The Pension System and Convergence in Corporate Governance

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This article explores the influence of the pension system on convergence in corporate governance. In a previous paper, I studied the effects of the shift in the private pension system of the US between the 1970s and today, arguing that the gradual transition from defined benefit (DB) to defined contribution (DC) plans turned workers into “forced capitalists.” This changed the incentives of firms and workers as well as the political economy of corporate governance and helped to lead the way toward the shareholder primacy model. I now take the theory to the international level and apply it to the corporate convergence debate. Compared to the US, Continental European and Japanese employees continue to rely to a much larger degree on government pensions that are essentially centralized DB plans. Where company-funded pensions exist, they often are of the DB variety, e.g. in the case of the German and Japanese book reserve plans. Thus, while the development of the stock market is of tremendous importance for members of the aging middle class in US, e.g. their German peers need to rely primarily on the continued ability of the government to fund pensions. Efforts to increase the significance of DC pension plans and private pension savings in Europe during the 1990s and 2000s coincide with the strengthening of the shareholder model. Historically, unfunded pension systems in Europe were introduced during and after World War II for reasons connected to destruction of the previous pension systems funding base, for reasons including infla-
tion, the collapse of capital markets and the need to alleviate poverty. The institutional framework developing at the time was not amenable to the development of a financial system fostering strong capital markets. By contrast, in the US capital markets continued to play a larger role in spite of the experience of the Depression.

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1. Introduction

Convergence in corporate governance has been discussed intensely in the comparative literature since the late 1990s. The proponents of convergence theories argue that cor-
Corporate governance practices around the world, or at least in the major industrial countries, are converging. The basic argument is that a certain set of corporate governance practices – based on the position that the ultimate objective of corporate law should be to maximize the wealth of shareholders in the long run – was found to be superior to other models, which is why it has found widespread acceptance in the US today. When comparative law research found became a more widespread pastime of US scholars in the 1980s and 1990s, they found very different systems when looking abroad. Other major corporate governance systems, particularly in Continental Europe and Japan, have long been thought to be characterized by a “stakeholder” view. Among the larger jurisdictions, Germany stands out by giving employees a say on the board of directors. In France and Italy, unions are an important player in corporate governance even in the absence of formal representation in the boardroom, and employment and labor law are considerably more pro-employee than in the US. Similarly, Japanese firms have long been known for strong pro-worker orientation, in particular a “lifetime employment” relationship with employees.

However, starting in the late 1990s, scholars began to observe “convergent” corporate governance practices. Observers began to note that many developed jurisdictions began to revamp their corporate and securities laws to strengthen the position of outside investors. International Financial Reporting Standards began to spread, thus

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making financial statements more transparent and attuned to the needs of the capital markets. At the same time, pro-labor institutions such as German codetermination or Japanese lifetime employment came started to be increasingly criticized.

What are the drivers for these changes? Henry Hansmann and Reinier Kraakman, in their famous 2001 polemic “The End of History for Corporate Law” identified a range of factors. First, they noted that the shareholder model simply proved superior to other models, such as the traditional managerial model of the US, the state-oriented model that characterized some European countries such as France, and the German labor-oriented model. The alleged superiority of the shareholder view, which they see supported by the quasi-natural forces of logic, competition, and example, is of course in the eye of the beholder and as such not entirely persuasive by itself, given that the relative economic fortunes of various corporate governance systems have waxed and waned several times over the past decades, and given that jurisdiction in Continental Europe and Japan experienced considerable economic growth from the 1950s through the 1980s with systems diverging very far from the recently asserted standard model of shareholder primacy. Moreover, as Hansmann and Kraakman themselves pointed out, the United States was characterized by managerial capitalism, i.e. a system of large firms dominated by an entrenched professional hierarchy (the “technostructure” in the words of John Kenneth Galbraith).

The convergence narrative is to some extent tied to the “legal origins” narrative. Legal origins theorists focus on the development of capital markets and dispersed ownership structures, which seem to go hand in hand with a shareholder primacy orienta-
tion. Legal origins theorists claim that the common law is more amenable to investor protection, which is why common law countries such as the US and the UK have deeper capital markets and a more dispersed ownership structure.\(^7\)

Others have therefore suggested that the development of corporate governance is contingent to specific political or economic circumstances. Mark Roe, in a widely cited body of work, has suggested that stock market development, corporate ownership structures and a country’s position on the scale between shareholder primacy and strong employee orientation can be traced to politics reasons.\(^8\) In an important article on the topic, he suggested that pro-employee populism, resulting from war and destruction in the first half of the 20\(^{th}\) century, helped to fuel “social democratic” sentiment in the core civil law jurisdictions.\(^9\) Consequently, institutions that promoted shareholder interests and kept agency cost in check, such as the board of directors, were undermined by pro-labor mechanisms such as codetermination.\(^10\) This, in turn, inhibited the development of strong capital markets on dispersed ownership structures along the lines seen in the US (and the UK). Political scientists, most notably Peter Gourevitch and James Shinn, as well as John Cioffi, have developed nuanced theories about the role of political interest groups in corporate governance.

Again, others, including this author, have suggested that shareholder primacy may be optimal only under a limited set of circumstances. In a previous article, I have suggested that pro-employee policies need not necessarily be one of the reasons for the persistence of concentrated ownership, but may in fact be one of its consequences. In systems giving shareholders both the power and the incentive to pursue their financial

\(^7\) MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).
\(^10\)
self-interest at the expense of other groups, policies such as codetermination or strong employment law may help to protect employees from what is known as “hold-up” in economic theory, namely an expropriation of quasi-rents.\textsuperscript{11} Such structures may therefore help to create or retain incentives for workers to make firm-specific investment.\textsuperscript{12} Relatedly, authors following the “varieties of capitalism” approach of economic sociology have suggested that some systems (e.g. Germany) may rely on specific investment and long-term commitment by employees to a stronger degree than others (e.g. the US). In either of these possibly complementary views, there is no single optimal corporate governance system, but there are sets of complementary institutions.

Authors emphasizing a political or broader institutional account have generally been more skeptical about convergence claims and sided with those who have claimed that the phenomenon of path dependence may inhibit the development of corporate governance, even if convergence to a certain level of optimality would be desirable. For example, if strong pro-shareholder institutions and strong pro-labor institutions have to balance each other, as I have suggested in previous work,\textsuperscript{13} it may be difficult to move from a local to a global optimum because the intermediary stage would be inferior to the local optimum, or because powerful interest groups cannot easily be persuaded to support the transition.\textsuperscript{14}

Nevertheless, whether one believes in a strong or more constrained degree of convergence, the phenomenon is widely recognized. Around the year 2000, the corporate governance literature began to identify a convergence toward purported “Anglo-American” corporate governance standards by strengthening pro-shareholder institu-

\footnotesize{\textsuperscript{11} Gelter, supra note 1. \\
\textsuperscript{12} Gelter, supra note 1, at ##. \\
\textsuperscript{13} Gelter, supra note 1, at ##.

\textsuperscript{14}}
tions. Finding an explanation why convergence seems to be happening begets the question why corporate governance systems diverged in the first place. Indeed, economists Raghuram Rajan and Luigi Zingales have shown that the capital markets in some important civil law jurisdictions in Continental Europe were more important – both relative to size of the economy and the common law countries that came to dominate in the late 20th century, coining the term “Great Reversal” for this phenomenon.

In this article, I draw attention to a factor for both the historical divergence and the more contemporary convergence that has received insufficient attention in the literature so far, namely the institutional complementarity between corporate governance and a country’s pension system. Over the course of the 20th century, developed economies have differed markedly in how employees provide for their retirement. Different components of the pension system differ from each other in at least three dimensions: First, they may be public or private. Second, they may be funded or non-funded (i.e. they operate under the Pay-As-You-Go or PAYGO system). Third, they may be defined benefit (DB) or defined contribution (DC) plans. Comparing the United States to Continental Europe and Japan reveals that in the US, the private component is relatively more important, the funded component is more important, and the significance of the DC component has grown compared to the DB component since the 1970s. I argue that these three differences imply that the capital markets are more important for individuals in the

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15 See Hansmann & Kraakman, supra note 2; Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 AM. J. COMP. L. 329 (2001) (both discussing convergence of corporate governance practices); Lucian Arye Bebchuk & Mark J. Roe, A Theory of Path Dependence and Corporate Ownership and Governance, 52 STAN. L. REV. 127 (1999) (suggesting that path dependence impedes convergence).

US than they are in these other jurisdictions, which has important consequences for the economics and the politics of corporate governance.

Thus, the theory has two components. First, at the level of political economy, by having to rely more strongly on capital markets for their retirement, voters, maybe even the median voter, will need to rely more strongly on pro-shareholder policies in the US than in these other corporate governance systems. When stock markets go down, *Joe Average*’s 401(k) loses value, which means that he may need to delay retirement, or that he will have to deal with a lower standard of living. By contrast, it matters much less for the German *Otto Normalverbraucher*, who is mainly sustained by a government pension in retirement, and maybe to some extent by an unfunded DB pension paid by his former employer.

Second, on the level of a “varieties of capitalism” theory, pensions may be connected with how much an economy relies on employee’s firm-specific investment. Historically, pension plans have often been used to inhibit labor mobility. Firm-specific pension plans are therefore often matched with firm-specific human capital that cannot be easily transferred to other firms. Systems that rely more strongly on the latter (such as Japan and Germany) may therefore be more likely to have a labor force with highly specialized training.

With respect to divergence and convergence of corporate governance systems, the gist of my argument is that changes in the pension system tend to coincide with changes in corporate governance. First, the pension system had a role in the divergence between corporate governance systems in the mid-20th century. In Continental Europe and Japan, systems that made workers dependent on either the state or directly their employer were put into place as a consequence of the upheavals of World War II, which
partly supports Roe’s theory of corporate governance changes in the mid-20th century, and may help to explain “The Great Reversal.” These systems had the consequence that funds that might otherwise have been invested in the capital markets were spent by the government or to employers, who financed their expansion from the retention of profits designated as pension reserves. To be sure, on a smaller scale a comparable development occurred in the US as well, with the introduction of Social Security by the Roosevelt administration, and the creation of the large DB pension plans in the mid-20th century. But financial markets never went out of the picture the completely.

Second, the pension system contributed to convergence. The apparent changes toward the shareholder model began during the 1990s, the same period when Europe and Japan began to reform their pension systems. I argue that this is no coincidence, and that the growth of private pensions helped to strengthen the position of shareholders. In fact, in some cases the promotion of private pensions was explicitly the improvement of the capital markets.

This paper proceeds as follows. Section 2 develops the basic surveys different types of pension systems and discusses the degree to which individuals are made dependent on the capital markets through them. Section 3 provides country-level discussions on how the foundations for divergence between different countries were laid in the period around World War II. Section 4 looks at changes late in the 20th century and their implications. I discuss pension systems in Europe and Japan, particularly the trend toward private pensions. Section 5 discusses possible implications for the future and concludes.
2. The theory: Retirement wealth and individual dependence on capital markets

2.1. Theory

The basic theory of this paper is that pension wealth matters. Most employees expect to retire at some point in their life, and the standard of living they will have in retirement is of great importance for individual well-being once individuals are no longer able to support themselves. Pension wealth can be – more narrowly – defined as all of the assets held in pension plans. More broadly, it will include all sources of income an individual will have in retirement (from which a net present value could be calculated). This includes not only the assets in one’s 401(k), but also expected income one is due to receive upon retirement, such as a state employee’s income from a DB plan and social security.

Broadly speaking, plans in which pension wealth is accumulated differ along three dimensions. First, pension plans may be public or private. The prior category would include social security in the US, the latter includes pension plans set up by an employer, 401(k)s, and IRAs (Individual Retirement Accounts).

Second, they may be funded or non-funded (i.e. they operate under the Pay-As-You-Go or PAYGO system). In a funded plan, assets are set aside to save for retirement benefits. A corporation promising retirement benefits to its employees may set aside assets in a fund to invest and disgorge them to employees upon retirement. In a PAYGO plan, the (corporate or public) entity promising benefits pays retirees from the current contributions made by workers, without substantial funds being invested.

Third, plans may operate under the defined benefit (DB) or the defined contribution (DC) principle. In the first case, employees are promised a specific amount of retirement benefits. The amount of benefits is typically calculated with a formula based on
contribution history, taking into account the length of the time period of which contributions are made, and the amount. Both in private and public DB plans, benefits are often based on the contribution history in most recent years in order to secure a standard of living comparing to the one before retirement.

<table>
<thead>
<tr>
<th>Defined benefit (DB)</th>
<th>Defined Contribution (DC)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Funded</strong></td>
<td></td>
</tr>
<tr>
<td>Dependence on capital markets and the employer/governments solvency (E.g. pensions for state employees, company DB plans in the US)</td>
<td>Dependence on capital markets (E.g. 401(k))</td>
</tr>
<tr>
<td><strong>PAYGO</strong></td>
<td></td>
</tr>
<tr>
<td>Dependence on the employer’s/government’s solvency and continued willingness to pay (Most public pension plans, German “book reserve” occupational pensions)</td>
<td>Dependence on the employer’s/government’s continued ability and willingness to pay (E.g. French supplementary pensions)</td>
</tr>
</tbody>
</table>

Table 1: Employees’ financial dependence created by pension wealth

As shown in Table 1, both DB and DC plans can either be funded or function under the PAYGO principle. The crucial point for this paper’s argument is that in each of the four cases, the extent to which employees will actually receive retirement benefits depends on different factors.

In the post-World War II decades, large US corporations typically offer either funded DB plans or contributions to funded DC plans to workers. Since the 1970s, DC plans have gained at the expense of DB plans.\(^1\) In a DB plan, the employer bears the plan’s investment risk since it promises a certain benefit based on a particular formula. If the assets in the fund lose value (e.g. because of a stock market downturn), the employer has to contribute the difference. ERISA attempted to reduce the employees risk

by requiring that the employer set up a trust to hold pension assets.\textsuperscript{18} While firms had begun to set up trusts for tax reasons decades earlier,\textsuperscript{19} they were often underfunded. Previously, employees had to hope that the firm stayed in business and continued to fund the plan; in other words, one of the main risks for employees was whether the firm would continue to honor its commitment and avoid going into bankruptcy.\textsuperscript{20} Even with the insurance provided by the PBGC today, beneficiaries of a DB plan run the risk of losing the uninsured portion of the plan when the firm is not financially solvent and the plan becomes underfunded (e.g. because of a capital market downturn):

By contrast, in a DC plan (such as a 401(k)) there are individual accounts that are controlled by the beneficiary. Thus, potential retirees bear the investment risk because the employer does not fill the gap if the plan assets do not suffice to meet pension obligations. The amount of funds available for retirement depends on investment success.\textsuperscript{21}

Employees are thus exposed to very different types of risk. In a funded DB plan, employees are exposed only if there is a funding gap, which could either be deliberate, or because of a decline in the stock market. If firms are unable to fill the funding gap at that time, employees will have fewer funds available in retirement.\textsuperscript{22} Thus, the major issue for employees is plan underfunding combined with the risk of the employer’s default.

\textsuperscript{18} § 403 ERISA, 29 U.S.C. § 1103.
\textsuperscript{19} Langbein, 107 YALE L. J. 169 (1997). By contrast, in some European countries such as Germany, Spain, Italy, Sweden and Austria, firms often commit to paying retirement benefits directly, and thus need to fund provisions for future payments in their balance sheets. GORDON L. CLARK, PENSION FUND CAPITALISM 59-60 (2000) (discussing “book reserve” plans in Germany).
\textsuperscript{21} E.g. ALICIA H. MUNNELL & ANNIKA SUNDÉN, COMING UP SHORT. THE CHALLENGE OF 401(k) PLANS 68 (2004).
\textsuperscript{22} Friedman, supra note 20, at 220.
While the funding capability of the employer may provide an additional layer of protection, this is not the case in a DC plan: Here, the employee is directly and entirely exposed to the value of the market in which his pension wealth is invested. Today, 401(k) most plans are invested “mostly in stock.” Consequently, it is important for future retirees that capital (in particular equity) markets are doing well. In the bull markets of the 80s and 90s, and even in the years after the 2002 financial scandals, many employees did quite well and accumulated a significant retirement bonus. The financial crisis that started in 2008 showed the downside of the defined contribution society: Pension assets were flattened, which made it difficult for many to retire as planned.

The employer’s bankruptcy does therefore not normally matter for the employee’s pension wealth in a DC plan. However, of course not all retirement accounts are properly diversified. Firms have often encouraged employees to invest in the firms’ own shares, often in the form of ESOPs (Employee Stock Option Plans). But even without that, normal retirement accounts were often weighed heavily in favor of the employer, partly because employers often only matched employee contributions if they were invested in their own stock. Here, employees are effectively equity-holders and not creditors of their employer. This led to disaster for some employees in cases such as Enron, where many lost much of their retirement savings. Of course, stock market downturns also affect

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25 See David Millon, Enron and the Dark Side of Worker Ownership, 1 SEATTLE J. SOC. JUST. 113, 119 (2002); MUNNELL & SUNDÉN, supra note 21, at 113 (providing statistics about cases where significant amounts of retirement assets were lost, and discussing Enron in more detail); Jeffrey N. Gordon, What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections, 69 U. CHI. L. REV. 1233, 1248-1249 (2002) (describing the retirement problem of Enron employees).
DB plans; they become less liquid and it may become harder to make pension payments due to financial constraints; in severe cases, the sponsoring firm may have to close the funding gap. The financial crisis of 2008/09 forced some firms to reduce shareholder’s equity by putting funding liabilities on their balance sheets.

Both DB and DC plans can also be structured as PAYGO plans. In this case, the entity running the plan pays retirement benefits out of current contributions. Most government-run pension systems, including social security in the US, are organized as DB PAYGO plans. As the historical overview in section 3 below shows, they were often set up in order to immediately make payments to retirees who had never paid into the system. In this type of plan, employees have to rely on the government’s continued ability to pay the originally projected pension benefits. Future retirees thus take the position akin to that of a creditor of the government. The difference to a buyer of a government bond is, however, subject to the respective constitutional limitations, a DB pension formula can be changed with a stroke of the legislator’s pen. To a certain extent, this requires the future retirees’ confidence in the political process.

There are also private DB PAYGO pensions. German and Japanese large firms are notorious for “book reserve” pension promises paid from current operating profits. In this case, employees are creditors of the employer; other than in a funded plan, the capital market is irrelevant. All that matters is the employer’s ability to continue making payments. Employers may be able to renege on promises depending on the applicable legal framework.

28 Reynaud, Financing Models ###
29 They are known as “book reserve” plans because firms have to create reserves in the balance sheet.
DC PAYGO plans are rare, but they do exist. An example is provided by the supplementary occupational pensions that almost all French employees receive. In this case, virtually all of the current contributions are paid out to current retirees; the formula used to compute retirement claims effectively gives every retiree the right to a specific share in current contributions. In this case, employees are most directly exposed to demographic risk, since fewer current contributions mean smaller benefits for current employees.\(^{30}\) Otherwise, the risk is similar to that in a DB plan.

### 2.2. Some comparative observations on employees’ dependence on funded pension wealth

We have seen that employees tend to be most dependent on the capital markets in funded DC plans, followed by funded DB plans, and not dependent on them at all in PAYGO plans.\(^ {31} \) The question for the theory is basically to what extent they depend on different plans in different countries. Most Continental European pension systems as well as the Japanese one were based primarily on government Pay-As-You-Go (PAYGO) pensions during the decades after World War II.\(^ {32} \) With some modification, this pattern persists. In a PAYGO system, employees and employers pay social security contributions (or an additional tax) to the government or a separate government-sponsored entity, which in turn pays out pensions to retirees. In contrast to a funded pension plan,

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\(^{30}\) In the French case, the risk is spread out across virtually the entire population. These are not company plans, but nationwide plans in which all firms are required to participate by collective bargaining agreements.

\(^{31}\) There may of course be some remote dependencies that are mediated through political channels. For example, if a country is richer because of a developed stock market, the government may be more inclined to increase benefits in a PAYGO plan.

\(^{32}\) E.g. Didier Blanchet & Florence Legros, *France. The Difficult Path to Consensual Reforms*, in **SOCIAL SECURITY PENSION REFORM IN EUROPE** 109, 111 (Martin Feldstein & Horst Siebert eds. 2002) (describing the French system); Bei Lu, Olivia S. Mitchell & John Piggott, *Notional defined contribution pensions with public reserve funds in ageing economies: An application to Japan*, **INT’L SOC. SEC. REV.**, 4/2008, at 1, 4-5; but see Bert Rürup, *The German Pension System. Status Quo and Reform Options*, in **SOCIAL SECURITY PENSION REFORM IN EUROPE**, id., at 137, 137 (pointing out that the German system installed under Bismarck was initially investment based, but transformed into a PAYGO system in the post-WW2 period due to the absence of suitable investment outlets in the [West] German economy).
government entities typically do not invest or save contributions until a retiree makes a claim, but simply pay current pensions out of current contributions, sometimes with a subsidy from the general pool of taxes collected by the government. PAYGO systems are essentially DB plans provided by the government.

While there are differences between the various Continental European countries and Japan, the principle is basically the same: The amount of the pension normally depends on the number of years worked, contributions made, and on the age of retirement. For example, the French system is based on a basic public pension and mandatory supplementary regimes, whose payouts are contingent on points that are computed from the retiree’s contributions.

Retirees’ reliance on public pensions can be illustrated by the German case: In 1991, a German public pension amounted to approximately 70% of the retiree’s last salary. If there was any discernible larger pension policy trend before 1990, reforms tended to make pensions less dependent on contributions and investment success and more dependent on income in the years before retirement, allowing retirees to maintain their previous lifestyle without having to rely on savings very much. Japan used to have a similar system consisting of a national minimum pension and employee’s pension insurance. In both systems, payouts depend on the number of years worked and highest in-

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33 Lothar Schruff, Pensions and Post-Retirement Benefits by Employers in Germany, 64 BROOK. L. REV. 795. 795 (1998); Rürup, supra note 32, at 139-143 (providing a more detailed description); Kathryn L. Moore, Lessons from the French Funding Debate, 65 OHIO ST. L. J. 5, 9, 13 (2004) (describing the defined benefit formula used to compute public pension payments in France); Charles Yuji Horioka, Japan’s Public Pension System in the Twenty-First Century, in JAPAN’S NEW ECONOMY 99, 99-101 (Magnus Blomström, Byron Gangnes & Sumner La Croix eds. 2001) (describing the Japanese system).

34 Moore, id. at 9-10.


36 See e.g. Daniele Franco, Italy. A Never-Ending Pension Reform, in SOCIAL SECURITY PENSION REFORM IN EUROPE, supra note 32, at 211, 213 (“in 1969, pension entitlements for private-sector employees shifted from the old contribution-based formula to an earnings-based one).
come years. Payments were to adjust for inflation and wage increases so that they corresponded to approximately 60% of an active wage.

PAYGO systems are normally equivalent to an unfunded DB plan: Instead of the employer, it is the respective government that guarantees a retirement benefit based on pre-defined criteria. For their retirement benefits, employees are therefore dependent on neither the capital markets nor the solvency of their employer, but only on the solvency of the respective national government.

Of course, the US has the “Old-Age, Survivors, and Disability Insurance Program” (OASDI, colloquially referred to as Social Security), which is also a PAYGO system. Compared to Europe and Japan, however, for a large proportion of retirees, its significance is comparatively small. While it is very difficult to obtain comparable data over a large set of countries (due to the intricate differences in the retirement systems), there is good evidence that US and UK pensioners stand out in how little they rely on public pensions. The amount of public expenditure on state pensions as a percentage of GDP is one indicator, as shown in Table 2 (the figures may not be exactly comparable because they are taken from different sources):

While these percentages are projected to rise in all countries due to aging populations,\textsuperscript{42} strictly speaking they only show what burden on the government budget public pensions are, but they provide at least some indication that they are at least a more significant in some of the major European countries (including the UK) than in the US, but not necessarily in Japan.

However, there is evidence that the share of public transfers – which includes government pensions such as Social Security is a smaller component of the income of retirees in the US than similar instruments elsewhere. The OECD provides data about the sources of income of those over 65, as shown in Table 3:\textsuperscript{43}

<table>
<thead>
<tr>
<th>Country</th>
<th>Public transfers</th>
<th>Work</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>85.44%</td>
<td>6.50%</td>
<td>8.07%</td>
</tr>
<tr>
<td>Germany</td>
<td>73.07%</td>
<td>12.09%</td>
<td>14.84%</td>
</tr>
<tr>
<td>Italy</td>
<td>72.20%</td>
<td>23.80%</td>
<td>4.00%</td>
</tr>
<tr>
<td>Japan</td>
<td>48.34%</td>
<td>44.29%</td>
<td>7.37%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>49.36%</td>
<td>12.09%</td>
<td>38.55%</td>
</tr>
<tr>
<td>United States</td>
<td>36.13%</td>
<td>34.20%</td>
<td>29.67%</td>
</tr>
</tbody>
</table>

Table 3: Sources of Income for those 65 and older\textsuperscript{44}

\textsuperscript{40} Source: Richard Minns, The Cold War in Welfare 9 (2001) (based on various sources).
\textsuperscript{41} Richard Disney & Paul Johnson, An Overview, in Pension Systems and Retirement Incomes across OECD Countries 1, 6 (Richard Disney & Paul Johnson eds. 2001).
\textsuperscript{42} Disney & Johnson, id., at 13.
\textsuperscript{44} ### See also for Germany Börsch-Suppan et al. in Disney & Johnson 173; Frommert ##; McGill et al. Fundamentals 763
The low dependence on public transfers partly seems to be explained by differences in old-age work-force participation: Senior citizens in the US and Japan draw a larger percentage of their income from work than those in the European countries. But consider the same data in a different light by only looking at the relative shares of public transfers (including Social Security) on the one hand, and capital income (including private pension plans):

<table>
<thead>
<tr>
<th></th>
<th>Public transfers</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>91.37%</td>
<td>8.63%</td>
</tr>
<tr>
<td>Germany</td>
<td>83.11%</td>
<td>16.89%</td>
</tr>
<tr>
<td>Italy</td>
<td>94.75%</td>
<td>5.25%</td>
</tr>
<tr>
<td>Japan</td>
<td>86.77%</td>
<td>13.23%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>56.15%</td>
<td>43.85%</td>
</tr>
<tr>
<td>United States</td>
<td>54.91%</td>
<td>45.09%</td>
</tr>
</tbody>
</table>

Table 4: Share of public transfers and capital compared of old-age income to each other (own computation on the basis of Table 3)

Table 4 supports the claim that retirees aged 65 or above rely to a much greater extent on public transfers (including public pensions) in the three Continental European countries and Japan than their American and British peers.

Similarly, Table 5 reports data on the sources of retirement income classified into the “three pillars” during the late 1990s. The first pillar represents public pensions, the second pillar privileged occupational ones (such as traditional DB plans and 401(k)s), and the third voluntary personal retirement savings, including IRAs and their equivalents:

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2.3. US: The shift from DB to DC plans

In comparative perspective, the United States and the Continental European jurisdictions developed very different modes of dealing with the capital-labor conflict of interest. In the United States, the managerial hierarchies of large firms effectively joined forces with labor. Other than in Europe, benefits such as health care and pensions are primarily provided by large employers. One core area where this can be seen is the pension system. So-called Taft-Hartley pension plans were often set up in cooperation between a large employer and the respective union, with both having a say in the administration of the plan. Possibly in part because skilled labor was a scarce commodity in the growing economy of the post-war decades, traditional defined benefit (DB) pension plans were used for purposes of personnel management. These plans were set up in a way that encouraged workers to stay in the same firm until retirement, primarily because payments depending largely on the number of years worked in the firm and the highest wage years, i.e. the last years of employment, and because a departing worker’s

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47 This includes PAYGO-financed mandatory occupational pensions.
48 Includes SERPS. See infra section 4.1.3 for an explanation.
49 See e.g. GORDON DONALDSON, CORPORATE RESTRUCTURING 161 (1994); ALAN DIGNAM & MICHAEL GALANIS, THE GLOBALIZATION OF CORPORATE GOVERNANCE 222-223 (2009) (describing labor bargaining power at its peak).
50 See WOOTEN, supra note 39, at 20-21 (describing how DB plans were used to encourage retirement at the age preferred by the employer).
51 See generally RICHARD A. IPPOLITO, PENSION PLANS AND EMPLOYEE PERFORMANCE 10-29 (1997) (providing a theoretical framework and empirical evidence to show that DB plans were used to create an implicit contract between employers and employees that resulted in low turnover).
52 In other cases, benefits were computed on the basis of a fixed dollar amount for each year of service E.g. Alicia H. Munnell, Employer-Sponsored Plans: The Shift from Defined Benefit to Defined Contribution,
claims were not adjusted to the time value of money. If a mid-career worker left his job, his pension from a former employer would typically be very low, since it was based on nominal payments decades ago.

On the collective bargaining level, similar forces were operating, since plans were typically underfunded. As labor economists such as Richard Ippolito have pointed out, underfunding was not an oversight or the consequence of mismanagement, but probably a way of keeping unions at bay: Since underfunding implied that the corporation had to fill up the gap and pay out pensions regardless of whether the pension funds’ assets were large enough, unions were discouraged from exerting too much pressure on firms. Driving a hard bargain against the employer could have resulted in excessive financial burdens, which would have consequently endangered the firm’s capability to keep funding the plan by bringing it on the verge of bankruptcy.

This balance changed when America started to drift from DB plans to defined contribution (DC) pension plans in the late 1970s. There were 20,035 DB plans and 8,587 DC plans with more than 100 participants in 1975, but only 11,368 DB plans and 70,125 DC plans with more than 100 participants in 2006. 33 million American workers participated in DB plans in 1975, and their number modestly rose to about 42 million by 2006. However, the number of DC plan participants rose from a meager 11.5 million to almost

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53 ZELINSKY, id., at 39-40.
55 Ippolito, id.
80 million. In relative terms, DB and DC plans switched places: While in 1981, 60% of pension beneficiaries relied solely on DB plans, in 2001 about 60% only had a DC plan.\(^{57}\)

In a DC plan, the employer has fulfilled his obligation once a payment to a plan provider – typically a financial firm such as Fidelity or Prudential – has been made. Employees to some extent have options to choose how their money is invested.\(^{58}\) There were various reasons for the shift, most of which can be traced to legislative changes intended to protect employees. In the 1960s, there had been a number of widely publicized bankruptcies that had left employees without pensions, most of all the Studebaker case, when a 1964 plant closure left 8500 workers in a DB plan with significantly reduced retirement benefits.\(^{59}\) This led to widespread criticism of the prevailing system, and eventually to reform.

The resulting reforms set a cycle in motion that led to the shift from DB to DC plans through various unintended consequences of regulation intended to protect employees. ERISA (the Employee Retirement Income Security Act) was passed in 1974 in order to secure private pensions, and led to a number of well-intentioned changes to the law that made DB plans less attractive for employers. First, DB plans were subjected to minimum funding rules, which made it impossible for firms to maintain the current balance of underfunding that kept unions at bay.\(^{60}\) Second, ERISA introduced mandatory vesting standards, which meant that DB pensions could no longer be used to create in-
centives tying employees to the firm.ERISA imposes a fiduciary duty on trustees managing the plan assets, which exposed employers (as plan trustees) to a liability risk that does not apply in self-directed DC plans. In combination, these requirements made DB plans comparatively unattractive for employers.

Other factors also contributed to the transformation of the American pension system. § 401(k) of the Internal Revenue Code, enacted in 1978, made DC pension plans attractive for employers from a tax perspective. Moreover, changes in the pensions system were accompanied by general changes in the structure of the American economy: Large unionized industries, where DB plans where widespread, began to downsize, whereas other industries grew. In some cases, leveraged buyouts resulted in the conversion of (temporarily) overfunded DB plans to DC plans, with profits accruing to shareholders. It is not entirely clear whether these changes precipitated or were the consequences of the changes in the pension system. However, it seems hard to doubt that the way most American firms interacted with workers gradually changed. The industrial structure in the US began to change, as workers had become more mobile since the

61 29 U.S.C. § 1053. See e.g. BRUNO STEIN, SOCIAL SECURITY AND PENSIONS IN TRANSITION 78-79 (1980).
62 ERISA § 404, 28 USC § 1104.
63 See Ippolito, supra note 54, at 13-14 (discussing matching contributions under Internal Revenue Code § 401(m)); Millon, supra note 25, at 115; MUNNELL & SUNDEHN, supra note 21, at 101 (discussing employee stock-option plans); ZELINSKY, supra note 52, at 51 (discussing participant-directed plans that eliminated ERISA liability under ERISA § 404(c)(1), 28 USC § 1104(c)(1)); see also WIEDENBECK, supra note 60, at 136-138; Michael E. Murphy, Pension Plans and the Prospects of Corporate Self-Regulation, 5 DePaul Bus. & Com. L.J. 503, 549 (2007) ("section 404(c) effectively relieves the corporate sponsor of fiduciary responsibility for the plan").
64 Econometric studies found that about half of the shift between 1979 and 1989 can be explained by "a reduction in the employment share in firms and industries that had relatively strong preference for defined benefit plans." Ippolito, supra note 54, at 18; see also Alan L. Gustman & Thomas L. Steinmeier, The Stampede Toward Defined Contribution Pension Plans: Fact or Fiction? 31 INDUS. REL. 361 (1992) (explaining about half of the shift with changes in employment in different industries); ZELINSKY, supra note 52, at 33; SASS, supra note 59, at 229.
Since workers were much less tied to the firm with their pensions, it is likely that firms’ investment in workers, and possibly workers firm-specific investment in the employment relationship decreased. Concurrently, the role of unions declined, as shown by decreasing membership numbers. In the terminology of the “varieties of capitalism” literature, the US began to look less like a “coordinated market economy” relying on macro-level coordination between different groups such as employers and employees, but more like a “liberal market economy” relying on individual contracts between employers and employees.

This transformation of the structure of the economy was likely linked to the rise of the idea of shareholder primacy since the late 1970s. In a DB plan, employees are essentially bondholders of their respective employer. Consequently, the amount of an employee’s pension wealth strongly depends on the corporation’s continued ability and willingness to fund the plan. Moreover, a back-loaded pension plan may create incentives for employees to perform in a way that results in a high income late in the career.

This incentive for high effort and investment in specific human capital requires – at least before ERISA – a credible commitment by the firm – possibly in the form of what econ-

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68 Cf. Peter A. Hall & David Soskice, An Introduction to Varieties of Capitalism, in VARIETIES OF CAPITALISM 1, 8-9 (Peter A. Hall & David Soskice eds. 2001) (describing the distinction between the two types of capitalism).
omists call an implicit contract (e.g. because employee expecting to advance in the corporate hierarchy and to continue to be employed if the firm consistently does well).  

By contrast, in the contemporary DC system, employment looks more like a spot contract, where employees are rewarded only with current wage payments and contributions to the pension plan that vest immediately. As a result of widespread investment in equities, employees saving for retirement have become shareholders, and in the words of Delaware Chancellor Leo Strine, “forced capitalists.” The amount of employees' pension wealth no longer depends on the financial viability of their current employer, but rather the development of the capital market overall. Hence, middle-class employees have relatively more to gain from pro-shareholder policies than they otherwise would. Their importance relative to pro-employee policies that protect employment in a particular firm or bargaining power by unions thus increased. In the United States, the pro-shareholder position has thus become a center-left view, with Democrats generally supporting shareholder rights and Republicans opposing them in the guise of pro-business

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72 Cf. e.g. MUNNELL & SUNDEN, supra note 21, at, at 68 (discussing employee dependence on investment success). Even those employees a large percentage of whose stock is invested in Employee Stock Option Plans (ESOPs) are not in the position of a bondholder, but a shareholder of the employer. Needless to say, ESOPs have in recent years caused problems for employees whose pension wealth was excessively concentrated in the stock of employers such as Enron. See Millon, supra note 25, at 119; MUNNELL & SUNDEN, id., at 113 (providing statistics about cases where significant amounts of retirement assets where lost, and discussing Enron in more detail); Jeffrey N. Gordon, What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections, 69 U. CHI. L. REV. 1233, 1248-1249 (2002) (describing retirement problems of Enron employees).

73 E.g. Gerald F. Davis, The Twilight of the Berle and Means Corporation, 34 SEATTLE U. L. REV. 1121, 1129 (2011) (suggesting the increasing political importance of shareholder value due to the increase of the number of households invested in the stock market from 20% in 1983 to 50% in 2001).
positions. In the words of political scientists Gourevitch and Shinn, we are seeing the rise of the “transparency coalition”, where shareholders and workers are aligned against managers. Pro-labor policies likely have little traction in America today in part because the voting middle-class participates in capitalism not only as workers, but also as owners through their pension savings.

A second and related movement in the United States seems to have led to shareholder activism: In the early 1980s, the regulatory requirements governing many public, DB-based pension funds were relaxed, which allowed them to invest a larger proportion of their clients’ funds into stock. While public workers’ interest in corporations is only mediated through the funds (and the respective public entities’ ability to fill the funding gap), entities such as CalPERS became very involved in the shareholder rights movement.

2.4. Occupational pensions and human capital

As we have seen, there are considerable cross-national differences between with respect to the financial dependencies created by pension plans: In the US, most private-
sector employees depend on capital markets because of their 401(k) plans. The shift from DB to DC plans has also brought a shift from dependence on the employer to dependence on capital markets. In the past, they depended more strongly on specific employers with DB pension plans. This applied even more so to German and Japanese employees, since these, in large firms, often receive considerable occupational DB pensions on top of their public one (which at least in Germany is quite generous).

If we think about managerial, shareholder and labor models in corporate governance, pension plans may play an additional role with respect to how firms interact with workers. This argument is tied to the “Varieties of Capitalism” (VoC) literature, which suggests that production is organized in different ways in different generally capitalist countries. Each “variety” is characterized by a different set of institutional complementarities in different areas relevant for business, including finance, corporate ownership, labor relations and management style. A reasonably successful corporate governance system could be considered to be in equilibrium or local optimum: It would likely be suboptimal to change, say, the financial structure while leaving labor relations unchanged, since this might disrupt a working set of institutional complementarities. In this spirit, I suggest that different ways of organizing the pension system not only are related to specific types of capital-labor relations, but the financial system overall.

An important aspect of this is how firms interact with labor. DB plans – both in the US and abroad – were and are often used to encourage employees to stay with the firm. In the US, traditional pension plans were often criticized for making it difficult for employees to switch jobs by setting incentives to stay in the firm until retirement. Benefits

78 See generally Richard A. Ippolito, Pension Plans and Employee Performance 10-29 (1997) (discussing how DB plans were used to create an implicit contract between employers and employees that resulted in low turnover).
were usually calculated as a percentage of the income in the highest-paid years, multiplied by a factor increasing with the number of years.\textsuperscript{79} This led to strong weight in the computation of the amount of the pension being given to the last, most highly-paid years.\textsuperscript{80} Claims of employees switching to another firm in mid-career would be put on hold until retirement and not adjusted to inflation, thus resulting in a considerable loss.\textsuperscript{81} Moreover, before ERISA pension plans were often underfunded, that exposing employees to risk when firms went out of business. ERISA’s funding requirements were induced by a debate resulting from a number of bankruptcies that had left employees without pensions,\textsuperscript{82} most famously the case of Studebaker in South Bend, Indiana, which went out of business in 1964.\textsuperscript{83} Critics therefore suggested that the actuarial complexities of pension benefits permitted managers to lure employees to the firm with promises of generous pension, while leaving it to their successors to ensure that these were actually paid.\textsuperscript{84}

Besides managerial short-termism there are more benign explanations for pensions: It may be beneficial to tie employees to the firm for reasons that have to do with the creation of human capital, which in the language of labor economics, is a term for skills and training that ultimately may produce financial benefits. Traditional human capital theory, going back to pioneering work by Nobel laureate Gary Becker, distinguishes

\textsuperscript{79} In other cases, benefits were computed on the basis of a fixed dollar amount for each year of service \textit{E.g.} Munnell, \textit{supra} note 52, at 365 (giving the example of 1.5\% of final three-year average pay for each year of service, which adds up to 30\% of income for an employee with a 20-year employment history with the firm); Edward A. Zelinsky, \textit{The Cash Balance Controversy}, 19 VA. TAX REV. 683, 687 (2000); \textit{EDWARD A. ZELINSKY, THE ORIGINS OF THE OWNERSHIP SOCIETY. HOW THE DEFINED CONTRIBUTION PARADIGM CHANGED AMERICA 1 (2007).}

\textsuperscript{80} Munnell, \textit{supra} note 52, at 365; Sass, \textit{supra} note 20, at 87 (describing that typically pension claims only vested after 10 years with the same employer); \textit{MUNNELL & SUNDÉN, supra} note 21, at 2.

\textsuperscript{81} \textit{ZELINSKY, supra} note 52, at 39-40. The retiree would then have two pensions that in combination would be smaller than the pension from one firm if he had stayed with the first employer.

\textsuperscript{82} Sass, \textit{supra} note 59, at 202-213 (discussing the legislative process that led to the enactment of ERISA).

\textsuperscript{83} \textit{See} Sass, \textit{supra} note 59, at 183-186; Munnell \& Sundén, \textit{supra} note 21, at 8; Wooten, \textit{supra} note 39, at 51-79.

\textsuperscript{84} Munnell, \textit{supra} note 52, at 367; \textit{Zelinsky, supra} note 52, at 43.
general human capital, which can be used in a wide range of occupations, industry-specific, which can only be used in a specific industry or type of job, and firm-specific, which increases the worker’s productivity only with a specific employer.\textsuperscript{85}

For purposes of corporate governance, only firm-specific is of particular interest since it creates a stake for workers in a particular job, and hence corporation. For example, the skill to use specific machinery may enable workers to perform a job more efficiently and to produce better quality products.\textsuperscript{86} In some cases, particular combinations of skills that are peculiar to the job may make workers more productive.\textsuperscript{87} If the entire package cannot be transferred to another job without a loss, one can already speak of firm-specific skills. Skills may also be of an organizational character or connected to a specific corporate culture, e.g. when somebody “has worked with the same people for a long time, and really knows how to create teams that work together for different kinds of jobs.”\textsuperscript{88}

Firm-specific human capital can have various effects. A corporation may pay for its employees’ specific training, but in doing so, it exposes itself to holdup by employees. Individually, employees can threaten to leave in order to secure higher wages and other


\textsuperscript{87} Edward P. Lazear, Inside the Firm 342 (2011) (giving the example of work in a tax software company requiring knowledge of computer programming, economics, and tax law).

advantages, thus reducing profits available for shareholders. Collective unions of employees that can be replaced only at the cost of retraining can extract rents from employers in the form of high levels of wages and benefits.

However, if employees pay for the acquisition of firm-specific human capital, they will not typically pay for training and courses to acquire, but they may do so by putting in the extra effort to learn how to best do the job early during their tenure. Obviously, employees will invest in this way only if there is a return, which could consist of higher future wages and benefits and career opportunities in the firm. In economic parlance, these advantages are (quasi-)rents on the employees’ investment.

An extensive literature therefore deals with the question how employees can get reasonable assurance that they retain this long-term perspective in the firm. Since long-term contracts are not a viable solution given the uncertainty of events many decades in the future, incomplete contracts theorists have suggested that conflicts between groups that make specific investment, including workers, could be avoided by giving control rights to a neutral third party that would mediate conflicts – and thus eliminate situations described as “hold-up” in the economic literature. According to the influential “team production” model, the board of directors fulfils this function; by reducing shareholders’ control rights, in this view, corporate law grants workers some degree of long-term cer-

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90 This type of learning may include both technical and organizational knowledge about the corporation. An employee who is ready to print out his CV at any time is unlikely to invest in this way.

91 See e.g. Andrei Shleifer & Lawrence Summers, *Breach of Trust in Hostile Takeovers*, in CORPORATE TAKEOVERS. CAUSES AND CONSEQUENCES 33, 37 (ALAN J. AUERBACH ed. 1988) (discussing implicit contracts between firms and employees); Charny, supra note 70, at 1613 (discussing the use of pension to encourage investment in employer-specific skills by employees).

92 Rajan & Zingales, Power 

93 Blair & Stout 

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tainty. In the managerial US of the 1950s through the 1970s, this view seems to be reasonably accurate; growth and continued survival tended to be the overarching goal, and not the shareholder wealth maximization norm that dominates today.95

The classic American DB plans of the post-war decades were used to manage employees in various ways. First, benefit levels could be set in a way that would incentive employees to retire at a certain age; this may have made it easier for firms to induce employees to retire when they were past their peak in terms of productivity.

Second, the formula on which benefits were based could be set in a way that would create incentives to stay in the firm by rewarding loyalty96 and a performance that achieves higher wages and promotions.97 It may not be possible to write human capital investment by the employee into a long-term contract because a court cannot observe and verify it, but superiors surely can. Back-loaded DB plans may thus create incentives to make such an investment (provided that employees can be reasonably sure that they will not be laid off).

Third, since it was difficult to switch jobs, trained employees were not well-positioned to threaten the firm with departure, and they thus could not “hold up” the firm. Even collectively, union-represented employees were not positioned to drive a very hard bargain, given that DB plans were often underfunded. With the combination of underfunding and high switching cost, even industry-specific investment that employees made very likely


97 See e.g. Neumark, supra note 85, at 724-725 (discussing the incentive set by DB plans for specific human capital investment); MACKENZIE, supra note 20, at 48-49 (“Final-salary pension plans … create a powerful incentive for strong (or at least promotion achieving) performance on the job and loyalty to the firm, and reward the build-up of know-how that is specific to the firm.”).
became firm-specific investment. As explained in the previous section, ERISA made this kind of arrangement impossible for firms.98

This situation would thus expose employees to a great degree of risk: Any human capital investment they make is, by virtue of shareholders’ residual control of the corporation, subject to holdup risk. Managers acting on behalf of shareholders may, for example, fire them before they reach retirement age, withhold wage increases and downgrade benefits while giving the profits to shareholders. Moreover, DB pension promises dramatically increase the stakes employees have in a specific job. Why would employees enter into such a relationship if they expose themselves to such a precarious situation?

As I have argued elsewhere, different corporate governance systems may have developed different solutions for the employee holdup problem.99 In the US, at least in the past, the answer may have been managerialism, for which Blair and Stout’s team production theory provides a good fit. By reducing the influence of shareholders on redistributive managerial decisions to a minimum, employees may have enjoyed some degree of protection. On the other hand, Continental Europe, where large and controlling shareholders have dominated over the past decades, also developed strong employment and labor law rules that strengthened the ex-post bargaining position of the workforce.

To summarize, occupational DB pensions helped to tie employees to the firm by setting incentives for employees to stay with the firm, and it made it more difficult for employees (both individually and collectively) to hold up the firm at the expense of shareholders. Moreover, it made most human capital firm-specific, since it became

98 Furthermore, firms may prefer to confer benefits only to long-term, high-skill employees. ERISA’s non-discrimination requirement prevents firms from targeting specific types of employees. Charny, supra note 70, at 1622-1623.
99 Gelter, supra note 1, at ##.
harder for workers to switch employers. The back-loaded schedule of DB pensions, combined with a certain degree of protection from holdup by shareholders, in turn created incentives for workers to develop human capital at all. Given the precarious situation they would have been in without these protections, they may not have developed any human capital at all. At least in the US, the “employee welfare state” thus helped to cement a semi-feudal relationship between firms and employees that tied firms and workers to each other.100

2.5. Effects on the politics of corporate governance

Given the contemporary dependence of the middle-class American on the financial markets, corporate law debates and practice are entirely different from what they were in the past. One could summarize the predominant sentiment under the slogan “We are all shareholders now!” since almost everyone with a typical middle-class job in the private sector has a pension plan (401(k)). Retirement accounts are accessible online like bank accounts, and beneficiaries periodically receive statements showing capital flows and investment success.

Given the changed structure of pension plans, a decline in unionization and increased labor mobility,101 managers seem less interested in a long-term relationship with labor. Employment relationships are less than secure and resemble spot markets. Moreover, managers at least have to profess to be acting in the shareholder interest, which was much less the case 30 or 40 years ago. The arrival of modern agency theory in the 1970s may have coincided with this change only accidentally. But changes in the pen-

100 From the employee perspective, maybe the best argument is that a job has a value. Margaret Blair estimates that the value of a job is considerable for employees, given that employees who are laid off in the course of a plant closing typically earn 10-15% less in their subsequent job. Blair, supra note 65, at 1310.
101 Supra note 66 and accompanying text.
sion systems and the fact that employee retirement savings today depend on the capital markets may have contributed to its attractiveness and further propagation among academics and policymakers. Corporate governance discussions were never to be the same again.

The financial crisis has put American corporate institutions to another test. It is not fully clear what role shareholders – or the orientation of corporations toward the shareholder interest – played in the financial crisis. Lucian Bebchuk and his coauthors, for example, have suggested that incentive-based executive compensation, which is today often intended to align the interests of managers with those of shareholders, have led to increased risk-taking in the financial industry, and thus been one of the leading causes of dubious lending practices that brought the financial system to the verge of collapse.102 However, in this view, it is mainly the pathologies of executive compensation that are troublesome for firms outside the financial sector. Bebchuk, for example, is maybe one of the most persistent and persuasive advocates of shareholder rights and shareholder activism in the US corporate law academia.103 The specific context of financial institutions aside, he is one of the most prominent critics of executive pay arrangements and argues that the system needs brought in line more strongly with the interests of shareholders.104


Moreover, the general thrust of regulation in recent years, both before and after the crisis, has been to increase shareholder influence, particularly that of institutional investors: First, managerial entrenchment capability is receding. Upon the insistence of institutional investors, an increasing number of firms have dismantled staggered boards, thus removing one barrier to hostile takeovers.\textsuperscript{105} Bylaw provisions requiring majority approval for uncontested elections of directors have also become more widespread,\textsuperscript{106} thus reducing managerial control over the process.\textsuperscript{107} Second, shareholders are becoming better able to act as activists. NYSE Rule 452 and the Dodd-Frank Act of 2010 prohibit brokers from discretionary voting shares held for clients in uncontested director elections without having received instructions.\textsuperscript{108} This change increases the influence of institutional investors by essentially eliminating retail investor votes that would otherwise have almost certainly been cast in the favor of the incumbents.\textsuperscript{109} Dissatisfaction with managerial compensation practices has led to calls for “say on pay” in the form of an

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\textit{Paid Like Bureaucrats}, 14 J. MGMT. INQ. 96 (2005) (arguing that pay for performance as such is a flawed and unworkable concept).
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\textsuperscript{106} STEPHEN M. BAINBRIDGE, \textit{THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE} 213 (2008) (reporting that 31\% of the Fortune 500 companies had adopted a majority voting bylaw by 2006); Kahan & Rock, \textit{supra} note 105, at 1010-1011. There was some debate whether Securities Law should require majority voting, but the Dodd-Frank Act was passed such a provision.

\textsuperscript{107} Under plurality voting, which is the default rule, an unopposed candidate is elected if he gets a single vote (with all other shareholders abstaining). See DEL. CODE ANN. tit. 8, § 216(3) (2010); MODEL BUS. CORP. ACT § 7.28(a) (2005). Both the DGCL and the RMBCA were amended in 2006 to prohibit directors from amending bylaws that require majority voting. See William K. Sjostrom & Young Sang Kim, \textit{Majority Voting for the Election of Directors}, 40 CONN. L. REV. 459, 474-79 (2007).


\textsuperscript{109} See, \textit{e.g.}, DGCL 242(b)(1); RMBCA 10.03 (both requiring a board resolution prior to a stockholder vote for an amendment of the certificate). In a dispersed ownership firm, directors will typically side with entrenched management and not make proposals favoring shareholder involvement.
annual shareholder vote on compensation packages. The Dodd-Frank Act now requires such a vote every three years. The only defeat shareholder activists had to take was on the frontline on “shareholder proxy access.” Implementing an option given to it by the Dodd-Frank Act, the SEC passed a rule that would have permitted larger shareholders to place nominees for a limited number of seats on the company’s proxy statement. When the US Court of Appeals for the DC Circuit struck down this rule, the SEC decided not to appeal the decision. Nevertheless, it is clear that the overall trend is one toward increasing shareholder power.

However, others have argued that the one-sided focus on shareholder orientation is one of the main reasons why many industries in the US are in dire straits. Martin Lipton, the inventor of the poison pill, has been one of the strongest critics of this trend for several decades. He and others suggest that that managers need to be able protect firms from hostile takeovers that push them into short-termism. Generally, it is often argued that hostile takeovers and executive compensation, at least as currently implemented in most firms, direct the incentives of directors too strongly toward short-term share-value maximization. There are reasons to believe that short-term pressures from

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112 See Kahan & Rock, supra note 105, at 1019-22. Section 971 of the Dodd-Frank Act clarifies that the SEC has the power to pass such a regulation.
113 Business Roundtable and Chamber of Commerce of America v. SEC, No. 10-1305, July 22 (DC Circ. 2011).
capital markets in general have been a leading cause of the financial crisis.\textsuperscript{116} However, different institutions obviously do not only have overt effects in unusual situations of turmoil, but they have more subtle long-run effects on the actions of firms. If it is true that pro-shareholder institutions inevitably create pressures toward short-term orientation, they will undermine long-term relationships with stakeholders such as employees. More recently, Lynn Stout has argued that a “Tragedy of the Investment Commons” applies: Shareholder primacy policies may also be harmful because they primarily redistribute between different forms of investment. Corporations focusing on shareholder wealth may be more successful than others in the short run, while at the same time reducing the value of shareholders’ other investments and depleting firms’ long-run development potential.\textsuperscript{117} In other words, the argument is that shareholder primacy redistributes profits from other firms to those that pursue this goal most relentlessly, but harms the economy overall. From the perspective of critics of shareholder primacy, the recent reforms strengthening shareholder power obviously must look misguided.

A shareholder primacist would likely retort that it is not clear why shareholders should support policies that are ultimately not beneficial, e.g. because they push firms into shareholder wealth maximization in the short run only. There are a number of possible reasons. Most of all, capital is often no longer thought to be sufficiently patient with firms, which has much to do with how institutional investment operates. A manager has to prove himself against a benchmark set by other managers. A fund manager betting on long-run success will be outcompeted in the short-run by her peers, and thus no longer


\textsuperscript{117} LYNN STOUT, \textit{THE SHAREHOLDER VALUE MYTH} 52-54, 91 (2012)
be able to pursue long-run objectives. But that does not explain why shareholders should favor short-run policies on the political level. One could speculate whether shareholders – both institutional and retail, overestimate their ability to accurately assess long-run benefits in decisions that influence corporate action.

This raises the questions whether there are good alternatives. Shareholder power not only has a certain (but highly deceptive) democratic appeal, it has also become very appealing because at least in the United States, the middle class has been made dependent on the capital market through the rise of DC pension plans. Improving shareholder influence on firms would therefore seem to undermine the power of managers, who are an easily visible culprit when things go wrong, and to create some semblance of control for investors. Stakeholder-oriented critics therefore seem to be in an inherently defensive position, since they have to seek to preserve the detested managerial status quo or go back even further. Society as a whole has become so dependent on equity investment that strong pressure towards maximizing the investor interest has become inevitable. Financial institutions managing pension wealth are a powerful force lobbying for shareholder value maximization. Given that in a DC pension system, the benefits of higher shareholder value are likely to be immediately apparent, the middle class will likely support policies that seem to be pro-shareholder. “Shutting out” investors may therefore have become inordinately difficult for practical business and political purposes.

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3. The origin of divergence: Non-funded pension systems in the mid-20th century

3.1. Overview
We have seen that the US pension system strongly relies on plans placing considerable investment risk on employees, while the situation is very different internationally. But why did national pension systems diverge, and to what extent does it matter for corporate governance? The history of pension systems had a very important impact.

Obviously, before the industrialized world set up pension systems, people where relying entirely on their private savings and the human capital of their children (and other family) for retirement. Both private pension plans and national pension systems entered the scene only in the late 19th and early 20th century. What stands out for corporate governance is that initially public pension systems did not follow the PAYGO principle, but were funded. Unfunded pension systems are in fact, by and large, children of the Great Depression and the upheaval in the middle of the 20th century.

In the mid-20th century, most Continental European economies and the Japanese one, beginning with hyperinflation a whole range of countries in the 1920s (most prominently Germany) followed by dramatic upheavals and destruction due to war and military occupation during World War II. Savings were in many cases annihilated, the distribution of wealth became more unequal, and pension wealth was in large parts eliminated due to destruction.

In much of Continental Europe as well as Japan, workers much less dependent on the capital market than their American counterparts from the beginning. Public pension systems – based on the pay-as-you-go (PAYGO) principle like Social Security in the

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United States, ensured that workers did not depend on employers for retirement benefits, but rather on the government’s ability and political will to continue to fund current retiree’s lifestyle out of the current taxpayers’ pockets. In some countries, company-sponsored private pensions remained significant.

3.2. Germany

Take the example of Germany, where pure DC plans are still discouraged by the law. Firms typically provided (and often continue to provide) employees with so-called “book reserve” plans. These types of plans are not set up as a separate fund with assets set aside for the purpose of funding pensions (as plans in the US are), but simply consist of a contractual commitment to pay a company pension to retired workers. While this provides firms with the ability to self-finance through assets they could not distribute to shareholders (since the pension liability reduces profits), workers were tied even more strongly to the firm through the dependence on the pension claim. In fact, the employees’ “property right” as claimants to the pension seems to have played a role in the

121 See e.g. Didier Blanchet & Florence Legros, France. The Difficult Path to Consensual Reforms, in SOCIAL SECURITY PENSION REFORM IN EUROPE 109, 111 (Martin Feldstein & Horst Siebert eds. 2002) (describing the French system); Bei Lu, Olivia S. Mitchell & John Piggott, Notional defined contribution pensions with public reserve funds in ageing economies: An application to Japan, INT’L SOC. SEC. REV., 4/2008, at 1, 4-5; but see Bert Rürup, The German Pension System. Status Quo and Reform Options, in SOCIAL SECURITY PENSION REFORM IN EUROPE, id., at 137, 137 (pointing out that the German system installed under Bismarck was initially investment based, but transformed into a PAYGO system in the post-WW2 period due to the absence of suitable investment outlets in the [West] German economy).

122 See Markus Roth, Employee Participation, Corporate Governance and the Firm: A Transatlantic View Focused on Occupational Pensions and Co-Determination, 11 EUR. BUS. ORG. L. REV. 51, 69 (2011) (stating that “it is still mandatory for the employer to provide employees with payment guarantees for the retirement phase” and describing that pure DC pensions are discouraged because they do not qualify as occupational pensions under German labor law).


German Federal Constitutional Court 1978 decision that found codetermination to be compatible with the German constitution; one reason was apparently that employees had a stake akin to that of owners because of their pension claims.\(^{125}\)

Historically, the German Empire created a model for public pensions in 1889. It is well known that Chancellor Bismarck wanted to undermine the spread of socialist ideas in the growing working class and introduced a law that covered all but the marginally employed and mandated contributions by both employers and employees into semigovernmental funds.\(^{126}\) The 1889 law covered blue-collar workers and white-collar workers up to a certain income limit; in 1911, it was extended to white-collar workers above the threshold.\(^{127}\) The pension assets collected in the system were largely to underwrite public works projects, such as hospitals or sewage systems, and the construction of workers’ dwellings.\(^{128}\) The Bismarck system became the model for many comparable Continental European systems, such as those of Austria, France, Italy, Sweden, whose systems to some extent resembled the German one.\(^{129}\)

The interesting point for corporate governance debates is how these systems changed as a result of the Great Depression and World War II. In the German system, except for short periods, the funding principle never worked, due to the destruction of the

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\(^{125}\) Tyrell & Schmidt, \textit{id.} at 492 n. 47 (referring to information received from Professor Friedrich Kübler, who defended the Codetermination Act on behalf of the government).


\(^{127}\) Ritter, \textit{id.}, at 91; Ebbinghaus et al., \textit{id.} at 124. The Act referred to is \textit{Versicherungsgesetz für Angestellte (VGFA)} vom 20. Dezember 1911.

\(^{128}\) Ritter, \textit{id.}, at 126-127.

\(^{129}\) Cutler & Johnson, \textit{supra} note 126, at 98. ### also Thane in Oxford Hdb 41
capital stock by hyperinflation in the 1920s, use of pension assets for public expenditures (especially by the Nazis), and the damage inflicted on the German economy by World War II. In fact, instead of operating as a funded DB system, it has been suggested that the German system already had become a de facto PAYGO system because most of its assets were invested in (German) government bonds during the interwar period.

Post-war West Germany initially continued with the Bismarck system, but in 1957, a far-reaching reform was enacted. The reform entailed a number of highly consequential. While under the old system, government pensions were only intended to supplement other sources of income, including support from the extended family, the public pension was now intended to provide the main and potentially only source for an elderly person; retirees now received 60% of their previous monthly income. In part this was considered expedient because inflation had greatly diminished the value of private savings. But maybe most remarkably, the Bismarckian funded DB system was converted into a PAYGO system in the 1957 reform. The reform was of course controver-

130 Bert Rürup, The German Pension System. Status Quo and Reform Options, in SOCIAL SECURITY PENSION REFORM IN EUROPE, supra note 32, at 137, 137; Schmähl, supra note 126, at 115; see also Peter A. Köhler, Entwicklungslinien der 100jährigen Geschichte der gesetzlichen Rentenversicherung: Die Zeit von 1891-1957, in HANDBUCH DER GESETZLICHEN RENTENVERSICHERUNG 51, 83 (Franz Ruland ed. 1990) (noting that the German retirement insurance system’s capital had been destroyed three times in 30 years in 1945).

131 Axel Börsch-Supan & Christina B. Wilke, The German Public Pension System: How it was, how it will be, NBER WORKING PAPER 10525, 4 (2004)


133 Ebbinghaus et al., supra note 126, at 125.

134 Jens Alber, Germany, in 2 GROWTH TO LIMITS. THE WESTERN EUROPEAN WELFARE STATES SINCE WORLD WAR II 3, 23 (Peter Flora ed. 1986).

sial, and Chancellor Adenauer’s Christian Democratic Union (CDU) passed the reform with the support of the opposition Social Democrats (SPD), whereas the free market Free Democrats (FDP), the CDU’s coalition partner, and the financial industry (which saw its interests threatened) objected to the reform.136

The funds paid to retirees no longer came from a funded capital stock (plus subsidies from the general tax pool because of the funding gap), but primarily from the contributions of current workers.137 At that time, the system was advantageous from a political perspective, since it allowed payouts to uninsured older workers and numerous refugees from Eastern Europe.138 Since pensions were no longer fixed and based on the original income, but tied to the growth of current wages, the reform virtually eliminated old-age poverty and permitted retirees to participate in the economic growth of the Wirtschaftswunder (economic miracle) years.139 Opponents criticized that the new system would lead to inflation, since pensions would be tied to wage increases, which in turn put retirees into the same boat with unions in their demand for higher wages.140

Moreover, they argued that it would threaten the capital market, as it would obliterate the

136 Hockerts, supra note 132, at 369-372 (describing the positions of the parties and suggesting that the reform secured Adenauer’s majority after the following election); Hans Günther Hockerts, Entwicklungslinien der 100jährigen Geschichte der gesetzlichen Rentenversicherung. Die Rentenreform 1957, in HANDBUCH DER GESETZLICHEN RENTENVERSICHERUNG 93, 99 (Franz Ruland ed. 1990) (noting that banks and insurance companies felt strongly threatened); Alber, supra note 134, at 106 (discussing opposition by liberals and banks); Schmähl, supra note 132, at 5, 23 (discussing voting patterns and views of the political parties); Schmähl, supra note 132, at 21 (discussing objections from providers of life insurance).
137 Ebbinghaus et al., supra note 126, at 125; see also Börsch-Supan & Wilke, supra note 131, at 4 (discussing the 1957 reform, but also mentioning that the “system converted to a de facto pay-as-you-go system when most funds were invested in government bonds between the two world wars.”)
138 Ebbinghaus et al., id. Politically, it apparently also helped to keep West Germany attractive as a target for East Germans considering a defection to the West. See Hockerts, supra note 132, at 571 (quoting Chancellor Konrad Adenauer that “the Federal Republic should remain attractive for inhabitants of ‘the zone’”). Among economists, so-called “Mackenroth thesis” came to dominate, according to which all social policy expenses in fact must be produced by the economy concurrently. Schmähl, supra note 132, at 19 (describing the “Mackenroth thesis”).
139 Schmähl, supra note 126, at 116; Schmähl, supra note 136, at 6 (quoting from a speech by Chancellor Adenauer); see also Hockerts, supra note 132, at 364-367 (discussing the idea of a “dynamic pension” in the context of preparatory debates).
140 Hockerts, supra note 132, at 368; Schmähl, supra note 132, at 16 (both discussing objections to the reform).
need for private savings (and may even make them impossible because of higher deductions), and because there would no longer be any retirement wealth that needs to be invested. Some analysts have suggested that the reform prevented the emergence of a strong capital market in Germany, given that funds were no longer available for occupational pension commitments.

Even before the introduction of the state-run system, German companies had begun to provide occupational pensions to employees in the mid-19th century. The social upheavals of the industrial revolution had apparently created a need for firms – on a voluntary basis – to provide for the protection of their workers. The inflationary period of 1923 wiped out private savings and made pensions as fringe benefits more and more important for employees. The basis for the contemporary private pension mix in Germany were set after World War II, when, again, high inflation devastated the economy. The financial sector being equally devastated, firms began to widely rely on internal financing, which had previously been rarely used, to fill their heavy need for capital investment. Given that the allied forces imposed marginal tax rates on company profits of up to 90%, firms were encouraged to create pension obligations, whose provisioning in the balance sheet would reduce profits and thus keep the funds in the firm. Given that public pensions provided a replacement ratio of 25% in that period, these (unfund-
ed) pension obligations provided a welcome supplement of their expected retirement income for employees.\textsuperscript{148} The introduction of the modern public pension system in 1957 shifted the objective of public pensions from poverty alleviation to income replacement\textsuperscript{149} did not so much crowd out occupational pension, but in fact further encouraged their introduction to secure this objective.\textsuperscript{150} Since contributions to the public plan (and hence also benefits) were capped, high-income employees in fact depended on private benefits to make up for the shortfall.\textsuperscript{151} Since then, German firms have primarily relied on “book-reserve” plans.

3.3. France

Concerned about an impoverished old-age populace, Pay-As-You-Go (PAYGO) pension systems were soon introduced by the governments across the Continent. The French development closely parallels the German one. Its pension system is also typically classified as following the Bismarckian style.\textsuperscript{152} French welfare legislation developed over the course of several decades in the late 19\textsuperscript{th} century, when sector-specific pension regimes for certain industries (mining, railroads) were introduced.\textsuperscript{153} Its incipient stage culminated in the 1910 Act on Pensions of Factory and Agricultural Workers\textsuperscript{154}, which “introduced a wage-related form of security in old age based on employers’ and employ-
ees’ contributions, to which a state contribution was added that, for the first time, was based on the idea of compulsory insurance for workers below a specified income level. Like the German system, it was – in theory – a funded DB system, but it suffered from a number of limitations. In practice, the government had to inject significant amounts of money into to allow people to retire. The integration of Alsace-Lorraine into France after World War I raised the question whether a reform should expand features of the more comprehensive German system applying there to the entire Republic.

The debate led to Social Insurance Act of 1928, which was reenacted with some modifications that strengthened the role of “mutual societies” in 1930. The law’s provisions on pensions were based on the same principles, but more comprehensive in that it instituted mandatory pension contributions of all private employees up to a certain in-

157 Art. 2 specified the amount of contributions, and art. 4 of the life annuity, both of which were independent from income.
158 The system was mandatory only for workers with an annual income up to 3000 Francs, and voluntary for those with an income of up to 5000 Francs. High-income earners above the threshold did not participate. See e.g. F. Netter, Les retraites en France au cours de la période 1895-1945 (fin), 1965 DROIT SOCIAL 514, 514. It was not always fully enforced. Netter, id. at 514-515.
159 See Reimat, supra note 156, at 1157 (explaining that, in the 1910s and 1920a, the funding principle applied to the contributions, while expenses were financed by the state).
160 Netter, id. at 515; Naczyk & Mailer, supra note 152, at 96; Walter Korpi, The development of social citizenship in France since 1930, in COMPARING SOCIAL WELFARE SYSTEMS IN EUROPE 9, 19 (Anne-Marie Guillemmard, Jane Lewis, Stein Ringen & Robert Salais eds. 1995); DUTTON, supra note 156, at 90 (discussing the motivation of Alsace-Lorraine employers to support the expansion of the German system, given that they had a competitive disadvantage having to make social insurance contributions that their compatriots in the rest of France did not have to make).
161 Loi du 5 avril 1928 sur Les Assurances Sociales modifié par la loi du 16 avril 1930; regarding changes between 1928 and 1930 see Korpi, id., at 20; DUTTON, supra note 156, at 106-107 (describing the system as “compulsory mutualism”).
come level.\textsuperscript{162} The system operated under the DC contribution principle, but with a minimum guaranteed benefit (of 40% the average income after the age of 16\textsuperscript{163}). Workers were able to choose between different caisses (i.e. funds that provided pension benefits and other “social insurance”), which could either be government-run or originating in “mutual societies” that sometimes stood under the influence of a specific large employer, or pensions funds maintained by employers or unions.\textsuperscript{164} The funds created individual accounts for workers, the balance of which determined the amount of the pension.\textsuperscript{165} 90% of the contribution (50% for workers under 30) was assigned to the individual account, whereas the rest went to a separate general fund that (with some subsidy from the government) would cover guaranteed amount.\textsuperscript{166}

The system ran into problems in the late 1930s, due to the fact that many new retirees did not have enough funds in their account to cover the minimum guaranteed pension (either from contributions to the new system or rolled over from old ones); moreover, some had not made enough contributions because of the transition period, and self-employed were not covered at all, which is why there were proposals to reduce allocations to individual accounts in order to be able to pay the amount directly to current retirees.\textsuperscript{167} Inflation and the economic crisis eroded the 1930 system’s funding basis, and

\begin{itemize}
\item \textsuperscript{162} See Netter, \textit{supra} note 158, at 515; Guillemand, \textit{supra} note 155, at 47-48; Naczyk & Palier, \textit{supra} note 152, at 96. The income threshold at this point was 15000 Francs, but was often increased to adjust for inflation. Netter, \textit{id.}, at 516.
\item \textsuperscript{163} Netter, \textit{id.}, at 515.
\item \textsuperscript{164} See Dutton, \textit{supra} note 156, at 105 (discussing Renaults efforts to create a separate pension fund for its employees, who would then formally have to opt out to switch to a state-run fund); Dutton, \textit{id.} at 110 (reporting that mutual societies accounted for 85% of pension wealth); see also Korpi, \textit{supra} note 160, at 21 (discussing the large number of separate pension funds).
\item \textsuperscript{165} Netter, \textit{supra} note 158, at 515; Reimat, \textit{supra} note 156, at 1167; see also F. Netter, \textit{Les retraites en France au cours de la période 1895-1945}, 1965 \textit{Droit Social} 449-450.
\item \textsuperscript{166} Netter, \textit{id.}, at 515-516.
\item \textsuperscript{167} Netter, \textit{id.}, at 517.
\end{itemize}
the German occupation struck the final blow to funding.\footnote{\textsc{Yves Bouthillier}, \textit{2 Le drame de vichy} 364 (1951) ("The war, the occupation and the loss of value of the Franc in comparison to the Mark led us rapidly but fatally to a monetary devaluation … The devaluation of 1936 should already have provoked the disappearance of the system").} Under the Vichy regime, the system finally came to be seen as financially unviable.\footnote{\textsc{Bouthillier}, \textit{id.} at 364 (the former Vichy finance minister, in his memoir, criticizing the funded pension system); \textsc{Naczyk & Palier}, \textit{supra} note 152, at 96 (discussing the failure of the system).} Consequently, the government abolished the income ceiling\footnote{\textsc{Korpi}, \textit{supra} note 160, at 21.} and introduced the PAYGO system in 1941.\footnote{Loi du 14 mars 1941 relative à l'allocation aux vieux travailleurs salaries.} Besides the failure of the funded capital stock, the motivation for introducing the new system was, as in the subsequent German 1957 reform, the inclusion of workers who had not made significant contributions to pension accounts.\footnote{\textsc{Reimat}, \textit{supra} note 156, at 1178 (attributing the general trend toward PAYGO in various parts of the French pension system to the inclusion of workers without a significant contribution history).} Yves Bouthillier, the finance minister during the Vichy period, reports that the PAYGO system switch allowed the use of accumulated reserves to pay pensions to old workers.\footnote{\textsc{Bouthillier}, \textit{supra} note 168, at 364-365.} Sending unemployed workers older than 65 (and therefore unlikely to ever hold a job again) into retirement relieved the burden on funds dedicated to provide unemployment benefits.\footnote{\textsc{Bouthillier}, \textit{id.} at 362.} Unsurprisingly, the reform was often seen, particularly by Gaullists, as an attempt by the Vichy regime to gain the support of the working class.\footnote{\textsc{Dutton}, \textit{supra} note 156, at 203-204.}

The reform that set the state for today’s French pension system by further entrenching the PAYGO principle was enacted in 1945.\footnote{Ordonnance du 30 décembre 1944, Ordonnance du 4 octobre 1945, Ordonnance du 19 octobre 1945.} The reform had been prepared by a group meeting in London during the German occupation in France and completely shook up French welfare policy.\footnote{\textsc{Dutton}, \textit{supra} note 156, at 202; \textit{see also} Bruno Palier, \textit{Gouverner la securite sociale} 71-72 (2005).} It largely consolidated the large number of caisses
and created a unified government-sponsored system.\textsuperscript{178} It was primarily inspired by principles developed by the labor unions and the left, which was strong right after France’s victory in World War II, but, after incorporating some compromises, also gained support from the center-right.\textsuperscript{179} As Guillemard points out, the PAYGO principle was very much in line with socialist ideas about solidarity between the generations, and it focused on retirees’ needs instead of their inability to pay.\textsuperscript{180} Like under the German reform a few years later, pensions were tied to the development of salaries.\textsuperscript{181} The experience of impoverishment and inflation in the 1930s clearly added to the popularity of the system,\textsuperscript{182} as did the prevailing material situation of the elderly, to whose remedy no political party wished to publicly object.\textsuperscript{183} But most of all, it is clear that the widespread view of the funded pension system of the 1930s as a failure helped the enactment of PAYGO as a permanent institution in post-war France\textsuperscript{184} and its continued popularity in subsequent years.\textsuperscript{185}

In France, supplementary occupational pensions are mandatory. Around 1900, only 5% of workers were employed in firms offering retirement benefits.\textsuperscript{186} Employees often distrusted company pensions because it made them dependent on managers, and

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{178} Dutton, \textit{id.}, at 213-214 (describing resistance against unification).
\item \textsuperscript{179} Korpi, \textit{supra} note 160, at 22; Naczyk & Palier, \textit{supra} note 152, at 95.
\item \textsuperscript{180} Guillemard, \textit{supra} note 155, at 53; see also Palier, \textit{supra} note 177, at 76 (describing the idea of eventually eliminating the requirement of a contribution history as soon as the entire population is included).
\item \textsuperscript{181} Pierre Laroque, \textit{Le Sécurité Sociale de 1944 à 1951}, 1971 \textsc{Revue Française des Affaires Sociales} 11, 17.
\item \textsuperscript{182} Guillemard, \textit{id.}, at 53; see also Anne Lavigne, \textit{Pension Funds in France: Still a Dead End?} 28 \textsc{Geneva Papers on Risk \\& Ins.} 127, 136 (2003) (suggesting that the destruction of pension wealth in the 1930s left the French skeptical toward pension funds).
\item \textsuperscript{183} Guillemard, \textit{supra} note 155, at 57.
\item \textsuperscript{184} Guillemard, \textit{id.}, at 65 (quoting a supporter of the PAYGO as saying “It is therefore absolutely vital to replace this system with a pay-as-you-go plan that allows the real resources to be shared constantly among all members”).
\item \textsuperscript{185} Moore, \textit{supra} note 33, at 25-26 (describing protests in 2003 to save the PAYGO system).
\item \textsuperscript{186} Jérôme Bourdieu, Lionel Kersztenbaum & Gilles Postel-Vinay, \textit{Thrifty Pensioners: Pensions and Savings in France at the Turn of the Twentieth Century}, 71 \textsc{J. Econ. Hist.} 383, 390 (2011).
\end{enumerate}
\end{footnotesize}
they risked losing pensions if the firm went bankrupt.\textsuperscript{187} However, plans were set up in the 1930s to cover employees whose income was above the ceiling of the government-provided equivalent of social security.\textsuperscript{188} Many firms set up industry-wide plans in 1936 and 1937 within the framework of collective bargaining,\textsuperscript{189} so that, in the end, cadres (executives) were generally covered.\textsuperscript{190} The plans were funded and supposed to be paid out to workers in the form of lifetime annuities after the age of 60.\textsuperscript{191} The extension of the public PAYGO plan to all employees in 1945 created widespread opposition among high-wage cadres (executives), who would have preferred to retain these private plans as their only retirement benefits.\textsuperscript{192}

The resulting compromise was AGIRC (Association général des institutions de retraites des cadres), which was introduced in 1947. Under this framework, companies could choose the institution managing the plan, such as friendly societies, insurance companies, or organizations run jointly by employer representatives and labor unions, all of which had to join a national association.\textsuperscript{193} While there were also death benefits for employees working while still in employment, the retirement plan was based on the PAYGO system.\textsuperscript{194} In 1961, ARRCO (Association des régimes de retraites complémentaires) was created as a parallel program for private-sector employees not qualifying for

\textsuperscript{187} Bourdieu et al, \textit{id}; see also F. Netter, \textit{Les problèmes posés par les régimes complémentaires de retraites}, 18 \textsc{Rêve Économique} 292, 293 (1967) (pointing out an 1895 law that provided personal liability of managers for pensions lost due to corporate bankruptcy).

\textsuperscript{188} Bernard Friot, \textit{The Origins of French Supplementary Pension Plans: The Creation of the General Association of Pension Institutions for Cadres (AGIRC), in International Perspectives on Supplementary Pensions}, at 40, 40.

\textsuperscript{189} Henry Lion, \textit{La convention du 14 mars 1947 et son évolution}, 1962 \textsc{Droit Social} 396, 396-397; Friot, \textit{id.}, at 40-41; Netter, \textit{supra} note 187, at 295-296.

\textsuperscript{190} André Leroux, \textit{Les régimes complémentaires de retraite des salariés}, 1962 \textsc{Droit Social} 383, 383.

\textsuperscript{191} Friot, \textit{supra} note 188, at 41.

\textsuperscript{192} Friot, \textit{id.}, at 41-42.

\textsuperscript{193} Friot, \textit{id.}, at 42; Lucy apRoberts, \textit{Comments}, in \textsc{Securing Employer-Based Pensions}, \textit{supra} note 144, at 105, 109.

\textsuperscript{194} Friot, \textit{id.}, at 44, 47.
Both programs (which cooperate closely) are jointly managed on the national level by employers and unions operating under collective bargaining agreements, and both are – interestingly – PAYGO plans operating under the DC principle. While these plans are therefore not funded, payouts to retirees depend on current contributions. To that end, a complex formula was established (based on the number of “points” acquired by an employee through his contributions) to compute a fictitious share in the payouts made from current contributions (with only a small fund to stabilize payments). Initially upon the introduction of the plans, workers could be given credit for their previous career without actually having made contributions to the new plans, which meant that these new plans could began to pay out pensions immediately. This was seen as important, given that many cadres’ wealth had been wiped out by inflation.

Other than e.g. in Germany or in the US before ERISA, benefits vested with the employees irrespective of where they worked, since the plans operate on the national level, which meant that retirement benefits did not inhibit labor mobility. Unlike 401(k) plans, however, these plans also do not tie employees to the capital markets (but rather make them dependent on a continued stream of contributions). Company pension plans,

196 OECD, id., at 365 (pointing out the existence of a groupement d’intérêt économique between the two associations).
197 OECD, id., at 366-367.
198 Didier Blanchet & Louis-Paul Pelé, Social Security and Retirement in France, NBER WORKING PAPER No. 6214, at 8 (1997); Emmanuel Reynaud, Financing Models for Pay-As-You-Go Systems, in INTERNATIONAL PERSPECTIVES ON SUPPLEMENTARY PENSIONS, at 71, 76-77; Naczyk & Palier, supra note 152, at 106 (describing the system as a notional DC system); see also OECD, id., at 367-368. The points are multiplied with a “point value” set on the basis of contributions by the plan managers twice a year. Emmanuel Reynaud, Private Pensions in OECD Countries: France, OECD LABOUR MARKET AND SOCIAL POLICY OCCASIONAL PAPERS, No. 30, at 39 (1997).
199 Reynaud, Financing Models, id., at 79; apRoberts, supra note 193, at 110.
200 Lion, supra note 189, at 398-399.
201 Heinz-Dietrich Steinmeyer, Labor Mobility and Supplementary Pensions, in INTERNATIONAL PERSPECTIVES ON SUPPLEMENTARY PENSIONS, at 185, 186; OECD, supra note 195, at 367.
by contrast, are rare in France and typically only offer small benefits. The reason for switching from the funded systems of the interwar period to PAYGO was apparently a concern about inflation, because of which funded systems were thought no longer to be able to fulfill their function.

3.4. Italy

In Italy, public old-age retirement insurance was introduced for public employees in 1864, for private employees in 1919. The centrally managed system, which followed the Bismarckian model, was introduced in 1919 and financed by payroll taxes. Like the other systems of this period, it was funded, but it was a DB system at the same time; the government provided an implicit guarantee to make up for a shortfall. Thus, it was characterized as a “forced saving” system.

The system slightly favored low-wage employees with shorter contribution histories. Most of the funds were invested in bonds issued by the government, municipalities, and state-owned companies (such as the railroad), and thus helped to finance infrastructural expansion. With only a small portion of the funds being invested in shares and most in long-term treasury bonds, the system was depleted by inflation, and by the use of pension assets to support the government budget in the aftermath of World War II.

\[\text{References}\]

\[\text{apRoberts, supra note 193, at 109.}\]
\[\text{Lion, supra note 189, at 397.}\]
\[\text{Matteo Jessoula, Italy: From Bismarckian Pensions to Multipillarization under Adverse Conditions, in The Varieties of Pension Governance: Pension Privatization in Europe 151, 152 (Bernard Ebbinghaus ed. 2011). The system was extended to the self-employed between 1957 and 1966. Jessoula, id., at 157.}\]
\[\text{Maurizio Ferrera, IL WELFARE STATE IN ITALIA 30 (1984).}\]
\[\text{Luca Beltrametti & Riccardo Soliani, Alcuni aspetti macroeconomici e redistributivi della gestione del principale ente pensionistico italiano (1919-1939), 16 RIVISTA DI STORIA ECONOMICA 147, 148-149 (2000); Jessoula, supra note 204, at 157.}\]
\[\text{Beltrametti & Soliani, id., at 149.}\]
\[\text{Beltrametti & Soliani, id., at 173.}\]
\[\text{Franco, supra note 36, at 213.}\]
\[\text{Beltrametti & Soliani, supra note 206, at 149-150.}\]
Italy hence had to switch to the PAYGO system, the transition to which was completed in several steps and finally completed in 1969, when pensions were made completely dependent on the employee’s final income. Moreover, an additional means-tested scheme was introduced to cover employees not covered by pensions, and benefits were automatically linked to inflation. Under this system, public pensions were so generous that they were thought to have largely crowded out private pensions from the market.

Hence, the outline of the Italian story is a somewhat different one. Presumably because of the comparatively low level of industrialization and the need for infrastructure investment at the time, shares and capital markets played a small role for the old funded Italian public pension system. However, following the precarious situation of government finances after the war, the residual funded system turned out not to be sustainable. Yet, neither the funded system of the interwar years, nor the post-war system made Italians dependent on corporate profits and capital markets.

Private pensions have traditionally been of very little significance in the Italian economy. Brugiavini & Fornero report that, as late as 1992, only 7% of workers were covered, “largely in the service sector and banking and insurance sector and in northern

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212 Ferrera, supra note 205, at 42; Jessoula, supra note 204, at 157; see also Maurizio Ferrera, *Italy*, in *Growth to Limits* 387, 416 (Peter Flora ed. 1988) (discussing the expansion of pension cost because of minimum pensions regardless of contributory status). Reforms during the 1950s and 1960s extended the public pension system to various categories of self-employed workers and thus ultimately led to a coverage of almost the entire population. See Ferrera, supra note 205, at 90-91 (listing reforms) and 93 (reporting the increase in coverage).

213 Ferrera, supra note 205, at 42; Brugiavini, supra note 211, at 194.

214 E. Philip Davis, *Pension Funds* 74 (1995); Jessoula, supra note 204, at 158.
regions of the country.” Until then, there was not even a legal regulatory framework for occupational pensions.\textsuperscript{215} At that time, most plans were employer-funded and operated on the PAYGO principle.\textsuperscript{216} Besides the level of benefits in the public system, one possible reason have been mandatory severance payments (\textit{Trattamento di fine rapporto}) for employees that retire or otherwise left the employer.\textsuperscript{217} Employers had to withhold a specified percentage from salaries to fund these payments, but which they did not have to set aside as a separate fund; these effectively constituted loans to the firm.\textsuperscript{218} Given the strong dismissal protection under Italian law since the 1970s, the TFR had lost its purpose of providing compensation for fired workers.\textsuperscript{219} In its effects, one could consider this a plan comparable to the German and Japanese “book reserve pensions”, since it turns workers into creditors of the company.\textsuperscript{220}

### 3.5. Japan

Japan was a relative latecomer in developing a public pension system, which is not surprising given that its “modern” economic development began only after the Meiji restoration in 1868 that eventually led to an emulation of Western economic models.\textsuperscript{221} Even though Japan had caught up with European countries in terms of the percentage of the population working in industry by 1920, it did not initially have a social welfare system.\textsuperscript{222} Business leaders successfully resisted all efforts in that direction, arguing that “Confu-
cian benevolence in the factory made welfare policy unnecessary."\textsuperscript{223} There was no meaningful labor movement under the Japanese dictatorship that could have pushed for social welfare protections.\textsuperscript{224}

As with other aspects of welfare policy, the introduction of a retirement system was tied to World War II. First, the public pension programs that were introduced at that time helped to sustain the workforce. Retention of seaman was the goal of the Seaman’s Insurance Law of 1939, which introduced health and retirement insurance for this group.\textsuperscript{225} A comprehensive pension system for private workers was implemented in 1942.\textsuperscript{226} It served a similar goal, as it required workers to contribute for three years to receive any benefits.\textsuperscript{227} Second, funding the war effort seems to have played a role as well. Nominally, the system was fully funded.\textsuperscript{228} While some have suggested that "finances were misused for the war effort",\textsuperscript{229} others argue that the purpose of the system was to raise money.\textsuperscript{230} Withholding contributions from wages had the consequence of reducing workers’ consumption, and given the novelty of the system, no benefits needed to be paid at that time. Hence, most of the funds went to the Ministry of Finance to pay

\textsuperscript{223} Kasza, \textit{id.} at 421.
\textsuperscript{224} Kasza, \textit{id.} at 429.
\textsuperscript{225} Kasza, \textit{id.} at 425.
\textsuperscript{226} Charles Yuji Horioka, Japan's Public Pension System in the 21st Century, in JAPAN'S NEW ECONOMY 99, 101 (Magnus Blomström, Byron Gangnes & Sumner La Croix eds. 2001); Kasza, \textit{id.} at 425.
\textsuperscript{227} Kasza, \textit{id.} at 425; see also HARALD CONRAD, THE JAPANESE SOCIAL SECURITY SYSTEM IN TRANSITION 24 n.10 (2001) (reporting that the objective was to "raise national defense capability").
\textsuperscript{230} Yukiko M. Katsumata, \textit{The relationship between the role of the corporate pension and the public pension plan in Japan}, in RETHINKING THE WELFARE STATE 56, 62 (Martin Rein & Wilfried Schmähl ed. 2004) (suggesting that the pension plan was in fact introduced to collect money to finance the war); Toshimitsu Shinkawa, The politics of pension reform in Japan: Institutional legacies, credit-claiming and blame avoidance, in AGEING AND PENSION REFORM AROUND THE WORLD 157, 162 (Giuliano Bonoli & Toshimitsu Shinkawa eds. 2005).
for the war.\textsuperscript{231} Any pension assets that were left were destroyed by post-war hyperinflation.\textsuperscript{232}

Initially after the war, companies took care of the welfare needs of their employees.\textsuperscript{233} When the economy began to grow during the 1950s, a more comprehensive welfare system was developed.\textsuperscript{234} The post-war Employee Pension Insurance (EPI) and National Pension Insurance (NPI) – which achieved universal coverage but provides a lower amount of benefits\textsuperscript{235} – were originally introduced systems in 1954 and 1961 respectively. Benefits remained comparatively low and constituted a basic means-tested welfare pension, the idea being to provide insurance against old-age poverty (and not more).\textsuperscript{236} This was largely due to the efforts of employers, who resisted a more comprehensive system comparable to those of European countries.\textsuperscript{237} However, even though the system was funded, people who had never paid into the system were entitled to benefits.\textsuperscript{238} The growth of the Japanese economy induced young people to move to the cities, which left older people in rural areas without being able to count on relatives for support, which had been the tradition.\textsuperscript{239} Reforms during the 1960s increased benefits while not increasing contributions very much, thus bringing the system closer to PAYGO.\textsuperscript{240}

\textsuperscript{231} Kasza, \textit{supra} note 222, at 425.  
\textsuperscript{232} Horioka, \textit{supra} note 226, at 101; Conrad, \textit{id.}, 200 (2003).  
\textsuperscript{234} Chopel et al., \textit{id.}, at 24-25.  
\textsuperscript{235} Horioka, \textit{id.}, at 101; Conrad, \textit{id.}, at 205 (comparing the amount of benefits in the NPI and EPI systems). Previously self-employed and workers in firms with less than 5 employees had been excluded.  
\textsuperscript{236} Conrad, \textit{supra} note 227, at 26; Conrad, \textit{supra} note 229, at 201.  
\textsuperscript{237} Shinkawa, \textit{supra} note 230, at 163.  
\textsuperscript{238} Chopel et al., \textit{supra} note 233, at 25.  
\textsuperscript{239} Chopel et al., \textit{id.}, at 25.  
\textsuperscript{240} Conrad, \textit{supra} note 227, at 26.
Following reforms in the 1970s, benefit levels were increased so that these plans had to be converted to PAYGO systems for financial reasons.\textsuperscript{241} The 1973 reform created a pure PAYGO system in which benefits were indexed to inflation and wage levels, which survived until 2004.\textsuperscript{242} Wage indexation ensured that the level of pension benefits relative to average wages of current workers remained stable at 60%.\textsuperscript{243} The political reason for the expansion was a crisis of the ruling LDP, which hoped to contain competing parties by expanding pensions.\textsuperscript{244}

While public pensions were low compared to European countries, occupational pensions made up for the shortfall. Historically, Japanese firms offered lump law severance payments to workers even before the Meiji restoration.\textsuperscript{245} Pensions developed from the “lump sum” retirement allowance, and researches feel that “it is difficult to draw a line between them.”\textsuperscript{246} When workers obtained the right to organize and the labor movement gained strength after World War II, one of its first goals was to obtain better retirement benefits.\textsuperscript{247} Corporate pensions thus helped to reduce labor unrest in this difficult period.\textsuperscript{248}

With industry in ruins, employers wanted workers to stay in the firms longer and introduced lifetime employment.\textsuperscript{249} Part of the deal were payments that were much larger when the worker reached mandatory retirement age (typically 55 in the post-war de-
ades) or was dismissed, than if he voluntarily left the firm. Lump sum plans in large firms were typically financed in under the “book reserve” method (similar to company pensions in Germany). Other firms, particularly smaller ones, often “contracted out” plans to financial institutions or special legal entities that would provide defined benefits. But even in these cases, employer contributions dominated. In the 1950s, firms increasingly shifted from lump sum payments to pension plans, given that it made it easier to set aside funds for payments.

Following regulatory changes in the 1960s, firms began to establish funded pension plans following the then prevailing US model of DB plans. Tax-qualified pension plans (TQPPs) were introduced in 1962 and as DB plans, whose funds were invested with banks, insurance companies and investment management firms. Larger firms tended to create Employees Pension Fund Plans (EPFP) from 1966 onwards, which could also be used to partly substitute social security contribution.

DC plans were established in the 1970s, but obtained relatively small significance at that time. In none of the DB plans, the risk of bankruptcy of the company was fully covered by insurance, leaving some risk with the employees. In the early 2000s, there

250 Watanabe, id., at 125.
252 Watanabe, id., at 127-129.
253 Watanabe, id., at 134-135.
254 Katsumata, supra note 230, at 62.
255 Clark, supra note 37, at 64; CONRAD, supra note 227, at 37; Conrad, supra note 272, at 206-207; Rajnes, supra note 271, at 91; MACKENZIE, supra note 20, at 232.
256 Clark, supra note 37, at 64-67; CONRAD, id., at 37-38; Conrad, id., at 205-206; MACKENZIE, id., at 232; Rajnes, supra note 271, at 92-93.
257 Watanabe, supra note 245, at 129.
258 Watanabe, id., at 139-140.
was some discussion of DB assets being shifted into DC plans to relieve Japanese firms from the burden of having to make up the shortfall for investment success.²⁵⁹

3.6. Effects on corporate governance

As we have seen, non-funded pension plans were introduced as the result of a particular confluence. They were not gradually phased in, but immediately began to pay out pensions to elderly people who had never contributed to the system, but might otherwise have become financially destitute upon retirement.²⁶⁰ Moreover, the introduction of earnings-based pension systems in countries such as Canada, Norway, Finland and Sweden, and the extension of these systems in Germany, France, Italy, the US and Austria) helped to spread the wealth created in the post-war boom to the older generation.²⁶¹

Consequently, Continental European and Japanese pensions provide a clear counterpoint to the US: Retirees relied and continue to rely largely on a government-organized pensions system that is considerably more extensive than Social Security in the United States. As far as it is supplemented by private pensions, these tend to be based on the DB concept. In the 1990s, Continental European and Japanese governments began to cautiously scale back public pensions and created incentives to shift to private pensions. Private pensions were as important as in the US only in the UK. Since the 1980s, the UK has been shifting from the DB to the DC form, and the more limited private pensions in Continental Europe and Japan started to follow suit more recently.

The pension system thus helps to explain differences in the corporate governance system. For the average middle-class person from these countries, the capital market is largely irrelevant. Savings, if they are invested in equities are “nice to have” to allow a

²⁵⁹ CONRAD, supra note 227, at 92.
²⁶⁰ ###
²⁶¹ Cutler & Johnson, supra note 126, at 99.
more comfortable retirement, but they are not essential. As is evident from the corporate governance and financial markets literature, stock markets are much smaller relative to GDP, and individual household savings were often rather held in savings accounts. Pro-investor policies are almost irrelevant for Otto Normalverbraucher in Germany, while they are essential for Average Joe in the United States.

4. Changes in the late 20th century as a driver for divergence in corporate governance

4.1. Recent changes to pension systems in Europe and Japan

4.1.1. The growth of private pension wealth

As shown above, occupational pension plans long remained of relatively limited significance outside of the US and the UK. Where they exist, DB plans still dominate over DC plans. For example, large German companies often provided employees with DB pension plans. However, other than traditional DB plans in the US, these funds are not set up as separate legal entities, but simply consist of a promise by the firm to employees to provide them with a specified pension once they retired (accordingly, this had to be reflected by provisions in the balance sheet). In 1996, about 56% of employment-related pension claims took the form of a direct promise by the employer, while pension

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263 E.g. Kübler, supra note 35, at 99 (“Pension funds so far have had very little importance.”).
265 Kübler, supra note 35, at 101; Charny, supra note 70, at 1641; Stefan Prigge, A Survey of German Corporate Governance, in CORPORATE GOVERNANCE – THE STATE OF THE ART AND EMERGING RESEARCH 943, 1019 (Klaus J. Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch & Stefan Prigge eds. 1998); Mackenzie, supra note 20, at 228; see also Schruff, supra note 33, at 800. The historical reasons seems to lie in the transition from the Reichsmark to the Deutschmark currency in 1948, which favored this method of pension finance over others. Peter Ahrend, Pension Financial Security in Germany, in SECURING EMPLOYER-BASED PENSIONS, supra note 144, at 74, 78.
trusts and employer-sponsored life insurance played a comparatively smaller role.\footnote{Schruff, supra note 33, at 804; see also Ahrend, supra note 265, at 86 (providing the 1991 data).} Employees had some additional security through pension insurance.\footnote{Schruff, supra note 33, at 800.} As a consequence of this lack of separation of pension assets, it is difficult to provide statistics regarding the value of pension assets.\footnote{Schruff, supra note 33, at 801.}

Similarly, in France, employers’ organizations and labor unions jointly set up a national DB pension plan in the years after World War II. It supplements pensions of those employees whose income is above the maximum for social security contributions in order to provide proportionate retirement benefits.\footnote{apRoberts, supra note 193, at 109-110.} Where pre-funded, employer-sponsored pension plans have existed in the 1990s, they continued to play only a minor role compared to the United States.\footnote{Moore, supra note 33, at 10-11.}

Many Japanese pension plans also took the form of “book reserve” plans, which remained unfunded like their German counterparts.\footnote{David Rajnes, The Evolution of Japanese Employer-Sponsored Retirement Plans, 67 SOC. SEC. BUL. 89, 91, 93 (2007).} Traditionally, private pensions were disbursed upon retirement as a lump-sum payment, or alternatively as an actual pension.\footnote{Clark, supra note 37, at 64; Kashiwazaki & Fukazawa, supra note 69, at 67-68; Harald Conrad, Sustaining Old-Age Security in Japan: Toward a New Public-Private Pension Mix, 8 J. JAP. L. 199, 205 (2003).} Following amendments to corporate and tax law during the 1960s, DB plans based on the then-prevailing US model expanded during Japan’s period of growth through the 1980s.\footnote{Clark, supra note 37, at 64; Sarah McLellen, Corporate Pension Reform in Japan, BENEFITS Q., First Quarter 2005, at 31, 32; Kashiwazaki & Fukazawa, id., at 68; Rajnes, supra note 271, at 91-93.} DC plans were unusual, since pensions were typically seen as a

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reward for years of good work in the public perception.\textsuperscript{274} Hence, the amount of retirement benefits was typically based on the employees’ years of services.\textsuperscript{275}

Unfortunately, cross country data consistently showing the relatively importance of government pensions, DB plans and DC plans does not seem to be available. Consider, however, the data in Table 6:\textsuperscript{276}

<table>
<thead>
<tr>
<th></th>
<th>Voluntary occupational pension</th>
<th>Voluntary personal pension</th>
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<tr>
<td>France</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>64%</td>
<td>44%</td>
</tr>
<tr>
<td>Italy</td>
<td>10.6%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Japan</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
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<td>19.9%</td>
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<tr>
<td>United States</td>
<td>46%</td>
<td>34.7%</td>
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\textbf{Table 6: Coverage of individuals by private pension schemes (Source: OECD)}

Between the six countries, private pensions are relatively uncommon in France and Italy. In Germany, Japan, the UK, and the US, more individuals are covered. However, as described above, in Germany and Japan plans are typically (still) DB plans, while in the UK and the US, there has been a shift to DC plans during the past decades. In Germany, however, it is estimated that occupational pension account for about 5% of the median retiree household income.\textsuperscript{277}

Another important part of the picture is the size of private pension assets relative to GDP, as shown in Table 7.

\textsuperscript{274} Conrad, \textit{supra} note 272, at 205.
\textsuperscript{275} Clark, \textit{supra} note 37, at 64.
\textsuperscript{276} OECD, \textit{supra} note 43, at 141. The data are also available at \url{http://dx.doi.org/10.1787/651756380648}.
\textsuperscript{277} \textsc{Mackenzie}, \textit{supra} note 20, at 227.
Table 7: Private pension assets as a percentage of GDP

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<tr>
<td>France</td>
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<td>Davis</td>
<td>Davis</td>
<td>Davis</td>
<td>D&amp;J\textsuperscript{279}</td>
<td>Davis</td>
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<td>2</td>
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<td>Gern\textsuperscript{281}</td>
<td>Minns, D&amp;J\textsuperscript{282}</td>
<td>Clark\textsuperscript{283}</td>
<td>Munnell\textsuperscript{284}</td>
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<tr>
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<td>63.0</td>
<td>76.7</td>
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</table>

The data are taken from sources that include various sets of assets in the report data (typically without making their divergent assumptions very clear). The most conspicuous discrepancy – a much larger percentage for Japan in 1988 and 1996 – can be explained with the great size of the life insurance sector in Japan.

Leaving these differences aside, the general tendency is clearly growth of the amount of pension assets, coinciding with the tendency to shift towards a greater reliance on private pensions. That trend, however, is much more marked in the US and the

\textsuperscript{278} Davis, supra note 214, at 55.
\textsuperscript{279} Disney & Johnson, supra note 41, at 20.
\textsuperscript{280} INTERNATIONAL LABOR OFFICE, SOCIAL SECURITY: A NEW CONSENSUS 87 (2001).
\textsuperscript{281} Gern, supra note 294, at 441-443.
\textsuperscript{282} Minns, supra note 40, at 9; Disney & Johnson, supra note 41, at 20.
\textsuperscript{283} GORDON L. CLARK, EUROPEAN PENSIONS & GLOBAL FINANCE 18 (2003).
\textsuperscript{284} Munnell, supra note 52, at 361.
\textsuperscript{285} This includes only assets held by pension funds. OECD, supra note 43, at 143.
\textsuperscript{286} This includes a larger set of pension assets, including assets held attached to insurance contracts or held by banks. OECD, supra note 26, at 44, data available at http://dx.doi.org/10.1787/514674153416.
UK, and to some degree Japan (leaving life insurance aside) than in France, Germany and Italy.

4.1.2. Pension reforms in the 1990s and 2000s

The interesting point for the corporate convergence debate is the shift toward an increased private component. In the last two decades, several OECD countries began to reform their pension systems, given that analysts had identified a “pension gap” opening as a consequence of demographics.\(^{287}\) Due to sinking birth rates and a longer life expectancy,\(^{288}\) it became increasingly difficult for current employees to fund the pensions for current retirees.\(^{289}\) While Texas governor (and presidential hopeful) Rick Perry was able to scandalize many observers by describing Social Security as a “Ponzi scheme” in September 2011,\(^{290}\) Europeans have been hearing essentially the same for their much more extensive national pension systems for the better part of two decades. While 100 German workers’ contributions supported 50 retirees in 1998, it is projected that the same number of active workers will have to support 96 pensioners in 2030.\(^{291}\) Obviously, with

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\(^{288}\) Schruff, supra note 33, at 797-798 (describing demographic trends in Germany); Blanchet & Legros, supra note 32, at 113-116 (describing the 1990 reform debate in France); Franco, supra note 36, at 211 (describing demographic problems in Italy); MACKENZIE, supra note 20, at 145 (table showing the growth of life expectancy in 10 OECD countries).

\(^{289}\) Rürup, supra note 32, at 160 (describing the German PAYGO system as “threatened by demographic changes within German society”).

\(^{290}\) See e.g. Jackie Calmes & Robert Pear, *A Bipartisan Move to Tackle Benefit Programs*, N.Y. TIMES, Sept. 8, 2011.

a growing number of retirees, the level of benefits can only be maintained if there is a corresponding increase in the number of workers paying into the system.\footnote{See e.g. Jonathan Gruber & David A. Wise, \textit{Different Approaches to Pension Reform from an Economic Point of View}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 49, 57-58 (describing the relationship with a simple formula).}

Consequently, several European countries began to implement reforms to confront this problem during the 1990s. Social security taxes were increased, as were subsidies from the general government budget.\footnote{See e.g. Assar Lindbeck, \textit{Pensions and Contemporary Socioeconomic Change}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 19, 32-35 (reviewing “marginal reforms” that do not entail a radical overhaul of the system).} Some countries began to increase the retirement age and reduce payouts already in the early 1990s,\footnote{Klaus-Jürgen Gern, \textit{Recent Developments in Old Age Pension Systems. An International Overview}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 439, 445 (briefly surveying reforms of the 1990s); Rürup, \textit{supra} note 32, at 143-145 (describing the German 1992 reform, which increased the retirement age for women from 60 to 65 and reducing the adjustment for wage growth for existing retirees), and \textit{id.} at 146-149 (describing the 1999 reform which created an automatic adjustment of retirement claims to demographic change); Franco, \textit{supra} note 36, at 219 (describing the Italian 1992 reform); CHRISTINA BENITA WILKE, GERMAN PENSION REFORM 49 (2009) (describing the German 1992 reform); Munnell, \textit{supra} note 52, at 370 (discussing the increased retirement age in the UK).} or to increase the number of participating years required to retire.\footnote{See e.g. Moore, \textit{supra} note 33, at 14 (describing a French 1995 reform proposal that would have had this effect); Franco, \textit{supra} note 36, at 219 (describing the Italian 1992 reform).} For example, the French reform of 1993 increased the number of working years taken into account when computing the pension from 10 to 25, resulting in lower payouts.\footnote{Moore, \textit{supra} note 33, at 13.} The Italian reform of 1995 initiated a gradual replacement of the public DB system with a Notional Defined Contribution (NDC) system: Under the new formula, payments are based on an annuity computed on the basis of the actual payroll taxes contributed.\footnote{Franco, \textit{supra} note 36, at 221-222. In other words, everyone is assigned a fictitious individual pension account whose return depends on current tax revenue.} However, while an NDC system is actuarially fair, contributions are not actually invested in the capital market, but rather tied to

\footnotesize{\textsuperscript{292}} See e.g. Jonathan Gruber & David A. Wise, \textit{Different Approaches to Pension Reform from an Economic Point of View}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 49, 57-58 (describing the relationship with a simple formula).
\footnotesize{\textsuperscript{293}} See e.g. Assar Lindbeck, \textit{Pensions and Contemporary Socioeconomic Change}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 19, 32-35 (reviewing “marginal reforms” that do not entail a radical overhaul of the system).
\footnotesize{\textsuperscript{294}} Klaus-Jürgen Gern, \textit{Recent Developments in Old Age Pension Systems. An International Overview}, in \textit{Social Security Pension Reform in Europe}, \textit{supra} note 32, at 439, 445 (briefly surveying reforms of the 1990s); Rürup, \textit{supra} note 32, at 143-145 (describing the German 1992 reform, which increased the retirement age for women from 60 to 65 and reducing the adjustment for wage growth for existing retirees), and \textit{id.} at 146-149 (describing the 1999 reform which created an automatic adjustment of retirement claims to demographic change); Franco, \textit{supra} note 36, at 219 (describing the Italian 1992 reform); CHRISTINA BENITA WILKE, GERMAN PENSION REFORM 49 (2009) (describing the German 1992 reform); Munnell, \textit{supra} note 52, at 370 (discussing the increased retirement age in the UK).}
macroeconomic indicators that show the amount of funds currently available for pension payments.298

In light of its severe demographic challenges, Japan enacted a series of pension reforms in the early 2000s, which overall had the effect of increasing contributions and lowering benefits.299 While Japan has refrained from introducing an NDC system, in 2004 pensions were made dependent on an automatic adjusting mechanism that took longevity into account, resulting in a similar effect.300 Furthermore, adjustments to inflation were reduced and contribution requirements increased.301

European and Japanese lawmakers also began to devise incentives to opt into private retirement savings plans.302 DC plans have gained ground on traditional DB plans in recent years. In Italy, employees previously had a right to receive a severance payment from the company in the case of the termination of the employment relationship. Reforms enacted in 1993 and 1995 created moderate tax incentives to set up defined-contribution based pension funds to finance the severance payment, although employees were initially reluctant to join.303

DB plans started to create significant problems particularly for Japanese companies during the country’s prolonged recession of the 1990s and 2000s. The combination of a poorly performing stock market and an increasing number of pensioners left many

298 E.g. John B. Williamson & Mathew Williams, Notional Defined Contribution Accounts. 64 AM. J. ECON. & SOC. 485, 490 (2005); MACKENZIE, supra note 20, at 131-133. While NDC systems are better able to cope with the funding problem resulting from an aging population, they result in lower payouts for retirees if productivity increases do not compensate the decrease in the number of workers paying into the system.
299 Conrad, supra note 272, at 210 (providing an overview).
300 Lu et al., at 5.
301 Horioka et al., supra note 38, at 311-312.
302 See generally OECD, supra note 43, at 140 (summarizing pension reforms).
303 Franco, supra note 36, at 223-224.
plans grossly underfunded. Some firms reacted by cutting benefit levels. In 2001, the Japanese legislature passed the Defined Benefit Corporate Pension Act and the Defined Contribution Pension Act, which in combination created a new regulatory framework for corporate pensions and for the first time allowed DC plans. The legislative intention of these reforms was to channel money into the Japanese capital market. Initially, firms’ reaction to the new legislation was lukewarm due to limitations on the amount of employer contributions to DC plans that would be tax deductible. However, partly in consequence of changed accounting standards, which forced firms to recognize unfunded pension obligations as a balance sheet liability, firms began to react more strongly by switching from DB plans to DC plans. Furthermore, certain types of previously unfunded plans now had to be funded with plan assets to qualify for tax benefits.

As of 2008, more than 3 million employees in the Japanese private sector had DC plans. Obviously, this figure still pales in comparison to the number of DB plan participants (almost 14 million), but it illustrates remarkable growth for a type of pension plan that did not exist a decade ago. The failure of DB plans investments during the 2008 financial crisis lead to a further shift towards DC plans. JAL’s January 2010 bankruptcy was partly fueled by its pension obligations and serves as a warning to other

304 Kashiwazaki & Fukazawa, supra note 69, at 70. McLellen, supra note 273, at 34 (reporting that in 2003, pension assets only covered 50% of payment obligations); Rajnes, supra note 271, at 93.
305 Kashiwazaki & Fukazawa, id., at 72.
306 Kashiwazaki & Fukazawa, id., at 69-70 (“the Defined Contribution Pension (corporate plan) which was introduced in the 21st Century”); Rajnes, supra note 271, at 95-98.
307 Rajnes, supra note 271, at 89, 97.
308 McLellen, supra note 273, at 35.
309 Rajnes, supra note 271, at 94. ### Katsumata 67-68!###
310 See Rajnes, supra note 271, at 99 (providing data about the prevalence of DB and DC plans between 2001 and 2006).
311 See Rajnes, supra note 271, at 100 (describing the 2001 DB law).
312 Kashiwazaki & Fukazawa, supra note 69, at 69-70.
313 Kashiwazaki & Fukazawa, id. at 69.
large companies.\footnote{Jason Clenfield & Tomoko Yamazaki, \textit{JAL Pension Shortfall May Prompt Japan Inc. to Change Its Ways}, \textit{BLOOMBERG NEWS}, January 21, 2010, at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aOaMUhFk5OYW.} It is predicted that most plans will be converted into DC plans by 2012.\footnote{Rajnes, supra note 271, at 89.}

Germany has long remained relatively conservative with respect to the trend toward DC pension systems. The German Occupational Pensions Act\footnote{Gesetz zur Verbesserung der betrieblichen Altersversorgung (BetrAVG) § 1.} governs only an enumerative list of types of pension commitments, which does not include a “real” DC plan where the investment risk is entirely borne by the employee. The closest variety is the “Promised Contribution with Minimum Payout.”\footnote{BetrAVG § 1 Z 2.} An employer opting for this type of pension commitment promises only a certain contribution, but also has to promise a stipulated minimum payment. In the case of unfavorable investment results, the employer is liable for the difference. In other words, the employer bears the downside investment risk, while the employee benefits from the upside risk. Pure DC plans are not technically illegal,\footnote{Supreme Labor Court (Bundesarbeitsgericht), September 7, 2004, 3 AZR 550/03, BAGE 112, 1 (stating in a dictum that DC plans can be set up by the employer under general principles of private law, as long as full disclosure about the character of the plan is made to the employee. See Markus Roth, \textit{Employee Participation, Corporate Governance and the Firm: A Transatlantic View Focused on Occupational Pensions and Co-Determination}, 11 \textit{EUR. BUS. ORG. L. REV.} 51, 69 (2010).} but they do not fall under the Occupational Pensions Act and therefore do not qualify e.g. for tax advantages. Nevertheless, some collective bargaining agreements in the chemical and metallurgical industries allow employers to achieve a similar result by placing the employee’s contributions in a personal pension account.\footnote{Markus Roth, \textit{Private Altersvorsorge: Betriebsrentenrecht und individuelle Vorsorge} 98 (2009).} The adopting of International Financial Reporting Standards (IFRS), which forces firms to
disclose the underfunding of DB plans, may have contributing for German firm’ increased interest in the DC model.\textsuperscript{320}

More significantly, since the early 2000s Germany has introduced a series of reforms designed to create incentives for private pension accounts, thus moving from a single-pillar PAYGO system to a multi-pillar system partly reliance on private plans. The reform of 2001, which also cut benefit levels in public pensions,\textsuperscript{321} concurrently created the “Riester pensions”, which resemble American IRAs.\textsuperscript{322} To qualify for subsidies or tax benefits, these pension plans have to fulfill a list of regulatory criteria.\textsuperscript{323} Among other things, the amount in the account must be annuitized upon retirement (resulting in a monthly pension), and the financial institution running the plan must guarantee that at least the total amount of contributions is available.\textsuperscript{324} While Riester pensions were not initially a success, they became one when the law was tweaked in 2004 and 2007.\textsuperscript{325} By 2008, there were almost 12 million qualifying accounts.\textsuperscript{326}

Because of these regulatory changes, potential retirees are partly protected from the downside of the investment, risk, but not completely. Most Riester accounts take the

\textsuperscript{321} Börsch-Supan, supra note 46, at 128; Wilke, supra note 294, at 50.
\textsuperscript{322} Börsch-Supan, \textit{id.} at 129.
\textsuperscript{323} These benefits are provided for by EINKOMMENSTEUERGESETZ § 10a, 79-82, and were increased in several steps between 2002 and 2008. See Axel Börsch-Supan, Anette Reil-Held & Daniel Schunk, Saving Incentives, old-age provision and displacement effects: evidence from the recent German pension reform, 7 J. Pension Econ. & Fin. 295, 298 (2008) (table showing the increase of tax subsidies); Wilke, supra note 294, at 51 (same).
\textsuperscript{324} ALTERSVORSORGEVERTRÄGE-ZERTIFIZIERUNGSGESETZ (GERMANY) § 1 (defining qualifying retirement provision contracts). See also Börsch-Supan, supra note 46, at 131 (providing a more detailed list of requirements).
\textsuperscript{325} Wilke, \textit{supra} note 294, at 54-56 (discussing the 2004 reform).
form of a life insurance contract, but even here the amount of the pension depends on the value of the underlying investments made by the insurer, given that the insured (typically) shares in the insurer's investment success. Concurrently, the reforms have also made employer contributions to occupational pensions tax-free. Consequently, coverage increased significantly during the 2000s.

4.1.3. The UK: Moving from DB plans to DC plans

Among the larger European countries, the UK pension system can be considered an outlier, as it is more in line with US practices. The Basic State Pension (BSP) is comparatively low for European standards and provides an average replacement ratio of only about 15%. The “State Second Pension” (S2P), which replaced a similar plan known as SERPS in 2002, provides additional benefits for low income and self-employed employees. Like its predecessor, it allows an opt-out into an occupational or a private pension plan. Changes in the regulatory framework following the transition

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327 Bundesministerium für Arbeit und Soziales, id.
328 VERSICHERUNGSVERTRAGSGESETZ (GERMANY) § 153.
329 EStG (GERMANY) § 3 Z 63.
330 See Bundesministerium für Arbeit und Soziales, supra note 326, at 126 (reporting an increase in coverage of the privately employed from 38% in 2001 to 52% in 2007); see also MACKENZIE, supra note 20, at 166 (discussing tax subsidies for Riester pensions).
331 The Netherlands and Switzerland are smaller countries that are partly exceptions to the Continental European pattern in their stronger reliance on private pensions. E.g. CLARK, supra note 287, at 17.
332 Carl Emmerson & Paul Johnson, Pension Provision in the United Kingdom, in PENSION SYSTEMS AND RETIREMENT INCOMES, supra note 41, at 296, 299, 301. Other government programs that provided poor, aged Britons with a minimum pension existed since 1908. Steven A. Sass, Reforming the UK Retirement System: Privatization plus a safety net, GLOBAL ISSUE BRIEF, June 2004, at 3. See also HANNAH, supra note 337, at 59 (reporting a state pension replacement rate of only 35% for the early 1970s, which compares to 60% in Germany and 56% in the US at the same time); David Blake, The United Kingdom. Examining the Switch from Low Public Pensions to High-Cost Private Pensions, in SOCIAL SECURITY PENSION REFORM IN EUROPE, supra note 32, at 317, 317 (noting that public finances are thus less affected by demographic change).
333 Emmerson & Johnson, supra note 332, at 303-304 (discussing the replacement of SERPS with the S2P). SERPS stood for “State-Earnings-Related Pension Scheme.”
334 Sass, supra note 332, at 4; Munnell, supra note 52, at 370 (both discussing SERPS’ objective to provide better old-age support for low-income earners, who typically lacked occupational pensions, the self-employed, and mobile employees).
335 Davis, supra note 214, at 12; Emmerson & Johnson, supra note 332, at 303; see Christopher D. Daykin, Occupational Pension Provision in the United Kingdom, in SECURING EMPLOYER-BASED PENSIONS,
have tended to push high- and middle-income employees into the direction of private plans.\textsuperscript{336}

Like the US, the UK has a long tradition of occupational pension plans going back to the late 19th century,\textsuperscript{337} when firms shifted away from hire-and-fire policies and sought to develop long-term relationships with workers and internal labor markets.\textsuperscript{338} Further fuelled by tax advantages for employers, occupational pensions covered about a third of the UK workforce by the middle of the century,\textsuperscript{339} and about half of it by the 1970s.\textsuperscript{340} Like in the US during the same period, departing employees incurred considerable dis-advantages.\textsuperscript{341} In the post-war period this was a deliberate design feature, given that labor scarcity made firms compete for workers.\textsuperscript{342}

Traditional DB plans lost ground to money purchase accounts (i.e. DC plans) and personal pensions under the conservative government of the 1980s and early 1990s.\textsuperscript{343} Alicia Munnell attributes the shift to a number of legislative changes: First, the Finance Act of 1986 allowed an overfunding of DB plans of only 5%, which prevented firms from building up surpluses in good years; second, the 1995 Pension Act introduced stricter fiduciary rules and protections against fraud for DB plans; third, the same reform introduced minimum funding requirements; and fourth, the Accounting Standards Board

\textsuperscript{336} Munnell, \textit{supra} note 52, at 373.
\textsuperscript{337} See e.g. LESLIE HANNAH, \textit{INVENTING RETIREMENT. THE DEVELOPMENT OF OCCUPATIONAL PENSIONS IN BRITAIN 18} (1986) (explaining that many employers introduced pensions for their workers in the first quarter of the 20th century).
\textsuperscript{338} HANNAH, \textit{id.} at 21-22. Commitment and loyalty of workers were increasingly thought to be necessary in large organizations. HANNAH, \textit{id.} at 25-26.
\textsuperscript{339} Sass, \textit{supra} note 332, at 3; see also HANNAH, \textit{supra} note 337, at 40 (providing data about the growth of occupational pensions between 1936 and 1956), and \textit{id.} at 44-45 (describing tax benefits that induced firms to promote occupational pensions)
\textsuperscript{340} Munnell, \textit{supra} note 52, at 371; see also Emmerson & Johnson, \textit{supra} note 332, at 310 (providing data on retirees covered by occupational pensions).
\textsuperscript{341} Munnell, \textit{supra} note 52, at 371; Sass, \textit{supra} note 332, at 4.
\textsuperscript{342} HANNAH, \textit{supra} note 337, at 52.
\textsuperscript{343} Munnell, \textit{supra} note 52, at 371; MACKENZIE, \textit{supra} note 20, at 245.
passed FRS 17 in 2000, which required mark-to-market accounting for pension assets.344

Since at least the mid-1990s the vast majority of new employer-sponsored plans were DC plans, and more than half of existing DB plans is being phased out.345 Reforms in the 2000s have further strengthened this trend, e.g. the Pensions Act of 2004 with its stricter funding requirements for DB Pensions.346 Furthermore, since 2003 the trustee in a DB plan has the right to ask the sponsoring employer to make good on any shortfall immediately. Simon Deakin argues that this has allowed more employers to terminate DB arrangements.347 In parallel to the introduction of IRAs in the US, the Conservative government of the 1980s several tax-preferred retirement savings vehicles that encouraged individuals to invest in equity.348

4.2. The push toward shareholder primacy since the 1990s
As we have seen, various factors have contributed to changes in European and Japanese pension systems, most strongly demographic pressure that is more salient than in the case of Social Security in the US. Clearly, the politics of corporate governance have not remained unaffected. Like in the US, greater dependence on capital markets must have increased electoral preferences for pro-shareholder policies at least on the margin.

To a large extent, however, the European corporate governance movement has been spearheaded by US and UK institutional investors, who sought to diversify their holdings internationally and succeeded in infusing at least some degree of a shareholder

344 Munnell, supra note 52, at 374; see also Sass, supra note 332, at 10-11.
345 Munnell, supra note 52, at 375.
346 Roth, supra note 318, at 68; MACKENZIE, supra note 20, at 246.
value spirit into Continental Europe and Japan. For example, CalPERS developed a considerable international portfolio in the 1990s and subsequently began to promote a set of “Global Corporate Governance Principles.” One element has been shareholder activism to increase pressure on corporate boards outside of the Anglosphere that began in the early 1990s. With the encouragement of American fund managers, local institutional investors in Europe and Japan jumped on the bandwagon, given that they were starting to become increasingly important managers of domestic pension wealth. Local associations representing the interests of minority shareholders were founded in various Continental European countries and became increasingly active.

In late 1990s, directors in countries such as France, Germany, and Italy were already quoted as saying that it is becoming more difficult for boards to ignore the wishes of shareholders, and some suggested that the prevailing cultural attitude that saw shareholder activism as anti-social was fading. Obviously, there was considerable


Fanto, supra note 349, at 22-28 (describing activism by US investors in Europe).

John Tagliabue, Europeans’ Rallying Cry: One Share, One Vote!, N.Y. TIMES, June 10, 2001 (“Encouraged by fund managers from the United States and Britain, European shareholders are catching the reform fever that took hold among American investors in the 1980’s).

See Rosenberg, supra note 355 (describing domestic shareholder activism by Dutch pension funds and by Deutsche Bank); Ken Belson, Holder Maneuvers to Sue Tokio Style, N.Y. TIMES, June 24, 2003 (describing efforts by a Japanese mutual fund to push for shareholder rights); Martin Fackler, An Investor Activism Uncommon in Japan, N.Y. Times, August 30, 2007 (describing the activities of Japan’s biggest pension fund to push for shareholder rights); SIEMS, supra note 349, at 289.

See e.g. Tagliabue, supra note 352 (describing activities of a French minority shareholders’ association).


Tagliabue, supra note 352.
resistance,\textsuperscript{357} and in 2000 French president Jacques Chirac “complained publicly that French workers were being asked to sacrifice simply to ‘safeguard the investment benefits of Scottish widows and California pensioners.’”\textsuperscript{358}

At least in some cases, strengthening the capital market was one of the goals of pension reform. German book reserve pensions were sometimes criticized because they gave firms an easy way to finance expansion through balance sheet reserves whose creation is tax-deductible, and which cannot be distributed. Encouraging or requiring firms to make contributions to a DC plan would channel the same money through the capital markets.\textsuperscript{359} Tyrell and Schmidt have therefore argued that book reserve pensions are connected the small size of the capital market in Germany compared to the UK; furthermore, they argue that they created a greater attachment of employees to firms.\textsuperscript{360} In order to have a credible protection of their firm-specific pension assets, German employees therefore require instruments such as codetermination on the board of directors.\textsuperscript{361}

\textsuperscript{357} Rosenberg, \textit{supra} note 355 (quoting a CalPERS manager saying that “Calpers says shareholder value is the only thing and the rest will follow for the stakeholders. In Europe, there are more parties at the table, and they behave better if you involve them early.”); Tagliabue, \textit{supra} note 352 (quoting a Swiss banker as saying that “Europeans may pay lip service to American-style capitalism, he added, “but when push comes to shove, the underlying reluctance is still rather strong.”).

\textsuperscript{358} Tagliabue, \textit{supra} note 355.

\textsuperscript{359} \textit{Comment & analysis: A boost for capital markets}, Financial Times, April 6, 1996 (quoting Deutsche Bank economist Alexander Schrader that putting the money into the capital market would result in a more efficient allocation of financial resources); MINNS, \textit{supra} note 40, at 83 (quoting this statement and criticizing that it would be harmful to the German economy); see also \textit{Dignam & Galanis, supra} note 49, at 331 (discussing effects of pension reform on German capital markets).


\textsuperscript{361} Tyrell & Schmidt, \textit{id.} at 492 (pointing out that employee’s pension wealth seems to have played a role in the noted 1976 constitutional court decision that declared codetermination to be constitutional); see also \textit{Clark, supra} note 287, at 97 (showing data on large German firms’ pension liabilities).
Shareholder activism began to pick up in Japan as well, where foreign institutional investors, such as pension funds, often played an important role.\textsuperscript{362} In 1993, Japanese companies still saw shareholder activists as “sokaiya, a kind of gangster who specializes in extorting payments” and took borderline legal measures to prevent them from disrupting annual shareholder meetings.\textsuperscript{363} By contrast, in 2007 Tomomi Yamo, the head of Japan’s largest pension fund, stated that shareholders are no longer “on the bottom of management’s priorities”, but “No. 2 or No. 3, after employees and maybe business partners.”\textsuperscript{364} The role of foreign institutional investors is still very significant, given that the percentage of the ownership stakes of domestic institutional investors decreased during the 2000s, while that of foreign institutional investors strongly increased.\textsuperscript{365}

Overall, however, there can be hardly any doubt that Anglophone institutional investors have had considerable influence. For example, the takeover of Mannesmann by Vodaphone, which created headlines in Germany in the earlier 2000s (not the least because of the ensuing litigation), ultimately went through partly because of the support of institutional investors.\textsuperscript{366} Even some profitable firms laid off workers to increase shareholder wealth.\textsuperscript{367}

The spread of the idea of shareholder primacy can be seen in a number of effects. The “corporate governance movement”, which had previously been a peculiar British phenomenon, led to the enactment of codes of “good” corporate governance in virtu-
ally every European country. The German Control and Transparency Act of 1998 has often been noticed as promoting shareholder primacy, given that it improved the position of minority shareholders in various ways, e.g. by prohibiting voting caps. Similarly, reforms in French capital market regulation around 2000 and a notable corporate law reform in 2001 are thought to have brought French corporation law in closer alignment with shareholder interests.

Various other practices that are ostensibly in the shareholder

368 Ruth V. Aguilera & Alvaro Cuervo-Cazurra, Codes of Good Governance, 17 CORP. GOV. 376, 377-379 (2009) (describing the spread of codes from their English origins). The ECGI provides a list at http://www.ecgi.org/codes/all_codes.php. Since a 2006 amendment, art. 46a of the Fourth EC Company Law Directive (the “Accounting Directive”) requires that publicly traded firms must disclose whether the company applies a corporate governance code, and explain if it does not apply some of its provisions. The significance of these codes in Continental Europe is questionable, given that there is little, if any empirical evidence showing positive effects. For alternative interpretations see Steen Thomsen, The Hidden Meaning of Codes: Corporate Governance and Investor Rent Seeking, 7 EUR. BUS. ORG. L. REV. 845 (2006) (interpreting codes a rent-seeking mechanism for institutional investors); Lutz-Christian Wolff, Law as Marketing Gimmick – The Case of the German Corporate Governance Code, 3 WASH. U. GLOBAL STUD. L. REV. 115, 132-133 (2004) (plausibly describing the German code as a marketing instrument aimed at foreign investors); Alessandro Zattoni & Francesca Cuomo, Why Adopt Codes of Good Governance? A Comparison of Institutional and Efficiency Perspectives, 16 CORP. GOV. 1, 13 (2008) (suggesting that the content and adoption process of codes supports a “legitimation theory” for the adoption of codes in civil law countries); SIEMS, supra note 349, at 56-59.


370 Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), March 3, 1998, BGBl I Nr.24 S. 786, April 30, 1998. See e.g. Mariana Pargendler, State Ownership and Corporate Governance (2011) at http://ssrn.com/abstract=1854452 (discussing the role of the KonTraG and privatization for the development of shareholder value thinking in Germany). However, the ostensible motivation of this comprehensive legal reform were actually a number of corporate failures in the late 1990s. For an overview of the act, see Ulrich Seibert, Control and Transparency in Business (KonTraG): Corporate Governance Reform in Germany, 1999 EUR. BUS. L. REV. 70, 70 (describing the collapse of Metallgesellschaft as a main trigger for the debate).

interest, such as stock-based executive compensation, also made considerable head-
way in Continental Europe.\textsuperscript{372}

The EU’s “High Level Report of Company Law Experts” of 2002\textsuperscript{373} promoted a
shareholder agenda, as did most EU level corporate law legislation of that period. In
2007, the EU passed the Shareholder Rights Directive, which did not go as far as man-
dating a one-share-one-vote rule, but at least attempted to facilitate the cross-border
exercise of voting rights, which institutional investors had lobbied for.\textsuperscript{374} Member States,
and subsequently the EU streamlined their accounting regulations, and in 2002 the EU
passed a regulation that mandates the use of International Financial Reporting Standard
(IFRS) as a set of rules that provide useful information to capital markets.\textsuperscript{375} The Takeo-
ver Directive of 2004 equally attempted to create a pan-European market for takeovers,
although the end result was riddled with compromises and thus did not achieve this
goal.\textsuperscript{376} Generally, comparative studies attempting to quantify trends in the law over time
identified a strengthening of shareholder rights.\textsuperscript{377}

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{372} E.g. Ben Clift, Debating the Restructuring of French Capitalism and Anglo-Saxon Institutional Investors: Trojan Horses or Sleeping Partners, 2004 FRENCH POL. 333, 341.
\item\textsuperscript{373} Report of the High Level Group of Company Law Experts on a Modern Framework for Company Law in Europe, Brussels, November 4, 2002.
\item\textsuperscript{375} Parliament and Council Regulation No. 1606/2002, art. 5(a), 2002 O.J. (L 243) 1.
\item\textsuperscript{376} Council Directive on Takeover Bids, No. 2004/25, 2004 O.J. L 142/12. Regarding the historical back-
ground and impediments to its enactment, see Joelle Simon, Adoption of the European Directive on Take-
over Bids; an On-Again, Off-Again Story, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 345
(MICHEL TISON ET AL. EDs., 2009); John C. Coffee, Jr., Convergence and its Critics: What are the Precondi-
tions to the Separation of Ownership and Control, in CORPORATE GOVERNANCE REGIMES 83, 91
(Joseph A. McCahery, Piet Moerland, Theo Raaijmakers & Luc Renneboog eds. 2003) (discussing the directive as a possible evidence of convergence in corporate governance).
\item\textsuperscript{377} John Armour, Simon Deakin, Priya Lele & Mathias Siems, How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection, 57 AM. J. COMP. L. 579,
609-612 (2009) (providing an index for the France, Germany, India, the UK and the US that shows an increase in France and Germany during the 1990s and 2000s); Mathias Siems, Convergence in Corporate
research project as supporting convergence in shareholder protection); Holger Spamann, The “Antidirector
Rights Index” Revisited, 63 REV. FIN. STUD. 467, 475 (2010) (showing an increase of the average of LLSV’s
\end{enumerate}
\end{footnotesize}
4.3. Resistance against shareholder primacy

The preceding account underscores how Anglophone institutional investors jump-started the corporate governance movement in Continental Europe and Japan. When demographic pressures began to push the pension systems of those countries towards more reliance on capital-market-based private pensions, domestic institutional investors began to join forces with international ones, and jointly they affected the political balance of corporate governance. The increased significance of pension funds may precipitate a further ascendance of shareholder primacy outside the Anglosphere. However, as the takeover debates of the 1980s show, the transition in the US was not painless and met considerable resistance. Will the spread of private pensions and DC plans lead to convergence in corporate governance, or is it still too early to announce the “End of History for Corporate Law”?378 In Europe in particular, the resistance comes from two directions, namely labor and large blockholders, and might remain more tenacious than in the US.

Political scientist John Cioffi points out that corporate and securities law reforms in Germany during the late 1990s and early 2000s were not spearheaded by the ostensible conservative Christian Democratic Union, but by Gerhard Schröder’s Social Democratic Party (SPD), when it was leading a coalition government with the Green Party between 1998 and 2005.379 He explains that the center-right saw corporate managers and blockholders as a one of their central political constituencies, whereas the center-left emulated the American Democrats by seeking support in the financial sector.380 Banks and insurance companies were unwinding their traditional large blocks of shares during

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378 Hansmann & Kraakman, supra note 2.
380 CIOFFI, id. at 152-153 (describing internal dynamics in the party).
that period, and instead focused more strongly on selling investment opportunities to the middle class.

It seems likely that the increasing dependence of the “working man/woman” on capital markets for retirement savings played a role in why the center-left undertook this political maneuver. Gourevitch and Shinn argued in 2005 that German corporate governance reforms were to be seen as signals for a solidifying “transparency coalition” between investors and workers in Germany, who increasingly shares similar interests, given that these two groups began to significantly overlap. The Schröder government also attempted to implement wide-reaching reforms in the employment sector, such as the “Hartz IV” welfare reforms and, more to the point here, laws seeking to flexibilize the labor market e.g. by facilitating layoffs. However, the alliance between the center-left and the financial sector was apparently not sustainable in Germany. Part of the traditional constituents of the SPD defected to form the new “Left Party” together with former communists from East Germany, which led to Chancellor Schröder’s defeat in the 2005 elections. Similarly, French and Japanese labor reforms have also met resistance.

381 Gourevitch & Shinn, supra note 75, at 160-167.
382 See e.g. Horst Siebert, Why the German Labor Market is Failing, 2004 INT’L J. COMP. LAB. L. & INDUS. REL. 489, 511-512, Thomas Ubber, Agenda 2010: Reform of German Labour Laws: Impact of Hiring and Firing Staff, 5 GERMAN L. J. 135 (2004), and Mark Lembke & Kai Goluecke, “Agenda 2010” – Recent Changes in German Employment Law, 2004 INTER ALIA 22 (all surveying the reforms); Wolfgang Ochel, The Political Economy of Two-Tier Reforms of Employment Protection in Europe, 25 INT’L J. COMP. LAB. L. & INDUS. REL. 237, 249-251 (2009) (describing the difficulty of implementing labor reforms in Germany). In contrast to employment law, employee codetermination on the supervisory board of German companies, never seriously came on the legislative agenda. Even though it is the poster child of a supposedly inefficient corporate governance institution whose persistence requires explanation, the empirical evidence on its effects on shareholder wealth (which may not be the only relevant measure) is in fact mixed. See Fauver & Fürst, supra note 85 (finding that moderate forms of codetermination actually increase productivity in some industries).
383 The story might be illustrative of Pagano and Volpin’s theory that proportional voting systems are more likely than majoritarian ones to produce stronger employment and weaker investor protection. Marco Pagano & Paolo F. Volpin, The Political Economy of Corporate Governance, 95 AM. ECON. REV. 1005 (2005).
Thus, it seems that for now the “labor interest” has trumped the “investor interest. There are several possible (complementary) explanations. First, the German labor movement may still be more strongly entrenched than the American one for reasons of path dependence, and thus better able to use employment law to capture rents. This may help to explain that while laws protecting investors got stronger across countries during the past two decades, worker protection laws, in which unions are often more directly involved, actually continued to diverge. Second, given the tradeoff between human capital and pension wealth, the difference is likely to stem from the fact that Germany has so far only taken very small steps towards DC-based pensions. Voters still care a lot more about preserving jobs than they care about the development of their pension investment, which is only marginally relevant besides public pensions. Third, the German industry (and the Continental European one in general) is sometimes thought to rely on greater firm-specific investment by employees than the US. If that is correct, then a specific job's value to the individual worker is likely to be greater, thus further increasing voter preference for pro-worker policies.

The second Continental European stronghold of resistance is incumbent controlling shareholders. It has often been pointed out that concentrated ownership is also receding in the non-Anglophone developed economies. In the case of Germany, banks and insurers began to unwind their controlling blocks in the late 1990s after tax penalties

385 Siems, supra note 377, at 255.
386 E.g. Margarita Estevez-Abe, Torben Iversen & David Soskice, Social Protection and the Formation of Skills: A Reinterpretation of the Welfare State, in VARIETIES OF CAPITALISM, supra note 68, at 145, 169-171. This is e.g. shown by German firms’ strategy of reducing working hours instead of laying off employees during the 2008 economic downturn.
were eliminated. Other blockholders such as families or other firms often continue to exert a heavy influence on other firms within the same corporate group. One example of resistance can be illustrated with the case of the EU Takeover Directive.\textsuperscript{388} Ventoruzzo has plausibly argued that the directive did in the end not serve the interests of outside investors, but the interest of blockholders by transplanting UK rules to the Continent (in particular Italy): While the mandatory bid made hostile bids much more expensive, the neutrality requirement remained irrelevant given the presence of large ownership blocks.\textsuperscript{389}

If pension-driven shareholder capitalism is to prevail, it must overcome resistance by these groups. In the US, managers were co-opted into the new order through executive compensation, which allowed them to reap extraordinary salaries while at the same time professing to maximize shareholder wealth. While European and Japanese banks and insurers have likely already been co-opted by the business opportunities created by pension wealth, finding an equivalent reward for other blockholders may be more difficult.\textsuperscript{390}

4.4. The contribution of accounting reform

[Continental European and Japanese accounting systems before the introduction of IFRS did typically not require firms to create provisions for pensions reflecting their full

\textsuperscript{388} Supra note 376.

\textsuperscript{389} Marco Ventoruzzo, Takeover Regulation as a Wolf in Sheep’s Clothing: Taking U.K. Rules to Continental Europe, 11 U. PA. J. BUS. L. 135 (2008); but see Paul Davies, Edmund-Philipp Schuster & Emilie van de Walle de Ghelcke, The Takeover Directive as a Protectionist Tool? in COMPANY LAW AND ECONOMIC PROTECTIONISM, supra note 369, at 105, 121-124 (arguing that the neutrality rule is significant even in the presence of block ownership).

\textsuperscript{390} E.g. Kübler, supra note 35, at 105 (writing in 1991 that manufacturing firms are for the current [PAYGO] system, whereas financial institutions want to expand private pension plans); Sanford M. Jacoby, Corporate Governance in Comparative Perspective: Prospects for Convergence, 22 COMP. LAB. L. & POL’Y J. 5, 15 (2000) (“Large German banks and insurance companies have sought greater liquidity in equity markets in the hopes of making the same juicy profits as their U.S. counterparts.”)
actuarial value. This permitted German and Japanese firms to create un(der)funded book-reserve pensions. This section will explain how IFRS – which were introduced because of pressures in the capital markets – made the retention of unfunded, non-capital market private pension systems harder to sustain.]

4.5. Shareholder‐centrism in the UK

The UK, however, has long been known as the one exception in Europe in corporate governance. However, in contrast to the US, large British firms were never fully managerialist. The UK has dispersed ownership, although with less dispersion than the US and stronger institutional investor ownership. While it is still contentious when exactly dispersed ownership developed in the UK, it is clear that it occurred at some point between the period following World War II and the 1980s. During that period, corporate ownership underwent a dual shift: First, the dominating families were gradually displaced by dispersed ownership. Second, like in the US, retail investors were gradually replaced with institutional investors, including pension funds. Pension funds shifted their assets into equities during the post-war decades when trustees learned that shares were delivering better returns than alternatives. Maybe in part because there was never a

391 Dignam & Galanis, supra note 384, at 221-222 (comparing the UK and the US).
393 BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL 11-17 (2008); (surveying the empirical evidence and describing the controversy).
394 Dignam & Galanis, supra note 384, at 221; CHEFFINS, id. at 14.
395 Dignam & Galanis, supra note 384, at 228; CHEFFINS, supra note 393, at 88 (both graphically tracking the ownership shares of individuals, pension funds, and insurance companies).
396 CHEFFINS, supra note 393, at 351 (reporting that the share of equities increased from 19% in 1953 to 48% in 1963).
managerialist period, UK corporate law has continued to provide a stronger degree of shareholder control since its inceptions in the 19th century.397

The result is that it is possible to discern a strong influence of institutional investors in British firms from at least the 1980s onwards. Scholars have therefore argued that large British firms were not dominated by managers like American firms of the Berle-Means type, but rather by “constellations of controlling interests” consisting of about twenty shareholders who jointly controlled most listed corporations.398 American observers have often admired the power of British institutional investors.399

However, in the transition period between the eclipse of family and institutional investor capitalism, Britain experienced a struggle between labor and shareholder interests. The onset of dispersed ownership led to increased managerial power, which animated reform agendas coming from both directions. Institutional investors first flexed their muzzles with the development of British takeover law. Since 1969, the “City Code on Takeovers and Mergers”400 has provided a self-regulatory framework for takeovers, one of whose defining characteristics has been the requirement for the board of directors to take a neutral stance vis-à-vis hostile takeover bids. With poison pills and similar defensive measures not being an option,401 directors have to persuade shareholders

397 E.g. CHEFFINS, supra note 393, at 30 (pointing out that in UK companies, shareholders can recall the board). See also L.C.B. Gower, Some contrasts between British and American corporation law, 69 HARV. L. REV. 1369, 1370-1373 (1956) (suggesting that British company law grew out of principles of partnership law, whereas US corporate law developed from corporate charters issued by the states that emphasized corporate personhood).
399 E.g. Black & Coffee, supra note 392.
that takeover offer should be in declined.\textsuperscript{402} The pro-shareholder influence of the market for corporate control is thus inherently much stronger in the UK than it is in the US.\textsuperscript{403}

The 1970s were, however, the period of a pro-labor reform agenda. Employment protection law grew during that period.\textsuperscript{404} More interestingly for corporate governance, “industrial democracy” came on the political agenda, when the “Bullock Report”, a study supposedly motivated by the concern of growing management power,\textsuperscript{405} recommended the introduction of employee representation on the board.\textsuperscript{406} The protracted debate ended when Margaret Thatcher came to power in 1980 and took on the unions.\textsuperscript{407} With unions out of the picture and DB pension plans being replaced with DC plans due to Conservative policies\textsuperscript{408}, the idea of shareholder primacy spread even more widely. The 1990s saw the British corporate governance movement, which culminated in the enactment of the Combined Code.\textsuperscript{409} The movement was again spearheaded by institutional investors.\textsuperscript{410} The Labor government’s “Company Law Review” project picked up the debate again in the 2000s and considered the merits of both a “pluralist” conception of company law, and an “enlightened shareholder norm” approach, according to which labor interests are relevant only as far as they serve the ultimate goal of maximizing

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\textsuperscript{403} Armour & Skeel, supra note 400, at 1734-1738 (contrasting US and UK takeover law).
\textsuperscript{404} Gelter, supra note 1, at, at 190 (listing employment legislation of the 1960s and 1970s).
\textsuperscript{405} Dignam & Galanis, supra note 49, at 242.
\textsuperscript{406} Lord Bullock (Chairman), Report of the Committee of Inquiry on Industrial Democracy (1977).
\textsuperscript{407} The proposal did not even enjoy unanimous support among the unions, who still feared being drawn into management responsibilities and losing their independence from capital. Regarding the debate and its politics, see e.g. Otto Kahn-Freund, Industrial Democracy, 6 Indus. L. J. 65, 67-68 (1977); David Marsh & Gareth Locksley, Capital in Britain: Its Structural Power and Influence over Policy, West Eur. Pol., March 1983, at 36, 49-50; Herman Knudsen, Employee Participation in Europe 54 (1995).
\textsuperscript{408} Supra section 4.1.3.
\textsuperscript{409} For the most recent version, see http://www.frc.org.uk/images/uploaded/documents/UK%20Corp%20Gov%20Code%20June%2020102.pdf
\textsuperscript{410} Cheffins, supra note 393, at 383-384 (discussing the history of the code).
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shareholder wealth. The latter version won and became the law in the Companies Act 2006, replacing an older statute that could arguably be interpreted as requiring directors to take labor interests into account on the same level.

Overall, the development in the UK seems to confirm the thesis. The UK always seems to have had a more shareholder-centric corporate law than the US, but the transition from “insider” family dominance to institutional investor domination was marked by several steps in line with a shareholder primacist view that strengthened the position of outside investors. This is not surprising, given the growth of private pension assets during the past three decades, and the increasing importance of DC plans. Furthermore, during the same period, Britain lost much of its manufacturing base and transformed into an economy dominated by services and the financial industry, both of which are characterized by greater labor mobility. Pro-labor policies have thus decreased in importance to the average person on the street, while the significance of individual pension wealth has increased.

5. Conclusion

If I had written this article in 2007, I might have ventured some educated guesses about the likely development of corporate governance in light of the international trend toward private DC pensions. Given demographic pressures, further deterioration of public pen-

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412 § 172(1) of the Companies Act 2006 (providing that a “director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole”, and in doing so must have regard to, among others, the effects on employees).

413 309(1) the Companies Act of 1985 (providing that the “matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members”). The statute was a remnant of the debate of the 1970s.
sions would have seemed unavoidable. It would have been easy to say that the pressure toward shareholder primacy should continue to increase, both as a normative and as a political matter. I might have predicted that labor would continue to lose clout in corporate governance around the world, following from increasing international competition for capital and on product markets. Continental European employment laws would have seemed likely to continue to flexibilize, and any reliance on firm-specific investment would have seemed to be disappearing in any country, both in light of changes in the pension system and external factors increasing labor mobility.414

With the 2008 financial crisis and the subsequent “Great Recession”, the future seems less clear than ever. DC based pension systems have taken a big hit in the public perception (at least in Europe), given turmoil in the capital markets. In the words of the worst critics of either type of pension system, we seem to have the choice between a Ponzi scheme and a casino for our retirement savings. We may well see increased economic protectionism in corporate law, as in other areas of economic policy.415

In spite of the current problems on the capital markets, it still seems likely that the trend toward DC pensions in Europe and Japan will continue because of demographic pressures, albeit at a slower pace. The advances that shareholder primacy made outside of the US during the past 15 years will not disappear overnight. However, the “end of history for corporate law” now seems farther away than 10 years ago.

414 Labor market mobility might e.g. result in adverse selection and a brain drain, since the most capable employees with the highest earning potential are likely to move to countries with private DC pensions, leaving behind redistributive public pension systems.

History is sometimes said to repeat. The Great Depression devastated private employer-sponsored plans, and thus led to the introduction of Social Security. Funded pension systems based on investment were widespread across the European Continent and in Japan up to approximately World War II. These were devastated by inflation, war, and the Great Depression, which is why France, Germany, Italy and Japan expanded and deepened PAYGO systems around or after World War II. Mark Roe has argued that war and destruction in the middle of the 20th century might explain why Continental Europe and Japan emerged as economies with small capital markets and concentrated ownership. Similarly, Perotti and von Thadden have suggested that the loss of pension wealth has resulted in a shift of median voter preferences in favor of labor rent protection. The collapse of the pension system may well have been an important factor in this, since it drove retirement wealth away from financial institutions into the hands of the government. Obviously, the destruction of private pension wealth through recent stock market downturns does not compare to the economic devastation.

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417 GUILLEMAULT, supra note 155, at 53; Nadine Legendre & Louis-Paul Pelé, Pension Provision in France, in PENSION SYSTEMS AND RETIREMENT INCOMES, supra note 41, at 131, 131-132; apRoberts, supra note 193, at 109-110 (describing how the French system was set up against the backdrop of the destruction of funded reserves in World War II and immediately began to pay out pensions).
418 CLARK, supra note 19, at 59; Axel Börsch-Span, Anette Reil-Held & Reinhold Schnabel, Pension Provision in Germany, in PENSION SYSTEMS AND RETIREMENT INCOMES, supra note 41, at 160, 162.
419 Franco, supra note 36, at 213; Brugiavini & Fornero, supra note 211, at 201.
420 Horioka, supra note 33, at 101-102; Horioka et al., supra note 38, at 308-309.
421 More recently, private pension savings in Argentina (2008) and Hungary (2010) were nationalized to give the cash-strapped government access to pension wealth to alleviate budgetary problems. See OECD, supra note 43, at 44 (Argentina); Deutsche Welle, Is Hungary's EU presidency doomed by controversy? December 31, 2010, 2010 WLNR 25686067 (Hungary).
many European and Asian countries experienced in World War II. In fact, the current European sovereign debt crisis might increase pressures to privatize the pension sector.

This article has shown that trends in pension systems have been important drivers for corporate governance. In the US, DC pensions helped to overcome the “managerial capitalism” of the mid-20th century, which began to be replaced by “shareholder capitalism.” However, managerial capitalism has not yet given way completely, with Delaware corporate law being to a large extent a holdout. Outside of the US, shifts in the pension system have fuelled convergence in corporate governance toward a shareholder model, although the changes so far have not gone far enough to allow us say that most countries have fully embraced it. Nevertheless, full convergence in corporate governance is nowhere near in sight.