit from the rents generated through the uncompetitiveness of domestic product markets.

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[2] The are also political benefits for insider capital in its alliance with insider labor. The main objective of insider capital is the retention of a position of corporate sector incumbency. However, it is by no means obvious that a corporate framework favoring the interests of existing corporate elites is likely to command political support. A political coalition with insider labor offers insider capital a more realistic chance of retaining its incumbency.

The losers in this process are both types of outsider actor. Outsider labor, as a consumer, has to pay higher prices in uncompetitive domestic product markets.[3] However, unlike insider labor, it does not receive any benefit from these higher prices in the form of improved conditions of employment and better job security. Outsider capital is also a loser. It is unable to gain access to domestic product markets. And it runs the risk of expropriation of its capital in cases where it co-invests in a blockholder-controlled firm in a political economy lacking minority shareholder protections, as indicated in the previous section.

In short, an insider-dominated economy provides a means of extracting rents from outsider actors, and passing the benefit of these rents to insider actors, both in the form of financial rewards and improved employment conditions. This was the situation prevailing in the 'golden age of social democracy' and beyond. Up to the 1980s, many European economies were characterized by a system whose primary purpose was to benefit insiders at the expense of outsiders via the mechanisms described above. We will show below, however, that insider labor has seen its power decline in recent years in most of these countries. What are the implications for our argument when insider labor experiences a reduction in its strength?

The main consequences of a decline in insider labor power derive from the fact that outsider labor has different preferences vis-à-vis product market competition. It objects to paying the higher product market prices that generate the rents for insider labor and insider capital. It seeks to eliminate these rents by promoting a greater degree of product market competition.[4] One means by which this

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[3] This is the situation described by Rogowski and Kayser (2002) as a "producer orientation".
[4] To use Rogowski and Kayser's terminology once again, it seeks to move from a "producer" to a "consumer" orientation (Rogowski and Kayser 2002).

can be achieved is via the liberalization of capital markets and corporate governance reform, thereby encouraging the entry into domestic product markets of non-incumbent capital, i.e. outsider capital.[5]

Consequently, the weakening of insider labor (and, consequently, the parallel strengthening of outsider labor) will cause corporate governance change as a result of two mechanisms. Firstly, a less insider-oriented labor sector will push for a liberalization of corporate governance and capital market regulation, in order to promote the entry of more competitors into domestic product markets. Secondly, insider capital will recognize that its ability to secure high rents is less secure. At some point, the discounted value of its future rental stream will no longer compensate it for the high level of its concentration risk. Consequently, it will increasingly focus on ways it can diversify out of its existing concentrated positions at the highest possible price. The main means of achieving this will be to adopt corporate governance practices (and promote regulatory changes) that are favorable to outsider investors. In other words, the preferences of insider capital vis-à-vis capital markets and corporate governance will experience a major shift in an outsider direction as insider labor strength diminishes.

In summary, a corporate governance regime that acts as a barrier to entry to outsider capital involvement– due to a lack of protections for minority shareholders—is likely to be reflective of a distributional coalition between insider labor and insider capital. We would expect there to be a high level of correlation between measures of the strength of insider labor and a corporate governance outcome that is unfavorable to minority shareholders. However, if the strength of insider labor declines, we would expect

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[5] It is important to point out that there is no basis for a partnership between outsider labor and insider capital, as outsider labor is the ultimate source of insider rents.

this to be associated with an improvement in the investment environment for minority shareholders, as measured both by the actual behavior of company management and the legal and regulatory regime.

## IV. RELATING OUR ARGUMENT TO THE EXISTING LITERATURE.

A number of theoretical approaches have been utilized to explain comparative patterns of corporate governance, and why they may be subject to change. Most of the explicit theorizing in this area has taken place since the mid-1990s, following the publication of a number of studies highlighting the extent of variation in corporate governance practices across a range of developed and emerging economies (Franks and Mayer 1990, 1997; Claessens et al 1998; La Porta et al 1999; Barca and Becht 2001; Faccio and Lang 2002). However, an earlier starting point for an explanation of corporate governance is the neoclassical economic theory of the firm.

The fundamental insight of neoclassical economic theory is that the *raison d'être* of the firm as an organizational entity is the enhancement of efficiency through the reduction of transaction costs (Coase 1937; Williamson 1975; Grossman and Hart 1980). This suggests that efficiency considerations should guide all aspects of a firm's organizational structure, including its corporate governance arrangements. This type of argument has led some commentators to predict a convergence in national corporate governance regimes. Companies that do not adopt the most efficient corporate governance practices—in terms of reducing agency costs—will find themselves at a competitive disadvantage. Given the intensity of global competition, such firms are likely to either disappear or adjust their strategy so as to converge on best practice (Alchian 1950; Stigler 1958; Hayek 1967; Hansmann and Kraakmann 2000). In particular, firms that adopt outsider- oriented corporate governance practices will acquire easier and cheaper access to external funding, given the "weight of money" in the hands of

outsider-oriented institutional investors in global capital markets (Hall and Soskice 2001; Lazonick and O'Sullivan 2000; Juergens et al 2000; Shinn 2000, 2001).

A related argument is that the firm is engaged in an evolutionary process matching the increasing complexity of the overall economic environment (Chandler 1990). The culmination of this development is a situation in which meritocratically-selected professional managers exert control over the largest public companies, and the amateurish meddling of family or elite capitalist interests is eliminated. The model of corporate governance that supports this development is one of diffuse ownership and minority shareholder protection, i.e. an outsider system of corporate governance, equivalent to that prevailing in the Liberal Market Economies, which frees managers from the direct hierarchical control of owners. Once again, if firms do not conform to this pattern, they are likely to become inefficient and ultimately disappear.

A second strand in the economics literature has suggested factors that might work against the adoption of identical corporate governance practices. Firms differ in terms of their technology, scale and scope of activities, and in terms of the size of market in which they operate. Some activities are more opaque to external investors than others (e.g. the activities of a technology company versus a natural resources company). The way in which firms seek to minimize agency costs may therefore depend on the specific nature of their economic activities. Different types of corporate governance arrangements may need to be employed by different firms in order to reassure external investors that agency costs are indeed being minimized. This could result in significant firm-level or sectoral variation in corporate governance outcomes (Gourevitch and Shinn 2005: 36; Burkhart et al 1997; Carlin and Mayer 2003).

Although influential in the popular discourse on corporate governance, each of the above arguments has difficulty in accounting for observable patterns of comparative corporate

governance. National corporate governance diversity has endured despite the increased involvement of foreign investors in domestic equity markets and the lower funding costs obtainable through the adoption of minority shareholder-oriented governance practices (Gourevitch and Shinn 2005: 105; Gompers at al 2001). Furthermore, corporate governance continues to exhibit greatest variance at the national level, not at the level of the firm or sector of activity (Stulz 2005; La Porta et al 1998), and corporate governance regimes appear only loosely related to the level of a country's economic development (Rajan and Zingales 2003; Roe 2003; Morck and Steier 2005). The market incentives favoring outsider corporate governance do not, therefore, appear sufficient to overcome the potency of nationally-based explanatory variables—such as the strength of insider labor—which we argue remain the most influential determinants of comparative outcomes.

An alternative approach to corporate governance has been developed by legal scholars, following seminal articles by La Porta et al (1997, 1998). Three propositions emerge from this literature, each of which may be evaluated separately. The first is that the legal and regulatory environment is an essential determinant of corporate governance outcomes (this contrasts with an implicit assumption of the economic theory of the firm: that corporate governance outcomes will be determined by the private behavior of independent economic agents). The "law matters" perspective asserts that law is required to shape the incentives of rational actors, and thereby determine the nature of firm-level corporate governance behavior (Schliefer and Wolfenzon 2002).

The empirical evidence regarding this assertion is mixed. A number of countries—such as the UK and Canada—have historically developed a minority shareholder-oriented governance regime in the absence of significant legal or regulatory incentives. The legal protections for minority shareholders identified as crucial for corporate governance by La Porta et al have only been introduced into developed economies in the relatively recent past

(Franks et al 2004; Morck et al 2004). Furthermore, there are several prominent examples of countries that possess significant legal protections for minority shareholders, and yet continue to be dominated by blockholders (Roe 2003: 7). Our analytical framework takes an agnostic position on this issue. We utilize both regulatory and behavioral measures of corporate governance as proxies for our dependent variable, implying both a recognition of the importance of the regulatory framework and a need to evaluate the direct impact of our explanatory variables on actual corporate governance outcomes.

A second proposition from the legal literature is that corporate governance outcomes are primarily determined by a specific kind of law and regulation: namely, the corporate and securities law directly relating to minority shareholder protections. Although general tort law, for example, provides an underlying framework for the enforcement of contracts, it is arguably insufficient to determine the nature of a corporate governance regime. Equally, law or regulation which is not directly focused on corporate governance, e.g. labor law, competition law, etc, will not be instrumental in driving firm-level corporate governance behavior (La Porta et al 1998).

This narrow focus on corporate and securities law is criticized by Gourevitch and Shinn (2005), who point to the empirical value of considering the impact of a wider range of law and regulation in determining corporate governance outcomes. In particular, they argue that all laws affecting the overall "degree of coordination" of an economy are of relevance. This includes laws relating to the labor market, competition policy, training and education, the regulation of financial institutions, pension legislation, etc. Such an outlook draws on Hall and Soskice's (2001) view that corporate governance will be structured to be "complementary" with the other component part of a political economy. Our theoretical claims are compatible with these two perspectives (we accept that laws and regulations both specific and beyond corporate and securities

law are relevant to corporate governance outcomes), but we emphasize the influence of a more political factor: the strength of insider labor.

Perhaps the most controversial component of the "law matters" approach to corporate governance is the hypothesis that legal origin is the key determinant of corporate and securities law orientation. According to this argument, a key distinction exists between countries that have developed on the basis of common law, and those inheriting a civil law tradition. Common law systems are characterized by judicial independence, the importance of precedent and less emphasis on codification relative to civil law systems. In contrast, the civil law tradition has given rise to a more centralized legal system, with insistence on codification, and consequently a greater potential scope for state-driven political influence (Rajan and Zingales 1999).

Although La Porta et al (1998: 1147) present cross-sectional evidence linking a country's legal family and its corporate governance (measured as ownership concentration), their analysis is highly dependent on the historical period chosen (the mid-1990s). The significant historical variation of corporate governance outcomes over the last century casts doubt on the validity of a explanatory variable such as legal origin which is time invariant (Rajan and Zingales 2003; Gourevitch and Shinn 2005). We argue that this paper's explanation of corporate governance is in a better position to explain corporate governance change due to its observable variation over time.

The explanation of corporate governance outcomes in terms of political alliances between social actors has been explored by a number of scholars (Cyert and March 1963; Aoki 1986; Jackson et al 2004; Gourevitch and Shinn 2005). Gourevitch and Shinn (2005), for example, utilize a framework with three social actors—investors, employees and management—and consider the corporate governance outcomes of six possible coalitions between these

actors. Their contention is that a "corporatist compromise"—between employees and management—best describes the coalition that has driven corporate governance outcomes in post-war continental Europe, while a co-called "investor model"—between owners and management - is the political alliance that has prevailed in the UK and US.

Our theoretical framework shares with Gourevitch and Shinn the perspective that some kind of social partnership between capital and labor has driven corporate governance outcomes in coordinated market economies. However, as Gourevitch and Shinn themselves recognize, their chosen classes of social actor — management, employees and investors—may be too broad to offer significant explanatory power. Although they subsequently identify the distinction between insider and outsider capital as relevant for corporate governance outcomes, our analysis highlights the importance of recognizing an equivalent insider-outsider cleavage in labor.

Several frameworks have been proposed linking political institutions to corporate governance. Using Lijphart's (1999) typology of political institutions, several writers have noted a correlation between majoritarian institutions and minority shareholder-oriented corporate governance outcomes, and between consensus political institutions and blockholder outcomes (Gourevitch et al 2003; Pagano and Volpin 2005). According to Gourevitch and Shinn (2005), consensus political institutions and insider corporate governance are complementary components of a political economy which seeks to promote credible commitments amongst economic actors and a willingness to invest in specific assets. Majoritarian institutions engender more uncertainty in terms of policy formation, and therefore necessitate more flexible corporate behavior. Such adaptability is complementary with more outsider-oriented corporate governance, which encourages management to constantly adapt in response to changing market signals.

Pagano and Volpin (2005) make a similar link between political institutions and corporate governance via a formal median voter model. According to their argument, a PR electoral system tends to increase the probability of coalition government. This leads to an increase in the focus of government policy on the preferences of homogeneous political groupings, which they assume are social actors favoring weak protections for minority shareholders. In contrast, their framework suggests that majoritarian systems will emphasize the importance of pivotal groups that are less politically aligned, which they assume are actors supporting minority shareholders (Pagano and Volpin 2005, p.1006). Perotti and von Thadden (2001) also present a median voter model, which determines outcomes in terms of alliances between shareholders, employees and creditors.

The difficulty of utilizing political institutions to explaining corporate governance outcomes is similar to that relating to the legal origin argument: the largely static nature of the explanatory variable (although there have been some limited recent examples of significant electoral system change; Norris 2004). Consequently, we once again emphasize the significance of our proposed model as an explanation of temporal, as well as cross-national, corporate governance changes.

The idea of financial openness driving the capital market orientation of the financial system—and by implication the outsider nature of corporate governance—is explored by Rajan and Zingales (2003). In a similar manner to this paper's analysis, they argue that incumbent blockholders will oppose an equity-oriented financial system because the latter increases the competitiveness of the business environment. Capital markets offer a source of financing to new entrants, which could lead to an erosion of the "positional rents" of incumbents. However, the increased openness of the economy—either in terms of trade or capital flows—serves to increase the competitiveness of the economy independently of changes to the financial system. In such circumstances, incumbents

are more willing to accept reform of the financial system, i.e. a shift to a financial system based on capital markets, as they have less to lose from such a change (Rajan and Zingales 2003: 7). The likely concomitant of such a shift will be a willingness to accept corporate governance reform in favor of minority shareholders.

As the authors themselves acknowledge, a potential criticism of this argument is its endogeneity. Why would incumbents agree to greater openness in the first place if the result was deterioration in their competitive position (Gourevitch 1986; Rogowski 1989; O'Rourke and Williamson 1999)? Rajan and Zingales argue that many countries have no choice but to open-up; they are small and are located close to other countries, and they seek to test this by showing that country size is significant as an instrument for openness in their regressions on financial development. They also argue that - if openness is associated with greater overall prosperity - countries will not wish to fall behind their neighbors who are benefiting from such prosperity, and will therefore be driven to open-up. Nonetheless, the danger remains that openness and financial market outsiderness are endogenous variables whose correlation is primarily reflective of their mutual dependence on a third explanatory variable. Our argument is that this additional variable is the strength of insider labor. It should also be noted that Deeg and Perez (2000) find no correlation between the introduction of capital mobility changes in Spain, France, Italy and Germany, and the advent of financial sector and corporate governance reform (Deeg and Perez 2000: 142).

The role of labor in driving corporate governance outcomes has been highlighted in the work of Mark Roe (1994, 2003). However, in contrast to our theoretical perspective, Roe's argument is not based on a social partnership between employees and owners. Roe argues that incumbent capital is forced to take concentrated ownership stakes in order to counter the political power of labor (which the latter manifests through its ability to deliver Left governments). As blockholders they can exert direct hierarchical control over

management to counter the strength of labor. In contrast, minority shareholders cannot exert this type of direct control over management. They are faced with agency costs spiraling out of control as management will be more influenced by the wishes of employees (operating through the intervention of left government) than minority shareholders. Consequently Left labor power is associated with blockholding, and labor weakness with a shareholder model of corporate governance.

In a recent paper Cioffi and Höpner (2006) claim—based on qualitative case studies relating to France, Germany, Italy and the US - that recent shifts towards a minority-shareholder orientation have primarily been promoted by centre-left parties, contrary to what would be expected according to Roe's explanatory framework. Cioffi and Höpner's rationalization of this policy stance is that partisan opponents on the centre-right are too enmeshed with the interests of existing managerial elites, and are therefore unwilling to support regulatory change favoring minority shareholders. In contrast, political entrepreneurs on the Left see corporate governance reform as an opportunity to undermine capitalist incumbents, and also present a modernist image that reaches out beyond core constituents. This leads centre-left parties—ironically –to adopt a more neo-liberal policy stance in corporate governance than that adopted by the centre-right.

Our own theoretical claims differ from both of these competing perspectives. Unlike Roe, our argument is cast in terms of the relative strength of a particular cleavage of labor rather than the absolute strength of labor as a whole.[6] According to Roe's approach, if labor in general is strong, the result will be a greater orientation to Left government and policies favoring a blockholding corporate governance outcome. However, our

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[6] Rueda (2005, 2006 and 2007) convincingly argues that identifying Left government (or Social Democracy) with labor as a whole is a mistake.

argument is centered on the position of a particular labor actor that in practice represents a limited proportion of the labor force. We argue that it is the strength of this sub-group—rather than labor in general—that is key to determining corporate governance outcomes.

Secondly, our analytical framework emphasizes—in contrast to Roe—the role of a social partnership between labor and capital in determining corporate governance outcomes in coordinated market economies. We disagree with the notion that insider capital is in a position to counter labor in a political economy in which labor is a dominant actor. If incumbent capitalist are dominant over the behavior of companies (which, according to Roe, is the main purpose of blockholding), it seems likely that there will be significant collaboration from labor-dominated Left governments. The fact that incumbent capitalists interests are permitted to retain their key role in corporate governance in political systems characterized by strong Left labor is suggestive of the existence of some kind of social partnership or *quid pro quo*.

## V. THE ANALYSIS: VARIABLES AND METHODOLOGY.

We test our hypotheses with data for a maximum of 18 OECD countries between 1976 and 2004.[7] The countries included in the sample are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the UK and the US.

We measure the power of insider labor with three different variables: employment protection, wage growth in manufacturing and hours worked in manufacturing. The justification for these

[7] The availability of the data limits our analysis to fewer observations in some regressions, see details below.

variables is pretty straightforward. High levels of employment protection insulate insiders from unemployment vulnerability and competition from insiders. Employment protection is, in fact, an essential part of the definition of "insiderness." We therefore expect employment protection to be a reflection of insider power and to determine changes in corporate governance. We also argue that the power of insider labor is captured by higher wage growth and lower working hours in manufacturing. When insiders are significant in an economy, we expect them to dominate the manufacturing sector (it would be more complicated to make this argument about the service sector, for example). The power of insider labor should therefore be correlated with better working conditions, both in terms of wages and working hours. Our argument is based on the existence of a partnership between insider labor and insider capital. We explained above that this partnership relies on extracting rents from outsiders. We hypothesize that these rents are reflected in higher wages and lower working hours for insiders in the manufacturing sector.

A number of different options exist for measuring the levels of employment protection in OECD countries. For the analysis in this paper, we will use a variable provided in Baker, Glyn, Howell, and Schmitt (2004). The data were created by joining together several series: an original one from Lazear (1990), an update using OECD data from Blanchard and Wolfers (2000), and a further update and interpolation from Nickell and Nunziata (2000).[8] The variable ranges from 0 to 2, where higher values mean stricter employment

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[8] It is important to note that the OECD data, used from 1985 onward, is constructed on the basis of a more extensive collection of employment protection dimensions. Lazear's index measures the severance pay and advance notice a blue-collar worker with ten years of service receives upon termination without cause. The OECD index is constructed by averaging the scores obtained by each country in three categories: "procedural inconveniences which the employer faces when trying to dismiss employees; notice and severance pay provisions; and prevailing standards of and penalties for unfair dismissal" (OECD 1999: 54).

protection. We measure growth in manufacturing wages as the percentage annual change in the hourly compensation costs for production workers in manufacturing (in US$).[9] Finally, we use a variable capturing the hours worked in manufacturing as the average per week.[10]

[Table 2]

Table 2 provides some summary statistics for our explanatory variables. The table presents the means, standard deviations, minimum and maximum values for our four measures of insider labor power. The table makes clear that there is great degree of both cross-national and temporal diversity in these variables.

The previous section has made clear our expectations regarding the effects of insider labor on corporate governance. There are, however, a number of additional variables that we want to control for in our analysis. These are factors that we do not have explicit theoretical expectations about, but that a number of authors in the comparative political economy literature have suggested should corporate governance.

To take account of the possible impact of economic factors on corporate governance, three commonly utilized "economic" variables are included in our analysis: the rate of GDP growth, the level of GDP per capita and the rate of consumer price inflation. In most studies of corporate governance, GDP growth is considered as a dependent variable to be explained by corporate governance (Carlin and Mayer 2000, 2003). However, inclusion of GDP growth as a control provides a means of testing the claim that corporate governance is driven by efficiency or economic performance considerations. Such a theory suggests some kind of a link between

[9] Source: US Bureau of Labor Statistics.
[10] Source: ILO LABORSTA.

a superior economic performance and the adoption of minority shareholder-oriented corporate governance. Inclusion of GDP per capita is a way of testing the idea that higher levels of economic development are associated with a greater minority shareholder orientation.

The rate of consumer price inflation has not been explicitly linked to corporate governance by the economics literature. However, it is included here due to its potential impact on several of the proxies that are being utilized for the dependent variable, such as the relative size and turnover of equity markets. In particular, the rate of inflation provides a way of controlling for the effect of cyclical factors that may exert a short-term effect on equity market valuation and issuance, but which are independent of the state of corporate governance. Interest rates would provide an alternative means of controlling for these cyclical effects; however, they are likely to be highly correlated with inflation, and are therefore not included as well.

Our regressions attempt to control for the possible effects of the legal origin argument through the inclusion of dummy variables that highlight the common law, Germanic or Scandinavian legal origins of a country's legal system. The default option—if a country is coded as a zero for each of these three dummy variable categories—is a French civil law legal tradition.

We include a binary control variable in our regressions to allow for the proportional or majoritarian nature of electoral rules. As has been discussed, Rajan and Zingales (2003) argue that corporate governance may be related to country size. Consequently, population is also included as a control variable in our regressions, to allow for the possibility that smaller countries may experience greater pressure to favor the interests of minority shareholders. This also controls for the possible effects of demographics as an explanatory variable, which has been suggested by some commentators (O'Sullivan 2000).

Finally, our regressions include left and right partisanship control variables (from Armingeon 2005), which can be used to assess the contrasting claims of Roe (2003) and Cioffi and Hoepner in respect of the corporate governance policy orientation of left government.

The specification adopted in the empirical analysis is as follows:

$$Y_{it} = \beta_0 + \beta_1 Y_{it-1} + \beta_2 X_{1it} + \ldots + \beta_n X_{nit} + \varepsilon_{it}$$

where $\beta_0$ represents a general intercept, $X_1$ to $X_n$ are the explanatory variables, $\beta_1$ to $\beta_n$ are the slopes of the explanatory variables, and $\varepsilon_{it}$ denotes the errors.

We present results for two models. First, we estimate random effects and specifying no heteroscedasticity. The existence of country-specific factors not included in the analysis (country-specific omitted variables) could affect the accurate estimation of our model. Like most analyses in comparative political economy, it is reasonable to assume that there are a number of country-specific effects that cannot be introduced explicitly into our models (specific historical circumstances, difficult to capture institutional developments, etc). To deal with these the variables, we produce a set of estimates with random effects.[11]

We also performed a modified Wald test for heteroscedasticity. This test, however, revealed a significant amount of heteroscedasticity. We therefore present a second set of results with panel-corrected standard errors (PCSEs). Beck and Katz (1995) show that PCSEs are consistent when there is heteroscedasticity.

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[11] An alternative would be to estimate models with fixed effects, but our need to include time-invariant explanatory variables in our analysis makes this impossible. For details on estimating random effects with panel data, see Hsiao (1986).

## VI. RESULTS

The results of our analyses are presented in Tables 3 to 6. In each table we use an alternative measure of corporate governance and different models in each table reflect alternative measures for insider labor power. We present both the random effects (RE) and the PCSE results side by side. We present the estimates for our measure of insider power first and then those for the rest of explanatory variables.

[Tables 3 to 6]

The tables make clear that our two methods to estimate the effects of insider labor power make very little difference to the results. Because of the results of the modified Wald test for panel-specific heteroscedasticity mentioned above, we will refer to the PCSE results in the paragraphs below.

Employment protection emerges as a very significant determinant of corporate governance in Tables 3 to 6. While employment protection is not a significant determinant of international equity issuance (Table 5), it is clearly associated with less equity market capitalization (Table 3), fewer shares traded (Table 4) and lower values in the index of minority shareholder protection (Table 6).[12] It is clear then that higher levels of employment protection for insider labor promote a more blockholder dominated system of corporate governance.

A similar picture emerges when we measure insider labor power as wage growth in the manufacturing sector. While wage growth in

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[12] These results are only present in the models with PCSEs and are not confirmed in those with random effects.

manufacturing is not a significant determinant of the index of minority shareholder protection (Table 6), it is clearly associated with less equity market capitalization (Table 3), fewer shares traded (Table 4) and less international equity issuance (Table 5).[13] As in the previous two cases, this measure of insider labor power promotes a system of corporate governance dominated by insider capital.

The effects of hours worked in manufacturing as very similar to those of wage growth (although, as suggested by our model, in the opposite direction). While hours worked in manufacturing are not a significant determinant of the index of minority shareholder protection (Table 6), they are significantly associated with more equity market capitalization (Table 3), more shares traded (Table 4) and more international equity issuance (Table 5). As insider labor gets weaker (and hours in manufacturing increase), corporate governance becomes more open to minority shareholders.

Turning now to our control variables, the results for the legal origin dummies are mixed. The common law and Scandinavian law dummies are often positive and significant, while the coefficient of the German dummy is often insignificant. We include a dummy variable in our regressions indicating the proportional or majoritarian nature of electoral rules. Our results show a significant negative relationship with our regulatory proxy for corporate governance (confirming Pagano and Volpin's results). With the rest of our corporate governance measures, however, the relationship is rarely significant and it does not retail its negative sign.

Our regression analysis includes a control variable for trade openness—measured by imports plus exports as a share of GDP—and capital openness, which takes the form of a dummy variable

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[13] The lack of significance when analyzing the index of minority shareholder protection may be caused by the fundamentally cross-sectional nature of the dependent variable.

indicating whether capital controls are present or not. Our results suggest that there is a positive and significant relationship between trade openness and our three proxies for actual corporate governance outcomes. However, the relationship is less convincing with respect to our regulatory proxy for corporate governance (although the latter is a much shorter time series). The capital controls dummy does not exhibit much significance in explaining any of our dependent variable proxies. As we do not look at the interaction of trade openness and capital controls, our results are not directly comparable with those of Rajan and Zingales. However, our result is broadly compatible with their theoretical claims, although it is subject to the same endogeneity problem that they identify.

Rajan and Zingales use country size—as measured by population—as an instrument for trade openness in their empirical analysis. Population is also included as a control variable in our regressions, although it is used in addition to trade openness rather than as a substitute. Our results offer no evidence of a significant relationship between population and our regulatory proxy for corporate governance. However, the relationship with our three measures of actual corporate governance behavior is statistically significant in some regressions, and positive in sign, i.e. size of country tends to suggest a more shareholder governance orientation. Once again, this appears to be broadly consistent with Rajan and Zingales results, although our analysis is not entirely comparable.

Our regressions include left and right partisanship control variables (from Armingeon 2005), which can be used to assess the contrasting claims of Roe (2003) and Cioffi and Hoepner (2006) in respect of left government. Our results offer some support for Cioffi and Hopner's claims. The coefficient on the Left government variable is invariably positive, indicating that more left-wing governments are associated with more minority shareholder-oriented corporate governance outcomes over the estimation period. However, the

statistical significance of this result is quite unstable, depending on which corporate governance proxy is used. Contradicting Roe (2003), there is certainly little evidence of a simple negative relationship between left government and blockholding.

## VII. CONCLUSIONS

In this paper, we have explained corporate governance change in terms of the relative strength of a particular cleavage of labor: insider labor. It is the strength of this sub-group—rather than labor in general—that is most relevant for the determination of corporate governance outcomes. Insider labor affects corporate governance via its relationship with a particular type of shareholder actor: blockholders (or insider capital). Similar corporate governance outcomes would not be expected in a system where blockholders did not exist, even if insider labor was a powerful actor. Nor is the power of insider labor necessarily synonymous with Left government, in contrast to the Labor power-Left government axis suggested by Roe (2003).

Our empirical results are also not supportive of a negative relationship between Left partisanship and shareholder-oriented corporate governance. Our data suggests that causation has recently been operating quite differently. Left government appears to be heavily implicated in the shift towards shareholder-oriented corporate governance. However, unlike Cioffi and Höpner (2006), we do not argue that the changed relationship between partisanship and corporate governance is reflective of a *volte face* in the material interests of left or right-wing party political actors. Rather, we believe that partisanship is interacting in a complex manner with changes in the relative strength of insider labor. It is the latter that is the underlying source of recent variation in corporate governance. The precise nature of the interaction of insider labor with partisanship is the subject of a future paper.

## Table 1: Corporate Governance in Industrialized Democracies

| **Australia** | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** | **2002** | **2003** | **2004** |
|---|---|---|---|---|---|---|---|---|---|
| International equity issuance divided by GDP | | 0 | 0.0012879 | 0.0016097 | 0.0092521 | 0.0167799 | 0.0095298 | 0.0105288 | 0.0112474 |
| Equity market capitalization divided by GDP | 0.3129979 | 0.5089837 | 0.3464832 | 0.6578772 | 0.9580936 | 1.012937 | 0.9287608 | 1.120894 | 1.229933 |
| Value of equity traded divided by GDP | 0.0575194 | 0.0906499 | 0.1266434 | 0.2646715 | 0.5816625 | 0.6513509 | 0.7200109 | 0.7080033 | 0.8319433 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 4 | | |
| **Austria** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0012369 | 0.0017011 | 0.0073525 | 0.0010517 | 0.0073003 | 0.0035555 | 0.0175796 |
| Equity market capitalization divided by GDP | 0.0225862 | 0.0686658 | 0.0709762 | 0.1382706 | 0.1572141 | 0.1288925 | 0.1634206 | 0.1462524 | 0.3025632 |
| Value of equity traded divided by GDP | 0.0013212 | 0.0102357 | 0.115092 | 0.1095473 | 0.0492883 | 0.0381245 | 0.0283058 | 0.0427099 | 0.0839626 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 3 | 3 | 3 | | |
| **Belgium** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0012071 | 0 | 0.0007229 | 0.0254057 | 0.0035225 | 0.0065388 | 0.0039749 | 0.0140068 |
| Equity market capitalization divided by GDP | 0.0823125 | 0.2519377 | 0.331931 | 0.3793998 | 0.799319 | 0.730218 | 0.5321929 | 0.573256 | |
| Value of equity traded divided by GDP | 0.0068806 | 0.0226455 | 0.032585 | 0.0551207 | 0.1665078 | 0.1810103 | 0.1381608 | 0.1242248 | |
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 2 | 2 | 2 | | |
| **Canada** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0002852 | 0.0001742 | 0.0030945 | 0.0082657 | 0.0051086 | 0.0073118 | 0.0019848 | 0.0110231 |
| Equity market capitalization divided by GDP | 0.4459516 | 0.4192071 | 0.4213226 | 0.6298015 | 1.178748 | 0.9944102 | 0.7910613 | 1.062704 | 1.201838 |
| Value of equity traded divided by GDP | 0.0925435 | 0.2050711 | 0.187867 | 0.8643542 | 0.8891956 | 0.6549149 | 0.5602022 | 0.5545095 | 0.6686107 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Shareholder protection index (6=highest, 0=lowest) | | | | 5 | 5 | 5 | 5 | | |
| **Denmark** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0007499 | 0.0022193 | 0.0063201 | 0.0018837 | 0.0046415 | 0 | 0.0148122 |
| Equity market capitalization divided by GDP | 0.0788834 | 0.2523008 | 0.2929141 | 0.3119405 | 0.6804575 | 0.5962347 | 0.4452951 | 0.5740818 | 0.6227289 |
| Value of equity traded divided by GDP | 0.0008473 | 0.0212925 | 0.0832709 | 0.1439333 | 0.5786663 | 0.4431857 | 0.2992329 | 0.3161672 | 0.4382986 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 2 | 2 | 2 | | |
| **Finland** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0007301 | 0.0046256 | 0.0366957 | 0.0164984 | 0.0121611 | 0.0012355 | 0.0085746 |
| Equity market capitalization divided by GDP | 0.0412958 | 0.1077114 | 0.1658932 | 0.3402714 | 2.448893 | 1.571104 | 1.055224 | 1.051993 | 0.9848251 |
| Value of equity traded divided by GDP | 0.0069524 | 0.009235 | 0.0287161 | 0.1465222 | 1.723388 | 1.477007 | 1.341264 | 1.009848 | 1.205016 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Shareholder protection index (6=highest, 0=lowest) | | | | 3 | 3 | 3 | 3 | | |
| **France** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0001349 | 0.0009835 | 0.0034743 | 0.0131018 | 0.0121096 | 0.0064861 | 0.008489 | |
| Equity market capitalization divided by GDP | 0.0916096 | 0.1065493 | 0.2576529 | 0.3358822 | 1.095576 | 0.8173499 | 0.5501564 | 0.6769475 | |
| Value of equity traded divided by GDP | 0.0169763 | 0.0197885 | 0.0957995 | 0.2345468 | 0.8203884 | 0.7497817 | 0.5318389 | 0.4970463 | |
| Shareholder protection index (6=highest, 0=lowest) | | | | 3 | 3 | 3 | 4 | | |

**Germany**

| | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** | **2002** | **2003** | **2004** |
|---|---|---|---|---|---|---|---|---|---|
| International equity issuance divided by GDP | | 0.0023278 | 0.0004787 | 0.0024812 | 0.0215476 | 0.0031795 | 0.0027189 | 0.007074 | 0.0061892 |
| Equity market capitalization divided by GDP | 0.0802663 | 0.2673605 | 0.2124487 | 0.23485 | 0.6791735 | 0.5775566 | 0.3454122 | 0.4490031 | 0.4400637 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Value of equity traded divided by GDP | 0.0170697 | 0.1041304 | 0.300242 | 0.2332979 | 0.5716369 | 0.7649995 | 0.6082242 | 0.5442781 | 0.5680395 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 3 | 3 | 3 | | |
| **Greece** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0011894 | 0 | 0.0017842 | 0.0042645 | 0.0097739 | 0.0150984 | 0.0073746 |
| Equity market capitalization divided by GDP | 0.061794 | 0.0186265 | 0.1811281 | 0.1451211 | 0.9887943 | 0.7380803 | 0.5041941 | 0.6192899 | 0.6157374 |
| Value of equity traded divided by GDP | 0.001762 | 0.0004139 | 0.0466737 | 0.0518132 | 0.8484403 | 0.3187789 | 0.1869817 | 0.2241073 | 0.2200569 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 3 | 3 | 3 | 3 | | |
| **Ireland** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0 | 0.0075227 | 0.0126645 | 0.0068174 | 0.0041077 | 0.0026022 | 0.0092613 |
| Equity market capitalization divided by GDP | | 0.1274233 | | 0.3884269 | 0.8641669 | 0.7333388 | 0.492407 | 0.5534154 | 0.6215156 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Value of equity traded divided by GDP | | | | 0.1953945 | 0.1523118 | 0.2194615 | 0.2703167 | 0.2863018 | 0.2480208 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 4 | | |
| **Italy** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0002346 | 0.0000907 | 0.0032812 | 0.0053035 | 0.0053191 | 0.0023605 | 0.0040182 | 0.0107038 |
| Equity market capitalization divided by GDP | 0.056367 | 0.1372483 | 0.1349498 | 0.1909651 | 0.7149137 | 0.4836676 | 0.4021965 | 0.4187399 | 0.4721411 |
| Value of equity traded divided by GDP | 0.0191024 | 0.0323332 | 0.0386128 | 0.0792071 | 0.7242576 | 0.5155395 | 0.455155 | 0.451682 | 0.5820334 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 1 | 5 | 5 | 5 | | |
| **Japan** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0002961 | 0.0000379 | 0.0018331 | 0.0016577 | 0.0006293 | 0.0014648 | 0.0017087 |
| Equity market capitalization divided by GDP | 0.3572602 | 0.7215347 | 0.9598598 | 0.694161 | 0.665229 | 0.5409942 | 0.520908 | 0.6866301 | 0.7694935 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Value of equity traded divided by GDP | 0.1690545 | 0.2897926 | 0.5271546 | 0.2331135 | 0.4878779 | 0.4387484 | 0.3941675 | 0.4954152 | 0.696464 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 5 | | |
| **Luxembourg** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0.0180489 | 0.0055302 | 0.0765171 | 0.0050862 | 0.0094427 | 0.0037741 | 0.0995408 |
| Equity market capitalization divided by GDP | 0.7695358 | 3.189147 | 0.9435971 | 1.683547 | 1.735224 | 1.209646 | 1.159119 | 1.409004 | 1.610108 |
| Value of equity traded divided by GDP | 0.0066412 | 0.0090701 | 0.0078513 | 0.0113368 | 0.0614687 | 0.0219723 | 0.0231819 | 0.0157759 | 0.0206756 |
| Shareholder protection index (6=highest, 0=lowest) | | | | | | | | | |
| **Netherlands** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0022713 | 0.0027141 | 0.0077143 | 0.0685304 | 0.029687 | 0.0157724 | 0.0140762 | 0.0116066 |
| Equity market capitalization divided by GDP | 0.1644742 | 0.4494429 | 0.4065158 | 0.8593768 | 1.727981 | 1.193264 | 0.959401 | | |

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|---|---|---|---|
| Value of equity traded divided by GDP | 0.028623 | 0.1276789 | 0.1363783 | 0.5993201 | 1.827147 | 2.691279 | 1.104824 | 0.9061214 | |
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 2 | 2 | 2 | | |
| **New Zealand** | | | | | | | | | |
| | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** | **2002** | **2003** | **2004** |
| International equity issuance divided by GDP | | 0 | 0 | 0 | 0.0038333 | 0.0076899 | 0.0150177 | 0 | 0.0020063 |
| Equity market capitalization divided by GDP | | 0.3836002 | 0.2025526 | 0.5253467 | 0.3577594 | 0.3417978 | 0.3631249 | 0.4153447 | 0.4386861 |
| Value of equity traded divided by GDP | | 0.040939 | 0.0443163 | 0.1382344 | 0.2066901 | 0.1620266 | 0.1246971 | 0.1317172 | 0.171249 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 4 | | |
| **Norway** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0015709 | 0.0025838 | 0.003379 | 0.0095862 | 0.0235657 | 0.0015735 | 0.0067918 | 0.0151898 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Equity market capitalization divided by GDP | 0.0501206 | 0.1580776 | 0.2250499 | 0.3013164 | 0.389644 | 0.406827 | 0.33657 | 0.434314 | 0.5653397 |
| Value of equity traded divided by GDP | 0.0013198 | 0.0294854 | 0.1205434 | 0.165029 | 0.3602263 | 0.3083163 | 0.2564486 | 0.3168295 | 0.5432885 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 4 | | |
| **Portugal** | | | | | | | | | |
| International equity issuance divided by GDP | | 0 | 0 | 0.0046624 | 0.0178476 | 0 | 0 | 0.0067614 | 0.0071309 |
| Equity market capitalization divided by GDP | 0.0063953 | 0.0077993 | 0.1287533 | 0.1712234 | 0.5700017 | 0.4216764 | 0.3514151 | 0.3940862 | |
| Value of equity traded divided by GDP | 0.000067 | 0.0002031 | 0.0236069 | 0.0394722 | 0.5107617 | 0.2482778 | 0.1667757 | 0.1450246 | |
| Shareholder protection index (6=highest, 0=lowest) | | | | 3 | 4 | 4 | 4 | | |
| **Spain** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0005819 | 0.0003922 | 0.0025677 | 0.014953 | 0.0042764 | 0.0056472 | 0.0026233 | 0.0065561 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Equity market capitalization divided by GDP | 0.0754646 | 0.1137132 | 0.2211763 | 0.3385718 | 0.8975711 | 0.8008968 | 0.7044637 | 0.8659647 | 0.9487927 |
| Value of equity traded divided by GDP | 0.004434 | 0.0196807 | 0.080328 | 0.1023497 | 1.754943 | 1.431067 | 1.547608 | 1.115088 | 1.217498 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 4 | 4 | 4 | 4 | | |
| **Sweden** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0009563 | 0.0012492 | 0.0048355 | 0.0454986 | 0.0100265 | 0.0219846 | 0.0036471 | 0.0155887 |
| Equity market capitalization divided by GDP | 0.09946 | 0.3566432 | 0.3835137 | 0.717457 | 1.370548 | 1.059901 | 0.7429855 | 1.06111 | 1.090813 |
| Value of equity traded divided by GDP | 0.0133678 | 0.1052292 | 0.0694802 | 0.3755418 | 1.628078 | 1.374483 | 0.906429 | 0.8746751 | 1.337213 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 3 | 3 | 3 | 3 | | |
| **Switzerland** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.0140468 | 0.0004241 | 0.002859 | 0.0410168 | 0.0279397 | 0.036434 | 0.0156192 | 0.011684 |

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|---|---|---|---|
| Equity market capitalization divided by GDP | 0.3388718 | 0.9030107 | 0.6787062 | 1.377452 | 3.217654 | 2.080267 | 2.232193 | 2.271357 | 2.306478 |
| Value of equity traded divided by GDP | 0.1195037 | 0.453214 | 0.2198946 | 0.987702 | 2.47375 | 1.200891 | 2.392721 | 1.797998 | 2.196045 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 2 | 2 | 2 | 2 | | |
| **UK** | | | | | | | | | |
| International equity issuance divided by GDP | | 0.000439 | 0.0035371 | 0.0050225 | 0.0221628 | 0.0215251 | 0.0094647 | 0.0045128 | 0.0099491 |
| Equity market capitalization divided by GDP | 0.3827458 | 0.7200342 | 0.8578528 | 1.240424 | 1.790388 | 1.549615 | 1.141645 | 1.351525 | 1.315302 |
| Value of equity traded divided by GDP | 0.0574518 | 0.2222952 | 0.3189664 | 0.5695137 | 1.316939 | 1.308205 | 2.557039 | 2.019084 | 2.417757 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 5 | 5 | 5 | 5 | | |
| **USA** | | | | | | | | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| International equity issuance divided by GDP | | 0.0000474 | 0.000448 | 0.0013518 | 0.0070999 | 0.002419 | 0.000124 | 0.0002363 | 0.0001278 |
| Equity market capitalization divided by GDP | 0.5188438 | 0.5507509 | 0.5272098 | 0.9269999 | 1.538564 | 1.363592 | 1.050293 | 0.7130752 | 0.8636631 |
| Value of equity traded divided by GDP | 0.1469136 | 0.236286 | 0.3017804 | 0.6905693 | 3.245653 | 2.867378 | 1.736237 | 0.6046872 | 0.8214002 |
| Shareholder protection index (6=highest, 0=lowest) | | | | 5 | 5 | 5 | 5 | | |

**Table 2:**

| Variable | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|
| Employment Protection | | | | |
| overall | 1.092545 | .5650517 | .1 | 2 |
| between | | .5635979 | .1 | 1.909833 |
| within | | .1404808 | -.0040064 | 1.435994 |
| Wage Growth Manufacturing | | | | |
| overall | 6.473011 | 11.61639 | -28.43137 | 45.61404 |
| between | | .9622613 | 4.588679 | 7.875384 |
| within | | 11.57863 | -27.63195 | 44.21166 |
| Hours Worked Manufacturing | | | | |
| overall | 39.08175 | 2.197446 | 34.8 | 46.8 |
| between | | 2.589281 | 36.29091 | 46.7 |
| within | | .4887782 | 37.59084 | 40.62175 |

| Table 3: The Determinants of Corporate Governance, Measured as Equity Market Capitalization (US$ mn) / GDP | | | | | | |
|---|---|---|---|---|---|---|
| | RE | PCSE | RE | PCSE | RE | PCSE |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Employment Protection | -0.176<br>(1.76) | -0.180<br>(2.19)* | | | | |
| Wage Growth (Manufacturing) | | | -0.003<br>(2.39)* | -0.004<br>(2.53)* | | |
| Hours Worked (Manufacturing) | | | | | 0.168<br>(5.03)** | 0.168<br>(5.45)** |
| Left Government | 0.000<br>(0.32) | 0.001<br>(1.80) | 0.001<br>(1.59) | 0.002<br>(2.78)** | 0.005<br>(2.56)* | 0.005<br>(3.90)** |
| Right Government | -0.000<br>(0.14) | 0.002<br>(3.54)** | 0.000<br>(0.19) | 0.002<br>(3.48)** | 0.003<br>(1.71) | 0.003<br>(2.72)** |
| Common Law | 0.302 | -0.052 | 0.552 | 0.048 | 0.032 | 0.032 |

| Legal Origin | (1.89) | (0.84) | (2.56)* | (0.61) | (0.17) | (0.22) |
|---|---|---|---|---|---|---|
| German | 0.003 | -0.015 | 0.150 | 0.120 | -0.389 | -0.389 |
| Legal Origin | (0.02) | (0.16) | (0.78) | (2.27)* | (2.08)* | (2.23)* |
| Scandinavian | 0.117 | -0.149 | 0.317 | -0.082 | 0.086 | 0.086 |
| Legal Origin | (0.76) | (2.44)* | (1.48) | (1.29) | (0.38) | (0.28) |
| Capital Controls | -0.006 | -0.116 | 0.015 | -0.114 | 0.417 | 0.417 |
| | (0.17) | (2.87)** | (0.33) | (2.36)* | (1.39) | (2.89)** |
| GDP Growth | 0.023 | 0.020 | 0.030 | 0.031 | 0.048 | 0.048 |
| | (3.90)** | (3.12)** | (3.74)** | (3.30)** | (1.36) | (1.47) |
| GDP per | 0.011 | 0.020 | 0.009 | 0.026 | 0.038 | 0.038 |
| Capita | (4.27)** | (6.25)** | (2.89)** | (5.83)** | (3.40)** | (3.13)** |
| Trade | 0.006 | -0.001 | 0.010 | 0.000 | 0.003 | 0.003 |
| Openness | (3.75)** | (1.17) | (6.16)** | (0.60) | (1.23) | (1.31) |
| Inflation | -0.010 | -0.003 | -0.010 | -0.003 | 0.008 | 0.008 |
| | (2.36)* | (0.55) | (1.88) | (0.46) | (0.23) | (0.24) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Population | 0.000 | 0.000 | 0.000 | 0.000 | -0.000 | -0.000 |
| | (2.38)* | (0.03) | (3.08)** | (0.74) | (0.74) | (1.03) |
| Corporatism | -0.053 | -0.005 | -0.082 | -0.038 | -0.384 | -0.384 |
| | (3.44)** | (0.27) | (4.15)** | (1.92) | (4.38)** | (4.17)** |
| Proportionality | -0.097 | 0.033 | -0.216 | -0.024 | 0.423 | 0.423 |
| | (1.01) | (0.60) | (1.77) | (0.43) | (2.08)* | (2.26)* |
| Constant | 0.159 | 0.248 | -0.311 | -0.074 | -6.285 | -6.285 |
| | (0.68) | (1.76) | (1.42) | (0.57) | (5.09)** | (5.41)** |
| Observations | 370 | 370 | 394 | 394 | 110 | 110 |
| Countries | 18 | 18 | 18 | 18 | 14 | 14 |

*Notes*: Absolute value of z statistics in parentheses, * significant at 5%; ** significant at 1%.

| Table 4: The Determinants of Corporate Governance, Measured as Value of Shares Traded (US$ mn) / GDP | | | | | | |
|---|---|---|---|---|---|---|
| | RE | PCSE | RE | PCSE | RE | PCSE |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Employment Protection | -0.127<br>(1.57) | -0.183<br>(2.36)* | | | | |
| Wage Growth (Manufacturing) | | | -0.003<br>(2.54)* | -0.005<br>(3.61)** | | |
| Hours Worked (Manufacturing) | | | | | 0.127<br>(4.94)** | 0.127<br>(5.32)** |
| Left Government | -0.001<br>(1.17) | -0.001<br>(1.47) | -0.000<br>(0.54) | -0.000<br>(0.51) | 0.003<br>(1.82) | 0.003<br>(2.97)** |
| Right Government | -0.001<br>(1.42) | 0.000<br>(0.01) | -0.001<br>(1.77) | -0.000<br>(0.55) | 0.000<br>(0.20) | 0.000<br>(0.31) |
| Common Law | -0.034 | -0.088 | 0.071 | 0.086 | -0.375 | -0.375 |

| Legal Origin | (0.24) | (1.06) | (0.39) | (2.06)* | (2.58)** | (3.20)** |
|---|---|---|---|---|---|---|
| German | 0.366 | 0.050 | 0.497 | 0.124 | 0.030 | 0.030 |
| Legal Origin | (2.77)** | (1.29) | (2.47)* | (1.90) | (0.20) | (0.27) |
| Scandinavian | 0.190 | -0.081 | 0.383 | -0.020 | -0.069 | -0.069 |
| Legal Origin | (1.48) | (1.71) | (1.91) | (0.38) | (0.39) | (0.39) |
| Capital Controls | 0.027 | 0.003 | 0.094 | 0.048 | 1.310 | 1.310 |
| | (0.91) | (0.10) | (2.32)* | (1.09) | (4.46)** | (3.89)** |
| GDP Growth | 0.017 | 0.018 | 0.027 | 0.027 | 0.023 | 0.023 |
| | (3.66)** | (3.97)** | (3.68)** | (3.57)** | (0.84) | (1.08) |
| GDP per | 0.005 | 0.016 | 0.007 | 0.023 | 0.034 | 0.034 |
| Capita | (2.74)** | (5.35)** | (2.23)* | (5.64)** | (3.69)** | (3.34)** |
| Trade | 0.007 | 0.000 | 0.011 | 0.002 | 0.005 | 0.005 |
| Openness | (5.51)** | (0.36) | (7.12)** | (2.36)* | (2.47)* | (2.95)** |
| Inflation | -0.006 | -0.000 | -0.007 | -0.002 | 0.019 | 0.019 |
| | (1.79) | (0.07) | (1.51) | (0.31) | (0.72) | (0.87) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Population | 0.000<br>(4.18)** | 0.000<br>(0.69) | 0.000<br>(5.41)** | 0.000<br>(1.76) | 0.000<br>(0.02) | 0.000<br>(0.02) |
| Corporatism | -0.026<br>(2.20)* | -0.013<br>(1.34) | -0.032<br>(1.81) | -0.038<br>(2.85)** | -0.268<br>(3.88)** | -0.268<br>(4.89)** |
| Proportionality | -0.110<br>(1.42) | 0.007<br>(0.23) | -0.192<br>(1.74) | -0.047<br>(1.52) | 0.284<br>(1.79) | 0.284<br>(2.48)* |
| Constant | -0.190<br>(0.97) | 0.131<br>(1.21) | -0.736<br>(3.53)** | -0.217<br>(2.04)* | -5.073<br>(5.30)** | -5.073<br>(5.29)** |
| Observations | 360 | 360 | 385 | 385 | 109 | 109 |
| Countries | 18 | 18 | 18 | 18 | 14 | 14 |

*Notes*: Absolute value of z statistics in parentheses, * significant at 5%; ** significant at 1%.

| Table 5: The Determinants of Corporate Governance, Measured as Value of International Equity Issuance (US$ bn) / GDP | | | | | | |
|---|---|---|---|---|---|---|
| | RE | PCSE | RE | PCSE | RE | PCSE |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Employment Protection | -0.002<br>(1.11) | -0.000<br>(0.20) | | | | |
| Wage Growth (Manufacturing) | | | -0.000<br>(2.99)** | -0.000<br>(3.87)** | | |
| Hours Worked (Manufacturing) | | | | | 0.001<br>(1.56) | 0.001<br>(2.01)* |
| Left Government | 0.000<br>(0.82) | 0.000<br>(1.74) | 0.000<br>(3.13)** | 0.000<br>(4.26)** | 0.000<br>(3.67)** | 0.000<br>(5.84)** |
| Right Government | 0.000<br>(0.77) | 0.000<br>(1.51) | 0.000<br>(2.72)** | 0.000<br>(4.16)** | 0.000<br>(2.38)* | 0.000<br>(4.08)** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Common Law | -0.002 | -0.001 | -0.001 | -0.004 | -0.014 | -0.014 |
| Legal Origin | (0.64) | (0.79) | (0.41) | (3.24)** | (4.68)** | (4.51)** |
| German | 0.000 | -0.001 | 0.007 | 0.000 | -0.000 | -0.000 |
| Legal Origin | (0.05) | (1.73) | (1.76) | (0.01) | (0.03) | (0.03) |
| Scandinavian | 0.002 | -0.000 | 0.006 | -0.000 | 0.004 | 0.004 |
| Legal Origin | (0.64) | (0.08) | (1.53) | (0.18) | (1.07) | (1.03) |
| Capital Controls | -0.001 | -0.002 | -0.000 | -0.001 | -0.000 | -0.000 |
| | (1.48) | (2.63)** | (0.04) | (1.75) | (0.11) | (0.19) |
| GDP Growth | 0.000 | 0.000 | 0.000 | 0.001 | 0.000 | 0.000 |
| | (1.31) | (1.72) | (1.20) | (2.78)** | (0.22) | (0.25) |
| GDP per | 0.000 | 0.000 | -0.000 | 0.000 | -0.000 | -0.000 |
| Capita | (0.17) | (1.77) | (0.42) | (2.02)* | (0.37) | (0.41) |
| Trade | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| Openness | (2.99)** | (0.94) | (7.07)** | (5.24)** | (5.62)** | (4.40)** |
| Inflation | -0.000 | -0.000 | -0.000 | -0.000 | 0.001 | 0.001 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | (2.65)** | (2.39)* | (0.84) | (0.92) | (1.33) | (1.56) |
| Population | 0.000<br><br>(0.72) | -0.000<br><br>(2.53)* | 0.000<br><br>(2.40)* | 0.000<br><br>(0.48) | 0.000<br><br>(2.30)* | 0.000<br><br>(3.00)** |
| Corporatism | -0.001<br><br>(1.98)* | -0.001<br><br>(2.47)* | -0.002<br><br>(3.38)** | -0.002<br><br>(4.21)** | -0.006<br><br>(4.60)** | -0.006<br><br>(3.82)** |
| Proportionality | 0.002<br><br>(1.05) | 0.001<br><br>(1.15) | -0.001<br><br>(0.44) | 0.002<br><br>(1.59) | 0.009<br><br>(2.81)** | 0.009<br><br>(2.46)* |
| Constant | 0.001<br><br>(0.33) | 0.004<br><br>(1.54) | -0.012<br><br>(2.67)** | -0.002<br><br>(0.83) | -0.032<br><br>(1.61) | -0.032<br><br>(1.94) |
| Observations | 271 | 271 | 307 | 307 | 116 | 116 |
| Countries | 18 | 18 | 18 | 18 | 14 | 14 |
| *Notes*: Absolute value of z statistics in parentheses, * significant at 5%; ** significant at 1%. | | | | | | |

Table 6: The Determinants of Corporate Governance, Measured as Index of Minority Shareholder Protection

| | RE | PCSE | RE | PCSE | RE | PCSE |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Employment Protection | 0.254<br>(0.68) | 1.123<br>(5.24)** | | | | |
| Wage Growth (Manufacturing) | | | -0.005<br>(0.97) | -0.006<br>(1.08) | | |
| Hours Worked (Manufacturing) | | | | | -0.041<br>(0.86) | -0.041<br>(0.85) |
| Left Government | 0.002<br>(0.97) | 0.002<br>(0.88) | 0.004<br>(1.76) | 0.002<br>(0.85) | 0.002<br>(0.78) | 0.002<br>(0.87) |
| Right Government | 0.002<br>(0.82) | 0.003<br>(1.33) | 0.004<br>(1.49) | 0.002<br>(0.80) | -0.001<br>(0.44) | -0.001<br>(0.45) |
| Common Law | 2.479 | 3.581 | 1.973 | 2.124 | 2.094 | 2.094 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Legal Origin | (5.13)** | (12.00)** | (6.13)** | (11.49)** | (7.07)** | (7.64)** |
| German<br>Legal Origin | 0.446<br>(1.17) | 0.300<br>(1.11) | 0.224<br>(0.61) | -0.018<br>(0.06) | -0.081<br>(0.31) | -0.081<br>(0.29) |
| Scandinavian<br>Legal Origin | 1.113<br>(3.14)** | 1.198<br>(5.44)** | 0.782<br>(2.22)* | 0.674<br>(2.65)** | 1.163<br>(3.85)** | 1.163<br>(4.79)** |
| Capital Controls | 0.062<br>(0.35) | 0.469<br>(2.24)* | 0.051<br>(0.24) | 0.534<br>(2.19)* | -0.172<br>(0.37) | -0.172<br>(1.33) |
| GDP Growth | -0.008<br>(0.32) | -0.037<br>(1.50) | 0.028<br>(0.88) | 0.026<br>(0.90) | -0.003<br>(0.07) | -0.003<br>(0.07) |
| GDP per<br>Capita | 0.003<br>(0.20) | 0.036<br>(3.07)** | -0.002<br>(0.14) | -0.005<br>(0.45) | 0.004<br>(0.25) | 0.004<br>(0.31) |
| Trade<br>Openness | -0.002<br>(0.54) | -0.001<br>(0.36) | -0.003<br>(0.89) | -0.008<br>(2.28)* | -0.001<br>(0.29) | -0.001<br>(0.33) |
| Inflation | -0.093<br>(2.40)* | -0.150<br>(3.15)** | -0.085<br>(2.03)* | -0.121<br>(2.61)** | -0.061<br>(1.02) | -0.061<br>(0.95) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Population | 0.000<br>(0.92) | 0.000<br>(0.90) | 0.000<br>(1.30) | 0.000<br>(0.26) | 0.000<br>(0.74) | 0.000<br>(1.13) |
| Corporatism | 0.135<br>(1.40) | 0.227<br>(3.17)** | 0.148<br>(1.46) | 0.294<br>(3.89)** | 0.099<br>(0.71) | 0.099<br>(1.08) |
| Proportionality | -1.083<br>(3.00)** | -1.360<br>(10.21)** | -0.932<br>(2.52)* | -1.122<br>(7.03)** | -0.933<br>(3.28)** | -0.933<br>(6.49)** |
| Constant | 2.243<br>(2.76)** | 0.265<br>(0.41) | 2.622<br>(4.83)** | 3.034<br>(7.44)** | 4.384<br>(2.56)* | 4.384<br>(3.21)** |
| Observations | 108 | 108 | 144 | 144 | 96 | 96 |
| Countries | 18 | 18 | 18 | 18 | 14 | 14 |

*Notes*: Absolute value of z statistics in parentheses, * significant at 5%; ** significant at 1%.

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