Corporate Governance and Income Inequality: The Role of the Monitoring Board

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ABSTRACT

It is hardly news that income inequality has become a serious problem in many countries, and the United States appears quite prominently on the list. Much has been written about the problem and there surely are multiple causes, but I argue in this paper that the dominance of the monitoring model of corporate boards of directors plays a significant role because of its responsibility for the creation of the shareholder value model of corporate purpose.

I trace the history of the evolution of American capitalism and the development of the monitoring board and map it on the history of American income inequality. While I cannot prove direct causation, the circumstantial evidence seems overwhelming.

I conclude with some brief suggestions for containing the problem.

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INTRODUCTION

The study of economic inequality has grown quickly during the past two decades.[1] While economists have been interested in the subject since the time of Adam Smith,[2] dramatic changes in United States' income inequality beginning in the 1980s and continuing beyond have sparked the interest of scholars from a range of disciplines.[3]

Several theories have been offered to explain this rapid and extraordinary expansion of income inequality. For analytical purposes, they can be grouped into three basic categories: market theories, institutional theories, and normative theories.[4] There is wide consensus on the data, but currently no consensus as to causes of the phenomenon.[5] This paper will focus primarily on the economics literature because all theories ultimately flow through economic channels-the corporate board in particular. [6]

Almost no theory is pure in the sense that it is "mono-causal"[7]—theories tend to overlap.[8] In general, market theories focus principally on

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[1] *See* Leslie McCall & Christine Percheski, *Income Inequality: New Trends and Research Directions*, 36 ANN. REV. SOC. 329, 330 (2010); *see generally* Thomas Lemieux, *The Changing Nature of Wage Inequality*, 21 J. POPULATION ECON. 21, 21–48 (2008) (providing an overview of economic inequality studies).

[2] *See* Andrew Leigh, *How Closely Do Top Income Shares Track Other Measures of Inequality?*, 117 ECON. J. F619, F619 (2007).

[3] The consensus view appears to be that our current levels of inequality grew at their fastest rate during the 1980s. Thereafter, income inequality has continued to grow at a rapid rate but with divergence in the behavior of the top and bottom of the wage scale. *See* Lemieux, *supra* note 1, at 22; *see also* McCall & Percheski, *supra* note 1, at 333, 337. There is evidence that economic inequality was being generated by the stock market long before the 1980s, with one scholar observing such changes as early as the 1950s. *See* Raymond W. Goldsmith, *Basic Considerations*, *in* INSTITUTIONAL INVESTORS AND CORPORATE STOCK—A BACKGROUND STUDY, YALE U., NAT'L BUREAU OF ECON. RES. 10, 10 (1973) (observing that the dominant factor stimulating economic inequality then was the stock market). Goldsmith was prescient. Not even the meticulously collected data of Piketty and Saez observe trends in American inequality tracing back as far as the 1950s. *See* Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913–1998*, 118 Q.J. ECON. 1, 3 (2003) [hereinafter Piketty & Saez, *Income Inequality*]; Thomas Piketty & Emmanuel Saez, *The Evolution of Top Incomes: A Historical and International Perspective*, 96 AM. ECON. REV. 200, 200 (2006) [hereinafter Piketty & Saez, *The Evolution of Top Incomes*].

[4] *See* McCall & Percheski, *supra* note 1, at 338.

[5] *See* Lemieux, *supra* note 1, at 22–23; *see also* McCall & Percheski, *supra* note 1, at 335–42.

[6] Given the consensus that contemporary inequality is proximately caused by wage increases, which clearly are an economic function, the observation in the text seems obvious.

[7] Although Thomas Piketty's theory comes close. *See generally* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer trans., 2014). For a biting, if not agitated, critique, *see* Daron Acemoglu & James A. Robinson, *The Rise and Decline of General Laws of Capitalism*, 29 J. ECON. PERSP., 3, 3 (2015).

[8] Lemieux illustrates significant theoretical overlap. *See* Lemieux, *supra* note 1, at 22–24. For an attempt to classify theories, *see generally* Martina Morris & Bruce Western, *Inequality in Earnings at the Close of the Twentieth Century*, 25 ANN. REV. SOC. 623 (1999).

labor markets, traditionally with a neo-classical focus,[9] or in some more recent scholarship, on financial markets.[10] Institutional theories look to the policies and practices of governmental and financial institutions,[11] while normative theories focus on ideology.[12]

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[9] Daron Acemoglu & David Autor, *Skills, Tasks and Technologies: Implications for Employment and Earnings*, *in* 4B HANDBOOK OF LABOR ECONOMICS 1043, 1159-60 (2011); *see also* David H. Autor et al., *Trends in U.S. Wage Inequality: Revising the Revisionists*, 90 REV. ECON. & STAT. 300, 300–01 (2008); Lemieux describes the neo-classical (supply and demand) based focus of the studies that began in the 1980s. Lemieux, *supra* note 1, at 22–23.

[10] *See, e.g.*, James B. Ang, *Finance and Inequality: The Case of India*, 76 S. ECON. J. 738, 738, 741–42 (2010); Thorsten Beck et al., *Finance, Inequality and the Poor*, 12 J. ECON. GROWTH 27, 28 (2007); George R.G. Clarke et al., *Finance and Income Inequality: What Do the Data Tell Us*, 72 S. ECON. J. 578, 580–81, 586 (2006); Mitali Das & Sanket Mohapatra, *Income Inequality: The Aftermath of Stock Market Liberalization in Emerging Markets*, 10 J. EMPIRICAL FIN. 217, 217–19 (2003); William Lazonick & Mary O'Sullivan, *Maximizing Shareholder Value: A New Ideology for Corporate Governance*, 29 ECON. & SOC'Y 13, 14, 29–30 (2000); Michael T. Owyang & Hannah G. Shell, *Taking Stock: Income Inequality and the Stock Market*, ECON. SYNOPSES 1, 2 (Fed. Reserve Bank of St. Louis, St. Louis, Mo.) (Apr. 29, 2016) (https://files.stlouisfed.org/files/htdocs/publications/economic-synopses/2016-04-29/taking-stock-income-inequality-and-the-stock-market.pdf [https://perma.cc/NC6M-945W]); Jakob de Haan & Jan-Egburt Sturm, *How the Development and Liberalisation of the Financial Sector Is Related to Income Inequality: Some New Evidence* (Baffi Carefin Ctr. for Applied Research on Int'l Mkts., Banking, Fin. & Regulation, Working Paper No. 2016-33, 2016) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2815852); Daniel Detzer, *Inequality and the Financial System-The Case for Germany*, 54 PAKISTAN DEV. R. 585, 585-86 (2015); Asli Demirgüç-Kunt & Ross Levine, *Finance and Inequality: Theory and Evidence*, 1 ANN. REV. FIN. ECON. 287, 289-90. Ang notes that "little is known about how finance impacts income inequality." Ang, *supra*, at 738. Financial development has been found to reduce income inequality. *See* Beck et al., *supra*, at 46; *see also* Clarke et al., *supra*, at 595. The effect financial liberalization has on inequality is far more equivocal, although Ang speculates that it could be beneficial in the long run. *See* Ang, *supra*, at 759.

[11] *See* PIKETTY, *supra* note 7. *See, e.g.*, Neil Fligstein & Taek-Jin Shin, *The Shareholder Value Society: A Review of the Changes in Working Conditions and Inequality in the United States, 1976–2000*, *in* SOC. INEQ. 401 (Kathryn M. Neckerman ed., 2004); Stephanie Moller et al., *Changing Patterns of Income Inequality in US Counties*, 1970–2000, 114 AM. J. SOC. 1037 (2009); Kathryn M. Neckerman & Florencia Torche, *Inequality: Causes and Consequences*, 33 ANN. REV. SOC. 335 (2007); Piketty & Saez, *Income Inequality*, *supra* note 3; Piketty & Saez, *The Evolution of Top Incomes*, *supra* note 3; Ola Sjöberg, *Corporate Governance and Earnings Inequality in the OECD Countries, 1979–2000*, 25 EUR. SOC. REV. 519 (2009).

[12] *See, e.g.*, Dep't of Econ. & Soc. Affairs, *Inequality Matters: Report on the World Social Situation* 2013, U.N. Doc. ST/ESA/345 (2013); PIKETTY, *supra* note 7; JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY (2012); Anthony B. Atkinson et al., *Top Incomes in the Long Run of History*, 49 J. ECON. LITERATURE 3 (2011); David R. Howell, *Increasing Earnings Inequality and Unemployment in Developed Countries: Markets, Institutions, and the "Unified Theory,"* 30 POL. & SOC'Y 193 (2002); Paddy Ireland, *Shareholder Primacy and the Distribution of Wealth*, 68 MOD. L. REV. 49 (2005) (analyzing the shareholder primacy norm's effect on wealth distribution in the United States and the United Kingdom); Lazonick & O'Sullivan, *supra* note 10. McCall and Percheski identify family formation patterns as significant normative and behavioral changes that may have a significant effect on income inequality. *See* McCall & Percheski, *supra* note 1, at 335–37.

It appears that almost all of these theories, explicitly or implicitly, recognize the role of corporate governance in the recent explosion of income inequality.[13] Yet corporate governance scholars have not paid attention to the issue.[14] My goal in this article is to provide a first attempt at investigating the links between corporate governance and income inequality.[15]

I conclude that the principal institution of corporate governance that drives income inequality is the modern monitoring board, which began to take shape in the 1970s and fully formed during the 1980s, the decade of the fastest growing economic disparity.[16] The shareholder value norm is the principal normative force motivating the monitoring board to dramatically increase top incomes. Although the shareholder value norm did not find its fullest practical expression until the late 1990s, it grew out of changes in business and financial practices, tracing back to the 1950s, and can be seen in practical operation by the mid-1980s.[17]

Historical analysis supports the conclusion that the modern monitoring board and the shareholder value norm are complementary.[18] However, while

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[13] As I will argue, market theories grounded in labor and financial practices, institutional behavior relating to issues of corporate management, tax policy, trade policy, deregulation, norm shifts including the possibly increasing acceptance of high compensation disparities, and shareholder valuism all can be traced back to corporate governance practices. Piketty directly attributes much of the blame for radical inequality to corporate governance without identifying the mechanisms. *See* PIKETTY, *supra* note 7, at 331–33. McCall and Percheski identify corporate governance as central to economic explanations of rising top-end wages. *See* McCall & Percheski, *supra* note 1, at 338.

[14] However, there are some scholars who have looked at the issue. *See* Ireland, *supra* note 12, at 56-57; Lazonick & O'Sullivan, *supra* note 10, at 13-14; Sjöberg, *supra* note 11, at 519-20.

[15] Despite the fact that wealth inequality historically has been far greater and more intractable than income inequality, most of the scholarly focus has been on income inequality, in part because wealth data is harder to obtain, and wealth is notoriously difficult to measure. *See* Charles I. Jones, *Pareto and Piketty: The Macroeconomics of Top Income and Wealth Inequality*, 29 J. ECON. PERSP., 29, 34-35 (2015). Wojciech Kopczuk explains some of the methods for measuring and determining wealth. *See* Wojciech Kopczuk, *What Do We Know About the Evolution of Top Wealth Shares in the United States?*, 29 J. ECON. PERSP., 47, 48–51 (2015). As Paul Krugman points out, income eventually becomes wealth. *See* Paul Krugman, *Why We're in a New Gilded Age*, N.Y. REV. BOOKS, May 8, 2014, at 15, 16–18. I focus on income.

[16] It appears to be the consensus view that the 1980s were the times of the fastest growth in income disparity. *See* Lemieux, *supra* note 1, at 22; *see also* McCall & Percheski, *supra* note 1, at 333.

[17] *See* Lazonick & O'Sullivan, *supra* note 10, at 13–14 (noting the development of shareholder valuism as a "relatively recent phenomenon").

[18] Jeffrey Gordon describes the phenomenon as "co-evolution," with which I largely agree. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1510 (2007). The history of the monitoring board's development is provided in the works of Lawrence E. Mitchell and Jeffrey Gordon. *See* Gordon, *supra*, 1473–76; *see also* Lawrence E. Mitchell, *The Trouble with Boards*, *in* PERSPECTIVES ON CORPORATE GOVERNANCE 17, 22–27 (F. Scott Kieff & Troy A. Paredes eds., 2010).

the monitoring board might be capable of generating different norms,[19] shareholder valuism is reliant upon the interplay of the monitoring board and corporate structure for its effectiveness.[20] Therefore, the monitoring board appears to be the driving force of shareholder valuism.

This conclusion is important. While it has explanatory power on its own, it also unites disparate causal theories of income inequality by providing a unifying and underlying explanation.[21] Changes in compensation practices, labor and employment practices, and the role of technology in modern production can be traced to the modern board's imperative to maximize the prices of their corporations' capital stock. Other changes, like changes in tax law, cannot directly be traced to corporate governance but are, in part, a product of corporate lobbying.[22] While space will not allow for the comprehensive analysis of all these factors, what this article provides will, I hope, stimulate further research. In this respect, I offer this article as an early effort to identify the links between inequality and corporate governance, while leaving more theoretical and empirical work to be done.

The story presented here also complements and largely affirms most of the explanation offered by Thomas Piketty and Emmanuel Saez. In particular, Piketty has been criticized, even by his greatest admirers, for his relatively unsupported explanatory assertions of norm change—stimulated by tax changes—and corporate collusion as causative of the inequality phenomenon presented by their data.[23] But this data can be mapped onto a narrative of the economic history of the 20th century to reveal sources of the norms and the apparent collusion Piketty describes. The story then becomes

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[19] Although I doubt it. *See infra* Part IV.

[20] *See generally* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 99 (2001) [hereinafter CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT].

[21] I do not mean to suggest a mono-causal explanation, despite appearances. Although I will trace the development of the shareholder value norm through the historical development of corporate governance and financial markets, I acknowledge that the shareholder value norm itself grows from many different sources, including shifts in economic ideology and changes in business practices, social norms, and government policy, among others. It is beyond my expertise to analyze them all. It is enough, I hope, to identify the shareholder value norm as the vector of these inputs to explain its role in income inequality. The conclusion is also important because it is a potent illustration of the way in which apparently esoteric changes in corporate law can profoundly affect the world in which we live. For a general argument of the pervasive power of corporate law, *see generally* Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1 (2008).

[22] *See* Brian Kelleher Richter et al., *Lobbying and Taxes*, 53 AM. J. POL. SCI. 893, 907 (2009).

[23] Saez has written with Piketty on the norm-change theory, but Piketty has been exposed most to criticism for his forceful statements in *Capital in the Twenty-First Century. See generally* PIKETTY, *supra* note 7. Even Krugman's celebratory review notes the relative lack of rigor in this analysis. Krugman, *supra* note 15, at 6.

considerably richer—dependent upon more than simply tax change and unobserved collusion.

The story is not one of capitalism, but of varying capitalisms. Corporate governance mechanisms develop in response to the specific needs of styles of capitalism.[24] Specifically, the monitoring board, which appears in different forms both at the beginning and the end of the 20th century,[25] directly responds to the needs of finance capitalism. The managerial board dominated the middle of the century, a period of relative income equality, and fulfilled the requirements of industrial capitalism. This observation does not resolve the issue of the tractability of significant income inequality,[26] but it does suggest that significant policy changes might reverse current trends. I do not propose solutions, if solutions indeed are desirable, but I will suggest that tax and accounting changes might have some power to begin a shift in the nature of American capitalism that could ultimately reduce the growth of income inequality.[27]

Part I provides a brief description of the leading contemporary economic theories of income inequality:[28] The Skills Biased Technological Change Hypothesis ("SBTC"), associated recently with Daron Acemoglu and David

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[24] The norms and structures of financial practice develop in response to the needs of finance. Lawrence E. Mitchell & Dalia T. Mitchell, *The Financial Determinants of Corporate Governance: A Brief History*, *in* CORPORATE GOVERNANCE: A SYNTHESIS OF THEORY, RESEARCH, AND PRACTICE 19, 19 (H. Kent Baker & Ronald Anderson eds., 2010). Gilson and Gordon make a similar point. Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 868 (2013).

[25] The 1940s through at least the early 1970s were periods of significant relative income equality. *See* Piketty & Saez, *Income Inequality*, *supra* note 3, at 30–31.

[26] There is dispute about the extent to which income inequality is episodic or secular. *Compare* STIGLITZ, *supra* note 12, at 5–6 (inequality can be slowed or reversed by institutional means), *with* PIKETTY, *supra* note 7, at 326–28 (inequality is pretty intractable but not necessarily irreversible), *and* Autor et al., *supra* note 9, at 301 (inequality is secular).

[27] Inequality as a normative matter is beyond the scope of this paper. There is literature that suggests that inequality actually increases economic growth, even in a manner that eventually helps the less well-off. *See, e.g.*, Dan Andrews et al., *Do Rising Top Incomes Lift All Boats?*, 11 B.E. J. ECON. ANALYSIS & POL'Y 1, 36–37 (2011) (finding that at the end of thirteen years, the benefits to the bottom of the income distribution from a 1% increase in inequality produce benefits that outweigh the costs). There is also evidence that Americans have a significant tolerance for economic inequality. STIGLITZ, *supra* note 12, at 147. But, there also is evidence that tolerance is waning. KATHERINE S. NEWMAN & ELIZABETH S. JACOBS, WHO CARES? PUBLIC AMBIVALENCE & GOVERNMENT ACTIVISM FROM THE NEW DEAL TO THE SECOND GILDED AGE 90 (2010). Extreme levels of inequality can certainly affect the way a society sees itself. Kopczuk, *supra* note 15, at 47 (observing that inequality can affect the degree to which a society sees itself to be a meritocracy). The interested reader can surely find many examples of these arguments, as well as others.

[28] Despite the existence of interesting theories from a variety of other disciplines, my focus is economic theories because all concerned appear to accept Piketty and Saez's data locating contemporary inequality in wages, which is ultimately an economic phenomenon. *See, e.g.*, Thomas Lemieux, *Postsecondary Education and Increasing Wage Inequality*, 96 AM. ECON. REV. 195, 195 (2006).

Autor, among others;[29] a more institutionally-grounded theory—or really set of theories—presented by Thomas Lemieux;[30] and the more normative theory presented by Thomas Piketty and his collaborators.[31] All three theories depart from pure neo-classical tradition, in that each, at some level, acknowledges the important explanatory power of institutional behavior.[32]

Part II examines corporate and market behavior from the 1950s revival of the American stock market to the present to determine the channels through which corporate governance could most likely affect income inequality. The shift from industrial capitalism to finance capitalism, and from managerial boards to monitoring boards, cemented the normative changes that implicate corporate governance as a culprit in the phenomenon.

Part III traces the historical conditions contributing to the rise of the shareholder value norm. Part IV ties that norm back to the monitoring board to explain its economic incentives and operating capabilities. Part V shows how an explanation of income inequality grounded in corporate governance practices and emerging norms can provide a foundation underlying the major theories of income inequality. Part VI concludes with some brief suggestions for reform.[33]

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[29] Lemieux notes that SBTC was the consensus view of the cause of inequality in the 1990s and "has remained central" despite serious challenges. Lemieux, *supra* note 1, at 23.

[30] *See id.* at 32, 36 (not presenting an overall theory of income inequality so much as developing possible causes of inequality that modify or compliment the dominant market theories); Thomas Lemieux et al., *Performance Pay and Wage Inequality*, 124 Q. J. ECON. 1, 2, 5, 45 (2009); Nicole M. Fortin & Thomas Lemieux, *Institutional Changes and Rising Wage Inequality: Is There a Linkage?*, J. ECON. PERSP., 75–76, 87 (1997).

[31] My principal interest is Piketty's more academic work, done principally with Emmanuel Saez and Anthony Atkinson, than the more sweeping theoretical work presented in Piketty's *Capital in the Twenty-First Century*, although I will have occasion to discuss this as well. *See generally* PIKETTY, *supra* note 7; Atkinson et al., *supra* note 12.

[32] Lemieux describes the departures from neo-classical supply and demand theories as innovative and important. Thomas Lemieux, *Decomposing Changes in Wage Distributions: A Unified Approach*, 35 CANADIAN J. ECON. 646, 648 (2002). Indeed, Acemoglu and Autor show how both supply and demand for certain types of labor can increase simultaneously. Acemoglu & Autor, *supra* note 9, at 1144, 1147. The Acemoglu–Autor theory hews closest to neo-classical traditions.

[33] While sociology and political science present cogent analyses of income inequality, reasons of space have led me to focus primarily on economic theories. I have some confidence that the analysis I present will hold true for other types of theories as well.

I. EXPLANATIONS OF INEQUALITY

A. The Theories

"[W]hen we turn to consider the *distribution* of economic welfare—economic equality, as it is commonly called—the central stylized fact is one of *constancy*,"[34] wrote Alan Blinder in 1980. He noted, however, that the stability of economic distribution masked the reality of a dynamic economy, and society should have been expected to produce much greater levels of inequality.[35] The principal stabilizing force, Blinder suggested, was governmental intervention to maintain stability.[36]

The nature of that intervention changed only six years after Blinder's writing. The Tax Reform Act of 1986 was a major blow to the progressive taxation that Piketty, along with Blinder, believed was a principal restraint on excessive inequality.[37]

The 1980s were a period of explosive inequality. While tax reform might have been a factor, empirical evidence suggests that the greatest proportion of inequality growth had already occurred by the late 1980s,[38] alluding to other factors at work. The earliest set of papers studying the inequality phenomenon had a different focus—a relatively straightforward neo-classical supply and demand story grounded in increasing technology and the educational attainment of workers.[39] The idea was that technological changes created new demands for skilled workers, raising wages only for those who possessed these skills.[40] Technological change, as an explanatory factor for the increased demand for skilled workers, has remained dominant throughout later research even as other important explanations for the phenomenon, such as globalization and international trade, appeared to have become considerably less persuasive.[41]

The simple neo-classical model ran into some difficulty. Graduates of four-year college programs were being squeezed out of work even more than unskilled workers, yet the number returning to post-graduate education

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[34] Alan S. Blinder et al., *The Level and Distribution of Economic Well-Being*, *in* THE AMERICAN ECONOMY IN TRANSITION 415, 416 (Martin Feldstein ed., 1980).
[35] *See id.*
[36] Blinder had an interesting seat from which to view the development of inequality as a member of President Clinton's Council of Economic Advisors and Vice-Chair of the Federal Reserve Board in the 1990s. PRINCETON UNIV., ALAN S. BLINDER BIOGRAPHY (2017), https://www.princeton.edu/blinder/Bio.pdf [https://perma.cc/989V-V9SQ].
[37] *See* Alan S. Blinder, *The Under-Taxed Kings of Private Equity*, N.Y. TIMES (July 29, 2007), http://www.nytimes.com/2007/07/29/business/yourmoney/29view.html.
[38] McCall & Percheski, *supra* note 1, at 333.
[39] *See* Lemieux, *supra* note 1, at 22–23 (reviewing this literature); *see also* Acemoglu & Autor, *supra* note 9, at 1096–107 (discussing what they refer to as "the canonical model").
[40] *See* Acemoglu & Autor, *supra* note 9, at 1097–98, 1105.
[41] *See* Lemieux, *supra* note 1, at 23.

soared—confounding the idea that demand for skill was the sole driver of inequality. Further explanation was needed. Staying within the neo-classical tradition but bending some of its assumptions, Acemoglu and Autor presented a more refined version of SBTC.[42] A squeezed college cohort could be explained by the computerization of tasks that were relatively routine, despite the fact that they required a reasonably high level of skill to be performed. The mechanization of these tasks allowed them to be performed more inexpensively offshore, resulting in corporations choosing to replace workers with technology and American workers with foreign workers.[43] The increasing supply of post-graduate workers met an increasing demand for people who could operate at high levels of adaptability and abstraction, thus leading to significant market increases in the prices of these skills.[44]

Technological change proved to be an incomplete explanation. If technological change alone explained inequality, one would expect to see similar inequality growth in other developed countries. However, this was not the case.[45] Moreover, while inequality growth during the 1980s was pervasive, its continuation solely at the very top of the wage scale was puzzling.

Wage setting institutions then entered the equation.[46] For example, a decline in union membership, de-unionization, was found to account for approximately 20% of observed inequality in the 1980s.[47] Lemieux and his colleagues estimated that significant increases in performance pay was the powerful explanatory factor, accounting for 21% of inequality growth in the 1980s by their calculations.[48] Piketty and Saez argued that tax changes and other related changes in social norms removed barriers to high pay.[49]

Wage setting institutions, in some form or another, have come to be an integral part of any persuasive economic theory explaining income

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[42] *See* Acemoglu & Autor, *supra* note 9, at 1069. Acemoglu and Autor cite a study showing "that between 1980 and 2006, the real cost of performing a standardized set of computations fell by [sixty] to [seventy-five] percent *annually*." *Id.* at 1075–76 (citing William D. Nordhaus, *Two Centuries of Productivity Growth in Computing*, 67 J. ECON. 128, 146 tbl.7 (2007)).
[43] *See* Acemoglu & Autor, *supra* note 9, at 1076–77, 1146.
[44] Interestingly, this was also true for non-skilled workers, like truck drivers and home-care aides, at the bottom of the distribution. *See id*. at 1077–78.
[45] Saez shows top income inequality increasing similarly in the United States, the United Kingdom, and Canada, but not continental Europe. *See* Emmanuel Saez, *Reported Incomes and Marginal Tax Rates, 1960–2000: Evidence and Policy Implication*s, 18 TAX POL'Y & ECON. 117, 169–70 (2004).
[46] Lemieux, *supra* note 1, at 23.
[47] *See id.* at 33.
[48] Lemieux et al., *supra* note 30, at 4.
[49] *See* Piketty & Saez, *The Evolution of Top Incomes*, *supra* note 3, at 203–04.

inequality. This is significant in understanding the role of corporate governance. If market forces alone could adequately explain the inequality phenomenon, corporations could perhaps be seen as impersonal or innocent actors in a somewhat deterministic free market economy. Yet the evidence suggests otherwise, leaving room for an explanation grounded in an analysis of *why* wage setting institutions make the decisions that they do beyond a simple supply and demand response. [50] While markets may provide the context for corporate behavior, the decision to grant performance pay in the form of bonuses and stock options is not an automatic market response, nor is collusion between boards and CEOs, nor is the decision to replace workers with machines.[51] These are decisions that must affirmatively be made by boards and top executives.

B. The Data

Despite a lack of consensus on the causation of inequality, there is substantial consensus on the importance of the data collected and analyzed by Piketty and Saez.[52] Their data attribute the explosion in income inequality to top executive wages and thus place it in an explicitly institutional wage-setting context.

Piketty and Saez presented their data as a time series, which allows for long-run analysis of inequality and helps to place the contemporary situation in context.[53] This data can be mapped onto the narrative history of twentieth-century American finance and corporate governance to show how corporate governance plays a central role in the inequality phenomenon, confirming the past intuitions of inequality scholars.

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[50] Of course, the principal wage setting institutions in the United States are its corporations.
[51] This last type of decision can, I suppose, be seen as driven by market forces, but it is a far more considered type of decision than one based on the simple fact that the market has established x as the price for workers holding skill set. That they may be responding to market pressures at a meta-level does not change the equation. There are many possible responses to market pressures for inputs and products. A decision requires human agency.
[52] Even Piketty's harshest critics acknowledge the importance of the data. *See, e.g.*, Acemoglu & Robinson, *supra* note 7, at 8–9, 12, 24.
[53] *See* Piketty & Saez, *Income Inequality*, *supra* note 3, at 2–3, 35. Their focus on the top 10% is primarily driven by the availability of good data. They provide a thorough explanation of the limitations of their data set and thus, the possible scope of their analysis, in *Top Incomes in the Long Run of History*. *See* Atkinson et al., *supra* note 12, at 12–40. Piketty provides a rich, nuanced, historical explanation of this and later data in CAPITAL IN THE TWENTY-FIRST CENTURY, where he also draws on later extensions of his data. *See generally* PIKETTY, *supra* note 7. In this discussion, I rely on his earlier academic work in presenting the data, while adding his updated analysis where it expands upon or qualifies earlier work, partly because this earlier work concentrates on the United States and partly because it provides a more detailed technical explanation.

The data demonstrates that income inequality has been a significant characteristic of the American economic landscape since the early 20th century.[54] Capital fortunes that generated early century inequality were destroyed by the 1929 Crash and top wages were flattened by progressive income taxation.[55] Income inequality dropped significantly as wages rose in the lower and middle cohorts. However, beginning in the late 1960s, wages for top corporate executives, including stock option compensation, began to soar. In the late 1980s, executive wages skyrocketed, reflecting how the largest proportion of wealth had come to be held by the "working rich" rather than by capitalists.[56]

Piketty and Saez's data consist of reported gross income.[57] With respect to stock option income, they did not explore the division between earned and capital income, largely because the IRS treats stock compensation as wages.[58] Data does not always easily permit income separation. Therefore, Piketty and Saez also did[59] not separate wage income from what they refer to as "entrepreneurial income," a term they do not define.[60] One would expect "entrepreneurial income" to be significant, given what we have learned in the last thirty years about business formation and venture capital.

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[54] *See* Piketty & Saez, *Income Inequality*, *supra* note 3, at 11 fig.1; *see also* LANE KENWORTHY & TIMOTHY SMEEDING, GROWING INEQUALITIES AND THEIR IMPACTS IN THE UNITED STATES (2013), http://gini-research.org/system/uploads/443/original/US.pdf?1370077377 (providing several sets of data ranging from 1967 to 2011).

[55] As Piketty & Saez demonstrate, the loss in wealth never was recaptured. *Income Inequality*, *supra* note 3, at 3, 30. They make the interesting point that the average level of "fortune" has held at an inflation-adjusted constant $80 million throughout the century from 1916 to 1997, despite growing GDP, which suggests that the capital wealthy have declined in wealth. *See id.* at 19, 21, 29–30.

[56] Although recovery in top wage income began in the late 1960s, Piketty and Saez observe the largest jump in recovery occurred in the two years following the Tax Reform Act of 1986. *See id.* at 11, 31. Saez observes that tax changes are not an adequate explanation of the increase in radical inequality. *See* Saez, *supra* note 45, at 159–60, 168, 170. I have previously noted the consensus view that the most significant portions of inequality growth had taken place by the late 1980s. *See* Lemieux, *supra* note 1, at 27, 46; McCall & Percheski, *supra* note 1, at 333.

[57] *See* Piketty & Saez, *The Evolution of Top Incomes*, *supra* note 3, at 202.

[58] *See id.* at 200.

[59] Along these lines, Stockhammer makes the interesting point that it is more appropriate to view exorbitant CEO salaries as profits rather than wages, implicitly treating them as income from capital regardless of their tax status. *See* Englebert Stockhammer, *Financialization, Income Distribution, and the Crisis*, 71 INVESTIGACIÓN ECONÓMICA 39, 55–56 (2012). He notes that a significant decline in profits can be observed simply by deducting the top 1% of the U.S. wage share. *Id.* Lazonick & O'Sullivan note the increase in the proportion of top executive pay from stock options as beginning in the 1950s, leading to a separation of top management from the rest of the managerial structure through substantially increased compensation. *See* Lazonick & O'Sullivan, *supra* note 10, at 24–25.

[60] *See* Piketty & Saez, *Income Inequality*, *supra* note 3, at 16 fig.4, 17.

[61] However, if we reasonably assume entrepreneurial income consists largely, if not entirely, of equity,[62] it is far more relevant to understanding wealth inequality than it is to income inequality.

Equity is important in explaining income inequality, especially with respect to growth of the shareholder value norm and, thus, the role of the monitoring board. Although wages are the driving force in contemporary income inequality, those same wages are also significantly composed of stock options,[63] which are close to worthless unless the stock price rises. While Piketty and Saez leave stock options simply as another form of wages, the fact that this type of compensation is really equity instead of cash intensifies the role of corporate governance in the story of inequality.

II. CAPITALISMS AND CORPORATE GOVERNANCE

A. *Two Capitalisms. Two Distributions.*

"Capital still matters."[64] The formation of capital in the early and late twentieth century also matters for our story of contemporary inequality.[65]

The creation of capital during both periods led to the dominance of finance capitalism grounded in the public securities markets.[66] Fortunes were

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[61] Kaplan and Rauh's analysis of the Forbes 400 suggests a very substantial number of entrepreneurs among them. *See* Steven N. Kaplan & Joshua D. Rauh, *Family, Education, and Sources of Wealth Among the Richest Americans, 1982–2012*, 103 AM. ECON. REV. 158, 159–61 (May2013); *see also* Agustino Fontevecchia, *There Are More Self-Made Billionaires in the Forbes 400 Than Ever Before*, FORBES (Oct. 3, 2014, 11:09 AM), http://www.forbes.com/sites/afontevecchia/2014/10/03/there-are-more-self-made-billionaires-in-the-forbes-400-than-ever-before/#53dd4eb7e0a5.

[62] *See generally,* Michael Wolfe, *The Three Ways To Make A Lot of Money at a Startup*, FORBES (Oct. 31, 2013, 11:42 AM), http://www.forbes.com/sites/quora/2013/10/31/the-three-ways-to-make-a-lot-of-money-at-a-startup/#606a621f6636.

[63] *See, e.g.,* LUCIEN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 1 (2004) (showing that stock option compensation has been important since the early 1990s); PIKETTY, *supra* note 7, at 115, 303 (noting the importance of stock options as compensation); Brian J. Hall & Jeffrey B. Lieberman, *Are CEOs Really Paid Like Bureaucrats?*, 113 Q. J. ECON. 653, 654–55 (1998). Sixty percent of executives held stock options in the 1960s, although the proportion of pay this represented was lower than it later became, rising rapidly in the 1980s. Carola Frydman & Raven E. Saks, *Executive Compensation: A New View from a Long-Term Perspective, 1936–2005*, 23 REV. FIN. STUD. 2099, 2107 fig.1, 2108 fig.2, 2120 (2010).

[64] Krugman, *supra* note 15, at 16. I should note, for accuracy, that Krugman shares Piketty's understanding of capital.

[65] While I return to the broader field of inequality theories in Part V, I will, in the story that follows, engage principally with Piketty and Saez for the simple reasons that theirs is the data from which all contemporary analysis of income inequality begins, and the historical sweep of their data allows it to be mapped onto a richer account of the century's financial history.

[66] *See generally* THORSTEIN VEBLEN, THE THEORY OF BUSINESS ENTERPRISE 1–3 (1904).

made and grown through market manipulation.[67] Early on, manipulation was largely the province of bankers, along with some willing former industrialists. Later, manipulation became the province of top executives, encouraged by institutional investors, hedge funds, and their own compensation structures.[68]

By contrast, the mid-century was characterized by a solidly industrial capitalism in which a strong equity-based financial market was absent, industry was heavily concentrated in the hands of its founders or their families,[69] financiers were relatively unimportant, and income and wealth were derived from the slow profits of mature industry.[70]

Gross economic inequality, however composed, arguably is not a feature of capitalism *simpliciter* but rather a feature of a particular type of capitalism—finance capitalism. Corporate governance is the necessary nexus that integrates and coordinates the factors leading to each type of capitalism, because corporations are the principal mechanism that sustains capitalism.

The story begins with the early period. The middle and, especially, the last quarter of the nineteenth century witnessed the rise of new industries, great businesses, and giant fortunes. The railroad was instrumental in spawning some of these changes. The railroad industry also made an important contribution to the growth of industrial giants.[71] But many more fortunes were grounded in industry conducted primarily in the form of partnerships, or interlocking partnerships called trusts.[72] Capital was grown from within; by reinvesting earnings in the business or making acquisitions, these corporations grew to enormous size. [73]

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67 *See id.* I am not using the term "manipulation" in a normative sense, legal or otherwise. Rather, I am following Veblen, whose description of the shift from industrialists to businessmen and their different ways of acquiring wealth at the end of the Great Merger Wave remains trenchant today. *See id.* at 1–3, 21–24.

68 *Id.*

69 *See* TEMP. NAT'L ECON. COMM., 76TH CONG., THE DISTRIBUTION OF OWNERSHIP IN THE 200 LARGEST NONFINANCIAL CORPORATIONS 13–15 (Comm. Print 1940); PHILIP H. BURCH, JR., THE MANAGERIAL REVOLUTION REASSESSED: FAMILY CONTROL IN AMERICA'S LARGE CORPORATIONS 20, 68 (1972); ROBERT J. LARNER, MANAGEMENT CONTROL AND THE LARGE CORPORATION 19 (1970); Maurice Zeitlin, *Corporate Ownership and Control: The Large Corporation and the Capitalist Class*, 79 AM. J. SOC. 1073, 1099, 1101 (1974); *see also* Clifford G. Holderness & Dennis P. Sheehan, *The Role of Majority Shareholders in Publicly Held Corporations*, 20 J. FIN. ECON. 317, 321, 323 (1988).

70 Lazonick and O'Sullivan describe the era's financial practice as "retain and reinvest." Lazonick & O'Sullivan, *supra* note 10, at 14-15.

71 *See* LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 12–13 (2008).

72 *Id.* at 9.

73 *See id.* at 9–12 (describing the growth of trusts).

Acquisitions, however, were problematic. Anti-monopoly legislation and litigation were constant features of the legal landscape, while corporate laws throughout the nation made any form of integrated acquisition impossible.[74] The transportation and industrial landscapes were characterized by too much competition, resulting in frequent price wars and loss of business for many entrepreneurs.[75] At least some degree of combination was necessary to sustain the benefits of this industrial development for businesses and consumers across the country.[76]

At this point, New Jersey undertook a major overhaul of its corporation laws, liberalizing them in a manner that ranged from permitting corporations to incorporate in New Jersey without engaging in business there to issuing stock in exchange for the stock of another corporation with the value to be determined solely by the board of directors, permitting them to make acquisitions more or less at will, even through a holding company created for no other purpose than to buy other corporations.[77] Concurrent with the completion of these changes, America emerged powerfully from a long and deep depression. Investment bankers like J.P Morgan and Jacob Schiff, who had spent many years on railroad reorganizations, as well as other bankers, stock speculators, and trust promoters, were ready to capitalize on these developments.[78]

They did so with a vengeance. Bankers and trust promoters arranged the combination of tens, and sometimes hundreds, of companies either by merger or under the auspices of a holding company created for that purpose.[79] The acquiring companies, taking advantage of New Jersey law, valued the acquired company at whatever price was necessary and paid the owners in stock of the parent. This resulted in enormous overcapitalization, an impossibility according to some modern economic ears, but indeed an actual phenomenon which took over two decades of congressional investigation and became a widely held concept among economists.[80] Dividends were stated as a percentage of this inflated capital. Thus, the amount of dividends paid to stockholders was a consequence of the amount of stated capital. The larger the stated capital, the higher the dividends. The newly created class of "rentiers," so identified by Piketty and Saez, lived off this dividend income.[81]

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[74] *See id.* at 29.
[75] *See id.* at 24.
[76] *Id.* at 24–25.
[77] *Id.* at 42–44, 54.
[78] *See id.* at 57–58.
[79] *Id.* at 9, 57.
[80] *Id.* at 58, 60.
[81] Piketty & Saez, *Income Inequality*, *supra* note 3, at 17.

This financial restructuring characterized the great merger wave, during which more than $4 billion of corporate capital, mostly in the form of equity, was pumped into the American economy within a period of seven years.[82] More than 2,600 businesses merged,[83] at least half of which were bought for stock.[84] Bankers realized profits by floating the stock on the market in mass quantities.[85] The new middle class, happily emerging from the depression, was all too pleased to get its piece of the action. The modern stock market was formed, and far greater fortunes were made, often from the nontaxable capital gains on sales of stock or dividends paid as a stated percentage of that stock.[86]

This period was one in which finance capitalism dominated industrial capitalism, a transformation Veblen observed even as it was happening.[87] He compared the relative disappearance of the industrialist with the ubiquity of the businessman who made his profits on industrial market disruption and arbitrage rather than on the production of goods and services.[88] While the merger wave ended and the market soon crashed, foundational changes had already been established.

The era of finance capitalism dominated that of industrial capitalism. Far more money was to be made under the new system. Of course, industry did not disappear. Not only was industry necessary to sustain the profits of finance, but it was also struggling to justify the outlandish earlier capitalizations put upon it by the captains of finance and their eager customers.[89] Yet, while finance capitalism waned during the second decade and the war years, the Liberty Bond drives created enormous demand for new securities that existed through the 1920s.[90]

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[82] *See* MITCHELL, *supra* note 71, at 9-13 (discussing the various studies determining that the amount of corporate capital put into the economy from 1897 to 1904 was over $4 billion).
[83] *Id.* at 12 (noting that another contemporaneous study estimated that 8,664 businesses were merged during this period).
[84] *See id*. at 47, 67-68, 71-72 (discussing the use of a combination of common stock and preferred stock to capitalize the new business).
[85] *See id.* at 31-32. As one example of investment bankers' fees, although perhaps an unusually large one, JP Morgan was paid the equivalent of $62.5 million in shares of US Steel for managing its creation through consolidation. *Id.* That is more than $1 billion dollars today. *Id.*
[86] *See generally id.* at 90–112 (discussing the rise of the modern stock market and the transition to profiting from capital gains).
[87] *Id.* at 13.
[88] *See* VEBLEN, *supra* note 66, at 30-31, 89-91.
[89] For example, it took U.S. Steel at least fourteen years of retaining earnings for its assets to equal its 1901 capitalization. ARUNDEL COTTER, THE AUTHENTIC HISTORY OF THE UNITED STATES STEEL CORPORATION 224 (1916). Other accounts put it at thirty years. MITCHELL, *supra* note 71, at 303 n.39.
[90] MITCHELL, *supra* note 71, at 262–63.

And then it ended. There was a brief stock market revival in 1933, but from the 1929 crash until the early 1950s the stock market and the general financial industry largely remained moribund.[91] Corporations once again were financing internally, as they had done in their previous iterations in the nineteenth century.[92] While bank borrowing remained important, they were not issuing stock, without which finance capitalism lapsed and an industry concentrated on the production of goods and services was revitalized. The reinvestment of earnings and the composition of boards, primarily of corporate executives, really led to the business of America as business.[93]

It was in this later era that Piketty and Saez observed the relative flatness of income distribution.[94] I do not dispute their explanation of the causes of the initial drop in inequality. Progressive taxation undoubtedly was one factor sustaining greater equality, as was the diminution in large fortunes; but also, at play was the domination of a different form of capitalism, a capitalism that drove the development of different governance mechanisms.

The relative equality generated by the 1929 Crash and the Depression was sustained in part because this different form of capitalism re-emerged in a manner that made the kinds of potential market manipulations in finance capitalism less available.[95] And they were also less important as industry returned to the practice of internal growth by reinvesting earnings, the practice of the late nineteenth century.[96]

Equality briefly existed until finance capitalism began to re-emerge. Starting with the New York Stock Exchange's ("NYSE") push in the 1950s to popularize stock ownership, to the rise and hegemony of institutional investors, the conglomeration movement of the 1960s, which led to the general realization that profits could be made more quickly by playing the market, to the de-conglomeration of the 1980s which reinforced the attraction of quick capital gains, the American financial scene was rapidly evolving.[97] The transformation of the investment banking industry from a provider of services to an integrated market player,[98] the increasing

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[91] *See* ROBERT SOBEL, N.Y.S.E.: A HISTORY OF THE NEW YORK STOCK EXCHANGE*, 1935–1975*, 218–22 (1975).
[92] *See id.* at 138–39.
[93] *See* Lazonick & O'Sullivan, *supra* note 10, at 14-15 (analyzing the principle of "retain and reinvest"). It is interesting to note that corporate ownership during this period was characterized by substantial blockholding, often by the families of founders, and that managers and directors took significant amounts of compensation in stock options. *See* LARNER, *supra* note 69, at 19; WILBUR G. LEWELLEN, EXECUTIVE COMPENSATION IN LARGE INDUSTRIAL CORPORATIONS 8-9 (1968).
[94] Piketty & Saez, *Income Inequality*, *supra* note 3, at 3.
[95] *See* SOBEL, *supra* note 91, at 245.
[96] *See* Lazonick & O'Sullivan, *supra* note 10, at 24.
[97] *See* Lawrence E. Mitchell, Lecture, *Financialism*, 43 CREIGHTON L. REV. 323, 325 (2009).
[98] A consequence of a shift in form from partnership to corporation, to public company, and the change in federal legislation. *See* Commodities Futures Modernization Act of 2000, Pub.

proportion of executive compensation paid in stock options, the rise of the private equity and hedge fund industry, and the increasing dominance of the financial industry all evolved so that, by 2006, over 30% of the profits of U.S. "industrial" corporations came from financial transactions.[99] Financial assets constituted almost 48% of the total assets of non-farm, non-financial corporations.[100] The fact that wages are the primary channel through which inequality has grown surely is true; but the context for those wages is a finance capitalism reminiscent of the early twentieth century. History therefore provides perspective from which to draw inferences.

United States economic history shows how radical inequality is a characteristic of finance capitalism, but not of industrial capitalism.[101] Radical inequality may not be destiny, but the way the rich make their money seems to bear on equality.

Corporate governance is important to sustaining and promoting each form of capitalism. Governance in industrial capitalism is aimed at the production of goods and services, with finance generated internally, from bank loans, and from bond issuances.[102] Governance in financial capitalism is aimed at stock price.[103] These are quite different enterprises, each supported by quite different governance regimes. The boards of industrial capitalism, the managerial boards, were composed largely of managers.[104] They knew how their businesses operated at a level of detail only obtainable

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L. No. 106-554, 114 Stat. 2763 (2000); Gramm–Leach–Bliley Act, Pub. L. No. 106–102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 and 15 U.S.C.).

[99] U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2009, at 506 tbl.762 (128th ed. 2008), https://www.census.gov/library/publications/2008/compendia/statab/128ed.html.

[100] *Id.* at 487 tbl.729. Stiglitz further observes that, just prior to 2008, 40% of all corporate profits went to the financial sector. STIGLITZ, *supra* note 12, at 96.

[101] I do not dismiss Piketty and Saez's emphasis on taxation. Surely progressive taxation with very high marginal rates had its impact. But capital gain taxes of the period were considerably lower. It may also be, although I do not explore the question here, that highly progressive taxation would be politically unsustainable if a finance economy were to begin to emerge, as happened in the 1980s with the passage of the Tax Reform Act of 1986, significantly diminishing the progressivity of U.S. taxation.

[102] Such, at least, is the financial history of the period. *See generally* Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH. & LEE L. REV. 1635, 1649-50 (2009) (noting the importance of debt financing and lack of a public equity market in the early American industrialization period).

[103] *Cf.* Gerald F. Davis & Suntae Kim, *Financialization of the Economy*, 41 ANN. REV. SOC. 203, 204 (2015) (arguing that "social institutions [are shaped] in fundamental ways" by the way "finance is intermediated.").

[104] For an interesting examination of changes in board composition, *see generally* Johan S.G. Chu & Gerald F. Davis, *Who Killed the Inner Circle? The Decline of the American Corporate Interlock Network*, 122 AM. J. SOC. 714, 715-16 (2016).

by corporate employees.[105] Modern boards of financial capitalism are composed of part-timers, the CEOs of other corporations, and others removed from daily operations.[106] No matter how well-intentioned, they generally lack time to understand the operations of the business of another CEO. Moreover, their compensation packages look like the top executive compensation packages on the boards of which they sit. [107] These board members come from roughly the same socio-economic and normative backgrounds.[108] Their expertise is in stock price, not production or sales.

The board model under industrial capitalism was also far from perfect. Indeed, contemporary corporate governance developed in part because of broad political challenges to real or perceived business and social pathologies of the industrial model. But the primary stimulus to the creation of contemporary corporate governance was finance itself. The right and left both converged on the desirability of an independent monitoring board.[109]

The contemporary monitoring board is an important key to understanding the creation and sustenance of these two types of capitalism, and thus the creation and sustenance of radical inequality. It acts both as a coordinator of financial and economic trends, and a perpetuator of the coordinated system.

The forms and rules of governance correlate with different capitalisms. An examination of the historical development of the monitoring board and the changes in business and financial practices reveal how we returned to finance capitalism and settled upon the independent monitoring board.

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[105] They also presumably understood their own corporate values. An interesting recent paper examines the relationship among corporate values, corporate social norms, and formal institutions as they affect firm value. John R. Graham et al., *Corporate Culture: Evidence from the Field* 5-6 (Nat'l Bureau of Econ. Research, Working Paper No. 23255, 2017), http://www.nber.org/papers/w23255. Although the study's data is considerably more recent, I suspect that the conclusions it draws are likely to apply to earlier periods, unless one thinks human nature has changed dramatically over the last seventy years.

[106] *See, e.g.*, Stephen Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1064-65 (2014) (arguing that directors have other jobs that take up most of their time); *see also* Chu & Davis, *supra* note 104, at 720-21 (noting that some companies believe it to be advantageous to have their executive officers serve on boards of other corporations).

[107] Kevin Murphy provides rather exhaustive research on the components of executive compensation. Kevin Murphy, *Executive Compensation: Where We Are and How We Got There*, *in* 2A HANDBOOK OF THE ECONOMICS OF FINANCE: CORPORATE FINANCE 211, 213 (G.M. Constantinides et al. eds., 2013).

[108] *See* Chu & Davis, *supra* note 104, at 718-720 (discussing demographics of board members).

[109] *See, e.g.*, George W. Dent, Jr., *The Revolution in Corporate Governance, The Monitoring Board, and the Director's Duty of* Care, 61 B.U. L. REV. 623, 623 (1981) (noting the emergence of the monitoring model).

B. Two Forms of Capitalism and Three Stages of Board Development

Finance capitalism and industrial capitalism each are sustained by their own corporate board structures. The differences between board structure in the first and second eras of finance capitalism reflect differences both in the identity of the economy's primary beneficiaries and in the types of capital income upon which they have relied. An examination of the development of board governance in general, and the monitoring board that emerged, helps to explain the contingent nature of the series of events that has brought us to our current circumstances.

1. The Development of Board Governance[110]

a. Two Types of Monitoring Boards

Relatively little thought was devoted to corporate board function before the latter third of the twentieth century, but boards certainly had their moments of public imagination and inquiry.[111] The Pujo Commission hearings in 1911 and 1912 sparked the first glimmer of interest only a few short years following the merger wave and the creation of the modern stock market. Despite a market crash in 1903 and a banking crisis in 1907, the Pujo Commission was not especially focused on the financial markets, but rather with concerns that had dominated debate over the preceding twenty years as the giant trusts began to grow.[112] Its inquiry centered around the monopolies and market domination achieved through the interlocking directorships held by members of the so-called "Money Trust".[113]

Samuel Untermyer, lead counsel to the Pujo Commission, interrogated bankers in particular about relationships among new large corporations and members of the Money Trust.[114] The rumors were true: corporate boards were dominated by a small group of bankers from a small group of banking houses, each sitting on multiple boards at a time.[115] While federal legislation was introduced to break up what appeared to be anti-competitive collusion,

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[110] *See also* Mitchell, *supra* note 18, at 22-27 (explaining the monitoring board and its rise in much greater detail).
[111] *See* Jeffrey Pfeffer, *Size and Composition of Corporate Boards of Directors: The Organization and Its Environment*, 17 ADMIN. SCI. Q. 218, 219 (1972).
[112] *See* Mitchell, *supra* note 18, at 23.
[113] SUBCOMM. OF THE COMM. ON BANKING & CURRENCY, 62D CONG., MONEY TRUST INVESTIGATION: INVESTIGATION OF FINANCIAL AND MONETARY CONDITIONS IN THE UNITED STATES UNDER HOUSE RESOLUTIONS NOS. 429 AND 504, at 2 (Comm. Print 1913).
[114] *Id.*
[115] *Id.*

the bankers continued to dominate.[116] Whatever their desire for industrial control and combination might have been, it is quite clear that their presence on the board was meant to fulfill a financial function.

Thomas W. Lamont clarified this function in a conversation with Louis D. Brandeis on December 2, 1913 after the Pujo Commission had ended its inquiry:

> *L. D. B.* [Brandeis]: Take your own house alone. Here are all you gentlemen, from all accounts, worked half to death. How, in the nature of things, can you possibly attend intelligently to the affairs of railroad management? It is simply impossible. . . .
>
> *T. W. L.* [Lamont]: But, Mr. Brandeis, we don't attempt to manage railroads. The public has an idea that we do, but that is just what we don't do. Nobody realizes better than we do that that is not our function. We give the best counsel that we can in the selection of good men, making mistakes sometimes of course . . . but on the whole doing fairly well, and we give our very best advice on the financial policy, looking both backward and forward over a series of years, for the purpose of building up and entrenching the company's credit.[117]

Lamont's definition of a board looks very much like the contemporary monitoring board. They hired, provided financial advice, and monitored the company's credit. The singular difference is that the contemporary board hires, monitors, and promotes stock price instead of credit. But this difference simply reflects a change in the composition of capital income, fitting Piketty and Saez's narrative quite well. Capital income during that era was a matter of dividends and interest.[118] Credit stability as a proxy for overall financial stability was a necessary and desirable status for ensuring

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[116] *See, e.g.*, Clayton Antitrust Act of 1914, Pub. L. No. 63-212, 38 Stat. 730 (codified as amended at 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53).
[117] *Brandeis and Lamont on Finance Capitalism*, 47 BUS. HIST. REV. 72, 82–83 (1973).
[118] *See* MITCHELL, *supra* note 71, at 11−14 (discussing board composition changes).

dividends and interest could be paid. It was also consistent with the role of the financial industry at the time.[119]

Whereas equity powered the great merger wave and stock speculation was the sport of the 1920s, credit was the stock-in-trade of the major banking houses.[120] All of the important banks emerged in an era before the stock market was a significant factor.[121] Many of them developed their craft in the arena of railroad reorganizations where credit was the coin of the realm. Credit is, of course, capital—paying interest to those who own it. Thus, the protection of the "rentier" class, described by Piketty and Saez, motivated much of the board service of the bankers. Because there were relatively few bankers compared to board seats, and interlocking assured stability, the Pujo commission's findings were unsurprising.

The model of board governance that dominated during the second era of finance capitalism is the independent monitoring board. In composition, this type of board looks and functions much like the boards described by Lamont and, like those boards, the independent monitoring board principally serves the beneficiaries of finance capitalism. Composed primarily of independent directors[122] who, unlike the members of early century boards are not necessarily bankers, the function of the independent monitoring board is to hire, compensate, and terminate the CEO, provide a check on the corporation's auditing process, vote on conflict of interest transactions, and decide upon the corporation's most important life-cycle events—more or less as described by Lamont in the early century.[123] Relatively little time is expected of these directors because they are drawn largely from the top ranks of other corporations and so have relatively little time to give. Case law has continually accommodated directors, evolving to ensure that little was demanded of them.[124] With limited knowledge about the operations of the business, and relatively little legal incentive to learn,[125] these directors can only engage in tasks allowing for very clear metrics and limited information. As the monitoring board developed, it was almost inevitable that the outside

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[119] *See id.* at 12−13.
[120] *See id.* at 13 (discussing implications of the Great Merger Wave).
[121] *Id*. at 12.
[122] *See* Gordon, *supra* note 18, at 1478−83 (describing the evolution of the narrow concept of directorial independence); *see also* Harold Baum, *The Rise of the Independent Director: A Historical and Comparative Perspective* (Max Planck Inst. for Comparative & Int'l Private Law, Research Paper No. 16/20, 2016), http://ssrn.com/abstract=2814978 (discussing the rise of independent directors).
[123] *See Brandeis and Lamont on Finance Capitalism*, *supra* note 117, at 82–83.
[124] *See, e.g.*, *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 774 (Del. Ch. 2005) (illustrating the relatively light duties of directors).
[125] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967−68 (Del. Ch. 1996).

directors' assessment of corporate success would be measured by the corporation's share price.[126]

The function of early century directors was clearly stated by Lamont—monitoring—mostly for the protection of the corporation's credit.[127] The function of the contemporary monitoring board, at least as it initially developed, was less clear. In fact, one could reasonably describe the condition of the board in the 1970s and long before as an institution in search of a function.

b. The Boards' Search for Meaning

While boards of directors, or institutions like them, have been around for centuries, few expressed interest in what they did or were supposed to do. In the United States, where incorporation prior to the twentieth century was largely limited to banks and railroads, there was no major reason to be concerned with the proper role of boards of directors.[128] When concern about boards was expressed during the late nineteenth and early twentieth centuries, it was a different sort of concern than later developed. Talk about the board was not so much about corporate governance or shareholder matters. It was more of a proxy for larger public issues, like antitrust and railroad pricing.[129] Issues of board behavior principally involved questions of corporate finance intermingled with the board.[130]

As noted earlier, board reform efforts in this earlier period were primarily concerned with the composition of boards and their interlocking nature that could create restraints on competition. Board function was not scrutinized. Corporate governance reform in the modern sense, that is, with regard to board function, traditionally traces to the beginnings of industrial capitalism and the publication of Berle and Means' *The Modern Corporation and Private Property* in 1932.[131] Despite their justifiable fame in provoking broad debate about the legitimacy of corporate dominance based on

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[126] *See* Mitchell, *supra* note 18, at 19–20, 22 (discussing the detailed history and reasons behind the development of the monitoring board).
[127] *See Brandeis and Lamont on Finance Capitalism*, *supra* note 117, at 82–83.
[128] While there were some large extraction and marketing corporations, almost all of the corporations Chandler talks about are railroads. *See* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 285–87 (1977) (dating the development of the large modern corporation to the 1880s); *see also* WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 81 (1997) ("For Chandler, the railroad served as a model for other industries to follow . . . ."). There were very few manufacturing corporations of any size until the late 1890s. CHANDLER, JR., *supra*, at 347; *see* MITCHELL, *supra* note 71, at 2.
[129] MITCHELL, *supra* note 71, at 1–4.
[130] *Id.*
[131] ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

observations of separation of ownership and control and the enormous amount of economic and social power held by management, Berle and Means had quite little to say about the appropriate role of the board. Their concern was largely political, focused on the acquisition of enormous power by corporate boards which, under governance systems at the time, had virtually no accountability to anybody.[132] Accountability to shareholders provides at least some check on the exercise of board power. Berle and Means's exploration of corporate governance was aimed at finding methods of board accountability that would permit the corporation to function while preventing it from dominating the state.[133]

The general understanding that boards did not contribute to the corporation's "financial and commercial policies"[134] any more than they managed the corporation came relatively late.[135] Eisenberg places this recognition as revelatory in 1945.[136] Thus, perhaps we can mark 1945 as the start of the debate on modern board functions.[137] The discussion of board function took place mostly among economists, management scholars, and sociologists, not legal academics.[138] However, even this literature was relatively sparse.[139] By 1960, the University of Chicago Law Review would publish an article suggesting the board itself was an "anachronism."[140]

Most of the legal literature concerned with public corporation boards from Berle and Means through the 1960s was focused on board control of

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[132] *See id.* at 1, 7.

[133] *See id.* at 1-7. For an early, rare piece on board function, *see* William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1305 (1934).

[134] Douglas, *supra* note 133, at 1314.

[135] MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 140 (1976).

[136] *Id.*

[137] There is very little legal literature on the subject following Eisenberg's work until the 1970s, a period which, interestingly enough, is encompassed by the low point of American income inequality.

[138] *See* George D. Hornstein, Book Review, 48 COLUM. L. REV. 164, 164 (1948) (reviewing MELVIN T. COPELAND & ANDREW R. TOWL, THE BOARD OF DIRECTORS AND BUSINESS MANAGEMENT (1947)).

[139] George Hornstein noted in 1948 that critiques of boards principally were the province of judges and sociologists. *Id.*

[140] Robert A. Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696, 696 (1960).

the proxy machinery[141] and the legal duties of directors.[142] Scholars continued to assume boards had at least a policy-making function, if not a management function, the latter of which they simply were not performing.[143] Nonetheless, it remained clear that management held the real corporate power.[144] Even as late as 1976, Eisenberg announced "most of the powers supposedly vested in the board are actually vested in the executives."[145] Yet, the board remained as the last best hope against the increasing displacement of all other interests by what was then seen as rampant managerialism.[146]

The modern monitoring board was an intentional creation, brought about as a result of business, economic, and political circumstances arising in the 1970s to shield directors from legal liability. By the early 1970s, the 1960s conglomeration movement was in crisis.[147] Conflicts of interest among conglomerate members were revealed, as was the overwhelming complexity of the conglomerates' extensive networks of worldwide unrelated businesses.[148] The failure of Penn Central in 1970 revealed surprising details about its unmanageable, and almost indecipherable, network of businesses, leading to a Securities and Exchange Commission ("SEC") investigation into the bankruptcy's causes as well as a securities

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[141] *See, e.g.*, Mortimer M. Caplin, *Proxies, Annual Meetings, and Corporate Democracy: The Lawyer's Role*, 37 VA. L. REV. 653, 655 (1951); Mortimer M. Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage*, 39 VA. L. REV. 141, 159−60 (1953); Note, *Corporations—Payment of Proxy Solicitation Expenses—An Aspect of Corporate Democracy*, 31 N.Y.U. L. REV. 825, 826 (1956). Restrictions on board function by agreement was another area of concern. *See* Chad Robinson, Comment, *"Shareholders' Agreements" and the Statutory Norm*, 43 CORNELL L.Q. 68, 70 (1958).

[142] "The very heart and soul of the development of corporate law in the last two decades has been the immense flood of cases and statutes concerned with the director's duty of loyalty." Samuel M. Fahr, Book Review, 35 IOWA L. REV. 150, 151 (1949) (reviewing PERCIVAL E. JACKSON, WHAT EVERY CORPORATION DIRECTOR SHOULD KNOW (1949)).

[143] *See* Arthur A. Ballantine, Book Review, 59 HARV. L. REV. 151, 152–53 (1945) (reviewing JOHN C. BAKER, DIRECTORS AND THEIR FUNCTIONS (1945)); Fahr, *supra* note 142, at 150–51; Hornstein, *supra* note 138, at 164 ("Corporations . . . function through directors[.]").

[144] *See* Sigmund Timberg, *Corporate Fictions: Logical, Social and International Implications*, 46 COLUM. L. REV. 533, 564–66 (1946). *But see* Mark S. Mizruchi, *Who Controls Whom? An Examination of the Relation Between Management and Boards of Directors in Large American Corporations*, 8 ACAD. MGMT. REV. 426, 426–27 (1983) (positing that boards actually controlled management).

[145] EISENBERG, *supra* note 135, at 141. This actually was not news to Eisenberg or any other careful observer, but the fact that it was worth noting suggests the tenacity of old ideas about board management.

[146] Perhaps the apex of managerialism is illustrated by the wonderful description of ITT's management meeting. *See* RALPH NADER ET AL., TAMING THE GIANT CORPORATION 76–77 (1976).

[147] *See* Lazonick & O'Sullivan, *supra* note 10, at 26.

[148] *See* Richard J. Farrell & Robert W. Murphy, *Comments on the Theme: "Why Should Anyone Want To Be a Director?"*, BUS. LAW.7, 7–22 (1972).

class action lawsuit.[149] Numerous corporate bankruptcies were filed in the failing economy—CEOs were fired, "Chrysler was in need of . . . [a] federal bailout, and even New York City faced bankruptcy."[150] The Watergate investigation revealed illegal corporate campaign contributions, prompting the SEC's broader investigation into questionable payments and bribery both at home and abroad.[151] The political activism of the late 1960s now found itself focused on corporate reform.[152] Corporate boards, long seen as internally-generated and self-perpetuating, came under attack and were viewed as major villains although, in reality, outside directors already constituted a majority of most corporate boards.[153]

While debate raged, largely about trifles within and between the legal and business communities, the monitoring board emerged as the consensus model.[154] The monitoring board was attractive for business because it protected corporate insiders from liability for engaging in conflict of interest transactions, which were increasingly common during the takeover decade of the 1980s. For reformers, the independent board offered the potential to protect stakeholder interests.[155] What neither side noticed is how this new

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[149] *See* SEC Staff Study of the Financial Collapse of the Penn Central Company, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,931 (Aug. 3, 1972).

[150] Mitchell, *supra* note 18, at 28–29 (discussing widespread corporate bankruptcies); Richard Kreitner, *September 7, 1979: Chrysler Asks the US Government for a Bailout*, NATION (Sept. 7, 2015), https://www.thenation.com/article/september-7-1979-chrysler-asks-the-us-government-for-a-bailout/ [https://perma.cc/MW5U-79KF]; Kim Phillips-Fein, *Lessons from the Great Default Crisis of 1975*, NATION (Oct. 16, 2013), https://www.thenation.com/article/lessons-great-default-crisis-1975/ [https://perma.cc/CZ3C-77SQ].

[151] The story is well-told by Seligman. *See* Joel Seligman, *A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEO. WASH. L. REV. 325, 333–36 (1987); S. COMM. ON BANKING, HOUS. & URBAN AFFAIRS, 94TH CONG., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES 2– 3 (Comm. Print 1976). Karmel gives a less sympathetic account. *See* Roberta S. Karmel, *The Independent Corporate Board: A Means to What End?*, 52 GEO. WASH. L. REV. 534, 540–41 (1984).

[152] NADER ET AL., *supra* note 146, at 78 (describing 1975 "a year of reckoning for a dozen major conglomerates").

[153] *See* Noyes E. Leech & Robert H. Mundheim, *The Outside Director of the Publicly Held Corporation*, 31 BUS. LAW. 1799, 1828–29 (1976); Cyril Moscow, *The Independent Director*, 28 BUS. LAW. 9, 11 (1972). It was this increase—or recognition of the increase—in the number of outside directors that led the ABA Committee on Corporate Laws to amend § 35 of the Model Business Corporation Act in 1974, moving to a monitoring model of the board. *See* MODEL BUS. CORP. ACT § 35 cmt. (AM. BAR ASS'N, amended 1974). Gordon reads the history as a happy one, where board structure comes to match the most efficient corporate performance metric. *See* Gordon, *supra* note 18, at 1511, 1540. I tell a darker tale. *See* Mitchell, *supra* note 18, at 20.

[154] *See* Gordon, *supra* note 18, at 1523–25; Mitchell, *supra* note 18, at 20, 34–36.

[155] *See generally* Mitchell, *supra* note 18, at 18-20 (explaining the evolution of the monitoring board from a collection of corporate insiders looking to decrease their liability to

board model provided fertile ground for the growing shareholder primacy norm. Eventually, shareholder primacy became its reason for existence and stock price maximization became the principal goal.[156]

III. THE DEVELOPMENT OF SHAREHOLDER PRIMACY

By the 1980s, the ground was fertile enough for the shareholder value norm to take root within a rapidly developing institutional and legal context—the monitoring board—which would come almost inevitably to articulate it and sustain it.[157] But norms do not just happen. How did the shareholder value norm develop in the first place?

Scholars almost unanimously trace its origins to the 1980s at the earliest, typically attributing its appearance to specific conditions existing at that time.[158] But this is not correct. Although the term may not have been used until the 1980s, underlying conditions that gave rise to shareholder primacy date back to as early as the 1950s. By the 1980s, the shareholder value norm already had begun to dominate, in fact, if not yet in rhetoric.[159] Thus, at the height of observed income equality, conditions were developing that would restore the kind of inequality seen later in the century. A brief exposition of the history will make this clear.[160]

The stock market's place of pride in American financial life is relatively recent. Nineteenth century stock market competition for the control of railroads provided intermittent entertainment to an often amused, but just as often confused and sometimes outraged general public.[161] Newspaper stories abounded and books were written, but no meaningful public market existed

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the independent monitoring board, whose primary focus was to protect the interests of shareholders).

[156] In an important, early paper on the subject, Lazonick and O'Sullivan trace a parallel and often intersecting history. *See* Lazonick & O'Sullivan, *supra* note 10, at 15–18. Their emphasis on the growth of agency theory as a reaction to the failures of the conglomeration movement and stimulus of the 1980s takeover movement, corporate downsizing with redistributions from labor to capital, Japanese competition catalyzing new business methods in the United States, financial deregulation, and the rise of stock buybacks as a return of capital, among other things, enrich the story. *Id.*

[157] I will later discuss the importance of institutional investors as well, but a full exploration of those actors is beyond the scope of this Article.

[158] *But see* Lazonick & O'Sullivan, *supra* note 10, at 16–17, 25–26 (tracing the history back to the conglomeration movement of the 1960s).

[159] *See* Mitchell, *Financialism*, *supra* note 97, at 325–27, 331.

[160] Although not addressing shareholder primacy, Levy and Temin tell an interesting parallel story of how federal policy has changed from the post-World War II years. *See* Frank Levy & Peter Temin, *Inequality and Institutions in 20th Century America* 2, 5, 38–42 (Nat'l Bureau of Econ. Research, Working Paper No. 13106, 2007), http://www.nber.org/papers/w13106.pdf [https://perma.cc/5BT7-HEQ6].

[161] *See* Charles F. Adams, Jr. & Henry Adams, *A Chapter of Erie*, *in* CHAPTERS OF ERIE AND OTHER ESSAYS 5–10 (Boston, James R. Osgood & Co., 1871).

until the turn of the century with the Great Merger Wave. This modern stock market was created in seven short years.[162] With its birth came a population increasingly eager to engage. From the late 1890s through the Crash of 1929, it seemed as if everybody wanted to get into the market. Whether you traded or not, whether you were among the wealthy or not, the exploits of "stock jobbers," the predation of brokers and "bucket shops," and the latest doings of the houses of Morgan and Schiff, flooded newspapers and the imaginations of all Americans.[163]

The 1929 Crash pretty much killed popular interest in the market, at least after the initial shock of collapse and its short-lived revival in 1933.[164] Focus instead shifted to the state of the economy itself, to the developing crisis in Europe, to the war, and finally, to its aftermath, including the growth and stabilization of the giant corporations formed fifty years earlier and the rise of post-war prosperity.[165] It was a time when corporations financed the majority of their businesses from their own retained earnings, bank debt and bonds, but not from publicly issued stock.[166]

To say nobody cared about the market is an overstatement. Certainly, the brokers, who more or less literally sat on the floor of the NYSE waiting to fill orders that rarely materialized, cared a great deal, as did the organization that housed them. There is little profit in the equities industry when people neither buy nor trade. And people did not buy or trade and so there was no profit in the equities industry.[167]

The rate of turnover on the NYSE, or the rate at which stocks turn over in a single year, had grown to madness in the late twenties.[168] But, the Crash brought things to a slowdown, and then to a crawl. From 1929 to 1939, turnover averaged 32%.[169] During the following decade that number was cut in half.[170] Trade-dependent brokers' commissions trickled in.[171]

Enter Keith Funston. A salesman, George Keith Funston rose to the ranks of executive prominence before serving on the War Production Board in the early 1940s. After brief service on the Navy Industrial Readjustment

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[162] MITCHELL, *supra* note 71, at 194.
[163] *See id.* at 192–208.
[164] *See* SOBEL, *supra* note 91, at 218–19.
[165] *See id.* at 218–19, 222.
[166] *See The Legitimate Rights of Public Shareholders*, *supra* note 102, at 1640, 1643 n.23, 1649, 1651–52.
[167] *See* Lazonick & O'Sullivan, *supra* note 10, at 22 (describing the virtual irrelevance of equity financing during this period).
[168] Lance E. Davis et al., *The Highest Price Ever: The Great NYSE Seat Sale of 1928-1929 and Capacity Constraints*, 67 J. ECON. HIST. 705, 711 (2007).
[169] *Id.*
[170] *Id.*
[171] *See* SOBEL, *supra* note 91, at 126, 134.

Branch, he served as President of Trinity College, an institution where he graduated valedictorian. Funston left Trinity College in 1951 to take the reins at the NYSE.[172] The NYSE greeted him with looming disaster. Funston wanted facts. The NYSE charged The Brookings Institution with a study of the number of Americans who owned stock: 4.2%.[173] In order for brokers and the Exchange to prosper, they needed to entice many more than 4% of Americans into the market.

Funston pitched a plan: "Own Your Share of American Business."[174] The salesman launched the Exchange on an advertising campaign that touted the benefits of owning common stock. A traveling road show made the rounds. The NYSE revived an idea pioneered in the early century by Charlie Merrill—permitting new or less well-heeled investors to buy stock on time.[175] At the same time, the NYSE continually battled the Federal Reserve Board over margin rates, doing its best to lobby them lower.[176] After all, commissions on buys and sells were bread and butter, but commissions on trading could be cakes and ale. With the increasing number of investors, Funston, in perhaps his crowning move, promoted broad-based investment in American industry as a way of fighting off Communism during the early Cold War years.[177]

By 1958, individual share ownership had almost doubled from 1952 and, by 1965, more than 10% of the population owned stock.[178] By the century's end, close to half of all American families owned stock in one form or another.[179] Additional changes took place that helped to make this possible. By the time Funston took office, twenty states had adopted the

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[172] Barnaby J. Feder, *Keith Funston, Head of Big Board Through '50s Revival, Dies at 81*, N.Y. TIMES (May 16, 1992), http://www.nytimes.com/1992/05/16/nyregion/keith-funston-head-of-big-board-through-50s-revival-dies-at-81.html?mcubz=0.

[173] LEWIS H. KIMMEL, SHARE OWNERSHIP IN THE UNITED STATES 90 (1952), *reprinted in* THE NEW YORK STOCK MARKET 89 (1975); JANICE M. TRAFLET, A NATION OF SMALL SHAREOWNERS: MARKETING WALL STREET AFTER WORLD WAR II 68–69 (Philip B. Scranton ed., 2013).

[174] TRAFLET, *supra* note 173, at 68, 88-89, 96; L.A. Times Staff, *G.K. Funston; Popularized Stock Market*, L.A. TIMES (May 17, 1992), http://articles.latimes.com/1992-05-17/news/mn-416_1_stock-market [https://perma.cc/BWE5-54BY]. The salesman launched the Exchange on an advertising campaign that touted the benefits of owning common stock.

[175] *See* TRAFLET, *supra* note 173, at 43–44, 112. This is like margin trading, except for margin calls. The balance of the stock price was to be paid in regular installments over a period of time. Thus, while you could in fact lose your money, you were not expected to pay your debt as soon as stock prices dropped.

[176] *See id.* at 71, 103.

[177] Feder, *supra* note 172.

[178] Janice Traflet, *"Own Your Share of American Business": Public Relations at the NYSE during the Cold War*, 1 BUS. & ECON. HIST. ON-LINE 1, 20 (2003).

[179] Ana M. Aizcorbe et al., *Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finance*, 89 FED. RES. BULL. 1, 12–13 (2003), https://www.federalreserve.gov/pubs/bulletin/2003/0103lead.pdf [https://perma.cc/7XV2-TRL9].

"prudent man rule," allowing fiduciary institutions to invest in common stock.[180] Pension fund value quadrupled to $40 billion between 1950 and 1957,[181] and mutual funds were adding $4.5 billion a year by 1959.[182] By 2007, institutions owned 76.4% of American equities.[183]

Styles of investing changed rather dramatically, setting the stage for the shift in corporate governance parameters from one of multi-constituency management to shareholder centrism.[184] Even during the height of the NYSE's marketing campaign, dividends remained the watchword.[185] But the early 1960s brought change. The great conglomeration movement of the 1960s, which led directly to the bust-up takeover movement of the 1980s and beyond, rapidly took off and with it, both stock prices and trading escalated.[186]

Public participation began to grow with the realization that trading for capital gains based on market movements generated faster cash than the patient capital generated through earnings.[187] Around this time, corporate retained earnings also began to disappear, slowly at first but with an increasing pace, so that by 2002 they were all but gone.[188] Stock buybacks overtook money spent on corporate investment like productive capital and

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[180] George Erickson, *Mutual Funds' Big Role in Investment World*, CHRISTIAN SCI. MONITOR (May 20, 1950), https://pqasb.pqarchiver.com/csmonitor_historic/doc/508200871.html?FMT=ABS&FMTS=ABS:AI&type=historic&date=May+20%2C+1950&author=By.
[181] Chicago Tribune Staff, *Pension Funds Rise Put at 4 Billion a Year*, CHI. DAILY TRIB., Feb. 11, 1958, at B7.
[182] *Does Merit or a Hard Sell Win?*, BUS. WEEK, April 4, 1959, at 109, 109.
[183] Barry B. Burr, *Institutional Investors Increase Ownership of U.S. Companies to All-Time High*, PENSIONS & INV. (Sept. 5, 2008), http://www.pionline.com/article/20080905/ONLINE/809049969/institutional-investors-increase-ownership-of-us-companies-to-all-time-high-new-report-%E2%80%A61/2 [https://perma.cc/S86C-SRMF].
[184] TRAFLET, *supra* note 173, at 161–62.
[185] This was also the era during which Miller and Modigliani developed their famous irrelevance hypotheses as to capital structure. Merton H. Miller & Franco Modigliani, *Dividend Policy, Growth, and the Valuation of Shares*, 34 J. BUS. 411, 414 (1961); Ezra Wasserman Mitchell, *Finance and Growth: The Legal and Regulatory Implications of the Role of the Public Equity Market in the United States*, 6 MICH. BUS. & ENTREPRENEURIAL L. REV. 155, 169 ((2017).
[186] *See* JOHN BROOKS, THE GO-GO YEARS 153–54 (1973); *see also* Sanjai Bhagat et al., *Hostile Takeovers in the 1980s: The Return to Corporate Specialization*, *in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1 (Martin Neil Baily & Clifford Winston eds., 1990).
[187] *See Federal Capital Gains Tax Collections, 1954–2009*, TAX FOUND. (Sept. 14, 2010), https://taxfoundation.org/federal-capital-gains-tax-collections-1954-2009/ [https://perma.cc/5FD5-5KR7] (illustrating that the amount of realized capital gains has grown steadily since the 1950s).
[188] *See The Legitimate Rights of Public Shareholders*, *supra* note 102, at 1655 fig.1.

research and development.[189] Close to 50% of all non-financial corporate profits traced back to finance.[190] Indeed, Tomaskovic-Devey and Lin calculate between a $5.8 and $6.6 trillion wealth transfer from the broader economy to the financial sector, largely in the form of profits, between the 1980s and 2008.[191] Finance became central.[192] Central to finance was, and is, the public stock market. And behind the public stock market is the corporate board.

This brief history illustrates the development of share price as a central focus of corporate attention, if not yet of formal governance, throughout the second half of the twentieth century. Although shareholder primacy as an articulated concept and governing norm did not blossom until after the late 1980s, share price as the metric of corporate success was already deeply rooted.

Corporate executives were far from embracing this focus on stock price, or at least the rhetoric of stock price, during the era of industrial capitalism.[193] Their mantra: Growth. Corporate executives worked to facilitate growth with careful consideration of workers, consumers and stockholders.[194] This might have appeared self-serving during the 1980s takeover market when corporate survival frequently was at stake, but it was a long-standing characteristic of the board during the industrial capitalism era. Evidence, at least from stock price movements, suggests their mantra wasn't just all talk.[195]

Although the market gained traction, little evidence suggests board members looked principally to the market for their performance metrics. Interestingly, in light of boards' articulated goals of giving share price no special prominence during industrial capitalism, most of these manager-directors still received a fairly significant portion of their income from stock option compensation.[196] Yet, the managerial board retained a significant

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[189] *See The Legitimate Rights of Public Shareholders*, *supra* note 102, at 1664 (showing buybacks overtaking capital investment during the first decade of the twenty-first century); *see also* Lazonick & O'Sullivan, *supra* note 10, at 23 (providing history on the rise of stock buybacks).

[190] Lazonick & O'Sullivan, *supra* note 10, at 23.

[191] Donald Tomaskovic-Devey & Ken-Hou Lin, *Income Dynamics, Economic Rents, and the Financialization of the U.S. Economy*, 76 AM. SOC. REV. 538, 553 (2011).

[192] Krugman notes "the concentration of very high incomes in finance." Krugman, *supra* note 15.

[193] Gordon, *supra* note 18, at 1511-12.

[194] Gordon cites a 1961 Harvard Business Review survey in which 83% of 1,700 executives agreed that to act solely in the interests of shareholders and not also employees and consumers was "unethical." Gordon, *supra* note 18, at 1512 (citing Raymond C. Baumhart, *How Ethical Are Businessmen?*, HARV. BUS. REV., July–Aug. 1961, at 6, 10).

[195] Gordon, *supra* note 18, at 1521-22.

[196] In the 1960s, 60% of executives held stock options, although the proportion of pay this represented was lower than it later became, rising rapidly in the 1980s. LARNER, *supra* note 69, at 34–35; Frydman & Saks, *supra* note 63, at 2120 & n.36; *see also* GABRIEL KOLKO, WEALTH AND POWER IN AMERICA: AN ANALYSIS OF SOCIAL CLASS AND INCOME

advantage over the monitoring board, allowing for it to focus on industry rather than finance. The managerial board was shielded from the market.

A board shielded from the market would feel less pressure to focus on stock price. Describing this as an advantage may appear to be counterintuitive after decades of market hagiography and the celebrated monitoring board, which is acutely sensitive to the market. But, the managing board had the space to focus on the core functions of business—sales, service, research and development, and supporting all of this, worker training and retention. Quarterly earnings reports and the accompanying market reaction were not the overwhelming distractions they are today. Corporate boards and senior executives could in fact manage their businesses rather than their finances.[197]

History suggests that corporate directors and executives do not appear to have been the primary drivers of shareholder primacy. Their acceptance of the monitoring board was grounded more in a desire to avoid liability in conflict transactions rather than any other reason.[198] However, developments beginning in the 1950s gave power to a market actor more focused on stock price—institutional investors.

The institutional dominance, already noted by the SEC in the early 1970s, was, by the 1980s, a cold, hard reality.[199] Institutions began to assert themselves in the years following the board crises of the 1970s, culminating in organized institutional activism in the 1990s, just as the monitoring board was becoming an entrenched corporate governance model.[200]

At first, institutional managers followed the practice of 1970s political activists by using SEC regulations to submit shareholder proposals to place their reforms on corporate agendas, or at least to generate publicity.[201] Eventually they began to understand that their quiet muscle power sufficiently molded managerial behavior to their liking. With a relatively small number of institutions holding highly concentrated ownership of so many large corporations, boards and managers listened.[202]

But institutions do not act by themselves. Discussion about the behaviors of institutional investors often overlooks the simple fact that

DISTRIBUTION 67–68 (1962) (indicating that managers owned "a very large portion, if not well over the majority, of shares in the United States").

[197] Frydman and Saks found that pay for performance nonetheless characterized this era as it did for most of the twentieth century. Frydman & Saks, *supra* note 63, at 2131.

[198] *See Panel Discussion*, 37 U. MIAMI L. REV. 319, 323 (1983).

[199] *See* Gordon, *supra* note 18, at 1568 fig.6.

[200] *See id.* at 1528; Terry McNulty & Donald Nordberg, *Ownership, Activism and Engagement: Institutional Investors as Active Owners*, 24 CORP. GOVERNANCE 346, 354 (2016).

[201] *See* Gordon, *supra* note 18, at 1496–97.

[202] *See id.* at 1528–39; McNulty & Nordberg, *supra* note 200, at 353.

institutions are comprised of people. Perhaps most important among these people are portfolio managers, whose compensation is heavily grounded in the value of their portfolios under management. Portfolios can grow through the investment of new money, but they also can grow as a result of performance—stock price appreciation. Compensation based on increased value provides a powerful incentive for money managers to push corporate agendas that focus on stock price.[203]

Managers had no reason to resist. Their compensation, increasingly paid in stock, would only be worth real money if stock prices rose. This alliance of incentives provided a very powerful motivating force in turning the board's focus to shareholder value.[204] Add to this the importance of stock price as the metric used by monitoring directors to judge executive performance, and the rise of shareholder valuism should be no surprise.[205]

It is also important to understand the effects of the contemporaneous rise of the neo-classical model of the corporation, disaggregating the institution into a series of market-based transactions coordinated by centralized boards whose financing by shareholders was based on a presumed agency contract.[206] Shareholders were principals. Directors were agents.[207] Whatever may have been the reality, the rhetoric was powerful.

Agents are required to act in the best interests of their principals. Those principals are highly dispersed shareholders, numbering in the thousands and tens of thousands. Consultation in order to aggregate average individual preferences is impossible, but there is one preference all shareholders are presumed to hold in common: increasing the value of their investments.[208] The market provides a metric of success. And if you manage what you measure, and what you measure is shareholder value, and if shareholder value is best expressed in terms of share price, there is little doubt that this will be the target at which you aim.

Taking the history of shareholder valuism back several decades from where literature generally presumes it began reveals that the shareholder

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[203] For a more extensive discussion, *see* CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 99, 109.
[204] Saez, *supra* note 45, at 168 (noting that that "[u]ndoubtedly, a reason for the huge increase in top wage income shares . . . has been the development of stock options").
[205] Frydman and Saks conclude that corporate governance was not a cause of increased compensation. *See* Frydman & Saks, *supra* note 63, at 2128. *See generally* Stockhammer, *supra* note 59, at 51, 55, 56 (describing the power shareholders—largely in the form of institutional investors—have developed to influence managerial decisions and finding that shareholder power can reduce investment and output but increase profit).
[206] The analysis is well-presented by Lazonick and O'Sullivan. *See* Lazonick & O'Sullivan, *supra* note 10, at 15.
[207] RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).
[208] The courts that have helped to entrench the monitoring board as a legal matter recognize this. *See e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

value norm really germinated much earlier as a product of a long evolutionary period in which a series of developments coalesced towards the end of the twentieth century. The NYSE push for popularization of stock ownership to increase broker revenues, the liberation of institutions to invest in common equities to improve pension outcomes, the conglomeration movement built on the principle that management is management and bigger is better, the deconglomeration movement built on pushing higher valuations onto corporate parts and profiting from their rise in stock prices, the statutory, judicial, and legal changes to accommodate the conflicts of interest inherent in these new corporate realities and concomitant changes in the identity and capabilities of corporate directors, changes in executive compensation, and the rise of an entrepreneurial economy in which quick riches from IPOs seemed the order of the day, all combined to focus business and investors on share prices. Thus, shareholder valuism was born—and the monitoring board was ready to make use of it.

IV. THE MONITORING BOARD AND SHAREHOLDER PRIMACY: THE ROAD TO CONTEMPORARY INEQUALITY

The monitoring board was well-poised to absorb the shareholder value norm, stimulating and expanding the contemporary explosion in income inequality. During each era of finance capitalism, the monitoring board's goals have been as much a function of its composition as any planned or reasoned theories. Lamont explained that the early period's board function of monitoring finance was a result of the limited capability of outside directors.[209] The same reason drives the contemporary monitoring board to fulfill the same function. The focus on credit in the earlier era transformed to a focus on stock price in the current era. Perhaps the transformation was inevitable.

Think for a moment beyond the appeal of a board of independent directors born in accusations of autocracy in a nation that prizes fairness and due process and despises entrenched privilege and conflicts of interest. Those are the liberal appeals of the monitoring board and, as a political matter, they are quite attractive. The problem: all these characteristics speak to process, not to function.[210] The corporation is not, nor has it ever been, a political democracy. The production of goods and services are accomplished through bureaucratic, often hierarchical, structures designed to channel information in both directions. Even horizontally managed companies must

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[209] *See Brandeis and Lamont on Finance Capitalism*, *supra* note 117, at 82–83.

[210] The courts that have helped to entrench the monitoring board as a legal matter recognize this. *See*, *e.g.*, In re Caremark, 698 A.2d at 969.

have some coordinating and reporting mechanisms, or they would rather quickly find themselves out of business. Yet, it is precisely in these political concepts that the modern board's legal obligations are grounded.

This was true in the managerial board as well.[211] It was within the so-called legal reforms of that era[212] when legal norms of modern board governance really began to flourish.[213] However, the managerial board's functions contained more substance than is currently possessed by the monitoring board.

To see this, step back and look at the two boards. One is composed mainly of employees of the corporation on whose board they sit—the CEO and president, certainly, but also executive vice presidents and perhaps even slightly lower-level managers. Like monitoring board directors, managing board directors are part-time in the sense that their principal jobs consist of running corporate divisions and departments. But, almost by definition, managing board directors also have deep and collectively wide experience in the management of the corporation. Well versed in corporate dealings, managing board directors arrive to meetings with a vast amount of information regarding the way the corporation runs, its plans, and its problems. Even if a majority of the board consists of outside directors, those directors can be more extensively informed and engaged at meetings because of their general understanding and background in corporate workings.[214]

Well, you might say, so what? One of the well-known, or at least frequently articulated, characteristics of the managerial board is that inside directors were often cowed by the CEO, fearful of being let go, not only from their position on the board but also from their employment. Inside directors, it was said, would not speak against the CEO. CEOs informed outside directors of the corporation's operations using carefully prepared reports by his subordinates.[215]

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[211] Articulated fiduciary duties were stricter during the managerial era. *See generally* Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 425 (1993) (arguing that "courts and legislatures unwittingly have destroyed the fiduciary fabric of corporate law").

[212] Legal reforms consisted of the loosening of rules governing conflict of interest transactions, for example.

[213] *Fairness and Trust in Corporate Law*, *supra* note 211, at 426-27.

[214] This does not mean that they always operate with integrity or are completely selfless and detached. Indeed, one of the complaints about the managerial board members is precisely that they were not detached. Maybe so. But they *were* informed.

[215] For a theoretical examination of the differences in information flows between a managerial board and a monitoring board, see generally Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies: The Missing Link in Corporate Governance*, 70 BROOK. L. REV. 1313, 1315 (2005) (addressing the possible holes in corporate governance scholarship). The institutional kowtowing of inside directors to CEOs during this period is an accepted fact. Gordon discusses the leading literature. *See* Gordon, *supra* note 18, at 1511. But this literature is largely anecdotal and highly unscientific. I suspect

This story probably is true[216] only up to a point, unless one assumes the entire enterprise suffered from corruption. A CEO, sitting in a boardroom with those who are principally responsible for running the company, would be reasonably checked in his ability to distort facts or lie to outside directors by the looming presence of those who would know he was lying. Employees, acting out of self-interest and, perhaps, fear, might tolerate some degree of lying, but there are limits, especially considering the risk of potential legal liability. Although such liability was rarely imposed, the possibility of legal liability remained as a meaningful deterrent.[217] The implicit check on the CEO by the presence of knowledgeable subordinates, and directors' presumable desire to avoid legal trouble most likely combined to create reasonably honest behavior.

Outside directors presumably also had some acquaintance with top-level managers because they sat together on the board. Outside directors might have owed their position to the CEO, but their acquaintance with other executives at least provided them with the possibility of verifying information received from or through the CEO.[218] One can at least arguably describe the managerial board, in contrast to the monitoring board, as the connected board.

Now let's turn to the monitoring board. Most, if not all, of the directors other than the CEO are outsiders. Typically, they are CEOs of other companies who have very demanding careers and thus very little time to devote to their board positions. Unlike managerial directors, they have no first-hand knowledge of the company's business. Unlike outsider directors on managerial boards, monitoring board directors have no regular contact with employees below the level of top executives.

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most of the legal academics who credit it would today find it not tenure-worthy. Although it comports with one assumed view of human behavior, much of it appeared in a context of generalized crisis when the institution of the board, as well as that of the corporation and the government, were under attack. I know of no rigorous analysis of the truth of this claim. Indeed, there is a theoretical reason to question it. *See generally* Mizruchi, *supra* note 144, at 426 (challenging the view that boards of directors in large American corporations are dominated by management); Quinn D. Curtis & Justin J. Hopkins, Do Career Concerns Create Incentives for Independent Directors to Monitor Executives? 27-29 (June 29, 2017) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800008 (providing a rigorous, contemporary study on whether *independent* directors have monitoring incentives and concluding that they do not).

[216] *See generally* MYLES L. MACE, DIRECTORS: MYTH AND REALITY 178-79 (1971) (providing the classic analysis of the role of directors of business corporations).

[217] *See* Gordon, *supra* note 18, at 1483–84.

[218] The modesty of outside directors' compensation might also have tempered their appetites for legal risk. *See id*. at 1487 (noting that director pay was negligible in the 1950s but evolved to significant pay in the 1990s).

Several consequences flow from this state of affairs. First, the monitoring board simply cannot manage. It neither has the time nor the information. But it does have legal responsibilities, no matter how forgiving they are. So, what can directors do? All they really can do is focus on simple metrics. Financial statements are rarely simple, but bottom-line quantifiers like earnings-per-share or free cash flow are good candidates.

Although seemingly less involved, monitoring board directors are very well compensated compared to the outside members of a managerial board.[219] Starting in the 1990s, directorial compensation began rapidly to rise. From the standard "gold piece" for mere attendance at board meetings, directors' compensation shifted to the form of stock options, sometimes reaching quite substantial amounts.[220] Although one cannot put earnings per share in the bank, one can sell stock that rises in value due to increased earnings per share, however achieved, and save or consume the profits.

As with the managerial board, monitoring board directors are selected primarily by the CEO. And how is that CEO compensated? In recent years more than 50% of CEO compensation was paid in stock.[221] The independent monitoring directors know this, just as they know their own principal compensation is similarly constructed. So, with limited information, limited time, the need for simple metrics of success, and pressure from institutional investors, where might independent directors look? The answer should be obvious. Every one of their incentives prioritizes stock price.[222]

Thus, corporate governance plays a leading role in generating and sustaining radical inequality.[223] The monitoring board is a tool of financial capitalism, and financial capitalism is concerned with financial markets, whether credit or equity.[224] The modern monitoring board, which sits at the

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[219] Mitchell, *supra* note 18, at 36-38, 54 (discussing the relatively minor rules of monitoring board directors and more generally, their high rate of compensation).

[220] CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 109 (discussing the rise of directors' compensation).

[221] Gordon, *supra* note 18, at 1530–31; Michael C. Jensen & Kevin J. Murphy, *Remuneration: Where We've Been, How We Got to Here, What Are the Problems, and How To Fix Them*, 26 fig.2, 31 fig.3 (European Corporate Governance Inst., Working Paper No. 44/2004, 2004), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=561305.##.

[222] Gordon makes the very interesting point that executive compensation has become a substitute for the corporate control market. *See* Gordon, *supra* note 18, at 1531. This observation suits both our narratives although again, with very different interpretations.

[223] *See, e.g.*, Jensen & Murphy, *supra* note 221, at 42 (discussing the perverse incentives created by stock option compensation).

[224] *See* Gerald F. Davis & Suntae Kim, Financialization of the Economy, 41 ANN. REV. SOC. 203, 204 (2015) (arguing that "social institutions [are shaped] in fundamental ways" by the way "finance is intermediated"); *see also Brandeis and Lamont on Finance Capitalism*, *supra* note 117, at 82–83 (discussing the early twentieth century managerial board's focus on "building up and entrenching the company's credit); *see* MITCHELL, *supra* note 71, at 11−14 (capital income in the early twentieth century was focused on dividends and interest but the focus was still a financial one).

heart of the financial governance system, is constructed in a way that limits its focus beyond share price—indeed to the boards' advantage. The explosive growth of stock prices over the last thirty years, coupled with board and managerial incentives to keep them high and rising, has been a significant contributor to income inequality in the United States.[225]

V. THE EXPLANATORY POWER OF THE MONITORING BOARD

The data developed by Piketty and Saez showing three distinct periods of income distribution maps rather nicely onto the historical narrative showing three distinct periods of capitalism and corporate governance.[226] The combined history points to the monitoring board as the contemporary source and promulgator of the shareholder value norm, which helps drive the increase in top executive compensation, principally through stock options.[227] The role of the monitoring board in fostering American income equality seems clear.

The argument appears to confirm the intuitions of leading scholars who attribute the rise in inequality to corporate governance, at least in part.[228] It also has the virtue of complementing the diverse claims about income inequality presented in Part I. The simple neo-classical model is explained simply by tying the demand for stock price maximization to the supply of skilled executives capable of achieving it.[229] The limited supply of such executives naturally drives up the price of their skills, resulting in wage explosion at the top of the pyramid.[230] Complicating the story a little, the particular skillset demanded—financial management skills—already commands the top of the wage scale,[231] thus presumably increasing the opportunity costs of executives who might be attractive candidates to monitoring boards. That said, however, the simple neo-classical story does not require a lot of explanation beyond the standard neo-classical assumptions, so in this respect the theory I propose likely does not add much.

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[225] CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 109–11 (discussing the rise of directors' compensation).
[226] *See* Income Inequality, *supra* note 3, at 25; *see* The Evolution of Top Incomes, *supra* note 3, at 200.
[227] *See generally* Part IV, at 42–43; *see also* Gordon, *supra* note 18, at 1510 (discussing the co-evolution of monitoring boards and the shareholder value norm).
[228] *See* PIKETTY, *supra* note 7, at 331–33; *see also* McCall & Percheski, *supra* note 1, at 338.
[229] *See* Lemieux, *supra* note 1, at 22–23.
[230] *See id.*
[231] Krugman notes the extraordinary compensation of financial professionals, including hedge fund managers, as having an important effect on wage growth at the top. Krugman, *supra* note 15.

Matters are different with the more refined market model, the various forms of SBTC. Here there is clear work for the board of directors. The decisions to replace workers with technology or to offshore jobs are in fact choices, no matter how obvious the choice might appear to be to those living in a shareholder primacy age. One can imagine the contrary, a midcentury board for example, or European or Chinese board, consistent with articulated strong commitments to workers, limiting their adoption of technology to maintain significant employment.

These observations link to explanations grounded in wage setting institutions. Government policy reinforced and, perhaps, even reflected, mid-century instincts, especially in the area of labor law.[232] This leads to the explanatory power of the theory in the case of de-unionization, which, as discussed above, empirically appears to contribute to about one fifth of the growth in income inequality.[233] Moreover, it helps to explain the explosion in performance pay—contributing about another one fifth of the explanation—as the shareholder value norm demanded ways to ensure top executives would focus directly on share prices.[234] It could also explain government action in encouraging boards to provide performance pay as compensation, which reached normalcy in the early 1990s.[235]

The moves to technology and de-unionization are obvious indicators of inequality as bottom-line reductions predictably bump up share prices.[236] Governmental actions like deregulation and tax reform could also be expected, at least in part, as a result of corporate lobbying pressure to help stimulate maximum share price growth.[237]

Finally, my theory can help explain the puzzling features about the rise in inequality and its concentration in Anglophonic nations. For a variety of well-researched reasons beyond the scope of this article, shareholder valuism and the monitoring board model have taken root in those countries but not in Continental Europe, where inequality growth has been considerably more limited.[238] The role of social and institutional norms becomes much clearer

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[232] For the major establishment of mid-century labor policy, see National Labor Relations Act of 1935, 29 U.S.C. §§ 151–69 (2012).
[233] *See* Lemieux, *supra* note 1, at 23–24.
[234] Lemieux et al., *supra* note 29, at 4.
[235] Murphy, *supra* note 107, at 2, 20–31, 31 fig.3.
[236] Lemieux, *supra* note 1, at 23-24. For a discussion of the impact of layoffs on stock prices under different conditions, *see generally* Oded Palmon et al., *Layoff Announcements: Stock Market Impact and Financial Performance*, FIN. MGMT., Autumn 1997, at 54.
[237] *See* Brian Kelleher Richter et al., *Lobbying and Taxes*, 53 AM. J. POL. SCI. 893, 907 (2009).
[238] For the dominance of shareholder primacy in the United States and the United Kingdom, and the preference for stakeholder models in Continental Europe, *see* Andrew Keay, *Shareholder Primacy in Corporate Law: Can It Survive? Should It Survive?*, 7 EUR. COMPANY & FIN. L. REV. 369, 370 (2010).

when the shareholder value norm and monitoring board are brought into focus.

While powerfully explanatory, this theory nonetheless is limited. Importantly, it does nothing to contribute to the empirical work of discovering and evaluating the various channels through which income inequality grows; empirical work might be done to prove this aspect of the theory. What it does do, however, is provide a foundation upon which other theories rest, a description of the source of motivating forces that animate income inequality. Perhaps that is enough.

VI. Concluding Thoughts and Some Suggestions For Change

As earlier noted, it is not my intention to normatively evaluate income inequality itself. Indeed, there is interesting data demonstrating that most Americans happily tolerate some inequality and would be comfortable if the top 20% held just over 30% of the nation's wealth.[239] But there are practical reasons to be concerned about inequality when it rises above the level of public tolerance. Political scientists, sociologists, and some economists, have warned about the destabilizing effect on society and the hindrance of real economic growth by such radical inequality.[240] The sustainability of capitalism and contemporary American finance capitalism is not at all obvious.[241] Part of the challenge to sustainability is capital market behavior itself.[242] Preventing economic damage is likely to be less expensive and more successful than cleaning up any ultimate devastation. I hope this article can stimulate both research and solutions for the problem of corporate governance in fostering radical inequality. Here are a few suggestions.

The monitoring board is a fact. It seems to work well enough. Its major dysfunction is its hyper-sensitivity to the public equity market.[243] In thinking

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[239] STIGLITZ, *supra* note 12, at 147. It is also interesting and perhaps ominous that those polled thought the top 20% held 60% of the nation's wealth, which is far less than the 85% they actually own. *Id.*; *see also* JAMES K. GALBRAITH, INEQUALITY: WHAT EVERYONE NEEDS TO KNOW 7 (2016) ("We all agree that some degree of inequality is essential.").

[240] *See, e.g.*, Dep't of Econ. & Soc. Affairs, *supra* note 12, at 63–66; STIGLITZ, *supra* note 12, at 92;
Alberto Alesina & Roberto Perotti, *The Political Economy of Growth: A Critical Survey of the Recent Literature*, 8 WORLD BANK ECON. REV. 351, 360 (1994); Beck et al., *supra* note 10, at 28; *cf.* Clarke et al., *supra* note 10, at 579–81 (suggesting that increased financial development will reduce income inequality).

[241] CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20.

[242] *See id*. at 59.

[243] *See* Gordon, *supra* note 18, at 1530-31 (demonstrating the sensitivity between monitoring boards and equity markets through executive stock option compensation packages).

about reform, it makes the most sense to begin with that market and the relationship between the market and reform.[244]

Scholars should begin by examining ways in which boards can better control the markets and slow them down, if for no other reason than to diminish corporate incentives to focus on share price and to give corporate boards the space they need to manage for the long term.[245] A modern monitoring board consisting of independent directors is not likely to accomplish this alone. However, with some breathing room, CEOs and managers might find their businesses require a different kind of director, if not an entirely different kind of board. Recent evidence shows many corporations are achieving just this by returning to private ownership after a period of being battered about by the tumultuous market.[246]

I have made some of the following suggestions in earlier work, but the continuing development of these problems suggests that they bear repeating.[247]

One solution might lie in taxation. Holding periods for capital gains taxation simply are too short, and rates are quite low compared with rates on earned income. More tailored forms of incentive-changing taxation are possible.[248]

While such measures would increase treasury revenue for potential redistribution, and while that would be salubrious, this suggestion is not primarily centered on redistribution or government investment.[249] Rather, higher capital gains taxation, perhaps even on parity with earned income taxation, would create disincentives for the quick buying and selling—and even quicker computer-generated buying and selling—that has increased market volatility and enabled financial industry players to capture significantly higher proportions of increased capital gains than ordinary investors. Pricing higher short-term taxation into the system by raising rates

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[244] It is also worth noting that the development of the monitoring board has been accompanied by a significant diminution in its legal liability. *See* Mitchell, *The Trouble with Boards, supra* note 18, at 34-35. I worry that rapid replacement of the monitoring board would fail to be accompanied by any necessary increases in rules, like conflict of interest rules, that might be necessary or at least desirable to prevent other problems.

[245] *See* CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 277–78.

[246] Geoff Colvin, *Going Private: Take This Market and Shove It!*, FORTUNE (May 17, 2016, 6:30 AM), http://fortune.com/going-private/ [https://perma.cc/P47G-UAY5].

[247] *See* CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 277–78.

[248] *See* Alan J. Patricof, *Close My Tax Loophole*, N.Y. TIMES (Aug. 22, 2016), https://www.nytimes.com/2016/08/27/opinion/close-my-tax-loophole.html?mcubz=3.

[249] One of the taxation-based arguments for greater equality suggests that inadequate taxation of the wealthy generates inadequate tax revenues for the government to invest in innovation, and government innovation has historically been one of the primary drivers of private sector innovation. *See* STIGLITZ, *supra* note 12, at 74, 86.

and extending the definition of long-term would result in equity pricing with tax input that might sufficiently reduce the profits from quick trading and help to diminish the activity.

Presumably, the market would slow down enough that even a board focused on stock price would have to come to terms with the fact that the kinds of short-term solutions which have generated quick and high stock prices in the past[250] would be less effective. It might even help to refocus their efforts on the humble business of industry, perhaps leading to greater employment.

Accounting reform could also help. Allowing the capitalization of a now-expensed item, such as worker compensation and training costs, at least above some sort of industry average, might return boards to the flatter era where they saw employees as investments rather than expenses. Such a move would increase corporate earnings per share by expensing these investments slowly over time, reducing massive layoffs or pay cuts as short-term solutions to sagging stock prices.[251]

That said, my point is not to solve the problem of income inequality, but rather to simply show the significant role corporate governance ultimately has played, and will continue to play, in income inequality. The most effective solution might lie in reforming the market itself.

Capitalism, or at least financial capitalism, may or may not ultimately fall from its own weight. But what can be seen with greater clarity is how the particular form of capitalism practiced in the United States may be unsustainable. The question now is whether the United States can harness a solid productive economy where inequality will have the time and space to be ameliorated to prevent it ultimately from crashing down, with unpredictable social and political consequences.[252]

Corporate governance reform is not the end-all-be-all, but it's a start.

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[250] Short-term solutions were, for example, to diminish investment in capital equipment and research and development, to impose significant layoffs and pay cuts, and to reduce the enormous funds spent on stock buybacks. *See, e.g.*, Palmon et al., *supra* note 236, at 67 (layoffs to quickly impact stock price); *see generally* CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT, *supra* note 20, at 277–78 (concluding that long-term management is more desirable than short-term management).

[251] *See* Palmon et al., *supra* note 236, at 67 (discussing the impact of layoffs on stock prices under different conditions).

[252] Simon Kuznets, *Economic Growth and Economic Inequality*, 45 AM. ECON. REV. 1, 7–8 (1955). Kuznet's theory of rising and then diminishing inequality dominated discussion of the issue for the latter half of the twentieth century.