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European Corporate Governance Reform and the German Party Paradox

by
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Abstract

This paper addresses the current discussion on links between party politics and production regimes. Why do German Social Democrats opt for more corporate governance liberalization than the CDU although, in terms of the distributional outcomes of such reforms, one would expect the situation to be reversed? I divide my analysis into three stages. First, I use the European Parliament's crucial vote on the European takeover directive in July 2001 as a test case to show that the left-right dimension does indeed matter in corporate governance reform, beside cross-class and cross-party nation-based interests. In a second step, by analyzing the party positions in the main German corporate governance reforms in the 1990s, I show that the SPD and the CDU behave "paradoxically" in the sense that the SPD favored more corporate governance liberalization than the CDU, which protected the institutions of "Rhenish," "organized" capitalism. This constellation occurred in the discussions on company disclosure, management accountability, the power of banks, network dissolution, and takeover regulation. Third, I offer two explanations for this paradoxical party behavior. The first explanation concerns the historical conversion of ideas. I show that trade unions and Social Democrats favored a high degree of capital organization in the Weimar Republic, but this ideological position was driven in new directions at two watersheds: one in the late 1940s, the other in the late 1950s. My second explanation lies in the importance of conflicts over managerial control, in which both employees and minority shareholders oppose managers, and in which increased shareholder power strengthens the position of works councils.

Contents

1 Introduction 1
2 European Corporate Governance Reform and Party Behavior 2
2.1 The Battle Over the Takeover Directive 4
2.2 Dependent and Independent Variables 4
2.3 Results of Analysis 7
3 The German Party Paradox **Error! Bookmark not defined.**
3.1 The KonTraG Reform of 1998 13
3.2 After 1998: Corporate Tax Reform and Takeover Regulation 14
4 Where Does the Paradox Come From? 17
4.1 Historical Conversion of Ideas 17
4.2 The Importance of Conflicts Over Managerial Control 20
5 Conclusion 22
References 25
Appendix: Definitions and Sources of Variables 30

1 Introduction

This paper is a contribution to the discussion of the impact of political variables on production regimes. An increasing part of the debate on national models of capitalism concerns the impact of party politics on the organization of production regimes and how this impact is mediated by such institutions as the electoral system and other features of majoritarian versus consociational democracies. Two different, but compatible and complementary ways of designing such research can be distinguished. The first way is to focus on macro variables such as consociational democracy and the organizational features of production regimes as a whole. For example, Gourevitch and Hawes (2002: 244–251) point out that most organized economies are consociational democracies, which can be explained by their tendency to include the interests of labor into politics and by the absence of radical political shifts, which fits in with stable long-term relations between different stakeholder groups. An alternative way of connecting politics with production regimes is to deconstruct the concept of organized economies and to test the partisan hypothesis for different subsystems of production regimes, countries, and points in history. Production regimes are conglomerates of quite different features, such as the corporate governance sphere, industrial relations, competition policy, skill formation, and the welfare regime. It is an open question whether or not parties and political institutions affect different subsystems in the same way: obviously, leftist parties in government tend to favor more codetermination rights for employees than conservative and liberal parties do, but there is no way of concluding from this that leftists also favor a greater degree of organization for the corporate governance sphere. In addition, the impact of parties may differ from country to country, being dependent on different institutional settings and historical experiences.

Both research strategies should be combined, as both are associated with different advantages and problems: comparison and analysis of macro variables reveal overall trends, but lack depth of sharpness, while case studies are detailed, but lack the proof of whether the findings represent typical or exceptional cases. However, the debate on national models of capitalism has identified paradigmatic cases of production regimes, such as Germany and Japan as typical cases of organized economies, and the United States and the United Kingdom as the most liberal market economies. This paper focuses on Germany in the 1990s by combining two lines of inquiry: corporate governance research and the "parties-do-matter approach." I will show that the German Social Democrats opt for more corporate governance liberalization than the Christian Democrats, which seems to violate expectations based on partisan theory. In fact, in the field of the market for corporate governance, Social Democrats instead of Christian Democrats tend to be the market-enforcing party. I will present two explanations for this paradoxical outcome: the conversion of leftist ideas after the Second World War, and the importance of conflicts over managerial control in which both shareholders and employees oppose managers.

The internationalization of financial markets has put European production regimes under pressure to liberalize. In the 1980s, European integration led to competition-oriented reforms of national business locations (Cerny 1997). Beginning in the mid-1990s, reforms were extended to the corporate governance spheres of production systems, resulting in the reform of stock exchange organization, company supervision, disclosure practices, minority shareholder protection, regulation of management compensation, and takeover regulation (McCann 2001; Cioffi 2002; Goyer 2002; Gregory 2000; Hansmann/Kraakman 2001; Hyytinen et al. 2002; Roe 2000, 2001).

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However, little is known about how party interests affect such reforms. Political science has pointed out that political parties have different socio-economic voter clienteles, which affects party ideologies (Budge/Robertson 1987), preferred policies (Schmidt 2002) and, as a result, political outcomes (Alt 1985; Alvarez et al. 1991; Hibbs 1977, 1992; Hicks/Swank 1992; Wilensky 2002). Party differences are most likely to emerge in policy issues with distinct distributional outcomes. As it is a long way from party ideologies to economic outcomes (Imbeau et al. 2001; Schmidt 1996), differences in party ideology are greater than differences in implemented policies, which in turn are greater than differences in outcomes.[1] Marked party differences have been described by welfare state research (Kwon/Pontusson 2002; Wilensky 2002). By contrast, findings on party differences in macroeconomic outcomes such as unemployment, inflation and growth seem to be unstable and very sensitive with respect to the observed time period. The idea that corporate governance arrangements are shaped by partisan politics was chiefly described by Roe, who points out that "social democracies widen the natural gap between managers and distant shareholders, and impede firms from developing the tools that would close up the gap" (Roe 2000: 19). This, according to Roe, leads to high degrees of ownership concentration and impedes the development of markets for corporate control (see also Bebchuk/Roe 1999: 37; Gilson/Roe 1999: 265).

2 European Corporate Governance Reform and Party Behavior

Corporate governance deals with the regulation of power over corporations and differs from country to country as well as over time. Different laws and cultures provide owners of large share blocks, minority shareholders, managers, banks, regional and state authorities, employees and trade unions with different degrees of access to the control of company policy. The main differences have been identified between the Anglo-American style "shareholder-oriented" systems and Continental European "stakeholder systems," in which ownership structures are more concentrated and banks, the state, works councils and trade unions limit the power of shareholders (La Porta et al. 2000). However, as Shleifer and Vishny (1997) have argued, the German, Japanese and US corporate governance systems may differ with respect to mechanisms and distributional outcomes, but they are functional equivalents in the sense that all three systems supervise managers effectively and have supported the economic success of the particular nation.

This paper sets out by focusing on takeover regulation. Institutions that regulate takeover markets are strategically decisive characteristics of production regimes. Hostile takeovers are governance mechanisms to force managers to act in a shareholder-oriented way (Manne 1965). Agency theorists argue that share prices will fall when managers lack shareholder orientation. Low share prices create incentives for takeovers, as the new owners may increase shareholder orientation, raise profits and, as a consequence, boost share prices. The difference between former and recent company price is the takeover premium. The greater the takeover premium is, the greater is the likelihood of takeovers. Therefore, managers who operate in corporate governance systems that permit hostile takeovers should behave in a shareholder-oriented manner in order to prevent hostile takeovers. Empirical studies have indicated that the effects of hostile takeovers are more limited than economic theory would suggest (see, as an overview, Höpner/Jackson 2001: 5–14). However, it is widely accepted that markets for hostile takeovers are the main characteristics of "shareholder-oriented" systems of corporate governance, while "stakeholder-oriented" systems lack hostile takeovers (de Jong 1997; Hall/Soskice 2001: 27–28; Streeck 2001). Consequently, the emergence of markets for hostile takeovers in Europe is likely to push the "Rhenish" models of capitalism in more market-driven, liberal directions (Hall/Soskice 2001: 61; Höpner/Jackson 2001; Streeck 2001). The main

[1] In addition to this, it is also a long way from economic outcomes to satisfying people. That is why the most far-reaching "long-shot" hypothesis on party effects was claimed by Radcliff et al. (2000), who argue that people are happier when leftist parties are in government.

matter of dispute in European takeover regulation has been the extent to which it would promote or impede hostile takeovers.

Why should there be an underlying left-right dimension to this disagreement? First, the procedure for company decision-making is likely to change when hostile takeovers occur. Where codetermination rights allow works councils and trade unions to discuss investment decisions, hostile takeovers might thwart the results of negotiation, as hostile takeovers replace the managements that have been the former bargaining partners. In contrast to "normal" changes in company strategies, hostile takeovers are exclusively decided by capital market participants and cannot be codetermined. In addition, in the case of takeovers by foreign companies, degrees of codetermination decrease as financial decisions are transferred to non-codetermined foreign holding companies.

Second, the rule of thumb that the design of economic institutions has distributional outcomes also holds true for the institutions that regulate takeovers. A crucial insight of the literature on different models of capitalism is that they tend to distribute welfare in dissimilar ways (Hall/Soskice 2001: 21). De Jong (1997) has pointed out that the distribution of the net value added of firms among shareholders, employees, the state, banks and retained earnings varies with respect to the likelihood of hostile takeovers. In systems that include hostile takeovers as governance mechanisms, firms distribute more value added to shareholders, while the percentages of value added that employees receive as wages, as well as retained earnings, are relatively low. Conversely, in systems that are characterized by the absence of hostile takeovers, ratios of wages and retained earnings tend to be higher. The mechanism behind this distributional pattern is the conflict of goals between company growth and profitability growth. Continental European companies have more scope to invest in company growth even if these investments do not increase profitability. As a consequence, German corporations tend to be bigger, but less profitable and less valued by capital market participants compared to UK companies. This is in the interest of managers and employees, but thwarts the interests of shareholders, who would gain an extra profit if "their" companies switched from the "high growth – low valuation" equilibrium to a "low growth – high valuation" point (Höpner/Jackson 2001: 12–14; de Jong 1997). Beyer and Hassel (2002) have shown that this mechanism changed the distribution of net value added in shareholder-oriented German companies in the 1990s. Further evidence comes from the "breach of trust" literature (Shleifer/Summers 1988; Deakin et al. 2002), which shows that shareholders' gains from hostile takeovers tend to result not from increased efficiency, but from the breach of implicit contracts with employees. To sum up, company governance by takeover markets might undermine distributional compromises to the disadvantage of employees.

The third reason why the argument over takeover regulation and corporate governance regulation as a whole should be affected by the ideological left-right dimension is rather theoretical. In the debate on different national models of capitalism, political economists have highlighted the existence of institutional complementarity between different spheres of production regimes, such as the corporate governance sphere, the industrial relations sphere, the education and training system, and even the welfare state. The idea is that these institutions are in a balanced relationship to each other, which should make major changes in only one of these spheres unlikely, although radical shifts in one sphere ought to affect institutional stability in other spheres also. There is no consensus among political economists on the extent and the strength of such complementarity, and some scholars find hybridizations between elements of liberal and organized market economies more conceivable than others.

The extent of complementarity between different spheres of production regimes is the latest point of contention in the models of capitalism debate. But, in the end, all scholars seem to agree that there are interferences between institutions that govern the economy, and also, to some extent, that there are elective affinities that make some combinations of institutions more likely and coherent than others (Amable

2000; Aoki 2001; Boyer 1998; Hall/Soskice 2001; Jackson 2001; Streeck 1991; Whitley 1999). Since centralized wage bargaining, codetermination, trade union participation, and a welfare regime that protects employees against the loss of specific investments are seen as integral parts of organized market economies (Gourevitch 2002; Hall/Soskice 2001: 24–25; Iversen/Soskice 2001) – and since these institutions represent typical goals of leftist movements and parties – there should be general support among leftist parties for the main institutions of organized market economies.[2] This should include an aversion to markets for hostile takeovers, which are a characteristic feature of shareholder-oriented, liberal market economies (see also Roe 2001).

These three considerations lead to the main subject matter of this paper, which is *the expectation that leftist parties, including the left parties of the center, should favor market-restricting corporate governance institutions that are associated with organized corporate governance regimes and, in particular, that they should oppose regulations that promote hostile takeover*s. Conversely, rightist and liberal parties should favor institutions that enhance the role of capital markets in company monitoring and should opt in the main for the introduction of markets for hostile takeovers.

2.1 The Battle Over the Takeover Directive

The aim of this section is to develop an initial indication of how European parties and corporate regulation interact as a whole. I will test the partisan hypothesis on a macro level by comparing the behavior of seventy-five different European parties. This will allow localization of the attitude of German parties, described in detail in the subsequent sections, on a broader landscape.

I use the crucial vote over the conciliation compromise on the European Commission's takeover directive that took place on July 4, 2001, in the European Parliament as a test case for the behavior of European parties toward corporate governance liberalization. Until the 1980s, hostile bids in most continental European countries were so rare that no special regulation was seen as being necessary. Mergers and acquisitions activity was low, and acquisitions were based on negotiations and not on hostile bids (Bergloef/Burkart 2002). In the late 1980s and 1990s, European mergers and acquisitions activity increased remarkably, and some of these acquisitions were hostile takeovers. It was the spectacular *Vodafone*/*Mannesmann* takeover battle in particular that brought takeover regulation, a long-since disputed matter of European integration, back on the agenda. The directive, which was twelve years in the making – the first proposal was presented in 1989 –, was part of the Commission's goal to create a common European capital market. The European Council of Ministers developed a common position on the basis of the 1999 Action Plan for Financial Services. The European Parliament amended the common position in June 2000, and a joint text was agreed by a Conciliation Committee in June of 2001.

The directive would have created a common European framework for takeovers and *would have resulted in a liberal body of rules conducive to hostile takeovers*. The sticking point was article nine of the proposed directive. This stipulated that, in the case of hostile takeover bids, shareholders needed to approve in advance any defensive measures taken by the target company. The only exception allowed would be the case of a company attempting to find an alternative bidder, the so-called "white knight." The opponents claimed that this framework was too liberal and would leave European companies unprotected against hostile bids from "Wall Street sharks." In opposition to the Commission's attitude, critics wanted to allow the boards of target companies to take defensive action if they had sought shareholders' authorization no earlier than eighteen months before the period of acceptance of the bid, which, of course, would

[2] For a general discussion on the interaction of parties and the characteristics of productions systems such as skill formation, see Gourevitch (2002: 25–29).

have adjusted the balance of power in favor of target companies and to the disadvantage of hostile bidders. The main opponent against the Council's position was the German government, and 99 percent of the German MEPs voted against the directive.[3]

The Commission proposal needed an absolute majority of the votes cast in parliament. On July 4, the parliament rejected the Conciliation compromise on the Commission's proposed directive in a tie vote, in which 273 members of the European Parliament voted for the compromise and 273 voted against it. Supporters of the compromise claimed that the voting behavior of MEPs damaged the credibility of the parliament, and that this was a setback for the common goal to create a single European market. However, as far political economy research is concerned, the July 4 incident is a godsend, as it is perfectly suited to use as an empirical test case for the partisan hypothesis, for several reasons. First, every relevant European party in every European member state had to form an opinion on this corporate governance liberalization issue. Second, the point of reference – the Conciliation compromise – was the same for every party in each member state. Third, all MEPs had to vote simultaneously, which keeps the time factor constant. And, fourth, every European party knew that the voting result would be extremely close, so everyone was aware that the behavior of their own European parliamentary subgroup might be decisive in the end. There was no scope for symbolic voting behavior. In fact, the killing of the European takeover directive seems to have been the most relevant decision the European Parliament has ever made, with the exception of the refusal to exculpate the European Commission in December 1998, which led to the resignation of the whole Commission in March 1999. The crucial point here is not that the directive was rejected, but that the voting argument allows us to identify the main dimensions that made national parties in Europe decide either for or against the directive.

2.2 Dependent and Independent Variables[4]

In 2001, the 626 members of the Fifth European Parliament elected in 1999 were delegated from fifteen member states and belonged to eight political groups:

- the Group of the European People's Party (Christian Democrats) and European Democrats (PPE-DE),
- the Group of the Party of European Socialists (PSE),
- the Group of the European Liberal, Democrat and Reformist Party (ELDR),
- the Confederal Group of the European United Left/Nordic Green Left (GUE/NGL),
- the Group of the Greens/European Free Alliance (Verts/ALE),
- the Union for the Europe of the Nations Group (UEN),
- the Group for a Europe of Democracies and Diversities (EDD) and
- the Technical Group of Independent Members (TDI).

By crossing national affiliation and political group affiliation, I divided the European Parliament into seventy-five subgroups. The *percentage* of MEPs of each subgroup – Danish Conservatives, British Labor Party members, Swedish Greens and so on – *that agreed with the takeover directive* is the dependent variable. Therefore, the *dependent variable* varies from 0 (for example, German Social Democrats) to 100 (for example, Spanish Liberals).[5]

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[3]One German PPE-DE member supported the directive. German Social Democrats and Greens voted uniformly against it. German Liberals failed to achieve the 5 percent vote in the 1999 elections.
[4]For data sources, see Appendix.
[5]For help in the construction of this variable, I would like to thank Simone Leiber from the Max Planck Institute in Cologne.

The main *independent variable* is the *ideological affiliation* of the subgroups. As the hypothesis to be tested is that there is an underlying left-right dimension to the range of corporate governance reforms, the subgroups had to be sorted into left-right categories. An obvious problem is to find an adequate position for the Liberal parties that tend to be left of center in questions of human rights, but right of center in the issue of the extent to which free markets should be modified by non-market institutions. Hearl's analysis (1988: 444–445) of 1000 party manifestos and party documents from fourteen countries demonstrates that Liberal parties have a "right-of-center bias indicated by the liberals' rather higher than average placings on such issues as free enterprise, incentives, economic orthodoxy" (about which see also Iversen/Soskice 2002: 10). As the dispute over the market for hostile takeovers fits exactly into this dimension, Liberal parties should tend to agree more with the takeover directive than the parties of the center. Therefore, by using a simple ordinal measure and by referring to the five main party families that Kitschelt (2003) distinguishes, the parties were indexed as follows: Leftist and Green Parties (GUE/NGL and Verts/ ALE): 1, Socialists and Social Democrats (PSE): 2, Christian Democrat and Conservative Parties (PPE-DE): 3, Liberals (ELDR): 4, Rightist Parties[6] (UEN): 5.[7]

I included several *controls*. The most important control variable represents national, party cohesive interests. It is obvious that some countries would profit more, while others would suffer more, from a free market for hostile takeovers. As corporate governance systems and capital market arrangements differ from country to country, companies in some countries are more likely to be the targets of hostile takeover attempts than others. Where economic institutions promote capital market orientation, companies tend to be higher valued by capital market participants, which – in the cases of shares used as takeover currencies – makes them stronger in takeover battles. In addition, companies tend to have better access to risk capital for speculative takeovers where capital markets are highly developed. Conversely, companies in the context of corporate governance systems that promote company growth more than profitability growth should tend to be cheaper for raiders, and the potential takeover premium should be higher. As a measure of these differences, I use the *La Porta et al. index on Shareholders' Rights* that indicates the extent to which a corporate governance system is designed to benefit capital market participants' interests. This index has six ranks and ranges from 0 (Belgium) to 5 (UK).

A further control should accommodate the fact that every parliament is characterized by its own voting characteristics, which may have some systematic influence on the observed data and may not wash out in the regression. Hix (2001: 673) has pointed out that such a dynamic is the *"government-opposition" dynamic*. As parties that belong to the governments of the European member states have had more chance to gain influence in the European Council compared to national oppositions, there may have been a tendency for national opposition parties to oppose the takeover directive more than parties in government. The government-opposition variable is binary coded (1=party is in national government, 0=party is member of

[6]Similar to the Liberals, it is not self-evident that rightist parties are really on the far right in economic issues, as German rightist parties have experimented with a combination of far-right positions on the liberal versus authoritarian axis, but interventionist and redistributive positions on the socio-economic axis. But, as Kitschelt (1995: 66) points out, this is an exception to the rule, and "the rightist parties in all countries but Germany are the most radically procapitalist in their own party system" (see also Betz 1994: 109–119).

[7]The Technical Group of Independent Members (TDI) was not indexed in the ideological affiliation variable as this group was simply set up to profit from the status of a parliamentary faction, which was exactly the reason why the European Court decided to disintegrate the group. The Group for a Europe of Democracies and Diversities (EDD), consisting of members from Belgium, France, the Netherlands and the UK, is a borderline case. Their ideological characteristic is anti-Europeanism, which should be assessed as being right from center. It was decided not to index them in the left-right dimension. However, it should be noted that an inclusion of this group would have supported the tested hypothesis, as most of the EDD members agreed with the takeover directive.

home country's opposition). A second conflict that is typical for the European level is the conflict between large and small member states, in which small member states claim to be excluded by the large states when main reforms are informally prepared. Therefore, country size, measured by the *number of residents*, was included.

Nation-specific attitudes toward takeover regulation may also be influenced by national economic business activity, as expanding corporations may be more interested in a takeover-facilitating framework than companies in stagnation. In order to control for this possibility, *national GDP growth in the half decade before the vote* of the European Parliament was calculated. This control varies from 9.01 percent (Germany) to 41.01 percent for the Irish economy, which was expanding enormously in the 1990s.

Results of Analysis

Table 1 shows the results of three OLS regression equations,[8] using the voting behavior of MEPs as dependent variables and both ideological affiliation of European Parliament subgroups and different combinations of controls as independent variables. The equations indicate *a strong influence of ideological affiliation in the predicted direction*. In each of the three equations, the ideological affiliation variable is significant at the 0.01 level. The non-standardized regression coefficients can be interpreted as percentage point differences. Assuming constant ideological differences between the five distinguished ideological

Table 1 Determinants of Voting Behavior[a]

Variable	Prediction	Equation 1	Equation 2	Equation 3
Constant		˜26.523	˜19.846	˜18.224
		(11.825)	(16.965)	(17.380)
Ideological affiliation		22.920***	22.529***	22.739***
		(3.295)	(3.361)	(3.439)
La Porta et al. index		9.082***	11.748***	–
		(3.257)	(4.172)	
Party in national government		–	9.766	4.671
			(9.024)	(9.047)
Country size 2001		–	˜0.169	0.033
			(0.203)	(0.195)
GDP growth 1995–2001		–	˜0.657	0.685
			(0.793)	(0.648)
N		75	75	75
R^2 (adj.)		0.474	0.464	0.403

OLS Regression Results with standard errors in parentheses. Missing values: see definitions and sources of variables; variables excluded pair-wise. *** p<0.01. Software: SPSS.

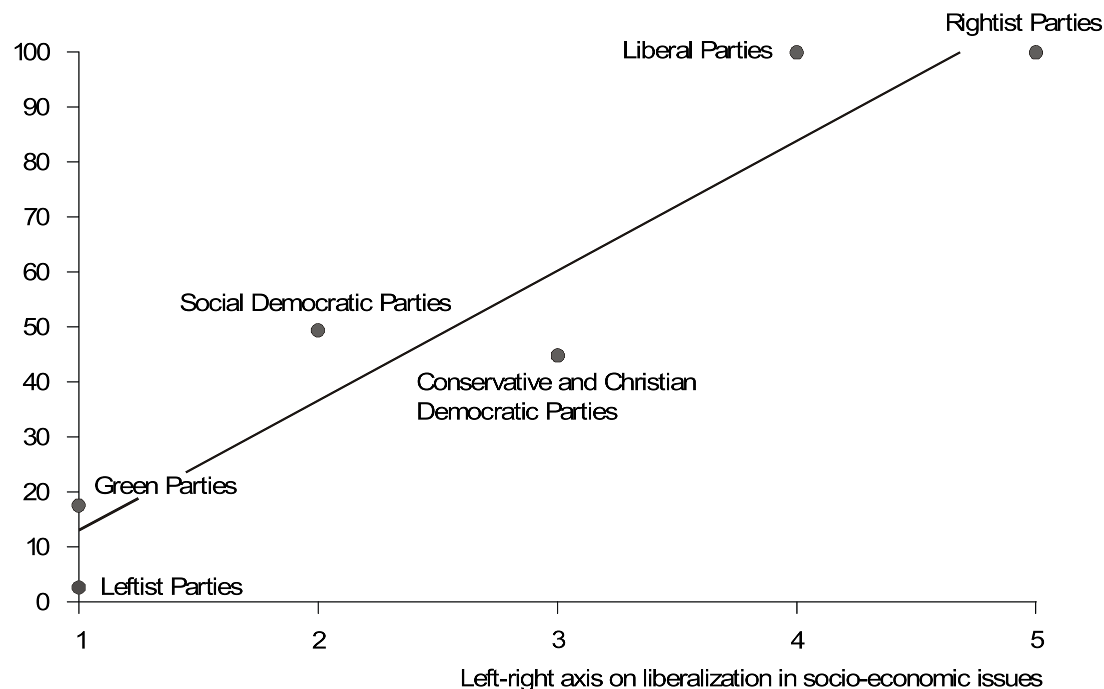
a Dependent variable: Percentages of subgroup members that voted in agreement with the takeover directive.

[8] As the dependent variable varies between 0 and 100 – similar to unemployment rates or ratios of public expenditure, which can by definition never be lower than 0 or larger then 100 – an alternative to OLS regression would have been a logistic regression. However, I argue that the strength of the results indicate that the replacement of the OLS method with logistic regression would not alter the results. I thank Andreas Broscheid for drawing my attention to this problem.

blocks, a change from one block to the next block on the right is associated with an approximately 23 percent increase of subgroup members in agreement with the takeover directive. The incorporation of controls does not affect the magnitude and significance of this effect.

However, these results *suggest greater explanatory power for the ideological affiliation variable than they actually have*. Figure 1 shows that the strong relationship between ideological affiliation and voting behavior (r=.95***, six party families) is exclusively driven by leftist, green, liberal and rightist parties. These groups behave as predicted. In contrast to this, the prediction that there should be differences in voting behavior between Social Democrats and Conservative or Christian Democrat parties does not hold true. 49.4 percent of PSE members and 44.8 percent of PPE-DE members agreed with the takeover directive. Furthermore, in 13 out of 15 national cases, the majorities of Socialist and Christian Democrat/Conservative subgroup members voted together. The data show that there actually is a left-right dimension to

Figure 1 Parties and Agreement with the Takeover Directive



r = .95, R^2 (adj.) = .87

the investigated corporate governance liberalization issue. But, as 65 percent of all MEPs belong to either the PSE or the PPE-DE groups, the voting behavior of a large part of MEPs was affected by other considerations.

For Social Democrats, Conservatives and Christian Democrats, national interests mattered more than differences in ideological affiliation. Table 1 shows that the La Porta et al. index on the development of national financial markets has a strong and significant influence on the agreement with the 2001 takeover directive. According to equations 1 and 3, every one-step increase in the six-ranked index results in a 12 percent increase in agreement with the suggested liberal takeover regulation. Figure 2 shows that the fi-

nancial market orientation of corporate governance institutions explains the voting behavior of center party members to a large extent. In Belgium, Italy, Germany, Greece, the Netherlands and Austria, where the magnitude of capital market orientation is below average, Social Democrats and Christian Democrats/ Conservatives tended to vote against the directive. In Finland, France, Portugal, Sweden, Ireland and the UK, where minority shareholders' rights are indicated to be above average, majorities of center party members agreed with the corporate governance liberalization issue. Table 1 indicates no significant influence of other control variables.[9] To sum up, analysis shows that the voting behavior of leftists, Greens, Liberals[10] and rightist party members was affected by their ideological affiliation, while Social Democrats, Christian Democrats and Conservatives voted with respect to their national affiliation.

Why did MEPs of the center from countries with less capital-market-oriented corporate governance regimes tend to oppose a liberal takeover regulation? The weapons in hostile takeover battles are share prices. Share prices vary with profitability, which is greatly affected by the institutions that regulate company behavior in the conflict of goals between company growth and profitability growth. As mentioned above, German companies tend to be much bigger, but much lower valued by capital market participants, compared to UK companies. Therefore the "share price weapon" tends to be more developed in countries with high levels of capital market orientation. In addition, politicians from organized economies might be more sensitive to the "breach of trust" problem: organized economies such as Germany's rely more than liberal market economies on the willingness of employees to invest in company-specific skills (Hall/ Soskice 2001). This increases the amount of both implicit and explicit contracts with employees that might be breached by successful hostile raiders, which might undermine the preconditions for the comparative advantage of organized economies.

By using data covering twenty-one OECD countries, Table 2 shows correlations between the La Porta et al. index and other institutional variables, which explore further characteristics of the different country groups. Not surprisingly, *transparency* and *share dispersion* tend to be higher in countries with capital-market-oriented corporate governance systems. The high correlation between the La Porta et al. index and the *Hall/Gingerich index of overall production regime coordination* shows that countries with less capital-market-oriented production regimes display further attributes of organized market economies. This index was constructed by using data on the degrees and levels of wage coordination (Hall/Gingerich 2001), among other measures. As Table 2 indicates, there is also a high and significant negative correlation between the shareholder orientation of corporate governance systems and *employment protection*. Employment protection tends to be lower when capital market orientation is high. The protection of different economic groups has different priorities in different countries, which affects outcomes such as company size, profitability and share prices. A liberal takeover regulation is likely to strengthen capital-market-oriented companies and to push others into a more capital-market-oriented direction. To conclude the empirical analysis of the voting behavior of European parties in July 2001, I demonstrate that none of the variables discussed in this section rule out the explanatory power of ideological affiliation and the La Porta et al. index (Table 3). By using all nine measures as independent variables in one regression, there still remains support for the findings of equations 1–3 in Table 1, while none of the four additionally included and moderately inter-correlated variables acquires a significant result.

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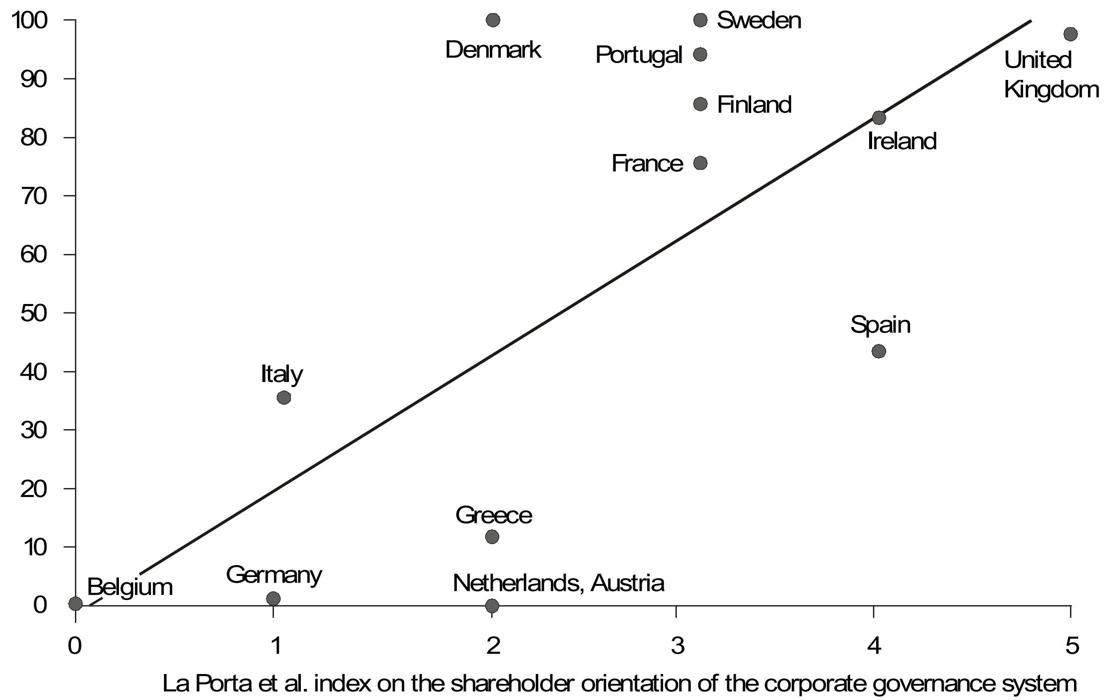
9 Because of heterogeneous error variances of the dependent variable, standard errors might be overestimated, which raises doubt as to the acceptance of the null hypotheses. I thank Andreas Broscheid for pointing this out.

10 The voting of the Liberals is also interesting with respect to the uniformity of their voting. Research on European party systems has emphasized on the lack of homogeneity of the liberal party family and the ELD group in the European Parliament (Hix 2002: 689; Kreppel/Tsebelis 1999: 957; Smith 1988: 16; Steed/Humphreys 1988: 396).

Figure 2 Shareholder Orientation of Corporate Governance System and Percentage of Social Democrats, Christian Democrats and Conservatives in Agreement with the Takeover Directive



$r = .67$, R^2 (adj.) $= .41$

Table 2 Correlation Matrix: Characteristic Features of Countries with Shareholder Oriented Corporate Governance Systems

	La Porta et al. index	Transparency	Ownership concentration	Hall/Gingerich index	Employment protection
La Porta et al. index	–	0.44 (n=20)	˜0.684* (n=21)	˜.743 (n=19)	˜.46 (n=21)
Transparency	–	–	˜0.634* (n=20)	˜0.4 (n=18)	˜0.49 (n=20)
Ownership concentration	–	–	–	0.59 (n=19)	0.586* (n=21)
Hall/Gingerich index	–	–	–	–	0.731* (n=19)

Pearsons r. *** p<0.01, ** p<0.05, * p<0.1.

As my analysis has shown, *two dimensions explain differences in the attitudes of European parties toward the liberalization of corporate governance*: first, *the ideological affiliation* of parties on the left-right axis; and, second, *national institutional configurations*, especially the national interests resulting from the degree of shareholder orientation of national corporate governance systems, which is highly correlated with the degree of overall production regime coordination.[11] So far, resistance to the pressures for further European-wide corporate governance liberalization should be anticipated where leftist parties are strong and where national configurations shape the characteristics of organized economies, such as low degrees of shareholder orientation, vocational training systems that create company specific skills, company networks, and high degrees of wage coordination. Laterally reversed, liberalization is likely to be pursued where not only current shareholder orientation is strong, but also where other characteristic features of organized market economies are absent and where leftist parties are weak.

3 The German Party Paradox

The analysis has shown that there actually is an underlying left-right dimension to the discussion on corporate governance liberalization. The existence of a second, national and cross-pary dimension might lead to a reduced significance of the first dimension. But it does not explain why national parties might behave paradoxically in the sense that they change their position on the left-right scale with another party. In the following section, I will show that *the German SPD supported more corporate governance liberalization than its rightist neighbor in the German party system, the CDU.*

[11]This finding fits with Hix' (2002: 688) distinction between two dimensions of voting behavior in the European Parliament, one depending on parties, the other depending on nations.

Table 3 Determinants of Voting Behavior[a]

Variable	Prediction	Equation
Constant		~124.681
		(70.772)
Ideological affiliation		22.743***
		(3.354)
La Porta et al. index		13.388**
		(6.904)
Party in national government		8.853
		(9.439)
Country size 2001		~0.301
		(0.223)
GDP growth 1995–2001		~0.908
		(0.873)
Transparency		0.819
		(0.693)
Ownership concentration		60.103
		57.853
Hall/Gingerich index		0.337
		(0.265)
Employment protection		0.795
		(7.602)
N		75
R^2 (adj.)		0.550

OLS Regression Results with standard errors in parentheses. Missing values: see definitions and sources of variables; variables excluded pairwise.

***p<0.01, **p<0.05. Software: SPSS.

a Dependent variable: Percentages of subgroup members that voted in agreement with the takeover directive.

The mid-1980s saw the start of a set of reforms in German stock market and company regulation (Cioffi 2002; Cioffi/Stephen 2000; Deeg 2001: 26–29; Lütz 2000; Ziegler 2000), initiated by a discussion on the quality of Germany as a location of production *(Wirtschaftsstandort Deutschland)*. In the first phase, when the underdevelopment of the national capital market was increasingly seen as a comparative disadvantage, the aim of these reforms was not to change the German corporate governance system fundamentally, but to add a more active capital market to the unaltered attributes of the economic system. The quality of reforms changed in the late 1990s, when the coherence of economic policy seemed to vanish and interlocking directorates, insider-oriented accounting standards and limited minority protection turned out to be inconsistent with the political goals of the "competition state" (Cerny 1997). The reforms of the late 1990s were not harmless, minor reforms like the introduction of electronic stock trading in 1989, but went straight to the heart of the German corporate governance system (Beyer/Höpner 2003).

I have distinguished three reform complexes. The first complex concerns transparency, management accountability and minority shareholder protection and was affected by the 1998 Corporate Sector Supervision and Transparency Act *(KonTraG, Gesetz zur Kontrolle und Transparenz im Unternehmensbereich)*, by the 1998 Raising of Capital Act *(KapAEG, Kapitalaufnahmeerleichterungsgesetz)*, by the work of the "Cromme Commission" that developed the Corporate Governance Codex published in 2001,

and by the 2002 Corporate Sector Transparency and Publicity Act (*TransPuG, Gesetz zur Transparenz und Publizität im Unternehmensbereich*). The second complex concerns the dismantling of interlocking capital, which was advanced and accelerated by the 2000 change to the Corporate Income Tax Law *(Körperschaftssteuergesetz)* that totally abolished the tax on profits from the sales of large share blocks. The third reform complex is takeover regulation, which concerns the discussion on the abandoned EU directive and the 2001 Takeover Law *(Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und Unternehmensübernahmen)*. What the three corporate governance reform complexes have in common is that they were connected, to some extent, with the creation of a market for corporate control, because the implementation of the "one share, one vote" rule, the disentanglement process and a reliable takeover regulation are all preconditions for company control through takeover markets. Some of the reforms implemented were passed in consensus, while parties were in conflict over others. Comparison of the corporate governance reforms shows that, when parties were at variance, the SPD favored market enforcement more than the CDU, which is inconsistent with the partisan hypothesis and the expectation that Social Democrats and trade unions prevent firms from developing tools to close the gap between shareholders and managers (Roe 2001).

3.1 The KonTraG Reform of 1998

The KonTraG was passed in 1998 and represented the first significant change of direction in German corporate governance regulation. Beside some limited modifications to supervisory board regulation, risk management and bank ownership of industrial capital, this capital-market-oriented law legalized share buybacks, facilitated the introduction of stock options and, above all, abolished unequal voting rights. As a result, Germany was one of the precursors of the "one share, one vote" rule in Europe, which was of importance in the 2000 takeover battle between *Vodafone* and *Mannesmann*. In its commentary on the law, the Federal Ministry of Justice took the historical step of abolishing the stakeholder view of the firm (which had been written down in the Stock Corporation Act *[AktG, Aktiengesetz]* of 1937 and approved by the Federal Constitutional Court in 1979) and of introducing a shareholder-oriented view, stating that it had no alternative but to introduce this reorientation (see Beyer/Höpner 2003). Another significant development in 1998 was the passage of a controversial law that allowed stock corporations to adopt capital-market-oriented accounting standards (IAS or US-GAAP) instead of the rules of the German Commercial Code *(HGB, Handelsgesetzbuch)*, thereby effectively deregulating accounting. Corporate governance reform continued with the 2002 TransPuG, which obliged stock corporations to publish a yearly statement in order to explain whether or not – and, if not, why – they accepted the corporate governance codex of the Cromme Commission, in addition to some further provisions to strengthen the rights of supervisory boards in their interaction with management boards.

How did the political parties behave in the debates on the KonTraG? The main driving force behind this corporate governance reform was the smaller CDU coalition partner, the FDP, the German Free Democratic (Liberal) Party. When the KonTraG was debated in the Bundestag, the FDP speaker Otto Graf Lambsdorff said that the law was only a partial success for the FDP, and he regretted that the FDP was not able to push the CDU toward further liberalization in the exhausting coalition negotiations. Germany, Graf Lambsdorff said, is a rent-seeking society, and German companies need more pressure exerted from capital markets.[12] The CDU speaker Joachim Gres opposed this, by saying that a change of direction in German corporate governance was neither intended nor necessary. "Constancy," he said, "is important in economic policy. … Please don't think that the job of economic policy makers is to permanently introduce new ideas," and

[12]See Otto Graff Lambsdorff in the debate over the KonTraG, minutes of the Bundestag debate 13/220 from March 5, 1998. The translated quotation that follows below is by the author, Martin Höpner, as are all other translations in this paper.

he insisted that the notion of a "Germany Inc." built upon quasi-cartels had no equivalence in reality (ibid.). And Hartmut Schauerte from the CDU insisted that it was pure ideology to say one should restrict the power of German banks, as it was politics that pleased banks to intervene in industrial crises (ibid.).

So far, this is consistent with the partisan hypothesis. The similarity ends, however, when we turn to Hans-Martin Bury, the corporate governance expert of the SPD who introduced its own corporate governance reform blueprint (see also Cioffi 2002). He called the KonTraG a placebo law to appease the demands of the public without introducing any substantial change, a law to protect managers and banks. The German corporate sector, Bury argued, suffers from the power of banks, interlocking directorates, a lack of transparency, and disabled company control by the capital market, which leads to a lack of innovation. He cited critics who called these "encrustations" the "sovietization of the German economy" and demanded a prohibition of industrial stock ownership of banks and more company control by capital markets (ibid.). Similarly, the SPD expert Eckehard Pick said that the protection of shareholders and the further development of the capital market were important goals for the SPD (ibid.). Margarete Wolf, speaking for the Green Party, concurred, criticized the power of banks and said that the share market has to be transformed into a market for corporate control (ibid.). And even a speaker of the post-communist PDS, Uwe-Ernst Heuer, made the criticism that interlocking capital turns the economic order upside down. More corporate control by the capital market, he said, would accommodate the ideas of the PDS on developing democracy, and it would revitalize the economy.[13] In this debate, *the CDU turned out to be the only party protecting "Rhenish capitalism"* (Albert 1993), having no other political ally anymore.

The behavior of the parliamentary left was supported by trade unions. They welcomed the KonTraG – including the abolition of unequal voting rights –, followed by the Corporate Governance Codex of the Cromme Commission (in which trade union representatives were incorporated) and the TransPuG, as well as the KapAEG that allowed companies to publish IAS and US-GAAP balance sheets instead of using the HGB accounting rules. Trade unions demanded (and still demand) a European directive to make the IAS standards incumbent on all German companies, not just stock-listed corporations, and also call for laws to enforce the determinations of the Corporate Governance Codex juristically (see Bolt 2000; Köstler 2000; Köstler/Müller 2001; Küller 1997; Putzhammer/Köstler 2002; Scheibe-Lange/Prangenberg 1997; Schmoldt 2002).[14]

3.2 After 1998: Corporate Tax Reform and Takeover Regulation

A manifest explanation for this puzzling constellation might be that there was simply a government-opposition dynamic in force that made the opposition criticize the (feigned) impotence shown by the government over introducing far-reaching reforms. It should be noted that the other two important corporate governance reforms were passed after the change in government in late 1998, when CDU and FDP were in opposition and SPD and Green Party were in government; still, the CDU was most likely to be the party of "German capitalism" (Streeck 1995). As there was a broad consensus over the recommendations of the Cromme Commission, the 2002 TransPuG was not as much disputed as the 1998 KonTraG was. Nonetheless, it was the CDU that suggested constancy in corporate governance regulation. In the Bundestag debate

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[13] Ibid. In the 2002 Bundestag debate over the TransPuG, the same PDS speaker argued that Germany had to catch up with international corporate governance standards. "There's much more to do in German corporate governance reform and shareholder protection. Let's do it together!" Minutes of the Bundestag debate 14/231 from April 19, 2002.

[14] Please note that Roland Köstler, Michael Müller and Arno Prangenberg – unlike Marie Bolt, Hans-Detlev Küller, Heinz Putzhammer, Ingrid Scheibe-Lange and Hubertus Schmoldt – are not trade union officials, but experts who advise trade unions.

on the TransPuG, the only speaker who cast some doubts on the current developments was Susanne Tiemann of the CDU who said that “no matter if we like it or not: shareholder value also concerns German corporations,” and she advised against accounting reforms that might be later abolished by EU regulation, as it was risky to jeopardize continuity in corporate regulation.[15]

In the late 1980s, an extensive restructuring of the German corporate network began which picked up speed in the mid-1990s. Between 1996 and 2000, the number of capital ties between the one hundred biggest corporations declined from 169 to 80,[16] and the large financial companies of *Deutsche Bank* and *Dresdner Bank* in particular moved from the network center to a more peripheral network position. It had long been discussed how politics could force the dismantling of interlocking capital, especially industrial capital held by banks. There were two possible options to choose from. The first was to forbid banks from owning more than five percent of industrial companies. Critics of this view – though they shared the view that interlocking capital should be dismantled – insisted that this was only possible in combination with lower taxes on profits from the sale of share blocks, which was the second possible course of action. Otherwise, it was argued, a law against industrial ownership of financial companies would be an expropriation act.[17]

It was a political surprise for all observers including capital market participants that the Schröder government opted for the total abolition of this corporate income tax *(Körperschaftssteuer)* in the context of the 2000 Tax Reduction Act *(Steuersenkungsgesetz)* without hurting banks with any prohibition act. The motivation for this reform was explicitly to abolish interlocking capital and, as a consequence, to change the corporate governance mechanisms and to create a more active market for corporate control. Beside the “systemic” redistribution consequences postulated in this article (i.e. the tax abolition should speed up network dissolution, which should lead to a growing number of companies exposed to the market for control, which in turn should increase shareholder orientation by causing a reorientation in the conflict of aims between company and profitability growth, which then should redistribute welfare from employees to shareholders), the abolition of the corporate income tax on profits from share block sales, sometimes called the “Eichel Plan,” had obvious immediate distributional consequences. When the insurance company *Allianz* sold their 13.6 percentage equity stake in *Hypovereinsbank* in 2002 and earned 2 billions of euros as a result, there was no profit tax raised for this. This “tax gift” for the big financial corporations led to a massive conflict between political parties, in which the SPD and the Greens were opposed by the CDU and the PDS, with the FDP caught between the ideological positions.

In the Bundestag debate over the Tax Reduction Act in May 2000, the opposition parties criticized the fact that SPD and Greens had redistributed in favor of large stock companies, while not assisting the small corporations *(Mittelstand)*. CDU, FDP and PDS members of parliament applauded the CDU speaker Peter Rauen when he said that he could not believe it when he heard that finance minister Hans Eichel planned to abolish this tax totally, pointing out that the SPD and trade union protest would have been enormous if the former CDU-FDP coalition had introduced this reform.[18] The CSU member of parliament Gerda Hasselfeldt said that the reform lacked any idea of fairness (ibid.), and the popular speaker of the postcommunist PDS, Gregor Gysi, received applause from the CDU and FDP groups when he said:

[15]See Susanne Tiemann in the minutes of the Bundestag debate 14/231 from April 19, 2002.
[16]Data source: Monopolkommission.
[17]See Otto Graf Lambsdorff in the debate on the KonTraG, minutes of the Bundestag debate 13/220 from March 5, 1998.
[18]See Peter Rauen in the debate over the *Steuersenkungsgesetz*, minutes of the Bundestag debate 14/105 from May 18, 2000.

> Our government is lead by Social Democrats. How can I explain the following to the citizens? If a baker sells his bread shop, the state wants taxes. If *Deutsche Bank* sells share blocks, the Social Democrat government says they don't want a single Pfennig as tax. I can't understand this. What's social democratic about that? (ibid.)

In this debate, SPD speakers like Lothar Binding were on the defensive when they explained their political goal to reform the corporate governance system by speeding up network dissolution.[19] Edmund Stoiber, who was the conservative candidate for Chancellor in the 2002 election, used this issue in his election campaign and announced his intention of reintroducing the tax as Chancellor, which was welcomed by trade union speakers, who said that "it seems like Stoiber found such ideas in trade union manifestos," while industrial representatives opposed Stoiber and wanted to protect this "good and important innovation" (see "heute online," 20.4.2002).

The third important corporate governance reform issue is takeover regulation. After the failure of the European directive, the Schröder government introduced a national takeover law in October 2001, which was less liberal than the Commission's proposal for two reasons: it allowed the target company's board to take defensive measures if it had sought the shareholders' authorization no earlier than eighteen months before the bid, and it allowed supervisory boards to legitimize defensive measures (see § 33 of the law). However, this law was definitely no "anti-takeover law" as liberal critics claimed it to be. The law still provides a regular playground for (friendly or hostile) takeovers, and it should be mentioned that most other countries provide more privatized companies with "golden shares" than Germany does. After decades of a virtual absence of hostile takeover attempts, the "hostile" trade of large share blocks is now accepted in Germany, which includes acceptance by the legislator (see also Cioffi 2002).

The crucial point here is the difference in party attitudes. Differences were smaller compared to the conflicts over the 1998 KonTraG and the 2000 Tax Reduction Act, but they existed and were emphasized. The FDP criticized the takeover law as not being liberal enough. Rainer Funke from the FDP said in the Bundestag debate, "the chancellor gave in to the pressures of trade unions and managers who protect their benefices against international competition" and called the takeover law provincial,[20] which is not surprising, but consistent with the ideological affiliation hypothesis. Once again, the CDU turned out to be the defender of Germany Inc. The CDU expert Hartmut Schauerte welcomed the failure of the European takeover directive and said that it was primarily the CDU that had criticized the European directive as being too liberal. In addition to this, he also argued that the German takeover law failed to allow enough defensive measures to be taken by managers in order to prevent hostile takeovers. The eighteen-month period allowed for shareholders' authorization resolutions, he argued, was too short and should be replaced by a 36-month period. In the negotiations of the responsible Parliamentary Financial Committee *(Finanzausschuss des Deutschen Bundestages)*, the CDU also wanted to decrease the 75 percent threshold provided for the resolutions of the shareholders' meetings.[21] In opposition to this, the SPD speaker Nina Hauer said that "the shareholders own the corporation and should have the final say,"[22] and Andrea Fischer from the

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[19]Ibid. – In a letter (No. XIV/2002) for the members of the CDU/CSU faction in the Bundestag, faction chairman Friedrich Merz wrote with respect to the crisis of the engineering company *Babcock*: "This is the disentanglement of Germany Inc. – a SPD type of disentanglement: the jewels are bought by Americans, the rest goes bankrupt" (online).

[20]See Rainer Funke in the debate on the takeover law, minutes of the Bundestag debate 14/192 from October 11, 2001.

[21]See Beschlussempfehlung und Bericht des Finanzausschusses, Drucksache 14/7477, November 14, 2001.

[22]See Nina Hauer in the debate on the takeover law, minutes of the Bundestag debate 14/201 from November 15, 2001.

Green Party declared that the German takeover law might be much more liberal than it appears, as many companies might abandon implementing the ex ante shareholders meetings' resolutions on defensive measures by management boards.[23] Trade unions, by and large, supported the SPD attitude, as they preferred to allow codetermined supervisory boards to legitimize defensive measures. The PDS decided to abstain from voting in the Bundestag ballot on the takeover law.

In summary, the attitudes of the German political parties toward the main corporate governance reforms since the late 1990s – the KonTraG, the KapAEG, the TransPuG, the abolition of the corporate income tax on profits from the sales of share blocks, and the Takeover Law – show a distinct pattern that is *inconsistent with the ideological affiliation hypothesis*. When differences in party positions occurred, Social Democrats favored more liberalization than the Christian Democrats and were closer to the attitudes of the FDP than the CDU was. The CDU, not the SPD, turned out to be the party of "Rhenish" capitalism. Taking the distributional outcomes of corporate governance liberalization into account, this paradox outcome contradicts the expectations of partisan theory. Are there any explanations for this discrepancy?

4 Where Does the Paradox Come From?

In this section, two explanations for the party paradox will be discussed: The historical conversion of ideas and the importance of conflicts over managerial control.

4.1 Historical Conversion of Ideas

I begin this argument by distinguishing two very different leftist views on interlocking capital as a main feature of organized capitalism. The first view was expressed by Lenin (1985/1917) and shared by most German socialists, including the early Hilferding. In his theory on imperialism, Lenin described German capitalism as a mixture between monopoly and competition, mostly driven by interlocking capital and interlocking directorates from the large German banks (Lenin 1985/1917: 45–50), which resulted in a concentration of capitalist power to the detriment of labor. Consequently, the centers of interlocking capital were seen as natural points of attack in the revolutionary endeavors of socialists and communists. This line of argumentation was further developed by supporters of the theory of "state monopoly capitalism" (*Staatsmonopolistischer Kapitalismus* – Stamokap) that was influential in German leftist movements, including parts of the SPD, at least until the late 1970s. In the Stamokap view, Lenin's theory on imperialism resulted in the strategy of building an "anti-monopolistic force" in formal agreement with other societal movements that disapproved of the entanglement and monopolization of financial and industrial capital (Esser 1998: 620; Huffschmid 1995: 2). A non-monopolistic capitalism was seen as an intermediate stage on the way toward socialism.

In the 1920s, this view lost ground in the discussions of the trade unions and the SPD and was replaced by a view that was expressed by socialist theorists like Naphtali and the late Hilferding. Both, together with other theorists like Sinzheimer, were asked by the board of the German trade union organization, the ADGB (*Allgemeiner Deutscher Arbeiterverband* – German General Workers Association), to develop a conception of the trade union's view on organized capitalism and on adequate leftist responses. The outcome was the 1928 book on "economic democracy" (Naphtali 1969/1928) that soon dominated the socialist discussion. Naphtali and his commission argued:

[23] See Andrea Fischer in the debate on the takeover law, minutes of the Bundestag debate 14/192 from October 11, 2001.

> This complete organization of capitalism, this onward development of free competition toward planned production with the aim of a monopolistic market formation is not a democratization process … However, although we do not wish to camouflage the capitalist character of the new form of organization, we believe that this development will result in an impulse for the development of economic democracy, and *we believe that this development has already begun.* [emphasis by the author] (Naphtali 1969/1928: 35–36)

They emphasized the *interpenetration* of the modern economic and political spheres, in opposition to the Leninist view, and believed that the competition-impeding organization of capital could be used as a tool to oblige corporations to act in accordance with societal goals. Consequently, the Naphtali commission rejected ideas that trade unions should call for the disentanglement of organized capital by the state. This, said the commission, would be a backward, not a forward, move (Naphtali 1969/1928: 37). Hilferding, in line with Naphtali, wrote that the innovation of organized capitalism was that corporations had ceased to be the private affair of capitalists, and that this introduced the socialist principle of planned production into a capitalist economy (Hilferding 1924). Such ideas were widely accepted by the late Weimar trade union and SPD movements, and Hilferding presented the new view on organized capitalism at the 1927 SPD party congress in Kiel, akin to Naphtali who gave his famous speech on economic democracy at the 1928 German trade union congress in Hamburg.

In order to understand the current trade union and SPD attitude toward interlocking, organized capital, it is crucial to conceive that these ideas were driven in new directions at two historical junctures. The Hilferding-Naphtali view on organized capitalism did not survive World War II. As to the collaboration of the center of interlocking capital with the Nazi regime and its important role in war preparation, the trade unions stopped their opposition to disentanglement. In their second nation-wide conference with representatives from the different Allied occupied districts in December 1946, the trade unions expressed the view that "both world wars have shown that the war-enforcing pressure came from the concentration of capitalist power in monopolies, cartels, trusts and horizontal economic groups and the malpractice of their power."[24] In his famous speech at the Munich founding congress of the Federation of German Trade Unions in October 1949, trade union leader Hans Böckler declared, "it must never happen again that economic agglomerations, transformed into political power, destroy a democratic constitution, as happened to the Republic of Weimar" (Deutscher Gewerkschaftsbund 1989/1949: 202). Beside the nationalization of main industries, the trade unions called for a consistent disentanglement of capital in their first manifesto (Leminsky/Otto 1974: 248) and, later, fiercely attacked both the reform of concentration and interlocking capital that happened in the 1950s and the powerless anti-cartel policy of the Adenauer government. With respect to the 1957 Act Against Restraints of Competition *(Gesetz gegen Wettbewerbsbeschränkungen)*, the trade unions organized a mass demonstration in Dortmund in November 1958, voicing the opinion that "the concentration of economic power again starts to endanger the democratic state."[25] In short, *the trade unions had definitely ceased to favor interlocking capital over separated, competing economic units*.

This reorientation was not undisputed. In 1950, galvanized by various draft laws over competition policy, the trade unions' attitude was discussed in the monthly trade union discussion forum "Gewerkschaftliche Monatshefte." Rolf Wagenführ, in line with the Hilferding-Naphtali approach, argued: "Trade unionists should not favor atomization, but organization of markets. But organization implies not disentanglement but the perpetuation, and even the creation, of interlocking capital" (Wagenführ 1950). But such expressions were an exception to the rule, and a majority of trade unionists and Social Democrats developed a

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[24] Quote from Weiss-Hartmann/Hecker (1977: 291).
[25] Quote from Deppe (1977: 379–380).

strong preference for anti-cartel competition policy.[26] This does not mean that trade unions and Social Democrats favored liberal market economies in the 1950s. They still were socialist movements, and their prevailing idea on "economic democracy" was a mixed economy consisting of a large nationalized economic sector in addition to a private sector under a strong competition regime without interlocking capital, supplemented by a sector with public ownership – but not state ownership, rather collective *(genossenschaftlich)* ownership – including trade union ownership *(Gemeinwirtschaft)*. Concentrated and interlocked, "organized," capital was no longer a welcome intermediate stage on the way to this goal.

Of course, the story does not end here. The late 1950s witnessed a second reorientation, clearly articulated in the November 1959 Godesberg manifesto of the SPD, when socialism was finally abandoned as the ultimate aim of the Social Democrats and the nationalization of main industries was no longer a political goal. Trade unions reproduced the same reorientation in their 1963 Düsseldorf manifesto. At this point, the still surviving idea of disentanglement lost its socialist background, and my argument is that *this conversion of ideology led to a liberal attitude that was formerly constructed as a part of a socialist idea*. In the 1963 Düsseldorf manifesto, and in all the manifestos that followed, trade unions called for disentanglement, the abolition of concentration-enforcing tax policies and, above all, the reduction of the power of the banks by state policy (Haferkampp 1966: 10; Leminsky/Otto 1974: 252). In 1966, a liberal observer concluded, "the manifestos of the SPD and trade unions have made, if I may say so, significant steps toward neo-liberal ideas" (Gutowski 1966: 17). The crucial point is not that trade unions and Social Democrats did away with leftist ideas, but that *a conversion of ideas set in that redefined what it meant to be leftist in the context of an organized economy*. Leftist thinking took a more liberal direction, and this attitude survived in the SPD, which claimed in its 1989 Berlin manifesto "in order to repress the power of banks and insurance companies, we favor the disentanglement of capital ties between companies" (Sozialdemokratische Partei Deutschlands 1998: 46).[27] This is the historical reason why the Social Democrats arrived at attitudes like the call to forbid banks to own more than five percent of industrial companies, which fitted exactly with calls from such quarters as the neo-liberal Monopoly Commission (Monopolkommission 1976, 1998) and Free Democrats like Graf Lambsdorff (1989: 81–82), and why Social Democrats favor more corporate governance liberalization than the Christian Democrats.

In the golden years of German organized capitalism, the SPD-FDP government between 1974 and 1982 also used organized capital as a vehicle to reach common goals. Banks and insurance companies were often directly forced to invest in industrial firms, sometimes even in conflict – in order, for example, to prevent takeovers from oil-producing companies in the 1970s *(Mercedes-Benz)*, to prevent the disintegration of companies *(Gerling)* and to prevent bankruptcies *(AEG, Holzmann)* (see examples in Beyer 2002, Streeck/Höpner 2003). Above all, the protection against hostile takeovers that was mainly arranged by financial corporations allowed industrial companies to persist in a low profitability – low market capitalization equilibrium that provided room to maneuver for huge company growth and diversification strategies, which in turn allowed the German industrial sector to absorb a greater element of the labor force compared to other countries, despite the fact that the overall labor- market participation rate was below average (Höpner/Jackson 2001). And, of course, the unions were also part of organized capitalism and profited from its steering capacity. For experts like Shonfield (1965) and Zysman (1983), the power of German banks was a functional equivalent to the high degree of state intervention seen in the French system.

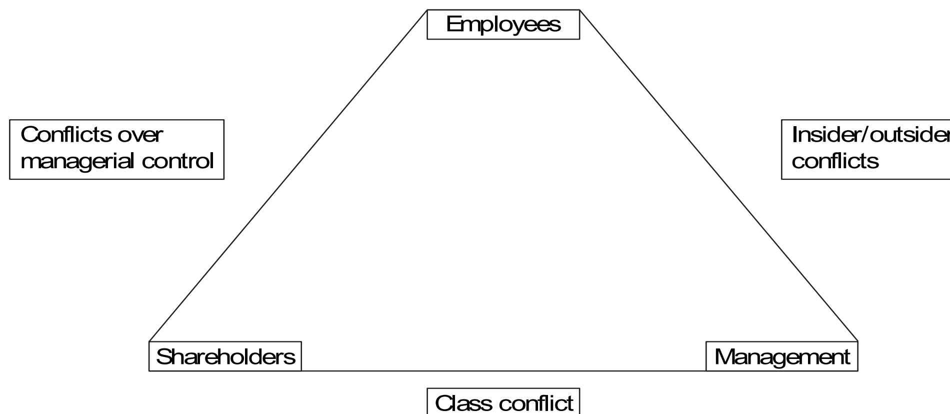
[26]See the statement of the Gewerkschaftliche Monatshefte editorial office (1950).

[27]As Green parties favor a decentralized economic structure, they also fit into the critique on organized capital. In their first Sindelfinger party manifesto from 1983, they called for the disintegration of big companies; in their recent Berlin party manifesto, they express the view that "monopolies and oligopolies can only be abolished if a strong merger control, a cartel supervision and an effective disentanglement policy for regional, national, and European markets are in existence. We want a functioning competition in favor of customers" (Bündnis 90/Grüne 2002: 50).

But, where political demands were concerned, trade unions and Social Democrats treated a Hilferding-Naphtali economy as if it was a Lenin-Stamokap economy, favoring the disorganization of capitalism on the capital side, in combination with codetermination and strong trade union influence on the labor relations side.

4.2 The Importance of Conflicts Over Managerial Control

Figure 3 Three Types of Coalitions and Conflicts between Shareholders, Employees, and Managements[a]



Adapted from Höpner 2001.

a Example: In conflicts over managerial control, both shareholders and employees oppose managers.

My second argument removes the discussion to the company level. I start theoretically by combining two different views on conflicts inside the firm that normally fail to address each other. While the industrial relations literature emphasizes different interests of employers and employees, principal-agent theory points to different interests of shareholders and insiders. By combining these conflict dimensions into one model, we arrive at a triangle, consisting of three interest groups, three conflict lines, and three different coalition lines in which two of the groups distinguished can form a coalition against the third one (see Figure 3). I define the conflict constellation in which shareholders oppose managers and employees as an insider-outsider conflict, the conflict in which shareholders and employees build a coalition against managers as a conflict over managerial control, and the conflict in which employees oppose the two other groups as a class conflict. This is still a simple conflict model, but it is much more realistic than both the principal-agent view and the industrial relations view on conflicts inside firms.

The class conflict view is the one that fits with the left-right dimension. If capital-market-oriented reforms strengthen the position of employees' opponents in class conflicts, trade unions should refuse such reforms. The same holds true for insider-outsider conflicts. But, opposed to this, employees and their works councils and trade unions turn out to be on the winning side if increased shareholder power is played out in conflicts over managerial control. By emphasizing class conflicts and conflicts over managerial control, I argue that *the losses in class conflicts are* – for several reasons – *less visible compared to the gains from conflicts over managerial control*, which makes trade unions support capital-market-oriented corporate governance reforms more than one might possibly expect. While changes in class constellation "only" result in redistribution, but leave the institutions of codetermination and central collective agreements intact,

changes in the organization of conflicts over managerial control result in much more visible, institutional change.

The center of class conflict is the distributional conflict. As increased shareholder protection and, in particular, the emergence of a market for corporate control strengthen the power of shareholders, one might expect a process of redistribution of net value added in firms that adjust to the new pressures by increasing their shareholder orientation. Beyer and Hassel (2002) found evidence that such a development is actually in process: in shareholder-oriented German companies, the share of net value added that employees receive as wages is in decline, while dividend payments toward shareholders are on the rise. I will come back to this, but prefer to examine conflicts over managerial control before doing so.

The share of conflicts inside firms that manifest themselves as conflicts over managerial control is surprisingly high. One of the crucial points in shareholder value is company transparency, and disclosure conflicts are conflicts over managerial control. Trade unionists interpret company transparency as a precondition and a tool for codetermination. Consequently, trade unions call for a European directive that should abolish German Commercial Code (HGB) accounting. The only works council I know that opposed international accounting is the Volkswagen works council – Volkswagen is codetermined to such an extent that the works council sees no need to pass more information toward outsiders. Both TransPuG and KonTraG concerned management accountability in management board-supervisory board interaction. As the supervisory board and not the management board is the codetermined institution, every increase in supervisory board rights is an increase in the degree of codetermination and is, of course, warmly welcomed by works councils and trade unions. The field of common interests of shareholders and employees turns out to be even larger, when considering that both shareholders and employees prefer variable to constant management payment. In general, German trade unions and works councils distrust managerial behavior. The managers' freedom of action in diversification and company growth also gives them more room to maneuver for prestige investments. "If shareholder value helps to limit this risk potential, this must be in the interest of employees," says one trade union expert (Küller 1997: 529).

Why is redistribution, as compared to this institutional change, less visible? There are two different ways in which such redistribution could happen. The first possible way is downward pressure on wages, which would result in enormous opposition to shareholder value, but which is not the way in which redistribution normally happens. Rather, redistribution results from a reorientation in the conflict of aims between company growth and profitability growth. Beyer and Hassel (2002) have shown that shareholder-oriented firms increase profitability targets and halt company growth, which *is compatible with rising wages of core employees*, who are not affected by rising employment insecurities. Why may core employees' wages rise, while the share of net value added that employees receive is in decline? Kurdelbusch (2002) has shown that there is a strong empirical connection between shareholder orientation and the introduction of non-management variable pay. Consider a shareholder-oriented firm that halts company growth and sells less-than-average profitable subunits in order to raise average profitability: when a part of employees' wages is variable according to company profitability, the number of employees will decrease, while their wages may increase – which, perversely, creates an incentive for works councils to tolerate such restructurings, as works councils tend to be dominated by core employees and not by employees on the periphery of corporations. Further mechanisms exist that *absorb redistribution conflicts* resulting from shareholder orientation, and the most important one is early retirement, which allows companies to shift the social costs of restructuring[28] toward welfare state institutions (Ebbinghaus 2001; Mares 2000). Unsurprisingly, early retirement is defended by both company and trade union representatives.

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[28]Note in addition that not all conflicts over restructurings are insider-outsider conflicts (in which shareholders force insiders to restructure) or class conflicts (in which shareholder pressure helps managers to introduce restructurings

However, redistribution occurs in a way that leaves not only the institution of central collective agreements intact, but is also compatible with rising wages of core employees. Different mechanisms, above all variable non-management pay and early retirement, absorb the destructive power of class conflict inside the firm and allow both works councils and employers to pass negative externalities on to society. By contrast, the works councils' and trade unions' gains in conflicts over managerial control are much more visible and result in institutional change. The importance of conflicts over managerial control is a second reason why trade unions and the SPD as their most associated party favor shareholder-oriented reforms. The implicit coalition between shareholders and employees in company conflicts over managerial control has an obvious analogy in the implicit SPD-FDP coalition in the Bundestag debates on the KonTraG and on takeover regulation.

5 Conclusion

Do parties matter in corporate governance reform? Why do German Social Democrats opt for more corporate governance liberalization than the CDU, although the distributional outcomes of such reforms would expect the converse? I have discussed these questions by dividing my analysis into three parts. First, I used the crucial vote over the European takeover directive in July 2001 as a test case, since each relevant European party had to decide on the same liberalization attempt at the same time, and everyone knew that the voting result would be extremely close. Two variables turned out to be important predictors of European MEPs' voting behavior: ideological affiliation – parties actually matter in corporate governance reform – and class and party cohesive national interests that result from the fact that the institutionalization of a European-wide market for corporate control would have asymmetric distributional outcomes, not only within but also between member states. The large parties tended to vote with regard to this dimension of interests. I used the capital market orientation of national corporate governance regimes as a proxy variable to estimate such nation-based, party cohesive interest dimension.

In a second step, I focused on the German case and discussed the parties-do-matter thesis with respect to the main German corporate governance reforms of the 1990s. The decisive measures were the abolition of unequal voting rights, company transparency, management accountability, takeover regulation, and disentanglement policies. I found that German parties behaved "paradoxically" in the sense that the SPD favored more liberalization and was nearer to the neo-liberal positions of the FDP, the Monopoly Commission and liberal economists than the CDU was. In respect of the corporate governance sphere, the CDU, not the SPD, turned out to be the party of "Rhenish," "organized" capitalism.

In the third part of the paper, I offered explanations for the unexpected behavior shown by the SPD (and, in part, also the trade unions) toward corporate governance liberalization. The first argument referred to the conversion of leftist ideas in the course of the twentieth century. In the second half of the Weimar Republic, it was common within the SPD and the trade unions to view organized, entangled capital as a part of the most developed (and, therefore, favorable) model of capitalism. Two watersheds fundamentally changed this view. Because of the collaboration of the capital entanglement center with Hitler and its role in the preparations for World War II, post-war trade unions and Social Democrats began to favor a strong anti-cartel policy, combined with a large nationalized and a large immediate sector (economic democracy – *Wirtschaftsdemokratie*). When the SPD (in the 1959 Godesberg manifesto) and the Federation of Ger-

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that they would have preferred anyway). There are also constellations, as in the *Mannesmann* case, where both works councils and shareholders preferred to split up the conglomerate, but were opposed by managers who had a preference for a big and powerful company. In such cases, even conflicts over restructurings are conflicts over managerial control.

man Trade Unions (in the 1963 Düsseldorf manifesto) abandoned the idea of nationalizing core sectors, the preference for disentanglement remained. *These reinterpretations of political goals introduced a liberal attitude into leftist thinking*. Thus, the historical goal of the German Left was a liberalized corporate governance regime on the one hand, in combination with a "non-liberal" industrial relations regime with centralized wage-bargaining institutions, codetermination, and strong unions on the other hand.

I focused on the company level to find a further explanation for the preference – in this case, of trade unions – for corporate governance liberalization. By combining the conflict models of principal-agent literature and industrial relations literature into one model, I distinguished different types of conflict inside the firm and found that the conflict type in which works councils and trade unions find themselves on the winning side of corporate governance liberalization – the "conflict over managerial control" – is of relatively high importance. Increased disclosure and increased management accountability with respect to the supervisory boards result in increasing degrees of employee codetermination. In contrast to this, different mechanisms absorb the conflict potential of redistribution as a result of shareholder orientation. As employees on the peripheries of companies tend to lose from shareholder value strategies, variable parts of wages in the core units are likely to increase. This kind of redistribution leaves the institution of central collective agreements intact. Early retirement is another absorption mechanism that decreases sensitivity to losses in class conflicts, compared to gains in conflicts over managerial control.

These findings have important theoretical implications. *First, parties do actually matter in corporate governance reform*. As corporate governance is one of the main sectors that constitute different models of capitalism, parties have to be taken into account in the discussion on the forces that change the models of capitalism. Another, quite different path of party influence on the organizational degree of production regimes has been identified by Iversen and Soskice (2002). They argue that welfare state arrangements, developed by political coalitions that involve leftist parties, are a precondition for employees' investments in firm-specific skills. This argument links party politics, the welfare state, and skill formation (see also Gourevitch 2002). My analysis shows that a further path of party influence exists.

Second, as shown for the German case, I have demonstrated that the conventional wisdom on party behavior in welfare state design should not be generalized toward corporate governance reform, which was one of the most dynamic economic policy fields in the 1990s. *Here, paradoxically, the SPD is not the party of "politics against markets."* As the political importance of the corporate governance policy field increases, traditional political economy models of left party behavior turn out to be lacking in complexity. The SPD might be the interventionist, market-restricting party in questions of labor market policy. But with respect to the enforcement of share markets and the conflicts between shareholders and managers, the SPD is the market-enforcing party, whereas the CDU is the market-restricting party, which has obvious implications for the literature on the interaction of parties and markets. Advanced capitalist societies have developed five different markets with different commodities, participants and cycles (Windolf 1994): markets for territorial property, product markets, labor markets, capital markets, and markets for corporate control. Accepted theories of party behavior in a given market like the product market or the labor market need not be generalized toward capital markets and markets for corporate control, as political parties can act in a market-restricting manner in one sphere, while simultaneously behaving in a market-enforcing manner in another sphere. With regard to corporate governance, the explanatory power of traditional left-right scales is limited – or, alternatively, the classification of some of the parties on this axis as it affects this political issue is incorrect.

Third, my analysis raises doubt about the assumption that one single parameter can be found that estimates the impact of parties on the organizational degree of production regimes that not only fits different spheres of the political economy, but also different countries. The voting behavior of European parties in

the crucial vote over the takeover directive in July 2001 has shown that – beside the existence of a left-right dimension in corporate governance issues – large center parties tend to rank national interests higher than ideological differences. In addition, as I have shown for the German case, *it is a consequence of historical experience and of the domestic institutional configuration whether or not corporate governance liberalization can be accepted as a part of a leftist idea*. For example, it is employees' codetermination of supervisory boards that make trade unions favor more supervisory board power in its interaction with managements. In the current state of research, it is an open question whether the described "paradox" party constellation also exists in other countries. Analogies to the German constellation may exist in Italy, France, and Portugal.

Fourth, the results of my analysis point directly to *the problem of institutional complementarity*. The theories concerning different national models of capitalism differ with respect to the degree to which they emphasize the coherent organization of subsystems of the political economy, such as the skill formation system, the industrial relations system and the corporate governance system. For supporters of the idea of an extensive complementarity connecting the subsystems of production regimes, the assessment of the described German leftist strategy should be self-evident: it lacks coherence. This view does not allow one to favor a liberalized corporate governance regime on the one hand and a "non-liberal" industrial relations regime on the other hand. Such a combination lacks stability, and in the event of such an institutional setting being designed, it would be likely to undermine economic success. Obviously, the German Left does not believe in the existence of a complementarity that would make a codetermined liberalized production regime a contradiction in terms, maybe even an oxymoron, or at best a possible, but incoherent and therefore unpromising, combination.

However, it is not immediately clear whether the reason for the incompatibility between the ideas of scientific "models of capitalism" and of German leftist movements lies in the misinterpretations of trade unionists and Social Democrats or of political economists. Some evidence exists for both. There was an obvious incompatibility in the demands of German trade unionists when they wanted to force the *Deutsche Bank* into investing in the construction company *Holzmann* in order to save the company from bankruptcy in 1999, while at the same time supporting the idea of forbidding banks to own more than 5 percent of non-financial companies. It is typical of those of a leftist persuasion to have a strong belief in progress, since in both the Lenin-Stamokap view and the Naphtali-Hilferding view it was the most developed version of capitalism that was meant to lead to socialism. Conservatives, by contrast, typically are sensitive to the fragility of institutional arrangements (see Hayek 1948). Consequently, in the Bundestag debate on the KonTraG, it was CDU members (and not PDS or FDP members) who pointed out that corporate governance liberalization might lead to a declining ability on the part of politics to force banks to make investments in order to reach common goals.[29]

[29]See Otto Hartmut Schauerte in the debate over the KonTraG, minutes of the Bundestag debate 13/220 from March 5, 1998.

On the other hand, there is also empirical support for the German leftist view, as opposed to the "models of capitalism" view. The possibility of a liberalized corporate governance regime combined with a centralized, strongly unionized industrial relations regime – with extensive employee codetermination rights – *is empirically proven insofar as precisely this transformation is already in progress* in the large company sector of Germany. In this process of hybrid convergence, codetermination and central collective agreements remain stable, and works councils on the one hand and shareholder-oriented company policies on the other fit together better than one might have expected (Höpner 2001, 2003). In keeping with their political goals, German trade unions and works councils do not see themselves as losers in the new interplay of elements that were formerly domiciled in different regime types.

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Appendix: Definitions and Sources of Variables

Voting behavior: Percentage of members of European Parliament subgroups (British Conservatives, Italian Greens etc.) who agreed with the takeover directive in the crucial vote at 4 July 2001. Own calculation: according to the information on the EP website, voting behavior and party group affiliation of each member was identified. As 75 party groups were distinguished, n=75.
Ideological affiliation: Party group affiliation of each subgroup. 1=affiliation with Confederal Group of the European United Left/Nordic Green Left or affiliation with Group of the Greens/European Free Alliance; 2=affiliation with Group of the Party of European Socialists; 3=affiliation with Group of the European People's Party (Christian Democrats) and European Democrats; 4=affiliation with the Group of the European Liberal, Democratic and Reformist Party; 5=affiliation with the Union for Europe of the Nations Group. As affiliations with the Group for a Europe of the Nations Group and with the Technical Group of Independent Members were not coded into the ideological affiliation variable, n=67.
La Porta et al. index: Country-based summary measure of shareholder protection. Index adds one when: the country allows shareholders to mail their proxy votes to the firm; shareholders are not required to deposit their shares prior to the General Shareholders' Meeting; cumulative voting or proportional representation of minorities in the board of directors is allowed; an oppressed minorities mechanism is in place; the minimum percentage of share capital that entitles a shareholder to call for an Extraordinary Share-

holders' Meeting is less or equal to 10 percent; shareholders have preemptive rights that can only be waived by a shareholders' vote. Data source: La Porta et al. (2000). As Luxemburg is not coded, n=71.
Party in national government: Dummy variable. 1=Party was member of national government in July 2001, 0=Party was in national opposition. Source of information: Fischer Weltalmanach. n=75.
Country size: Number of national residents in 2001 (millions). Data source: Fischer Weltalmanach. n= 75.
GDP growth 1995–2001: Growth of GDP between 1995 and 2001. Own calculation. Data source: OECD Main Economic Indicators. n=75.
Transparency: Index on the inclusion or omission of 90 items in the 1990 annual reports. Data source: La Porta et al. (1998). As Ireland and Luxemburg are not coded, n=66.
Ownership concentration: Country-based measure, calculated as the median percentage of common shares owned by the largest three shareholders in the 10 largest privately owned non-financial firms. Data source: La Porta et al. (1998). As Luxemburg is not coded, n=71.
Hall/Gingerich index: Index assessing the balance of strategic coordination relative to market coordination in the political economy, combining data on shareholder power, dispersion of control, size of stock market, level of wage coordination, degree of wage coordination, and labor turnover. Data source: Hall and Gingerich (2001: 46). As Luxemburg and Greece are not coded, n=68.
Employment protection: Country-based index on the degree of protection of temporary employment. Data source: Nicoletti et al. (2000: 84). As Luxemburg and Greece are not coded, n=68.