Regional Integration and the Diversity of Corporate Governance: Some Lessons from European Integration

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OUTLINE

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1 What “Model” of Corporate Governance? A View from Europe

The economic and political processes of internationalization and regional integration occurring today raise new questions about the prospects of institutional diversity and convergence among advanced industrialized countries. Whereas economic theory long assumed that there was “one best way” to organize the economy, it is increasingly recognized that diverse forms of economic organization can have *comparative institutional advantages* for different types of economic activity. A large literature now explores the different “varieties of capitalism” and their relation to economic performance, as well as social equality.

Corporate governance lies at the heart of this debate. Large corporations not only act as the major engines of innovation, but their governance has strong consequences for national employment and the stability of the financial system. As national economies grow together, international efforts have increased to guarantee common standards regarding investor protection, bank stability and the governance of global workforces. For example, the 1998 OECD report on corporate governance spelled out the need for “global minimum standards” regarding corporations. Yet at the same time, the OECD explicitly outlined the need for diverse approaches to corporate governance that fit nationally specific history and culture.

As the countries of East Asia undergo economic integration with each other and the rest of the world through increasing cross-border activity, questions of the institutional architecture for such activity will become more pressing. How can regional or global standards for corporate governance be developed, and what should such standards be based upon? How will the promotion of international standards impact existing corporate governance practices in different countries? And what are the realistic prospects for a simultaneous integration and diversity of corporate governance around the world?

In the context of this short paper, I will address these general issues by looking at the European experience and particularly the German case. In contrast to East Asia, European integration is more advanced politically. These geopolitical and cultural differences will, of course, continue. But despite these differences, the European experience does point out a number of general dilemmas that Asia also faces and may face more acutely in the future.

A starting point is to ask whether Europe has a common model of corporate governance? Most policy discussions remain influenced by a "standard" view of corporate governance that reflects the large separation of ownership and control in the United States. Here ownership is largely dispersed, and management potentially has a large scope to control firms in their own interests. Within this context, corporate governance is understood in terms of how investors can effectively monitor management to act in shareholder interests. Important devices here are corporate information disclosure, incentive pay for managers, mandating independent outside directors and ultimately an open market for corporate control. Given the success of U.S. capital markets during the 1990s, this "shareholder-oriented" model has become a sort of benchmark in many academic discussions and policy related debates.

While the UK shares many of these features with the United States, most of Continental Europe deviates from this model in important ways.

(1) Corporate ownership remains more concentrated in the hands of large blockholders. Family ownership has survived to a greater extent. Likewise, state ownership, cooperative networks among industrial corporations and strong ties between banks and industry are important to varying degrees in different countries.

(2) Employee participation is an institutionalized part of corporate governance, although the extent of such rights differs widely across countries. Germany, for example, has the most extensive codetermination rights, both through employee representation within the board and works councils having wide ranging rights to information, consultation and codetermination.

(3) More broadly, different conceptions of the public interest play a role in defining good corporate governance. Whereas the British tradition sees the firm as a private association, Germany historically developed a different approach where the role of shareholders and employees each became "constitutionalized" within law (Donnelly et al 2001).

2 The Failure of Harmonization in Europe

While at odds with the dominant international model of corporate governance, Europe does not share a uniform common alternative. Corporate governance tends to differ *nationally*, because their key institutions have developed historically as the legacy of political struggles fought within the arena of the national state. In the U.S., for example, politics promoted the primacy of shareholders and the use of markets as a form of corporate control (Roe 1994). Yet other countries developed quite different political legacies. For example, Germany's nonliberal corporate governance was historically legitimated by the idea of the corporation as an entity "in itself" comprising multiple constituents (Jackson 2001).

Today, pressures to reform corporate governance in Europe stem both from external international environment, as well as domestic actors. International capital markets now raise new issues: the growing importance of institutional investors from Britain and the U.S., public concern over outward foreign direct investment (FDI) by large corporations, desire to attract inward FDI, and cross-border mergers and acquisitions. Given the "regime competition" to attract mobile capital, states often initiate market-oriented reforms in order "to make economic activities located within the national territory...more competitive in international or transnational terms" (Cerny 1997, 257). Unilateral U.S. pressure and the politics of building the EU common market have catalyzed such pressures. European countries have attempted to establish level playing fields for investors, particularly by moving standards of information and disclosure "up" toward standards of the U.S. Securities and Exchange Commission.

Within this context, European debates are often framed politically in terms of perceived strengths of the U.S. model. Specifically, the information technology paradigm is argued to give renewed competitive strength to the U.S. due to its liquid stock markets, venture capital, and strong external labor markets that rely on portable professional qualifications. The privatization of state enterprises and reforms to public pensions also created new political support for the stock market. Finally, corporate scandals continue to raise questions about the effectiveness of existing institutions.

Thus, both international and domestic pressures have mounted to promote *liberalization* of corporate governance within Europe. Nonetheless, the examples below will show how these forces have fallen short of institutional harmonization. Political resistance has prevented abandonment of certain past institutions—such as different national rules for employee participation or composition of corporate boards. The public remains concerned over the social and distributional consequences of shareholder value. And corporate management may also resist changes that reduce its own autonomy.

In this context, Europeanization has largely proceeded through a process of 'negative integration' (removing barriers) and the expansion of markets through intergovernmental agreements and bureaucratic agencies rather than positive political integration with uniform sets of rules. 'The result is a multi-level political economy, where politics is decentralized in national institutions located in and constrained by integrated competitive markets extending far beyond their territorial reach, and where supranationally centralized institutions are primarily dedicated to implementing and maintaining those markets' (Streeck 1998). Three examples of this integration process are described below, with particular reference to their impact on Germany.

European Company Statute

In the early 1970s, efforts to enact a stature for a European Company began. Many believed that a common European market would ultimately require a uniform legal framework for incorporation and corporate governance. For example, administrative expenses would decline and help transnational companies avoid the psychologically difficult choices between different national "corporate cultures."

However, German supervisory board codetermination proved a central barrier (Donelly et al. 2001; Streeck 2001). The failed "Fifth Directive" on company law shows the political impossibility of Germany 'exporting' its employee-oriented model to Europe. Numerous European countries such as Britain opposed strong European codetermination rules, as did both German business itself and a large proportion of European trade unions with other traditions and experience of labor participation. Subsequent proposals included much weaker rules, but faced the opposition of German unions to any measures that might weaken codetermination by allowing German firms to "migrate" to a new European corporate form.

Following the negotiation of the Single European Act in 1985, national law came to be mutually recognized under the principle of subsidiarity rather than aiming for harmonization under a supranational structure. By the 1990s, the Davignon committee reintroduced but further reduced the scope of the proposal to apply only for international mergers, and providing safeguards to protect existing national practices. Yet even this proposal failed. The breakthrough of the Nice Summit in 2000 would open European incorporation only to multinational firms and require social partners to negotiate over company-specific codetermination rules. If management and employee representatives fail to agree on the extent of employee board representation for the new company, the highest applicable level from national law would remain in force.

While the EU fell far short of harmonization, a number of directives have been passed, particularly seeking to ensure that shareholders have access to sufficient and reliable information on companies. The earliest measures were introduced in the context of the Single European Act to promote economic integration by liberalizing capital markets and ensuring equal protections for small investors across member states, thereby leveling the competitive playing field. How have European countries implemented these directives in their national law? Notably, Britain felt the least impact given its strongly market-oriented institutions. However, for Germany, these reforms have helped catalyze dramatic change in the nature of the German financial system.

Germany began efforts to broaden and deepen its capital markets through a number of complex regulatory measures. Three *Financial Market Promotion Acts* (in 1989, 1994, and 1997) sought to liberalize German capital markets, as well as implement EU directives.

- The First Law introduced secondary capital markets for the first time, making it possible for investors in company debt to trade bonds. Secondary capital markets had been banned in the 1890s, and only permitted in a limited form since the 1970s.
- The Second Law, introduced in 1995, focused on increasing transparency, protecting small investors, and allowing more types of investment funds. These measures helped bring German practice in line with international standards as expressed in EU Directives (Lütz 1996). These EU directives include those on insider trading (89/595/EC, transparency (88/627/EEC), and investment services (92/22/EEC). The law established a Federal Securities Trading Commission (*Bundesaufsichtsamt für Wertpapierhandel*) to monitor securities trading—particularly to enforce new insider trading rules and disclosure requirements on large blocks of equity.
- The Third Law in 1998 seeks to increase both the supply and demand for risk capital by reducing the costs of securities issues (e.g. reducing prospectus liability) and authorizing a broader range of investment funds and transactions. Further important changes include capital gains becoming tax-free after one year (rather than 6 years), loosening rules on the minimum number of shareholders, and removing the obligation that investment companies go public within 10 years.

German corporate law reform centered on the Law on Control and Transparency of 1998 (*Gesetz zur Kontrolle und Transparenz im*

Unternehmensbereich, hereafter KonTraG) (Donnelly et al. 2001).[1] The KonTraG aimed to improve auditor independence by requiring appointment by the supervisory board, as well as disclosure of multiple supervisory board memberships and ownership stakes exceeding 5 percent. Several provisions also increased shareholder influence: multiple voting rights and voting rights restrictions were eliminated, banks were barred from using proxy votes if their direct shareholding exceeded 5 percent, banks had to solicit more instructions from shareholders, and the supervisory board was given greater duties of financial oversight. Restrictions on share buybacks and stock options were removed.

In accounting, Germany also traditionally had conservative prudence rules (*Vorsichtsprinzip*) and favors creditors through conservative asset valuation and allowing up to 50 percent of profits to be used as internal reserves. By contrast, both GAAP (U.S. generally accepted accounting practices) and IAS (International Accounting Standards) are significantly more shareholder-oriented by stressing market valuations and more precise definitions of profits. The U.S. Securities and Exchange Commission (SEC) is able to resist loosening its standards to facilitate uniform international rules. While convergence theories posit that corporations will push for international accounting standards or voluntarily adopt them by obtaining a listing on a foreign stock exchange, others warn that market-valuation principles make balance sheets overly vulnerable to short-term market fluctuations.

Debates over accounting were sparked by Daimler-Benz and Deutsche Telekom being the first German companies seeking NYSE listing during the mid-1990s. Initially, corporations were forced to maintain two sets of calculations in fulfillment of both NYSE listing requirements and German tax law. The large discrepancies in the profit calculations of DM 2.5 billion at Daimler-Benz led to bad publicity and encouraged skepticism of German standards. Germany enabled corporations to adopt GAAP or IAS for domestic tax purposes until a uniform global standard emerges.[2] This flexible approach does not require a wholesale shift in accounting principles, but allows firms to adopt rules according to their needs in accessing international capital markets or continue a more creditor-oriented approach. By March 2002, 18 German corporations were listed on the New York Stock Exchange,

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1 The earliest measures were introduced in the context of the Single European Act to promote economic integration by liberalizing capital markets and ensuring equal protections for small investors across member states.

2 These rules were introduced in the 1998 Kapitalaufnahmeerleichterungsgesetz (Investment Facilitation Act) for a period of 6 years. The International Accounting Standards Committee (IASC) and International Organization of Securities Commissions (IOSCO) are currently negotiating to bring the IAS and GAAP together.

and all the corporations listed on the Deutscher Aktien Index 30 (DAX 30) use international standards—17 use IAS and 13 use either U.S. GAAP or both standards.

Self-regulation has been important in promoting transparency and investor protection in Anglo-Saxon countries. During the 1990s, voluntary codes proliferated internationally, being issued by the OECD, national stock exchanges and various interest associations. Voluntary codes promote institutional change through the diffusion of ideas, as well as create normative pressures and sanctions (DiMaggio and Powell 1991). Self-regulation may thereby act as a functional substitute to law in promoting international convergence.

More generally, a government commission also developed a German Code of Corporate Governance n February 2002.[3] The code follows several private codes of best practice[4] that were more far reaching in scope but largely without influence. The new code will act as soft law via a "comply or explain" rule in the forthcoming Transparency and Disclosure law (*Transparenz- und Publizitätsgesetz*).

European Works Council Directive

In contrast to the blockage regarding European corporate law, the European Works Council Directive succeeded largely because it did not interfere with national systems of company interest representation. Rather, the directive supplements them with firm-specific institutions to represent non-domestic European workers at the MNC headquarters. European regulation is procedural, and stresses both voluntarism and the principle of subsidiarity. In practice, European works councils are institutions worked out through company-level negotiations and thus strongly shaped by the home country practices. Thereby councils have different consequences for national regimes. In Britain, European regulation gives unions a foothold to strive for 'higher' standards, and helped renew debate over employee representation. German works councils, by contrast, see the European institutions as a way to potentially extend their influence transnationally. In both countries, the EU and national institutions each remain important. The

3. For details, see www.corporate-governance-code.de.

4. Two codes were developed by the German Panel on Corporate Governance (www.dai.de) in January 2000 and the Berlin Initiative Group German Code of Corporate Governance (www.gccg.de) in June 2000. The former advocates a number of Anglo-American practices uncommon in Germany: stock-market-oriented compensation, rapid disclosure, the independence of supervisory board members from ongoing business relations, committee work among supervisory boards, and greater concern for conflicts of interests.

European Works Council Directive thereby provides some formal rights for representing European workforces in large firms —although their strength depends upon being an extended arm of national labor representatives. The case shows both the difficulties in moving standards 'up' and the resistance to measures that lower standards —either because EU regulation would directly interfere with national institutions or increase the exit options of actors from those institutions.

Takeover Directive

A central international difference concerns the role of markets for corporate control. Whereas takeovers are considered an important devise for disciplining management within market-oriented countries, open markets for corporate control have remained largely absent in Continental Europe. Concentrated ownership greatly limited the number of target firms vulnerable to takeover threats. In addition, legal devices were often used to limit such threats (voting rights caps, multiple voting rights, golden shares, etc.) Over the course of the 1990s, ownership concentration has begun to decline at a slow pace, particularly among former state-owned industries. More dramatically, EU directives have forced countries to make substantial moves to one-share-one-vote principles and thereby eliminating a substantial takeover barrier.

Germany began to address takeovers through a voluntary takeover code in 1995 aimed to fill the legal gap regarding takeover bids given a deadlocked European Directive. As the Takeover Commission lacked sanctioning power, only 540 of 933 listed companies and 79 of the Deutscher Aktien Index 100 (DAX 100) companies participate. The hostile takeover of Mannesmann in 1999 exposed the urgency of binding regulation on bidding procedures and permissible defensive actions. The case dramatically illustrates that European countries face an international market for corporate control with dramatically different institutional endowments (see Höpner and Jackson 2001). Liberalization has eliminated many past barriers to takeovers in Germany. However, as the playing field becomes more level, British companies such as Vodafone enjoy much higher market capitalization for their size and can use this to leverage even a takeover of an old German industrial giant. These differences in market capitalization reflect historical differences in the development of stock markets, particularly the size of investment by institutional investors such as pension funds (differences which reflect, to a large degree, the organization of the welfare state). Table 1 illustrates these strong differences in valuation, as well as their relation to operational strategy and employment.

Table 1 Corporate Performance, Selected Averages 2000

	Germany	United Kingdom
Real returns to capital		
Price-earnings ratio	17.8	21.5
Dividend yield	2.7%	2.6%
Return on equity	18.2%	20.4%
Market valuation		
Market value (mill. euros)	20,754	42,337
Ratio of market value to turnover	0.51	2.14
Market value per employee (mill. euros)	0.14	0.97
Price-book ratio	2.5	4.6
Sales, profits, employment		
Turnover (mill. euros)	38,122	22,015
Return on sales (EBIT to sales)	9.4%	19.2%
Employees	138,072	60,676

Source: Handelsblatt Europa 500, Handelsblatt June 11, 2001. Averages are calculated from the 19 largest British and 20 largest German industrial firms belonging to the "Europa 500."

The direct impact of the Mannesmann case was the renewed discussion over the urgency of a binding takeover law in Germany. The law should not only protect the interests of shareholders, but also create clear procedures for the bidding process. In March 2000, the Chancellor's Office set up an expert commission to make recommendations. The Ministry of Finance then presented a draft laws that would restrict defensive actions taken by management by requiring the Management Board [5] to be "neutral" and to refrain from issuing shares, undertaking share buy-backs, or engaging in measures that have a significant impact on company balance sheets. White knights would thus be the only active defense permitted. This clause was praised by various shareholder associations, but was criticized by German corporations and unions. The opposition stalled the quick passage of a law.

5 This notion of neutrality is much more restrictive than prohibitions on "frustrating actions" in the British code, which prevent management from taking actions that intentionally destroy value and go against the interests of the company.

At the same time, surprising developments occurred at the European level.[6] In June 2001, a special mediation committee reached agreement on a draft takeover directive for submission to the European Parliament. Among its liberal provisions, this compromise draft included the controversial requirement of management neutrality. The dramatic vote by the European Parliament was 273 in favor, 273 against, and 22 abstentions. The directive thus failed to be passed, because the President Nicola Fontaine abstained. Germany was sharply criticized in the press, being viewed as responsible for the failure after having withdrawn its support in the last few days before the vote. In particular, Volkswagen chairman Ferdinand Piëch, BASF finance officer Max Dietrich Clay, and union leader Hubertus Schmoldt (IG-BCE) were cited as having had an influential political lobby for more protective regulation. Their two main arguments both pointed to German firms being put at a disadvantage in takeover contests: U.S. managers are allowed much more freedom to implement takeover defenses and, unlike Germany, other European countries retain "golden shares" that give the state power to block takeover attempts. The Federation of German Industries and the German Banking Association both welcomed this result.

Subsequently, the German Government moved quickly to present another revised takeover law scheduled for a vote in the Bundestag in Fall 2001. While drawing largely on the previous draft law, the neutrality rule has been replaced by the option for defensive actions with shareholder approval. Specifically, the shareholders' meeting can empower management to take defensive actions for an 18-month period with a 75 percent majority vote. The law also requires the Management Board to publish the stance of the works council on takeover bids as part of the official response. The content of the final law remains open at the time of writing. However, given its present form, the law is unlikely to create major barriers to takeovers.

3 Integration and Diversity: A Possibility or Paradox?

The experience of Germany in Europe suggests that integration means largely the liberalization of markets, rather than the harmonization of

6 The EU has been unsuccessful in developing a takeover directive since the initial draft in 1989. The main points of debate were: the control threshold for requiring tender offers, requirements for cash payments to slow takeover activity, time limits for the acceptance of a tender offer, information rights for employees, and the scope for defensive tactics that management is allowed.

underlying institutions. But to what extent does liberalization entail de facto convergence of corporate governance around the world?

Comparative institutional analysis (Aoki 2001) offers useful tools for studying the dynamics of integration and diversity. This perspective examines institutional changes or international diffusion of particular practices in the context of an existing system of institutions. Here, institutional changes may be unstable if their components lack complementarities--resulting in further institutional change, inefficient outcomes, or abandonment of an initial change (Bratton 1999). Alternatively, new practices may prove stable if practices can be reconfigured to "fit" within a firm-specific competitive environment, existing firm coalitions or a national institutional context. Conflicting logics may sometimes even help balance each other and preserve beneficial requisite variety in the long run.

Returning to the German case, liberalization has enabled corporations to adopt many new capital market-oriented practices, while leaving significant national differences in the powers of corporate boards and labor participation. Viewed from comparative institutional theory, such change can be interpreted as a process of institutional and organizational <u>hybridization</u> in order to understand "the ways in which forms become separated from existing practices and recombine with new forms in new practices" (Pieterse 1994, 165). The hybrid corporate governance emerging in Germany now mixes shareholder or market-oriented practices developed within Anglo-American economies with nonliberal practices, particularly the institutions for employee codetermination.

In some domains, hybridization has led to substantial institutional erosion and a fair degree of international convergence. A key example in German concerns <u>relationship banking.</u> Somewhat like Japan, German banks have traditionally performed monitoring roles in lieu of markets. Their large ownership stakes, use of proxy votes, board members and use of credit give them considerable influence over industry. Liberalization inserts different sorts of rules—those that "level the playing field" through information, disclosure, and arm's-length relationships. Transparency erodes rents available to banks as insiders through private information, while requiring greater neutrality in mediating market-oriented transactions. German banks face role conflicts in acting as traditional house bank and simultaneously as investment banker as markets for corporate control emerge. Thus, a viable hybrid between relationship banking and market-oriented control has been hard to achieve. The result seems to be a <u>bifurcation</u> between sectors within national models—itself a type of hybridization. Large international firms and banks are increasingly moving toward market-oriented control, whereas small firms and the regional and cooperative banks seek to uphold more traditional relations.

Many open questions remain as to whether the diffusion of shareholder-value (SV) practices among large German corporations will ultimately undo existing patterns of strong employee participation and commitment to long-term employment. When examining German corporations in detail (Hoepner 2001), numerous attempts of accommodation can be seen along the lines of weak or enlightened shareholder value. Here labor has given conditional support to SV measures but used its influence to "codetermine" their substance to either improve managerial accountability or lessen class conflict. Labor generally favors greater transparency to enhance employee participation and thus improve managerial accountability. Labor has also pushed accountability in managerial remuneration in efforts to prevent excessive inequality that damages employee morale, as well as foreclosing short-term misincentives. Moreover, in accepting the legitimacy of managerial stock options, labor gained a springboard to implement ESOPs. Of course, the success of such efforts is mixed. But the examples suggest that strong labor may potentially play a positive role by lessening the class conflict aspects of SV and stressing their positive sum potential.

This positive-sum potential for capital and labor within of a shareholder model depends on the degree that labor constraints force managers to resist the temptations of pleasing shareholders in the short-term without considering long-term strategic consequences—e.g., rapid downsizing of personnel, mergers, or spin-offs. Performance targets may be reached by improving productivity, rather than short-term cost-cutting or balance sheet manipulation. Or, faced with corporate restructuring (e.g., focus on core competence), labor may promote "good" buyers during spin-offs (e.g., those who intend to act as good employers, rather than the highest bidder). Such measures may be compatible with the long-term interest of capital, even where short-term returns are sacrificed. Just as labor acts as a "beneficial constraint" for product market competition by promoting a "high road" strategy, labor also helps block the temptations of excessive short-term rationality in responding to capital markets.

A further consequence of hybridization is the growing heterogeneity of organizational practices within national systems. Corporations choose their corporate governance practices within the boundaries of prevailing institutional constraints. While national models were never entirely homogeneous, the capacity to generate relatively isomorphic practices across companies and sectors within a particular country is declining. Inherent institutional tensions inherent facilitate deviant patterns of behavior and greater firm-specific experimentation in combining elements of different models. Even as nations retain distinct "profiles" of corporate practices, the range of internal variation is growing particularly between large internationalized corporations and more protected domestically oriented or private corporations. Heterogeneity itself entails a de facto element of convergence (Streeck 2001).

4 Implications for Corporate Accountability and Asian Integration

To what extent does the European experience have parallels in Asia? Some big differences are obvious. First, Asian regionalism is far less politically integrated and its countries subject to greater bilateral pressure from the United States. Second, the levels of economic development are much more disparate. Countries such as China and Korea face greater difficulties in establishing credible "rule of law" within its regulatory environment, and thus resemble Eastern Europe more than the EU. Yet I would argue that integration in Asia, to a large extent, also entails de facto liberalization rather than institutional harmonization. Thus, integration raises some broadly similar challenges for institutional diversity in the medium term.

These parallel challenges can be seen most dramatically by comparing Germany and Japan, as I have done in detail elsewhere (Jackson forthcoming). In Japan, similar problems have arisen for banks to adapt themselves to international accounting standards and choosing whether to abandon relationship banking. Likewise, Japanese corporations face growing pressure to adopt shareholder-value practices, although Japanese corporations have been much more cautious about adopting them than German corporations. In Germany, shareholder-value practices enter a "constitutional" governance regime and are accommodated by contractualizing existing arrangements such as codetermination. Where the legal checks and balances remain strong, negotiated outcomes have a somewhat stable footing. By contrast, the pressures for Japanese employment practices may be less resilient in the face of strong shareholder pressures without the same legal guarantees of codetermination. Thus many challenges of building a successful hybrid are quite similar, although the institutional resources available for doing so differ.

Why should Asian (or European) countries be concerned with maintaining their diverse institutions rather than simply adopting perceived "best practices"? Nobody can predict with certainty which corporate governance model will prove most well adapted within the rapidly evolving international economy. New information technologies (IT) and internationalization raise fundamental questions about the appropriate scale and boundaries of corporate organization—as well as the legitimate criteria of rationality to guide decisions. Facing high uncertainty about the appropriate "model," corporations engage in decentralized processes of experimentation. Corporations may seek to imitate perceived best practices (DiMaggio and Powell 1991). But any future paradigm remains a moving target, and firms may not necessarily become competitive by replicating the strategies of successful first-movers. Corporations must also differentiate themselves from their competitors by distinct profiles of competence and strategy. Given diverse organizational and institutional endowments, market pressures can initiate searches for new opportunities and learning that lead to <u>further specialization</u> rather than convergence (Hollingsworth/Streeck 1994, 284).

The risks and social costs of a shareholder-oriented model, the model favored by existing integration processes, should not be overlooked. Creating the integrated rules for capital markets is likely to increase the dispersion of ownership around the world, and may help attack some privileges of existing blockholders. But there are very good reasons to question whether this will result in more innovative firms, better employment, or more corporate accountability. Institutions for market-based finance will likely expand the supply of capital trading in the secondary market for existing corporate shares more rapidly than the current growth of real economic activity. Such "financialization" (Dore 2000) subjects corporations to pressures for higher profits, but penalizes them with greater volatility when expectations are not met, as witnessed by the recent IT stock bubble. Moreover, Asian corporations will remain at a disadvantage in global markets for corporate control for a long time to come.

Conversely, new market actors have little responsibility to contribute to active corporate monitoring. A long way remains to close the gap between the demands of the market and the indirect monitoring it provides—a consequence being a reassertion of managerial capitalism under the guise of shareholder control. The recent crisis of ENRON illustrates that the much praised U.S. practice of independent directors is no catch all solution. The long-term beneficiaries would likely be those corporate managers whose fortunes come to be tied with stock market, but remain largely emancipated from careful stakeholder scrutiny.

Meanwhile, "industrial citizenship" of corporate workforces in countries like Japan or Germany will become less of a politically or socially guaranteed right and more a contractual arrangement used by firms to increase productivity. The shrinking core enjoying membership in the corporation as comanagers and coowners contrasts with the growing social closure at its boundaries (see Streeck 2001). A smaller core no longer has the same weight within national economies to sustain positive macroeconomic externalities as during much of the postwar era—notwithstanding the high demands corporations now make on the institutional infrastructure of society to sustain their competitiveness. This raises serious questions of corporate accountability to the public interest. Politically, the future prospects depend upon the will and capacity to internationally establish a “level playing field” for labor. While shareholder protection has become a major part of the international political agenda, less has been done to address basic rights of employee representation. The experience of EU directives on works councils and European companies shows the continued barriers to raising labor standards internationally. In the meantime, we can expect the consequence to be rising inequality in wealth and incomes.

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