"Fiduciary Capitalism," the "Political Model of Corporate Governance," and the Prospect of Stakeholder Capitalism in the United States

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Abstract

As progressive pension reforms seek to increase the opportunities for stakeholder involvement, they confront an existing set of class relations that by design exclude workers, retirees, and the state from real economic participation. This article argues that pension reforms must explicitly recognize the class underpinnings that jeopardize their success; proposes a workable, class-sensitive orientation for pension reforms; and includes the legislative context for governance reforms.

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1. Introduction

As early as 1880, Karl Marx asked skeptically, "Do you know of any cases when the workers have benefited from the so-called pension schemes, which are controlled by the employers, but the initial capital of which is deducted beforehand from the workers' wages?"[1] The current relationship between pensions and labor in the United States warrants

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1. The question is one of one hundred listed in "A Workers' Inquiry," written by Karl Marx but published anonymously. It was first published in *La Revue Socialiste* on April 20, 1880. Marx's authorship "was established from his letter to Sorge of November 5, 1880" (Marx and Engels 1989: 636). A complete version of "A

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similar scrutiny.[2] A recent example of a poor relationship between pensions and labor is the Enron collapse, which resulted in significant losses for many of Enron's employees. Even more troubling, however, is the fact that labor faces adversity even as pension values soar. In 1973, the total financial assets of private pensions and federal, state, and local government employee retirement funds was $264.5 billion; in 2000, the total was $6,805 billion.[3] In real terms, the mean annual rate of increase in the total level of these funds over the period was 8 percent.[4] In 1973, the ratio of total private pension fund financial assets and government employee retirement funds to the level of gross domestic product was 19 percent, and in 2000 it was almost 69 percent. Therefore, pensions experienced both impressive absolute growth and growth relative to GDP.

Unfortunately, the growth in labor's real compensation was far less impressive. From 1973 to 2000, the average yearly percentage change in real compensation per hour was a mere 0.963 percent, while real output per hour increased on average during the period by 1.585 percent per year.[5] Such disparities between wage and productivity growth have led Mishel, Bernstein, and Schmitt (2001: 151) to the conclusion that "the 'average' worker is not benefiting fully from productivity growth." Furthermore, during the 1980s and 1990s, CEO compensation rose dramatically relative to average worker pay. Specifically, in 1978 the ratio of CEO compensation to average worker pay was 28:5, and in 1999 the ratio increased to 106:9 (ibid.: 211). At the same time, families worked more hours, from 1,745 hours on average in 1979 to 1,898 hours in 1998. All the while, the percentage of workers covered by private health insurance fell from 70.2 in 1979 to 62.9 percent in 1998 (ibid.: 115, 140). Finally, from 1980 to 1998 as pension assets have grown in real terms, "the average real pension benefit has declined by one-third. Coverage has stagnated, and the importance of pension income as a source of retirement income has fallen by 2 percentage points" (Ghilarducci 2001: 159). The facts are worrisome; the impressive growth of labor's pension capital has not been accompanied by a prolonged period of significant gains in many traditional measures of labor well-being such as real wage gains in accordance with productivity gains, expanded employer-supplied health care coverage, and increased pension benefits.[6] Particularly among progressive economists, these realizations have prompted a wave of interest in reassessing the role of pension capital in the economy.

Workers' Inquiry" that contains the quoted question in the text can be found on the Marx and Engels Internet Archive at http://www.marxists.org/archive/marx/works/1880/04/20.htm (accessed December 2001). "A Workers' Inquiry" represented the first "serious attempt to form an opinion of the condition of the French working class" (Marx and Engels 1989: 636). It served as the basis for surveys published in Polish, Italian, Dutch, and English.

2. For example, pensions are often treated today as deferred wages or deferred compensation. Ghilarducci (1992) exposes some of the theoretical and legislative reasons for pensions to be considered a deferred form of wages. For an extensive account of the evolution of pensions from a gratis payment to a deferred form of compensation, see Schuller (1985, chap. 5).

3. Board of Governors of the Federal Reserve System (2001, Tables L.119 and L.120: 68).

4. Calculations based on the GDP implicit price deflator supplied by the *Economic Report of the President* (2002, Table B-3), and include principal contributions and the returns on contributions.

5. Averages calculated from data supplied by the *Economic Report of the President* (2002), Table B-49.

6. Mishel, Bernstein, and Schmidt (2001) do find some gains for labor since 1995, such as increases in the percentage of workers covered by employer-provided health insurance, but these gains were not sufficient to produce overall net gains for labor since 1979.

Progressive economists have proposed various ways to empower labor via new directions in pension management. One of the most impressive proposals involves the rising power and potential of “fiduciary capitalism,” an era in capitalism where fiduciaries of institutional funds, such as pension funds, control a significant portion of the total capital in financial markets.[7] If labor, as a class, could assume more control of pensions, it could direct financial capital in ways that serve workers’ best interests by leading to higher wages and greater job security. Another answer lies in the theory of the “political model of corporate governance,” which relies on shareholder negotiations with management to achieve gains for labor and other shareholders.[8] Given the widening gap between pension values and labor’s welfare, however, it is imperative that current progressive pension fund theory and policy explore new approaches to pension empowerment.

Below are a summary and a critical assessment of fiduciary capitalism and the political model of corporate governance. The focus is on the extent to which these mechanisms can produce significant gains for workers and investors. An important finding from the summary and the evaluation is that both approaches, as they seek to influence corporate decisions regarding production, capital investment, and employment, “semiconsciously” challenge the exclusive authority of capitalists to make those decisions. At the same time, however, these approaches seem at ease with existing capitalist class processes, as if the issue of pension reform would not or should not involve any form of class transformation. This semiconscious acceptance and rejection of existing class processes undermines the progressive discourse on pensions, making a more explicit acknowledgment of the role of class beneficial.

This article provides a class-theoretic approach to understanding the conflicts between workers, retirees, and the state, as manifested under current pension schemes in the United States. An outline of a class-sensitive pension strategy is then advanced, wherein the goals of pension reform are viewed, in part, as being contingent on and compatible with the goals of class transformation. The article assesses briefly the relative strengths of a class-sensitive pension strategy over other proposals for achieving class changes in the United States. The United Airlines’s experience with worker-directors is critiqued. Then, the legal issues involved with class-sensitive pension strategy are evaluated. Finally, the reasons to expect that the presence of workers and other stakeholders on boards of directors will increase company performance are advanced.

2. Progressive Responses to Pension Realities

Fortunately, the cumulative effect of slow wage growth, rising pension values, and an increased awareness of financial issues by heterodox economists has produced impressive progressive contributions regarding pensions. One significant component of this new thinking is the rising influence of “fiduciary capitalism.” The distinguishing feature of “fiduciary capitalism” is “the increased importance of various fiduciary institutions” such as “mutual funds, pension funds, insurance companies, and bank trusts” (Ghilarducci, Hawley, and

7. To my knowledge, the term was coined by Ghilarducci, Hawley, and Williams (1997) and has been further developed by Hawley and Williams (2000).

8. This view is promoted by Pound (1993).

Williams 1997: 26). As capital accumulates in these institutions, the power of the fiduciaries of these funds likewise accumulates. The result is that a small number of pension managers control a significant amount of the total financial capital (ibid.: 34). The rising influence of fiduciary power to control capital and the reality that pension funds control significant amounts of corporate equities present a powerful opportunity for labor, albeit an opportunity wrapped in a potential contradiction. Labor, as investor, seeks to maximize shareholder value; labor, as employee, seeks to maximize wages and job growth. Certainly, the two goals do not always conflict, but often they do.[9] When the goals conflict, should labor pension funds privilege their beneficiaries' role as investors or employees? Labor, pension fund managers, activists, and academicians have yet to agree on how to solve this dilemma. However, the point made by Ghilarducci, Hawley, and Williams (1997) is that workers should be granted increased power to participate via their strength in financial markets in any decisions that involve trade-offs between shareholder and employee gains. Unfortunately, current legislation prohibits labor from freely controlling its pension assets.

For example, the Employee Retirement Income Security Act (ERISA), which legislates the behavior of private pension fund fiduciaries, hampers pension fund activism by imposing rules interpreted to force pension fiduciaries to maximize traditional rates of return, given appropriate risk considerations. According to ERISA, pension funds must be invested

> (1) solely in the interest of the plan participants and beneficiaries; (2) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses of the plan; and (3) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims. (U.S. Congress 1989: 28)

As a product of this stipulation of pension fund management legislation, "the goal of most shareholder activism has been to maximize shareholder value, usually defined as total return (dividends plus capital appreciation) over a five year period" (Ghilarducci, Hawley, and Williams 1997: 28). In effect, the above ERISA clause narrows the potential for shareholder activism as it, in practice, defines fiduciary responsibility to mean the maximization of short-term financial gains in dividends and capital appreciation. Unfortunately, the same corporate behaviors that produce short-term gains may conflict with labor's longer-term concerns of employment, increased productivity, and wage growth. Because of this facet of ERISA, many seek changes in the act that would acknowledge and accommodate pensioners' joint identities as workers and investors. To invest in their clients' best interest, pension fiduciaries must allow "investment in firm-specific human capital, or the investment in social infrastructure (including education) required for maximum firm productivity in the long run" (Ghilarducci, Hawley, and Williams 1997: 29).

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9. The contradiction is most succinctly explained by Baker and Fung (2001). They state, "The answer to the question of whether and how pension fund investments work for or against the interests of workers is simple: pension fund investments harm the interests of workers to the extent that capital markets in general work against their interest. . . . The focus on profitability, and particular short-term profitability, often leads financial markets to favor firms that engage in practices that are harmful to U.S. workers" (14–5).

The existing ERISA, then, limits labor's choice among various investment goals and often forces investment into growing speculative equity markets. At the same time, labor is hindered in its ability to voice concerns as equity owners since corporate boards have largely regained their ability to insulate themselves from shareholders' wishes. While shareholders may have had the initial upper hand in the struggle for corporate control during the 1980s, surviving capitalists were ultimately successful in defending their position to manage companies as they desired (Ghilarducci, Hawley, and Williams 1997: 35). The primary tools of this defense were poison pills, classified boards, dual-class stock, and antitakeover state legislation, which entrenched existing boards of directors despite unsatisfied shareholders (Hawley and Williams 2000: 79).[10] Thus, labor suffers in two regards. The current legislative and regulatory environment does not permit labor much control over pension investment decisions and often channels pension funds into equities. Furthermore, workers have almost no voice in corporate governance, even though they are equity holders.

Nevertheless, this does not mean that labor is completely powerless. The California Public Employees' Retirement System (CalPERS), LENS Inc., and the Council of Institutional Investors (CII) provide viable models of pension fund activity that alter corporate behaviors. Also, the market for corporate control, which greatly favored existing managers, has been replaced by what Pound (1993) argues is a superior mechanism of shareholder empowerment in the form of a "political model of corporate governance": powerful institutional investors seek alliances with corporate management for the purpose of opening channels of communication where negotiation, rather than conflict, is the norm. "The most significant aspect of the new political process is the rise of informal political mechanisms to supplant, and even replace, the extreme measure of the formal voting challenge" (ibid.: 1008). Within this perspective, shareholder power manifests itself not primarily through proxy voting or buyouts but via negotiations, communications, alliances, and public campaigns that inform management of shareholder interests in a less contentious fashion (ibid.: 1012). Successful shareholder campaigns of this kind occurred at IBM, American Express, and Eastman Kodak (ibid.: 1006), as well as at Kmart and Chrysler (Ghilarducci, Hawley, and Williams 1997: 36–7).

Hence, we see that despite poison pills, classified boards, supermajority voting rules, and ERISA, shareholders have some limited capacity to alter management's behavior. But how much can we expect from the new era of "fiduciary capitalism" and from the negotiations contained in the "political model of corporate governance"? Can these approaches be successful enough to reverse a disturbing trend for labor?

3. The Limits of Fiduciary Capitalism and Political Governance

Ghilarducci, Hawley, and Williams (1997), who theorize the possibilities for pensions in a period of fiduciary capitalism, directly highlight the contradictions confronting workers. "Though workers have entered the manager-owner nexus as pension-fund beneficia-

10. Hawley and Williams (2000: 147–65) present an extensive case on the many legislative hurdles to shareholder activism.

ries, it is through the emergence of fiduciary capital, the exercise of power and influence, that labour's traditional and narrower interests may be significantly altered by their role as property owner" (26). In practice, the contradiction arises from potential conflicts between short-term investor quests for quick capital gains (often at the cost of employment reductions, low productive investment, and shifts to low-cost, nonunion suppliers) and long-term employee desires for higher wages and greater job stability. Often, patient long-term investment is necessary to increase labor productivity, employment, wages, and profits (Barber and Ghilarducci 1993). This method of increasing worker productivity is consistent with CalPERS's promotion of high-performance workplace practices in the firms in which it invests (Hawley and Williams 2000: 24). From this perspective, a pension strategy designed to increase productivity may encourage greater profits, worker incomes, and stock valuations for the benefit of all economic participants. Nevertheless, a problem arises from using fiduciary power for the narrow goal of promoting long-term investment.

The direct link between productivity and wage gains, which is widely accepted as economic fact, has come under increasing suspicion. Mishel, Bernstein, and Schmitt write in *The State of Working America* (2001: 151) that "the 'average' worker is not benefiting fully from productivity growth." They argue that many of the gains from increased productivity went toward capital income and not toward labor income. In the presence of rising productivity, "labor's share of corporate sector income has dropped, thus providing evidence of a redistribution of wages to capital incomes" (ibid.: 152). As discussed above, empirical evidence from 1973 to 2000 shows that real compensation (which includes employer contributions to retirement benefit plans) is not keeping pace with productivity growth. This gap between productivity gains and wage gains has not gone unnoticed by the AFL-CIO.[11] Furthermore, pension coverage has stagnated, and despite rising equity markets that have dramatically increased the size of pension assets, real pension benefits have fallen (Ghilarducci 2001: 159).

Of course, political economists should not be surprised at this possibility as wages reflect more than just technical, marginal productivity relationships. Actual wages and total compensation reflect a whole host of institutional power arrangements, as the recent divergence between productivity and wages reaffirms. Therefore, even as productive investment is required for increased productivity and growth, we must be skeptical of capitalism's need to share prosperity in accordance with labor's contribution to it.

The issue of wages not keeping pace with productivity involves the issue of class conflict as it pertains to growth. Productivity-enhancing investment is a necessary condition for increases in wages, employment, and standards of living. The progressive literature on pensions has correctly identified a critical economic precondition for bettering the lives of workers. However, attempts to increase productive investment alone may only weakly improve workers' situation because class conflicts intercede between the accumulation processes and the consequences of it.[12]

With regard to the political model of corporate governance, the fact that entities like CalPERS, LENS, New York City Funds, TIAA-CREF, and the CII influence capital mar-

11. For more on the AFL-CIO's views on the gap between productivity and wage gains, visit the AFL-CIO Web site, "America's Union Movement," at www.aflcio.org (accessed March 2003).

12. Even in cases where capitalists clearly benefit from economic growth, "their class instinct tells them that lasting full employment is unsound from their point of view and that unemployment is an integral part of the normal capitalist system" (Kalecki 1971: 141).

kets supports the viability of existing progressive theoretical and activist contributions. Nevertheless, experience exposes the limitations of shareholder negotiations. Recent shareholder disputes with McDonald's and Wal-Mart reveal the relative power of capitalist firms to manage the assets of shareholders according to their own capitalist wishes. It would seem that companies such as these would be prime candidates for shareholder activism, given the importance of public relations for them. Nevertheless, each of the companies urged its shareholders in 2001 to vote against shareholder resolutions concerning work standards.[13] Certainly, these companies did not proclaim that they were against fair labor standards; indeed, each respective company had, and continues to have, policies and procedures designed to protect their workers from abuse. Yet when companies face challenges from shareholder resolutions, they often produce their own persuasive rhetoric in defense of current business practices to sway public and shareholder opinion. McDonald's states in its proxy statement to shareholders that

> McDonald's has a well-respected and well-recognized record and reputation for business honesty and integrity, and everyone at McDonald's shares a commitment to high standards of behavior and performance on issues of social responsibility. . . . McDonald's is deeply concerned about the protection of human rights in China, *and we believe our existing practices in this regard in many ways surpass those raised in the proposal.* (McDonald's 2001: 18)

According to McDonald's, the shareholder proposal on work standards would only weaken the company's ability to be a good corporate citizen. McDonald's response demonstrates clearly that corporations are willing and able to argue persuasively against seemingly "popular" shareholder issues.[14] In part because of savvy corporate public relations, shareholder resolutions face the difficult task of getting enough votes to change corporate policy.[15] This issue has lasting significance because shareholder resolutions represent a significant challenge to corporate behavior; as businesses defeat these resolutions, corporations severely weaken shareholders' power to negotiate issues of corporate governance.

The section of the Securities Exchange Act of 1934 that addresses shareholder resolutions also severely limits prolabor pension activism. Despite the reversal of the cracker barrel position, "which provided that all employment-related shareholder proposals raising social policy issues would be excludable under the 'ordinary business' exclusion" (Securities and Exchange Commission [SEC] 2001, Final Rule: S7-25-97), proposals that are deemed to concern only "ordinary business" are still excludable. Examples of "ordinary

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13. The full text of the shareholder-supplied arguments for the resolutions and the company-supplied arguments against the resolutions are published in each company's respective proxy statement for 2001. The McDonald's resolution concerns work conditions in China. The Wal-Mart resolution is more general and applies to all workers who are employed by suppliers of goods sold in Wal-Mart stores (Wal-Mart 2001: 14-15).

14. Many firms react to shareholder resolutions concerning popular issues such as those concerning the environment or labor by arguing that their current policies are stricter than those sought after in the resolution. This allows companies to claim that they are more sensitive to these concerns than those supporting the resolutions.

15. The McDonald's shareholder resolution concerning labor practices in China received only 9.27 percent of the shareholder vote in favor of the resolution. The Wal-Mart shareholder resolution against the use of forced or child labor received only 5.25 percent of the shareholder vote in favor of the resolution. These numbers are provided by the Interfaith Center on Corporate Responsibility, "Companies, Resolutions and Status," at http://www.iccr.org/products/rezstatus_chart.htm (accessed July 2002).

business" according to the SEC include "the management of the workforce, such as hiring, promotion, and termination of employees, decisions on production quality and quantity, and the retention of suppliers" (S7-25-97). These issues regularly affect most workers in the United States, yet the "ordinary business" exclusion expressly prohibits shareholder input concerning them. In summary, given that pension activists are not the only ones who engage in rhetoric to shape public perception (corporations too have a rhetoric of corporate citizenship and responsibility), and given the legal hurdles that entrench management by prohibiting shareholders' control of the work process and compensation, we must be careful not to expect too much from political, informal means, at least as they are now formulated.

The above critique of pension-investing strategies demonstrates a few of the impediments that currently hinder labor's ability to use its financial capital in ways that best serve its interests. Strategies that seek to invest pension funds in the long-term interests of workers threaten to further exacerbate existing class tensions and may not be supported by labor, investors, or capitalists. Furthermore, attempts to change capitalist behaviors via shareholder resolutions face too many hurdles to be considered an effective and consistent mechanism for inducing change. What these criticisms reveal, however, is that class issues are central to the pension debate, despite the lack of attention they garner. Therefore, a careful class-analytic approach to pensions is worthwhile. Such an analysis must be able to handle the complexities of a pension system that distorts the identities of stakeholders by metamorphosing workers into investors and, in turn, dividing labor against retirees, the state, and itself.

4. Class Contradictions of Pensions

Because of the complexities concerning the identities of labor, it is important to represent analytically a number of the most significant contradictions between class processes facing "workers," "investors," and the state. Perhaps the most obvious contradiction involves current producers of surplus-value and retirees. This contradiction is most acute for retirees whose retirement is funded by defined contributions, in contrast to defined benefit plans that guarantee a level of benefit. As returns vary with defined contributions, retirees have a stake in increasing the level of exploitation of current productive workers, as surplus-value provides the pool of funds from which profits and dividends flow. They also have a stake in decreasing other class payments to unproductive workers, such as payments to current managers and CEOs, as they too receive a distribution of the surplus-value. Because of this, retirees may actively support measures that decrease wages and move production overseas, along with other measures that do not generally promote labor interests. An example of this was Michelin's decision in 1999 to cut its European workforce by 10 percent. One reason for the job cuts stated in the press was pressure by U.S. pension funds and retirees to increase Michelin's financial performance. The decision by Michelin provoked outrage by union members and by socialist and communist parties in France, who condemned the "Americanization" of the French economy (Dale 1999).[16]

16. Much was made of the media accounts of the relationship between Michelin and U.S. pension investors. For more information on this specific incident, see the TIAA-CREF Web site, "Meet Peter Clapman," at www.

While the conflict just described is the most easily identifiable one, two other significant conflicts remain. Productive employees are often invested in 401(k)s with defined contributions. Hence, current workers have an interest in increasing surplus-value extractions from other current workers. Specifically, current workers have an interest in increasing the rate of exploitation in the firms in which their 401(k) funds are invested. This causes a significant division among those who are currently working. This division is exposed in union pension fund administration. In the United States, union investing activity potentially undermines long-standing union strategies, not by investing in nonunionized firms—a practice that is often criticized—but by investing in other unionized firms. Many union pension funds have become members of the CII in an effort to maximize asset returns. In the CII's own words,

> The Council of Institutional Investors is an organization of large public, Taft-Hartley and corporate pension funds which seeks to address investment issues that affect the size or security of plan assets. Its objectives are to encourage member funds, as major shareholders, to take an active role in protecting plan assets and to help members increase return on their investments as part of their fiduciary obligations.[17]

Union retirement fund participants in the CII include the AFSCME Employees Pension Plan, the California State Teachers' Retirement System, the Communications Workers of America Pension Fund, the Hotel Employees and Restaurant Employees International Union Welfare-Pension Funds, New York City Pension Funds, Sheet Metal Worker's National Pension Fund, and the United Food and Commercial Workers International Union Staff Trust Fund, to name only a few. One important aspect of the CII's attempt to increase returns for its members is its Focus List. This annual list highlights underperforming companies for the purpose of pressuring these firms to increase financial performance and thereby increase equity values for the benefit of CII members. In 2001, the list included both Hilton Hotels and Tyson Foods. This is interesting because Hilton employs workers represented by the Hotel Employees and Restaurant Employees International Union, and Tyson employs workers represented by the United Food and Commercial Workers International Union. Both of these unions face the difficult and contradictory position of pressuring employers to increase financial performance and, at the same time, to accommodate union goals for better wages. It seems likely that gains resulting from union-supported CII pressure will come at the expense of the unionized employees at Hilton and Tyson. This example exposes the difficulties facing current workers who must support additional levels of exploitation for other workers or even themselves as a condition of receiving sufficient income for retirement.

Finally, there exists a contradiction between current productive workers and the state. Many federal and state employees have defined benefit plans. Therefore, federal and state governments have a vested interest in rising levels of exploitation in the private sphere that enable them to maintain a level of benefits with minimal contributions. If they do not receive adequate returns from investments, federal and state authorities must either raise

tiaa-cref.org/siteline/archive/gen0110_128.html (accesssed June 2002). There, Peter Clapman, TIAA-CREF Senior Vice President and Chief Counsel for Corporate Governance, replies to the media reports.

17. Council of Institutional Investors' Web site, "Welcome," at www.cii.org (accessed January 2002).

taxes or decrease funding for other purposes.[18] In contrast, high returns help to maintain existing funding levels and decrease the need for tax increases. Given these contradictions, which take the form of exploitative pressures from retirees, current workers, and the state, we are faced with another important question: in contrast to present realities, can pensions work to lessen exploitation?

5. Why Exploitation Should Matter to Stakeholders and Why It Should Be a Concern of Pension Reforms

Before one can seek changes in exploitative practices, it is imperative that a definition of exploitation be clearly articulated and the negative aspects of it be exposed. In Marxian terms, exploitation occurs when those who produce the surplus are not involved in the appropriation of the surplus. This occurs in many different fundamental class processes. In a feudal class process, the serfs produce the surplus, but it is appropriated by the feudal lord. In a slave class process, the slaves produce the surplus that is appropriated by the slave owner. In modern capitalism, the productive laborer produces the surplus that is appropriated by the corporate board of directors (Resnick and Wolff 1987: 175). However, the existence of a surplus does not necessarily represent the existence of exploitation: by definition, all productive societies produce a surplus. "The important point is that the exploitative injustice of capitalist production lies not in the disposition of the surplus per se . . . but rather with the fact that those who perform the surplus are labor who are excluded from the decisionmaking over its disposition. . . . Similarly the justness [of a cooperative enterprise] is that . . . workers collectively appropriate and participate in the decisionmaking over the disposition of the surplus" (Cullenberg 1998: 70).

Realizing that corporate dividends, debt repayments, retained earnings, executive salaries, internally funded capital investment, and advertising are examples of some of the many distributions of a corporation's surplus, and further appreciating that all of these expenditures, which affect current workers, retirees, and the state in so many ways, are the product of unrepresentative processes that exclude affected parties, one can identify the detrimental aspects of the present class configuration.[19] In terms of stakeholder discontent, current workers are subject to board-level decisions concerning hiring, wage, and production policies that do not reflect their concerns. Retirees face excessive executive compensation, questionable corporate disclosure of profits, and an increasingly short-term mentality in corporate planning, which may not maximize returns for retirees over the long run. The state must confront the problem of corporations moving production abroad, thereby reducing jobs, incomes, and tax revenues. All of this occurs even though workers, retirees, and the state own a significant portion of the companies that do not behave in their best interest,

18. The millions of dollars lost by state-funded pension plans in the Enron collapse have caused many states to reassess spending priorities. New York City funds were particularly hard hit. " 'It comes down to two things: we gave a lot of benefits, and we had bad investments,' said Robert North, the chief actuary for the city's five pension funds. 'Our benefits went up, our investment income went down, and the place you have to make up for it is in contributions. It is a classic pension funding problem' " (Cooper and Lipton 2002).

19. Cullenberg (1998) argues that exploitation is harmful not for its own sake but because it violates the democratic principle of self-government.

and it happens because capitalist boards of directors autonomously make the decisions via their class position as the sole appropriators and distributors of surplus-value. Hence, stakeholder empowerment, corporate governance, and progressive pension reform movements must confront the existing class structure and its exploitative components, which excludes workers, retirees, and the state from participating in decisions concerning the surplus. In short, the control over the corporate appropriated surplus-value matters; this is just another way of saying class and exploitation matter. This point is underappreciated by shareholder activists who traditionally have not sought direct forms of control over corporations.

Current shareholder strategies attempt to change some of the decisions of capitalists, but they do not challenge the exclusive authority of capitalists to make those decisions. This view is shared by Simon (1993):

> Shareholders get to elect the directors and to approve "organic" changes, but, typically, that's it. Thus, if workers are to be given control over shop-floor issues or over strategic decisions (investment, marketing, work-force level) other than the basic "organic" ones, forms of participation other than those routinely accorded shareholders need to be built in. (177)

At best, shareholders can replace one set of capitalists for another, or they can induce changes by convincing management that it is in their best interest to eliminate sweatshops, to increase investment in new technologies, or to use environmentally sensitive production techniques. The unfortunate reality is that labor-, retiree-, and state-friendly policies often conflict with capitalists' narrow interests.

6. A Class-Sensitive Pension Agenda

The above discussion demonstrates the extent to which the limited ability of pensions to be a force for positive change is partially a class issue. Hence, if pensions are to support the interests of their beneficiaries, class changes must be a part of the reform process. But how can pension activism encourage favorable, less exploitative class changes?

Given that the problem lies, in part, in capitalist boards' ability to exclude the wide participation of equity owners, pensions must use their fiduciary power to attain seats on the boards of directors. As this creates an opportunity to widen participation in the appropriation of surplus-value, a class transformation occurs. This can take place through a shareholder cooperative. A cooperative of the type explained below can address the diverse needs of various constituencies, from current workers to retirees to the state, and it can function with both defined benefit and defined contribution retirement plans.

Since current workers are the source of the surpluses needed to fund retirement plans, and since they are the directly exploited population, their needs must be addressed. Current workers with defined contribution plans can form a class-aware consortium of pension funds. Such a consortium would bring together pension fund fiduciaries who represent current workers; it could coordinate their efforts to force the firms in which they invest to alter their corporate bylaws and to allow representatives chosen from among the firm's employees to be placed on the board of directors. These representatives would serve as constituent directors for the employees. As the size of these funds grows and if they synchronize pressure, the consortium of funds would have unprecedented power to invoke change. The consortium could threaten to divest, or to invoke company campaigns against firms who resist employee representation.

Of course, not all companies could be targeted. But by pressuring a few industry-leading firms, labor could make some progress toward participation in the decisions affecting these firms. The strategy could work in the following manner. The consortium could use its combined financial power to pressure firm X to allow representatives chosen by X's employees to sit on X's board of directors. This would then allow firm X's employees a significant forum to affect corporate governance: they would no longer be excluded from the process of surplus appropriation and distribution. In return for bringing about this change, firm X's labor-controlled pension fiduciary would pledge to support employee representatives in the other firms whose employees are members of the consortium. Fortunately, an organization of pension funds already exists at the CII. However, the CII is too narrowly focused on maximizing short-term returns that may not serve workers or investors in the long run, and they have traditionally declined to seek seats on the board of directors.[20]

The class changes that would be brought about by this modest proposal are dramatic. As workers' representatives assume seats on the board, exploitation is lessened. This occurs not because surplus-value has necessarily decreased, but rather because labor begins to partially appropriate its own surplus-value. This creates two significant class changes. First, labor takes on a new role in the class process. Instead of being only a producer of surpluses, labor now shares in the appropriation of its own surplus. Does this class change turn laborers into capitalists? No, because the class process itself is partially changed from a purely capitalist form, which excludes producers of surplus, to a more inclusive and participatory form of surplus appropriation. According to Cullenberg (1992), as the surplus appropriation is shared (meaning that labor and possibly others participate in the decisions concerning the surplus at the initial site of surplus production), concomitant class changes occur. Furthermore, if a majority of firms would use a shared form of appropriation, socialism would exist (81). Hence, the second class implication is that a transition to a more participatory but market-driven economy begins via the presence of labor representatives on boards of directors.

This does not mean, of course, that workers from firm Y who invest in firm X may not seek increasing surpluses from firm X in an effort to bolster X's share price. However, one must realize that under all class situations (ancient, slave, feudal, capitalistic, and communal) struggles take place concerning the surplus. Even in perfectly communal situations, some workers will produce surpluses that go toward funding workers and nonworkers alike. Examples of this may include support for a legal framework, national defense, socialized medicine, and socialized child care.[21]

The relevant class difference between exploitative and nonexploitative economies is that the decisions to spend the surplus, and the conditions under which it is produced, are determined, in part, by the producers of the surplus themselves. In the United States, only a

20. For example, according to Monks and Minow (1991: 218), in reference to the Council of Institutional Investors (CII), "They do not want to run the companies."

21. Cullenberg (1992: 65) calls attention to the dangers of seeing socialism as a system free of conflict: "the Left has held an image of socialism as utopian, one that often puts excessive demands on the criteria for its success."

small portion of the surplus, that part being collected as taxes, is subject to a vague form of wide economic participation.[22] The remaining surplus remains the exclusive domain of non-value-producing capitalists. Within the confines of the pension consortium, workers' representatives from a firm's board of directors could meet with pension fund fiduciaries from other firms and negotiate agreements on the best ways to maintain equity returns without unduly harming workers, the environment, and the public treasury in the process. This degree of firm-level involvement is generally not currently available either to workers as employees or to workers as investors.

While such a strategy helps current workers, it neglects retirees with either defined benefit plans or defined contribution plans, and it excludes the state, which must also seek adequate returns to support its pension obligations to defined benefit plans. Despite differences in these groups, they have significantly aligned interests.[23] Retirees, regardless of pension funding, generally have a vested interest in federal and state finances that contribute to their standard of living. At the federal level, current retirees depend heavily on federal programs such as Social Security and Medicare, and many are seeking further assistance in the form of a federal prescription drug benefit plan. If the federal treasury does not grow in conjunction with the demands of the aging population, retirees face a possible lower standard of living as federal services are cut. A similar dynamic occurs at the state level for state-supplied services.

Unfortunately, corporations are likely to continue to invoke the standard set of efficiency-enhancing measures from outsourcing to slashing employee benefits to moving production overseas. These same measures that may help pension returns initially may also undercut the government's ability to collect tax revenues, and this will undermine their ability to meet the diverse needs of retirees, which extend well beyond investment returns. Therefore, public pension funds should also form a coalition and demand representation on the boards in which they own equity shares.

A consortium of public pension funds could likewise pressure firms to allow representatives from the consortium to sit on the boards of directors of select companies. If only twenty-five states joined the consortium and if they targeted only the Fortune 500 companies, each state could contribute four constituent board members to represent its interests. This would be possible if each of the four state-sanctioned board members sat on the boards of five companies. The consortium could arrive at a set of policies that would encourage firms, when possible, to maintain operations in the United States, expand job growth opportunities, limit excessive executive pay, and ensure sound accounting practices. By bringing the trillions of dollars held in public pension funds to bear on these issues, government treasuries, retirees, and the economy as a whole would be better served because they would be better represented.

22. This claim is based on the democratic appointment of legislators who produce and follow public budgets.

23. The idea that shareholders have aligned interests with other shareholders and stakeholders is proposed by Hawley and Williams (2000). Here, I use the state as an example of a shareholder who has compatible goals with other shareholders such as retirees. The state's interests, which range from capital appreciation to overall economic development, are therefore "congruent with those of society" (3).

7. Contrasting a "Class-Sensitive" Pension Strategy with Other Forms of Economic Participation

The complete list of proposals and strategies to increase economic participation in capitalist economies is extensive, and space does not allow a detailed comparison of the approach presented in this article to all the other attempts. However, a brief contrast of this approach to traditional producer cooperatives in the United States, the Mondragón model in Spain, German-style codetermination, and the Swedish model of wage-earner funds is helpful since it serves to clarify the many beneficial components of class-sensitive shareholder cooperatives.[24]

Traditional U.S. cooperatives are organized by workers who own and manage the cooperative. Hence, they represent a nonexploitative form of production. There are, however, numerous impediments to their success on a large scale. First, as the capital is raised by the workers themselves, cooperatives suffer from a lack of capital and typically avoid debt financing from bank loans because such loans constrain the autonomy of the firm (Thomas and Logan 1982: 75). Furthermore, it is difficult and expensive to significantly debt finance a firm. This impediment to debt financing pushes capitalist firms into the equity market to raise capital, but cooperatives usually do not allow ownership shares to be purchased by nonemployees; this prohibits cooperatives from raising capital in equity markets. The lack of capital hinders the growth possibilities of these firms. Second, even if employees can raise enough capital to purchase an existing firm or to create a new entity, workers' retirement investments are not usually sufficiently diversified because workers' earned incomes and unearned incomes are largely bound by the performance of the same firm. Third, upon retirement, workers typically must sell their ownership shares to new employees. As the firm grows and ownership values rise, new employees may not have sufficient capital necessary to purchase the shares of retirees. Producer cooperatives should be supported; however, they are best suited for small firms with employees who already have significant capital to invest.

The Mondragón model addresses some of the financial constraints facing traditional U.S. cooperatives. Its Caja Laboral Popular provides loans to new Mondragón employees who cannot afford the initial investment needed for employment. Also, workers' capital is slightly more diversified in Mondragón cooperatives than in traditional U.S. cooperatives, where employee returns are tied to only one enterprise. The reason for this is that "ownership is arranged in a combined collective and individual manner. While a collective reserve capital account receives on average about a 45 percent share of net income and a collective social fund (for service projects in the community) is usually allotted 10 percent of positive

24. Here is only a very partial list of contributions to this literature. I do not address all of these approaches in strict detail, in part because I do not generally disagree with the theorizations or the goals of these approaches. In fact, the theorizations proposed here are largely compatible with them. My critique is general and serves mainly to highlight a different strategy for implementing increased economic participation within the present U.S. experience. For a detailed investigation of codetermination, see Pistor (1999), Roe (1999), and Baums and Frick (1999). For an extensive review of Swedish reforms, see Pontusson (1992). Archer (1995) provides a brief comparison of wage-earner funds and codetermination in the context of achievable economic democracy. Schuller (1985) provides an overview of various worker participation schemes with an emphasis on pensions. Issues of cooperative development in the United States are addressed by Jackall and Levin (1984). Experiences and theorizations of worker-owned firms are presented by Ellerman (1990) and Blair (1995).

net income, the remainder of net income is apportioned to the internal individual accounts of each member" (Moye 1993: 265). In the case of losses, deductions from these accounts are in the same percentages as the contributions (Thomas and Logan 1982: 154). And while the performance of individual accounts depends on the financial performance of the worker's firm, the reserve capital account buffers the full positive or negative returns individual workers would receive if they contributed to only an individual account (ibid.: 259). Furthermore, Mondragón's extensive one-person, one-vote rules of organization represent a superior form of economic participation than can occur with the proposed shareholder cooperative described above, which relies on representatives of constituencies.

However, a significant problem remains for using existing pension funds to support a Mondragón system in the United States. The overriding principle in the Mondragón cooperatives is employee self-governance. Potential outside investors such as U.S. union pension funds, even if they were allowed to purchase nonvoting shares, would have little opportunity to participate in the corporate governance of these firms unless cooperatives included unions that represented the workers in the cooperative. If U.S.-styled unions could represent some cooperative workers, the pension fund consortium strategy could be expanded to develop links between Mondragón-styled cooperatives and other unionized firms. Otherwise, as existing labor pension funds are seeking to increase and not decrease their ability to influence the corporations in which they invest, Mondragón systems would be a relatively unattractive option to union pension funds seeking shareholder empowerment for themselves.

German codetermination allows workers to participate in the management of a firm by mandating that employee representatives have seats on German supervisory boards. As the cooperative shareholder plan proposed above seeks a similar form of representation for workers in the United States, the two plans may seem to be identical. While they both seek to achieve similar forms of participation, however, the means to achieve these goals are very different. In Germany, the Law on Codetermination "provides for equal representation of employees and shareholders on the supervisory board" (Pistor 1999: 174). While such legislation represents a tremendous step forward in terms of advancing economic participation possibilities for workers, the likelihood that similar legislation will be passed in the United States is small. The United States simply lacks the necessary political conditions required to support legislation that requires labor representation on boards. A similar fate confronts proposals for wage-earner funds in the United States. Swedish wage-earner funds were a legislatively forced distribution of corporate profits for the benefit of workers. Forced profit sharing has almost no chance of becoming a reality in the United States in the near future, despite the benefits it may yield. Therefore, mandated codetermination or wage-earner funds do not seem to be the most workable alternatives at the present time.[25]

Traditional cooperatives, the Mondragón model, codetermination, and wage-earner funds must face one of two undeniable obstacles when applied to the U.S. experience. Traditional or Mondragón cooperatives face a difficult task of attracting the approximately $7 trillion held in pensions if they are unwilling to allow an increased role in corporate governance for nonemployee equity holders. Codetermination and wage-earner funds require political conditions that do not presently exist in the United States.

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25. I do not address employee stock ownership plans (ESOPs) because workers who hold ESOP shares suffer from the same legislative restrictions that impede all other equity holders.

In contrast, class-sensitive shareholder cooperation, as proposed above, is not subject to these same limitations. It takes as its starting point the reality that if any form of broad-based economic participation is to exist in a significant form in the United States, it must seek capital beyond that available from the employees themselves. Capitalists long ago realized that they must seek capital beyond that provided by the capitalist proprietors themselves. The rise of the modern public corporation reflects this. The limited liability provided by equity legislation created vital financial conditions for the existence of capitalism. In class terms, the class positions of equity holders supported the capitalist class process. Once the class conditions of capitalism's success have been recognized, one can outline one of the important conditions of existence for a more participatory class process: namely, it too needs the class support of investors.

8. United Airlines Corporations: A Case of Employee Board-Level Representation

The bankruptcy filing of United Airlines (UAL) suggests that employee board-level representation should be treated with a healthy amount of skepticism. Before we can arrive at a general conclusion concerning employee representation based on United's experience, however, it is important to appreciate the details of the arrangement there. In an effort to restructure in 1994, the company—which had lost more than $1 billion from 1990 to 1993—implemented an employee stock ownership plan that exchanged 55 percent of the firm's equity shares for wage concessions and work rule changes (Gordon 1999: 338). The deal was unique in at least two respects. First, a majority of the firm's equity was transferred to the employees via the employee stock ownership plan (ESOP) trust. Second, as part of the agreement, employees would have three representatives on the board of twelve directors.

On the surface, this arrangement corresponds to the sought-after proposal presented above. However, a closer examination of the details suggests that exactly how a board of directors is constructed and how decisions and powers are distributed within a board matter greatly. By virtue of their board membership, employees have a strong mechanism for effectively vetoing certain major changes at UAL. For example, a buyout of the firm would require approval from employee representatives on the board. However, the participation of board representatives in a whole host of other decisions that affect labor is severely limited. Specifically, collective bargaining agreements are referred to the Labor Committee (Gordon 1999: 343). According to the UAL's 2001 Annual Report, none of the three employee board representatives are members of that important committee. In fact, union wages and benefits are negotiated largely without leverage from board member representation.

Hence, even though employees own 55 percent of the shares and maintain one-fourth of the board seats, employee board representatives do not participate in UAL's decisions concerning wages and benefits. Of course, it makes sense for labor's representatives not to be in exclusive control of wage negotiations with the unions, as those negotiations will affect other equity- and non-equity-holding investors. However, it seems reasonable for labor's representatives to be part of the board committee that negotiates wages and benefits, in an effort to increase information exchange and to lessen the suspicion between the firm and the unions. Without membership on this committee, labor's representation on the board is largely a matter of style rather than substance, which ultimately pits labor against a capitalist board of directors and contributes to distrust, conflict, and inefficiencies.

This helps to explain the recent labor conflicts at UAL, which included a federally mandated cooling-off period to temporarily prohibit unions from striking. Furthermore, UAL's bankruptcy filing essentially forced the unions to renegotiate existing contracts because of the threat that bankruptcy courts would void existing labor contracts.[26] After the bankruptcy filing, United pilots agreed to a temporary 29 percent wage reduction. In contrast, the machinists rejected the terms of United's offers to cut wage costs, and in January 2003, a bankruptcy judge ordered temporary pay cuts.[27] In 1999, Gordon prophetically claimed that "the UAL example illustrates that institutions matter, including the structure of the board, the nominating procedure, and the committee structure" (353).

The situation at UAL demonstrates that for employees to take advantage of board-level representation, effective employee representation on the board depends on much more than the proportion of the board representing labor interests. Methods to ensure significant employee participation include the following:

> 1) Workers should be given parity representation on the board of directors and full participation in all company committees on which board members sit. 2) Resources should be available to help worker-directors analyze the information they require. . . . 3) Worker-directors should be based firmly on in-plant organizations with direct ties and accountability to plant-level organizations. 4) More information must be available to the worker-director. (Eric Batstone, summarized in Carnoy and Shearer 1980: 255–56)

While the above recommendations would serve unions' interests, they currently cannot be enacted in the United States due to legislative constraints.

9. Legal Impediments to a Class-Sensitive Pension Strategy

As the above proposed strategy to manage pensions touches on a wide variety of disparate issues, including alterations in the character of pension management, the role of boards of directors, and union pension investing strategies, a variety of potential legal issues arise.[28] It is important to note that since the 1930s, legislation in the United States severely and purposefully limited financial institutions' abilities to control corporations. The Great Depression caused a backlash from workers, corporate managers, industrialists, and small banks against large Wall Street financial interests and institutions. Distrust of large banks, insurers, mutual funds, and pension funds runs deep in the U.S. experience, and therefore, most financial institutions are heavily constrained by legislation from seeking additional

26. Reuters, December 17, 2002, "United Warns of Legal Action on Cuts," www.msnbc.com/news/848933.asp.

27. Reuters, January 10, 2003, "Pay Cuts Ordered for UAL Machinists," www.msnbc.com/news/857524.asp#BODY.

28. I use the term "potential" because the increased power of institutional investors, shareholder activism, and the corporate merger and acquisitions wave in the 1980s have led to a diverse set of court rulings that fail to concretely define the roles of pension administrators and boards of directors.

power and influence in the economy.[29] Unfortunately, the protections placed on financial institutions to protect workers now inhibit workers as they amass concentrations of wealth in pension assets. The most important legal impediments affecting union pension strategies are addressed below.

In an effort to protect union members from the possibility of inappropriate dealings between a union representative and the firm, wherein a firm secretly cooperates with the "union-friendly" official (such as a union representative on the board of directors) to harm the interests of the unionized employees, the National Labor Relations Act (NLRA), section 8(a)(2), prohibits an employer from interfering with or supporting a labor organization. This section of the act raises the possibility that the union could be decertified and lose its collective bargaining rights if it is involved in management decisions (Stern 1988: 412). The fear of losing certification certainly inhibits the pension strategy advanced above and explains why some unions may resist any attempt at board representation. Despite this fear, some industries and unions do have union representatives on boards. The airline industry in the United States is the best example of an industry embracing board-level representation of unions. Also, the National Labor Relations Board (NLRB) has increasingly defined the permissive boundaries of union members serving on boards. For example, the NLRB ruled that no violation occurred when Chrysler admitted Douglas Fraser, then United Autoworkers president, to its board because Fraser held a minority position on the board, was not involved in collective bargaining, did not receive compensation for serving as a director, and did not compromise his duties to the union membership (412).

Therefore, the NLRA clearly does not make union representation on boards illegal or a cause for decertification, but it severely limits the effectiveness of union directors by maintaining their minority status and prohibiting their direct involvement in the collective bargaining process. One method suggested to circumvent this issue is to have the union or shareholders choose candidates "who are not formally or effectively influential in union affairs" (Harper 1988: 27). Nevertheless, the NLRB's interpretation of the act and the act itself should be changed to allow unions a significant voice in management. Many legal scholars embrace this view.[30]

A second legal hurdle involves the potential for antitrust violations with regard to interlocking directorates. In particular, a violation can occur even if two different people representing the same organization sit on competing boards of directors (Stern 1988: 411). Hence, unions or states that have representatives on boards of competing companies may be in violation of the Clayton Act. As the effective boundaries of this act have not been sufficiently tested, it is difficult to predict what level or form of an interlock would be permitted, if any. For example, it is not clear whether constituent directors of states or unions would be considered part of an organization, if they were not employees or agents of a union or a state but were merely union- or state-approved candidates. However, here too legislation should

29. See Roe (1994) for a detailed look at the political aspects that influenced U.S. legislation concerning banks, insurers, mutual funds, and pension funds.

30. "The NLRA [National Labor Relations Act] should be revised to accommodate the growing use of employee involvement committees. Labor scholars assert that Section 8(a)(2) should be repealed to allow firms to develop programs that permit employees to voice their concerns about the workplace environment and production methods. In addition, the NLRB should be amended so that unionized employees can retain their right to participate in collective bargaining" (O'Connor 1993: 949).

be reconsidered not to change the intent of the law (which is to avoid undermining competition) but rather to change how that goal is achieved. For example, a system of firewalls could be developed that would prevent the sharing of sensitive information by directors of competing firms, or policies that discriminate across firms or involve any sort of price collusion.

A third issue involves the duties of directors. Here again we face a surprising degree of ambiguity in the law. In contrast to agency theory, which views directors as agents of the shareholders, corporate law less clearly defines directors' relations to shareholders. "Although elected by the shareholders and removable by them for cause and possibly without cause, the directors are not agents of the shareholders. Nor are directors, in the strict sense, trustees. Their position is *sui generis*. They are fiduciaries, their duties primarily running to the corporation" (Henn 1970: 415–6). As officers and fiduciaries, they are guided by a "duty of due care" to act with "reasonable skill and prudence," but such statements provide neither concrete direction nor absolute standards for directors. This ambiguity enables constituent directors to pursue the goals of improved welfare for workers. For example, "testimony of union leaders who have served as directors suggests that they may modify their definition of employee interests in order to rationalize away any conflict between those interests and the corporate interests that traditional directors are to advance" (Harper 1988: 20). Furthermore, corporate law is increasingly moving away from the notion that shareholders are the only constituents that the board can serve. According to O'Connor (1993: 951), the *Paramount Communications, Inc. v. Time, Inc.* case "established that directors have no duty to maximize the shareholders' short-term value and that directors may take into account the interests of other constituents when making decisions." It is also important to note that "corporate supervisory boards often include representatives of other non-shareholder interests affected by the corporation, such as major suppliers, customers, and holders of senior securities, without generating troublesome litigation" (Harper 1988: 19).

In summarizing the legal ramifications of a class-sensitive pension strategy, it is clear that legislative changes are needed. What is needed is essentially less regulation by the NLRA concerning section 8(a)(2) and more flexibility than the current Clayton Act allows pertaining to interlocking directorates. Because these legislative changes allow for new possibilities for firms to reorganize their boards, if they so desire, these legislative changes may be more politically feasible than mandated codetermination or wage earner funds, which limit forms of organization. The legislative changes proposed above—to lessen the regulatory structure imposed by the NLRA and the Clayton Act—only increase the number of ways in which a board can constitute itself and merely allows for the possibility of truly significant employee representation on boards.

Despite the legal hurdles, it is encouraging to note that "though the current ambiguity over the legal status of worker and union directorships may inhibit the future development of these plans, thus far the agreements reached between labor and management have not been seriously challenged. Where interested parties agree, worker and union directors have been appointed" (Stern 1988: 413). This suggests that the likelihood of achieving significant worker representation on boards of directors depends largely on its ability to improve the functions of existing boards for the benefit of all concerned parties, including shareholders, employees, the state, and creditors. If this is possible, then it seems likely that the legislative environment will adapt.

Just as the Great Depression caused a populist movement for legislative changes, perhaps so too the collapses of Enron and Worldcom, and the increasing distrust of investment firms such as Merrill Lynch, can cause a populist movement for more democratic involvement in *both* the management of financial assets and the management of the firms where the capital flows. Moreover, the knowledge that the existing legal framework largely prohibits effective union representation on boards helps to shed light on the numerous failures of companies with such representation. The only conclusion we can glean from the U.S. experience is that superficial union board representation is ineffective.

10. Can Worker-Directors Improve the Performance of Corporate Boards?

Ultimately, the usefulness of employee, state, pension, or other representatives on boards is contingent on corporations' ability to satisfy diverse constituencies. While the United States has relatively little experience with empowered employee representatives on boards of directors, not to mention additional representatives of states and pension funds and other institutional investors, there are sound theoretical reasons to expect that the presence of such a cadre of representatives on the board will result in improved company performance.

A typical corporate board of directors in the United States primarily serves three functions: (1) it monitors the firm to ensure that management does not harm investors through wasteful expenditures; (2) it provides advice and guidance to management in an effort to achieve and maintain a high level of performance; and (3) it is a useful source for aiding in the procurement of resources.[31] The monitoring function is perhaps the most important for investors, but the current system of having most of the candidates for board membership essentially chosen by the CEO provides little aggressive monitoring.

Therefore, the New York Stock Exchange's (NYSE's) Corporate Accountability and Listing Standards Committee, which is responsible for overseeing the corporate governance and disclosure practices of NYSE-listed companies, is proposing that companies listed on the exchange employ stricter criteria for independent board members. It is apparent that the current definition and practice of using "independent" directors leaves much to be desired; "independent" board members often have extensive relationships with the firm, and this limits their ability to direct the firm in the shareholders' interest.[32] Therefore, in even the most conservative financial circles, dramatic changes are under way concerning the composition of corporate boards.

While stricter criteria for independent directors are better than the current criteria, even truly independent directors face difficulties in monitoring firms. For example, the increased use of independent members means using persons who are not necessarily familiar with the

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31. See Johnson, Daily, and Ellstrand (1996), who review the extensive literature addressing boards of directors in terms of control, service, and resource dependence roles.

32. The full report is available on the New York Stock Exchange Board Web site, "NYSE Board Releases Report of Corporate Accountability and Listing Standards Committee," at www.nyse.com/press/NT00565884.html (accessed June 2002). It is likely that this proposal will be accepted by the New York Stock Exchange by the time this article is published.

firm or even the industry in which the firm operates. Consequently, independent directors must often rely on manager-supplied information. Employee representatives may serve as a more effective monitor for shareholders than independent directors. "Most individuals agree that today's typical corporate board does not actively control firm management, in part because of a lack of alternative sources about firm operations. By providing information, employee directors can help to control managerial waste and opportunism. Because employers cannot exit the firm or diversify their human capital as easily as shareholders can exit the firm and diversify their financial capital, employee representatives on the board may also have more incentive to monitor management than do other outside directors" (Harper 1988: 18). Furthermore, the knowledge of shop-floor procedures provides a valuable source of information that may improve the advice and guidance that a board can provide to management.

Despite these potential gains in monitoring and guidance, one of the most significant foreseeable gains pertains to the acquisition of resources. Access to capital is, of course, vital to the success of a firm, and research by Sterns and Mizruchi (1993) finds that board membership matters in acquiring funds. Specifically, they

> have shown that a firm's borrowing strategies are associated with the type of financial institution represented on its board. We believe that this association occurs because once established, a financial interlock provides both a firm and a financial institution with an ongoing opportunity to coopt one another. In addition, the interlock may increase the firm's access to funds by reducing the governance costs involved in the borrowing action. . . .What the firm's management loses in autonomy from having a financier on the board, it gains in access to external funds. (616)

In this light, state representatives, who have knowledge of state-advanced development initiatives, state-supplied sources of capital, and a firm grasp of a state's resources, would be valuable assets on a board. State representatives on boards would serve as conduits of information between state development agencies and firms. Also, union or state pension representatives could serve as valuable sources of capital by diverting pension assets out of equity investments and into productive investments.

Another important function that employee representatives can achieve that most existing boards cannot is an opening of communication links between labor and management. Open lines of communication should not be easily dismissed, as asymmetric information and distrust between bargaining parties leads to *X*-inefficiency (O'Connor 1993: 936–40). According to Harper (1988: 16), it is incorrect to view collective bargaining as a zero-sum game, as shareholders can benefit from certain information flows between parties. For example, "In bargaining situations that have been tainted by suspicion, granting employees a credible information source may benefit shareholders more than it harms them by making it easier for the bargaining parties to structure employee benefits in a way closer to Pareto optimality" (16). Information supplied from employee representatives on the board could serve as the source of credible information. Therefore, there are significant economic reasons to expect that such a system of board representation would serve firms, states, employees, and investors well.

11. Conclusion

Proposals to increase representation on boards of directors is not new; Austria, Denmark, Finland, France, Germany, Greece, Ireland, Luxembourg, the Netherlands, Norway, Portugal, Spain, and Sweden have experience with various forms of board-level representation. Nor is it a new idea that pensions should be managed in ways that do not merely seek to maximize short-term returns. The significance of the class-sensitive pension strategy proposed here is that it combines the financial strength of pensions with class-theoretic insights. The result is a pension strategy directed toward class changes that support a more productive and democratic economy.

Beyond the arguments presented above for a class-sensitive pension agenda, three related historical circumstances further support the need to reconsider now the constitution of board membership and responsibilities. The first historical circumstance is the Enron collapse. In the wake of this collapse, individual workers, institutional investors, and firms themselves realize the dangers of passive board involvement. The second historical circumstance is the recession. During the booming 1990s, there was little need to question the status quo. However, as slow growth continues, it is reasonable to expect that board functions pertaining to monitoring, guidance, resource dependence, and effective communications with employees are especially salient.[33]

The third historical circumstance is the tremendous size of pension funds. As Hawley and Williams (2000) make clear, the staggering size of pensions limits the power of market buying and selling decisions to affect corporate governance. This is because the diversification strategies of large pension funds preclude exit as an effective mechanism of voice. "And if they can't sell, then they must 'care' " (xiv). Employee, union, and state representation on boards provides a better approach to corporate governance than currently exists in the United States, and it makes for a more inclusive and participatory economy.

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