

Finance and Labor:
Perspectives on Risk, Inequality, and Democracy *

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We live in an era of financialization. Since 1980, capital markets have expanded around the world; capital shuttles the global instantaneously. Shareholder concerns drive executive decision making and compensation, while the fluctuations of stock markets are a source of public anxiety. So are the financial scandals that have regularly occurred in recent years: junk bonds in the 1980s; lax accounting and stock manipulation in the early 2000s; and debt securitization today.

We also live in an era of rising income inequality and employment risk. The gaps between top and bottom incomes and between top and middle incomes have widened since 1980. Greater risk takes various forms, such as wage and employment volatility and the shift from employers to employees of responsibility for pensions and, in the United States, for health insurance.

There is an enormous literature on financial development and another on inequality. But relatively few studies consider the intersection of these phenomena. Standard explanations for rising inequality--skill-biased technological change and trade--account for only 30% of the variation in aggregate inequality.¹ What else matters? We argue here that an omitted factor is financial development. This study explores the relationship between financial markets and labor markets along three dimensions: contemporary, historical, and comparative. For the world's industrialized nations, we find that financial development waxes and wanes in line with top income shares. Since 1980, however, there have been national divergences between financial development--defined here as the economic prominence of equity and credit markets--and inequality. In the U.S. and U.K., there remains a strong positive correlation but in other parts of Europe and in Japan the relationship is weaker.

What accounts for swings in financial development and inequality and the relationship between them? Economic growth is one factor. Another is the politics of finance. The model presented here is simple but consistent with the evidence: Upswings in financial development are related to political pressure exerted by elite beneficiaries of financial development. Political objectives include policies that favor financial expansion—and finance-derived earnings--and the shunting of investment gains to top-

¹ IMF, *World Economic Outlook: Globalization and Inequality* (Washington, DC 2007), 48.

income brackets. Against financial interests is arrayed a shifting coalition that has included middle-class consumers, farmers, small business, and organized labor, upon which we focus here. When successful, these groups cause a contraction in the economic and political significance of finance, which registers in the distribution of income and wealth. In other words, politics drives the swings in financial development and mediates the finance-labor relationship.

Political contests occur not only in the public arena but also within firms. We expand the politics of financial development to include contests over corporate resource allocation through the mechanisms of corporate governance. Corporate governance affects the distribution of a firm's value-added among shareholders, executives, workers, and retained earnings. Here too, organized labor is an important player. In both public and private arenas, labor wields influence via its bargaining and political power and, more recently, via its pension capital.

Our historical framework draws from Karl Polanyi's classic study of markets and politics in the nineteenth and early twentieth centuries. Polanyi challenged economic liberalism by showing that market expansion in the Western countries was not a natural development; it was embedded in politics and society. He also showed that markets are not self-regulating. Undesirable side-effects--instability, monopoly, externalities--can not be rectified by the market itself. As a result, every market expansion is followed by spontaneous countermovements to "resist the pernicious effects of a market-controlled economy." Polanyi called this the double movement: "the action of two organizing principles in society ... economic liberalism, aiming at the establishment of a self-regulating market ...[and] the other was the principle of social protection aiming at the conservation of man and nature as well as productive organization." Writing in the early 1940s, Polanyi could not foresee the relevance of his ideas to our present age. Today, laissez-faire ideas, including those relating to financial markets, again are with us as are countermovements to contain the market's failings. ²

The focus of this study is on financial markets in the world's richest nations. Much of the material is based on the American experience, although there are comparisons to Europe and Japan. Part I analyzes the mechanisms that link contemporary

² Karl Polanyi, *The Great Transformation* (New York 1944): 132.

financial development to rising inequality and risk. Part II considers the political and ideological bases for post-1980 financial development and corporate governance. The next two parts are historical, focusing on the period from the late nineteenth century through the 1970s: Part III describes financialization and Part IV traces political movements to contain it, emphasizing the contributions of organized labor. Part V takes us back to the present. It considers the efforts of organized labor to re-regulate finance and reshape corporate governance, in part by using its pension capital.

I. Labor and Financial Development Since 1980

Financial development since 1980 is unprecedented. The value of financial assets—bank assets, equities, private and public debt securities—increased from \$12 trillion in 1980 to \$140 trillion in 2005. Equities alone drove nearly half the rise in global financial assets during those years, with stock market capitalizations reaching or exceeding levels not seen since the 1920s. Along with this has come abundant capital that lowers debt costs, thereby permitting banks, hedge funds, and private equity funds to leverage small asset bases while using derivatives to insure against risk. As of June 2008, the outstanding notional amount of OTC derivatives worldwide was \$648 trillion. Of this, 67% were interest rate contracts, 9% were foreign currency contracts, and 8% were credit default swaps which, along with collateralized debt obligations, wreaked havoc in the markets several months later. ³

Although financial development is global, the wealthiest regions of the world—the U.S., the U.K., the Eurozone, and Japan—account for 80% of world financial assets. Finance has become a key sector of the American and British economies, representing over 15% of their GDPs and over 40% of total corporate profits.⁴

³ Bank for International Settlements, *Semiannual Over-The-Counter (OTC) Derivatives Markets Statistics* (Basel 2008).

⁴ Raghuram Rajan and Luigi Zingales, “The Great Reversals: The Politics of Financial Development in the 20th Century,” 69 *Journal of Financial Economics* (2003), 13-15; Charles R. Morris, *The Trillion Dollar Meltdown* (New York, 2008); *NYT* Aug. 31, 2007; Diana Farrell et al., “Mapping the Global Capital Market,” McKinsey Global Institute (2007): 8.

Finance is vital to economic growth. It provides capital to sustain firms and households, and mechanisms to mitigate risk. The relationship between financial development and growth is ambiguous, however. The effects vary by a nation's GDP level and the type of financial development—credit markets, equity markets, or financial openness—under consideration.⁵ Other aspects of finance are more controversial. Investors are prone to herd behavior and to mercurial speculation about an uncertain future. Because perceptions of the future constantly are changing and because speculation involves leveraging, capital markets are prone to volatility and periodic crises that can damage the real economy, as with the recession that started in 2008.

There is also the problem that financialization raises risk. Optimism--animal spirits--and the opportunities for diversification associated with financial development raise the risk-tolerance levels of investors. Wall Street asserts that derivatives and other instruments have mitigated the problems that this poses. But the events of 2008 suggest the opposite: that hedging amplifies, rather than reduces, risk. Until recently, it was claimed that we were at the end of history--that financial crises, at least in advanced economies, were a thing of the past thanks to savvy central banking and savvy derivatives. Today the assertion appears to be another case of irrational exuberance.⁶

Another problematic aspect of financial development is its relation to inequality.⁷ The finance-inequality link occurs via the concentration of finance-derived incomes in

⁵ Levine and Zervos find that stock market liquidity is positively associated with growth but that stock market size has no effect. Arestis et al. (2001, 2006) show that the contribution of stock markets to growth is modest and that the effect attenuates in developed countries. An IMF (2006:16) review of the evidence on financial openness concludes that "it remains difficult to find robust evidence that financial integration systematically increases growth, once other determinants of growth are controlled for," a finding replicated by Rodrik. Ross Levine and Sara Zervos, "Stock Markets, Banks, and Economic Growth," 88 *American Economic Review* (1998); Philip Arestis et al., "Financial Development and Economic Growth," 33 *Journal of Money, Credit, and Banking* (2001); Arestis et al., "Financial Development and Productive Efficiency in OECD Countries," 74 *The Manchester School* (2006); M. Ayan Khose, Eswar Prasad, Kenneth Rogoff, and Shang-Jin Wei, "Financial Globalization: A Reappraisal," IMF working paper 189 (2006); Dani Rodrik and Arvind Subramanian, "Why Did Financial Globalization Disappoint?" working paper, March 2008.

⁶ Philip T. Hoffman, Gilles Postal-Vinay, and Jean-Laurent Rosenthal, et al., *Surviving Large Losses* (Cambridge, 2007); David Skeel, *Icarus in the Boardroom* (New York 2005); Charles Kindleberger and Robert Aliber, *Manias, Panics, and Crashes* (New York, 2005).

⁷ The literature on finance and inequality largely deals with developing, not developed, countries: Clarke (2006) and Beck et al. (2007) find a negative association between financial development and inequality, although they examine credit provision, not equity markets; Baddeley (2006) finds a positive association between financial development and inequality; Das and Mohapatra (2003) show that stock market liberalization is followed by rising inequality, especially through the effects on top-income shares; and Goldberg and Pavcnik (2007) find that trade openness, which is correlated with financial openness, is

the top brackets. Since 1980, the top 1% doubled its income share in the U.S, reaching levels not seen since the early 20th century. (Table 1) Atkinson estimates that a rise of 8 percentage points in the top 1% share--which occurred in the U.S. since 1980--can account for nearly all of the Gini coefficient's increase during this period. Of course, this does not prove that the former caused the latter. But the difficulty of demonstrating causality is endemic to studies of inequality, as with the well-known example of the returns to computer usage.⁸

In the next sections we discuss four mechanisms by which finance affects labor outcomes: wealth ownership, finance-derived salaries, investment risk, and corporate governance.

Wealth Ownership

After remaining stable during most of the postwar period, top wealth shares recently have trended upward in the United States. The average net worth (wealth minus debt) of the top 1% wealth class grew by 78 percent from 1983 to 2004, while for the middle 20%, net worth grew by 27 percent. Financial development is related to wealth accumulation at the top. Non-residential assets are relatively unimportant for the median

positively associated with inequality. Claessens and Perotti find that the relationship between financial openness and consumption smoothing by the poor is mediated by politics: when the rich have political control, the relationship is negative, which is consistent with our argument. Aghion explains how growth is hampered by inequality. George Clarke et al., "Finance and Income Inequality: What Do the Data Tell US?" 72 *Southern Economic Journal* (2006); Thorsten Beck, Asli Demirguc-Kunt, and Ross Levine, "Finance, Inequality, and the Poor," working paper (2007); Michelle Baddeley, "Convergence or Divergence? The Impacts of Globalisation on Growth and Inequality in Less Developed Countries," 20 *Intl. Rev. of Applied Econs.* (2006); Mitali Das and Sanket Mohapatra, "Income Inequality: The Aftermath of Stock Market Liberalization in Emerging Markets," 10 *Journal of Empirical Finance* (2003); Pinelopi Goldberg and Nina Pavcnik, "Distributional Effects of Globalization in Developing Countries," *J. of Econ. Lit.* (2007); S. Claessens and E. Perotti, "Finance and Inequality," *J. of Comp. Economics*, forthcoming; Philippe Aghion et al., "Inequality and Economic Growth," 37 *J. of Econ. Lit.* (1999). A recent paper, however, focuses on financial development in wealthy countries over the past century and finds a positive association between financial development and top-share incomes, the same relationship considered here. Jesper Roine, Jonas Vlachos, and Daniel Waldenstrom, "What Determines Top Income Shares?," SSRN working paper 1018332 (October 2007).

⁸ A.B. Atkinson, "Measuring Top Incomes: Methodological Issues" in A.B. Atkinson and T. Piketty (eds.), *Top Incomes over the Twentieth Century* (New York, 2007), 18-42; John DiNardo and Jorn-Steffen Pischke, "The Returns to Computer Use Revisited: Have Pencils Changed the Wage Structure Too?" *Q.J.E.* (1997). In contrast to the Kuznets inverted-U curve charting inequality against industrialization over time, the post-1980 data look like the first part of a subsequent inverted U.

wealth bracket (24 percent of net worth), but for the top 1% they constitute 91 percent of net worth. The top 1% owns 42 percent of net financial assets; the bottom 90% owns 19 percent. Wealth appreciation and income flows derived from owning financial assets have risen in recent years, much more so than for residential housing, the primary asset held by the less wealthy. Corporate payouts are up, as are opportunities for capital gains. (A dollar invested in an S&P index fund in 1980 would be worth \$1500 today.) In 2004, the top 10% accounted for 61 percent of all unrealized capital gains. To the extent that the wealthy get better (including inside) information and realize larger financial returns than the less wealthy, their share of wealth-derived income will be greater than their total share of wealth.⁹

Financial Occupations

Forty-five percent of the income going to the top 1%-bracket derives from wages and salaries, 25 percent from business income, and 30 percent from wealth (dividends, interest, capital gains, and rents). One might think that the last figure is an upper limit on the contribution of finance to top income shares. But the top 1% contains a large number of individuals who earn their salaries or their business incomes in financial occupations. These include but are not limited to investment bankers, commercial and trust bankers, managers of hedge, venture, private equity, and mutual funds, financial advisors and consultants, and attorneys specializing in financial transactions. Consider that the 50 highest-paid hedge fund managers in 2007 earned a total of \$29 billion. Then there is the well-known phenomenon of skyrocketing compensation for CEOs and other executives. The lion's share derives from capital gains via stock options. In 1980, less than a third of CEOs was granted stock options; today options are universal for top U.S. executives. Individuals in finance-dependent occupations are estimated to account for as much as

⁹ Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America* (Ithaca 2006): chap. 5; *Financial Times*, Feb. 22, 2007; Harry De Angelo et al., "Are Dividends Disappearing?" 72 *Journal of Financial Economics* (2003); Edward N. Wolff, "Recent Trends in Household Wealth in the U.S.," Economics Department, NYU (2007); Wojciech Kopczuk and Emmanuel Saez, "Top Wealth Shares in the United States, 1916-2000," NBER Working Paper 10399 (2004); "Recent Changes in U.S. Family Finances," *Federal Reserve Bulletin* (2006): A1-A38.

40% of those in the top income brackets. In fact, the figure likely is higher because the estimate excludes some capital gains and many financial occupations.¹⁰

Risk

Investors affect the level of risk in the real economy and its allocation among owners, creditors, suppliers, executives, and employees. A firm's financial structure influences outcomes in this area. Debt, for example, interferes with cyclical risk insurance for employees (e.g., via wage smoothing and job guarantees). Ownership dispersion also matters. Blockholders, more prevalent in continental Europe, are relatively undiversified so their risk preferences will be closer to those of similarly undiversified employees, whose main asset is their illiquid firm-specific human capital. As owners become more diversified, they can tolerate greater risk.

In fact, this is what has happened with the rise of institutional investors, a heterogeneous group including mutual funds, trusts, insurance companies, and pension funds, the largest category. Institutional composition varies across nations, with pension funds more important in the U.S. and U.K. than other countries. U.S. institutional investors in 1960 owned 12% of U.S. equities; by 1990 they owned 45% and the share rose to 61% in 2005. Institutions today own 68% of the 1000 largest U.S. public corporations. Although institutional holdings rose over a long period, it was in the 1980s that institutions began to flex their muscles as shareholder activists.¹¹

Institutional investors are highly diversified; they rarely own more than 1 percent of a company. They also supply much of the capital for the M&A market: raiders in the 1980s and

¹⁰ Data from Emmanuel Saez, tables A7 and A8 at <http://elsa.berkeley.edu/~saez/>; *New York Times* (hereafter *NYT*), June 21, 2007; *Los Angeles Times*, April 25, 2007, April 16, 2008; Lucian Bebchuk and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Cambridge 2006); Gerald Epstein and Arjun Jayadev, "The Rise of Rentier Incomes in OECD Countries," in Epstein (ed.), *Financialization and the World Economy* (Cheltenham, UK 2005); Steven N. Kaplan and Joshua Rauh, "Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes?" NBER working paper 13270 (2007). The change in executive pay after 1993 is not explained by changes in firm performance or size. Bebchuk and Fried, *Pay without Performance*. Problems with stock options recently have caused a modest decline in the share of CEO compensation based upon them. *WSJ*, Apr. 14, 2008.

¹¹ Margaret Blair, *Ownership and Control* (Washington DC 1995): 46; Conference Board, "2007 Institutional Investment Report" (2007); IMF, *Global Financial Stability Report* (2005): 68. Total U.S. institutional assets of \$24 trillion are owned by corporate pension funds (28 percent), public pension funds (11 percent), mutual funds (25 percent), trusts (11 percent) and insurance companies (25 percent).

private equity today. Hence they can and do cause companies to pursue riskier business strategies such as heavier debt, the regular payment of which can endanger a firm when markets turn down, as is presently the case with many debt-laden companies owned by private equity. Institutions also press firms for a larger share of corporate resources. As a result, institutional activism statistically is associated with asset divestitures and with layoffs. This does not mean that institutions push firms to the edge of bankruptcy but even a bankruptcy now and then would not do serious damage to their portfolios.¹²

Institutional investors have never been the paragons of long-term investing that some claim them to be. In the 1980s, one CFO said that institutional investors “have the short-term, total-return objective as their primary objective.” (short-termism). Pension funds have always had myopic tendencies in some degree because of the short tenures of in-house fund managers. Recent changes in portfolio composition have accelerated short-termism. Active trading of equities is increasing; indexed equities are now only 30% of all pension fund assets. To raise returns above those provided by equities, institutions also are putting more money into “alpha” (riskier) investments, illiquid and/or leveraged. These include private equity, venture, and hedge funds; real estate and real estate CDOs; commodities; and micro-cap stocks. Some pension funds and private endowments have 50% or more of their assets in these alternative investments. Private equity and hedge funds come with much shorter time horizons than for indexed equities. On average, private equity’s purchase-to-sale process takes around four years. To pay off debt during the holding period, many private equity funds will skim cash, raid pension funds, or sell business units that previously had smoothed product--and derived employment--demand. They also pursue downsizing. Five years after an acquisition, the average PE buyout has shed 10% more jobs than a comparable firm. The impact is economy-wide because PE funds account for 7 to 10% of private employment in the U.S. and the U.K. Hedge funds, which make more than half the trades on the NYSE, have even shorter time horizons, sometimes less than a second.¹³

¹² Michael Firth, “The Impact of Institutional Investors and Managerial Interests on the Capital Structure of Firms,” 16 *Managerial and Decision Economics* (1995); Sanford M. Jacoby, “Convergence by Design: The Case of CalPERS in Japan,” 55 *Amer. J. of Comp. Law* (2007): 249.

¹³ Quote from Michael Useem, *Investor Capitalism* (New York 1996): 82; Gary Gorton and Matthias Kahl, “Blockholder Identity, Equity Ownership Structures, and Hostile Takeovers,” NBER working paper W7123 (1999); *Pensions & Investments* (hereafter *P&I*), Nov. 15, 2004, April 17, 2006, Aug. 21, 2006;

Thus institutional investors and their alpha investments raise a firm's risk levels and shorten its time horizons. For workers this induces wage and employment volatility and the shifting of other risks, such as health insurance and pension costs. What is telling is that volatility is greater in public than private firms; the latter have exhibited a *decline* in employment volatility, suggesting an association with financial markets. Another result is that investment projects with long-duration payoffs, such as employee training, are adversely affected. The decline in employee job duration is attributed by many economists to technology-driven shifts from specific to general technology that permit labor mobility. But it is also quite possible that changes in investor time horizons have undermined the viability of career-type employment systems. In fact, there is an empirical association between greater shareholder control and a reduction in employee tenure levels.¹⁴

Corporate Governance

Finance enthusiasts assert that giving shareholders a larger role in corporate governance promotes efficiency. When shareholders lack influence, executives build overstuffed empires, pay themselves too much and, to avoid conflict and enjoy a quiet life, overpay and coddle employees. When shareholders gain power, the effects are attenuated. Measures of shareholder power are statistically associated with downsizing and with lower levels of executive and worker compensation, outcomes that allegedly are efficient.¹⁵

Bus. Wk., Sept. 17, 2007; Stephen J. Choi and Jill E. Fisch, "Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance," working paper, Fordham Law School, 2007; World Economic Forum, *Globalization of Alternative Investments* (Geneva 2008). The institutions that had the greatest exposure to alpha suffered sharp declines in portfolio value in 2008, including Ivy League university endowments such as Harvard's and Yale's.

¹⁴ Robert A. Moffitt and Peter Gottschalk, "Trends in the Transitory Variance of Earnings in the U.S.," 112 *The Economic J.* (2002); Clair Brown, John Haltiwanger, and Julia Lane, *Economic Turbulence: Is a Volatile Economy Good for America?* (Chicago 2006); *Economist*, July 14, 2007; Boyd Black, Howard Gospel, and Andrew Pendleton, "Finance, Corporate Governance, and the Employment Relationship," 46 *Industrial Relations* (2007); Steven J. Davis et al., "Volatility and Dispersion in Business Growth Rates: Publicly Traded vs. Privately Held Firms," NBER working paper 12354 (2006).

¹⁵ Marianne Bertrand and Sendhil Mullainathan, "Enjoying the Quiet Life? Corporate Governance and Managerial Preferences," 111 *Journal of Political Economy* (1999); Henrik Cronqvist and Rudiger Fahlenbrach, "Large Shareholders and Corporate Policies," Fisher College, Ohio State University, working paper 14 (2006); Michael C. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," 76 *Amer. Econ. Rev.* (1986). Note that the "lazy executive" view is an analogue to the view

But owners, too, can exacerbate inefficiency. They may seek excessive payouts and burden firms with ill-conceived practices like stock options, which promote instead of inhibit executive malfeasance.¹⁶ The new field of behavioral finance, which applies psychological concepts to executive and investor behavior, calls into question assumptions of investor rationality. It shows that investors are prone to cognitive distortions such as myopia, overconfidence, and biased self-attribution. The findings undermine the claim that share price is a reliable criterion of performance and that shareholders know better than executives and boards how to create value. Behavioral finance provides justification for practices that limit shareholder influence, such as takeover defenses.¹⁷

Institutional activism generally brings a larger share of value-added to owners but this is not the same as an increase in value-added. In fact, activism can undermine value creation. First, downsizing does not boost productivity, although it raises shareholder returns and reduces labor share of value-added, especially when downsizing is aggressive (i.e., when it occurs during periods of profitability). Second, cutting compensation undermines the efficiency wage effect, which is the rise in productivity induced by above-average wages and that occurs via a decline in employee turnover and a rise in effort. Third, attempts by activist investors to reduce takeover barriers may harm, rather than help, efficiency. The average takeover is not associated with pre-existing performance defects or with subsequent profitability gains, even nine years after the event. Instead, the average

that employees are shirkers. Both assume that the pursuit of self-interest leads individuals to the sub-optimal quadrant of the prisoner's dilemma, an idea that originates in classical liberalism. For a different and more empirical view, see Robert M. Axelrod, *The Evolution of Cooperation* (New York 1984).

¹⁶ Bronwyn Hall, "Corporate Restructuring and Investment Horizons in the U.S., 1976-1987," 68 *Bus. Hist. Rev.* (1994); Brian J. Bushee, "The Influence of Institutional Investors on Myopic R&D Investment Behavior," 73 *The Accounting Review* (1998); Julian Franks and Colin Mayer, "Capital Markets and Corporate Control," 5 *Economic Policy* (1990); Clayton Christensen and Scott Anthony, "Put Investors in Their Place," *Business Week* (May 28, 2007); *The Economist*, April 23, 2005, 71. Note that Michael Jensen recently recanted his faith in stock options. See http://papers.ssrn.com/sol3/papers.cfm?abstract_id=480401.

¹⁷ A sampling of behavioral finance includes: Russell Korobkin and Thomas Ulen, "Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics," 88 *Cal. L.R.* (2000); Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* (Oxford, UK 2000); Robert J. Shiller, *Irrational Exuberance* (Princeton 2000); Ray Fisman et al., "Governance and CEO Turnover: Do Something or Do the Right Thing?" SSRN working paper (2005).

takeover is driven by arbitrage of price imperfections and by tax benefits associated with leverage. Hence when managers oppose takeovers, it is not always to preserve their empires but sometimes because of skepticism that takeovers make economic sense.¹⁸

Earlier we observed the high proportion of individuals in the top 1% who come from finance-dependent occupations. Why have their salaries been rising so quickly? The standard explanation has to do with market forces: returns to skill of corporate and financial elites. Surely there is some truth in that. But finance-related incomes not only reflect value creation; again there is also value extraction in the form of rising payouts to shareholders.¹⁹ Owners, who include top executives, appropriate resources that otherwise would have been reinvested or returned to other factors of production, including employees, whose share of productivity gains has declined in recent years. Resources also come from taxpayers who subsidize the tax benefits associated with debt, capital gains, compensation of private equity and hedge fund managers, and more.²⁰

True, a portion of shareholder payouts find their way back to middle-class households via retirement plans. But even including these plans, the flow is a trickle. The wealthiest 10% owns about 80 percent of all equities, including pension assets. And when shareowners receive larger payouts, less is left for non-executive employees, which is one reason—albeit only one—that labor’s share of GDP has fallen and is smaller now than at

¹⁸ Bebchuk and Fried, *Pay without Performance*; William J Baumol, Alan Blinder, and Edward N. Wolff, *Downsizing in America* (New York 2003): 261; Gunther Capelle-Blancard and Nicolas Couderc, “How Do Shareholders Respond to Downsizing?” SSRN working paper 952768 (2007); David I. Levine, “Can Wage Increases Pay for Themselves? Tests with a Production Function,” 102 *Economic Journal* (1992); Julian Franks and Colin Mayer, “Hostile Takeover and the Correction of Managerial Failure,” 40 *J. of Fin. Econ.* (1995); Andrei Shleifer & Lawrence H. Summers, “Breach of Trust in Hostile Takeovers” in Alan J. Auerbach, ed., *Corporate Takeovers: Causes and Consequences* (Chicago 1988); Andrei Shleifer and Robert Vishny, “Stock Market Driven Acquisitions,” 70 *Journal of Financial Economics* (2003); William W. Bratton, “Is the Hostile Takeover Irrelevant? A Look at the Evidence,” working paper, Georgetown Law Center, 2007; Lynn Stout, “Do Antitakeover Defenses Decrease Shareholder Wealth?” 55 *Stanford L.R.* (2002).

¹⁹ See text at note 33.

²⁰ Regarding the effect of takeovers on labor’s share of value-added, see Andrei Shleifer & Lawrence H. Summers, “Breach of Trust in Hostile Takeovers” in Alan J. Auerbach, ed., *Corporate Takeovers: Causes and Consequences* (Chicago 1988); Jagadeesh Gokhale, Erica Groshen, and David Neumark, “Do Hostile Takeovers Reduce Extramarginal Wage Payments,” 77 *REStat* (1995); Martin J. Conyon et al., “Do Hostile Mergers Destroy Jobs?” 45 *J. of Econ. Behav. & Orgzn.* (2001): 427-440. The claim also is made that high pay for private equity and hedge fund managers is a return to skill and to risk taking. Bear in mind, however, that hedge and private equity principals--regardless of their skill or lack thereof-- are guaranteed 2 percent in management fees. Compensation of fund managers also derives from a guaranteed 20 percent of any earnings (“carried profit”), which is taxed not as income but as capital gains, a favorable provision that also applies to venture capital and real estate partnerships.

any time since the mid-1960s. Within labor's share, there also has been a reallocation to top brackets. From 1972 to 2001, the top .01% saw their real earnings rise by 181 percent, whereas real earnings for the median worker fell by 0.4 percent. The result is a combination of rising inequality along with stagnant incomes for the less affluent.²¹

II. The Origins of Modern Financial Development

Why was there a surge in financial development after 1980? The standard explanation is that market forces were unleashed by globalization and deregulation. Higher levels of world trade spurred cross-border capital flows. Deregulation and privatization created investment opportunities. Technological innovation, such as derivatives, created demand for risk-reducing instruments and for the talented individuals who could design them.²²

But it would be naïve to think that financial development was due only to market forces. The financial industry is a paradigmatic example of a lobby that secures for itself political benefits whose costs are born by other, often unsuspecting, parties. The workings of finance are recondite, unlike trade, and for this reason it is difficult to mobilize consumers and workers around financial policy. The result is regulatory capture.

The current era of financial development can be traced back to the mid-1950s, when London bankers sought to expand their business by weakening capital controls associated with Bretton Woods. Initially the effort was rebuffed by British governments committed to Keynesian policies. Wall Street also sought weaker capital controls but it too failed. Eventually the bankers realized that it was easier to do an end run around regulations than to change them and the result was the Euromarket, an offshore and unregulated foreign currency market that emerged in the 1960s and was a challenge to Bretton Woods. In favor of less regulated currency markets were central bankers and treasury personnel;

²¹ Ian Dew-Becker and Robert J. Gordon, "Where did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income," NBER working paper 11842 (2005); Richard Freeman, *America Works* (New York 2007): 39; *NYT*, Aug. 28, 2006; Alan B. Krueger, *Measuring Labor's Share*, 89 *Amer. Ec. Rev.* (1999).

²² Raghuram G. Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists* (Princeton 2003).

opposing it were officials from the executive and legislative branches who saw a threat to domestic Keynesianism. President Kennedy allegedly said that it was “absurd” to shrink government spending for the sake of facilitating private capital flows. But elite financiers had access to top monetary officials, who often were former colleagues, and throughout the 1960s they lobbied steadily for financial deregulation. Wall Street’s persistent complaints about the SEC led Richard Nixon to criticize the agency for its “heavy-handed bureaucratic schemes.” Nixon’s choice to head the SEC in 1969, Hamer Budge, was a diehard libertarian who favored relaxation of Glass-Steagall. Paul Samuelson complained that Budge’s indifference to financial concentration was “sad, if not scandalous.”²³

Changes also were afoot at the corporate level as conglomerates emerged in the 1960s. Conglomerates are hodgepodge corporations formed out of unrelated businesses, some of them purchased through hostile acquisitions. Unlike the Chandlerian M-form corporation, the *raison d’être* of conglomerates was not administrative efficiency. Rather it was risk minimization through diversification and, more importantly, use of financial and accounting innovations to secure a myriad of tax benefits. Hence conglomeration led to tighter linkages between financial considerations and business strategy. The percentage of CEOs coming out of finance jumped in the 1960s and rose steadily thereafter. Decisions now were made by the numbers; CFOs tend to view strategy as the maximization of share price via financial engineering. Gradually they came to dominate managers from line-related functions like operations and personnel that are sensitive to non-quantitative intangibles such as internal resources and capabilities. Hence conglomerates left a legacy of financial hegemony in the corporate order.²⁴

²³ Eric Helleiner, *States and the Emergence of Global Finance* (Ithaca 1994): 81-122; James Hawley, “Protecting Capital from Itself,” 38 *International Organization* (Winter 1984): 131-165; Joel Seligman, *The Transformation of Wall Street* (Boston, 1982) 382, 441;

²⁴ Baskin and Miranti, *History of Finance*, ch. 7; Andrei Shleifer and Robert Vishny, “Takeovers in the ‘60s and the ‘80s,” 12 *Strat. Mgt. J.* (1991): 51-59; David Halberstam, *The Reckoning* (New York 1986); Dirk Zorn, Frank Dobbin, Julian Dierkes, and Man-Shan Kwok, “Managing Investors: How Financial Markets Reshaped the American Firm” in K.K. Cetina and A. Preda, *The Sociology of Financial Markets* (New York, 2006); Neil Fligstein, “The Intraorganizational Power Struggle,” 52 *American Soc. Review* (1987).

Economic stagnation in the 1970s made it easier for banks (and other industries) to press for deregulation. Major financial institutions like First National City Bank and Morgan Trust lobbied for deregulation, including repeal of Glass-Steagall. Their argument was that New Deal regulatory policies were strangling growth, a claim that became conventional wisdom not only for Republicans but also for centrist Democrats like Presidents Carter and Clinton. Carter kicked off a “deregulatory snowball” when he signed a bank deregulation act in 1980. Under Ronald Reagan, financial deregulation intensified. The virtual demise of antitrust enforcement encouraged hostile takeovers and permitted the emergence of financial powerhouses like Citibank. Following their historic 1994 Congressional victory, the Republicans placed on their agenda proposals to scrap restrictions on margin buys by large investors and to limit lawsuits against allegedly fraudulent underwriters, executives, and accountants.²⁵ Although a Republican Congress repealed Glass-Steagall, it was Clinton’s Treasury Secretary, Robert Rubin, who plied the halls of Congress to line up Democratic support. (The 1999 Financial Services Modernization Act that repealed Glass-Steagall came to be known as the Citigroup Authorization Act. Shortly after its passage, Rubin resigned to become chairman of Citigroup.) With Glass-Steagall out of the way, commercial banks like Citigroup were free to move into relatively unregulated domains such as securitization.²⁶

Tax policy is crucial to finance and to top incomes, a fact that has never been lost on the financial industry. For example, the industry worked closely with other business organizations to secure passage of the 1981 tax reform act. The main lobbying group was the newly formed Business Roundtable, which included on its board financiers such as David Rockefeller of Chase Manhattan and Walter Wriston of Citibank. Citing supply-

²⁵ In 1995, Congress passed the Private Securities Litigation Act with near-unanimous support from Republicans and also from some liberal Democrats. Treasury Secretary Rubin favored the bill and, initially, so did Clinton. But Clinton later made a symbolic concession to consumers by vetoing the bill, knowing that Congress had the votes to override him, which it did. *NYT*, Dec. 20, 1995; David Leinsdorf and Donald Eltra, *Citibank: Ralph Nader’s Study Group Report on First National City Bank* (New York, 1973); Ernie Englander and Allen Kaufman, “The End of Managerial Ideology,” *5 Enterprise & Society* (2004): 417; Charles Geisst, *Undue Influence: How the Wall Street Elite Puts the Financial System at Risk* (Hoboken, 1995); Thomas H. Hammond and Jack H. Knott, “The Deregulatory Snowball: Explaining Deregulation in the Financial Industry,” *50 The Journal of Politics* (Feb. 1988): 3-30.

²⁶ Robert Kuttner, *The Squandering of America* (New York 2007): 105; *NYT* May 14, 1998; Robin Blackburn, “The Subprime Crisis,” *50 New Left Rev.* (March 2008).

side theories, the Roundtable argued that tax cuts rather than government spending would remedy economic stagnation. The act contained a cornucopia of tax goodies, including more favorable treatment of corporate debt. The provision underwrote the decade's leveraged buyouts, which were touted as a tonic for American competitiveness but proved a chimera when the junk bond market collapsed in the late 1980s.

The 1980s also saw a decline in top marginal income-tax rates. Two-thirds of the decline in tax progressivity between 1960 and 2004 occurred during the Reagan presidency. Additionally, there were cuts in personal tax rates related to finance, including a 29% reduction in the capital-gains tax. Although the capital gains reduction was rescinded in 1986, preferential rates were restored in 1990 and made even more generous in 2003 when dividend rates also were cut. It is Republicans--going back to 1954--who consistently favor low rates on unearned incomes. When the GOP is in power, spending by corporate political action committees has an additional negative effect on unearned rates. Investment tax provisions directly affect income inequality because they disproportionately benefit the top 1%. In the Anglo-Saxon nations, a 10 percent cut in the top investment rate is associated with a 0.4 percentage point increase in the top 1% income share.²⁷

The financial sector gave huge campaign contributions in its quest for financial deregulation: nearly \$250 million between 1993 and 1998 alone. But it understood that money was insufficient to overturn existing regulations. Ideas mattered too. The 1970s and 1980s saw the rise of several major think tanks promoting the interests of business

²⁷ J. Craig Jenkins and Craig M. Eckert, "The Right Turn in Economic Policy," 15 *Sociological Forum* (June 2000): 307-338; Thomas Piketty and Emmanuel Saez, "How Progressive is the U.S. Federal Tax System?" 21 *J. of Economic Perspectives* (2007); *Bus. Wk.* June 14, 2004; Dennis P. Quinn and Robert Y. Shapiro, "Business Political Power: The Case of Taxation," 85 *Amer. Pol. Sci. Rev.* (Sept. 1991): 851-874; A.B. Atkinson and A. Leigh, "Understanding the Distribution of Top Incomes in Anglo-Saxon Countries over the 20th Century," Working paper, Australian National University (2004). In the 1980s, wealthy businessmen endowed tax-related think tanks such as Grover Norquist's Americans for Tax Reform, launched in 1985, which received support from the Olin and Scaife Foundations. Even the Brookings Foundation swung from liberal to centrist as business donations rose from \$95,000 in 1978 to \$1.6 million in 1984. Brookings' fund-raiser at the time, a conservative Republican named Roger Semerad, said the gifts demonstrated that Brookings was "no longer tied to decades of ideology." A 1984 Brookings report advocated a cash-flow tax, the first step towards the long-sought conservative goal of substituting consumption taxes for progressive income taxes. The chief economist for the U.S. Chamber of Commerce said that the report "shows that we have won the philosophical revolution." *Boston Globe*, March 31, 2006; Peter Bernstein, "Brookings Tilts Right," 110 *Fortune* (23 July 1984), 96.

and the rich. These ran the gamut from the Heritage Foundation (home to William E. Simon, Nixon's treasury secretary) to the American Enterprise Institute (on whose board Walter Wriston served). How "the power of ideas" helped to change political discourse is an oft-told story. Less well-known is the campaign to give shareholder primacy and financial deregulation doctrinal status in academia and the courts.²⁸

Shareholder primacy asserts that maximizing shareholder value is the corporation's sole objective. It is a break from previous legal doctrines that the corporation is an entity distinct from its shareholders. The earlier view held that boards were legally autonomous from shareholders and could exercise independent business judgment on behalf of the enterprise. Promotion of the shareholder-primacy doctrine, starting in the 1970s, came in tandem with a surge in hostile takeovers that circumvented boards and made direct appeals to shareholders to tender their shares. Economic justification for the doctrine was provided by agency theory, an old idea that now received scientific grounding. The theory did not constitute a rebalancing of the relationship between shareholders on the one hand and boards, executives, and other stakeholders on the other; it simply cut off the latter part of the scales. Agency theory offered an economic rationale for hostile bids, stock options, and other governance changes intended to boost shareholder influence. As the Council of Economic Advisers opined in 1985, takeovers "improve efficiency, transfer scarce resources to higher valued uses, and stimulate effective corporate management." The self-regulating market was born again.²⁹

Agency theory and deregulatory dogma became increasingly influential in law schools and the courts. They traveled from economics to law over a bridge erected by conservative philanthropists. The annual "Pareto in the Pines" retreats were started in the 1970s to educate legal scholars about the applicability of economic concepts to antitrust law, corporate law, and other topics. The concepts were technocratic, such as cost-benefit

²⁸ Thomas R. Dye, *Who's Running America* (Saddle River 2002): 43; Martha Derthick and Paul Quirk, *The Politics of Deregulation* (Washington DC 1985).

²⁹ Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (New York 1992); Stephen M. Bainbridge, "Director Primacy and Shareholder Disempowerment," 119 *Harvard L.R.* (2006); Margaret Blair and Lynn Stout, "Specific Investment and Corporate Law," 7 *Eur. Bus. Org. L.R.* (2006); Simon Deakin, "The Coming Transformation of Shareholder Value," 13 *Corporate Governance* (2005); Connie Bruck, *The Predators' Ball* (New York, 1988): 261.

analysis, as well as normative, such as agency theory and public choice. Later the students included regulators and jurists. By 1991 the Law and Economics Center at George Mason had given economics training to nearly a thousand state and federal judges. Funding for the seminars and for academic research in law and economics came from wealthy libertarian ideologues like Richard Scaife and John M. Olin. The intent was to offer a platform to academic “norm entrepreneurs” whose ideas would confer legitimacy on shareholder primacy in the private sector and deregulation in the public sector. Institutional investors took these ideas as their own and embedded them in codes of corporate governance that were thrust upon stock exchanges and foreign governments in the 1990s.³⁰

Law and regulation establish boundaries for another type of political contest, this time played at the corporate level. Here the players—workers, executives, and owners—press singly or in coalition for alternative forms of corporate governance with different allocations of value-added. Following Gourevitch and Shinn, one may identify three games, each with a winner and loser: (i) owners + executives vs. workers, (ii) executives + workers vs. owners, and (iii) owners + workers vs. executives. The first game, which Gourevitch and Shinn label “class conflict,” was prevalent in the early decades of the twentieth century, with workers usually the losers. The second game, which I term “producerism,” gained currency during the postwar decades when managers and workers, many of them unionized, replaced class conflict with cooperation to raise productivity; owners got the short end of the stick. The third coalition, “institutional capitalism,” emerged after 1980 as institutional owners pressed executives to focus on share price, thereby creating a bond between owners and worker-shareholders who own stock directly

³⁰ Michael C. Jensen and William Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,” 3 *Journal of Financial Economics* (1976); Cass Sunstein, “Social Norms and Social Roles,” 96 *Columbia L.R.* (1996); Sanford M. Jacoby, “Economic Ideas and the Labor Market: Origins of the Anglo-American Model and Prospects for Global Diffusion,” 25 *Comp. Labor Law & Policy* (2003); J.P. Heinz, A. Southworth, and A. Paik, “Lawyers for Conservative Causes,” 37 *Law & Society Rev.* (2003): 5-50; *USA Today*, May 3, 2006. Many of the governance reforms spawned by agency theory and pressed by shareholder activists turn out to have little or no relationship to performance; some even have negative effects. One explanation is that optimal governance is endogenous to a firm’s idiosyncratic characteristics; the activists’ formulaic approach ignores this fact. See Jacoby, “Convergence by Design,” 250-254; Sanjai Bhagat, Brian Bolton, and Roberta Romano, “The Promise and Peril of Corporate Governance Indices,” draft, University of Colorado, October 2007.

or through pension plans. But institutional capitalism is not the only game being played today. There is nascent class conflict because the median worker owns but a pittance in equities and many executives, encouraged by stock options, have cast their lot with owners. Another prevalent game today is the “war of all against all”: executives exploit owners and workers; owners try to do the same to executives and workers. The vast majority of workers, however, is powerless.³¹

What about the situation outside the Anglo-American world? Northern Europe and Japan since 1980 have experienced rapid financial development, with growth rates exceeding those in the U.K. and the U.S., although Northern Europe and Japan started and remain at lower levels. What is crucial, however, is that despite recent financialization, their top income shares have not increased to the same extent as in the U.S. and the U.K. (Table 1). Why?

First, Northern European and Japanese unions have shrunk less in size and influence than their American and, to a lesser extent, British, counterparts. Japanese and Northern Europeans have relatively cooperative relations among workers, executives, and owners. This is relational capitalism, or what David Soskice calls the “coordinated market economy” (CME). It is a fifth type of game, the obverse of the war against all. In CMEs, there remains support for the idea that the corporation is beholden to all of the stakeholders who have invested in it, not only shareholders. Hostile takeovers and private equity are resisted in European CMEs and remain rare in Japan. Foreign norm entrepreneurs, chiefly U.S. investors, have been less successful than at home in molding CME law and regulation to their purposes, although they have found a more receptive audience in the European Commission.³²

³¹ Note that multiple games can be played in the same country at the same time, although one game is likely to be more prevalent than others. This has caused endless debates in the Varieties of Capitalism literature over how to classify a nation’s type. Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton 2005); Sanford M. Jacoby, *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States* (Princeton 2005).

³² David Soskice, “Reinterpreting Corporatism and Explaining Unemployment: Coordinated and Uncoordinated Economies,” in Renatta Brunetta and Carlo Dell’Arringa, eds., *Labour Relations and Economic Performance* (1990); Ronald Dore, *Stock Market Capitalism, Welfare Capitalism* (Oxford 2000); Jonas Pontusson, *Inequality and Prosperity: Social Europe vs. Liberal America* (Ithaca 2005); Gregory Jackson and Hideaki Miyajima, “Varieties of Capitalism, Varieties of Markets: M&A in Japan, Germany, France, the UK, and USA,” RIETI working paper (June 2007). In 1999, AFL-CIO president

Table 2 shows the allocation of value-added at the firm level under different corporate-governance regimes in Europe. Labor's share is relatively low in the United Kingdom and Ireland, where governance coalitions changed after 1980 in the direction of shareholder primacy. Conversely, labor's share is higher under the CME coalitions found in Europe and in Japan. Since the mid-1990s, German companies have shifted shares away from labor, although this tends to be the result of a union-sanctioned reallocation from wages to investment, with relatively less flowing to shareholders than in the United States. The U.S. has seen a huge jump in payouts to shareholders, from 58% of after-tax profits in 1981 to 89% in 2000. In Japan, allocations have changed only modestly. Hence politics, broadly defined, drives a wedge between finance and labor in CMEs but tightens the connection in liberal economies.³³

III. Financial Development in the Past

Another way of gauging the relationship between finance and labor is to consider earlier periods of financial development. From the 1870s through the 1920s the industrialized world experienced an expansion of trade and finance that rivals today's. Before the First World War, trade growth averaged 3.8% annually. The share of trade in GDP for the Western economies reached a high point in 1913 that was not exceeded until the 1970s (and for some countries not until the 1990s). Trade and finance were positively related but it was finance that was the more dynamic. Between 1870 and 1913 foreign investment flows, including portfolio investments, grew faster than, and exceeded the

John Sweeney issued a statement opposing Vodafone's hostile bid for Mannesman and endorsing the CME approach to governance: "The AFL-CIO," he said, "believes value is created over the long-term by partnerships among all of a corporation's constituents--workers, investors, customers, suppliers, and communities. Mannesman, and the European model of corporate governance under which it is structured, has allowed just those kinds of value creating partnerships to flourish." "Statement by AFL-CIO President John Sweeney on Mannesman Takeover", Nov. 22, 1999.

³³ Henk von Eije and William Megginson, "Dividends and Share Repurchases in the European Union," 89 *Journal of Financial Economics* (2008); Gregory Jackson, "Stakeholders Under Pressure: Corporate Governance and Labour Management in Germany and Japan," 13 *Corporate Governance* (2005); Takeshi Inagami, "Managers and Corporate Governance Reform in Japan: Restoring Self-Confidence or Shareholder Revolution?" in Simon Deakin and Hugh Whittaker, *Corporate Governance and the Spirits of Capitalism* (forthcoming 2009); J. Fred Weston and Juan Siu, "Changing Motives for Share Repurchases," UCLA Anderson working paper, December 20002. Data on labor's share and on corporate payouts that are derived for roughly comparable companies are a more reliable indicator of distributional outcomes at the firm level than aggregate measures of labor's share of value-added, which comprise a changing mix of firms and have the added problem of including income from self-employment.

level of, trade-related flows. After 1918 financial development proceeded apace. (Table 1) Postwar growth was rapid in the United States, with New York challenging London as the world's financial center. The financial sector grew larger and more concentrated as banking and the security industries converged. The number of U.S. national banks with securities affiliates increased from 10 in 1922 to 114 in 1931.³⁴

Financial development was related to industrialization. But the relationship went in both directions: finance serviced industry, and owners poured their wealth into financial assets. Hence income concentration in the late nineteenth century rose in tandem with financial development. Top income shares in Germany increased from 1870 to 1900; British top 5% shares declined in nominal value but rose in real value between 1867 and 1911; and top wealth shares in France rose after 1880. As compared to the U.S. in 1913, Europe and Japan had more developed stock markets and a slightly larger share of income going to the top 1%. The United States caught up on both dimensions by 1929. (Table 1)

U.S. wealth concentration did not match that of previously feudal countries until the 1980s. Yet it hardly was egalitarian: the top 1% in 1912 held about 56% of U.S. wealth. The rich invested their assets through financial intermediaries such as trust banks that grew rapidly after the turn of the century. Stock ownership was concentrated; many of the wealthy were company founders and their descendants. After the First World War, however, stockholding became more diffuse. The initial reason was progressive income taxation, which induced the rich to shift assets into municipal bonds. Wall Street brokers responded with campaigns to persuade less affluent individuals to buy stock directly or through employer stock purchase plans. The 1920s were an era of exuberance. On the eve of the crash, a series of articles in the *Saturday Evening Post* described the preceding decade as one in which "buying [of stock] . . . was not based on reasoning but simply on the fact that prices had risen; a rise led the public to expect more and more returns." The

³⁴ Angus Maddison, *The World Economy*, vol. 2 (Paris, 2006), 362; Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton 1996); Paul Bairoch and Richard Kozul-Wright, "Globalization Myths," UNCTAD discussion paper 113 (1996); Charles Kindleberger, *A Financial History of Western Europe* (New York 1993); Richard F. Biesel, *The Political Economy of American Industrialization, 1877-1900* (Cambridge, UK, 2000): 418-442; Larry Neal, "Trust Companies and Financial Innovation," 45 *Bus. Hist. Rev.* (1971).

magazine presciently warned that excessively optimistic speculation would lead to depression and unemployment.³⁵

Despite more dispersed shareholding in the 1920s, ownership remained concentrated. Fifty-five% of the 200 largest U.S. companies were controlled by their owners in 1929, either through total or majority ownership, or through minority control and various legal devices. The top 1% in 1927 had around 60 percent of their wealth in stock and received 82 percent of all dividend payments, a conservative estimate. The association between financial wealth and personal income was close: for the top 1%, capital returns were the largest component of income (50 percent in 1927). With concentrated wealth came sizable top 1% income shares.³⁶

From the late nineteenth century through the 1920s, labor-market risk was high and, for the most part, shouldered by workers. Only a small minority of employers pursued welfare capitalism: risk-mitigating policies such as layoff avoidance, private unemployment insurance, pensions, and health benefits. But these employers were influential beyond their numbers. Many of them were blockholders and, in fact, there is an association between blockholding and welfare capitalism. Among midsized companies, the exemplars of welfare capitalism were firms controlled by their founders, such as Filene's, Dennison Manufacturing, Leeds & Northrup, and Endicott-Johnson. At

³⁵ Emmanuel Saez, "Income and Wealth Concentration in a Historical and International Perspective" in Alan Auerbach, David Card, and John Quigley, *Public Policy and Income Distribution* (New York, 2006); Peter Lindert, "Three Centuries of Inequality in Britain and America" and Christian Morrisson, "Historical Perspectives on Income Distribution: The Case of Europe" in A.B. Atkinson and F. Bourguignon, *Handbook of Income Distribution* (New York 2000), 179; Thomas Piketty, Gilles Postel-Vinay, and Jean-Laurent Rosenthal, "Wealth Concentration in a Developing Economy: Paris and France, 1807-1994," 96 *AER* (2006); Jeffrey Williamson and Peter Lindert, *American Inequality: A Macroeconomic History* (New York, 1980): 50; Kevin Phillips, *Wealth and Democracy* (New York 2002): 43; Kopczuk and Saez, "Top Wealth Shares"; Cedric B. Cowing, *Populists, Plungers, and Progressives* (Princeton 1965): 170.

³⁶ Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York 1932): 106; Robert A. Gordon, *Business Leadership in the Large Corporation* (Washington, DC 1945); Dennis Leech, "Concentration and Control in Large U.S. Corporations," 35 *Journal of Industrial Economics* (1987); Gardiner C. Means, "The Diffusion of Stock Ownership in the U.S.," 44 *QJE* (1930): 599; Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States" in A.B. Atkinson and T. Piketty (eds.), *Top Incomes over the Twentieth Century* (New York, 2007); Irving B. Kravis, "Relative Income Shares in Fact and Theory," 49 *Am. Econ. Rev.* (1959). In 1914, Scott Nearing, a socialist economist then teaching at the Wharton School, found similarity of labor's share in France, Germany, Switzerland, the U.K., and the United States; it was about 60 percent This is close to Kravis's figures. Nearing, "Service Income and Property Income," 14 *Publics. of the Amer. Stat. Assoc.* (1914); Krueger, "Measuring Labor's Share."

large companies (those with sales over \$500 million), owner control was positively associated with spending on welfare programs in 1929.³⁷

Market development in this era, including financial markets, did not occur in an autonomous economic realm but was abetted by the business community's reliance on political power. The result was "an enormous increase in continuous, centrally organized and controlled interventionism."³⁸ This included tariffs, subsidies, special charters, pro-business tax and spending policies, monetary and banking regulation, and suppression of labor unions. The most visible expression of financial politics was the prolonged effort to establish the gold standard, which subordinated worker and farmer concerns to financier interests in a strong currency. The battle came to a head during the 1896 presidential contest between William Jennings Bryan, the Democratic nominee (also nominated by the Populists), and Republican William McKinley. John D. Rockefeller and J.P. Morgan each contributed vast sums to McKinley's campaign, as did other business leaders. The 1896 Republican campaign was unprecedented in American politics. Millions of pamphlets were printed; hundreds of paid speakers went out into the field. When the gold standard became law in 1900, it was unanimously supported by Congressional Republicans. Approximately one-third of the Senate's members were millionaires (in 1900 dollars), not a few of them financiers. Later that year the New York stock exchanges rose to record levels.

A strong central bank, free of Congressional purview and "special interests," was crucial for maintenance of the gold standard. The deliberations over the Federal Reserve Act of 1913 were conducted by a small group of financiers, industrialists, and politicians. There was contention within this elite--between Wall Street and banks from other regions--that resulted in a compromise creating 12 district banks with New York at their apex. The key figure in these negotiations was Paul Warburg of Kuhn, Loeb, who Woodrow Wilson later appointed to the first Federal Reserve Board. Warburg believed that the Act would insure that New York and the dollar, rather than London and the pound, had the upper hand in global finance. The financial elite understood the power of ideas and that they had to give the appearance of acting in the public interest, and so they

³⁷ C. Canby Balderston, *Executive Guidance of Industrial Relations* (Philadelphia 1935).

“recruited, attracted, and developed the talents of leading economists, journalists and intellectuals.”³⁹

The courts became the shareholders’ best friends. For much of the nineteenth century, jurists held that corporations were subject to regulation because they were public or quasi-public entities with powers derived from the state. But by the end of the century, the courts were asserting that corporations were islands of private property—like land—and had nothing to do with the state or any entity other than their owners. “Outside” interference with the corporation, whether by government or trade unions, was a taking, in the legal sense, whose harm could be measured by changes in the firm’s market value. Eventually the theory developed that corporate power derived from shareholders--the principals--thereby allowing courts to “disaggregate the corporation into freely contracting individuals.”⁴⁰

IV. The Double Movement in the Past

The late nineteenth and early twentieth centuries saw varied and spontaneous reactions to financial development from farmers, workers, small business, and professionals. Space precludes a full discussion; the emphasis here is on organized labor in the United States.

From the 1870s through the early 1900s, labor organizations were active in popular movements opposing the deflationary tendencies and tight credit associated with the gold standard. The movements ran the gamut from Greenbackers, radical Republicans, and free silverites to the Knights of Labor and the People’s Party. Labor’s initial effort to promote the greenback, the “people’s currency,” came through the National Labor Union, the country’s first amalgamation of trade unions. Trade unionists espoused the republican

³⁸ Polanyi, *Great Transformation*, 137.

³⁹ Lawrence Goodwyn, *The Populist Movement* (New York 1978): 278-84; Phillips, *Wealth and Democracy*, 239; Bense, *American Industrialization*, passim; Gabriel Kolko, *The Triumph of Conservatism* (New York 1963); J. Lawrence Broz, *The International Origins of the Federal Reserve System* (Ithaca 1997); James Livingston, *Origins of the Federal Reserve System* (Ithaca 1986): 228. *Haute finance* strong-armed other nations—in Asia and Latin America—to adopt the gold standard. Emily S. Rosenberg, *Spreading the American Dream* (New York 1982).

⁴⁰ Horwitz, *Transformation*, 90.

ethos that direct producers, including small owners, were the source of value creation, whereas financiers were speculative parasites. This was an early expression of the idea that finance and the real economy operated in separate and conflicting realms. Labor not only had a distrust of concentrated financial power; it saw its interests as antithetical to those of finance. Labor opposed monetary stringency, condemned speculation that led to panics and depressions, and loathed the inequities associated with Gilded Age finance.⁴¹

Yet popular movements against the gold standard could neither unify nor sustain themselves, nor could they muster the resources to win elections. The Knights of Labor, the Populist Party, and the Bryan campaign of 1896 were valiant efforts. But Bryan's 1896 anti-gold campaign was run on a shoestring. The collapse of the Knights and later on of the Populist Party brought a halt to labor's financial activism.⁴²

The political baton passed from agrarians and labor to Progressive reformers. Richard T. Ely, Thorstein Veblen, and Louis D. Brandeis were among the intellectuals who railed against financial monopoly. Brandeis criticized investment banking —“the money trust”—in a series of essays published in 1914 as *Other People's Money and How the Bankers Use It*. His ideas overlapped another strand in Progressive thought: an enthusiasm for social engineering. In a contemporaneous book, *Business—A Profession*, Brandeis predicted that corporations would become more efficient as a new class of technocratic managers separated itself from self-interested owners, eschewed class conflict, and adopted producerism in the form of scientific management and employee participation.⁴³

Progressive jurists such as Brandeis advanced a pragmatic conception of the corporation that challenged conservative views. Ownership rights were held to be

⁴¹ Louis Hartz, *Economic Policy and Democratic Thought* (Cambridge 1948); Mark Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton 1994): 68; David Montgomery, *Beyond Equality: Labor and the Radical Republicans, 1862-1872* (Urbana 1967): 445.

⁴² Goodwyn, *The Populist Movement*, 278-84; Phillips, *Wealth and Democracy*, 239; Bense, *American Industrialization*, passim; Kim Voss, *The Making of American Exceptionalism: The Knights of Labor and Class Formation in the Nineteenth Century* (Ithaca 1994).

⁴³ Louis D. Brandeis, *Other People's Money and How the Bankers Use It* (New York 1914); Brandeis, *Business -A Profession* (Boston 1914); Samuel Haber, *Efficiency and Uplift: Scientific Management in the Progressive Era* (Chicago 1964).

relative, not absolute. This required a balancing test to weigh claims made by shareholders against those of other claimants. Challenging assertions that the market was self-regulating, the legal realists argued that the market was embedded: “a social creation, a creature of law, government, and prevailing conceptions of legitimate exchange.” The realists drew on a broad set of ideas, including those of the institutional economists, several of whom, like John R. Commons, had ties to the labor movement.⁴⁴

Yet labor, or at least the AFL, mostly was silent on the era’s financial issues, whether the 1912 Pujo investigations or the backroom negotiations over the Federal Reserve. One reason is that after the 1908 *Danbury Hatters* case, the AFL’s political efforts were absorbed with undoing the judiciary’s repressive interpretation of anti-trust and other laws. Another is that organized labor, unlike farmers or small business, had options other than legislation to tame finance. Lloyd Ulman has well described the process by which unions formed national organizations in response to the extension and interpenetration of markets. Collective bargaining gave labor the power to privately challenge shareholder claims. A third reason for labor’s silence was its electoral weakness. Compared to European unions, the AFL was small and did not form alliances with socialists, farmers, or the middle class. There were exceptions of course, chiefly at the local and state levels. Labor cooperated with the middle class in “sewer socialist” cities. And in the Midwest, labor participated in fusion parties or supported politicians like Wisconsin’s “Fighting Bob” LaFollette, Jr., who opposed “Wall Street dictatorship” and demanded nationalization of banks.⁴⁵

When it came to financial politics, European labor faced different incentives than the AFL. In much of Europe there was proportional instead of majoritarian voting, which gave labor a political voice through labor and other left-wing parties representing worker

⁴⁴ Horwitz, *Transformation*, passim.

⁴⁵ Lloyd Ulman, *The Rise of the National Trade Union: The Development and Significance of Its Structure, Governing Institutions, and Economic Policies* (Cambridge 1955); James Weinstein, “Radicalism in the Midst of Normalcy,” 52 *Journal of American History* (1966); Cedric Cowing, “Sons of the Wild Jackass and the Stock Market,” 33 *Bus. Hist. Rev.* (1959). The AFL had almost nothing to say about the gold standard during the 1910s and 1920s, whereas Britain’s 1926 General Strike, in which 2.5 million workers participated, had at its heart the gold standard and the wage cuts attributed to it. Melvin C. Shefitz, “The Trade Disputes and Trade Unions Act of 1927: The Aftermath of the General Strike,” 29 *Review of Politics* (1967).

interests. European labor was able to negotiate a political *quid pro quo* wherein it supported trade and financial openness in return for a social compact mitigating the risks that openness brought. The compact was based on social insurance for accidents, unemployment, sickness, and old-age indigence. The extensiveness of social insurance enacted before 1913 is positively related to a nation's level of openness in 1913. The United States, with majoritarian voting and a labor movement lacking political allies, was a social insurance laggard until the New Deal.⁴⁶

Only at the midnight hour, in 1929, did the AFL weigh in on finance. Five months before the crash, its official magazine demanded that “growth of speculative credit shall not be permitted to undermine business stability.” It warned that inaction would have deleterious effects on wage earners and, via underconsumption, on growth. When tax figures for 1929 were released, the AFL observed that the bulk of income gains since 1927 had gone to the top brackets. It blamed three factors: concentrated stock ownership, stock speculation that benefited the rich, and an uneven distribution of value-added due to excessively high dividends. But these words came late in the game, in fact, after the game was over.⁴⁷

The Great Depression hit the U.S. especially hard, impoverishing the middle class along with workers and farmers. This created a broader political coalition than existed in 1896 and helped put Roosevelt into office. The belief was widespread that financial

⁴⁶ Michael Huberman and Wayne Lewchuk, “European Economic Integration and the Labour Compact,” 7 *European Review of Economic History* (2003). Did social insurance expenditures have a redistributive effect on top shares? For the three northern European countries shown in Table 1 (Germany, Netherlands, Sweden), social spending as a share of national income rose from an average of .61 percent of national product in 1900 to 2.9 percent in 1930, nearly a five-fold gain; top shares declined after 1920. In France, social spending rose but only two-fold, and top shares did not change. In the U.S., social spending did not change at all between 1900 and 1930 and top shares rose after 1920. The big changes in welfare expenditure and top shares did not occur in Europe or the U.S. until after the Second World War, however. In 1965, social expenditures in the three northern European countries stood at 21 percent of GDP, an expenditure that required substantial redistribution of pre-tax incomes. Peter Lindert, “The Rise of Social Spending, 1880-1930,” 31 *Explorations in Econ. Hist.* (1994); Jens Alber, “Is There a Crisis of the Welfare State?” 4 *European Sociological Review* (1988): 190.

⁴⁷ According to the AFL, between 1927 and 1928 capital gains rose by 70 percent, dividends by 7 percent, and wages by 1.5 percent. At International Harvester—a bellwether corporation in its day—wages barely budged during the 1920s despite the firm's record profits. 36 *American Federationist* (May 1929): 535; 37 *American Federationist* (March 1930): 339-41; Cowing, *Populists, Plungers*, 155-186; Robert Ozanne, *Wages in Practice and Theory* (Madison 1968): 49.

speculation and graft had caused the stock market crash and depression. Antipathy to finance led to a myriad of investigations and regulations. The official leadership of the AFL played a minor role in these events. But parts of the AFL, and of the urban working class more generally, were deeply involved in financial politics. Before the emergence of industrial unionism, the largest popular movements of the 1930s were led by demagogic populists like Senator Huey Long and Father Charles Coughlin. In a reprise of 1896, they blasted the money interests and called for the remonetization of silver.⁴⁸ Long attacked the nation's unequal distribution of wealth--"concentrated in the hands of a few people"--and tied it to the "God of Greed [worshipped] by Rockefeller, Morgan, and their crowd." Coughlin, too, asserted that "bankers and financiers are the chief obstacles to constructive change." Coughlin's heated rhetoric attracted millions of adherents from the same groups that had elected Roosevelt. Coughlin had close ties to the Detroit labor movement, including Homer Martin's anti-CIO faction in the UAW. Other labor leaders, such as attorney Frank P. Walsh, became Coughlinites. Coughlin was a skilled orator, who could connect a worker's problems to abstruse financial forces: "Your actual boss, Mr. Laboring Man, is not too much to blame. If you must strike, strike in an intelligent manner not by laying down your tools but by raising your voices against a financial system that keeps you today and will keep you tomorrow in breadless bondage." Coming from Louisiana, Long had less to do with labor, although his magazine reprinted speeches by AFL president William Green.⁴⁹

In the Senate, Long disrupted the Glass-Steagall deliberations by filibustering for three weeks until the bill included limits on branch banking. Meanwhile Coughlin angrily testified to Congress about financial "plutocrats." He demanded a silver standard and

⁴⁸ Roe, *Strong Managers*, 42. Said Coughlin, "God wills it—this religious crusade against the pagan of gold. Silver is the key to prosperity—silver that was damned by the Morgans." Members of the House and Senate pressured Roosevelt to send Coughlin to the 1933 London Conference on the gold standard and in 1934 Congress passed the Silver Purchase Act, a mostly symbolic gesture. William E. Leuchtenberg, *Franklin D. Roosevelt and The New Deal* (New York 1963): 101; Daniel J. B. Mitchell, "Dismantling the Cross of Gold: Economic Crises and U.S. Monetary Policy," 11 *North American Journal of Economics & Finance* (2000): 77-104.

⁴⁹ *Ibid.*, 103; Alan Brinkley, *Voices of Protest: Huey Long, Father Coughlin, and the Great Depression* (New York 1982): 140, 150, 171.

nationalization of the Federal Reserve, which led Congressman Wright Patman to sponsor a bill along those lines. Not only demagogues attacked finance. Fiorello La Guardia proposed that dividends be taxed as regular income. And the AFL chimed in, asking that Congress erect safeguards “against speculation that destroys wealth and business structure.”⁵⁰

Congress and the Roosevelt administration spun a web of financial restraints, including the Securities Act of 1933 and suspension of gold convertibility, the Securities Exchange and Banking Acts of 1934, and the Investment Company Act of 1940. Some argue that these laws were designed by a New Deal brain trust that was deferential to finance and thereby permitted regulatory capture. But limits on securities trading and financial centralization shrank the financial sector. (Table 1) Along with this came fewer opportunities for finance-derived incomes. The proportion of Harvard Business School graduates choosing Wall Street as their first position fell from 17% in 1928 to 1% in 1941. Not until the 1980s would fresh MBAs become as prevalent on Wall Street as they had been in the 1920s.⁵¹

Financial regulations also took hold in Europe and Japan. Some of the controls were adopted before the war, while others were adaptations of wartime policies. The world’s industrialized nations experienced what John Ruggie calls “a common thread of social reaction against market rationality,” which caused a contraction of global financial markets through 1980 (with a blip in the late 1960s). Top income shares in Europe, Japan, and the United States tracked these changes. They contracted from the 1930s

⁵⁰ Leuchtenberg, *Roosevelt*, 54-56, 60; Cowing, *Populists, Plungers*, 223; Geisst, *Undue Influence*, 68; Paul Studenski and Herman E. Kroos, *Financial History of the United States* (New York 1952): 363; Herbert M. Bratter, “The Silver Episode: II,” 46 *JPE* (1938); Ellis Hawley, *The New Deal and the Problem of Monopoly* (Princeton 1966): 307; *NYT*, Dec. 13, 1937. Congressional Republicans and supply-side economists revived the gold-standard debate in the 1980s, leading to formation of the Gold Commission, which issued a pro-gold report in 1982. Nothing happened, although the idea has recurred since then, as in the 1996 presidential campaign of Steve Forbes. Mitchell, “Cross of Gold,” 101.

⁵¹ Vincent Carosso, “Washington and Wall Street: The New Deal and Investment Bankers,” 44 *Bus. His. Rev.* (1970); Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (New York 1992); Steve Fraser, *Every Man a Speculator: A History of Wall Street in American Life* (New York 2005): 444-7; 473.

through the 1970s, at which point top shares in the U.S. and the U.K. started a steady climb that left Europe and Japan behind. (Table 1) ⁵²

Producerism

The Bretton Woods treaty stemmed from the concern that unregulated currency markets had harmed the global real economy, an enduring idea in more respectable Keynesian clothing. Although the treaty negotiations did not include organized labor, labor leaders like Sidney Hillman and Walter Reuther publicly endorsed the agreement. Bretton Woods resonated with their beliefs in economic planning and international cooperation. They viewed it as a remedy for isolationist and laissez-faire tendencies on the right and for Communist influence on the left. The CIO campaigned to win public support for Bretton Woods and tied it to risk-mitigating legislation such as the Full Employment Act. A growing number of labor leaders understood that the agreement, and Keynesianism more generally, would protect America's fiscal autonomy and its emerging welfare state.⁵³

The labor movement scored a trifecta of high bargaining, organizing, and political power from the 1930s through the 1950s. Rather than seeing labor as a special interest, middle-class households often, but not always, viewed it as a counterweight to forces that had caused the depression. With the ideology of self-regulating markets discredited, and with a broad base of support, the labor movement advanced a variety of social programs: the G.I. bill, higher minimum wages, better unemployment insurance, and more extensive and expensive Social Security benefits (although labor gave up on national health insurance in the late 1940s in favor of employer provision). As earlier had occurred in Europe, labor's support for trade openness in the 1950s was due in some measure to these programs, although now the social compact also included countercyclical spending. To pay for it all, labor pursued redistributive taxation. It familiarized itself with the tax

⁵² John G. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," 36 *International Organization* (1982): 387.

⁵³ *NYT* Jan. 1, 1945, April 13, 1945, Feb. 13, 1945; Nelson Lichtenstein, *Walter Reuther: The Most Dangerous Man in Detroit* (New York, 1995); Patrick Renshaw, "Organised Labour and the U.S. War Economy," 21 *J. of Contemp. Hist* (1986).

code's arcana: during the war, when it opposed a sales tax in favor of higher taxes on corporations and the wealthy, and after the war, when it demanded progressive tax cuts and the closing of loopholes benefiting the rich.⁵⁴

Collective bargaining offered another method for changing the distribution of income. Slichter dates the origins of a rise in labor's share of national income to the 1939-1950 period, when union wage changes became synchronized and unrelated to sectoral variations in productivity. The GM-UAW agreements of 1948 and 1950, the Treaties of Detroit proffered by management, sought producerist solutions to labor militancy by offering labor a guaranteed share of real value-added. But labor, unlike management, saw the treaty formulas not as a fixed allocation of shares but as a base on which to add hefty new fringe benefits and wage gains outside the formula (for example, when new or reopened contracts were negotiated). Labor's share of national income continued to rise through the 1970s, propelled by pay gains in the union sector. Hence the period from the 1930s through the 1970s witnessed a mixture of producerism and class conflict, at least in ritualized form.⁵⁵

Ownership changes facilitated labor's gains. The basic trend in postwar shareholding was toward dispersion; by 1965 individuals owned 84% of U.S. equities.⁵⁶ Writing in

⁵⁴ *NYT* April 8, 1943, Feb. 12, 1943, April 8, 1943, Feb. 12, 1943, April 22, 1944; Studenski and Kroos, *Financial History*, 471; William L. Cary, "Pressure Groups and the Revenue Code," 68 *Harvard L.R.* (1955); Boris Shiskin, "Organized Labor and the Veteran," 238 *Annals of the Amer. Acad. of Pol. and Soc. Sci.* (1945); Robert M. Collins, "The Economic Crisis of 1968 and the Waning of the 'American Century'", 101 *Amer. Hist. Rev.* (1996). While unions from export-producing industries championed trade openness in the 1950s, those exposed to import competition were anxious about the decline in tariffs. The Steelworkers union proposed in 1954 an explicit social compact: workers, firms, and communities damaged by tariff reductions would be compensated with public spending built on the new welfare state, including special unemployment benefits, retraining, and early retirement covered by Social Security. Several of these items were included in the 1962 Trade Expansion Act. Daniel J.B. Mitchell, "Labor and Tariff Question," 9 *Ind. Rels.* (1970)

⁵⁵ Robert Ozanne, "Impact of Unions on Wage Levels and Income Distribution," 73 *QJE* (1959); Sumner H. Slichter, "Do the Wage-Fixing Arrangements in the American Labor Market Have an Inflationary Bias?" 44 *American Econ. Rev.* (1954); Harry C. Katz, *Shifting Gears: Changing Labor Relations in the U.S. Automobile Industry* (Cambridge 1985); Frank Levy and Peter Temin, "Inequality and Institutions in 20th Century America," in this volume.

⁵⁶ Jonathan Baskin and Paul J. Miranti, Jr., *A History of Corporate Finance* (Cambridge, UK 1997): 232; Blair, *Ownership and Control*, 46. Calibrating the decline in owner control is tricky. The TNEC investigations of the late 1930s showed blockholding persisting in many companies. Assessing subsequent blockholding depends on the choice of an ownership criterion conferring control as well as on assumptions regarding the influence of bank ownership and board memberships. Using a 10 percent criterion, Lerner

1941, legal scholar E. Merrick Dodd said that corporate governance had “reached a condition in which the individual interest of the shareholder is definitely made subservient to the will of a controlling group of managers.” Fifteen years later, a team of economists found American executives professing producerist principles. Executives, it said, believe

“that they have four broad responsibilities: to consumers, to employees, to stockholders, and to the general public . . . In any case, each group is on an equal footing; the function of management is to secure justice for all and unconditional maxima for none. Stockholders have no special priority; they are entitled to a fair return on their investment but profits above a “fair” level are an economic sin.”⁵⁷

The concept of management rights today refers to decisions that management reserves for itself free of union influence. In the 1950s, however, management rights had an additional meaning: freedom from shareholders. The concept was “designed to defend for management a sphere of unhampered discretion and authority which is not merely derivative from the property rights of owners.” Managerial discretion included the allocation of value-added among retained earnings, shareholders, and employees.⁵⁸

Under the new balance of power, dispersed owners had few options to assert their claims. Annual dividend yields, for example, showed a downward trend from the late 1930s through the 1960s. Yet most executives did not exploit their autonomy to plunder. A database of CEOs for the period 1936-2003 finds a decline in real compensation for top executives in the early decades followed by pay sluggishness until the 1970s. The practice then was to plow retained cash into investments, which reduced dependence on

found that 84 percent of the top 200 nonfinancial corporations in 1963 were under management control. On the other hand, Burch found only 40 percent under management control because he included holdings by families, trusts, and estates. Gordon, *Business Leadership*, 38; 157; Marco Becht and J. Bradford DeLong, “Why Has There Been So Little Blockholding in America?” working paper (2004); Philip Burch, *The Managerial Revolution* (Lexington, MA 1972); Maurice Zeitlin, “Corporate Ownership and Control,” 79 *American Journal of Sociology* (1974).

⁵⁷ Francis X. Sutton et al., *The American Business Creed* (Cambridge 1956): 64-5.

⁵⁸ E. Merrick Dodd, “The Modern Corporation, Private Property, and Recent Federal Legislation,” 54 *Harvard LR* (1941): 924; Sutton et al., *American Business Creed*, 64-5.

financial markets, moderated shareholder influence, and constrained financial development. The preference for retained earnings sometimes caused “slack” and wasteful spending. But in other circumstances slack encouraged risky innovation and provided a buffer against unforeseen developments.⁵⁹

The era’s producerist ethos went beyond the union sector. The proclivity to cooperate also could be found in large nonunion companies employing white-collar professionals who disdained, and would never join, unions. What motivated large nonunion employers to largesse? One reason, of course, was union avoidance. But there was more to it than that. According to one study, executives believed that “the key to effective employee relations is the presence of trust and confidence between managements and employees. Such a climate is considered desirable for its own sake, and also because it fosters the efficient and effective long-run implementation of corporate strategy.” That is, another reason for sharing rents with employees was management’s belief that it sustained the cooperation required for value creation. The view later was rationalized in the literature on the productivity consequences of practices based on long-term employment and on trust: firm-specific training, Lazearian wage profiles, and gift exchanges.⁶⁰

A rising tide did not lift all boats, however. Labor’s share was unevenly distributed. Unionized workers fared especially well, as evidenced by a widening union-nonunion wage premium from 1950 to 1980, when it peaked at 30%. The union sector’s payroll weight—its share of labor’s share—was much larger than its employment weight. There *were* union-to-nonunion wage spillovers during this period but evidence of spillovers is ambiguous. They occurred in some periods and some industries but not others. In those

⁵⁹ G. W. Schwert, “Indexes of U.S. Stock Prices from 1802 to 1987,” 63 *The Journal of Business* (1990); Mary O’Sullivan, “Living with the U.S. Financial System: The Experiences of General Electric and Westinghouse in the Last Century,” 80 *Bus. Hist. Rev.* (2006); Carola Frydman and Raven Saks, “Historical Trends in Executive Compensation,” MIT working paper (2005); Kalman Cohen and Richard Cyert, *Theory of the Firm* (Englewood Cliffs, 1963); Nitin Nohria and Ranjay Gulati, “Is Slack Good or Bad for Innovation?” 39 *Acad. of Mgt. J.* (1996).

⁶⁰ Charles Maier, “The Politics of Productivity: Foundations of American International Economic Policy After World War II,” 31 *Intl. Org.* (1977); Fred Foulkes, *Personnel Policies in Large Nonunion Companies* (Englewood Cliffs 1980): 325. Some assert that the recent dismantling of internal labor markets, although it may contribute to inequality, nevertheless has raised efficiency. The evidence does not support the claim. C.W. Kim and A. Sakamoto, “Does Inequality Increase Productivity?” 35 *Work & Occupations* (2008).

parts of the nonunion sector where employee turnover was high and firm size modest, wage gains were smaller and less synchronized with union pay trends. Here management lacked an appreciation of cooperation and of what Slichter called “the relation between morale and the efficiency of labor.”

Arguably the most important innovation in postwar collective bargaining was the 1955 Ford-UAW agreement in which the union demanded and won a guaranteed annual wage. This took the form of supplemental unemployment benefits (SUBs) paid by the company and coordinated with unemployment insurance. Not only did this shift risk from workers to owners, it placed an imprimatur on what had become a quasi-permanent employment relationship. Yet SUBs never spread to the nonunion sector. In fact, they were limited to a minority of workers in heavily unionized industries, the elite within the working-class elite. In other words, pay and benefit norms established in the union sector were circumscribed.⁶¹

The SUB agreements illustrate the peculiar structure of postwar risk protection in the United States. It was a two-tier affair in which private benefits, the legacy of welfare capitalism, sat on top of a modest public base. Corporate pensions supplemented and were coordinated with Social Security; employer medical insurance patched holes in the public safety net. Unions were partly responsible for the two-tier system and their members benefited from it, as did some nonunion workers in large firms. The same groups enjoyed additional protection because their employers practiced countercyclical labor hoarding and wage smoothing.⁶²

⁶¹ Richard Freeman and James Medoff, *What Do Unions Do?* (New York 1982): 53; Sanford Jacoby and Daniel J.B. Mitchell, “Measurement of Compensation: Union and Nonunion,” *27 Industrial Relations* (1988); Sumner H. Slichter, “The Current Labor Policies of American Industries,” *43 Qrt. J. of Econ.* (1929): 398; Daniel J.B. Mitchell, *Unions, Wages, and Inflation* (Washington, DC 1980); Sumner H. Slichter, James Healey, and E. Robert Livernash, *The Impact of Collective Bargaining On Management* (Washington DC 1960). In the 1970s, SUBS covered 10 percent of unionized workers and none in the nonunion sector.

⁶² Robert Hart and James Malley, “Excess Labour and the Business Cycle,” *63 Economica* (1996); Robert J. Flanagan, “Implicit Contracts, Explicit Contracts, and Wages,” *74 Am. Econ. Rev.* (1984); David M. Gordon, Richard Edwards, and Michael Reich, *Segmented Work, Divided Workers* (Cambridge, UK 1982). In the mid-1970s, pension coverage among union workers was 91 percent; for nonunion workers it was 47 percent. Union workers were 14 percent more likely to have medical insurance and their benefit levels were more generous. Freeman and Medoff, *What Do Unions Do?*

Organized labor did not have much to say about financial regulation in the 1950s and 1960s except when it came to taxes or when it periodically denied that its pay gains were responsible for gold outflows.⁶³ But organized labor nevertheless shaped the postwar financial order. Its commitment to Keynesianism was a prop under Bretton Woods. It supported the expansion of the regulatory state. And its efforts in collective bargaining and contract administration were integral to producerist governance. In some respects the U.S. during these years resembled the European CMEs, although there were important differences in ownership, labor relations, and social spending.⁶⁴

V. Double Movement Redux

As the New Deal coalition broke down in the 1970s, labor found itself isolated. It was a Democrat, Jimmy Carter, who deregulated union strongholds such as the transportation and communications industries. But the situation went from bad to worse in the 1980s. The Reagan administration shut labor out of the executive branch. Employer hostility to unions, encouraged by Reagan's PATCO actions, made it difficult for unions to retain members and gain new ones. Rising imports, deregulation, and the emergence of a market for corporate control had similar effects. Hostile takeovers and management buyouts were accompanied by downsizing on a massive scale. Pay norms in the union sector turned from "pushiness" to passivity. Labor's previous trifecta had transmogrified into a triple defeat.⁶⁵

With its house collapsing, labor focused attention not on capital markets--though it criticized hostile acquisitions--but on product markets (trade) and on survival. In any event, it seemed that there was little labor could do with respect to finance because of its weak bargaining power and political influence, except at the state level, where it secured passage of anti-takeover legislation in several states. The situation was eerily reminiscent

⁶³ However, labor complained in the late 1960s and early 1970s that conglomerate acquisitions were causing layoffs and the transfer of jobs to nonunion regions. There is evidence to support the charge. *NYT* Feb. 16, 1961, Feb. 13, 1970, July 1, 1973; Anil Verma and Thomas A. Kochan, "The Growth and Nature of the Nonunion Sector within a Firm" in Kochan, ed., *Challenges and Choices Facing American Labor* (Cambridge 1985).

⁶⁴ Ruggie, "Embedded Liberalism"; *NYT* Feb. 16, 1961. Feb. 13, 1970, July 1, 1973.

⁶⁵ Daniel J.B. Mitchell, "Union vs. Nonunion Wage Norm Shifts," 76 *Amer. Ec. Rev.* (1986).

of the 1920s. There was, however, at least one new factor: the trillions in pension assets over which unions had influence. In the late 1980s, labor awoke to the fact that these funds offered leverage to partially compensate for its deficiencies.

The development of labor's pension activism is a complicated story, involving the interplay between financial markets, state and local government pension funds (SLPFs), and union-affiliated pension funds (UAPFs). SLPFs changed in the 1980s as they were freed of limits on their equity allocations, which permitted them to raise their equity stakes to accommodate funding gaps and demographic shifts. In search of higher returns and influenced by shareholder-primacy doctrines, the SLPFs became leaders of the shareholder rights movement. The UAPFs were and are somewhat different. They came more slowly to shareholder activism and gave it a different twist.⁶⁶

The largest and most active SLPF is CalPERS, which today has assets of almost \$250 billion. (SLPFs have total assets of around \$4.5 trillion.) CalPERS was one of the first institutional investors to pressure corporations to be more shareholder-friendly. It proposed what agency theorists saw as standard remedies for instantiating shareholder primacy: greater board independence, lower takeover barriers, larger payouts to shareholders, and tighter links between CEO pay and share performance. CalPERS relied on a variety of tactics, including proxy resolutions, public targeting of underperformers, and alliances with other owners, including corporate raiders. In 1985 CalPERS formed the Council of Institutional Investors (CII) to bolster its clout. The CII's initial members were other SLPFs. The CII later included UAPFs and corporate pension funds, although the UAPFs opposed the latter's entry and, later on, their leadership role in the CII. After the mid-1990s CalPERS and some other large funds shifted to less visible methods of influence, such as relational investing and private equity.

SLPFs professed to be interested in long-term performance but disgruntled corporate executives said that the funds abandoned their long-term philosophy whenever raiders offered sufficiently juicy premiums for their shares. The SLPFs supplied capital for financing hostile takeovers in the 1980s, which they justified in the same way as the raiders: that they were performing a public service by prodding underperforming

⁶⁶ Teresa Ghilarducci. *Labor's Capital: The Economics and Politics of Private Pensions* (Cambridge 1992).

companies to maximize shareholder value. CalPERS officially was on record that it preferred companies to improve shareholder returns without layoffs. But it was not averse to downsizing. Patricia Macht, a CalPERS official, told the *New York Times* in 1996, “There are companies that are fat, that have not taken a good look at the number of employees they need.”⁶⁷

It would be a stretch to call SLPFs worker-owner coalitions. Although many of those enrolled in SLPFs are public-sector union members, there are limits on union and worker influence because ultimate control of an SLPF resides with the government entity that created it. Also, none of the “workers” covered by SLPFs is employed by companies in which their pension funds invest. Hence the SLPFs sometimes take positions that are pro-shareholder but harmful to private-sector employees. Union leaders from the private sector will state off the record that SLPFs can pursue shareholder primacy because doing so will never hurt their members. SLPF trustees retort that UAPFs ignore their fiduciary duties by favoring workers over retirees.⁶⁸

There are two types of UAPFs: funds for a union’s own staff employees and Taft-Hartley multiemployer funds that are jointly administered by unions and employers. The Taft-Hartley funds’ inclusion of employers and their decentralized administration generally make them less activist than the staff funds. On the other hand, although both types of UAPFs have combined assets that are only about 9% of the SLPFs’, their influence belies their size. They place greater emphasis than SLPFs on a corporation’s employment responsibilities and on the negative aspects of financialization.⁶⁹ For example, in 1989 the AFL-CIO opposed having pension funds invest in junk bonds whereas the CII, dominated by the SLPFs, supported it. Although UAPFs and SLPFs both criticize executive pay levels, the SLPFs are inclined to focus on damage to owners whereas UAPFs additionally emphasize any harm done to employees. Yet the funds

⁶⁷ *P&I*, Feb. 6, 1989; Jacoby, “Convergence by Design,” 249. Note that one reason SLPFs could become equity-holders in LBOs was that they were, and are, exempt from ERISA, which continues to afford them greater investment flexibility than UAPFs.

⁶⁸ Sean Harrigan, former president of CalPERS, found out the hard way that SLPFs are not worker funds. At the time of his appointment to the CalPERS board by Governor Gray Davis, Harrigan was a union official. He staked out a laborist path for CalPERS during his tenure as board member and later chairman (1999-2004). But when Harrigan led CalPERS into conflict with California companies such as Disney and Safeway, Governor Arnold Schwarzenegger had him removed from the board.

⁶⁹ One of the largest and most active UAPFs is the SEIU Master Trust, with assets of around \$1.5 billion.

overlap and work closely on many issues. UAPF staff funds include unions that represent public employees, such as AFSCME, while SLPFs from liberal regions stake out positions close to the UAPFs'. In fact, because the UAPFs' holdings are usually small, they must rely on friendly SLPFs to pressure companies and their boards to make desired changes.⁷⁰

The architect of a distinctive UAPF approach was William B. (Bill) Patterson, field director for ACTWU in the 1970s. During the J.P. Stevens textile-workers organizing drive, Patterson helped to develop the corporate campaign, in which unions pressure a company's major shareholders in hopes that the latter will restrain anti-union managers. It was a logical progression from pressuring managers via owners to deploying labor's own pension assets for similar ends. UAPFs began utilizing their pension assets tactically in support of traditional union objectives in organizing, negotiations, strikes, and against layoffs. Today that approach is still alive, especially at Change To Win (CTW) and the unions affiliated with it. CTW's unions have combined their pension assets to support organizing at companies such as Columbia Health Care, Manor Care (nursing homes), and Unicco (building services). Support from SLPFs has proven crucial in several of these efforts, as has support from large European pension funds.

As compared to the CTW, the AFL-CIO and its national unions are less likely to engage in tactical pension activities, that is, those in support of traditional union objectives. The AFL-CIO has more members in manufacturing, where organizing potential is low and where employers can threaten to move overseas, unlike services. However, some AFL-CIO unions, such as the Steelworkers, regularly pursue the tactical approach. SLPFs have no members in the private sector but they occasionally refuse to invest in firms that benefit from privatization, such as bus companies.⁷¹

Employers strenuously oppose labor's tactical use of its pension assets. Among other things, they have filed RICO lawsuits alleging that pension activism is a form of

⁷⁰ *P & I*, Feb. 6, 1989; *NYT*, April 1, 1996.

⁷¹ Paul Jarley and Cheryl Maranto, "Union Corporate Campaigns," 43 *ILRR* (1990); Stewart Schwab and Randall Thomas, "Realigning Corporate Governance: Shareholder Activism by Labor Unions," 96 *Mich L.R.* (1998); *P&I*, April 4, 1994; *P&I* Sept. 29, 2003; Teresa Ghilarducci et al., "Labour's Paradoxical Interests and the Evolution of Corporate Governance," 24 *Journal of Law & Society* (1997); Interview with Carin Zelenko, 24 March 2008; *Boston Globe*, 26 Sept. 2002; *The Deal*, 30 April 2007.

racketeering, asked the SEC to ban union-sponsored proxy resolutions during labor disputes, and pressured the SEC to prosecute UAPFs.⁷² Union pension funds must be extremely careful lest they be accused by the government of seeking collateral benefits that are inconsistent with their fiduciary obligations.

To avoid these problems, Patterson and others have tried to develop a pension model that will raise worker concerns, meet fiduciary standards, and attract support from other shareholders. As he said in 1993, “It’s important to represent workers as stockholders as well as workplace advocates . . . so employees are engaging companies with their view of shareholder value.” What is called the “worker-owner” or “capital stewardship” philosophy has four parts. First is a search for investment criteria that promote worker interests while satisfying fiduciary law. For example, companies that overpay their executives are wasting money that could have gone to better purposes, including investments that enhance employee pay and security. Also, if two investments offer similar returns, labor will favor the company with better human resource management and human rights policies.⁷³ Second, UAPFs seek to persuade other investors that pro-worker policies promote long-term value. Third, there is the hope that shareholder activism will give labor influence at the corporation’s highest levels, a goal that has eluded it since the 1970s. Fourth, UAPFs espouse mainstream governance principles so as to establish common ground with other active investors.⁷⁴

In this regard UAPFs have demanded that corporations limit executive pay; hold binding, not advisory, votes on shareholder resolutions; and minimize takeover defenses

⁷² In the waning days of the Bush administration, the U.S. Chamber of Commerce and its friends stepped up pressure on the Department of Labor, which regulates UAPFs. A *Wall Street Journal* column by Eugene Scalia, former general counsel of the department, alleged that UAPF shareholder activism does not maximize shareholder value. He urged the Labor Department to increase its investigations of, and bring federal court actions against, UAPFs found in violation of their fiduciary obligations. In October 2008, the Department issued two separate interpretive bulletins that proscribed types of shareholder activism associated with, but not limited to, UAPFs. Eugene Scalia, “The New Labor Activism,” *WSJ*, Jan. 23, 2008; <https://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=21630&AgencyId=8>

⁷³ On the relationship human resource policies and firm performance, see Alex Edmans, “Does the Stock Market Fully Value Intangibles?,” working paper, Wharton School, 2007. There are three mutual funds that invest in union-friendly companies. Two of the funds are above their benchmarks over the past five years; one is below by one-half of one percent. “Pro-Labor Mutual Funds Not Sacrificing Profits” (2007), www.thestreet.com/pf/mutualfundinvesting/10381202.html

⁷⁴ *P&I* April 5, 1993; Interview with Damon Silvers, March 26, 2007; Thomas Kochan, Harry Katz, Robert McKersie, *The Transformation of American Industrial Relations* (New York, 1986); Schwab and Thomas, “Realigning.”

such as staggered boards. As noted, UAPF activism has eclipsed that of the SLPFs; they file more shareholder resolutions than any other investor group. The problem here is that UAPFs occasionally give the impression that they are in favor of shareholder primacy and, in fact, these governance principles sometimes can harm employee interests.⁷⁵

A turning point came in 1997, when the AFL-CIO created an Office of Investment to coordinate labor's capital-market activities and hired Patterson to oversee it. Almost overnight, the AFL-CIO became the center of UAPF activism. One of Patterson's first moves was to create a website called PayWatch, which allows employees to compare their earnings to those of their CEO. The site was extremely popular, getting over four million hits in its first year. According to AFL-CIO Secretary-Treasurer Rich Trumka, PayWatch offers employees a way to "vent their anger, anxiety, and outrage." Later the website added a feature called "Pick-a-Pension," which divulges the value of egregious CEO retirement packages and calculates how much health insurance those packages could purchase for uninsured families.⁷⁶

The AFL-CIO's Office of Investment and the CTW Investment Group have the freedom to be aggressively vocal on capital-market issues because neither has fiduciary obligations and therefore is free of legal actions by employer groups and an anti-union Bush administration. The CTW Investment Group is closely linked to the tactical concerns of the CTW unions, especially SEIU. The AFL-CIO, because of the federation's long tradition of national-union autonomy, does less to directly support traditional objectives of its constituent unions and spends more time on strategic activities: gathering information, coordinating UAPFs, and lobbying on Capitol Hill. It issues "Key Votes" lists prior to proxy season that describe resolutions which various UAPFs intend to submit. The lists are circulated to UAPFs and SLPFs and to other institutional investors. Another coordinating effort is the AFL-CIO's Proxy Voting Guidelines, which are disseminated to UAPF trustees and their investment advisors. The guidelines identify good governance practices that also promote employee welfare, what is called "the high road to competitiveness." For example, long-term metrics are held to

⁷⁵ Schwab and Thomas, "Realigning." *Houston Chronicle* April 17, 1994; *P&I* April 3, 1995; *NYT* March 12, 1996.

⁷⁶ *P&I* April 23, 1998; Trumka in *Wash. Post* April 11, 1997; *Bus. Wk.* Sept. 29, 1997, Dec. 8, 1997.

be better for judging--and promoting--executive performance than short-term bonus criteria.⁷⁷

The AFL-CIO cast itself into the limelight during the corporate scandals epitomized by Enron. In January 2002, the federation's Executive Council was the first to respond to Enron when it demanded that companies refuse to renominate any Enron director serving on their boards. Two months later, Damon Silvers, the AFL-CIO's Associate General Counsel, appeared before the Senate Banking Committee to offer recommendations for reform. He called for an omnibus law to insure directorial independence, tighter regulation of accountants and analysts, and repeal of the law shielding executives and auditors from lawsuits. Several of Silvers' proposals were included in the Sarbanes-Oxley Act of July 2002. One expert dubs SOX "the most sweeping securities law reforms since the New Deal." The AFL-CIO hailed SOX and said the law was needed to reform financial markets which "once were well-regulated but are now trapped in a destructive cycle where short-term financial pressures combine with the greed of corrupt corporate insiders." Harking back to the 1890s, the AFL-CIO condemned markets for being "rigged to entrench and enrich speculators ... at the expense of employees, shareholders, and communities."⁷⁸

In what follows, we focus on UAPF activism in five areas. Two of them-- executive pay and board structure--are old chestnuts of the shareholder-rights movement.

⁷⁷ Interview with Rich Trumka, AFL-CIO, March 26, 2007; *IRRC Corporate Governance Bulletin*, April 2001; *P&I* March 23, 1998; AFL-CIO, *AFL-CIO Proxy Voting Guidelines: Exercising Authority, Restoring Accountability* (2003); *Bus. Week*, April 15, 1993; Ron Blackwell and Bill Patterson, "The Crisis of Confidence in American Business," draft working paper, March 2003; *The Economist* July 14, 2007. Long-term measures of performance make intuitive sense but many economists reject the claim that the long term is anything more than a concatenation of multiple short terms and that a focus on the long-term necessarily results in better long-term performance. They may be wrong but research contesting their claims is scanty at best, a problem that plagues not only pension activism but social investing more generally.

⁷⁸ *FT* Jan. 26, 2002; Damon A. Silvers, Testimony, to the U.S. Sen. Comm. on Banking, Housing, and Urban Affairs, "Hearing on Accounting and Investor Protection Issues Raised by Enron and Other Public Companies," 107th Cong., 2d. Sess., March 20, 2002; Skeel, *Icarus*, 175; Blackwell and Patterson, "Crisis of Confidence,"; John C. Coates, "The Goals and Promise of the Sarbanes-Oxley Act," 21 *J. of Econ. Perspectives* (2007). Labor's effort to capitalize on the scandals was undercut by revelations that Robert Georgine, a long-time building trades official, personally profited from Ullilco's investment in Global Crossing's IPO. *Bus. Wk.* March 18, 2002.

The others are proxy access, scrutiny of investment managers, and regulation of private equity and hedge funds.⁷⁹

Pay Issues

Ever-higher CEO compensation and scandals such as options backdating have kept executive pay at the forefront of pension activism. The AFL-CIO and CTW have called for regulations to prevent backdating and to force executives to return pay if corporate earnings are revised. The proposals tap into public anger over stratospheric executive pay levels. In a recent survey of American households, 70% agreed with the statement, “When corporations are profitable, the benefits are not shared with workers but go only to the top.” Even President George W. Bush has acknowledged the prevailing political winds. During a 2007 visit to Wall Street, Bush told the audience to “pay attention to the executive pay packages that you approve.” Amazingly, he tied finance to inequality and made a point previously contested by conservatives. “Income inequality,” he said, “is real. It has been rising for more than 25 years.”⁸⁰

The SEC’s new executive pay disclosure rules--for which the AFL-CIO lobbied--have uncovered numerous types of executive excess, including free personal use of corporate jets, which is permitted by 70% of companies. The *New York Times* said that the rules brought to mind Brandeis’s quip that “sunlight is said to be the best of disinfectants” (from his post-Pujo book, *Other People’s Money*). In the 2006 and 2007 proxy seasons, UAPFs sponsored the vast majority of advisory pay resolutions. Some sought limits on golden parachutes and executive retirement benefits; others demanded that executive bonuses be awarded only if performance was superior to a peer group. (PayWatch now carries case studies of egregious options grants.) By far the most popular of the UAPFs’ resolutions are those urging a “Say on Pay” by holding advisory shareholder votes on a board’s pay proposals. Say on Pay resolutions have garnered an average positive vote of 43%, which is on the high side for advisory resolutions. To avoid negative publicity, some companies have agreed to privately meet with activist

⁷⁹ Schwab and Thomas, “Realigning”; Damon Silvers, William Patterson, and J.W. Mason, “Challenging Wall Street’s Conventional Wisdom,” in Archon Fung, Tessa Hebb, and Joel Rogers, ed., *Working Capital: The Power of Labor’s Pensions* (Ithaca 2001).

⁸⁰ *San Diego Union Tribune*, Jan. 31, 2007.

shareholders, including labor, to discuss their pay policies. This has brought labor a measure of influence at strategic corporate levels. As one union official said, “Five years ago we would never have gotten in a corporate boardroom. Now we’re regularly meeting with corporate directors about substantive issues.”⁸¹

The House in 2007 approved a bill backed by the SLPFs and UAPFs requiring companies to offer a say on pay, which is now the law in Britain. The bill was sponsored by the Democratic chair of the House Financial Services Committee, Barney Frank, who is sympathetic to the labor movement’s financial agenda and a key figure in recent efforts to re-regulate financial markets. Damon Silvers attributed the vote to “increasing discontent in our country about income inequality generally and CEO pay specifically.” Although Silvers’ words echoed Bush’s, the White House opposed the bill. As of this writing, prospects for its passage have improved due to revelations of the phenomenally high salaries paid to CEOs of financial companies damaged by the crisis. Both the AFL-CIO and CTW have blasted executive pay at Countrywide, Bear Stearns, Citigroup, Morgan, and other firms. Several of the bailout packages crafted by the Federal Reserve Bank and the Treasury include limits on executive pay and clawback provisions of the type earlier promoted by the labor movement.⁸²

Board Reforms

Less dramatic but no less important has been the continuing emphasis on board reform. UAPF proposals include demands that originated with SLPFs to limit board interlocks, separate the CEO and chairman positions, and require boards to seek shareholder approval of takeover defenses. A new issue is to demand majority voting for corporate directors instead of the present plurality system that ignores uncast votes. In the past two proxy seasons, UAPFs took the lead in sponsoring resolutions for majority voting. The idea is popular with other institutional investors and received more than 70%

⁸¹ *Bus. Wk.* Dec. 28, 2006; *NY Times*, April 8, 2007; Brandeis, *Other People’s Money*, 92; AFL-CIO, “Key Votes Survey: How Investment Managers Voted in the 2006 Proxy Season,” (2006); *L.A. Times* April 21, 2007.

shareholder support in the 2007 proxy season. Bowing to the inevitable, more than half the proposals were withdrawn after companies adopted the rule.⁸³

Proxy Access

UAPFs have proposed that long-term owners holding a minimum percentage of shares be given the right to nominate directors, what is called proxy access. Labor's hope is that owners will nominate directors who not only are independent in a meaningful sense but also knowledgeable about the company and the ingredients for its long-term success.⁸⁴ Rich Trumka is more ambitious. He wants directors who are "worker-friendly," which might include employees, who, he notes, are relatively likely to be independent of management.⁸⁵

Other institutional investors are allied with UAPFs on this issue; they see proxy access as an effective tool for board independence and executive accountability. It is also a way of making boards more transparent. As an AFL-CIO official says of proxy access, "You're opening up the kitchen inside these companies. That's a dark secret. That's a place where the insiders really play inside ball." AFSCME, the AFL-CIO, and the CII submitted petitions to the SEC in 2003 seeking a ruling on proxy access. When the SEC issued a staff report later in the year, it identified two issues for consideration: Should proxy access be adopted and, if so, what ought to be the requirements for shareholders to obtain it? The SEC report elicited vociferous opposition from companies. The Business Roundtable warned that proxy access was "a thinly veiled attempt by labor unions and public pension funds to increase their influence over corporate America in order to further private agendas." But a wide variety of investors, not only pension funds, is seeking proxy access, as evidenced by advisory votes on the issue. AFSCME, for example, filed proxy-access resolutions at AIG, Citigroup, and Hewlett Packard. AIG, a scandal-ridden insurance company, took AFSCME to court and claimed that SEC rules

⁸² *Atlanta Constitution* June 6, 2007; *Fin. Times* April 1, 2007; *Bus. Wk.* June 11, 2007; *NY Times*, March 7, 2008; *WSJ* 14 April 2008.

⁸³ *Ibid.*; "Key Votes."

⁸⁴ Many corporate boards are comprised of CEOs from other companies who, although they are classified as independent, tend to be deferential to other CEOs. They also are prone to groupthink.

⁸⁵ Lucian Bebchuk, "The Myth of the Shareholder Franchise," 93 *Va. L.R.* (2007); Silvers interview; *Daily Deal*, Oct. 20, 2003; Damon Silvers and Michael Garland, "The Origins and Goals of the Fight for Proxy

prohibit these resolutions. The courts ruled in favor of AFSCME, which later came close to achieving proxy access at HP, where only 52% of shares were cast against the proposal. For now, however, proxy access--once the UAPFs' holy grail--is dead. In December 2007, the SEC voted along party lines to permit companies to deny proxy access. But President Obama's appointment of Mary Schapiro to replace Christopher Cox as SEC head will likely bring proxy access back to life. ⁸⁶

Mutual Funds and Investment Managers

Because UAPFs and SLPFs are minority owners, they need allies. Mutual funds--whose share of U.S. equities is 25% and rising--are a logical place to look. The mutuals have not been shareholder activists. Most are subsidiaries of companies that sell financial services to business, such as administration of benefit plans, record keeping, and investment options for 401(k), usually their own mutual funds. Trumka calls this "a rigged system" and alleges that financial companies tell prospective clients, "make me your mutual fund for your 401(k) ... and I guarantee you the vote." The evidence supports Trumka's claim: the larger the share of fees a parent firm derives from providing services to a client, the less likely are the firm's mutual funds to adopt anti-management voting policies. ⁸⁷

Until recently, mutual funds did not disclose their proxy votes nor were they required to do so. In response to a request from the AFL-CIO, the SEC in 2000 considered to adopt a disclosure policy. Investment companies selling mutual funds were opposed, even TIAA-CREF. To turn up the heat, Bill Patterson organized a demonstration outside Fidelity headquarters, protesting the firm's adamant refusal to disclose its votes. The timing was auspicious--mutuals were then being hit by pricing scandals--and in 2003 the SEC adopted a disclosure rule. Since then the AFL-CIO has published annual reports showing how mutual funds vote for items on labor's agenda.

Access," in Lucian Bebchuk, ed., *Shareholder Holder Access to the Proxy Ballot* (Cambridge 2005); Interview with Daniel Pedrotty, AFL-CIO, March 26, 2007; Trumka interview.

⁸⁶ Interview with Ron Blackwell, AFL-CIO, March 26, 2007; Bebchuk, "The Myth,"; *L.A. Times* Feb. 17, 2003, July 26, 2007; *Fin. Times* April 1, 2007; Conference Board, "2007 Report," *NYT*, Nov. 29, 2007. The SEC also has proposed doing away with nonbinding shareholder resolutions, which would eliminate advisory votes on executive pay and other issues.

Sixty percent of the items are mainstream “good governance” issues; 20% have to do with the environment and the poor; and another 20% are employee issues.⁸⁸

In recent years, financial companies have lobbied to privatize Social Security and to turn public-employee defined-benefit (DB) pensions into defined-contribution (DC) plans. The threat is real. California’s governor attempted to convert the state’s SLPPs into DC plans, as have lawmakers in ten other states. The AFL-CIO now publishes reports listing the companies that donate money to politicians and advocacy groups who back privatization. Demonstrations have been held at several of these firms, including Schwab and Wachovia. Letters were sent warning that the firms would lose labor’s pension business unless they backed off. “We’re seeking to pull Wall Street money out of the debate,” said Bill Patterson. “Wall Street’s covert funding of the drive to privatize Social Security is a conflict of interest because they stand to gain billions of dollars.”⁸⁹

The labor movement knows that its pension-fund leverage will decline in the future. Already more than 40% of AFL-CIO members have DC plans. Although the labor movement criticizes DC plans, it sees the handwriting on the wall and is quietly designing hybrid pension plans that would pool risk, integrate with Social Security, and provide portability. Whether or not hybrids come to pass, DC assets surely will grow and mutual funds will receive them. To keep its agenda alive, the labor movement has to build ties with mutual-fund managers and align them with labor’s emphasis on long-term value. Efforts to make mutuals more transparent are one step in this direction. Another is Trumka’s proposal to put investor representatives on the mutual funds’ boards. A different idea that some are batting around is to have a union-affiliated entity sell mutual funds.⁹⁰

Private Equity and Hedge Funds

Private equity funds (PE) are a throwback to earlier eras: to the LBOs of the 1980s and, because of their diversification, to the conglomerates of the 1960s. PE’s

⁸⁷ Trumka interview; AFSCME, “Failed Fiduciaries: Mutual Fund Proxy Funding on CEO Compensation,” (Wash. DC 2007); Gerald F. Davis and E. Han Kim, “Business Ties and Proxy Voting by Mutual Funds,” *85 J. of Fin. Econs.* (2007).

⁸⁸ *Boston Herald*, Dec. 3, 2002; AFL-CIO, “Key Votes”; AFL-CIO, “Retirement Security: How Do Investment Managers Stack Up?” May 11, 2006.

⁸⁹ *Fin. Times*, March 8, 2005; *NYT* March 17, 2005.

modus operandi is to leverage its assets via debt, buy companies or their subsidiaries, take them private, dispose of corporate assets to pay off debt, and sell out. How PE makes money is a matter of dispute. PE funds say that, because they are blockholders aiming for a future sale, they have an incentive to manage corporate assets so as to raise efficiency and thereby earn capital gains. Critics charge that that the productivity effects of PE are undemonstrated and that PE derives its profits from the tax benefits of leveraged debt, from employee squeezing, from the sale to PE of companies at below-market value by incumbent executives seeking private benefits, and, last but not least, from aggressive cash withdrawals. For example, a coalition of PE firms bought Hertz for \$15 billion and paid themselves a dividend of \$1 billion six months later. Much of this money goes to pay the fees charged by PE principals, who can come out ahead even if a deal does not do well. Approximately 12% of PE investments are “quick flips” in which exit occurs in less than two years.⁹¹

The great irony is that pension plans in recent years were the largest source of capital for PE. SLPFs account for 26% of PE capital raised in 2006 and some of them have as much as 20% of their total assets invested in it. For underfunded SLPFs, PE’s high returns prior to 2008 were too tempting to ignore.⁹² UAPFs initially did not invest in PE because they associated it with layoffs and because many PE funds did not want to do business with them. In 1999, UAPFs had only 0.1 % of their assets in PE. At that point, labor-friendly investment managers began encouraging UAPFs to boost their PE holdings. Later the AFL-CIO issued guidelines advising UAPFs only to invest in PE funds that respect worker rights and are committed to preserving or expanding jobs. With this encouragement, and faced with underfunding of their own, the UAPFs turned to PE.

⁹⁰ *P&I*, Sept. 9, 2006; *WSJ*, March 3, 2003.

⁹¹ Patrick A. Gaughan, “How Private Equity and Hedge Funds Are Driving M&A,” *Journal of Corp. Acctg. and Finance* (2007); *Economist* Feb. 10, 2007; *Bus. Wk.* Feb. 10, 2007, Oct. 30, 2006; *Wash. Post* April 4, 2007; *WSJ*, July, 25, 2007; World Economic Forum, *Globalization*.

⁹² CalPERS used to earn 20% on its PE investments but the return rate sank in 2008 when PE funds, including large ones, suffered badly. One of them is the Carlyle Group, a controversial PE fund, 6% of which is owned by CalPERS. Carlyle’s main holdings are in the defense industry, where it is alleged to have profited from inside information about the planning of the Afghanistan and Iraq invasions. Other CalPERS investments also are controversial. In 1993 it placed \$250 million in Enron’s Joint Energy Development (JEDI) limited partnership. After selling the investment back to Enron (actually Chewco) for a large profit, CalPERS made a second investment in 1997 of \$156 million. These were the off-book entities that helped cause Enron’s collapse. *San Francisco Gate*, Dec. 2, 2001; *The Nation*, April 1, 2002; *San Francisco Chron.* March 21, 2004.

As a share of portfolio, however, UAPFs have invested less in PE and are more critical of it than the SLPFs. An association of SLPFs came out against a UAPF proposal to raise taxes on PE, although it later withdrew its opposition.⁹³

PE's first critics were transnational and European unions, especially in Britain, the largest PE market in Europe. One of labor's bête noires is Permira, Europe's largest PE fund. After Permira purchased a British company in 2004, it laid off 3,500 workers and cut vacation time for survivors. Elsewhere, Permira announced a plant closure one month after buying the parent firm. Another target is KKR, from which British unions extracted a pledge to add jobs after KKR bought Boots, the pharmacy chain. A recent TUC report to the government charges that PE funds exacerbate inequality and threaten long-term growth. It urges an end to PE's tax advantages and seeks measures to protect employees after buyouts.⁹⁴

One reason that the U.S. labor movement was slow to criticize PE is that some unionized workers are the beneficiaries of PE investments. There is a part of the PE industry specializing in buyouts of unionized firms in troubled industries such as auto parts, coal, steel, and textiles. The best known investor here is Wilbur L. Ross, a wealthy billionaire and donor to the Democratic Party. Ross's firm makes its buyouts profitable with help from taxpayers. After an acquisition, it will declare bankruptcy, terminate the union's pension plan, and shift pension liabilities to the federal government. Job cuts are obtained by offering severance bonuses to dismissed workers; survivors are offered profitsharing. Says Ross, "We found that if you approach with a realistic request -- in that you are not cutting them [union members] just so management can live in the lap of luxury - and if you have a quid pro quo so that they can share in the profits, you get along reasonably well." In steel, the unions were successful in striking these deals; in coal, where unions are weaker, deals were harder to come by.⁹⁵

⁹³ *P&I* May 4, 1998, Dec. 25, 2000, Sept. 29, 2003, Aug. 21, 2006; Dec. 11, 2006; *WSJ*, Feb. 28, 2007, Aug. 27, 2007. *Buyouts* Aug. 2, 1999; 5-3-99; *Bloomberg News*, Sept. 5, 2007; AFL-CIO, "Investment Product Review: Private Capital," (2002); *Bus. Wk.* Oct. 30, 2006; *Economist* Feb. 10, 2007; *Fin. Times*, Aug. 28, 2006; *Bus. Wk.*, Sept. 17, 2007. State pension plans in 2006 held 4.4 % of their assets in private equity, a 25% increase since 2001. Wilshire Consulting, "Report on State Retirement Systems," (2007).

⁹⁴ *Daily Teleg.* Feb. 27, 2007; *The Guardian* March 27, 2007; *P&I* May 14, 2007; TUC, "Private Equity: TUC Evidence to the Treasury Committee Inquiry," (May 2007).

⁹⁵ *NYT* Sept. 18, 2005; *Wash. Post* June 10, 2007; *IHT* May 15, 2007; *Labor Notes*, June 2007.

Low-wage service workers are especially vulnerable during and after a PE buyout because they are easier to replace. One of the first American unions to launch a public campaign against PE was SEIU, whose members--actual and potential--come from this group. Blackstone, the largest PE fund, owns nearly 600 large office buildings whose janitors are or could be SEIU members; Cerberus and other PE funds are major players in the hotel industry; and Carlyle owns the nursing-home giant Manor Care, whose 60,000 employees the SEIU is seeking to organize. CTW uses a combination of tactics to put pressure on PE funds. It has organized street theater to personally embarrass PE executives and has released facts about PE funds that might hurt their public image, such as their heavy reliance on Chinese and Middle Eastern capital. SEIU has a website that tracks Blackstone's activities and it publishes reports on PE deals that involve labor squeezing, such as layoffs at Hertz and KB Toys. Many of these activities are, however, a bargaining tactic. Andy Stern, head of SEIU and of CTW, has approached the funds, notably KKR, and offered to call off his attacks on PE tax breaks if the funds agree to treat workers fairly, including neutrality during organizing drives.⁹⁶

The AFL-CIO's approach to PE is less tactical. After Blackstone announced its 2007 IPO, Rich Trumka filed two statements with the SEC criticizing the IPO as being motivated by tax evasion. The AFL-CIO also is working with its friends in Congress to regulate the industry. Barney Frank has held several hearings on PE and says that the funds are causing "gross imbalances." He notes that a recent buyout of Tommy Hilfiger led to the replacement of unionized janitors making \$19 per hour by nonunion workers earning \$8 per hour. Both the House and the Senate are considering bills to raise tax rates on PE principals and investors, which stand a good chance of being passed by the new Democratic Congress. Legislators and the labor movement hope to show an anxious middle class that they are forcing the rich to play by the rules; PE is an economic wedge issue.

The AFL-CIO has other reasons for speaking out. Before the 2008 meltdown, its Office of Investment presciently feared that some UAPFs were putting dangerously large

⁹⁶ World Economic Forum, *Globalization; Workforce Mgt.* May 7, 2007; *The Independent* April 2, 2007; SEIU, "Behind the Buyouts: Inside the World of Private Equity," April 2007; Andrew L. Stern to U.S. House, Committee on Financial Services, May 16, 2007; *Wash. Post* April 4, 2007; *Wash. Post*, 18 April 2008. The Chinese government recently purchased a \$3 billion stake in Blackstone.

amounts in PE. Said Damon Silvers, “What we are trying to do in this environment is to put some distance between the labor movement and the hunger of our funds for return.” A different and controversial approach is to have UAPFs--or union-affiliated financial entities, like Amalgamated Bank--become principals of, rather than investors in, PE funds, an approach being tried in Canada. ⁹⁷

The labor movement also has targeted hedge funds, which have assets of over \$1.5 trillion. The figure understates their influence because they are the single largest trader in the equity markets. The funds have broadened their hedging strategies from stocks and foreign exchange to riskier assets like subprime debt, an investment that has caused the demise of several giant hedge funds since 2007. Hedge funds today are also making corporate acquisitions, blurring the line between them and PE. Some are even going public. Late in 2007, Och-Ziff, a \$30 billion hedge fund, listed itself on the NYSE, making the firm’s founder a multi-billionaire. ⁹⁸

As with PE, hedge funds have attracted considerable pension-fund capital; SLPFs invest relatively more than UAPFs. After the giant hedge fund Amaranth collapsed, it was revealed that SLPFs had invested several hundred million dollars in it. At this point the AFL-CIO asked the Senate Banking Committee for new rules regarding hedge-fund transparency, trading tactics, and taxation. The following year Barney Frank offered a bill along these lines. Sensing a shift in the political winds after the recent financial meltdown, one influential Wall Street executive has proposed a plan that accepts some regulation of hedge funds, but the plan falls short of what Frank and the AFL-CIO have proposed. In the last days of the Bush presidency, the Treasury and the SEC were reluctant to ramp up regulation of hedge funds. Damon Silvers of the AFL-CIO characterized the Treasury’s post-crisis approach as “an attempt to weld together two contradictory ways of thinking. One is what Treasury has learned over the past year, and

⁹⁷ Richard L. Trumka to John White (SEC) and Andrew Donohue (SEC), May 15, 2007 and June 12, 2007; *NYT* May 17, 2007; *Inv. News* May 29, 2007; *Fin. News* May 28, 2007; *Wash. Post* April 4, 2007; Silvers interview; *NYT* Sept. 6, 2007. The AFL-CIO is demanding that the SEC classify publicly-held PE and hedge funds as investment companies, which means that they would face corporate, not partnership, tax rates, and asking Congress to tax a PE manager’s carried interest as ordinary income instead of capital gains.

⁹⁸ *NYT* Nov. 14, 2007. Hedge funds own 55% of Stelco, a unionized steel producer in Canada. Stelco’s CEO is a former associate of Wilbur Ross, causing the union to fear that the funds will cut jobs and pensions. *Toronto Star*, June 2, 2007.

the other is the pre-existing deregulatory agenda coming out of the business community.” Here too, the new administration and Congress are likely to favor stricter regulation. ⁹⁹

Conclusion

Today as in the past, conservatives proclaim that financial development is a free-market phenomenon unrelated to politics and best left free of them. Benefits of finance are touted; costs are ignored or portrayed as inevitable. The recurrence of financial crises, including the one that started in 2008, and of popular movements to restrain finance, suggest an opposite conclusion: that there *are* costs--inequality and volatility being two of them--and that they are neither trivial nor inevitable.

Sophisticated conservatives recognize a connection between finance and politics but it is the libertarian doctrine that financial development weakens the chokehold of vested interests such as unions, entrenched managers, and the state. In fact, as we have discussed, financial elites themselves are a vested interest. Financial markets flourish when elites can goad governments to favor finance, as was the case with the gold standard and the Federal Reserve system, and with post-1980 deregulation. Financiers not only are lobbyists; they also are norm entrepreneurs. To take one recent example, Wilbur Ross in 2006 funded a bipartisan group, the Committee on Capital Markets Regulations, which issued a highly publicized reports calling for “smarter” regulation, protective limits on financial litigation, and a rollback of Sarbanes-Oxley. One corporate law expert described the committee as “an escalation of the culture war against regulation.” And then the crisis hit. ¹⁰⁰

⁹⁹ Around the same time as Amaranth came another hedge-fund scandal--share lending--in which investors loan their shares to hedge funds seeking to throw a proxy contest in the direction of their bets. It emerged that CalPERS had earned \$130 million in a single year through this practice. *NYT* Aug. 24, 2007; Richard L. Trumka to Senators Richard C. Shelby and Paul Sarbanes, Senate Banking Committee, July 25, 2006; *WSJ* Jan. 26, 2007; *NYT* March 15, 2007; *L.A. Times* July 12, 2007; Henry T.C. Hu and Bernard Black, “The New Vote Buying,” 79 *USC L.R.* (2006); *NYT* April 15, 2008.

¹⁰⁰ Kaplan and Rauh, “Wall Street and Main Street”; Rajan and Zingales, *Saving Capitalism*; Marco Pagano and Paolo Volpin, “The Political Economy of Finance,” 17 *Oxford Review of Economic Policy* (2001); *NYT* Oct. 20, 2006, Dec. 1, 2006. The Committee is a blue-ribbon group whose roster includes prominent financiers, business leaders, and academics, such as R. Glenn Hubbard (Columbia), Hal C. Scott (Harvard), and Luigi Zingales (Chicago).

It is difficult not to feel a touch of schadenfreude for those who, over the past twenty years, have confidently asserted the virtues of deregulation and the irrelevance of government in an era of globalization. Now is not a good time for libertarians, who are backpedaling furiously as governments around the world take dramatic steps to rescue financial markets from their follies. It is unclear what will be the long-term consequences of the rescue effort. For now, at least, the deregulatory impulse in finance is spent. Even conservatives accept that the *quid pro quo* for government assistance is tighter scrutiny and more regulation. But already financiers are demanding that any new regulations be removed when the crisis has passed.

Conservatives portray financial markets as democratic; they help the masses, not only the elite. Financial regulation therefore has perverse effects, they say, harming less affluent households who are the beneficiaries of financial development: “The financial revolution is opening the gates of the aristocratic clubs to everyone...it puts the human being at the center of economic activity.” (Identical claims about finance’s democratizing effects were made in the 1920s.) An oft-cited example is the availability of credit for purchasing homes and smoothing consumption. Without doubt, a broad spectrum of households benefits from deeper credit markets, even from payday lending. However, the reality is that credit is not the great democratic leveler. Consumption inequality has risen, not fallen, since 1980. Housing credit has turned out to be a sham. Sub-median households face particular difficulties when their income shrinks due to job loss. The average high-school dropout facing unemployment has liquid assets worth only 5% of the income lost through unemployment--not much to borrow against--versus 124% for college graduates. For sub-median households, it is not credit but government safety nets such as unemployment insurance and food stamps that are their main resources for smoothing.¹⁰¹

Another benefit cited by conservatives is the spread of shareholding within the middle class, those straddling the median. Ostensibly it has made these households more

¹⁰¹ Albert O. Hirschman, *The Rhetoric of Reaction: Perversity, Futility, Jeopardy* (Cambridge, 1991); Adair Morse, “Payday Lenders: Heroes or Villains?” SSRN working paper 999408 (2007); Rajan and Zingales, “Great Reversals,” 92; Cowing, *Populists, Plungers*, 177-180; Claessens and Perotti, “Finance and Inequality”; Susan Dynarski and Jonathan Gruber, “Can Families Smooth Variable Earnings?” *Brookings*

affluent, tolerant of risk, and supportive of financial deregulation. A recent study uses cross-national data on shareholding by household quintiles and identifies nations in which the median household has a propensity to own shares. Because these nations--the U.K. and the U.S.--have in recent years had relatively unregulated financial markets, the authors infer that “the existence of a financially solid median class may be essential for democratic support for a market environment.” The problem is that the authors fail to examine the value of the middle quintile’s shareholdings relative to debt. In the U.S., the middle quintile owns shares--directly or indirectly via pension plans--worth \$7500, which account for 5% of its assets. Its debt, mostly from mortgages but also from credit cards, stands at \$74,000. Now take the average household from the top 1%. Its shares are worth \$3.3 million and account for 21% of its assets. Debt stands at \$566,000. So let’s compare: The median household has a debt/equity ratio of 9.9; the top 1% has a ratio of 0.17. One need not be an economist to predict who will be leery of unregulated finance and who will welcome its risks. Efforts to rectify the imbalance between finance’s costs and benefits are not “strange,” as conservatives allege, nor are they evidence of an anti-market conspiracy.¹⁰²

Conservatives assert that coordinated economies--where owners, executives, and workers cooperate in the pursuit of value creation--lack the discipline needed to sedulously pursue efficiency. Again the claim is a throwback, in this case to libertarian ideologues like Henry C. Simons of the University of Chicago, who criticized New Deal producerism as a “flagrant collusion between unions and employers.” Yet the empirical evidence does not support the claim that relational corporate governance sacrifices growth. Between 1960 and 1980, CMEs on average grew faster than the liberal economies. If the period is narrowed to 1980-2000, the edge goes to the liberal economies. But even during those years, some liberal economies (Australia and Canada)

Papers on Economic Activity (1997), 229-03; David Cutler and Lawrence Katz, “Macroeconomic Performance and the Disadvantaged,” *Brookings Papers on Economic Activity* (1991:2), 1-74.

¹⁰² Enrico C. Perotti and Ernst-Ludwig von Thadden, “The Political Economy of Corporate Control and Labor Rents,” 114 *Journal of Political Economy* (2006): 169; Mishel et al., *Working America*, 261; Rajan and Zingales, *Saving Capitalism*, 18. After 2001, subprime mortgages also were touted as a democratizing force that would bring homes within the reach of those who previously could not afford them.

grew less rapidly than some CMEs (Austria, Belgium, Finland, Norway, and the Netherlands).¹⁰³

The financial meltdown has affected the entire global economy. But its impact has been uneven: the greater was a nation's involvement in the shadow banking system, the more heavily it has been hit. Most affected are the U.S. and the U.K. The British are paying an enormous price for hitching their economic wagon to the financial services industry. Relatively less affected are the CMEs in Japan and continental Europe, as Angela Merkel likes to remind Gordon Brown. Perhaps these differences will generate more support for a stakeholder approach to corporate governance in the United States. There are efforts along these lines but as yet they are straws in the wind.¹⁰⁴

The conservatives' infatuation with finance has unintended (dare we say perverse?) effects. By causing a lopsided distribution of productivity gains, financial deregulation and shareholder primacy foster resistance to productivity improvements because employees think that the game is not worth the candle. Employee dissatisfaction and distrust in employers are at all-time highs. Moreover, financial development undermines public support for trade and financial openness. The direct effect is to raise employment risk so that individuals become wary of the additional risks associated with an open economy. While both types of risk can be mitigated with social insurance, efforts to strengthen America's sagging social nets are being undermined by finance-induced inequality. This is the indirect effect. Rising top-income shares permit the rich to separate from the commonweal and withdraw their support for public spending. In the past, social compacts offered public education and social insurance as cushions against the volatility

¹⁰³ Rajan and Zingales, *Saving Capitalism*, ch. 11; Henry C. Simons, "For a Free-Market Liberalism," *Univ. of Chicago L.R.* (1941): 206; Pontusson, *Inequality and Prosperity*, 5;

¹⁰⁴ A new realism is emerging in legal scholarship that challenges shareholder primacy and supports a more balanced approach. The neo-realists are at pains to point out that under law shareholders are not the corporation's sole residual claimants. They observe that corporations are cooperative teams rather than a nexus of arms-length contracts. To produce wealth, team members invest in firm-specific assets that are worthless if the firm goes bust. Hence all team members--not only shareholders--bear residual risk. With illiquid investments and low diversification, employees have strong incentives to monitor agents and may be best placed to do so. See, for example, Margaret Blair and Lynn Stout, "A Team Production Theory of Corporation Law," 85 *Va. L.R.* (1999); Lynn LoPucki, "The Myth of the Residual Owner," 82 *Wash. U. L.Q.* (2004).

of an open economy. In our more inegalitarian age, the compacts are providing less in return for openness than before.¹⁰⁵

The efforts of organized labor to reshape capital markets over the past twenty years have often been disappointing. There is a Janus-faced tendency among union-influenced pension funds to publicly embrace responsible investing while putting millions of dollars into socially retrograde investments. Then there is the problem of fissures in the labor movement: between the federations, between the federations and their unions, between SLPFs and UAPFs, and between local unions and their internationals. These splits--mostly about turf--hinder the coordination of labor's many separate pools of capital. As yet there is no coherent, strategic vision to guide the labor movement's activities in this realm.

Nevertheless, an opening for labor has been created by the financial crisis of 2008 and the subsequent election results. The middle class is worried about stagnant incomes and fearful of financial risk that has caused loss of homes, jobs, and retirement assets. Labor is the main group connecting the dots between those concerns and the casino capitalism that is our financial system. It's striking how quickly labor's pre-crisis ideas have moved from the periphery to the center of political discourse. And during the worst of the financial crisis it was the AFL-CIO and CTW who were among the loudest voices alleging incompetence and greed on the part of America's financial industry. Just as business leaders and laissez-faire were lionized in the 1920s and laughed at in the 1930s, so today we are witnessing a similar sort of delegitimation.

Labor has other allies besides a new Democratic Congress and a battered middle class. Corporate liberals like John Bogle and William Donaldson share labor's concern that financial short-termism has harmed the economy's growth prospects. And there is an entirely new and promising phenomenon: labor organizations around the developed world are cooperating more closely on capital-market issues: sharing ideas, coordinating their pension capital, and pressing for regulation at the national and transnational levels.

¹⁰⁵ Dani Rodrik, *Has Globalization Gone Too Far?* (Washington DC 1997): 62-63; Geoffrey Garrett and Deborah Mitchell, "Globalization, Government Spending, and Taxation in the OECD," 39 *European Journal of Political Research* (2001); Kenneth Scheve and Matthew Slaughter, "A New Deal for Globalization," *Foreign Affairs* (2007). Concerned about declining support for financial and trade openness, the Financial Service Forum, representing the nation's twenty largest financial institutions,

Both the AFL-CIO and CTW are participants in this effort and maintain close ties with sister labor federations and with the European Parliament. The International Trade Union Confederation--successor to the organization created after Bretton Woods--participated in the G-20 summit in November 2008, an unprecedented event.

The outcome of the contests between financial elites and these new coalitions is uncertain. The elites have enormous monetary resources for lobbying, public relations, and other activities. And, as the logic of regulatory capture predicts, they will strive harder than the average citizen to influence the course of current regulatory efforts.¹⁰⁶ But a successful re-regulatory coalition, as emerged during the New Deal, can neutralize the power of financial elites. It is happening now.

The present does not repeat the past but it rhymes. The *New York Times* in 2007 said that we were in the midst of a new Gilded Age and a new populism. The current financial crisis is putting government financial regulation back on the political agenda with a level of urgency not seen since the 1930s. Ironically, labor's engagement with financial markets before the crisis has put it in a leadership position during the crisis. Reports of its demise are indeed premature.¹⁰⁷ Today finance is the master. Will it once again become the servant? The outcome depends on the politics of the double movement.

issued a report urging the government to do more to reduce risk and inequality in U.S. labor markets. Peter Gosselin, *L.A. Times*, Aug. 20, 2007

¹⁰⁶ Daron Acemoglu and James Robinson, "Persistence of Power, Elites, and Institutions," 96 *AER* (March 2008). As during the Clinton years, donations by the financial services industry to Democrats in 2008 dwarfed contributions to the GOP. *LA Times*, 21 March 2008.

¹⁰⁷ *NYT* July 15, 2007, March 23, 2008; April 11, 2008.

Table 1. Financial Development and Inequality, 1913-1999

		Financial	Development		Inequality	
	Stock Capitalization	Market as GDP share	Gross Fixed Raised via	Capital Equity	Top 1%	Income Share
	<i>U.S. & U.K.</i>	<i>Eur. & Japan</i>	<i>U.S. & U.K.</i>	<i>Eur. & Japan</i>	<i>U.S. & U.K.</i>	<i>Eur. & Japan</i>
1913	.74 (.39)	.55	.09	.15	.19 (.18)	.19
1929	1.07 (.75)	.65	.37	.30	.19 (.20)	.16
1938	.85 (.56)	.64	.05	.27	.16 (.15)	.15
1950	.55 (.33)	.14	.06	.01	.11 (.12)	.10
1970	1.15 (.66)	.22	.04	.20	.08 (.08)	.09
1980	.42 (.46)	.16	.04	.02	.08 (.09)	.07
1999	1.89 (2.3)	1.32	.11	.21 [.08]	.16 (.18)	.08
1980/1929	.39 (.61)	.27	.11	.07	.39 (.45)	.46
1999/1980	4.5 (4.9)	8.3	2.8	10.5 [3.4]	2.1 (2.0)	1.1

Notes: The European nations and Japan include two using the French legal system (France and Netherlands), two using the Germanic system (Germany and Japan), and one following the Scandinavian system (Sweden). Figures in parentheses are for the U.S.; figures in brackets exclude the Netherlands.

Source: Financial data are from Rajan and Zingales, "Great Reversals," 13-15. Top share sources are as follows. U.K.: A.B. Atkinson, "Top Incomes in the U.K. over the 20th Century," 168 *J. of the Royal Stat. Soc.*, (2005); U.S.: Emmanuel Saez website, <http://elsa.berkeley.edu/~saez/>. France: Thomas Piketty, "Income Inequality in France, 1901-1998" CEPR Working Paper 2876 (2001). Germany: Fabien Dell, "Top Incomes in Germany and Switzerland over the 20th Century," 3 *Journal of the Eur. Econ. Assoc.* (2005). Netherlands: A.B. Atkinson and Wiemer Salverda, "Top Incomes in the Netherlands and the U.K. over the 20th Century," 3 *Journal of the Eur. Econ. Assoc.* (2005). Sweden: Jesper Roine and Daniel Waldenstrom, "Top Incomes in Sweden over the 20th Century," Stockholm School of Economics, working paper 602 (2005). Japan: Chiaki Moriguchi and Emmanuel Saez, "The Evolution of Income Concentration in Japan, 1886-2005," working paper, Northwestern University (2007). Data do not include capital gains.

Table 2: Distribution of Net Value Added in Large European Corporations, 1991-1994

	Labor	Capital	Government	Retained Earnings	Dividends
Anglo-Saxon	62.2	23.5	14.3	3.2	15.0
Germanic	86.1	8.8	5.1	5.2	3.0
Latinic	80.3	14.4	5.3	3.0	4.7
Average	79.0	13.7	7.3	3.6	6.1

Note: Dividends and retained earnings do not equal the capital share because net interest payments and third-party shares are not included. Source: Henk Wouter De Jong, "The Governance Structure and Performance of Large European Corporations," 1 *Journal of Management and Governance* (1997).