Reforming German Corporate Governance: Inside a Law Making Process of a Very New Nature Interview with Professor Dr. Theodor Baums

By Professor Dr. Theodor Baums


Introduction:

[1] Just over a year ago, in the Spring of 2000, a Government Commission entitled "Corporate Governance - Unternehmensführung (corporate management) - Unternehmenskontrolle (corporate control) - Modernisierung des Aktienrechts (Modernization of corporate law)" and consisting of a group of selected lawyers and business practitioners from the banking and insurance industry, took up the task of engaging in an in-depth analysis of the structure and challenges of "German corporate governance." The Commission's work has drawn to an end and its 300 page report was presented to the public on July 10, 2001. It is German Law Journal’s privilege to provide its readers with the first-hand insights of the Chair of the Commission, Professor Theodor Baums of the University of Frankfurt's Institute of Banking Law. In his discussion with GLJ, Professor Baums addressed specifics of the Commission's Report as well as the heritage of and the future prospects for German corporate and capital market law. The Commission Report itself is fully available at: http://www.bundesregierung.de/Anlage7628/Bericht_der_Regierungskommission.pdf

[2] By way of introduction, the following is a brief sketch of the fundamental questions arising in the context of German Capital Market Law. While excellent studies are easily accessible (1), it may suffice here to point to some central characteristics. The term corporate governance circumscribes rules pertaining to the management and control of the corporation. The separation of ownership (investors, shareholders) and control (management), as problematized in the path-breaking study (2) by Adolf Bearle and Gardiner Means in 1932 has been on the minds of bankers, lawyers, investors and other corporate founders for a long time. (3) Comparative studies after Berle/Means' book revealed striking differences with regard to the structure of the capital market between the United States and, say, Germany. (4) While the American corporate market can be described as characterized by dispersed ownership and a strong focus on market control, the German system is determined by the presence of immensely concentrated ownership, mostly dominated by banks and other institutional investors. Another telling difference is the two-tier structure of German corporate governance, establishing a management board which is under control by supervisory board, made up of representatives of investors and stake-holders. In 1965, the German parliament adopted a huge reform of the German Stock Corporation Act of 1937 (Aktiengesetz), the policy objective being to allow an increasing number of investors to buy equity in order to contain a concentration of ownership while providing for a broad dispersion of shares. (5) While the law brought about a number of changes to German Stock corporation law with regard to transparency requirements, disclosure, shareholder meetings and shareholder litigation, the system as a whole stayed the same. Mainly, the strong influence of banks as primary investors and shareholders has not been broken. The striking difference to the U.S.-American model is closely connected to the function and role played by banks such as in the economic system. While German law always allowed its universal banks to offer all financial services and to control other industries by prominent stock holdings, American legislation early on insisted on the separation of commercial and investment banking. While a proposal of a European Directive on the harmonization of corporate governance structures ("Company Law Directive Number 51") has still not been finally sketched, the German Bundestag, in 1998, adopted the KonTraG (Gesetz für mehr Kontrolle und Transparenz im Unternehmen) hereby allowing for a number of improvements with regard to central corporate governance aspects. (6) The debate about necessary reforms of German corporate and capital market law is and will be, as Professor Baums convincingly underlined in the following interview, not confined to national borders. While it is of mandatory importance to bear in mind and to be sensitive to national political heritage and socio-economic path-dependencies, the search for "good corporate governance" must take place on an international, global scale. This simultaneously national and international perspective will allow us to come up with adequate answers to the pressing questions put to our existing law at this time.

Interview:

[3] GLJ: Professor Baums, your Commission has just published its impressive 300 page Report addressing many aspects that are central to the future of German Corporate Law and Capital Market Law. What do you take to be the principal achievements and insights of the Report?

[4] Baums: We had 148 recommendations on the future of our company law, i.e. for listed as well as for smaller companies in the form of an Aktiengesellschaft (joint stock corporation). Central aspects on which we received
recommendations and upon which focused our work were prospects of reforming our auditing and accounting process, the rules of which are laid down in the Handelsgesetzbuch (commercial code). Other aspects concerned shareholders and investors, finance instruments as well as the consequences of important developments in information technology. When we speak here of the work that was done by the Commission and of the reform proposals that it has presented, both with regard to amendments of mandatory company law as well as with regard to the creation of a Code of Best Practice, we must see that the reform even-tually touches upon all organs, indeed, all bodies of the corporation. That includes the Vorstand (managing board) and, in the German system, the Aufsichtsrat (supervisory board), which is different from the structure as it exists in, say, Anglo-Saxon companies. In Germany, the main characteristic embodied in the so-called "two-tier system" is the difference between managing and supervisory boards. The reform proposal touches, furthermore, upon the role and the function of the Hauptversammlung (general meeting) and on the role of the annual auditor, who, as we will see, will play a very decisive and eminent role in the implementa-tion and control of the "soft law" laid down in a corporate governance code. What has become ob-vious is that a lot of attention must be given to the communication between the shareholder and the company as well as amongst the shareholders. Therefore, one of our central aims was to illuminate the intricacies connected with the rights of the shareholder vis-à-vis the company and its management. Trying to pinpoint what might be the central achievement of the Commission's work, it seems that the Report reflects a strong hope for the promotion of improvements of our corporate governance system and the functioning of the capital market, hence of the performance of our firms. This can only be achieved in a tandem with an attentive and caring eye on the rights of shareholders and on the German capital market as a whole.

[5] GLJ: What do you expect the first reactions to the Commission's report to be? Among government members, among lawyers, bankers and in the Academy? And what do you think to be central in your proposals - the so-called Code of Best Practice?

[6] Baums: Already before the Report's very recent publication - on July 10 - the reaction to our work has been very positive. That may have to do, for one, with the composition of the Commission. It was made up of representatives of business interests, shareholder activists, lawyers, legal academics, trade unionists and four high-ranking members of the government. Thus, it was possible to integrate a very broad range of perspectives into the Commission's work. Therefore, I tend to expect a broad acceptance by the public as a whole. While we do, indeed, suggest a "code of best practice," most of our recommendations refer to im-provements of our statutes in corporate law. Most of the easier amendments to our statutory corpo-rate law can be made during the current parliamentary session, that is before the national elections in 2002. The more complicated amendments could be implemented after the election. The devel-opment of the Code of Best Practice, for which we issued a number of recommendations, is to con-tinue until the end of this year under the guidance of a Commission to be set up by the government in the following days.

[7] GLJ: The field of corporate governance is likely associated with names from the American context such as Berle & Means, Coase, as built upon and further elaborated by thinkers such as Jensen and Meckling, Alchian and Demsetz, Gilson or Roe. Many of these are your colleagues and they have been shaping the debate immensely. Behind these names lie competing theories as to the "Nature of the Firm." Through the design of models which perceive of the corporation as a nexus of contracts or, alternatively, as an organizational entity between hierarchy and market (Williamson), we have been attempting to grapple with the great challenge that the collective actor "firm" has put to us since the beginning: "How to effectively mobilize the vested interests while providing for their protection?" Or, in other words, referring to Berle & Means' pinpoint analysis, the question is how to reconcile ownership and control? In light of this American theoretical background, where do you see the main focus of the German debate on Cor-porate Governance?

[8] Baums: There are certain factors, underlying forces, which lead the specific German structure into another direction. First, what we observe on the capital markets is an inter-nationalization of shareholding. When Vodafone launched its hostile takeover bid for Mannes-mann, they found out - for the first time - that the majority of Mannesmann was made up by foreign institutional investors, basically from Anglo-Saxon countries. This a factul, empirical observation which leads to interesting legal questions. For example, we must ask ourselves how to preserve the rights of foreign shareholders. How are they to be adequately informed or invited to the shareholder-er's meeting? It is, among others, this background against which we must check whether our rules still fit. A second development which has proven to be of eminent importance for the future pros-pects of German corporate governance is that all of us recognize the decline of state organized pen-sion and old age security systems. Therefore, we will need a second, a private response for old age pensions, which - as has become apparent - will predominantly rely on the capital markets. Be this through immediate or institutional investments such as investment or pension funds. The third de-velopment that we have observed is related to the progress made in the field of technology. Information and communication technology have made such great progress that, inevitably, transaction costs related to information and control can substantially be reduced. By means of modern technology it will be possible in the future to take part in a German shareholders' meeting while being in Los Angeles. At the same time,
we can think of board meetings taking place in cyber space. This changes corporate law dramatically. A fourth development we need to consider is the challenge presented by the need for venture financing. In this context the question put to us is how our regulatory framework fits the needs for venture finance as in cases of start-ups and in formative industry. There can be no doubt, in my view, that in order to have mature and competitive, grown-up firms, you have to provide for a living and vivid venture finance culture! In contrast, our rigid corporate law is designed with a view to large, publicly held and "arrived" companies, but less for smaller start-up firms. Therefore we first have to look at the specific finance needs of these small, "beginning" firms and then to make flexible or to introduce new finance instruments for those firms such as redeemable shares or tracking stock. Observing these developments, we - in the Commission over the past year - have closely analyzed, e.g. the existing rules on auditing in our commercial code in order to formulate first steps in an on-going process of reform- ing our corporate law and to make it hopefully as competitive as necessary.

[9] GLJ: With regard to the good responses that you and your Commission received to the questions presented to selected experts and practitioners, how would you describe the particular importance of national debates for the reform and improvement of vital and eminent elements of a legal order? Do you see "Path dependencies" at work? Do they stand in the way of mutually learning with and from other countries' experiences or do they, instead, sensibilize for the respec-tive embeddedness of different corporate governance systems?

[10] Baums: Of course, there are path-dependencies. Our system of Mitbestimmung (co-determination), our two-tier structure at the top of German companies (Vorstand, Aufsichtsrat) and other unique structural features of our corporate law system are, no doubt, path dependent. The idea of path dependency implies that proposed solutions to certain problems must fit the terms of this path dependency, meaning that in different environments you can find differing technical solutions to one and the same problem. Our particular technical answers will thus appear different from those in, say, Great Britain or in the United States. The real issues, however, are the same ones, even if the normative answers may be different. Here we need to be aware of the challenges presented by what we call globalization or the pressures I already mentioned with regard to technical advances and its influence on communication techniques, the principal-agent problem between shareholders and managers, the conflicts of interest between the majority and the minority, communication between the company and among the shareholders. We can see that the issues are common while the answers may vary greatly. And these answers are, to a certain extent, path dependent in themselves.

There is, however, a second and more complicated dimension of path dependency: formerly, the German system was a closed system in the sense that there were personal and capital interlocks between firms and the absence of a market for corporate control. Traditionally there was a strong position held by banks with large equity shares and voting the stock that was deposited with them. Furthermore, banks would send their representatives to the supervisory board. All in all, this closely knit structure embedded a very specific form of corporate finance as well as corporate governance. If we consider reform proposals in the light of path dependency we can come to ask whether breaking one or two elements out of the system would lead to the general collapse of the system. Hence, every step into a new direction must be taken with great care. For, to ignore the embeddedness of regulations and models in a particular setting might lead to catastrophes. In the Commission, we always tried to remain aware of this problem.

[11] GLJ: The level of sensitivity of the legislature to the particular environment appears to be particularly high. The question then is, who do you, who did the Commission turn to for rec-ommendations, advice and informational input? How did you choose the eighty groups, founda-tions, representational organizations to whom the Commission sent out the questionnaires? In other words: who are the actors in this form of law making process.

[12] Baums: The answer to this question must be given from a political science background. Looking at the political style of our present chancellor, Mr Schröder, the importance of setting up commissions to research various issues and to formulate solutions becomes obvious. To a certain extent, this bypasses the role of the parliament. To choose one recent example, we might name the Immigration Commission chaired by Rita Süssmuth from the Christian Democratic Union. In this Commission there were representatives of practically all political sectors. If these people come to a conclusion, if they indeed reach consensus, there is a strong chance that it will be echoed and followed by political forces in society. This we might call the real "trick" by which such commissions operate. And if it seems that this form of generating legislative proposals and this particular mode of paving the way for later amendments in hard or, with regard to the already mentioned Code of Best Practice, soft law, circumvents the political opposition and even the minis-tries charged with preparing legislation, it is nevertheless true that the Commission's work provides a mechanism for promoting a possibly very broad consensus. Of course, considering the composi-tion of the Commission and the attempt to include a broad range of societal interests, there is a cer-tain persuasiveness that follows from the establishment of the Commission and its work. It is, therefore, considerably difficult to challenge the Commission's findings and proposals as they ap-pear to reflect - at least to some degree - a societal consensus. In
my Commission we had, indeed, an impressive line-up, including leaders of the big trade unions, of financial institutions, high-ranking government and administration members as well as parliamentary representatives. Thus, the Commission’s work is done and presented with quite a strong political force behind it. And this is a way of conducting politics. Certainly, there are concerns about the relationship between the work of such commissions and the parliamentary law making procedures. But there is no question of its admissibility from a legal point of view. But, there is more to it. If we look at, say, the Prus-sian King, we find that eminent political decisions were prepared within the so-called Staatsrat (state’s council), one or even a number of bodies that ultimately took on ruling competencies. On the other hand, in a parliamentary democracy we can see similar processes at work, processes that in fact make the fact that a commission is established and that it, eventually, issues rule amendment proposals, seem less alien to the system as such. If you look at the practice of detailed issues being debated and prepared in commissions and then presented to parliamentary vote, you surely have a picture that ultimately does not vary so drastically from what commissions such as this one do. And, even more, already in the bureaucracy itself, i.e. within the gov-ernment, there are ways by which a minister or other official may react to proposals coming from industry or other economic lobbyists that can at best be called erratic. To establish a commission, then, at an early stage of deliberation, is another way of creating a body of people, all of them inde-pendent and not - necessarily - belonging to the ruling parties. We should acknowledge the fact that, considering the Commission’s composition and its efficient way of inviting expert testimony and close advice from many different interest groups, this law proposing body is able to reach re-sults in a way an official, traditional law making body would - most likely - not have been able to.

[13] GLJ: Would you describe the Commission’s work then as a kind of “third way” of law making, parliamentary deliberation being one and administrative rule making the other? In comparison, to what extent does the Commission’s work lean towards democratic accountability?

[14] Baums: First, we ought to keep in mind, that the Commission is not a body elected by an ordinary constituency. Instead, the Commission’s members were selected by the Chancellor. At the same time, there is no conflict with democratic legitimacy as the Commission functions as a preparatory organ while it remains the parliament’s competence to vote for or against the various proposals made by the Commission. Depending on the commission’s composition, there can, however, be a strong positive prejudice in favor of the Commission’s proposals which can be expected to facilitate the ensuing parliamentary law making. In this light, preparatory work and drafting proposals, whether they are done by the bureaucracy or by a commission, qualify in the same way under the scrutiny of a functioning parliamentary process.

[15] GLJ: After these very illuminating observations concerning the institutional side of this form of law making, let us now turn to the substantial dimension. Here, the central question seems to be the nature of the relationship between a legislative act on one hand and what your commission proposes as a CODE OF BEST PRACTICE on the other. This Code must be seen as soft law as compared to the hard law of legislative acts, i.e. to the already existing mandatory corporate law to which your commission has also made a great number of proposed amendments. While the Code itself will be drafted in the following months, your Commission has already suggested a number of elements and, most importantly, made the suggestion to adopt the governing principle of COMPLY OR EXPLAIN. Would you, please, illuminate what lies behind this idea?

[16] Baums: We have to ask ourselves, indeed, what the advantages are of man-datory corporate law. Certainly, the share that we have available is a standardized product and it is a result of fixed, mandatory corporate law. There are definite advantages ensuing therefrom for the capital market which has no interest in researching every detail of any company’s charter. Instead, the shares and their value - ignoring for a moment all other intricacies involved here - can be as-sessed within this standardized setting by the potential investor. On the other hand, we need to see the negative effects of mandatory law. In treating highly different firms in the same manner, it can prove too rigid. In comparison, soft law as my commission envisions it, is far more flexible as it allows for individual adaptation to the particular structure and needs of companies.

[17] In the course of our work we learned an immense amount about the possibilities with regard to combining elements of hard and soft law, in particular, by directing our attention abroad, namely to Great Britain. The English enacted a Code which is part of the listing rules at the London Stock Exchange (LSE) which had enforced the Code before this task was taken on by the UK Listing Authority, a London based supervisory agency for the LSE. If a firm is not in compliance with the Code, it can even be taken off the listing. The underlying idea is that the code contains cornerstones and principles as well as recommendations for good corporate practice with which firms do either comply - as if it were mandatory law - or, in the alternative case, oblige the firms to explain to the capital market the reasons of their deviation. This justification will center on the specific needs of the firm and with this information the firm will also have to communicate to the market the set of rules it is implementing instead.

[18] To give an example we can take a quick look at the provisions in the German Stock Corporation Act with regard to the required number of annual meetings of the supervisory board, § 110 AG). While the catch-all requirement of
four meetings of the board in person might be adequate for some companies, there does not seem to be the same justification available for, say, a sleeping firm solely holding some real estate. Why and who would anyone object to this firm's supervisory board meeting only once a year for the balance sheet approval? In contrast to the written law, for most firms it would seem appropriate to meet more than four times a year. Here we can see quite clearly the inflexibility of mandatory law. Now, if we were to embed this rule within a corporate governance code, the company would have the option to either comply with it or to explain the reasons for which it adopts an alternative rule. If a company would explain its reasons for holding monthly supervisory board meetings, the market would surely honor this.

[19] Now, however, arises the question of enforceability. Delisting would, for several reasons, not be an adequate option in our environment. Already, the governing administrative law renders such procedures highly difficult. Instead, we in the Commission propose another mechanism which builds on an entirely different understanding of enforcing and sanctioning firms' behavior. Our suggestion is to focus on the annual auditor who shall check and certify a particular firm's compliance or deviation by demanding respective information by the supervisory board. In case of the firm's non-compliance with either the rules as provided for in the Code or as declared by the Company itself, the auditor would have the discretion if not the duty to withhold the annual Testat (certification).

[20] GLJ: What you just described appears to be very close to what others have called reflexive law, i.e. a way of creating and recreating law in steady adaptation to the specific circumstances in a concrete case. With regard to your Commission's work, this would be the implementation of corporate law provisions and their execution as well as control not only in direct communication with the firms but, in fact, by these firms themselves. Now, as we might see here the beautiful reflections of law made by those that are to be governed by it, we must still ask ourselves why it is so difficult to come up with this, seemingly, simple and persuasive proposal. Could the reasons be found in the "political roots" of a corporate law system which your American colleague Mark Roe so pointedly analyzed in a comparison of Germany, Japan and the United States? What are we to think, from that perspective, of the Chancellor's decision to free himself for a moment from political constraints and, instead, simply invite a group of experts, thereby initiating a highly efficient dialogue across various societal interest fields and, at the end of the day, presenting a whole catalogue of clear proposals? Considering the fact, that you and your Commission have had an overwhelmingly good response to your invitation from interest groups, it almost seems that this procedure has no downside.

[21] Baums: We have to make a clear distinction between the issues that many participants in the discussion, including the Commission, find to be necessarily be situated in a body of mandatory law and those aspects that ought to be transferred into a Code. If we ask ourselves where we need mandatory corporate law, we can list three main arguments in favor of adopting rules by means of a legislative procedure building on parliamentary deliberation. The first argument focuses on the advantages of mandatory law in connection with lowering transaction costs. The mere existence of a legal provision in written corporate law takes the obligation off the contracting parties for additional bargaining. The next argument is concerned with the avoidance of market failure. In the case of torts committed by organs of a limited liability company, or company creditors with little or no bargaining power, we can easily see that ensuing negative effects can, for example, be avoided or mitigated by statutory creditor protection. Finally, the third argument picks up what Max Weber referred to as "autonomous political decisions." Unlike the aspects just mentioned - lowering transaction costs or avoiding market failure - the idea of an autonomous political decision embodies a different idea altogether. Let us take the example of employee Mitbestimmung (co-determination), surely one of the most debated - including internation-ally - characteristics of German corporate governance. We must see that we are dealing here with a political decision in the Weberian sense. While you might be able to promote the reduction of transaction costs by enabling law, i.e. the prospect of incentives and rewards, this does not apply to market failure and, surely, not to the issue of co-determination. These demand, by their nature, mandatory law for their implementation and enforcement and there is no room, seemingly, for the use of a Code of Best Practice. The Code of Best Practice, by definition, does not require strict compliance. Therefore, if you require strict compliance, this is not an appropriate avenue. In this light, the Code of Best Practice appears to be the place for those provisions in reaction to which you expect the appearance of "bad boys" who will cheat or attempt to cheat the market. Besides the sanction we already mentioned with regard to the annual control of the public accountant, there is a great chance that - under the regime of non-mandatory law - the risk of market cheating by some firms is even higher. The sanction we might expect from the market - "reputation" or, rather, punishment by loss of reputation - depends on information in the absence of which there will most likely be no sanction.

[22] When our commission made its recommendations, we necessarily had to bear these limits of the Code in mind. Again, however, we can learn by looking abroad: the Cadbury Commission in Great Britain and the Code enacted by that Commission in 1992, foresees that there are regular empirical checks executed by special research groups and meant to gather information on the level of the firm's compliance with the Code's provisions. If these checks reveal strikingly broad cases of non-compliance, the Commission can move to propose to take the respective rules out of
the Code. The Commission which will soon be in charge of drafting a Code of Best Practice for the German market ought to follow the British example. This means that regularly there must be market researches in order to gain information as to the level of compliance by the market with certain rules contained in the Code. If specific rules are found as being particularly disregarded, there can be recommendations to shift back or to originally enact this specific rule within mandatory, statutory law. What we see here is, indeed, a completely different law making process.

[23] GLJ: One, that apparently appeals to you, is that right?

[24] Baums: Indeed. And it is not altogether alien to our legal system. This becomes evident in light of the procedure laid down in Paragraphs 342 and 342a of the German Handelsgesetzbuch (Commercial Code) related to the establishment of private bodies for the creation of accounting principles. While this is not entirely the same model embodied in a Code of Best Practice, we can still see here a specific institutional as well as substantial openness and flexibility. Namely, the mentioned provisions in the Commercial Code allow for the recognition by the Federal Ministry of Justice of a private body for setting standards and the creation of rules in accordance with the governing accounting principles. This framework does, in fact, constitute a form of soft law comparable to that which we found in the British Code. The rules adopted by this standard setting body are published by the Official Bundesanzeiger (German Gazette) and applied by the accounting profession and the firms. This law-making process unfolds in close proximity to the economy and it is very flexible as there is no need for a lengthy parliamen-tary debate. And it is transparent. Yet, there is one decisive feature that we already briefly touched upon, which makes our proposal, in my view, more charming even in comparison with the ac-counting model. Precisely, our model allows for an autonomous development of own rules within the firms. And this is missing in the German Accounting Standards Committee (Deutsches Rechnungslegungs Standards Committee e.V. - http://drsc.de).

[25] GLJ: If we speak about the specifics of this law-making process, and this certainly includes your Commission and the dialogue into which it entered with outside experts, you might want to illuminate to what degree the deliberations that have been taking place and which are set to continue are a national, international or, possibly, global affair.

[26] Baums: We did indeed invite expert opinions from a large share of German interest groups including - among others - the Bundesverband der deutschen Industrie (BDI -- Federation of German Industry, http://www.bdi-online.de), the Deutscher Industrie- und Handelkammer (DlHT -- Chamber of Commerce, http://www.dlht.de), the Bundesverband deutscher Banken (Federal Federation of Bankers, www.bankenverband.de) and other members of the German business community - as we were con-cerned with German corporate law. But, we must acknowledge that German corporate law does not only affect German investors but, indeed, many international institutional investors as well. Therefore, we approached big institutional investors as well as international institutions and experts who deal with corporate governance on an international level. In addition to that, we asked a large American advisor to institutional investors to publish our questionnaire on its website in order to trigger more recommendations. The response was tremendous, we received a great amount of very valuable and helpful information and suggestions but, most importantly, most of the answers com-menced by expressing their gratitude for and their appreciation of being allowed to participate at some level in a German law making process - an event which was, apparently, novel.

[27] Certainly, and we need to keep this in mind, this procedure is not fit for every issue. But un-like cases that ask for analytical, scientific answers, eventually leaving little room for deliberation, we were and are dealing here with issues and rules that are very close to the actors which will have to live with them. Therefore, there is a strong case to be made for a deliberation close to those af-fected interests.

[28] GLJ: Would you assume that parliamentary bodies as such are less apt or inclined to initiate and to enter into such rich dialogues with interest groups? And what do you think of the already existing corporate governance principles such as those established by the OECD or the material prepared by the World Bank?

[29] Baums: We frequently see in the German Bundestag (Federal Parliament), but even more frequently in other, foreign parliaments, that national and international experts are invited to testify before the members of parliament. This shows that law making has, naturally, been taking on international dimensions and that dialogues of the nature with which my Commission recently was concerned are - per definitione - not entirely confined to national borders. The capital market is not nor are the actors within it. As to the principles worked out by the International Organizations you mentioned: we have to bear in mind the supra-national character of these institutions. There is a great number of states - among them Germany, represented by Professor Feddersen from Frankfurt and the German Ministry of Justice - that participate in the drafting of the principles. From this follows, almost automatically, a certain level of generality and lack of detail in comparison with, say, corporate governance rules as prepared within a national political economy. The result is what we might want to call an average, a medium standard of good corporate governance as a recommendation to the Member States. Such recommendations build on the premise and the presumption that they are, basically, applicable everywhere. As for Germany, our mandatory corporate governance
rules doubtless meet these standards.

[30] In some respects then, such international standards are very helpful as points of orientation - but they are not detailed enough with respect to a thorough overhaul of an existing national system. Therefore, we need to - on one hand - consider international standards while we have to pay close attention to our national specifics on the other, namely the institution of co-determination as well as the two-tier structure involving both a management and supervisory board.

[31] GLJ: In this light, would you tend to recognize trends towards a globalization of corporate law which, to be sure, does not grow independent of its national setting and embeddedness but, instead, incorporates specific background conditions that are characteristic to the state in which the law - and the economic, political and social system in which it evolved - developed over time? As Peter Hall and David Soskice have recently suggested under the heading of "Varieties of Capitalism," when attempting to assess the national or international nature of rules, institutions and actors, we ought to ask for the specific environmental factors that have accompanied and at least co-determined the building and evolution of certain structures. How do you assess this persisting national quality of economic actors and institutions? Are we speaking of "Law without" or of Law beyond "a State", especially in light of the central role still played by such terms as Standortvorteil (locational advantage)?

[33] Baums: In my view, we must take a historical perspective in order to answer this question. But even if we can say that, formerly, it was the state in correlation with a nation-tal economy and, correspondingly, rules were set by the state for this national economy, we can find, for example with regard to Prussia, that the Prussian King sent an official to England in order to gather information on the causes of the English economic success. Thus, what we see early on in Continental Europe, is this look across borders, a decisive comparative perspective which was considered to be of vital importance at times of reforming national statutes or institutions. It was, at the same time, an academic learning process leading to a variety of outside perspectives on issues that often were observed only from within.

[34] While this process is still continuing, we have to realize a dramatic new development: today we are faced with a competition for rules. This is very evident in tax law. But it is also true for company law. In a cross-border merger you will today ask the question where to put the headquarters of the group and we must see that trends can be observed to place it in non co-determined countries instead of in, say, Germany. But there is still another development that comes to play here: when we speak of accounting and auditing rules, we surely speak of the most interna-tionalized rules around. Not only are there differences among the rules of individual states but there are international entities setting standards as well. These associations are non-formal, non-state and they develop far-reaching rules and standards. These will eventually serve as models for national as well as for EU legislation. This development does not render the state superfluous because the implementation and transformation of the rules still involves the state. At the same time, what we have to see is that if the Nation state does not comply with these rules, this will lead to considerable disadvantages of the respective economy. Thus, these international, informal entities that set standards exercise a strong pressure on states to comply with these rules if a punishment by the interna-tional capital market is to be avoided. This dimension goes beyond that of the bi-lateral "learning from your neighbor" and that of the competition for regulation. The market force that we see un-fold-11 here is much more difficult to assess because it is no longer obviously defined along the lines of national boundaries. The advent of informal international actors and the pressure exerted by them in connection with the international capital market against non-complying states do indeed present a new challenge to our traditional understanding of corporate law but also international law.

[35] Meanwhile, corporate law, which is traditionally of national nature, has become highly inter-nationalized by, for example, the EU harmonization process and international investors. Namely, these large investors have a great influence on national law making as well as our Commission by way of recommendations and standards that can be found worldwide. This market pressure is difficult to assess because it is not resulting from what we naturally identify as market behavior: competition. The strong role played by these informal international actors does, indeed, evade our traditional assessments. And while we find many standards put forward by such actors convincing we, with view to our German system, cannot simply adopt all of them. Other countries such as the United States have a strong capital market culture embedded almost in what we might call the country's popular culture: while an American traditionally might invest his/her money in the capital market, the German would tend to pay the money into a savings account. These differences are reflected in the specific creation of control and supervisory agencies of the capital market in various countries. The crucial importance of the organization of a capital market is now seen in light of the erosion of traditional state dominated security systems (old age and pension). The successful turn to the capital market as substitution of declining public security and welfare systems depends to a large extent on the specific level of capital market supervision and control. And here it seems: the best of all ways - and keeping in mind what we have said about embedded-ness and national characteristics - is to imitate your best competitor.

[36] So, not instead but, rather, in accompaniment of the necessarily detailed and analytical scrutiny of single
elements and aspects of the envisioned reform we need to remain aware of the background both of the rules we might want to change in the future as well as of the instruments we employ in this reform process. So, our aim cannot solely be to turn certain screws a bit further. Instead, we need to think about the system and the specific challenges to which it is exposed. Only then can we answer the question whether we will eventually need to follow a very different path.