The Anglo-Saxon market for corporate control, the financial system and international competitiveness: notes for the Notre Dame conference on "strengthening U.S. competitiveness"

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I.Introduction

The last decade has witnessed a growing debate on both sides of the Atlantic on the effectiveness of the stock market based financial systems of the U.S. and the U.K. for promoting international competitiveness and industrial strength. The two countries share a broadly common framework of corporate law and possess the most advanced and complete stock markets in the world. As far as the corporate sector is concerned, in both countries, the financial system is more or less similar, being dominated by the stock market and a vigorously functioning market for corporate control. In principle, the latter is supposed to constitute an important additional mechanism by means of which the stock market can discipline firms and promote corporate efficiency. However, an increasing number of industrialists as well as academic economists argue that the Anglo-Saxon financial system is inferior to that of Japan and Germany and puts the former countries at a competitive disadvantage.

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There is, of course, a long history of dissatisfaction in both countries with the financial system in general and the stock market in particular, but these criticisms have usually come from a minority of heterodox economists. Significantly, in the U.S., the activities on the stock market have also often attracted popular suspicion and populist reaction. In the 1930s, the populist sentiment linked the stock market to the Great Depression. This led to the creation of the Securities and Exchange Commission, the passage of the Glass-Steagall Act and other measures to regulate the financial system. In the U.K., academic critics have long argued that the financial system was in part responsible for the low rate of investment of the economy; specifically, it is suggested that the system facilitated investment abroad of domestic savings at the expense of investment at home to the detriment of the domestic economy. However, the financial establishment as well as the mainstream of the economics profession has traditionally maintained that the low rate of investment in the economy has not been due to the availability of finance but rather the lack of investment opportunities; that investment abroad has simply been due to the fact that the risk adjusted rates of return on foreign investment have been greater than on home investment[2].

However, today far-reaching criticisms of the Anglo-Saxon financial system come from the heart of the establishment itself. Thus, Michael Porter, reporting recently on the results of a large research project on various aspects of the U.S. financial system: "..the change in nature of competition and the increasing pressure of globalization make investment the most critical determinant of competitive advantage. ... Yet the U.S. system of allocating investment capital both within and across companies is failing. This puts American companies at a serious disadvantage in global competition and ultimately threatens the long term growth of the U.S. economy."[3]

One cannot help noticing a certain irony in the fact that this scepticism about the virtues of the stock market is manifesting itself in the very citadels of these markets at a time when Third World countries are falling over themselves to establish and to encourage such markets in order to promote economic development. Existing stock markets are being further developed or new ones being established from Kingston, Jamaica, to Ulan Bator, in Outer Mongolia. More significantly, stock markets have been embraced by socialist China. In India, which now has more companies listed on

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[2] See, for example, Feinstein [1992]; Wilson [1978]; Ball [1991].

[3] Porter [1992a, p.65]. This paper reports the findings of a large research project sponsored by the Harvard Business School and the Council on Competitiveness, a project that included 18 research papers by 25 academic experts.

the stock market (6,000 companies) than almost any other country, most leading cities already possess or are about to establish their own stock exchanges[4].

In these notes for the Notre Dame conference, I shall concentrate on the role of the market for corporate control in the Anglo-Saxon financial systems and its relationship to issues of international competitiveness. These links are far from being obvious and some are quite controversial.

In the accompanying paper [Singh, 1992a], which was written for a somewhat different purpose, I have analyzed various aspects of the market for corporate control in the two countries. In particular, I have examined the diametrically opposite conclusions and analyses concerning the virtues of such a market, of industrial organization economists (see, for example, Scherer, 1988) on the one hand, and of specialists in finance on the other (see, for example, Jensen, 1988, 1989). Much of that discussion bears directly on the present subject. I shall refer to and build on that analysis in the following paragraphs.

II.The Stock Market, the Market for Corporate Control and International Competitiveness; the Causal Links

1.It is a striking fact that the rate of investment both in the U.S. and the U.K. has been appreciably less than in Japan and West Germany. On one estimate, manufacturing capacity in the U.S. increased by only 2.75% per annum in the 1980s, compared with 3.5% in the previous 15 years. Net investment fell from an average of 7% of GNP in the 1970s to 5% in the 1980s - the lowest rate in any of the big industrial economies other than the U.K. In the U.K. case, it is estimated that if investment as a proportion of national expenditure had been the same in that country as in West Germany, in almost every year in the 1970s and the 1980s, investment would have been 12 to 20 billion pounds higher (at 1989 prices) [Cosh, Hughes and Singh, 1990]. Moreover, in the second half of the 1980s, which saw an unprecedented wave of corporate takeovers (Singh, 1992b), privately funded R&D spending in the U.K. fell to a lower level than in the other major economies.

2.Both the U.S. and the U.K. are running sizeable current account and trade deficits, even at their

[4]For a discussion of the role of the stock market in socialist countries and in economic development, see Singh [1989] and Singh [1990], and Singh [1993, forthcoming].

present high rates of unemployment. The causal link between this phenomenon and a low rate of investment is quite straight forward and generally accepted. In a world of imperfect non-price competition in manufacturing products, economies with high rates of investment, other things being equal, are also likely to have higher rates of technical progress, new product development, etc, which, in turn, will enhance their international competitiveness.

3.However, the causal connections between lower rates of overall or long term investment and the stock market are much more controversial. The case of the critics of the Anglo-Saxon financial system runs along the following lines. At the simplest level, the argument is that the existence of a highly active market for corporate control, with its hostile takeovers and leveraged buy-outs obliges the U.S. and the U.K. managers to pay close attention to their earnings per share performances every quarter or every six months. This forces them to become "short-termist" in their outlook and to sacrifice long term useful investments at the altar of short term earnings.

4.At a more sophisticated level, the literature now contains several alternative and mutually reinforcing formulations of the short-termist position.

(a)*Myopic markets*. This was the original argument of Keynes in chapter 12 of the General Theory. Keynes complained that "day-to-day fluctuations in the profits of existing investments, which are obviously of an ephemeral and non-significant character, tend to have an altogether excessive, and even absurd, influence on the market". On this analysis, which clearly implicitly rejects the "efficient market" hypothesis of share price determination, the stock market induces short-termism even if there is no market for corporate control or even in the absence of fickle institutional fund managers. Neither corporate takeovers, nor institutional investment were important elements in the functioning of the stock market at the times Keynes was writing. The Keynesian argument has been formalized in recent theoretical contributions[5].

(b)*Myopic managers*. In important contributions, Stein [1988, 1989] has established that even if the stock market was rational, it could be an optimal strategy for managers to be

[5]See, for example, Shleifer and Vishny [1990]. See also Shleifer and Summers [1990] and the papers by Dcarf and Shiller, both published in Coffee [1987.

myopic and undertake short rather than long term value-maximizing projects. The argument rests on assuming imperfect and asymmetric information between shareholders and managers, the use of current earnings by managers to "signal" future prospects of the firm and the notion that there is "signal jamming", as it pays any manager not to provide accurate signalling information and to inflate the corporation's current earnings. The threat of takeovers is an integral part of this analysis as it implicitly assumes that, ceteris paribus, the lower the share price of a firm, the greater its likelihood of being taken over.

At a much simpler level, managerial myopia can also arise from inappropriate incentive structures for the managers - for example, one which implicitly or explicitly links managerial compensation to short term performance measures.

(c) *The role of the institutional investors.* Increasingly corporate share ownership in the U.S. and the U.K. is being concentrated in financial institutions, particularly the pension funds and insurance companies. In the U.K., these institutions own almost three quarters of the shares of the companies quoted on the stock market. [Cosh, Hughes, Lee and Singh, 1989]. In the U.S. the corresponding figure is nearly 60%. [Ghilarducci, 1992]. In principle, with typical long term liabilities, institutional share ownership should lead to long term value maximization and to patient capital. In practice, it is suggested that because of the particular structural features of institutional fund management, the opposite situation prevails. Fund management is a highly competitive industry and increasingly the performance of fund managers themselves is assessed on the basis of short term results. This leads to high share turnover, acceptance of takeover bids on the basis of short term financial gain rather than long term industrial logic.[6] The latter behavioral pattern is also connected with the phenomenon of "asymmetric payoff". It is pointed out that there are sound reasons for fund managers to display a "herd" instinct: if a fund manager who does not follow the "herd" turns out to be wrong in his investment policies when the herd is right, he or she may be subject to severe penalties. Thus faced with the prospect of an immediate stock market gain from a "takeover situation", the fund managers are more likely to accept it than not.

[6]For a fuller discussion of this argument, see Cosh, Hughes and Singh, 1990.

(d) *Contrast with the German and Japanese Financial Systems*. A very important part of the argument of the critics of the Anglo-Saxon financial system rests on its contrast with the financial systems in Germany and Japan. In the latter two countries, for a number of legal and institutional reasons, the stock market has relatively little influence on the performance and the behaviour of industrial companies. The following differences between these financial systems are particularly important in the context of the present discussion.

First, in sharp contrast to the situation in the U.S. and the U.K., there are hardly any hostile takeovers in Japan or West Germany. The main reason for this phenomenon is that compared with Anglo-Saxon countries, the Japanese or the German shareholders have far less effective power than other "stakeholder" in the corporation, for example, the corporation's workers, suppliers and customers. In West Germany, the right of workers in large companies to be consulted over important investment and employment decisions is institutionalized through the 1976 Co-determination Act and by the employee representation on the corporate supervisory boards. This system of corporate governance is a major barrier to hostile takeovers in Germany; it is reinforced by other features of the system outlined below. Similarly, in Japan, in addition to other aspects, Odagiri and Hase [1989] suggest that the system of lifetime employment in large companies plays an important role in deterring involuntary takeover bids.

The second important feature of the German and Japanese systems is the concentration of corporate shareownership in a relatively small number of "safe" hands. In Japan, for example, in a typical large corporation, almost three quarters of the shares are likely to be held by its suppliers, customers and banks. There is similar complex cross-holdings of shares in Germany.

Thirdly, in relation to Germany, Hart [1992] notes that there are only 545 large German companies with a stock exchange quotation (plus 94 in the unlisted securities market). There is, however, an active trading in shares of a small handful of these companies, about 30 or so. These are probably the only large companies where majorities of voting shares are not controlled by a parent company, families or other institutions (particularly banks) closely linked to incumbent management. In the case of Japan, Dore [1985] argues that not only is the stock market viewed with suspicion by the general public, it also has rather inferior social status. It is the real wealth creating corporate sector or the government which attracts the best talent rather than the stock market.

For all these and other reasons, it is argued that the bank based German and Japanese financial systems are more conducive to long term investment not only in plant and equipment, but more importantly in training and in firm-specific, often intangible, human capital. In the case of the U.S., Shleifer and Summers [1988] had suggested that the microeconomic private efficiency gains from takeovers, even to the extent that they exist (see further below), may greatly overstate the social benefit. Increased post-takeover profitability may not represent a genuine improvement in social efficiency, as it may simply be a transfer of resources from one group of "stake-holders" (for example, employees) in the firm to another, i.e., the shareholders. Shleifer et al. went on to suggest that such transfers, which takeovers, for various institutional reasons, facilitate, may be socially harmful, in that they involve a breach of trust, and the breaking of implicit contracts, between managers and workers. It is on the basis of trust and these associated implicit contracts that workers undertake firm-specific training which leads to greater productivity and thus benefits both the firm and the economy. However, as Jenkinson and Mayer [1992] rightly note, that it is not so much that hostile takeovers lead to a breach of implicit contracts, but that under this system such contracts are unlikely to emerge at all.

III.The Anglo-Saxon Financial System: the Case for the Defense

Against the above indictment, the following broad arguments can be made in defense of the system.

1.First, there is a prior argument. Is there an Anglo-Saxon competitive problem at all which needs to be addressed? As the table below shows that during the period 1973 to 1990, U.S. manufacturing production increased at a faster rate than in Germany or in the E.E.C. as a whole, excluding Germany. True, Japanese manufacturing production grew more rapidly than that of the U.S. in the post 1973 period, but even here compared with the previous experience (1950-73), the gap has narrowed very considerably. Similarly, the rate of growth of manufacturing productivity in the U.S. is now more or less the same as in the West European countries and there is a much smaller handicap with respect to Japan compared with the situation before.

Manufacturing Performance
in U.S., Japan and EEC, 1950-90
(Annual Growth Rates)

	Output			*Output per Worker*		
	66/50	*73/66*	*90/73*	*66/50*	*73/66*	*90/73*
US	4.5	3.2	2.4	3.0	2.6	2.5
Japan	14.8	14.4	5.5	8.7	11.1	5.3
Germany	7.8	5.3	1.6	4.2	5.1	2.4
EEC, ex. Germany	5.0	6.0	1.7	3.3	5.9	2.8

Source: Rowthorn [1992], Table 3.

The comparative performance of U.K. manufacturing has also greatly improved in the 1980s compared with the position in the 1960s and 70s. O'Mahony [1992] and Prais [1990] report that in the early 1980s, the level of manufacturing productivity in West Germany was 33% greater than that in the U.K. - the gap being considerably larger in, say, the mid-1960s. However, by 1987, the difference in the levels of manufacturing productivity in the two countries had been reduced to 22%. Today in the light of the problems of German re-unification, the German advantage will be even smaller.

2.Hatsopoulos, Krugman and Summers [1988] forcefully argue that the problems of low U.S. investment and short time horizons of U.S. corporations stem essentially from the fact that the cost of capital in the U.S. is higher than in Japan and in other competitor countries. However, they ascribed this phenomenon entirely to macroeconomic causes, specifically the much lower rate of U.S. savings compared with, for example, Japan. Between 1981 and 1985, the U.S. national savings as a proportion of GNP averaged only 3.2%; the corresponding figure for Japan for that period was 10.6%.

On this argument, then, the problems of short-termism and low rate of investment in the U.S. have little to do with myopic markets, or myopic managers, or with impatient institutional investors and other failings of the U.S. financial system. Rather, Hatsopoulos et al. suggest: "The short-term focus of American managers ... is a rational response to their market situation. If anything, the evidence from takeovers and market valuations suggests that American managers take a longer view than it is in the best interests of their stockholders. The appropriate strategy for lengthening business planning horizons and encouraging long-term investments is not to criticize corporate cultures but to change the market incentives that shape them. ... it is important to emphasize the role of the macroeconomic environment, of which the cost of capital is a key feature, in our competitive performance." [p.303]

3.Michael Jensen, in a number of influential contributions [see, for example, Jensen 1988, 1989] has robustly defended the merits of the market for corporate control in the U.S.. He writes: "The market for corporate control is creating large benefits for shareholders and for the economy as a whole by loosening control over vast amounts of resources and enabling them to move more quickly to their highest-valued use. This is a healthy market in operation, on both the takeover side and the divestiture side, and it is playing an important role in helping the American economy adjust to major changes in competition and regulation of the past decade." [Jensen, 1988, p. 23]

Specifically, Jensen suggests that gains from takeovers in the U.S. amount historically to 8 percent of the total value of both companies. In his view, these value gains represent "gains to economic efficiency, not redistribution between various parties". He commends the activities of takeover specialists such as T. Boon Pickens, as benefiting shareholders and, hence, the society. He rejects the myopic markets hypothesis on a number of different analytical and empirical grounds. He appeals to an empirical study by the Office of the Chief Economist of the SEC (carried out in 1985) to suggest that takeovers do not discourage R&D spending.

For good measure, Jensen [1989] asserts that unless the Japanese establish for themselves a market for corporate control of the kind which exists in the U.S. the Japanese corporation will become bureaucratic and inefficient and lose their competitive edge in the world markets.

IV.The Case for the Defense: A Critical Analysis

We shall briefly analyze each of the above points in turn below.

1.First, on the question of improved Anglo-Saxon comparative industrial performance in the 1980s, two points may be made. One, as noted earlier, both countries continue to run large current and trade deficits, despite the fact that they have very high rates of unemployment. In the U.K. case, there is little evidence of any structural change during the last decade either in the country's relatively high long term propensity to import manufactures, or in the world income elasticity of demand for U.K. manufactured exports. The problems of U.K. deindustrialization can be traced essentially to these adverse import and export elasticities. The undoubted improvement in the comparative record of growth of manufacturing productivity in the U.K. during the last decade has not helped to alter these critical structural variables. As a consequence it is estimated that as North Sea oil revenues dwindle in the 1990s, the country will only be able to maintain a current account balance at double digit rates of unemployment.[7]

Two, in relation to the U.K. economy, it has been observed that its *comparative* performance improves when the world economy is growing slowly, and deteriorates when the latter is growing fast. This stylized fact is interpreted to suggest that the U.K. economy is usually supply constrained whilst those of competitor countries tend to be demand constrained. [Feinstein, Matthews and Odling-Smme, XXX]. Thus, the comparative improvement in the U.K. industrial record in the 1980s reflects more a deterioration in the performance of other countries than a genuine betterment of the country's industrial economy. [Michie, 1992]

2.On the issue of short-termism being primarily a macroeconomic phenomenon, caused by high cost of capital arising from a lower U.S. savings rate, the following points are in order. Firstly, even if one were to accept the proposition that high cost of capital leads to short-termism, it does not imply that it is not caused by other factors as well. Myopic managers or myopic markets, etc., may reinforce the effect of the cost of capital.

Secondly, turning to the cost of capital itself, is it really entirely a macroeconomic phenomenon? Surely, it is influenced by microeconomic as well as institutional factors. For example, for a given savings rate in an economy, the cost of capital to the corporate sector is likely to be higher the more variable and unstable the economic performance. This line of reasoning

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[7]There is a large literature on this subject. See Singh [1977, 1987]; Coutts, Godley and Rowthorn [1988]; Coutts and Godley [1990]. For a different perspective, see Ball [1990]. For response to Ball, see Singh [1989].

provides an important link between the micro and macroeconomic variables. For, if as a result of myopic stock markets, managers do not invest enough in training or other forms of long term investment, it will make the economy less internationally competitive, and therefore more subject to stop-go syndrome and hence more unstable at the macroeconomic level.

Similarly, it has been rightly emphasized that, even with the same savings rate, the cost of capital in the corporate sector in Japan and Germany would be lower than in the Anglo-Saxon countries because of the particular institutional arrangements for the provision of corporate finance in the former countries. As the banks in Germany and Japan have close relationships with the corporations, and they closely monitor corporate performance, the problem of asymmetric information is greatly attenuated. Other things being equal, this should lead to a lower cost of outside finance. [Singh an Hamid, 1992].

3.Turning to Michael Jensen's favourable analysis of the role of takeovers, the accompanying paper [Singh, 1992a] contains a detailed examination of his various propositions. Very briefly, in principle, the takeover mechanism can promote economic efficiency through two distinct channels: (a) the *threat* of takeovers, operating via the market for corporate control, may discipline firms which are not making the best use of the resources under their command; and (b) even if the firms were operating efficiently, the *actual* takeovers and mergers themselves may lead to a reorganisation and restructuring of an economy's resources and thereby enhance their social value. Research during the last two decades has shown that there are a number of important reasons (imperfections in the capital market, the free-rider problems, transaction costs, etc.) why neither of these channels may work effectively in the real world. More importantly, empirical studies show that contrary to Jensen and the folklore of capitalism, takeovers do not simply punish the inefficient and the unprofitable, and select for survival companies which best enhance shareholder wealth. These studies unequivocally conclude that although takeover selection does take place to a limited degree on the basis of profitability or stock market valuation, it also importantly does so in terms of size. Thus in the market for corporate control a large unprofitable corporation has a much higher chance of survival than a small relatively much more profitable company. As a consequence, the *threat* of takeover instead of forcing firms to improve their profitability, may in fact encourage them to further increase their size. This "perverse" result of the takeover mechanism may be compounded by the takeover mechanism itself since it may enable relatively inefficient large firms to grow larger still by taking over more efficient smaller firms.[8]

Further, for detailed reasons given in the accompanying paper, Jensen's assertion that the substantial bid premia paid for taken over firms constitute "gains in economic efficiency" simply cannot be accepted. His view rests on the assumption that share prices in the real world are always efficient in the fundamental valuation sense of Tobin. If this assumption is not accepted - and there are powerful analytical and empirical grounds for not doing so - the big premia can be interpreted in a rather different way. Charkham [1989] has put forward a dual valuation view of stock market pricing of the takeover victims, which provides a more plausible interpretation of the observed facts. In this conception there is a normal day-to-day valuation of the company's shares, based on its expected earnings and reflecting valuation at the margin. However, there is a higher alternative valuation when the company is put into "play" and is subject to a takeover bid; this reflects the price to be paid for buying the intramarginal shareholders in order to gain control of the company [Shleifer, 1986]. If the raiders are empire-building managers they may be willing to offer a large premium for control, especially as they are paying with money which is not their own.

V.Conclusion and Proposals for Reform

1.It has been argued here that the market for corporate control today provides an important link in the chain of causation connecting the Anglo-Saxon financial system with short termist corporate culture, low investment in long term projects (particularly training and firm-specific human capital) and hence diminished international competitiveness. The supposed benefits which orthodox economic analysis ascribes to the market for corporate control do not materialize in practice. Evidence indicates that the operations of the market not only do not enhance efficiency, but the results of the takeover process may be perverse in a number of ways.

As a disciplinary device, the takeover mechanism is shown to have serious shortcomings, particularly as far as the very large firms are concerned. And further, with respect to the workings of the

[8] There is a large literature on the subject for both the U.S. and the U.K.. For the U.K. see Singh [1971, 1975], Meeks [1977], Cosh, Hughes and Singh [1980], Cosh, Hughes, Lee and Singh [1989], Hughes [1991]. For the U.S., see Mueller [1980], Schwarz [1982], Warshawsky [1987], Ravenscraft and Scherer [1987]. For a recent review of this literature, see Singh [1992b].

takeover selection process, it is not at all clear that the managements which are selected for survival are necessariliy the better managements from the point of view of creating real wealth, rather than simply being more skilled at financial engineering.

2.Available research does not allow us to assess the relative quantitative significance of short-termism and that of a whole host of other factors (e.g., the English class system, labor management relations) which may be responsible for the international competitive disadvantage of the Anglo-Saxon countries. However, what is quite clear from a number of surveys carried out both in the U.S. and the U.K. is that corporate leaders in both countries believe that the Anglosaxon financial system puts them at a competitieve disadvantage with respect to their counterparts in Germany and Japan[9]. Hart [1992, p.2] notes in relation to the U.K. "that even if there is no conclusive evidence that City financial institution are biased against companies with long-term research programmes, industrialists think that they are and opt for short-term results to protect their share price. This belief may be wrong, but it is very powerful nevertheless".

3.Although in the city-industry divide each side blames the other for short-termism, I agree with Michael Porter that the problem is a systemic one. The Anglo-Saxon corporate executives and institutional fund managers are both faced with a market environment and an incentive system which leaves them with little room for manoeuvre, except to give primary importance to short-term financial gain. Instead of a system which places a premium on launching and resisting takeover bids and on skills in financial engineering, the Japanese and German financial systems provide the corporate executives with a rather different set of incentives.The latter favour organic growth and corporate investment which are directly beneficial to the economy.

4.There is a whole plethora of proposals both in the U.S. and the U.K. for reforming the system. These are usually piece-meal proposals directed at one aspect or the other of the system - for example, the regulation of takeovers, the structure of corporate law or the fiscal status of the shareholders, etc.. However, they do not view the system as a whole. Michael Porter's recent work does provide recommendations which consciously address the systemic problems of the U.S. financial and industrial systems.

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[9]See Hart [1992] for the U.K., and Porter [1992] for the U.S..

Since it is not practical to reform everything at the same time, the first important issue in reforming an inter-dependent and complex system is to identify the causal link and the area where the reform effort should be concentrated. The centre piece of Porter's proposals is his "long-term equity investment incentive". Broadly, this entails an incentive for holding shares in manufacturing corporations for a minimum of five-year holding period, with greater incentives provided for even longer holdings. The incentives would be applied prospectively to new investments. Porter [1992b, p.152] believes that this is the "single most powerful tool for changing the U.S. system". He argues that "if investors have a reason to hold shares for five years or more, the whole approach for investing in America would change". The market players would then be interested in the long term prospects of the company rather than in the "current game of predicting near-term share price movements".

5.My own proposal for reform would concentrate on a different part of the system - the nature and extent of property rights of shareholders of large corporations. In the Anglo-Saxon system of corporate law, the property rights for buying and selling corporations lie entirely with the shareholders of the corporation. Is it desirable or economically efficient that the right to dispose off the whole corporation should solely be the prerogative of the mostly absentee shareholders of the company without reference to any of the other interested parties (e.g., the workers)?

Whether or not it is otherwise desirable, I believe it will be economically efficient for serious restrictions to be placed on the existing property rights of shareholders in the large U.S. corporations. Specifically I would propose that long term employees of the corporation, as well as the broader community where the corporation is located, should have a legally recognized voice - but not necessarily a decisive one - in major corporate decisions such as takeover of the corporation as a whole or a divesture of a large part of its assets. This will not only help reduce the incidence of takeovers for short term considerations, but depending on the institutional form in which this proposal is implemented (see below), it should also lead to better labor management relations.

On the face of it, changing property rights and the basic structure of corporate law may appear to be a radical proposal, which may strike terror in the heart of the capitalists. But in fact we find that capitalists outside U.S. and U.K. have no difficulty in accepting some restrictons on property rights to meet a broader social purpose. The German system of corporate governance, with its two-tier boards, entails important restrictions on property rights of the owners. Yet the German corporate excutives seem quite content with it and the system works with conspicuous efficiency.So one way of implementing the proposal I have outlined above would be to instiute in the U.S. and the U.K. a suitable variant of the German type system of corporate governance - i.e., one in which half of the corporation's upper level supervisory board consists of representatives of the employees. If newspaper reports are to be believed (see *Independent*, London, 9 January, 1993), the new U.S. Labor Secretary Robert Reich is contemplating the establishement of such a system in the U.S.. More power to his elbow!

The two-tier board is of course not he only way in which workers can be given statutory right to be consulted on important corporate decisions. The longer version of this paper will contain a fuller elaboration of these ideas. Finally, I note that a proposal of the kind I have outlined above was put forward by Keynes as long ago as 1927 as a part of the manifesto for the U.K. Liberal Party.

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