CORPORATE REFORM IN AN AGE OF INTENSIFIED CLASS WARFARE

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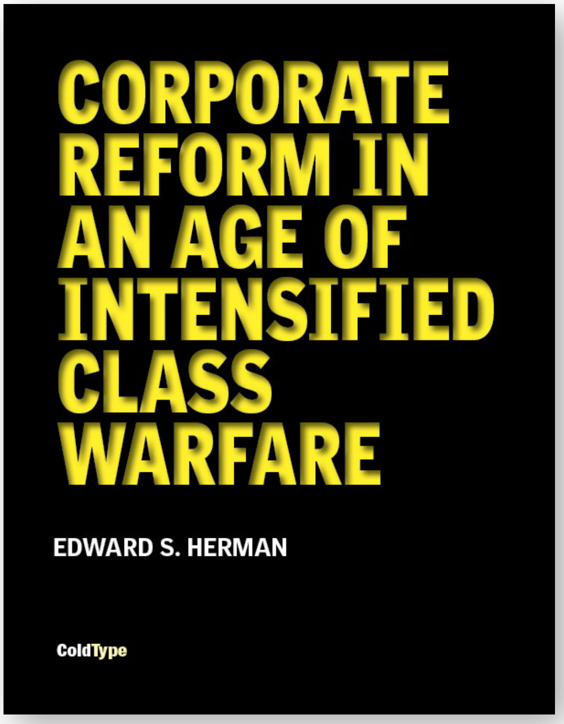

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In a system where corporations are central in economic activity, economic crises have always and necessarily produced plans and programs of renovation and improvement designed to make corporations more responsive to the public interest. Of course there have always been some who urged nationalization or worker control; i.e., the replacement of the corporate system with a genuinely new order. Thus far the system has been able to fend off all such demands, although government ownership has sometimes spurted in emergencies, so far only briefly (e.g., during World War II, and as a result of the S & L crisis), followed by subsequent divestment. Over time government ownership has declined as the business system has sought to occupy all space in which profits can be made – thus as the military budget has grown, in-house arms production has largely disappeared, displaced by the "contract state." The triumph of neoliberalism and the parallel intensified class war has been associated with further "privatization," which has not only opened up more avenues for private profits, it has also weakened the state as a potential agent of ordinary citizens.

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A similar point can be made as regards worker control. It does not fit well into a neoliberal system, in which worker protection at all levels tends to be eroded in favor of "flexible" labor markets. Workers' rights got a major boost during the crisis of the Great Depression, with the Wagner Act and the federal government serving to some extent as an employer of last resort. But class warfare was renewed with the 1947 Taft-Hartley Act and the Red Scare and purges of the Truman-McCarthy era. It subsided for the next decade or so, but the Vietnam war and

"60s" peace and civil rights protests, and new competition from abroad, revitalized business class war aggressiveness. The resultant decline of the labor movement and reduced labor bargaining power has been manifested in the weakened safety net, stagnant wages and greater inequality, and increased worker insecurity and loss of control.

Other long-standing reform strategies have been decentralization – breaking up the large corporations so as to reduce their political muscle and enhance competition – and regulation, sometimes involving the establishment of government bodies to oversee corporate activities and approve or disapprove corporate decisions. These have a long history, reflected in antitrust laws and policies and regulatory authority over many activities, from railroads, banks and public utilities to alcoholic beverages and waste dumps. Regulation surged in the Great Depression, forcing the separation of commercial and investment banks, and establishing the SEC and securities regulation. Antitrust was revitalized and public utility holding companies were broken up.

Today there is talk of breaking up the giant financial conglomerates that are "too big to fail," and there is some possibility that large companies like GM and Chrysler, as well as AIG, might be sold off in pieces as part of bankruptcy proceedings (and government ownership actions as regards AIG). But with respect to the largest financial institutions there has been a tendency to favor them with extraordinary subsidies and guarantees and to encourage them to merge into still larger entities. The situation is still volatile, but major decentralizations would appear less likely than greater concentration, along with an increased unwillingness to allow the super-giants to fail and an even closer relationship between big finance and big government.

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Regulatory changes in the 1930s included the splitting off of commercial and investment banks, required disclosure of corporate developments, bans on insider trading, tightened supervision of banks and bank holding companies, and the regulation of investment companies (mutual and closed-end funds). Equally important, of course, was that the regulators in the early years tended to believe in regulation and often actually tried to enforce the law. We had William Douglas in charge of the SEC in the 1930s, a rather marked contrast with the regulation-hostile (and incompetent) Christopher Cox chairing the SEC in the Bush-Cheney era.

Regulation in the 1930s and after put a fair amount of weight on disclosure, in the belief that compelling business to reveal all the relevant business facts would protect buyers of securities and other products from abuses like insider trading and market manipulation and would make markets work more efficiently. In the oft-quoted line by Louis D. Brandeis, "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." There is some truth in this, and there is little doubt that required disclosure has been economically beneficial. But it has its limitations, as truth can be buried in an avalanche of irrelevancies ("kitchen-sinking"), important facts may not be meaningful without context, and weak regulation may make it good business to suppress inconvenient truths. The explosion in executive (over)-compensation took place in a world of theoretical "full disclosure," but with the media and government doing their duty by the vested interests this explosion was only brought under some limited constraint by the 2007-2009 economic collapse.

Getting the Board of Directors to Work in the Shareholder and/or Public Interest: From Berle and Means to John Bogle

In the midst of each economic crisis, there is also a regular outcry at the failure of corporate boards to keep managers in line and prevent their suddenly more evident and better publicized personal aggrandizement and mistaken policies. There is also criticism of large investors, individual and corporate, who failed to press the boards and managers to do the right thing. There is a demand for new laws and improved regulation of corporations, more independent directors, and a change in the outlook and sense of responsibility of these directors and stakeholders who should be guiding and constraining the managers.

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There was also an important line of thought that the managers themselves should take a more generous and community-oriented view and self-transform the system. This kind of thinking was encouraged by the 1932 publication of The Modern Corporation and Private Property by A. A. Berle and Gardiner Means, which argued and gave empirical evidence for the view that the wide dispersion of stock and management control of the proxy machinery led to the dominance of managers in the leading corporations. This gave the managers a fair amount of discretion, and, arguably, they could use it to benefit a range of stakeholders.

This line of argument was pursued later by A. A. Berle in articles and books on corporate responsibility and managers as trustees, and the phrase “corporate soul” is traceable back to Berle, who thought corporations had them and whose soulfulness and trustee service in the larger social interest should be encouraged and would develop further. It should be noted that these ideas were evolving in the 1930s crisis, at a time when the corporate system was very much on the defensive and regulation and antitrust thinking was on the upswing. The corporate soul and corporate trustee role for society were last gasp ideas of a system and ideology in retreat, and Berle, who was an official in the New Deal and later a noted Cold War hawk, served that ideology, which later made such a spectacular comeback.

As we know the reformers of the 1930s didn’t depend on soulful managers doing their duty to society, but from then up to the present corporate law was grounded in the belief that the directors, and especially the independent directors, would keep managers in line, and in particular help make them agents of the shareholders. This has never worked, because the directors are not very independent – they are selected or approved by the top managers, may be their friends, are well paid, lack the knowledge or time needed for effective surveillance or challenge, and they may have or want business relationships with the companies they serve as directors. Deference by leaders of other companies may be part of a system of reciprocal behavior. It is especially hard to actively intervene and constrain managers when companies prosper.

Of course, in theory and law the directors represent the shareholders, but the managers themselves are also supposedly agents of the shareholders. There is a long tradition of belief that, especially with the growth of large institutional holdings of stock by mutual funds, pension funds, bank trust departments, and other substantial investors, that these would intervene, individually or collectively, to press the directors and keep managers from looting or making grave decision errors. This also has never worked, because the big holders don't have the staff to intervene, and more important, don't want to disaffect the managers and lose access to useful corporate information. When they lose faith in the managers they sell the companies' stock and go elsewhere. This is called the "Wall Street Rule."

It is interesting and even amusing to see Gretchen Morgenson in the *New York Times* building the case for activating those big investors as the route to corporate reform, using as her source John Bogle, the retired head and founder of the Vanguard Group of money managers and mutual funds.("He doesn't Let Money Managers Off the Hook," April 12, 2009). Bogle complains that the big investors have failed to serve as shareholder agents, as they did fifty years ago. He calls for passing a law "establishing the basic principle that money managers are there to service their shareholders… [and that] fiduciaries act with due diligence and high professional standards."

As it happens, in 1962 a Wharton School group, of which I was a member, working under the auspices of the SEC, published A Study of Mutual Funds, the first large-scale study of that rapidly growing institution. John Bogle was one of a group of mutual fund representatives who met with the group and worked hard to soften any criticisms of the industry. The study was critical of the high management fee rates charged by the funds, which often failed to decline as a rate even with major asset growth; and it pointed up the fact that investment advisers charged higher fees to their affiliated mutual funds than to outside clients (a continuing problem mentioned by Bogle to Morgenson but definitely not new).

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Most interesting, the 1962 study featured the fact that the mutual funds were quite inactive in using their holdings to discipline portfolio company managers (this was a part of the study that I worked on and wrote). Rather than intervening to serve the fiduciary interests of the company's shareholders they followed the "Wall Street Rule" when managerial behavior displeased them. So there was no golden age of mutual fund (or other institutional investor) behavior fifty years ago. John Bogle has changed and become something of a moral force and conscience in the industry, but he remains an exception. Laws and exhortations are not going to make institutional investors into manufacturers of a corporate soul.

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