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## Countercyclical Corporate Governance

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## COUNTERCYCLICAL CORPORATE GOVERNANCE\*

ANEIL KOVVALI\*\*

*The American economy has lurched from crisis to crisis for over a decade, enduring long stretches of high unemployment, market dysfunction, and ineffective government policy. Despite the enormous scale of this suffering and disruption, the full implications of the experience have not been absorbed by the corporate governance literature. Corporate law's focus on delivering financial returns to shareholders works reasonably well in a robust economy, when markets function effectively and align shareholder incentives with the goal of maximizing social wealth. But these tidy mechanisms fail in periods of macroeconomic stress, when markets send faulty signals and firms pursuing short-term shareholder profits can destroy social wealth. The layoffs or price increases often desired by shareholders can be useful in a healthy economic environment, as they cause resources to be allocated more efficiently to higher-value uses, and competitive markets prevent harm from falling on workers or consumers. But the same maneuvers can be destructive when the economy is afflicted by unemployment or inflation. Revising corporate governance arrangements so that companies focus less on maximizing short-term shareholder profits during crises can thus be a useful tool for managing economic problems and improving outcomes.*

*This Article begins the theoretical and practical work of adapting corporate governance to periods of economic crisis. After demonstrating that the assumptions that have driven corporate law debates depend on macroeconomic context, the Article shows that correcting those assumptions could make corporate governance a powerful tool for managing crises. These insights offer a useful framework for evaluating measures undertaken by businesses, investors, and the government in response to the COVID-19 crisis, while suggesting new avenues for action.*

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INTRODUCTION

As the economy lurched from the global financial crisis, to the period of prolonged stagnation and elevated unemployment that followed, to the suspension of economic activity in the COVID-19 crisis, and now to a period of dislocation and elevated inflation, the limits of traditional macroeconomic tools were revealed. Governments looked to existing fiscal and monetary policy tools for solutions to each challenge but found that those tools were often unavailable or ineffective. A new wave of legal scholarship has sought to expand the toolkit by identifying ways legal rules could be altered to induce businesses and individuals to increase investment and spending in times of economic trouble.<sup>1</sup> But relatively little has been done to use insights from the study of corporate governance to mobilize the capacity of corporations to move the economy out of a crisis.<sup>2</sup>

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1. See generally YAIR LISTOKIN, *LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS* (2019) [hereinafter LISTOKIN, *LEGAL REMEDIES TO RECESSIONS*] (“I also will argue for the benefits of novel legal instruments—and novel uses of existing legal instruments—for stimulating aggregate demand when monetary policy is ineffective”); Jonathan S. Masur & Eric A. Posner, *Should Regulation Be Countercyclical?*, 34 *YALE J. ON REG.* 857 (2017) [hereinafter Masur & Posner, *Should Regulation Be Countercyclical*] (examining whether regulation should adapt to the business cycle); Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, 34 *YALE J. ON REG.* 791 (2017) (“[B]ecause the same law has different effects at different times, law should be different at the zero lower bound than in other times.”); Zachary Liscow, *Counter-Cyclical Bankruptcy Law: An Efficiency Argument for Employment-Preserving Bankruptcy Rules*, 116 *COLUM. L. REV.* 1461 (2016) (arguing that bankruptcy law should be explicitly counter-cyclical).

2. This Article writes on a relatively clean slate, as academic study of the use of corporate governance to counter recessions is at an early stage. Some works have alluded to aspects of the story. See Tianna Larson, Note, *Countercyclical Antitakeover Law: Dead Hand Poison Puts in a Zero Lower Bound Recession*, 21 *WAKE FOREST J. BUS. & INTELL. PROP. L.* 319, 354–55 (2021) (suggesting that the law should be more tolerant of dead hand poison puts during recessions); Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better than Corporate Governance Reform*, *CLS BLUE SKY BLOG* (Aug. 21, 2019), <https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/> [https://perma.cc/M4HP-GYS7] (blog post suggesting that “many politicians . . . are really looking for companies to provide a kind of Keynesian stimulus – that is, a way to drive the economy by spending not government funds, but more shareholder capital, to promote a boom,” before quickly rejecting the concept); cf. Zohar Goshen & Doron Levit, *Agents of Inequality: Common Ownership and the Decline of the American Worker*, 72 *DUKE L.J.* 1 (2022) (noting connection between corporate governance arrangements and level of

This Article seeks to explore this gap. The conceptual and practical tools the Article develops have substantial potential. Corporations command extraordinary financial resources and have enormous operational scope. And because corporations can act flexibly and with dispatch, they can readily respond to changing circumstances from high unemployment to high inflation. Harnessing corporate capacity would dramatically improve the economy's ability to recover from a variety of serious economic crises.

Corporate governance is a natural starting point in the effort to harness the power of business. Traditional macroeconomic policy tools seek to encourage businesses to invest and hire in recessions by changing the external environment in which they operate.<sup>3</sup> But altering corporate governance arrangements—the incentives and mechanisms that drive corporate decisions—can operate more directly on corporate investment and hiring decisions.

Corporate governance tools can also help address market dysfunction. Recessions and other macroeconomic crises are market failures in which wealth-generating transactions fail to occur.<sup>4</sup> During a recession, there are unemployed workers who would be happy to buy more goods if only they could get a job, and there are struggling businesses that would be happy to hire if only they could sell more of their products. Markets are slow to reach an efficient equilibrium in which these wealth-generating transactions occur. Governments and firms can help coordinate this beneficial activity without waiting for the market to equilibrate. Where direct government action is not forthcoming or is not effective, firms can step in to fill the gap.

Beyond practical implications, the analysis can shed new light on longstanding theoretical debates in corporate governance. Macroeconomic crises break the intuitions that have shaped corporate governance. The traditional view of corporate governance is that directors and officers should focus exclusively on the interests of shareholders.<sup>5</sup> While corporations make

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investment and employment in the economy). This Article provides a broader theoretical framework that allows for evaluation of these mechanisms and intuitions.

Prior work has also narrowly considered how corporate governance at large financial institutions ought to be revised to address financial crises. *See generally* Yair J. Listokin & Inho Andrew Mun, *Rethinking Corporate Law During a Financial Crisis*, 8 HARV. BUS. L. REV. 349 (2018) (suggesting modifications to fiduciary duties and voting rights at systemically important firms targeted for acquisition in transactions arranged to avoid a financial crisis); John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35 (2014) (suggesting weakening business judgment rule protection for managers of systemically important firms, to align their incentives with those of diversified shareholders). This Article analyzes a broader range of corporations and considers how changes to corporate law rules might improve macroeconomic performance during recessionary periods.

3. *See infra* Part II.

4. *See infra* Section II.A; Morgan Ricks, *Money, Private Law, and Macroeconomic Disasters*, 83 L. & CONTEMP. PROBS. 65, 73 (2020) (describing recession caused by lack of aggregate demand “as a kind of economy-wide coordination failure”).

5. *See infra* Part I.

decisions affecting many other constituencies, including workers, creditors, and local communities, those other constituencies are considered protected by contracts and regulations.<sup>6</sup> Because shareholders are paid only after these legal obligations to other constituencies are satisfied, shareholders are thought to feel the effects of marginal changes in the firm's value most directly. They are thus believed to have the right incentives to create wealth by maximizing output and minimizing costs like wages.

When the economy is succeeding, this outlook has a rough alignment with the goal of maximizing social wealth. Labor is a scarce social resource, and when a firm uses a worker's time, that time is not available for other valuable activities. When labor markets are functioning properly, the social opportunity cost of deploying that worker's time at the firm instead of elsewhere is reflected in market wages. Suppose that an employee commands wages of \$20 an hour at a firm when labor markets are robust. In that scenario, the \$20-an-hour wage likely reflects the employee's ability to find another job paying roughly \$20 an hour, which in turn indicates that the employee could create more than \$20 of value at that other job. If the firm found a way to maintain existing production without using the worker's time, the worker would go to that other job and create that value—the \$20 an hour saved by the firm would reflect a genuine efficiency gain that permits society to redeploy productive resources and create additional wealth.<sup>7</sup> As a result, in ordinary times, the goal of maximizing shareholder profits has a rough correlation with the goal of maximizing social wealth creation.

But in a recession with dysfunctional labor markets and persistently high unemployment, wages may not correspond to the opportunity cost of labor: if an employee is laid off, they may not be able to find another job or create any value. The employee's customary wages would still represent a cost from the shareholder profits perspective but would not reflect a genuine opportunity cost from the social wealth perspective. Maximizing shareholder profits by laying

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6. *E.g.*, Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 656–57, 666 (2006); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 26 (1991).

7. This is not to slight the real pain and disruption that would be experienced by the worker. Even in a robust economy, a layoff that improves efficiency can be personally devastating for the affected workers and their dependents—harms that should be mitigated by policy. *See* Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536, 587 n.214 (2018) (“Empirical evidence verifies that workers who are laid off suffer significant harms and have trouble finding equally good jobs.”); Jonathan S. Masur & Eric A. Posner, *Regulation, Unemployment, and Cost-Benefit Analysis*, 98 VA. L. REV. 579, 613–18 (2012) [hereinafter Masur & Posner, *Unemployment*] (documenting harms from layoffs, including increased mortality rates). But in a robust economy and competitive labor market, the harms are reduced because the affected workers are more likely to be able to find alternative employment on comparable terms. Naidu et al., *supra*, at 587.

off workers could also have destructive effects. A layoff would mean a period of extended unemployment for the worker, meaning that the worker goes from creating some social wealth to none. Other costs of a layoff include loss of income to the worker, a potential loss of productive capacity for the economy if the worker is unemployed for an extended period and loses skills, and a loss of demand as the worker curtails spending. These costs are not borne by the firm's shareholders directly,<sup>8</sup> and they are not likely to be part of the calculus of directors and officers who are focused on a narrow conception of shareholders' interests. It would thus be helpful to reform corporate governance to encourage managers to maintain spending and investment, even if some shareholders feel slighted.

Reforming corporate governance in response to these issues could yield substantial benefits because American corporations control substantial resources. Apple Inc. alone reported having almost \$200 billion in cash, cash equivalents, and marketable securities as of March 28, 2020,<sup>9</sup> about ten percent of the amount that the entire federal government devoted to its unprecedented March 27, 2020, package to address the harms caused by COVID-19.<sup>10</sup> If corporations could be induced to use their resources to expand investment and employment in times of economic trouble, they could have an impact comparable to a major government program. And because of their unique capabilities, relationships with employees and other stakeholders, and capacity to act rapidly, their financial firepower may actually understate their usefulness. Therefore, countercyclical corporate governance is worth exploring whether as a complement to government efforts or as a substitute in the wake of an inadequate government response.

These points support a range of policy approaches, with the primary goal of reorienting firms to serve constituencies other than shareholders during a crisis. Although they were not conceptualized as efforts to revise corporate governance, various features of the policy response to COVID-19 suggested a growing recognition that corporations were vehicles to serve constituencies like employees and customers and not simply to generate financial returns for shareholders.<sup>11</sup> Shareholders, like index funds, can deepen this trend with thoughtful interventions at portfolio companies, mitigating recessions in a way

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8. LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 93 (describing multiplier effect through spending as a "classic externality").

9. Apple Inc., Quarterly Report (Form 10-Q) 9 (May 1, 2020). Apple is not unique. *See infra* Appendix A.

10. *See* Letter from Phillip L. Swagel, Director, Cong. Budget Off., to Mike Enzi, Chairman, U.S. Senate Comm. on the Budget, 1-2 (Apr. 27, 2020), <https://www.cbo.gov/system/files/2020-04/hr748.pdf> [<https://perma.cc/6YQ7-KZS5>] (program estimated to provide financial assistance of more than \$2 trillion at cost of \$1.7 trillion).

11. *See infra* Part III.

that improves their long-term returns and marketing position.<sup>12</sup> Additionally, the government can further support countercyclical corporate governance through appropriate regulations.<sup>13</sup> The discussion of policy approaches here is not intended to be exhaustive but should open an important conversation on ways that corporate governance could support an economic recovery.

The Article proceeds as follows. Part I situates the analysis by describing the broader corporate governance debate between advocates of shareholder primacy and stakeholder governance, before showing how the arguments are shaped by macroeconomic context. Part II discusses the use of macroeconomic policy to mitigate the business cycle and shows how existing tools are influenced by and could be supplemented by corporate governance. Part III describes certain responses to the recession prompted by COVID-19, and suggests that they signal an emerging appetite for countercyclical corporate governance. Part IV discusses how a countercyclical corporate governance scheme could be implemented through private measures such as index fund engagement. Part V briefly describes government reforms that could further support countercyclical corporate governance. Finally, Part VI considers limits and objections.

## I. SHAREHOLDER PRIMACY AND MACROECONOMIC CONTEXT

This part situates the analysis in the ongoing debate over the proper orientation of corporate governance. Section I.A begins by describing the debate between the shareholder primacy and stakeholder governance schools. Section I.B shows how the debate is affected by macroeconomic context, examining how the normal relationship between shareholder value maximization and social wealth maximization breaks down in recessionary periods.

### A. *Shareholder Primacy and Stakeholder Governance*

The shareholder primacy or shareholder wealth maximization norm posits that a corporation should be managed only to generate profits for its shareholders.<sup>14</sup> Under this paradigm, employees, creditors, and other groups

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12. See *infra* Part IV.

13. See *infra* Part V.

14. See, e.g., *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (“A business corporation is organized and carried on primarily for the profit of the stockholders.”); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 278 (1998) (“Employees, creditors, suppliers, customers, and others may possess contractual claims against a corporation, but shareholders claim the corporation’s heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy.”); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41 (2001) (describing a “standard shareholder-oriented model” under which “ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; [and] other



that are affected by a corporation's decisions must either bargain for specific contractual protections or obtain relief through governmental regulations. Absent some specific formal limitation, corporate directors and officers are to focus solely on shareholder welfare. This norm is supported by the majority of academics and is the conventional account of the law of Delaware, America's most important corporate law jurisdiction.<sup>15</sup>

The principal argument for shareholder primacy conceptualizes shareholders as the "residual claimants" on the corporation, and suggests that they have the correct incentives to maximize economic value:

Bondholders have fixed claims, and employees generally negotiate compensation schedules in advance of performance. The gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in line. . . . The firm should invest in new products, plants, etc., until the gains and costs are identical at the margin. . . . The shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion.<sup>16</sup>

The conventional criticism of this argument attacks the claim that shareholders are the residual claimants on the firm. When a firm is doing well, it is likely to reward many constituencies, including employees; when it is doing

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corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance").

15. See Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015) [hereinafter Strine, *Dangers of Denial*] ("[W]ithin the limits of their discretion, directors [of Delaware corporations] must make stockholder welfare their sole end, and . . . other interests may be taken into consideration only as a means of promoting stockholder welfare."); Hansmann & Kraakman, *supra* note 14, at 440 (describing "growing consensus on these issues").

16. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983); see also Eugene F. Fama, *Market Forces Already Address ESG Issues and the Issues Raised by Stakeholder Capitalism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 9, 2020), <https://corp.gov.law.harvard.edu/2020/10/09/market-forces-already-address-esg-issues-and-the-issues-raised-by-stakeholder-capitalism/> [perma.cc/7GR8-ZWJP] (arguing that the common solution to the problem of contract costs "is a contract structure in which almost all stakeholders negotiate fixed payoffs . . . and shareholders bear the residual risk of net cashflows—revenues minus costs" and "[i]n exchange for fixed payoff contracts for other stakeholders, shareholders get most of the rights with respect to decisions that affect net cashflows"); LYNN STOUT, THE SHAREHOLDER VALUE MYTH 39 (2012) [hereinafter STOUT, THE SHAREHOLDER VALUE MYTH] ("The belief that shareholders are the residual claimants in corporations leads naturally to the belief that maximizing shareholder wealth will maximize overall social wealth as well. After all, if the interests of other stakeholders in the corporation are fixed and predetermined, the only way to increase the value of the shareholders' residual interest is to increase the value of the corporation itself."); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 2 (1993); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 36 (1991) [hereinafter EASTERBROOK & FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW].

poorly, it is likely to squeeze or even remove them.<sup>17</sup> Given that other constituencies also bear risk, it is not clear that shareholders have the right incentives to maximize the value generated by the firm's activities.

The shareholder primacy approach faces increasing competition from stakeholder governance, which suggests that corporations should consider and advance the interests of a broad range of constituencies, including workers, creditors, suppliers, customers, and surrounding communities.<sup>18</sup> Influential organizations like the Business Roundtable<sup>19</sup> and the World Economic Forum<sup>20</sup> have committed to stakeholder governance.

Stakeholder governance has faced serious criticism. First, critics have argued that the stakeholder governance model is indeterminate and fails to provide a clear criterion for corporate decision-makers.<sup>21</sup> Because it fails to provide a criterion for corporate decision-makers to apply, it also fails to offer a criterion for others to use in holding decision-makers accountable.<sup>22</sup> Second, critics have argued that American corporate law only empowers shareholders.<sup>23</sup> Because only shareholders can vote for corporate directors, who in turn select officers, corporate actors lack adequate incentives to consider the interests of other stakeholders.<sup>24</sup>

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17. See STOUT, *supra* note 16, at 41; Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1194 (2002) [hereinafter Stout, *Bad and Not-So-Bad Arguments*].

18. E.g., *Business Roundtable Redefines the Purpose of a Corporation To Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans%20> [https://perma.cc/EGV8-ZYWA].

19. *Id.*

20. See Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), <https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/> [https://perma.cc/N89D-QZ75] (“The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders—employees, customers, suppliers, local communities and society at large.”).

21. See Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 121 (2020); Stephen Bainbridge, *The Importance of the Shareholder Wealth Maximization Standard*, PROFESSORBAINBRIDGE.COM (Feb. 7, 2006), <https://www.professorbainbridge.com/professorbainbridge.com/2006/02/the-importance-of-the-shareholder-wealth-maximization-standard.html> [https://perma.cc/PYF6-Z3R7] (describing “Bainbridge hypothetical” in which company faces decision on whether to shutter a plant, and insisting that only shareholder wealth maximization standard provides clear basis for decision).

22. Bebchuk & Tallarita, *supra* note 21, at 164; Bainbridge, *supra* note 21 (“[D]irectors who are allowed to consider everybody's interests end up being accountable to no one.”).

23. See generally Bebchuk & Tallarita, *supra* note 21 (arguing that stakeholderism results in decision-making being left to directors of corporations); Strine, *Dangers of Denial*, *supra* note 15, at 766 (“In the corporate republic, no constituency other than stockholders is given any power.”).

24. Bebchuk & Tallarita, *supra* note 21, at 143–46; Strine, *Dangers of Denial*, *supra* note 15, at 783.

B. *The Relevance of Macroeconomic Context*

Macroeconomic context adds an important dimension to these issues. When the economy is producing at capacity and markets are functioning properly, the interests of shareholders correlate with the broader goal of maximizing social wealth. This relationship is broken during recessionary periods when productive resources are idle and markets fail to equilibrate.

Consider a simple firm that pays workers to produce a product, which the firm sells on the market. After workers have been paid their wages, the remaining profits are distributed to shareholders. In a tight labor market with all workers in the economy employed, the shareholders have appropriate incentives to bring the firm's operations toward the social optimum. With all workers fully employed, social wealth could only be increased by moving workers from low-value activities to high-value activities. This suggests a simple social criterion: a worker should be employed at the firm if and only if the worker would generate more value at the firm than they would generate if employed elsewhere. By contrast, shareholders have their own criterion: a worker should be employed at the firm if and only if the worker would generate more value at the firm than their market wage.

With properly functioning labor markets, the social criterion aligns with the shareholder criterion because market wages would correspond to the value that a worker would generate at other firms. If the worker is not generating more value than their market wage, the worker should leave the firm and take on higher value work. While the worker might experience painful disruptions in shifting from one job to another, the pain would be mitigated by the speed with which the worker would get their next job. Focusing on shareholder profits would thus lead a corporation to the correct decision.<sup>25</sup>

High unemployment and dysfunctional labor markets would break the relationship between the social criterion and shareholders' criterion by damaging the ability of wages to send appropriate signals. Upon being fired, a worker would not necessarily shift into a higher value activity. Instead, the worker might face a prolonged period of unemployment, generating no value at all. Societal wealth would decrease as production decreased, the worker pared back spending, and the worker's community was immiserated. Yet shareholders would have an incentive to undertake layoffs until wages found a new equilibrium.

To illustrate, suppose that Alpha Corporation pays an employee \$20 per hour and is happy to continue doing so because the employee generates \$21 in value per hour. The eccentric CEO of Beta Corporation then poaches the employee by offering her more than \$20 per hour in wages and assigns her to a

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25. For a more formal statement of this point, see equation (3) in Appendix B.

make-work job that generates just \$5 per hour. The decision would cost Beta's shareholders—the employee's wages are reducing profits by more than \$15 an hour. And the decision would cost society—the employee was generating \$21 of wealth per hour at her job at Alpha and is now generating \$5 of wealth.

Now suppose instead that Beta's CEO filled the make-work job by recruiting an unemployed person who previously had no prospect of finding productive work. Of course, Beta's shareholders would still protest, because the employee's wages are reducing profits by more than \$15 an hour. But the effect on social wealth would be positive—the employee was generating \$0 of wealth when unemployed and is now generating \$5 at Beta.

A hot economy resembles the former scenario. In the aggregate, hiring would mean pulling a person away from another valuable job, so social wealth is maximized when businesses adopt the shareholders' focus on efficiency. But a slowing economy resembles the latter scenario. In the aggregate, hiring would decrease unemployment, so social wealth can increase when businesses undertake activities that do not directly increase shareholder wealth.

When the economy is producing at capacity and labor markets are functioning properly, it is also reasonable to contend that the shareholders are the residual claimants on the firm. In a tight labor market, workers would have a robust exit option if the firm sought to reduce their wages. As a result, shareholders could not offload risk onto workers and would have to bear the firm's risks. Under harsh macroeconomic conditions, this logic collapses. Shareholders would be free to offload some of the firm's risks onto the workers, because workers would be afraid of termination.<sup>26</sup>

Importantly, this analysis does not depend on contestable claims that shareholder primacy has contributed to social and macroeconomic ills like income inequality, underinvestment in research and stagnant innovation, and environmental degradation.<sup>27</sup> Instead, it simply suggests that the ordinary logic of corporate governance debates breaks down in macroeconomic crises.

These observations could be cast in the familiar language of externalities. Firing a worker when the economy is performing well has limited externalities because the worker would quickly get a new job. Firing a worker when the economy is performing poorly would have extensive externalities, as the worker

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26. See Stout, *Bad and Not-So-Bad Arguments*, *supra* note 17, at 1194.

27. See Karen Ho, *In the Name of Shareholder Value: Origin Myths of Corporations and Their Ongoing Implications*, 43 SEATTLE U. L. REV. 609, 610 (2020); Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1401 (2020) (attention to stakeholder issues would reduce vulnerability to crises). These assertions are hotly contested. See Matteo Gatti & Chrystin Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*, 46 J. CORP. L. 1, 60 (2020).

faces prolonged unemployment and cuts back on spending at other businesses.<sup>28</sup> Increased externalities during periods of crisis complicate the ordinary logic of corporate governance.<sup>29</sup>

Of course, a *diversified* shareholder will absorb some of the consequences of an economy-wide slowdown, and as a result would capture some of the benefits from actions that ameliorate a recession. A shareholder can also have preferences and economic interests outside of their holdings at a given firm; a worker who owns stock may derive greater benefits from a robust labor market than from marginally better stock returns. To the extent these forces lead shareholders in the right direction, countercyclical corporate governance may only require firms to listen to the *right* shareholders, as opposed to listening to stakeholders.<sup>30</sup>

The discussion suggests other implications for corporate governance debates. For example, critics of stakeholder governance complain that it fails to offer a criterion for action. This complaint has some force in periods of robust macroeconomic performance. Under those conditions, stakeholder governance must rely on economically indeterminate ideas about fairness or corporate purpose to guide decisions. But in recessionary periods, social wealth maximization becomes a valid criterion to guide corporate action. Indeed, in such periods corporate governance can become a useful tool for policymakers seeking to maximize social wealth.

## II. MACROECONOMIC POLICY

This part begins the work of considering corporate governance as a tool of macroeconomic policy. Section II.A briefly discusses recessions and their costs. It then describes traditional policy responses to recessions and the nontraditional policy lever of changing ordinary legal rules and regulations. These tools either substitute for a decline in demand by private actors or encourage private actors to spend or invest. Section II.B shows that corporate governance arrangements affect the way that firms respond to macroeconomic

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28. LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 93 (“When multipliers exceed one, spending causes a positive externality . . . . When the buyer spends, she raises the seller’s income. In turn, the seller spends, benefiting people who had no connection to the first transaction. Such ‘downstream’ third-party effects are a classic externality, and the literature demonstrating high multipliers at the zero lower bound testifies to the importance of this externality.”); LISCOW, *supra* note 1, at 1481 (describing multiplier effect as a “positive externality” that exists only “when unemployment is high”).

29. Alternatively, a firm’s decision to consume workers’ scarce time normally has an externality: workers’ time is not available to other firms for other productive activities. In that environment, wages serve as a kind of Pigouvian tax; because shareholders must pay wages, they do not consume workers’ time beyond optimal levels. But when unemployment is elevated for an extended period, the externality has declined and the Pigouvian tax has not dropped in response.

30. *See infra* Section IV.A.

policy interventions and thus affect interventions' impact. As a result, policymakers seeking to prevent or mitigate macroeconomic crises must be attentive to corporate governance. Finally, Section II.C considers whether changes to corporate governance might provide a nontraditional economic stimulus. During a recession, prioritizing stakeholder interests could be a useful tool to boost economic activity.

A. *Policy Responses to Recessions*

In the long run, the economy should naturally move to an equilibrium that reflects its real capacity. If workers are unemployed and the economy is producing below its capacity, real wages and prices should gradually decline. The decline in real prices effectively increases the money supply and lowers interest rates, causing businesses to borrow, invest, and hire. The resulting increase in business activity brings the economy back to its equilibrium.

But as Keynes wrote, "In the long run[,] we are all dead."<sup>31</sup> Wages can be "sticky," meaning that they do not adjust immediately to changes in the marketplace. As a result, labor markets may fail to clear for long periods, with wages remaining too high to properly match the demand and supply for labor, leaving large numbers of willing workers unemployed. Delays in reaching full employment are painful for individuals who are unable to find work. A long delay can also damage the economy's productive capacity in the long run as workers lose skills and valuable relationships dissolve.<sup>32</sup> And long recessions can damage the legitimacy of governmental institutions, prompting adoption of dangerous political philosophies.<sup>33</sup>

As the Great Depression unfolded and these threats materialized, governments assumed responsibility for mitigating and shortening recessions.<sup>34</sup> To discharge that responsibility, policymakers sought new tools. These tools include the three standard levers of fiscal policy, monetary policy, and automatic stabilizers. Recent research has explored a fourth avenue of regulatory changes. The different tools operate using different mechanisms.

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31. JOHN MAYNARD KEYNES, A TRACT ON MONETARY REFORM 80 (1923).

32. See LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 70–72 (describing "hysteresis" phenomenon in which periods of unemployment reduce the long term potential of the economy); Masur & Posner, *Unemployment*, *supra* note 7, at 583 ("A senior worker who is laid off will on average experience a long-term reduction in income of as much as twenty percent, probably because the worker loses significant firm- and industry-specific human capital as a result of the layoff.").

33. See LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 73 (noting that "deep recessions and financial crises have a history of boosting the populist right in particular"); Steven A. Ramirez, *Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515, 525–26 (2003) (describing political instability in the United States during the Great Depression).

34. See Ramirez, *supra* note 33, at 533.

### 1. Fiscal Policy

Fiscal policy entails government deficit spending. The government responds to a decline in aggregate demand by increasing its own expenditures, reducing taxes to encourage expenditures by private persons, or both. As demand increases, firms respond by hiring to increase their production of goods and services. Newly hired employees spend a large portion of their income, further increasing demand and multiplying the effect of the stimulus. This multiplier effect can be substantial.<sup>35</sup>

But fiscal policy suffers from serious institutional impediments. Fiscal policy generally requires congressional action: the House, Senate, and President must agree on a bill to have the federal government spend more money or to revise tax policy. Unfortunately, the necessary consensus is often lacking in Washington, and even when it is present, the process often moves slowly.

### 2. Monetary Policy

Monetary policy offers a different tool for managing recessions. The Federal Reserve is led by expert appointees who are insulated from political pressures and processes.<sup>36</sup> As a result, it can quickly take actions that influence the money supply and the cost of borrowing. Chief amongst these are open market operations, in which the Federal Reserve buys or sells financial instruments.<sup>37</sup> When the Federal Reserve spends money to buy financial instruments, it increases the supply of money in the economy and makes it easier for economic actors to raise funds by issuing financial instruments. This lowers real prices and makes it easier for firms to raise money to invest in new projects that create jobs.

The institutional set up of the Federal Reserve solves the problems of speed and consensus, as its expert leaders can agree quickly on a course of action and move with dispatch. But these features also contribute to a sense that its actions are undemocratic and illegitimate.<sup>38</sup> It is also easier for the Federal Reserve to directly assist large economic actors than to help individuals or small businesses. Governments, financial institutions, and large corporations can

35. See Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 863.

36. Ramirez, *supra* note 33, at 540–41 (describing introduction of Federal Reserve independence in response to Great Depression).

37. See *Open Market Operations*, BD. GOVERNORS FED. RSRV. (Nov. 2, 2022), <https://www.federalreserve.gov/monetarypolicy/openmarket.htm> [<https://perma.cc/M2SE-E26V>].

38. See Matt Taibbi, *How the COVID-19 Bailout Gave Wall Street a No-Lose Casino*, ROLLING STONE (May 13, 2020), <https://www.rollingstone.com/politics/politics-features/taibbi-covid-19-bailout-wall-street-997342/%20> [<https://perma.cc/PAG3-ZXQR> (staff-uploaded, dark archive)] (asserting that the Federal Reserve had been “shooting a bazooka of cash daily at Wall Street,” as part of the “coronavirus bailout”); Anthony J. Casey & Eric A. Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479, 495 (2015) (stating that Federal Reserve action to reduce interest rates could be labeled a suspicious “bailout”).

issue securities in the capital markets, which the Federal Reserve can act on directly. To assist small businesses and individuals, the Federal Reserve must generally act indirectly.

In recent years, near-zero interest rates have also constrained monetary policy. At this “zero lower bound,” it is difficult to reduce interest rates further—a negative interest rate would mean charging people to lend money, and at some point, they would rather physically store money than loan it out. As a result, it has been difficult to use monetary policy to encourage firms to borrow more and invest in projects.

### 3. Automatic Stabilizers

Automatic stabilizers are policies that naturally deliver stimulus during recessions. For example, programs that provide funds to unemployed people or people with low incomes will naturally entail higher government expenditures when the economy is ailing. Similarly, a progressive tax system will naturally take a smaller percentage of income out of the economy when incomes decrease. Such policies are often put in place outside of an economic crisis for fairness or humanitarian reasons largely separate from their macroeconomic effect. Moreover, because they do not require additional legislative action, their implementation is not delayed.

The main problem with automatic stabilizers is that there are not enough of them. Although they help reduce suffering and unfairness, they are not sufficient to bring the economy out of a major crisis.

### 4. Reforming Legal Rules

Like other policy interventions, government mandates can affect price levels and induce businesses to spend and invest. Academics have been increasingly attentive to these effects, suggesting that legal rules might be altered during recessions to improve economic outcomes.<sup>39</sup>

Perhaps due to the relative infancy of academic study of this set of tools, it seems to have been used in a blunderbuss fashion, if at all. For example, during the economic crisis prompted by COVID-19, the Trump administration ordered that agencies should respond to the “economic emergency by rescinding, modifying, waiving, or providing exemptions from regulations and other requirements that may inhibit economic recovery.”<sup>40</sup> A subsequent order purported to suspend environmental reviews of infrastructure projects.<sup>41</sup> The

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39. *See supra* note 1.

40. Exec. Order No. 13924, 3 C.F.R. pp. 354–55 (May 22, 2020), *repealed by* Exec. Order No. 14018, 86 Fed. Reg. § 11855 (Feb. 24, 2021).

41. Exec. Order No. 13927, 3 C.F.R. p. 366 (June 4, 2020), *repealed by* Exec. Order No. 13990, 86 Fed. Reg. § 7037 (Jan. 20, 2021).



orders themselves did not appear to reflect a careful weighing of the costs or benefits of relaxed rules.<sup>42</sup>

B. *Corporate Governance as a Complement to Traditional Macroeconomic Policy Tools*

Corporate governance can interact with traditional macroeconomic policy interventions. As a result of these interactions, revisions to corporate governance rules can help preserve the effectiveness of traditional government tools.

Expanding purchases as part of a traditional fiscal policy will likely entail contracting with existing private firms. It may be possible for the government to expand purchases by directly employing workers and coordinating their production of goods and services, as with the New Deal Civilian Conservation Corps.<sup>43</sup> But that approach would require the government to build, or to rebuild, the capacity to flexibly scale activities up and down.

Contracts with existing firms implicate corporate governance principles because a firm that seeks to maximize shareholder wealth will attempt to divert a contract's value to its shareholders.<sup>44</sup> While funds diverted to shareholders will provide some stimulus, the effect is likely to be less than that of funds flowing to newly employed workers. Unlike a relatively wealthy shareholder seeing a stock price appreciate, a newly employed worker is likely to spend her paycheck at other businesses, multiplying the effect of the stimulus.<sup>45</sup> As a result, when a firm bargains hard to maximize shareholder profits on a government contract, it dampens the stimulus from government spending.<sup>46</sup>

Monetary policy also interacts with corporate governance. Monetary interventions are thought to work by encouraging investment and spending. By lowering the cost of borrowing, the Federal Reserve can cause firms to

42. Cf. Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 868–73 (laying out factors relevant to whether a regulatory suspension would provide net benefits).

43. Ramirez, *supra* note 33, at 556–57.

44. For example, during the global financial crisis, banks arguably used additional government funds to bolster their balance sheets for the benefit of shareholders, instead of expanding lending to stimulate the economy. See MEHRSA BARADARAN, *HOW THE OTHER HALF BANKS* 16 (2015); Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1303 (2011).

45. See Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 870.

46. It might be possible to address this issue with more complicated contractual terms. But such terms may be time-consuming to negotiate, reducing their effectiveness in responding quickly and forcefully to a recession. Any complexities may also diminish the effect of the stimulus by reducing the business's confidence in profits and willingness to hire. And any restrictions may be leaky, or subverted through the allocation of fungible funds. Cf. Dhammika Dharmapala, C. Fritz Foley & Kristin J. Forbes, *Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act*, 66 J. FIN. 753, 757 (2011) (finding that firms that repatriated funds at favorable tax rates during a tax holiday were able to direct additional money to shareholders despite regulations intended to limit repatriated funds to domestic investment or employment).

undertake new projects that employ more workers. But the effectiveness of the mechanism depends on firms translating lower borrowing rates into new economic activity.

When firms borrow money from creditors simply to give money to shareholders, they complicate this mechanism. Instead of increasing economic activity and employment by encouraging firms to embark on additional projects, the monetary tool simply sends funds to shareholders.<sup>47</sup> This may provide some stimulus, because shareholders may increase their spending as a result. But the effect will be less than if firms translate lower borrowing costs into new business activity.<sup>48</sup>

Firms that transact in their own shares may have an incentive to go further, and engage in “costly contractions.”<sup>49</sup> A firm should return capital to shareholders if and only if the shareholders would be able to redeploy the capital in opportunities outside the firm that would have a higher value than activities within the firm. But if the stock price is depressed, firms may be able to generate greater financial returns for their long-term shareholders by forgoing valuable projects and using the extra funds to cash out uncommitted shareholders at the depressed price. This may be more of a threat if stock markets are depressed and volatile.

Of course, shareholders may not appreciate this maneuver, even though it would be designed to maximize the eventual share price.<sup>50</sup> The funds returned to them would have to be deployed elsewhere at a time when there are relatively few investment opportunities available.<sup>51</sup> Like an employee fired during a recession, a shareholder may struggle to redeploy their capital at a higher value

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47. See RANA FOROZHAR, *MAKERS AND TAKERS* 142–44 (2016) (urging that “the barbarians stole our stimulus” because “companies didn’t take advantage of low borrowing rates” created by Federal Reserve action “in order to invest in Main Street; they did it to buy back stock and enrich corporate leaders and investors”).

48. See *infra* notes 54–59 and accompanying text.

49. See Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 *YALE L.J.* 1554, 1562, 1593–94 (2015).

50. Cf. Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 *YALE L.J.* 1870, 1891 n.64 (2017) [hereinafter Strine, *Who Bleeds When the Wolves Bite?*] (“And the market no longer gives much credit to buy-backs and return of capital . . . I have never thought buy-backs did anything, and the return of capital platform is a lot less credible now.” (citation omitted)). Indeed, maximizing return on equity—as opposed to total shareholder value—might be understood as a species of agency problem. Cf. *Examining Corporate Priorities: The Impact of Stock Buybacks on Workers, Communities, and Investors: Hearing Before the H. Subcomm. on Inv. Prot., Entrepreneurship, and Cap. Mkts. of the H. Comm on Fin. Servs.*, 116th Cong. 6 (2020) (statement of Jesse M. Fried, Professor of Law, Harvard Law School) (executives may use stock buybacks to game performance measures in compensation agreements).

51. See Strine, *Who Bleeds When the Wolves Bite?*, *supra* note 50, at 1939 (“For the stuck-in human investor, increased dividends have to be invested back into the very companies paying them out, and the same is basically true as to buybacks.”). If index fund investors simply reinvest within the index, there will be no impact on spending, and the monetary intervention would simply inflate the price of financial assets.

activity if it is returned to them at a time when other opportunities are lacking.<sup>52</sup> By advancing a narrow conception of its shareholders' interests, the firm would thus fail to maximize the value of its shareholders' full portfolio. More fundamentally, financial engineering to support share buybacks would sap the force of a monetary intervention.

This is more than theoretical. After the Federal Reserve's massive intervention to ensure that credit would continue to flow in the wake of the COVID-19 crisis, companies borrowed extensively and used funds to support stock buybacks.<sup>53</sup> A macroeconomic intervention intended to permit companies to undertake new projects that would boost employment was instead partially used to pump up returns to shareholders.

Appropriate corporate governance rules can thus improve the effectiveness of traditional fiscal and monetary stimulus. If firms are oriented toward objectives other than shareholder value maximization, they are more likely to direct the impact of fiscal and monetary interventions toward their intended targets. Even if political institutions like Congress and the Federal Reserve are prepared to respond appropriately to a crisis, corporate governance tools would be a useful complement to their efforts.

### C. *Corporate Governance as an Independent Macroeconomic Policy Tool*

Apart from supporting macroeconomic policy, corporate governance arrangements could also be used independently to deliver a macroeconomic stimulus. In some sense, the point follows directly from the observations above regarding the sensitivity of corporate governance debates to macroeconomic context<sup>54</sup> and the macroeconomic impacts of regulations.<sup>55</sup> If employment-creating projects or precautions are more justified in a recession, a system of corporate governance that encourages the same steps is similarly justifiable. This section works through potential impacts of a macroeconomic focus.

#### 1. Revising the Profit Maximization Goal

Traditional tools change corporate decisions by changing the external environment in which corporations operate. Policymakers encourage firms to

52. In a challenging economic environment, other firms may lack the company's capacity to pursue a project, or might have difficulty accessing capital at the low rate that makes it worthwhile. *Cf.* Andrei Shleifer & Robert Vishny, *Fire Sales in Finance and Macroeconomics*, 25 J. ECON. PERSP. 29, 32 (2011) (when a firm is in distress and selling off productive assets, its competitors are likely to also be in distress and unable to buy).

53. *See, e.g.*, Apple Inc., Preliminary Prospectus Supplement (Form 424B9) S-9 (May 4, 2020) ("We intend to use such net proceeds [from a notes sale] for general corporate purposes, including repurchases of our common stock and payment of dividends under our program to return capital to shareholders, funding for working capital, capital expenditures, acquisitions and repayment of debt.").

54. *See supra* Section I.B.

55. *See supra* Section II.A.4.

hire more workers or make job-creating investments by allowing wages to decline, stimulating demand for products, or lowering interest rates. Policymakers might consider an alternative approach that changes corporate decisions by changing their internal objectives.

Appendix B presents a simple model, but the intuition is straightforward. Given a particular price and wage level, a profit maximizing firm will continue to hire workers and increase production until the marginal productivity of labor equals wages. That is, it will continue to hire until an additional worker would bring in less money in revenue than the worker would cost in wages.

If a policymaker wants the firm to hire more workers in a recession, it can allow wages to decline.<sup>56</sup> Lower wages would mean that additional workers cost less, causing a profit maximizing firm to hire more than it would at a higher wage level. But the policymaker could achieve the same level of hiring by changing the firm's internal objective so that it does not maximize profits. A firm that balances profits and worker well-being will hire more at a given wage level than a firm that simply maximizes profits.

Reorienting the firm may be a better approach than allowing wage declines. First, while both mechanisms would induce the firm to make the desired hiring and production decision, they would not be identical in their effects: allowing wages to decline reduces worker earnings, while reorienting the firm away from shareholders reduces shareholder profits.

Because workers are more likely to spend an additional dollar of wages than shareholders are to spend an additional dollar of wealth, reorienting the firm toward workers will do more to stimulate consumption and aggregate demand than lowering wages. Shareholders are disproportionately wealthy and are less likely to need the additional money to fund expenditures.<sup>57</sup> Increased profits also may not translate into real net cash flows to shareholders. If the firm simply retains the funds, shareholders can only tap their portion of the funds by selling stock. But while the seller receives cash in a transaction, the purchaser gives up cash, keeping the net effect at zero.<sup>58</sup> If the company uses the additional profits to repurchase shares or pay dividends, the effect may still be muted. If index fund investors simply keep the money in the fund—as they are likely to do, given that the purpose of an index fund strategy is to hold passively for

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56. Policymakers could also actively intervene to push wages down. *See generally* MARTIN L. WEITZMAN, *THE SHARE ECONOMY* (1984) (proposing alternative compensation scheme in which workers are paid a fixed share of firm revenue, causing an increase in hiring and a decrease in wages).

57. *See* Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 870 (explaining if a regulatory stimulus resulted in funds going to shareholders as opposed to new projects, the impact would “be limited or nil because shareholders are typically wealthy and unlikely to spend much of their savings”).

58. That said, there may be a second order effect, in which a shareholder sees that their wealth has increased and spends more of their available cash.

decades instead of actively reallocating capital—they have nothing to gain from the inflated prices.

Ordinary people, like typical workers, are also risk averse and derive the bulk of their wealth from their involvement with their employers. By contrast, shareholders of large firms are generally diversified and indifferent to idiosyncratic events at particular firms. As a result, protecting workers will do more to help individuals' wealth and well-being than protecting shareholders' interests.<sup>59</sup> This in turn will do more to prop up demand.

Second, reorienting the firm can also be a particularly efficient way to inject funds into the economy because the increase in total worker earnings would be greater than the decrease in shareholder profits: the firm's use of additional labor results in increased production and sale of goods that partially offsets the increase in total wages. The firm is not a zero-sum battleground between worker and shareholder interests.

In a robust economy, the seeming multiplier effect is not real. Any labor that is not employed at the firm and earning a wage of \$1 from the firm would have been employed elsewhere, earning a wage of \$1 there. Increasing the total wages paid by the firm does not create real value for the economy, but the reduction in shareholder profits represents genuine destruction of value.<sup>60</sup> As a result, the shareholders' perspective on the firm aligns with the goal of maximizing societal wealth. But in a weak economy, workers not employed by the firm may not be able to find work at a \$1 wage. Some portion of the increase in total wages represents a real increase in the value generated by the firm.

Third, this type of stimulus can be delivered quickly. For example, suppose the firm already has a high labor level. In that case, it can deliver a stimulus immediately by simply holding off on layoffs that would be pursued by a profit-maximizing firm in the more challenging economic environment. By contrast, fiscal policy can require months of congressional deliberation, followed by months of effort to prepare projects. And even if the Federal

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59. Cf. Casey & Posner, *supra* note 38, at 532 (suggesting that it makes “more sense for the government to bail out ordinary people than large firms,” because “ordinary people are risk-averse, while large firms are owned by diversified shareholders”).

60. Under ideal conditions, wages equal the marginal productivity of labor. The point is captured at the firm level by equation (3) in Appendix B, with  $s = 1$ . The ideal conditions may not always apply. In some labor markets, employers may enjoy market power and may be able to set wages below the marginal revenue product of labor. See Naidu et al., *supra* note 7, at 537. However, there is significant evidence that macroeconomic trends in wages have been driven more by a decline in workers' market power—that is, its ability to capture economic rents by commanding wages above labor's marginal revenue product. See generally Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy*, BROOKINGS PAPERS ON ECON. ACTIVITY, Spring 2020, at 1 (noting that monopsony explanation is difficult to square with lack of inflation).

Reserve acts quickly to lower interest rates, it can take months for the rate change to be translated into improved investment activity.<sup>61</sup>

Transactional frictions can also make the internal approach faster than an external approach. For instance, if “sticky wages” are preventing wages from declining enough to clear the labor market, the firm may still be able to act more quickly to achieve the proper production decision by reweighing its objective function to focus more on workers. Mechanically, it may also be easier for a firm to reorient its approach to major decisions (a strategy that can be handled at the hub of the firm by the officers and directors) than to renegotiate wages with each employee (a strategy that requires reworking every spoke between the firm and each individual).<sup>62</sup> Governments sometimes bail out companies instead of individual stakeholders because of the administrative difficulty of reaching each individual.<sup>63</sup> The same consideration supports reorienting firms instead of attempting to address every individual’s relationship with the firm.

## 2. Revising Decisions on Risky Investments

Altering firms’ approach to risk would also encourage investments that have macroeconomic value. Suppose that a company has assets of \$8, debts of \$6, and equity of \$2. The firm has an opportunity to make an investment of \$5 at time  $t$ , with a 50% probability of delivering \$8 at time  $t + 1$  and a 50% probability of delivering \$0 at time  $t + 1$ . Risk neutral shareholders would prefer that the investment be made: with the investment there is a 50% chance of equity being worth \$5 at  $t + 1$  and a 50% chance of equity being worth \$0, for an expected value of \$2.50, which is greater than \$2 without the investment. Creditors would prefer that the investment not be made: there is a 50% chance of there being \$6 to settle the debts and a 50% chance of there being \$3 to settle the debts, for an expected value of \$4.50, which is less than \$6 without the investment.

In ordinary times, society would prefer that the corporation follow the creditors’ lead. The project has a negative expected value: there is a 50% chance of delivering a total of \$3 (costing \$5 of resources at  $t$  and delivering \$8 at  $t + 1$ ) and a 50% chance of delivering a total of -\$5, for an expected value of -\$1. Commentators have described the selection of a “risky project that makes

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61. See Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 864–65 (“However, economists believe that most businesses make investment decisions approximately six months in advance. Accordingly, the effects of a change in monetary policy will typically be visible only after that much time has passed.”).

62. There is some evidence that codetermination systems are more effective in permitting this type of negotiation. See *infra* note 221 and accompanying text.

63. See Casey & Posner, *supra* note 38, at 532 (“Unfortunately, bailouts of ordinary people such as homeowners may be administratively infeasible. As the number of bailout recipients increases, the government must spend more money on administrative costs.”).

creditors worse off by more than it makes shareholders better off” as a form of “misbehavior” referred to as “overinvestment.”<sup>64</sup>

But in stressed macroeconomic conditions, the analysis could be more complicated. The benefit of \$5 of stimulus today may be worth the overall cost. If the corporation follows the interests of equity holders, it would effectively be investing as if real interest rates were -20% or lower—an extreme trade-off to be sure, but potentially worthwhile temporarily if the economy is being held back because interest rates are unable to reach a below zero equilibrium.<sup>65</sup>

### 3. Setting Corporate Priorities

These points suggest an opportunity to operationalize the connection between corporate governance debates and macroeconomic context.<sup>66</sup> If policymakers can find ways to reset corporate priorities to encourage regard for workers and openness to risk-taking, they can create value for society during a crisis. The magnitude of these benefits should not be understated. The cost of being laid off to one worker alone could be as high as \$260,000.<sup>67</sup> Knock-on effects from the resulting decline in the worker’s spending are substantial, with estimates of the multiplier effect going as high as 1.5.<sup>68</sup> Avoiding layoffs and boosting hiring could have an enormous impact.

To operationalize the approach, it would be necessary to address the concern that stakeholder governance does not offer a clear criterion for weighing competing interests.<sup>69</sup> But the analysis above shows that a criterion based on macroeconomic context can suggest priorities for corporate actors. For example, a corporate leader trying to decide between maintaining wages for the current workforce and hiring previously unemployed workers at lower wages might apply macroeconomic reasoning and findings. Raising someone’s income from zero is likely to do more to increase demand—the previously unemployed person is likely to spend more of the new income—suggesting that the latter course would be preferable.<sup>70</sup>

64. Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 874 (1996).

65. Of course, this would transfer value from creditors to equity holders. If creditors have a higher marginal propensity to consume, disruptions to the credit markets would be more damaging to the real economy than disruptions to the equity markets, or the costs of a bankruptcy restructuring would be high, thus the calculus would shift.

66. See *supra* Section I.B.

67. See Masur & Posner, *Unemployment*, *supra* note 7, at 618 (providing estimates of earnings losses of \$100,000 and nonpecuniary costs like increased mortality of as much as \$160,000).

68. LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 234 n.27.

69. See *supra* note 21 and accompanying text.

70. Cf. Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 866 (discussing empirical finding that programs that raise a person’s income from zero, such as unemployment benefits or food stamps, do more to stimulate the economy than programs that provide marginal disposable income, such as reductions in income tax rates).

Naturally, there is likely to be debate about the best way for a corporate actor to react to the macroeconomic context. But debates about business strategy are common as well. Business executives disagree and advocate for different strategies, even when their shared goal is to maximize shareholder returns; academics and the press then debate their actions. Indeed, if there were obvious right answers to business problems, there would be little reason for a business judgment rule insulating decisions from judicial review. A criterion based on a blinkered microeconomic efficiency approach is not more determinative than one that accounts for the broader context.

The discussion does raise the question of why policymakers should employ countercyclical corporate governance instead of more traditional means. First, the argument above shows that firms oriented solely to shareholder wealth maximization will make decisions that are suboptimal for society during a period of crisis. Even if the government used traditional means to speed the end of a crisis, countercyclical corporate governance would correct corporate decision-making in the interim. Second, traditional tools are often slow and unavailable during a crisis<sup>71</sup> or are inequitable and distortionary.<sup>72</sup> Corporate governance tools have the potential to permit rapid action in a less distortionary form. Third, corporations may be able to take advantage of economies of scope in delivering stimulus.<sup>73</sup> They have substantial operations that place them in contact with workers, suppliers, customers, shareholders, and creditors; thus, they can modify their operations to benefit those constituencies. Finally, corporations may have access to information that is not available to the government. For example, there is clearly some point at which shareholders will refuse to accept reduced returns at a company to support the goal of bringing the economy out of a crisis. In its capacity as a regulator or contractual counterparty to the corporation, the government may not be able to find that breakpoint with the same precision. Thus, the government may not be able to squeeze shareholders to the same extent.

The discussion also raises the question of whether changes to corporate law would be an *effective* tool. The analysis in this Article does assume a basically Keynesian framework, in which policymakers manage a decline in aggregate demand by acting to encourage spending and investment.<sup>74</sup> The basic

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71. See *supra* Sections II.A.1, II.A.3.

72. See *supra* Section II.A.2.

73. See M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 COLUM. L. REV. 571, 590–93 (2009) (discussing how a company's operations may give it unique access to opportunities to deliver benefits).

74. Not all macroeconomic crises involve declines in aggregate demand that can be remedied through a macroeconomic policy. Cf. Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 887 n.106 (carving out “exogenous demand shocks that do not reflect negatively on the fundamentals of an industry”). And Keynesian ideas are not universally shared among economists. Liscow, *supra* note 1, at 1470 n.38.



framework does not seem controversial in the sense that a broad range of policymakers pursue it: Republicans seek to boost savings and investment through tax cuts, and Democrats seek to boost savings and investment through direct expenditures and transfer payments to the needy. All parties seem to recognize the value of boosting business confidence during a recession,<sup>75</sup> presumably because they recognize that businesses could help the economy if they decided to increase their activity level.

As noted above, large companies have enormous resources to draw on in a recession, often in the form of cash.<sup>76</sup> Apple alone had approximately \$200 billion in cash and equivalents at its disposal at the time of the federal government's \$2 trillion stimulus package to address the economic crisis caused by COVID-19. Apple also knows how to employ people. The median salary for an Apple employee in 2019 was \$57,596.<sup>77</sup> By comparison, the federal government's Paycheck Protection Program adopted in the wake of COVID-19 cost between \$162,000 and \$381,000 per job saved, with a preferred estimate of \$224,000.<sup>78</sup> As an extremely crude estimate, if Apple used all of its cash reserves to put people to work at the median salary for its employees, Apple could theoretically keep over three million people employed for a year. If the company put all of its net income into employing new people at its median salary, Apple could theoretically employ 700,000 people. If those workers were being employed productively, generating additional income, the numbers would be even greater. This is just one company, and these are not small numbers.

Of course, firms might have the *financial* firepower to act in ways that have macroeconomic effects, but may lack the operational capacity to productively employ tens of thousands of additional people on short notice. There may also be distributional concerns—if relatively wealthy tech firms simply act in ways that benefit their relatively wealthy employees, the approach would be unfair,

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75. See, e.g., Kevin Liptak, Pamela Brown & Sarah Westwood, *Trump Has Private Concerns Over the Economy Despite Public Displays of Confidence*, CNN (Sept. 7, 2019, 11:14 AM), <https://www.cnn.com/2019/09/07/politics/economic-warning-signs-trump-all-hands-on-deck/index.html> [<https://perma.cc/MT37-T5CN>] (“Trump and top aides . . . have phoned business leaders to update them on the state of China trade talks and other economic efforts in an attempt at reassurance.”); Jake Tapper, *Cheerleader in Chief Obama Projects Confidence*, ABC NEWS (Mar. 13, 2009, 4:07 PM), <https://abcnews.go.com/Politics/Economy/story?id=7079085&page=1> [<https://perma.cc/7PAS-AQGL>] (“The president and his economic team have upped the ante in their language when discussing the economy, sensing that . . . the nation needs an investment of optimism.”).

76. See *infra* Appendix A.

77. See *infra* note 262 and accompanying text.

78. See Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner & Opportunity Insights Team, *How Did COVID-19 and Stabilization Policies Affect Spending and Employment? A New Real-Time Economic Tracker Based on Private Sector Data* (June 17, 2020) (unpublished manuscript) (on file with the North Carolina Law Review).

and the stimulus effect would be muted.<sup>79</sup> But these concerns also apply to government action. The government might also struggle to find useful work for hundreds of thousands of people, and its chosen measures to respond to crises can have unfair distributional impacts that limit their effectiveness.<sup>80</sup>

Large firms also have operational moves readily available. They can simply hold off on layoffs, even where layoffs would create profits for shareholders. They can also commission new construction or blue-sky investment projects, including by contracting with other firms. Another Amazon headquarters project or Google fiber optics project would mobilize blue-collar workers.

This effect might be muted if shareholders reduced their spending in response to the diversion of wealth from them to workers. But this is unlikely. In 2020, Apple stock traded at a price to earnings ratio of over thirty to one.<sup>81</sup> In other words, only about three percent of the value of an Apple share came from the income Apple generated in 2020. In principle, if Apple committed to devoting *all* of its earnings to workers for one year (and one year only), Apple shareholders would see the value of their Apple shares reduced by just three percent.<sup>82</sup> It is hard to imagine that the size of this effect on the shareholders' spending could be comparable to the size of the effect on new workers' spending.

Multiplier effects amplify the point. A firm that is willing to accept a \$1 reduction in shareholder profits can spend more than \$1 because some of the additional spending will be offset by additional revenues.<sup>83</sup> And \$1 of additional wages in the hands of a low-income worker is likely to drive more overall spending than an additional \$1 of shareholder wealth.<sup>84</sup>

Finally, even if countercyclical corporate governance is less effective than traditional policy tools, it may be a useful complement to those measures. It does not need to be the favored tool of policymakers for it to be a worthwhile addition to the toolbox.<sup>85</sup> To be useful, countercyclical corporate governance

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79. Cf. Liscow, *supra* note 1, at 1483 n.82 (“[P]oorer workers have a higher marginal propensity to consume, leading to greater macrostimulus benefits.”).

80. See FOROZHAR, *supra* note 47, at 142–43 (urging that monetary response to the Great Recession largely benefitted the wealthy and not the middle class).

81. See *infra* note 262 and accompanying text.

82. Cf. Paul Krugman, *Stocks Are Soaring. So Is Misery.*, N.Y. TIMES (Aug. 20, 2020), <https://www.nytimes.com/2020/08/20/opinion/stock-market-unemployment.html> [https://perma.cc/ZB7B-A2A7 (staff-uploaded, dark archive)] (noting that “only around 3 percent of the value investors place on the company reflects the money they expect it to make over the course of the next year”).

83. See *supra* note 57 and accompanying text.

84. See *supra* note 57 and accompanying text.

85. See LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 5; Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 880.

only needs to outrun government action<sup>86</sup> or show up for the race when the government does not. And even when the government is prepared to act, countercyclical corporate governance can make its interventions more effective. Indeed, as shown below, actual leaders in business and government increasingly recognize countercyclical corporate governance's potential as a complementary tool.

### III. EARLY RESPONSES TO THE COVID-19 CRISIS

This part analyzes measures adopted in response to the economic crisis prompted by COVID-19. Proxy advisory firms, the government, and corporations themselves took steps to advance various stakeholder interests. All of these measures could be understood as steps toward revising corporate governance to meet the needs of the moment.

#### A. Proxy Advisory Services and Shareholders

Proxy advisory services are firms that provide recommendations on how shareholders should cast their votes on corporate decisions.<sup>87</sup> Because many passive institutional investors are unwilling to undertake a careful analysis of every decision that is up for a vote, they rely heavily on the recommendations of these services.<sup>88</sup> The combination of the voting strength of passive institutional investors and their reliance on advisors' recommendations has placed enormous power in the hands of the two leading providers, Institutional Shareholder Services ("ISS") and Glass Lewis.<sup>89</sup> As a result, their positions

86. See generally Liscow, *supra* note 1 (suggesting that bankruptcy reorganizations should be reworked to promote employment in a recession if and only if the cost per job saved through this action would be lower than the costs from government programs).

87. Because relatively few shareholders attend shareholder meetings, most vote by submitting a "proxy," which provides instructions on how they should cast their vote.

88. E.g., BLACKROCK, PROXY VOTING OUTCOMES: BY THE NUMBERS, Exhibit 4 (2019), <https://www.blackrock.com/corporate/literature/whitepaper/policy-spotlight-proxy-voting-outcomes-by-the-numbers-april-2019.pdf> [<https://perma.cc/JB8V-UXD3>] ("[R]ecommendations by proxy advisors can determine between 15% and 25% of a vote."); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 558 (2016) ("Institutional investors differ in terms of how much they rely on ISS's recommendations, but many appear to defer almost entirely. One 2014 study finds that over 25% of mutual funds vote almost exactly as ISS recommends. Other funds rely less and vote independently, but a Business Roundtable survey found that 40% of its member firms' shares were held by institutions that basically followed ISS's voting recommendations."). The claim that institutional investors heavily defer to proxy advisory firm recommendations is somewhat controversial, at least as to the largest institutions. See Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2074 n.121, 2078–79, 2078 n.130 (2019) [hereinafter Bebchuk & Hirst, *Index Funds*].

89. Neil Whoriskey, *The New Civil Code: ISS and Glass Lewis as Lawmakers*, CLS BLUE SKY BLOG (July 28, 2020), <https://clsbluesky.law.columbia.edu/2020/07/28/cleary-gottlieb-discusses-the-new-civil-code-of-iss-and-glass-lewis/> [<https://perma.cc/C34Y-G5SP>].

carry enormous weight, and have been analogized to a “civil code” regulating corporations on a broad range of issues.<sup>90</sup>

Historically, ISS and Glass Lewis have reliably taken positions that enhanced immediate shareholder power over corporate decision-making.<sup>91</sup> These positions have included support for a consequential campaign to declassify or de-stagger corporate boards (so that all board members are forced to seek election annually) and heavy skepticism of takeover defenses.<sup>92</sup>

In a departure from their normal orientation, ISS and Glass Lewis signaled openness to takeover defenses adopted as a result of financial market dislocations that accompanied the coronavirus crisis.<sup>93</sup> In a policy guidance document, ISS explained that under its “appropriately flexible” approach, a “severe stock price decline as a result of the COVID-19 pandemic is likely to be considered valid justification in most cases for adopting a pill of less than one year in duration.”<sup>94</sup> Similarly, Glass Lewis reaffirmed its general opposition to poison pills, but stated that it would consider “companies that are impacted by the coronavirus and the related economic crisis as reasonable context for adopting a poison pill” if they meet certain conditions.<sup>95</sup>

It is important to acknowledge the limits of this position. ISS and Glass Lewis were not explicitly endorsing stakeholder governance, in which poison pills could be deployed to protect stakeholder interests. And they were not explicitly endorsing a paradigm in which corporations could set a policy favoring stakeholders in a recession as part of an effort to end it.<sup>96</sup> Instead, they were simply recognizing that dislocated financial markets would not set an appropriate framework for corporate decisions.<sup>97</sup> But the practical import was to create space for corporate decision-makers to set policies that could be opposed by shareholder activists.

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90. *Id.*

91. *Id.*

92. *Id.*

93. See Ofer Eldar & Michael D. Wittry, *Crisis Poison Pills*, 10 REV. CORP. FIN. STUD. 204, 210 (2021) (“In fact, even proxy advisors, such as the Institutional Shareholder Services (ISS) and Glass Lewis, have recently indicated that they understand the potential justifications for pill adoptions in the wake of the pandemic and will not automatically recommend withholding votes from directors who adopt them as per their standard policies.”).

94. ISS GLOBAL POLICY BOARD, IMPACTS OF THE COVID-19 PANDEMIC: ISS POLICY GUIDE 6 (2020), <https://academic.oup.com/rfs/article/10/1/204/6026972?searchresult=1> [<https://perma.cc/7NH5-VGFE>].

95. Aaron Bertinetti, *Poison Pills and Coronavirus: Understanding Glass Lewis’ Contextual Policy Approach*, GLASS LEWIS (Apr. 8, 2020), <https://www.glasslewis.com/poison-pills-and-coronavirus-understanding-glass-lewis-contextual-policy-approach/> [<https://perma.cc/8CF8-N5NU>].

96. Proxy advisory firms also did not approve of all takeover defenses. See Eldar & Wittry, *supra* note 93, at 241–42 (“ISS still criticized the poison pill adopted by the Williams Companies on the basis that the 5 percent trigger was very low.”).

97. See *id.* at 210 (summarizing finding that poison pill adoption caused abnormal shareholder returns).

As these changes occurred, many activist hedge funds backed down on campaigns or struck friendly or constructive settlements.<sup>98</sup> With the possible exception of plaintiffs' law firms and a few holdout activist funds,<sup>99</sup> even shareholders' fiercest advocates appeared to recognize that they could not and should not dictate the corporate agenda.

Index funds also sought to take a more patient approach. As BlackRock's Investment Stewardship 2020 Annual Report explained:

For many companies, COVID-19 has created near-term existential challenges. . . . In the immediate response period, we were able to be supportive as companies sought flexibility from investors to weather the initial storm.<sup>100</sup>

These efforts were described to investors as part of a reexamination of corporate purpose that would help generate sustainable corporate value.<sup>101</sup> It remains too early to tell whether there will be a lasting shift in the corporate ecosystem. But some analysts suggested that a more sustainable outlook might be the result.<sup>102</sup>

98. See Edward B. Rock & Haley Sylvester, Opinion, *It's Not the Time To Fight Over Poison Pills*, BNN BLOOMBERG (Apr. 7, 2020), <https://www.bnnbloomberg.ca/its-not-the-time-to-fight-over-poison-pills-1.1418456> [<https://perma.cc/44BH-8XQT>] ("Many [activist investors] have voluntarily walked away from planned attacks, or pursued constructive and friendly settlements with target-company boards."); Corrie Driebusch, *Activists Lay Down Their Arms as Companies Cope With Coronavirus Spread*, WALL ST. J. (Mar. 29, 2020, 5:30 AM), <https://www.wsj.com/articles/activists-lay-down-their-arms-as-companies-cope-with-coronavirus-spread-11585474201> [<https://perma.cc/FQ-B9-AAK5> (staff-uploaded, dark archive)]; cf. Melissa Sawyer, Marc Trevino & Lauren Boehmke, *2020 U.S. Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 20, 2020), <https://corpgov.law.harvard.edu/2020/12/20/2020-u-s-shareholder-activism/> [<https://perma.cc/HF8Y-8YN4>] (noting that activists in 2020 also changed objectives, with activists focusing on urging buybacks and some highlighting social concerns).

99. See Memorandum from William Savitt, Wachtell, Lipton, Rosen & Katz on Litigation Priorities and the Crisis (Mar. 23, 2020), <https://static.reuters.com/resources/media/editorial/20200324/wachtelllitigationprioritiesmemo.pdf> [<https://perma.cc/E4PB-LG53>].

100. Michelle Edkins, Hilary Novik-Sandberg & Victoria Gaytan, *Investment Stewardship 2020 Annual Report*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 30, 2020), <https://corpgov.law.harvard.edu/2020/09/30/investment-stewardship-2020-annual-report/#more-133380> [<https://perma.cc/N57W-TJWE>].

101. *Id.*

102. For example, Barclays launched a Fundamental ESG Research offering with a press release that said, "Prior to the outbreak of Covid-19, finance was already at a tipping point, where the integration of sustainability concerns was becoming the norm. . . . Today's launch of Barclays' Fundamental ESG Research is an opportunity to reflect on whether Covid-19 will accelerate this trend even further – creating a greater sense of urgency and responsibility toward everything from consumer behavior to climate change, supply-chain practices and the future of work and mobility – and potentially alter the nature of the investment process as a result." *Barclays Adds ESG Assessment and Indicators to Fundamental Research*, BUS. WIRE (Mar. 24, 2020, 8:30 AM), <https://www.businesswire.com/news/home/20200324005224/en/Barclays-Adds-ESG-Assessment-Indicators-Fundamental-Research> [<https://perma.cc/D3UC-E8UB>] (citation omitted).

## B. Government

Government action in response to the crisis has also been instructive. Throughout the crisis, federal support has been both critical to the survival of businesses and largely premised on a particular vision of the purpose of those businesses in society. Government support was intended to help employees and customers, not shareholders. As former President Donald Trump explained:

I don't want to give a bailout to a company and then have somebody go out and use that money to buy back stock in the company and raise the price and then get a bonus . . . . So I may be Republican, but I don't like that. I want them to use the money for the workers.<sup>103</sup>

Congress's phase three stimulus package, the Coronavirus Aid, Relief, and Economic Security Act<sup>104</sup> ("CARES Act"), thus provided financial support to businesses with the express understanding that the support provided under certain programs should not be channeled to shareholders but rather to other stakeholders.<sup>105</sup> For example, the Federal Reserve's Main Street Lending Facility was designed to encourage the flow of credit to medium-sized businesses by committing the Federal Reserve to purchasing qualifying loans.<sup>106</sup> By statute, a loan would only qualify for purchase under the facility if the business that received the loan committed to limitations on share repurchases and capital distributions.<sup>107</sup> Similarly, the Treasury Department's support to airlines under the CARES Act included provisions requiring the airlines to prioritize support for workers and customers over servicing shareholders.<sup>108</sup>

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103. Erica Werner, Seung Min Kim, Rachael Bade & Jeff Stein, *Senate Falls Far Short of Votes Needed To Advance Coronavirus Bill, as Clash Between Republicans and Democrats Intensifies*, WASH. POST (Mar. 22, 2020, 11:33 PM), <https://www.washingtonpost.com/us-policy/2020/03/22/vast-coronavirus-stimulus-bill-limbo-crunch-times-arrives-capitol-hill/> [<https://perma.cc/4SLL-VQRM>] (citation omitted).

104. CARES Act, Pub. L. No. 116-136, 134 Stat. 281 (codified as amended in scattered sections of 2, 15, 17, 21, 22, 26, 33, and 42 U.S.C.).

105. Various provisions in the CARES Act were intended to ensure that recipients of financial assistance would not make payments to equity holders or reduce employment levels. *See, e.g.*, CARES Act §§ 4003(c)(2)(E)–(F), (c)(3)(A)(ii), (c)(3)(D), 4114(a)(2)–(3), 134 Stat. 281, 471, 472, 473–74, 499 (2020) (codified at 15 U.S.C. §§ 9042, 9074 (2021)) (limitations on dividends and stock buybacks by beneficiaries); *id.* §§ 4003(c)(2)(G), (c)(3)(D)(i)(III), 4114(a)(1), 134 Stat. 471, 473, 499 (codified at 15 U.S.C. §§ 9042, 9074 (2021)) (requirements on maintaining or restoring employment levels).

106. *See* FED. RSRV., MAIN STREET NEW LOAN FACILITY 1 (2020), <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a3.pdf> [<https://perma.cc/G83T-NWVX>]; LEV MENAND, THE FED UNBOUND 56–58 (2022).

107. CARES Act § 4003(c)(3)(A)(ii); MENAND, *supra* note 106, at 56.

108. *See, e.g.*, Delta Airlines, Inc., Current Report (Form 8-K) Item 1.01 (Apr. 22, 2020) ("The payroll support payments are conditioned on Delta's agreement to refrain from conducting involuntary employee layoffs or furloughs through September 30, 2020. Other conditions include prohibitions on share repurchases and dividends through September 30, 2021, continuing essential air service . . . and certain limitations on executive compensation.").

Such conditions have precedents in prior government responses to macroeconomic crises.<sup>109</sup>

The CARES Act and Federal Reserve program provisions could be understood as efforts to protect the integrity of the government's macroeconomic interventions and to limit potentially perverse side effects.<sup>110</sup> That reading is supported by the federal government's failure to impose similar restrictions on support provided under other programs.<sup>111</sup> It is also unclear how effective these efforts have been,<sup>112</sup> or whether it would be practical to apply such restrictions to other measures designed to prop up corporate borrowing.<sup>113</sup> But the restrictions do suggest a particular understanding of the purpose of the corporation during periods of macroeconomic crisis. At least for the duration of the crisis, corporations became tools for policymakers to channel support and services to stakeholders, not tools for shareholders to generate immediate financial returns for themselves.<sup>114</sup>

Former Delaware Chief Justice Leo Strine, Jr.—a jurist who has written influential pronouncements that shareholder primacy is legally required under Delaware law<sup>115</sup>—gestured toward this emerging paradigm in an op-ed emphasizing that businesses had an obligation to follow the government's lead

109. See, e.g., Kahan & Rock, *supra* note 44, at 1306–07 (including a quote from General Motors' description of conditions placed on it by the U.S. Treasury).

110. See *supra* Section II.B. In the case of loans that were intended to be repaid, the provisions could also have the benefit of protecting taxpayers' capital.

111. See Amanda Fischer, *Main Street's Workers, Families, and Small Businesses Are Now Suffering as Wall Street Prospers from Policies To Fight the Coronavirus Recession*, WASH. CTR. FOR EQUITABLE GROWTH (Sept. 17, 2020), <https://equitablegrowth.org/main-streets-workers-families-and-small-businesses-are-now-suffering-as-wall-street-prospers-from-policies-to-fight-the-coronavirus-recession/> [<https://perma.cc/USZ9-V2S7>]; Jim Zarroli, *The Fed Helped Companies Borrow Money. Some Laid Off Thousands Anyway*, NPR (June 10, 2020, 5:00 AM), <https://www.npr.org/2020/06/10/873190315/the-fed-is-throwing-money-around-not-everyone-is-reaping-the-benefits> [<https://perma.cc/TKZ6-3JMT>]; Jeff Stein & Peter Whoriskey, *The U.S. Plans To Lend \$500 Billion to Large Companies. It Won't Require Them To Preserve Jobs or Limit Executive Pay.*, WASH. POST (Apr. 28, 2020, 12:58 PM), <https://www.washingtonpost.com/business/2020/04/28/federal-reserve-bond-corporations/> [<https://perma.cc/K5YS-E7EK>]; Michael Grunwald, *The Corporate Bailout Doesn't Include the Limits Democrats Promised*, POLITICO (Apr. 2, 2020, 12:40 PM), <https://www.politico.com/news/2020/04/02/coronavirus-corporate-bailout-deal-161374> [<https://perma.cc/V97J-EZ6T>].

112. Cf. Dharmapala et al., *supra* note 46, at 757 (finding that government restrictions on use of repatriated funds in a prior tax holiday had limited effectiveness in changing financial policy at affected firms).

113. See *supra* note 109 (collecting sources regarding the Federal Reserve's refusal to impose such conditions with respect to certain financial facilities).

114. Cf. Casey & Posner, *supra* note 38, at 488 (describing this type of intervention as a bailout or subsidy for stakeholders, depending on whether the intent is to solve a liquidity crisis among stakeholders); *id.* at 505 (considering possibility that the airline bailout after the September 11, 2001, attacks “was a form of humanitarian relief for airline stakeholders, akin to government support for individuals and businesses struck by a natural disaster like a hurricane”).

115. See, e.g., Strine, *Dangers of Denial*, *supra* note 15, at 768.

in addressing the crisis, instead of using the crisis as an opportunity to frustrate government purposes or derive excessive shareholder profits.<sup>116</sup>

Again, it would be incorrect to take this as an endorsement of a general countercyclical corporate governance regime. The unique challenges of the COVID-19 crisis—which threatened lives as well as livelihoods—may have supported extraordinary measures, and protecting long-term shareholders by defending the viability of the business fits easily within standard shareholder primacy thinking. But it again suggests a recognition among thought leaders that government action called for a reorientation of corporate priorities.

### C. *Businesses*

Business leaders themselves seemed to appreciate this reality during the early days of the COVID-19 crisis, and properly prioritized the health of their employees, customers, and suppliers.<sup>117</sup> Businesses facing liquidity or solvency concerns also worked to resolve those issues with creditors. Businesses also turned to antitakeover devices like the poison pill to defend their strategies against activist attacks.<sup>118</sup>

Some of this was simple necessity. Equity markets swung wildly based on news events that were largely outside the control of any given business firm. In many cases, the very survival of the business enterprise—and thus, all hope for a financial return to equity—required leaders to get their approach to stakeholders right. Such measures can thus be justified as efforts to maximize shareholder value.<sup>119</sup>

But these actions suggested that the crisis context had normalized a revised approach to corporate decision-making, in which businesses sought to prioritize stakeholders apart from shareholders. Prominent companies also sought to emphasize these efforts and present them as part of a thoughtful and

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116. Leo E. Strine, Jr., *Remembering What Comes First Is More Important than Ever*, FIN. TIMES (Mar. 27, 2020), <https://www.ft.com/content/9ee6d82e-6fc2-11ea-89df-41bea055720b?emailId=5e7ddd98753e510004780143&segmentId=a8cbd258-1d42-1845-7b82-00376a04c08f> [https://perma.cc/QB52-CXQ5 (staff-uploaded, dark archive)].

117. See Sarah Keohane Williamson, *A Hierarchy of Stakeholder Needs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 22, 2020), <https://corpgov.law.harvard.edu/2020/06/22/a-hierarchy-of-stakeholder-needs/> [https://perma.cc/23EW-BV5Z] (suggesting a prioritization of needs of competing stakeholders, and presenting results of surveys of businesses).

118. See generally Eldar & Wittry, *supra* note 93 (“We show that a large number of firms adopt poison pills during periods of market turmoil. . . . Likewise, we find a positive reaction to pills with provisions directed at stalling activists’ interventions.”).

119. See *id.* at 22 (noting that shareholders frequently enjoyed superior returns in the wake of adoption of poison pills); cf. Scott Guernsey, Simone M. Sepe & Matthew Serfling, *Blood in the Water: The Value of Antitakeover Provisions During Market Shocks*, 143 J. FIN. ECON. 1070, 1072 (2022) (finding that various firms with antitakeover measures in place have smaller declines in stock price after a shock).



enlightened strategy; they did not seek to present them as emergency measures that they had been forced into by dire conditions.<sup>120</sup>

#### IV. PRIVATE IMPLEMENTATIONS

This part considers shareholder engagement as a mechanism for bringing about corporate governance arrangements that are responsive to macroeconomic crises. Section IV.A identifies institutional voices that might advocate a countercyclical approach. Section IV.B considers what policy they might advocate for—a consistent approach in which stakeholders are always considered, or a switching approach in which the degree of stakeholder consideration depends on the business cycle. Section IV.C considers the mechanics of implementation. Finally, Section IV.D identifies ways that the law could support these steps.

##### A. *Potential Shareholder Advocates*

Various institutional investors have the means and incentive to advocate for countercyclical corporate governance. Index funds are the most promising potential advocates, though pension funds and bond funds might also play a role.

Index funds establish a portfolio that passively tracks a target index in the marketplace, such as the S&P 500.<sup>121</sup> Instead of actively trading—trying to identify undervalued or overvalued shares and buying or selling accordingly—in an effort to generate outsized returns, these funds simply try to replicate the returns from the index and charge investors a modest fee to do so. These products allow investors to cheaply and easily hold a diversified portfolio that reflects the overall economy’s performance.<sup>122</sup> As a result, the funds have become increasingly popular. The “Giant Three” index fund providers, BlackRock, State Street, and Vanguard, hold a combined total of approximately twenty percent of the shares of S&P 500 companies and cast approximately

120. See, e.g., *Amazon’s COVID-19 Blog*, AMAZON (Aug. 19, 2022), <https://blog.aboutamazon.com/company-news/amazons-actions-to-help-employees-communities-and-customers-affected-by-covid-19> [<https://perma.cc/M8SV-KXWQ>] (describing measures like one-time bonuses totaling \$500 million, time off for employees diagnosed with COVID-19, and a \$25 million relief fund for certain employees facing hardship). Various companies also made more traditional donations. See Medea Giordano, *The Nonprofits and Companies Helping To Fight the Pandemic*, WIRED (May 7, 2020, 7:00 AM), <https://www.wired.com/story/covid-19-charities-nonprofits-companies-helping/> [<https://perma.cc/N2L5-PR7Y>].

121. See Bebchuk & Hirst, *Index Funds*, *supra* note 88, at 2043–44.

122. See, e.g., BURTON G. MALKIEL, *A RANDOM WALK DOWN WALL STREET* 355–56 (2003 ed.) (describing investing in index funds as a “no brainer” for these reasons).

twenty-five percent of the votes.<sup>123</sup> Professor John C. Coates, IV, has suggested that consolidation in the space will soon result in the twelve largest providers controlling a majority of U.S. public companies.<sup>124</sup>

Admittedly, index funds have real constraints on their engagement with the companies in their portfolio.<sup>125</sup> Index funds principally compete on cost: investors rationally seek to buy into funds that charge low fees, so funds prefer not to incur the cost of active stewardship of portfolio companies. Index funds also cannot take a disproportionate stake in a given company and must share any benefits created by their engagement.

Despite these constraints, index fund stakes do appear to affect corporate conduct. For example, there is evidence that firms behave differently when their shareholders also hold stock in their competitors. Company executives are compensated in ways that reflect industry performance instead of performance at their companies, and there have been claims that companies charge their customers higher prices because competition is muted.<sup>126</sup>

Index funds have a real incentive to use their power to support a countercyclical regime. First, an investor in an index fund would have little to gain and much to lose from an ordinary shareholder primacy approach in a recession. Returning capital to shareholders through dividends or share repurchases does little for investors in a bad economic environment, when few profitable investment opportunities are available.<sup>127</sup> And if index fund investors keep dividend or buyback payments in the fund—as they are likely to do, given that the purpose of an index fund strategy is to simply hold passively for decades instead of actively allocating capital—they have nothing to gain from the inflated prices.<sup>128</sup>

At the same time, the actual human beings whose capital is deployed through index funds would have much to lose. Most derive a majority of their wealth from salaries instead of financial assets and so would suffer from

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123. See Bebchuk & Hirst, *Index Funds*, *supra* note 88, at 2033, 2106; see also Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 724 (2019). Because index funds vote all of their shares and ordinary investors do not, index funds routinely cast a disproportionate fraction of the votes. See *id.* at 738–39.

124. See John C. Coates, IV, *The Future of Corporate Governance Part I: The Problem of Twelve 2* (Harv. Pub. L., Working Paper No. 1001, 2019).

125. See Bebchuk & Hirst, *Index Funds*, *supra* note 88, at 2088. But see John C. Bogle, *Reflections on “Toward Common Sense and Common Ground?”*, 33 J. CORP. L. 31, 37 n.10 (2007) (arguing that cost should not be an obstacle to engagement if index funds choose to intervene).

126. See Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1272, 1281 (2016) [hereinafter Elhauge, *Horizontal Shareholding*]. There are areas where effects are more muted. See Philippe Aghion, John Van Reenen & Luigi Zingales, *Innovation and Institutional Ownership*, 103 AM. ECON. REV. 277, 278 (2013) (explaining that institutional ownership generally has a positive impact on research and development spending and productivity, but index fund ownership has no effect).

127. See *supra* notes 50–51 and accompanying text.

128. See Strine, *Who Bleeds When the Wolves Bite?*, *supra* note 50, at 1912.

persistent high unemployment.<sup>129</sup> An index fund that focused on its investors' needs would prioritize measures to boost employment in a recession over measures to boost share prices at a particular company.

Second, index fund investors also have financial interests apart from their stake in any particular company. Index fund investors are diversified: an investor in a fund that tracks the S&P 500 at least has exposure to the shares of the 500 companies that make up that index. They only have reason to care about systemic risks which affect the performance of the economy as a whole, not idiosyncratic risks at particular companies. Index funds have already taken an interest in systemic issues like climate change and social instability.<sup>130</sup> A persistent macroeconomic downturn would have a similarly systemic impact, and index funds have reason to focus on macroeconomic crises to improve their returns.

Finally, index funds could use countercyclical corporate governance to improve their competitive position vis-à-vis other index funds. Index funds have relatively few ways to differentiate themselves, as they all seek to replicate the returns from set indices. At the same time, they are eagerly seeking ways to market themselves to the rising millennial generation of investors, including by engaging in advocacy on social issues<sup>131</sup> and climate change. Millennials have been uniquely damaged by recent macroeconomic crises<sup>132</sup> and are likely to respond positively to index funds that seek to mitigate them.

Importantly, the marketing motivation for index fund action applies even if it is unclear whether the action will boost overall returns. Index funds like State Street mounted a forceful campaign for gender equity on corporate boards without citing clear-cut evidence that it would impact financial performance<sup>133</sup>

129. *See id.*

130. *See* John C. Coffee, Jr., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk*, 2021 COLUM. BUS. L. REV. 602, 620 [hereinafter Coffee, *The Future of Disclosure*]; Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 17 (2020) (explaining that investors' actions aim to reduce both climate damages and exposure to risk).

131. *See* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1291 (2020).

132. *See, e.g.*, Janet Adamy, *Millennials Slammed by Second Financial Crisis Fall Even Further Behind*, WALL ST. J. (Aug. 9, 2020, 1:07 PM), <https://www.wsj.com/articles/millennials-covid-financial-crisis-fall-behind-jobless-11596811470> [<https://perma.cc/T8M6-HY2K> (dark archive)]; *see also* Annie Lowrey, *Millennials Don't Stand a Chance*, ATL. (Apr. 13, 2020), <https://www.theatlantic.com/ideas/archive/2020/04/millennials-are-new-lost-generation/609832/> [<https://perma.cc/2RKS-5Z8W>] (stating that millennials are facing factors such as debt and dead-end jobs during the worst downturn since the Great Depression).

133. *See* Jill Fisch & Steven Davidoff Solomon, *Centros, California's 'Women on Boards' Statute and the Scope of Regulatory Competition*, 20 EUR. BUS. ORG. L. REV. 493, 507 (2019) ("[T]he results of empirical studies evaluating the relationship between female board representation and corporate economic performance have been 'largely inconclusive.'" (citation omitted)). *But see* Steven A. Ramirez, *Games CEOs Play and Interest Convergence Theory: Why Diversity Lags in America's Boardrooms*

or developing a strategy carefully tailored to maximize financial impact.<sup>134</sup> The index funds were motivated to pursue the social value of diversity even where the financial value was unclear.

While index funds have powerful incentives to support countercyclical corporate governance, the incentives are limited by divergences between the wealth of index fund investors and social wealth. The stock market is not the economy. During the COVID-19 crisis, stock indices reached record highs even as unemployment reached historic levels. Index fund performance thus seems insulated from macroeconomic performance. And the harms from a macroeconomic crisis are also not evenly distributed, with the wealthy people who are likely to hold index funds being relatively less affected.

Still, such divergences are unlikely to persist over an extended period, which is the relevant time horizon for a long-term investor pursuing a buy-and-hold strategy supported by index funds. At some point, the economy must grow for investors to reap gains. The divergences also would not make financial chicanery any more attractive to index fund investors, or eliminate index funds' marketing incentive to engage constructively.

But while there are sound theoretical reasons for index funds to support countercyclical corporate governance, the clearest proof of their incentive structure is their support for stakeholder governance and macroeconomic stimulus. Even without a recession, major index funds endorsed a "new paradigm" in which corporations would seek to care for stakeholders other than shareholders and seek to serve social purposes beyond immediate shareholder wealth maximization.<sup>135</sup> During the COVID-19 crisis, index funds put this patient approach into practice, recognizing the need for corporate leaders to prioritize nonshareholder constituencies for the duration of the crisis.<sup>136</sup> And the leaders of index funds have been attentive to issues of macroeconomic policy, publicly urging stimulus where needed.<sup>137</sup>

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*and What To Do About It*, 61 WASH. & LEE L. REV. 1583, 1587 (2004) ("Diversity in the boardroom enhances corporate profitability according to the consensus of scholars of business management, finance, and economics.").

134. See Barzuza et al., *supra* note 131, at 1266–67, 1277–78 (discussing the lack of empirical evidence supporting the relationship between board diversity and shareholder returns).

135. See William Savitt & Aneil Kovvali, *On the Promise of Stakeholder Governance: A Response to Bebchuk and Tallarita*, 106 CORNELL L. REV. 1881, 1887 n.17 (2021). For an example of this type of advocacy, see Larry Fink, *A Fundamental Reshaping of Finance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 16, 2020), <https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/> [<https://perma.cc/WA34-7Z8N>].

136. See Edkins et al., *supra* note 100.

137. See Saqib Iqbal Ahmed, *Economic Recovery Further Away than Markets Think: BlackRock CEO Fink*, REUTERS (July 17, 2020, 10:48 AM), <https://www.reuters.com/article/us-blackrock-results-fink/economic-recovery-further-away-than-markets-think-blackrock-ceo-fink-idUSKCN24I20E> [<https://perma.cc/5Y9T-KV4T>] (including a quote from Fink as stating that "[t]here is going to be a need

Other institutional voices could also use their economic clout to advocate for stakeholder interests, but their views are likely to be more parochial. For example, pension funds might serve as advocates for worker positions.<sup>138</sup> While bond funds cannot cast shareholder votes, they could also use their economic clout to advocate for creditor interests. But pension funds' interests may skew toward longstanding employees or retirees instead of capturing the needs of the overall labor market. And in advocating for creditors, bond funds might be unhelpful during a macroeconomic crisis.<sup>139</sup>

### B. *Potential Approaches*

Institutional voices would ideally seek adoption of a disciplined variant of stakeholder governance, in which corporate leaders deploy resources to various stakeholders in response to macroeconomic crises. This concept could be pursued in two basic ways. Corporations could maintain a consistent stakeholder governance orientation, weighing the needs of stakeholders in good times as well as bad, or they could switch between shareholder and stakeholder-focused regimes based on context.

#### 1. Consistent Approach

Under a consistent or time-invariant approach, disciplined stakeholder governance would be encouraged in both good and bad times. This could entail engaging with companies to select stakeholder-friendly directors and officers; setting long-term compensation criteria based on employee, environmental, social, and governance criteria that are aligned to macroeconomic performance; and encouraging the development of stakeholder-friendly norms.

A consistent approach would avoid debates about whether a triggering macroeconomic crisis has started, and it would avoid delays in implementation. Instead of identifying a crisis, engaging with corporations to shift governance regimes, and waiting to have those changes take effect, index funds could simply count on existing measures. Given that dispatch is one of the benefits of a

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for some kind of stimulus for job creation"); Dawn Lim, *BlackRock's Larry Fink Makes Case for Government Infrastructure Stimulus*, DOW JONES INSTITUTIONAL NEWS (May 27, 2020), <https://www.marketscreener.com/quote/stock/BLACKROCK-INC-11862/news/BlackRock-Larry-Fink-Makes-Case-for-Government-Infrastructure-Stimulus-30681964/> [https://perma.cc/3YBT-YW24].

138. See David H. Webber, *Reforming Pensions While Retaining Shareholder Voice*, 99 B.U. L. REV. 1001, 1005–06 (2019) (urging that pension funds should be supported and supplemented in effort to use shareholder voice to advance labor interests); Stephen F. Diamond, *Exercising the 'Governance Option': Labour's New Push To Reshape Financial Capitalism*, 43 CAMBRIDGE J. ECON. 891, 908 (2019) (describing labor's increased use of "governance option" embedded in common stock to tilt balance of power in modern corporations). See generally DAVID WEBBER, *THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON* (2018) (discussing different ways pension funds can use their power to act in the best interest of workers).

139. See *supra* Section II.C.2.

private stimulus as compared to a traditional fiscal stimulus, a consistent approach may do more to capitalize on the strengths of countercyclical corporate governance.<sup>140</sup>

The counterarguments to this approach are similar to the normal criticisms of stakeholder governance.<sup>141</sup> In a good macroeconomic environment, it may contribute to inefficient expenditures. It would also lead to concerns about indeterminacy. Absent a clear goal like delivering useful macroeconomic stimulus in an environment where stimulus would do real good, stakeholder governance may not provide a criterion for corporate decisions. This would create confusion and managerial slack. But even macroeconomic environments that seem like peaks, in which there is no benefit to further stimulus, may actually be susceptible to improvement.<sup>142</sup> In addition, an approach that lowers some of the peaks in the business cycle as a cost of raising some of the troughs would be countercyclical. Trading some of the gain from a peak to avoid some of the pain of a trough would be a reasonable approach.

## 2. Switching Approach

Under a switching approach, a shareholder focus would apply in good times, but disciplined stakeholder governance would be encouraged in bad times. An approach that switched between a shareholder and stakeholder focus based on the macroeconomic environment could be implemented as easily as announcing a supportive approach during a crisis and voting accordingly. Deeper measures might include engagement with companies undertaking layoffs during a recession and with companies that are sitting on capital or returning it to shareholders.

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140. A consistent approach might have other benefits, such as additional credibility to employees. If employees believe that they have some protection against a layoff in the event of an economic downturn, they will be more likely to make firm- and industry-specific investments that increase worker productivity but that are difficult for the worker to keep in the event of a layoff. See Masur & Posner, *Unemployment*, *supra* note 7, at 607–08. Similarly, a firm that made credible commitments might be able to pay lower wages, because its workers will no longer need to be compensated *ex ante* for the risk of a layoff. *Cf. id.* at 621 (“Economists hypothesize that employers pay a wage premium to workers that compensate them for the risk of layoff.”). These effects do not necessarily depend on a stakeholder versus a shareholder orientation for the firm.

141. See *supra* Section I.A.

142. For example, economists had been skeptical that there was slack in the economy at the end of the Obama administration, thus stifling government policy that could have boosted employment. But after the Trump administration delivered further fiscal stimulus and a friendly Federal Reserve took a patient approach, unemployment rates dropped further. See, e.g., *Why American Unemployment Is So Low*, ECONOMIST (Dec. 10, 2018), <https://www.economist.com/the-economist-explains/2018/12/10/why-american-unemployment-is-so-low> [<https://perma.cc/HV2R-5MEW>] (staff-uploaded, dark archive)] (crediting fiscal stimulus and patient monetary policy for driving unemployment rate to 3.7% even though economists had previously estimated that unemployment rates below five percent would cause accelerating inflation).

A switching approach would allow the economy to reap the benefits of a close focus on efficiency during good economic times and the benefits of a private stimulus during bad economic times. An efficiency focus during periods of strong macroeconomic performance could also help ensure that wasteful or inefficient projects are regularly cleared out, and that workers and consumers expect a return to normalcy during a crisis.<sup>143</sup>

However, the cleansing effect during periods of strong economic performance could go too far, with firms reducing capital reserves in good periods to ensure that there are no reserves left over in bad periods to direct to other constituencies.

It would also be difficult to implement a switching approach. It would take time to recognize a macroeconomic crisis and react to it. Incentives could also create problems. Part of the reason for an index fund to pursue a countercyclical approach would be a reputational benefit,<sup>144</sup> that benefit would be eroded if the fund was perceived as adopting a ruthless shareholder-focused approach during any part of the business cycle. Stakeholder governance also normally relies on norms and understandings within the business community to inculcate a sense of responsibility and cause leaders to internalize their obligations to stakeholders;<sup>145</sup> it may not be possible to create strong understandings that can be toggled like a switch. Still, there are potential responses. Macroeconomic policy would have low salience to consumers during the business cycle's peak. And the idea that businesses should do more to protect their communities during a crisis is a natural one that may be adopted by business leaders.

### C. *Installing the Approach*

Advocates might use three broad categories of tools to install a countercyclical approach. First, index funds can announce positions and exhort business leaders to follow them. Major index funds have a bully pulpit within the business community, and are familiar with using that pulpit to urge revisions to corporate governance arrangements. For example, Larry Fink, the leader of BlackRock, has emphasized the need for businesses to have a sense of purpose, and to focus on sustainability in order to be profitable in the long term.<sup>146</sup> Even standing alone, statements of this type serve a valuable function in coordinating activities and developing norms. Business leaders can be encouraged to use their discretion to orient themselves toward stakeholders, can

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143. See *infra* note 269 for a discussion of some of the macroeconomic benefits of improved expectations.

144. See *supra* Section IV.A.

145. See Savitt & Kovvali, *supra* note 135, at 1883, 1894.

146. Fink, *supra* note 135; see also Edkins et al., *supra* note 100.

be pointed toward a common approach that will be more impactful, and can be reassured that they will not be going it alone if they do take action.<sup>147</sup>

Second, index funds can use their votes. Withholding, or threatening to withhold, votes from directors at companies that fail to adopt a countercyclical approach would send a powerful message. Voting in connection with merger transactions and activist efforts could also be an important lever. Funds could oppose transactions that are based on operational synergies that will reduce employment, either by voting against deals that need to be approved at target companies or by backing management in defending against such offers. While relatively few companies will be involved in such transactions, a few interventions would be sufficient to send a strong and meaningful message.<sup>148</sup>

Third, index funds could undertake more intensive stewardship activities, actively monitoring and engaging with companies. For example, a fund could select companies with high potential to deliver stimulus and either engage with management proactively or defensively upon announcements of potential job cuts.<sup>149</sup>

Critics might question the ability of index funds to implement this approach through more intensive stewardship.<sup>150</sup> The countercyclical corporate governance approach would also place new demands on their operations by requiring them to form views on macroeconomic issues.

The capacity of index funds to implement the approach will depend in part on the precise approach taken. Index funds probably could not actively engage on a broad array of business issues with every company represented in their portfolio. But issuing a clear statement of their approach and then engaging in targeted and high-profile interventions would send the same message and create similar incentives.

The differences in approach are analogous to the differences between the “police patrol” and “fire alarm” models of political oversight.<sup>151</sup> In a police patrol model, the supervisor actively looks for possible infractions, thus expending resources on investigating many situations where there has been no infraction.<sup>152</sup>

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147. See Savitt & Kovvali, *supra* note 135, at 1886.

148. Indeed, transactions are one of the few contexts in which Delaware courts have sent a clear signal in favor of shareholder primacy. See *infra* Sections IV.D.1–2.

149. This approach could leverage existing notices that are required by law. The Worker Adjustment and Retraining Notification Act of 1988 (“WARN Act”) requires covered employers to provide sixty days’ notice of layoffs and plant closings. 29 U.S.C. § 2102.

150. See *supra* notes 123–24 and accompanying text.

151. See Mathew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols Versus Fire Alarms*, 28 AM. J. POL. SCI. 165, 165–66 (1984); cf. 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, 896 (2013) (suggesting that activist funds identify problems and prompt index funds to act).

152. See McCubbins & Schwartz, *supra* note 151, at 166.



In a fire alarm model, the supervisor responds to infractions after they have been identified by key constituencies.<sup>153</sup> This requires much less active monitoring, and makes it easier to claim credit with the constituencies that are affected. Index funds plainly have the capacity to respond if the problem is obvious or others sound the alarm, even if they lack the capacity to proactively patrol the corporate landscape for possible issues.

Admittedly, index funds would need to formulate policies based on macroeconomics. But funds should be able to attract and use the necessary expertise. Indeed, the leaders of index fund companies already have fluency in macroeconomic concepts, and are comfortable opining on macroeconomic policies.<sup>154</sup> Difficult decisions could also be outsourced to competent bodies like the Federal Reserve. For example, instead of reaching an independent judgment about the state of the economy, index funds could commit to acting when the federal funds rate drops below some threshold near zero percent.<sup>155</sup>

#### D. *Adjustments to Corporate and Securities Law*

As noted above, shareholder primacy is the conventional model for understanding Delaware corporate law. This section urges that shareholder primacy should not be an obstacle to a shareholder implementation of countercyclical corporate governance, and turns to adjustments that would provide further support.

##### 1. Consistency with Current Law

Delaware law would not prevent actual shareholders from implementing a countercyclical approach. Delaware jurists routinely caution that corporate actors are normally required to prioritize the interests of shareholders above all other constituencies.<sup>156</sup> But Delaware law does not require corporations to maximize short-term share price, or to submit all corporate decisions to continuous shareholder referenda.<sup>157</sup> Between those two clear boundaries is a wide range of possibilities. Shareholder primacy could be understood as a set of mandatory commands designed to advance the narrow financial interests of an

153. *See id.*

154. *See, e.g.,* Ahmed, *supra* note 137 (including a quote from Fink saying that “[t]here is going to be a need for some kind of stimulus for job creation.”); Lim, *supra* note 137.

155. *See* Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 891 (“One final option is to trigger regulatory suspension when the federal funds rate is very low—at or near 0%. . . . This approach effectively allows agencies to piggyback on the expertise of the Fed in setting rates.”).

156. *See* Strine, *Dangers of Denial*, *supra* note 15, at 768.

157. *See id.* at 764 (“[D]irectors are generally empowered to manage the corporation in a way that is not dictated by what will best maximize the corporation’s current stock price.”).

idealized shareholder, or as an approach that permits private ordering by the shareholders themselves.<sup>158</sup>

Although some cases provide support for the mandatory view, the broader tendency of Delaware law is toward private ordering by the shareholders.<sup>159</sup> For example, Delaware courts have become more deferential in their review of transactions that have been approved by a vote of informed disinterested shareholders.<sup>160</sup> Delaware's public benefit corporation statute has similarly been amended to permit a simple majority of shareholders to reframe a corporation's purpose and make it explicitly responsive to stakeholder interests.<sup>161</sup>

At a more basic level, it is hard to imagine a Delaware court holding anyone liable for pursuing an expansionary business plan during a recession. Resisting layoffs, expanding production or investment, or pursuing a risky project are fairly standard business strategies that are generally subject to highly deferential review under the business judgment rule.<sup>162</sup> To the extent any

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158. See Ann M. Lipton, *What We Talk About When We Talk About Shareholder Primacy*, 69 CASE W. RESV. L. REV. 863, 866–67 (2019) [hereinafter Lipton, *What We Talk About*] (distinguishing between shareholder primacy as an approach that permits shareholders to have their way and approach in which courts enforce particular conception of what shareholders want).

159. See, e.g., Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 674 (2005) [hereinafter Strine, *The Delaware Way*] (“Consistent with a contractarian vision, our statute is, by design, a broad enabling one that permits and facilitates company-specific procedures. In other words, our statute is much different than one might find in a civil law nation, which would more likely have a prescriptive corporation law chock full of mandatory terms specifying exactly how corporations must conduct their business.”).

160. See *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 312–14 (Del. 2015) (stating that an uncoerced and informed vote of disinterested shareholders approving transaction bars suit for breach of fiduciary duty); *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (deciding that going private merger by a controlling shareholder is subject to deferential business judgment review instead of searching entire fairness review when the transaction was negotiated by a special committee of independent directors and conditioned on approval of a majority of the minority shareholders); Lipton, *What We Talk About*, *supra* note 158, at 871–72.

161. H.B. 341, 150th Gen. Assemb. (Del. 2020).

162. Under the business judgment rule, courts generally will not attempt to second guess a decision that corporate directors and officers make in good faith to advance the interests of the enterprise. This principle is easily rationalized under the shareholder primacy paradigm. See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738 (2005) [hereinafter Elhauge, *Sacrificing Corporate Profits*] (“[E]ven a legal regime that seeks only to maximize shareholder profits would provide the sort of business judgment rule deference that inevitably allows latent profit-sacrificing discretion to exist.”); EASTERBROOK & FISCHER, *supra* note 16, at 93 (“Behind the business judgment rule lies recognition that investors’ wealth would be lower if managers’ decisions were routinely subjected to strict judicial review.”). But the rule also prevents judicial review of many corporate decisions that benefit stakeholders. See STOUT, *THE SHAREHOLDER VALUE MYTH*, *supra* note 16, at 29 (discussing how “[t]he [b]usiness [j]udgment [r]ule’ [r]ules [o]ut [s]hareholder [p]rimacy”). For example, when Henry Ford introduced a wage of five dollars per workday for employees of the Ford Motor Company, he arguably transferred wealth from the company’s shareholders to its workers. M. Todd Henderson, *Everything Old Is New Again: Lessons from Dodge v. Ford Motor Company*, in *CORPORATE LAW STORIES* 37, 50 (J. Mark Ramseyer ed., 2009). But the decision would be shielded under the business judgment rule as a justifiable effort to improve worker efficiency and generate good publicity. *Id.* at 51.

shareholders disagree with the strategy set by the directors and officers, they can obtain relief not from legal restrictions but through voting.

## 2. Removing Uncertainty

Properly understood, Delaware law would not block a countercyclical corporate governance scheme backed by shareholders like index funds. But there are Delaware precedents that are routinely cited in opposition to stakeholder governance, and that may be used by opponents of a countercyclical approach. Contextualizing those cases would remove uncertainty and would make a countercyclical governance scheme more effective.

For a brief period, Delaware courts seemed prepared to allow corporate boards to deploy defensive measures to prevent corporate raiders from harming nonshareholder constituencies.<sup>163</sup> But in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,<sup>164</sup> the Delaware Supreme Court suggested that there were limits on the extent to which a corporate board could consider such constituencies:

A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. . . . However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.<sup>165</sup>

As a result, the Revlon board was not permitted to end the auction.<sup>166</sup>

As others have observed,<sup>167</sup> *Revlon* arose in a unique context where a sale and breakup of the corporation had become inevitable. That context had the effect of flattening out the heterogeneous preferences of shareholders—there was no competition between investors with short- and long-time horizons, because the company would not exist in the long term—and ensuring that no corporate policy benefitting stakeholder interests would endure. Put differently, in *Revlon*, the only benefit that shareholders could derive from the corporation was the highest possible sales price. As a result, the board was required to have a single-minded focus on that goal. By contrast, shareholders urging a corporation to act in a countercyclical mode would have much to gain from corporate policies that expand employment and promote economic activity, and *Revlon* would not preclude corporate actors from meeting those needs.

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163. See *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 955 (Del. 1985) (stating that takeover defenses can be justified by concerns, including “the impact on ‘constituencies’ other than shareholders (i.e. creditors, customers, employees, and perhaps even the community generally)” (citation omitted)).

164. 506 A.2d 173 (Del. 1986).

165. *Id.* at 182.

166. See *id.* at 185.

167. E.g., STOUT, THE SHAREHOLDER VALUE MYTH, *supra* note 16, at 31.

The *eBay* case<sup>168</sup> provides a more complex statement on corporate priorities. eBay purchased a stake in craigslist in August 2004; the other two shareholders, Craig Newmark (“Craig”) and James Buckmaster (“Jim”) together owned a majority of the shares and controlled the board.<sup>169</sup> After eBay opened a competing business, Craig and Jim caused craigslist to adopt various measures in 2008, including a poison pill that prevented eBay from ever acquiring more shares.<sup>170</sup> Craig and Jim defended the plan as necessary to protect the corporate culture of craigslist, which was based on the website refusing to monetize services.<sup>171</sup> The court rejected that explanation, concluding that Craig and Jim had failed to prove the existence of a corporate culture “that sufficiently promotes stockholder value to support the indefinite implementation of a poison pill.”<sup>172</sup> The board could not justify a poison pill using a corporate policy of refusing to monetize the website, given that the policy “admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders.”<sup>173</sup> The court also held that the poison pill would be an unreasonable way to pursue the stated purpose, as Craig and Jim could keep the culture in place as long as they held their shares and retained control.<sup>174</sup>

The *eBay* case generated substantial critical commentary,<sup>175</sup> and there are many contexts in which it is problematic for an entity to be unable to credibly commit to maintaining a noneconomic policy even after its existing shareholders have departed.<sup>176</sup> But regardless of *eBay*’s impact on the general project of stakeholder governance, it does not prevent implementation of a countercyclical corporate governance approach in which the current shareholders urge the corporation to enact policies that advance their purely economic interests.

The events surrounding *Air Products & Chemicals, Inc. v. Airgas, Inc.*,<sup>177</sup> are relevant to the overall framework. Beginning in 2009, Air Products sought to acquire Airgas, another supplier of gasses and related goods.<sup>178</sup> The approach turned public and hostile, with Air Products launching a tender offer for Airgas

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168. See, e.g., *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

169. *Id.* at 6.

170. See *id.* at 6–7.

171. See *id.* at 33.

172. *Id.*

173. *Id.* at 34.

174. *Id.* at 35.

175. E.g., Anthony J. Casey & M. Todd Henderson, *The Boundaries of “Team” Production of Corporate Governance*, 38 SEATTLE U. L. REV. 365, 388 (2015).

176. See, e.g., Emilie Aguirre, *Beyond Profit*, 54 U.C. DAVIS L. REV. 2077, 2115 (2021); see Ann Lipton, *Benefit Corporations Go Public*, BUS. L. PROF. BLOG (July 18, 2020), [https://lawprofessors.typepad.com/business\\_law/2020/07/benefit-corporations-go-public.html](https://lawprofessors.typepad.com/business_law/2020/07/benefit-corporations-go-public.html) [<https://perma.cc/9UNT-UHV9>] [hereinafter Lipton, *Benefit Corporations Go Public*].

177. 16 A.3d 48 (Del. Ch. 2011).

178. *Id.* at 63.

shares that was conditioned on the Airgas board dismantling its takeover defenses.<sup>179</sup> Air Products repeatedly raised its offer price, and even persuaded Airgas shareholders to elect three nominees selected by Air Products to the Airgas board.<sup>180</sup> Yet the Airgas board—including the three Air Products nominees—insisted on maintaining a poison pill takeover defense that prevented the tender offer from going through.<sup>181</sup>

The Delaware Chancery Court upheld the Airgas board's actions after concluding that it was a reasonable response to the threat that a majority of shareholders might choose to tender into an offer at an inadequate price.<sup>182</sup> The court reached the conclusion with apparent reluctance, stating explicitly that Airgas shareholders were fully informed and had taken enough time to consider the Air Products offer.<sup>183</sup> But it held that because the board had made the required showings of good faith and a legitimate threat from inadequate price, the board was justified in “blocking the tender offer and forcing the bidder to elect a board majority that supports its bid.”<sup>184</sup>

This result seems to be a decisive refutation of shareholder primacy.<sup>185</sup> But if the shareholder-oriented language of Delaware decisions is taken seriously, the case actually presents a challenge for stakeholder governance. It suggests that Delaware law enforces some concept of shareholders' interests that is abstracted away from the actual expressed preferences of the shareholders themselves.<sup>186</sup> Even where shareholders seemed to have placed directors on the board to clear the way for a sale,<sup>187</sup> the board was permitted to take actions for the specific purpose of preventing shareholders from voluntarily selling their shares. The court seemed to recognize a platonic purpose of the corporation, divorced from shareholders' actual views, which directors were empowered to defend. Such a reading might suggest that countercyclical corporate governance could be barred by courts, even if it is accepted by key shareholders like index funds.

This would be a misreading of the case. The board's power was derived from the fact that it had been elected by shareholders, and would have to be

179. *See id.* at 68–69.

180. *See id.* at 77. Because Airgas had a staggered board structure, prevailing in one election was not sufficient to gain majority control. *See id.* at 115.

181. *See id.* at 90.

182. *Id.* at 55.

183. *See id.* at 57.

184. *Id.* at 54.

185. *See* STOUT, THE SHAREHOLDER VALUE MYTH, *supra* note 16, at 30.

186. For a more extreme, though more obscure, example, see Lipton, *What We Talk About*, *supra* note 158, at 863–65 (discussing *In re* PLX Tech. Shareholders Litig., No. 9880-VCL, 2018 WL 5018535, at \*1 (Del. Ch. Oct. 16, 2018), *aff'd*, 2019 WL 2144476 (Del. May 16, 2019)).

187. The *Airgas* court did note some ambiguity in the platform of the new directors. Air Products ran the three as “independent directors who promised to take a ‘fresh look,’” not as directors who would dismantle the takeover defense. *See Airgas*, 16 A.3d at 123 (emphasis in original).

reelected by shareholders to maintain the defense.<sup>188</sup> Shareholder voting remains largely sacrosanct. Even though Delaware courts permit boards to frustrate hostile tender offers, boards are largely precluded from interfering with shareholder voting.<sup>189</sup> The corporation is not a self-perpetuating entity with goals that courts will endlessly defend even against shareholder opposition.<sup>190</sup>

This difference in treatment between boards interfering with a shareholder's decision to sell her shares and boards interfering with a shareholder's vote also suggests that Delaware law is designed to facilitate enlightened deliberation by shareholders. The difference might be rationalized as pure formalism,<sup>191</sup> or as the result of strategic judicial behavior.<sup>192</sup>

But a more powerful explanation is that Delaware law allows boards to structure the shareholders' decision in the way that best engages their moral and practical faculties.<sup>193</sup> As Professors Oliver Hart and Luigi Zingales have explained, a given shareholder's decision is unlikely to make the difference in whether a takeover goes through.<sup>194</sup> This fact means that a shareholder has little reason to resist a premium offer to buy her shares, as she will not be morally responsible for any unsavory conduct that results and cannot prevent the damage to her other interests.<sup>195</sup> But it also means that a shareholder has no reason to vote for a transaction that she would prefer not to occur, either on moral grounds or out of concern for other practical interests.<sup>196</sup> By allowing boards to require that decisions be made through voting instead of sales, Delaware law ensures that corporate control decisions maximize the

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188. The *Airgas* court specifically held that it was realistic for Air Products to replace a majority of the Airgas board at the next annual meeting. *See id.* at 121.

189. *See generally* Blasius Inds., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (holding that the board violated fiduciary duties when it adopted antitakeover measures with the purpose of interfering with shareholder vote).

190. *But see* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (rejecting poison pill where stated purpose was to require corporate policy even after controlling shareholders had died and were unable to maintain it themselves).

191. The Delaware General Corporation Law grants a duly elected board the power to manage the business, justifying deference on all matters apart from the board's election. *See* 8 DEL. CODE ANN. § 141 (LEXIS through 83 Del. Laws, c. 476) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

192. *See* Leo E. Strine, Jr., *The Story of Blasius Indus. v. Atlas Corp.: Keeping the Electoral Path to Takeovers Clear*, in CORPORATE LAW STORIES 243, 288–89 (J. Mark Ramseyer ed., 2009) (suggesting that appellate review of *Blasius* was dodged at a time when the Delaware Supreme Court was inclined to sweep away obstacles to takeover defenses).

193. *See* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 256 (2017).

194. *Id.*

195. *Id.*

196. *Id.*

shareholders' welfare as understood by the shareholders themselves, and not simply the financial value of company shares.

Courts and scholars could advance a countercyclical corporate governance scheme by placing the precedents in their proper context, thus eliminating confusion. It could also provide useful support by changing norms. Any system of corporate governance—including one based on pure shareholder wealth maximization—will ultimately depend on directors and officers internalizing a correct understanding of what values they are supposed to serve.<sup>197</sup> Mixed messages from the legal system interfere with internalization of the proper norms.

### 3. Preventing or Rolling Back Contrary Reforms

Countercyclical corporate governance would depend on authorities refraining from introducing new legal obstacles to institutional investors using their power to vote and engage with corporations.

But various commentators and government actors have sought to prevent certain institutional investors from using their power at a given corporation to advance any goal other than maximizing the value of their investment in that corporation.<sup>198</sup> In support of this effort, Trump administration Secretary of Labor Eugene Scalia stressed his view that “[p]rivate employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan.”<sup>199</sup> The Department of Labor published a final rule on November 13, 2020, advancing these principles.<sup>200</sup> These regulatory changes were put on hold by the Biden administration. In a March 2021 statement, the Department of Labor stated that it intended to revisit the rules and that it would not enforce the rules in the interim.<sup>201</sup>

197. See Savitt & Kovvali, *supra* note 135, at 1881; Lynn A. Stout, *On the Proper Motives of Corporate Directors (or, Why You Don't Want To Invite Homo Economicus To Join Your Board)*, 28 DEL. J. CORP. L. 1, 1 (2003); John C. Coffee, Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151, 2151 (2001).

198. See U.S. Dep't of Labor, *U.S. Department of Labor Proposes New Investment Duties Rule*, U.S. DEP'T LAB. (June 23, 2020), <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623> [<https://perma.cc/4PNW-5CKL>]; Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 384 (2020).

199. U.S. Dep't of Labor, *supra* note 198.

200. See 29 C.F.R. pts. 2509, 2550 (2020). A related rule addresses the use of shareholder votes. See *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 Fed. Reg. 81,658 (Dec. 16, 2020).

201. U.S. DEP'T OF LABOR, U.S. DEPARTMENT OF LABOR STATEMENT REGARDING ENFORCEMENT OF ITS FINAL RULES ON ESG INVESTMENTS AND PROXY VOTING BY EMPLOYEE BENEFIT PLANS (2021), <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf> [<https://perma.cc/D5YY-8L45>]. As this Article went to press, the Biden administration finalized

Even if they were reinstated, such rules may not prohibit support for countercyclical corporate governance. Casting votes to hasten the end of a recession would be in the pecuniary interest of underlying customers and would secure an economic benefit for them.<sup>202</sup> But introducing uncertainty on the issue could diminish the willingness of institutional investors to pursue the approach. Indeed, the Biden administration suggested that in the few months that they had been in force, the rules had “already had a chilling effect on appropriate integration of ESG factors in investment decisions, including in circumstances that the rules can be read to explicitly allow.”<sup>203</sup>

If it did prove to be an obstacle, government regulators should be willing to introduce appropriate exceptions for macroeconomic context. Whether motivated by a general skepticism toward financial institutions exercising power<sup>204</sup> or a partisanship-inflected view on issues like climate change and social stability,<sup>205</sup> the proposed reforms are not deliberately targeted at countercyclical corporate governance.

#### 4. Facilitative Reforms

The law could do more to facilitate countercyclical efforts by private actors. A supportive reform would encourage institutional investors to better serve the real interests of underlying customers by focusing on issues that impact sustainable growth.<sup>206</sup>

Expanded disclosure requirements would also help investors hold managers accountable for failing to deliver stimulus. Disclosure on workforce issues would be particularly useful in evaluating whether companies have selected employment levels that are appropriate for a given point in the business cycle. This would not require a substantial departure from ordinary

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a new rule on the use of environmental, social, and governance factors by fiduciaries of employee benefit plans. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 Fed. Reg. 73822 (Dec. 1, 2022) (to be codified at 29 C.F.R. pt. 2550).

202. *But see* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72850 (Nov. 13, 2020) (to be codified at 29 C.F.R. pts. 2509, 2550) (rejecting view that “fiduciaries should be permitted to consider the potential for an investment to create jobs for workers who in turn would participate in the plan”); *id.* at 72847 (explaining “the fact that an investment . . . arguably promotes positive general market trends or industry growth” does not imply that it “is a prudent choice for retirement investors”).

203. U.S. DEP’T OF LABOR, *supra* note 198.

204. *See* Bebchuk & Hirst, *Index Funds*, *supra* note 88, at 2067.

205. *Cf.* Madison Condon, *The Firm Administering the Coronavirus Rescue Considers Climate Risks in Its Ordinary Investments*, SLATE (Apr. 20, 2020, 2:03 PM), <https://slate.com/news-and-politics/2020/04/republicans-block-blackrock-climate-risk-assessment.html> [<https://perma.cc/7D6T-5XCB>].

206. For a recent example of thinking along these lines, see Leo E. Strine, Jr., *Stewardship 2021: The Centrality of Institutional Investor Regulation to Restoring a Fair and Sustainable American Economy* (Colum. Ctr. for L. & Econ. Studies, Working Paper No. 633, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3719145](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3719145) [<https://perma.cc/CJQ8-3YFV>] [hereinafter Strine, *Stewardship 2021*].



considerations, as there has already been investor agitation for expanded disclosures on human capital issues. For example, when adopting updates to Regulation S-K, the Securities and Exchange Commission received extensive comments urging that a variety of employee issues were important to investment decisions.<sup>207</sup>

## V. GOVERNMENT IMPLEMENTATIONS

The government could also directly install a countercyclical approach to corporate decision-making. This part provides a brief and nonexhaustive sketch of potential strategies for reform, with the goal of identifying some promising avenues for future analysis. Section V.A considers changes to the legal regime governing extraordinary corporate events, such as mergers and bankruptcies. Section V.B considers potential changes to ordinary corporate governance, such as changes to fiduciary duties or the introduction of a codetermination scheme. Section V.C considers the potential for governments to act in their capacity as shareholders. Finally, Section V.D considers tax and regulatory reforms.

### A. *Changing Regulation of Extraordinary Corporate Events*

The law's approach to mergers and acquisitions could be revised. Delaware law might empower boards or other groups to resist takeovers if they would cause harm to stakeholders. For example, a corporation might resist a takeover if it would result in mass layoffs. At a minimum, Delaware could expressly revive the approach of *Unocal Corp. v. Mesa Petroleum Co.*<sup>208</sup> and reject the approach of *Revlon*.<sup>209</sup> As a stronger measure, Delaware might empower outside groups to prevent takeovers, or permit boards to empower outside groups.<sup>210</sup>

There are some good reasons to be skeptical of such measures, unless outside groups are given formal powers or the board is given incentives that align to stakeholders' interests. Some states have adopted "constituency statutes" intended to permit boards to consider stakeholders' interests, but because the statutes did not change incentives or stakeholders' powers, it is not

207. Allison Herren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence*, U.S. SEC. & EXCH. COMM'N (Aug. 26, 2020), <https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26> [<https://perma.cc/HT5D-D6J2>]. The SEC ultimately adopted a principles-based approach that Commissioner Lee found inadequate. *Id.*; see also Coffee, *The Future of Disclosure*, *supra* note 130, 602 (noting that diversified institutional investors have sought additional ESG disclosures, and suggesting that their purpose is to control systemic risks).

208. 493 A.2d 946 (Del. 1985).

209. See *supra* Section IV.D.2.

210. In a thoughtful student note, Tianna Larson suggests that Delaware should be more tolerant of dead hand poison puts during a zero lower bound recession. Larson, *supra* note 2.

clear that they had the desired effect.<sup>211</sup> Empowering certain constituencies may also frustrate a countercyclical approach because constituencies like creditors would not want firms to take the steps that would most increase economic activity.<sup>212</sup>

An alternative would be to revise government and judicial review of proposed transactions. Under current law, operational synergies are generally seen as a positive feature of merger transactions. If a shareholder of the acquired company demands an appraisal—that is, to be paid the value of their shares as determined by a court—the value of the synergies will be deducted from the appraisal result.<sup>213</sup> Similarly, antitrust regulators are more likely to approve a transaction if it creates “efficiencies” by cutting costs.<sup>214</sup> If these synergies are to be realized by slashing staff or spending, they may not be helpful during a recession.<sup>215</sup> As a result, eliminating the credits under current law may be worthwhile in a recession. Indeed, an almost total inversion of the normal approach—for example, granting workers an “appraisal” right based on the value of their eliminated role in the company—may be worth considering.<sup>216</sup>

Reforms might target other extraordinary corporate events. Professor Zachary Liscow has proposed revising bankruptcy practice during periods of high unemployment.<sup>217</sup> Under his approach, bankruptcy judges would strive to preserve jobs in reorganizations that occur during a recession, provided that the jobs could be preserved at lower cost within the reorganization than through ordinary fiscal policy.<sup>218</sup> The regime would pick up firms outside the reach of

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211. See Bebchuk & Tallarita, *supra* note 21 (concluding that constituency statutes have not caused boards to strike deals that better serve stakeholder interests); Savitt & Kovvali, *supra* note 135 (critiquing this analysis).

212. See *supra* Section II.C.2.

213. See Lawrence A. Hamermesh & Michael L. Wachter, *Finding the Right Balance in Appraisal Litigation: Deal Price, Deal Process, and Synergies*, 73 BUS. LAW. 961, 993 (2018) (“[D]eal price . . . must be adjusted to eliminate the portion of that price attributable to synergistic merger gains.”).

214. See Naidu et al., *supra* note 7, at 585.

215. On the other hand, firms’ increased ability to charge higher prices—a clear problem under antitrust law—could be helpful in the context of a recession, because it would raise inflation expectations and encourage immediate spending. See LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 141, 165–66 (describing analysis by Gauti Eggertson suggesting that collusion between firms facilitated by early New Deal reforms may have been beneficial in the context of the Great Depression).

216. The value might be presumptively set at zero outside the context of a recession. While this would fail to take into account the value of workers’ firm-specific investments, it would avoid imposing a tax on transactions that are efficient in periods of macroeconomic success. Still, this approach would have serious problems. Making it more difficult to fire workers could discourage hiring. See Liscow, *supra* note 1, at 1471. Ordinary appraisal litigation is often inefficient and had become an arbitrage opportunity for hedge funds. Workers are also diverse, making it difficult to consolidate their claims or dispose of them efficiently. See Naidu et al., *supra* note 7, at 543. On balance, the difficulties may outweigh any putative benefits.

217. See Liscow, *supra* note 1, at 1461.

218. *Id.*

the index fund mechanism—index funds are unlikely to have a meaningful stake in a bankruptcy reorganization. And it would help address concerns about increased risk taking by firms that face potential insolvency,<sup>219</sup> by ensuring that a bankruptcy would not necessarily lead to mass layoffs.

#### B. *Changing Ordinary Corporate Governance*

The federal government could also revise the fiduciary duties of directors and officers at substantial firms<sup>220</sup> or at firms receiving bailout funds.<sup>221</sup> Instead of having a duty to maximize the value of a corporation for the benefit of its shareholders, corporate officers and directors would have a duty to serve other groups. Uniform duty rules have drawbacks.<sup>222</sup> But they would help limit the need for customized engagement by shareholders, would facilitate a coordinated response by orienting all corporate leaders in the same direction, and would put real teeth behind the concept.

If the reform were pursued, action at the federal level seems appropriate. Delaware is an attractive site for normal corporate law decision-making in part because it is not a major economic power. As a result, it is not normally tempted to manipulate the content of corporate law to advance an industrial policy in the way that larger states might be.<sup>223</sup> But that advantage in normal times could be an impediment to a countercyclical corporate governance scheme, which would seek to align corporate law with economic policy.

At the same time, federalizing corporate law would be a major change that would carry substantial costs. For the scheme to work, decisions would also have to be made rapidly; relying on Congress would render the approach as slow as ordinary fiscal policy tools. This problem might be addressed by delegating authority to an expert agency like the Federal Reserve, or an expert bench of commercial judges.

The federal government could also pursue a more fundamental reform, such as implementing a codetermination scheme in which workers are entitled to elect representatives to the boards of important companies. Proposals have

219. See *supra* Section II.C.2.

220. Provisions of Senator Elizabeth Warren's proposed Accountable Capitalism Act, which are modeled on Delaware's benefit corporation statute, would revise fiduciary duty law to call for consideration of stakeholders.

221. See Leo E. Strine, Jr., *Toward a Fair and Sustainable Capitalism* 5, 13 (Roosevelt Inst., Working Paper 2020), [https://rooseveltinstitute.org/wp-content/uploads/2020/08/RI\\_TowardFairandSustainableCapitalism\\_WorkingPaper\\_202008.pdf](https://rooseveltinstitute.org/wp-content/uploads/2020/08/RI_TowardFairandSustainableCapitalism_WorkingPaper_202008.pdf) [<https://perma.cc/XJJ5-FYSJ>].

222. *E.g.*, Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1309 (2008).

223. See, *e.g.*, Strine, *The Delaware Way*, *supra* note 159, at 679–80 (“[F]or us, a small state, it is vital that we remain the leader in corporation law.”); ROMANO, *supra* note 16, at 38.

been floated in Congress,<sup>224</sup> and ideas have been debated in the academic literature.<sup>225</sup> Such a scheme would almost certainly have to be mandatory and federal to prevent evasion.<sup>226</sup>

A full evaluation of an American codetermination scheme would be beyond the scope of this Article.<sup>227</sup> But codetermination schemes might help limit the duration of a macroeconomic crisis by helping firms to renegotiate relationships with employees instead of engaging in layoffs.<sup>228</sup> By empowering workers within the corporate structure, it could also help prevent layoffs that deepen a crisis, even if such layoffs would generate some short-term financial returns for undiversified shareholders.

However, codetermination would be a blunt instrument for implementing a countercyclical approach. By institutionalizing a particular allocation of power, codetermination would reshape corporate decisions even outside of an economic crisis. The changed decisions might entail underinvestment in other forms of capital, or an inefficient deployment of labor across firms.<sup>229</sup> A firm with a codetermination governance structure may also provide inefficient

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224. *E.g.*, Accountable Capitalism Act, S. 3348, 115th Cong. (2018); Reward Work Act, S. 2605, 115th Cong. (2018).

225. *See, e.g.*, Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155, 156 (1982).

226. *See id.*

227. For a broader analysis, see Leo E. Strine, Jr., Aneil Kovvali & Oluwatomi Williams, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice and Power Within American Corporate Governance*, 106 MINN. L. REV. 1325, 1325 (2022) [hereinafter Strine et al., *Lifting Labor's Voice*].

228. Firms subject to codetermination schemes were slower to fire employees during the Great Recession. *See, e.g.*, *Deutschland AG Rethinks Workers' Role in Management*, ECONOMIST (Feb. 1, 2020), <https://www.economist.com/business/2020/02/01/deutschland-ag-rethinks-workers-role-in-management> [<https://perma.cc/9CUJ-STDA> (staff-uploaded, dark archive)] (discussing study suggesting that “companies with labour representatives on supervisory boards . . . sacked fewer workers and reinvested more” with “[t]heir cumulative total returns between 2006 and 2011 . . . 28 percentage points higher”); MARC STEFFEN RAPP & MICHAEL WOLFF, STRONG CODETERMINATION - STABLE COMPANIES 4–5 (2019), <https://www.econstor.eu/bitstream/10419/204837/1/1679444662.pdf> [<https://perma.cc/6SHF-CNJP>] (reporting findings that German companies with codetermination laid off fewer employees, maintained research and development, raised more outside capital, and engaged in fewer transactions to deliver returns to equity holders); Aleksandra Gregorič & Marc Steffen Rapp, *Board-Level Employee Representation (BLER) and Firms' Responses to Crisis*, 58 INDUS. RELS. 376, 376 (2019) (explaining that Scandinavian firms with board level employee representation conducted fewer layoffs during Great Recession, in part because of their success in negotiating labor cost reductions); Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law To Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 939 (1993) (“[W]orkers may be more willing to accept lower working conditions in times of financial difficulty because they will have more confidence that they will gain from these sacrifices in the long-run.”). Codetermination may also make it easier to renegotiate wages, reducing the stickiness of wages and making prolonged periods of elevated unemployment less likely. Gregorič & Rapp, *supra*, at 396; O'Connor, *supra*, at 939; Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L.J. 1749, 1765–66 (1990); Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155, 164 (1982).

229. *See* Section VI.B.

stimulus. For example, if existing employees have a seat at the table and potential employees do not, a company might choose to pay existing employees more instead of hiring an additional unemployed worker.<sup>230</sup> But delivering funds to someone who is unemployed would be likely to prompt more spending—a cash-strapped, unemployed worker will be more likely to spend a marginal dollar than an employee who has been drawing a stable salary—and thus provide more stimulus.<sup>231</sup> Codetermination could also unhelpfully make firms more risk averse by giving partial control to workers, who are unable to diversify their holdings to manage firm-specific risk in the way that shareholders can.<sup>232</sup> A broader codetermination scheme that addressed these issues by reserving seats for interest groups other than current workers could prove difficult to install and administer.

Where it is practiced, codetermination is just one of a number of interrelated mechanisms, including some that can help mitigate these tensions.<sup>233</sup> For example, strong trade unions would have the means and incentives to attend to the health of the overall labor market, instead of focusing exclusively on the parochial interests of employees at a particular firm. But codetermination in isolation could have different effects, which would make it a problematic tool for a countercyclical approach.

### C. *Government as Shareholder*

Government entities might build up equity stakes and use their voting power to support a countercyclical approach. This would represent more of an evolution than a revolution: sovereign wealth funds are already used to support the macroeconomic policies of various countries,<sup>234</sup> and government entities in the United States are increasingly interested in using equity investments to

230. Cf. Michael C. Jensen & William H. Meckling, *Rights and Production Functions: An Application to Labor Managed Firms and Co-determination*, 52 J. BUS. 469, 478 (1979) (observing that if firms maximize average earnings per worker, they may contract employment in response to exogenous shocks).

231. See *supra* note 70 and accompanying text.

232. Jensen & Meckling, *supra* note 230 (describing this as one of a class of problems relating to the nonmarketability of the workers' control rights); Jens Dammann & Horst Eidenmüller, *Codetermination: A Poor Fit for U.S. Corporations*, 3 COLUM. BUS. L. REV. 870, 932–34 (2020). Risk aversion may be unhelpful in a crisis. See *supra* Section II.C.2.

233. See generally Strine et al., *Lifting Labor's Voice*, *supra* note 227 (discussing codetermination as one of several mechanisms including strong unions and sectoral bargaining).

234. See Attracta Mooney, *Coronavirus Ends 'Golden' Era for Sovereign Wealth Funds*, FIN. TIMES (Aug. 30, 2020), <https://www.ft.com/content/46a6bdf4-c965-48ff-be58-820067b04e81> [<https://perma.cc/5G39-RQ4S> (staff-uploaded, dark archive)] (noting that governments are tapping sovereign wealth funds to support stimulus spending in the wake of the recession caused by COVID-19).

support public policy.<sup>235</sup> Such an approach could also be used in combination with revised strategies by the Federal Reserve. If the Federal Reserve purchased equity stakes in open market operations, it could use the accompanying control rights to implement a countercyclical approach.

This approach would raise a host of problems. At a mechanical level, the government would have to manage and monitor a large portfolio of equity securities. The government would also have to manage dangerous tensions—it might be tempted to protect its portfolio companies by using its regulatory muscle to lean on competitors or counterparties, or to respond to political pressures by forcing portfolio companies to take value-destroying steps.<sup>236</sup>

Some of these tensions might be reduced by enacting a clear statutory regime,<sup>237</sup> or by delegating authority over stewardship decisions to an insulated and relatively apolitical agency. And many of the tensions are in play even without governments taking or using equity stakes, as the government and community can already pressure companies to fulfill an expected social role.<sup>238</sup> But they are substantial issues, and may prompt serious opposition to a new scheme of government ownership of equity.

#### D. *Taxes and Regulations*

Governments might adopt tax or regulatory schemes that encourage corporations to take countercyclical actions. While these measures would not represent internal reforms to corporate governance in the sense of changing corporate objectives or decision-making, they might induce similar behavior.

One strategy might be to target retained earnings during recessions, with the goal of inducing corporations to spend or invest funds instead of hoarding them in a crisis. For example, an undistributed profits tax designed to prevent corporations from holding on to excess capital was proposed during the New Deal.<sup>239</sup> Such a measure could force corporations to spend, invest, or return

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235. See, e.g., Michael Garland, Jennifer Conovitz & Yumi Narita, *NYC Comptroller's Boardroom Accountability 3.0 Results*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 24, 2020), <https://corpgov.law.harvard.edu/2020/06/24/nyc-comptrollers-boardroom-accountability-3-0-results/> [<https://perma.cc/E4YP-KMTW>] (describing efforts by the New York City Comptroller and New York City Retirement Systems to use shareholder engagement to advance various policies on social judgment and climate change).

236. For an analysis of some of these issues, see Kahan & Rock, *supra* note 44.

237. See *id.* at 1344–45 (noting that Congress had not expected the Treasury to acquire equity securities in past crisis, and so had not provided any guidance on how an equity stake was to be managed).

238. See, e.g., Elizabeth Pollman, *Quasi Governments and Inchoate Law: Berle's Vision of Limits on Corporate Power*, 42 SEATTLE U. L. REV. 617, 619 (2019) (excavating the concept of “inchoate law” from Adolf Berle's scholarship).

239. See LISTOKIN, *LEGAL REMEDIES TO RECESSIONS*, *supra* note 1, at 165; Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167, 195–96 (2002).

capital to investors. But it could also cause corporations to decrease capital reserves in periods of strong economic performance, making them more vulnerable to shocks.<sup>240</sup> And as discussed above, distributing value to shareholders may not be useful during a macroeconomic crisis.

Another strategy would be to target the means by which corporations distribute value to shareholders during recessions. At an extreme, the government could ban stock buybacks during recessions.<sup>241</sup> Alternatively, the Securities and Exchange Commission could withdraw the current safe harbor for share repurchases during recessions.<sup>242</sup> The government might create similar incentives by removing tax code preferences for capital gains or instituting transactions taxes that would help limit shareholder returns from corporate financial activities that provide a quick boost to share prices without creating long-term value.<sup>243</sup> While some recent legislative and regulatory changes are steps in this direction, the reforms might be strengthened and tied more directly to macroeconomic goals.<sup>244</sup>

A final strategy would be for the government to use regulations to build up centers of “countervailing power” that could deal with corporations at arm’s length.<sup>245</sup> Empowering external forces like organized labor would shape the environment in which corporations operate, driving them toward outcomes that are similar to those that would be achieved by internal corporate governance reforms like codetermination.<sup>246</sup> An exploration of such external reforms would

240. The government might respond by layering on capital reserve requirements akin to those applied to financial institutions. *See* Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 860, 878–79 (describing macroprudential regulations which set capital requirements for banks that increase during booms and decrease during recessions). But nonfinancial firms may not be well positioned to cope with such regulations.

241. For example, Senator Tammy Baldwin’s Reward Work Act would prohibit companies from purchasing shares on national securities exchanges. S. 2605, 115th Cong. (2018).

242. *See* 17 C.F.R. § 240.10b-18 (2005). A modification to the rule during recessions may be appropriate on other grounds. During a period of financial volatility and dislocation, buybacks could pose particular dangers, and be more likely to have manipulative effects. *See supra* notes 50–51 and accompanying text.

243. *See* Strine, *Stewardship 2021*, *supra* note 206, at 30.

244. The Inflation Reduction Act of 2022 includes an excise tax of one percent on stock buybacks by covered corporations. Inflation Reduction Act of 2022, Pub. L. No. 117-169, § 10201(a), 136 Stat. 1818, 1828–29 (2022) (codified at 26 U.S.C. § 4501 (2022)). As of this writing, the SEC is also considering new rules regarding stock repurchases.

245. *See* Brian R. Cheffins, *Corporate Governance and Countervailing Power*, 74 *BUS. LAW.* 1, 2 (2018) (excavating John Kenneth Galbraith’s concept of countervailing power); *cf.* Kate Andrias & Benjamin I. Sachs, *Constructing Countervailing Power: Law and Organizing in an Era of Political Inequality*, 130 *YALE L.J.* 546, 546 (2021) (suggesting legal reforms to facilitate organizing by the poor and working class).

246. *Cf.* LISTOKIN, *LEGAL REMEDIES TO RECESSIONS*, *supra* note 1, at 165 (noting that the National Labor Relations Act of 1935 was a New Deal measure that “aimed to empower unions so that workers’ wages would increase” and “raise inflation expectations, stimulating spending”).

be beyond the scope of this Article, but such reforms are a viable path for changing corporate behavior.

## VI. LIMITATIONS AND OBJECTIONS

While countercyclical corporate governance has potential, it is not a perfect tool. This part considers some limitations and objections to the approach.

### A. *Indeterminacy and Uncertainty*

Commentators frequently object to stakeholder governance by urging that it is indeterminate and fails to provide meaningful guidance to corporate actors on how they should make decisions.<sup>247</sup> But the macroeconomic perspective provides a framework for evaluating which stakeholder constituencies firms should focus on, and how they should do so.

For example, increasing total payouts to workers would generally be helpful, but hiring more workers would be preferable to paying higher wages to existing employees.<sup>248</sup> Attention to customers could also be helpful if it temporarily decreases prices, effectively increasing the money supply and lowering real interest rates by prompting expectations that prices will snap back upward in the future. Concern for the environment could be helpful if it results in investments in better equipment and infrastructure, but unhelpful (at least from a recession management perspective) if it drives down the level of investment or activity.<sup>249</sup>

Still, although a macroeconomic approach does offer a criterion for decision-making, critics might argue that macroeconomic thinking is not sufficiently developed to evaluate these considerations.

There are at least three responses. First, it is not clear which way any uncertainty cuts. There are meaningful debates among macroeconomists on important issues, such as the reason for prolonged recessions after financial crises.<sup>250</sup> But if competing explanations all point to the need for measures to increase demand, the dispute is not relevant.<sup>251</sup> Uncertainty can also affect the

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247. See *supra* note 21 and accompanying text.

248. See *supra* note 68 and accompanying text.

249. See LISTOKIN, LEGAL REMEDIES TO RECESSIONS, *supra* note 1, at 129–38 (discussing government positions on the Keystone pipeline).

250. *Id.* at 158–59 (discussing and contrasting “liquidity trap,” “secular stagnation,” and “debt supercycle” theories).

251. See *id.* Other disputes may be more meaningful to the law and macroeconomics agenda. For example, some macroeconomists have suggested that slow economic growth has been caused by a lack of technological innovation, while others stress a lack of aggregate demand. See Masur & Posner, *Should Regulation Be Countercyclical?*, *supra* note 1, at 892 (discussing dispute between Robert Gordon and Larry Summers). A corporate governance regime that is less eager to please shareholders and more willing to



costs of the approach. The key efficiency concern with the approach is that corporations may overhire or overinvest at a point in the business cycle where costs outweigh benefits. If firms overinvest or overhire when the economy has no spare capacity, they will do little to boost the economy and will instead distort behavior. But there is sometimes slack in the economy that is not readily apparent to economists.<sup>252</sup>

Second, the critique demands too much. *Microeconomic* theory only gives limited guidance to corporate actors about how to proceed. An academic standing at a blackboard can hardly derive the optimal business strategy from microeconomic principles. Instead, shareholder primacy theorists simply supply a criterion that corporate directors and officers are expected to apply. Corporate law reflects this reality. If it were possible to derive the optimal course of action from pure theory, there would be little reason to shield corporate decisions from judicial scrutiny using the business judgment rule. In the same way, macroeconomics suggests a criterion that corporate actors can use in making decisions, and offers relevant insights. To expect it to provide crystalline instructions in all circumstances would be to hold it to a higher standard than other approaches.

Third, the critique demands too much in another way. Government actors have little to guide them except macroeconomic theory when they act to mitigate recessions. This is not to say that governments know in advance how a policy will turn out: the New Deal was characterized by “bold, persistent experimentation.”<sup>253</sup> But it is not clear why federal policymakers studying macroeconomic theory would do a better job of dealing with uncertainty than business leaders.

#### B. *Inefficient Investment*

A final category of concerns relates to the possibility that firms will invest in inefficient projects or underinvest in capital. But these potential problems must be measured against an appropriate baseline. In a macroeconomic crisis, markets already fail to set prices that will drive efficient behavior and maximize social wealth. In such circumstances, changing the way that a firm responds to prices would cause behavior that is more efficient. Capital markets participants could also change their behavior in response to countercyclical corporate governance, but such effects are unlikely.

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divert value to workers would still help alleviate suffering if growth and innovation slow down. And if slow growth is inevitable, the cost of the change could actually go down.

252. See *supra* note 140 and accompanying text.

253. Franklin D. Roosevelt, Address at Oglethorpe University (May 22, 1932).

### 1. Firm Investments

A firm implementing countercyclical corporate governance would not seek to maximize shareholder profits in all circumstances. To the extent that maximizing shareholder profits aligns with maximizing economic efficiency, as it arguably would outside of a macroeconomic crisis, this results in inefficient behavior.

For example, a firm that sees wage payments less as a pure cost would increase not only its level of production, but also its relative use of labor as opposed to other inputs.<sup>254</sup> But this type of distortion could be limited by some of the mechanisms discussed here, which allow for flexible engagement instead of setting strict priorities. A firm that considered all stakeholder interests would value its suppliers and equipment manufacturers, not just its workers. Depending on the approach taken, firms could also use periods of macroeconomic success to rationalize their operations and reverse temporary distortions.

Firms might also pursue less valuable projects and investments. This is partly by design, and is a feature of traditional macroeconomic tools as well: the goal behind using monetary policy to reduce interest rates is to induce private actors to make investments that they would not make in a more robust macroeconomic environment.

But it is a potential reason to prefer government fiscal action to countercyclical corporate governance (or to a purely monetary response). There are many investments that could set up the economy for long-term success but that are outside the reach of private firms, such as investments in infrastructure, education, or fundamental research. Investments in such projects would improve the overall productive capacity of the economy even in good periods. However, such projects may not be the most effective way to deliver a macroeconomic stimulus, given that they are unlikely to be “shovel-ready” and allow spending to be delivered rapidly. By contrast, firms can spend immediately simply by retaining workers whose productivity is less than the prevailing wage.

Any distortion would also be limited by the nature of the firms involved. The size of the stimulus delivered by a particular firm would necessarily be proportionate to the resources available to that firm. As a result, the stimulus would be delivered in a way that is somewhat proportional to business success. Employment and investment would increase at firms positioned to deliver

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254. As shown in equation (8) in Appendix B, the capital intensity of labor ( $\frac{K}{L}$ ) is affected by the firm's focus on shareholder as opposed to worker interests ( $s$ ):

$$\frac{K}{L} = \frac{\alpha s w}{\beta r}.$$

things that the market will want. This in itself may be less than optimal—smart government spending during a crisis could improve upon ordinary market preferences, such as by leading a shift toward clean energy—but it does entail less distortion away from the outcomes a properly functioning market would generate.

The approach could also distort competition. If firms produce at levels that cannot be justified by a pure profit maximization objective, they may distort goods markets in a way that stifles competition: wealthy companies will produce “too much” and depress the price of goods below levels that would permit other firms to turn a profit.<sup>255</sup> The problem relates to a more general concern that nonprofit maximizing behavior by companies would unsettle the usual assumptions that drive antitrust theory and practice.<sup>256</sup> But the effects would be limited if firms only take a countercyclical approach during recessions, when there would be little hope of new entrants emerging in any event.

A more fundamental objection could draw on the debate over whether efficient legal rules should be altered to achieve outside goals such as fairness.<sup>257</sup> But the core purpose of corporate governance arrangements is to generate wealth for society; that goal is not an outside distraction.<sup>258</sup> There is a happy

255. Cf. Shaoul Sussman, *Prime Predator: Amazon and the Rationale of Below Average Variable Cost Pricing Strategies Among Negative Cash-Flow Firms*, 7 J. ANTITRUST ENF'T 203, 203 (2019) (suggesting competition may be stifled by firms that engage in predatory pricing in anticipation of growing large enough to reap scale benefits).

256. Cf. Damian G. Didden & Christina C. Ma, *ESG Factors and Antitrust*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 27, 2020), <https://corpgov.law.harvard.edu/2020/02/27/esg-factors-and-antitrust/> [<https://perma.cc/6VS4-WARQ>] (“Fundamentally, antitrust analysis is underpinned by the economic assumption that corporations are motivated by profit maximization. . . . An era in which corporations measure performance by factors other than profit could change this fundamental assumption with potentially interesting implications.”).

257. See, e.g., David A. Weisbach, *Should Legal Rules Be Used To Redistribute Income?*, 70 U. CHI. L. REV. 439, 447 (2003); Liscow, *supra* note 1, at 1466–67 (urging that if a modified legal rule can achieve a desired effect with less than one-third distortion, it is likely to be more efficient than a tax-and-spend policy directed at the same goal).

258. See, e.g., Ann M. Lipton, *Doyle, Watson, and the Purpose of the Corporation*, BUS. L. PROF. BLOG (Sept. 17, 2020), [https://lawprofessors.typepad.com/business\\_law/2020/09/doyle-watson-and-the-purpose-of-the-corporation.html](https://lawprofessors.typepad.com/business_law/2020/09/doyle-watson-and-the-purpose-of-the-corporation.html) [<https://perma.cc/WBA4-64GN>] (“I don’t think there’s any dispute that corporations exist to serve the community as a whole. We charter corporations, we create rules for their operation, we develop infrastructure to facilitate investing, all because we believe that on balance, corporations are (or can be) a net good. . . . Corporate purpose debates are not about those principles - on which, I suspect, everyone agrees.”); REINIER KRAAKMAN, JOHN ARMOUR, PAUL DAVIES, LUCA ENRIQUES, HENRY HANSMANN, GERARD HERTIG, KLAUS HOPT, HIDEKI KANDA, MARIANA PARGENDLER, WOLF-GEORG RINGE & EDWARD ROCK, *THE ANATOMY OF CORPORATE LAW* 22–23 (3d ed. 2017) (“As a normative matter, the overall objective of corporate law—as of any branch of law—is presumably to serve the interests of society as a whole. More particularly, the appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm’s activities, including the firm’s shareholders, employees, suppliers, and customers, as well as third parties such as local communities and beneficiaries of the natural environment. This is what economists would characterize as the pursuit of overall social welfare.”).

equilibrium in which workplaces hum with activity, and workers are employed and collect wages that they can confidently spend on the products created in those workplaces; and there is a sad equilibrium in which workplaces fall quiet, and workers lose incomes and restrict their spending out of fear. If corporate governance locks in the sad equilibrium, it fails in its core purpose and is not efficient in any real sense. If distributing some control or value to workers or other constituencies would correct the problem, it would be consistent with the ordinary purpose of corporate law.

## 2. Capital Markets

Countercyclical corporate governance could also distort financial markets. But the strength of this concern would depend on the intervention selected. For example, an implementation mediated by index funds<sup>259</sup> should not lead to outcomes that are so adverse to shareholders that they seriously distort financing decisions. An index fund presumably will not pressure companies into behavior that is so extreme that investors pull back dramatically from equity markets.

A countercyclical approach also would not be a radical departure from the expectations set by existing law. Business leaders already enjoy ample discretion to make decisions that benefit stakeholders. Although the decisions are frequently defended as being for the long-term benefit of shareholders, they are functionally insulated from meaningful judicial review under the business judgment rule.<sup>260</sup> No current shareholder could reasonably expect that the *law* would force business leaders to put shareholder interests ahead of all others, so they are unlikely to take radical action in response to a shift in corporate orientation.

Any impact would also be muted by the broader macroeconomic context during a crisis. Even if some shareholders were frightened by a temporary turn toward stakeholders in a crisis, they would have relatively few higher yielding alternatives. And if shareholders are unlikely to pull away, the prospect of a shareholder response is unlikely to distort the behavior or performance of firms.

## CONCLUSION

Modifying corporate governance arrangements is a problematic tool for managing the business cycle. But all macroeconomic tools have problems—some of which could be exacerbated by corporate governance arrangements that were crafted without adequate attention to macroeconomic considerations. Macroeconomic arguments could play an important role in breaking the long stalemate in debates over corporate governance arrangements, and corporate

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259. See *supra* Part IV.

260. See *supra* note 162 and accompanying text.

governance debates are a fertile source of new options for those who have an interest in improving macroeconomic outcomes.

## APPENDIX A: ILLUSTRATIVE STATISTICS ON SELECTED FIRMS

Company Name	Cash & Securities (billions)	Annual Earnings (billions)	Compensation of Median Employee	P/E Ratio <sup>261</sup>
Microsoft <sup>262</sup>	\$137.6	\$44.3	\$172,512	35.42
Apple <sup>263</sup>	\$192.8	\$55.3	\$57,596	37.71
Amazon <sup>264</sup>	\$55.0	\$11.5	\$36,640	97.63
Alphabet <sup>265</sup>	\$117.2	\$34.3	\$258,708	33.88
Facebook <sup>266</sup>	\$60.3	\$18.5	\$247,883	33.08
Berkshire Hathaway <sup>267</sup>	\$133.3	\$81.8	\$65,740	12.92
Johnson & Johnson <sup>268</sup>	\$18.0	\$15.1	\$76,000	18.83

261. P/E Ratios obtained from Nasdaq.com “2020 Actual” of “Price/Earnings Ratio” for MSFT, “2020 Estimates” for AAPL, “2020 Estimates” for AMZN, “2020 Estimates” for GOOGL, “2020 Estimates” for FB, and “2020 Estimates” for JNJ. P/E Ratios obtained from Yahoo Finance of “Forward P/E” for BRK-B.

262. Cash & Securities figure is March 31, 2020, “Total cash, cash equivalents, and short-term investments” value from Microsoft 10-Q. Annual Earnings figure is “Net Income” for year ended June 30, 2020 from Microsoft 10-K. Compensation of Median Employee was reported on page 48 of Microsoft’s 2019 proxy statement.

263. Cash & Securities figure is March 28, 2020, “Cash and cash equivalents” plus “Marketable securities,” both current and noncurrent, from Apple 10-Q. Annual Earnings figure is “Net Income” for year ended September 28, 2019, from Apple 10-K. Compensation of Median Employee was reported on page 52 of Apple’s 2020 proxy statement.

264. Cash & Securities figure is March 31, 2020, “Cash and cash equivalents” plus “Marketable securities” from Amazon 10-Q. Annual Earnings figure is “Net income” for year ended December 31, 2019, from Amazon 10-K. Compensation of Median Employee figure based on “median annual total compensation for all U.S. full-time Amazon employees” reported on page 65 of Amazon’s 2020 proxy statement.

265. Cash & Securities figure is March 31, 2020, “Total cash, cash equivalents, and marketable securities” value from Alphabet 10-Q. Annual Earnings figure is “Net income” for year ended December 31, 2019, from Alphabet 10-K. Compensation of Median Employee was reported on page 49 of Alphabet 2020 proxy statement.

266. Cash & Securities figure is March 31, 2020, “Cash and cash equivalents” plus “Marketable securities” from Facebook 10-Q. Annual Earnings figure is “Net income” for year ended December 31, 2019, from Facebook 10-K. Compensation of Median Employee was reported on page 42 of Facebook’s 2020 proxy statement.

267. Cash & Securities figure is March 31, 2020, “Cash and cash equivalents” plus “Short-term investments in U.S. Treasury Bills” from Berkshire Hathaway 10-Q. Annual Earnings figure is “Net earnings” for year ended December 31, 2019, from Berkshire Hathaway 10-K. Compensation of Median Employee was reported on page 10 of Berkshire Hathaway’s 2020 proxy statement.

268. Cash & Securities figure is March 29, 2020, “Cash and cash equivalents” plus “Marketable securities” from Johnson & Johnson 10-Q. Annual Earnings figure is “Net earnings” for 2019 from Johnson & Johnson 10-K. Compensation of Median Employee was reported on page 96 of Johnson & Johnson 2020 proxy statement.

## APPENDIX B: EFFECT OF STAKEHOLDER FOCUS ON FIRM PRODUCTION DECISIONS

In a typical model of the firm's production decision, the firm is modeled as setting a level of capital  $K$  and labor  $L$  that maximizes shareholder profits  $\pi$ , given a revenue function  $R$ , a cost of renting capital  $r$ , and wages  $w$ .<sup>269</sup> Under this model, the firm seeks to set  $K$  and  $L$  to maximize:

$$\pi(K, L) = R(K, L) - rK - wL$$

Suppose instead that the firm seeks to balance shareholder and worker interests by maximizing a linear function of profits received by shareholders, weighted by a codetermination factor  $c_S$ , and wages received by workers, weighted by a codetermination factor  $c_L$ . Under this model, the firm seeks to set  $K$  and  $L$  to maximize:

$$c_S \pi(K, L) + c_L wL = c_S (R(K, L) - rK - wL) + c_L wL$$

After collecting terms and normalizing, the firm's task can be described as seeking to maximize an objective function  $f(K, L)$ :

$$f(K, L) = R(K, L) - rK - s wL \quad (1)$$

Here,  $s \in (0, 1]$  is a variable representing the firm's degree of focus on shareholders as opposed to workers.<sup>270</sup> The variable  $s$  is a fraction greater than zero and less than or equal to 1 which captures the firm's degree of focus on shareholders as opposed to workers. If  $s = 1$ , the firm is fully focused on shareholders, and the objective function collapses to a computation of shareholder profits. Setting  $s$  to 1 thus models firm behavior in a traditional shareholder-focused regime. As  $s$  declines, the firm is more focused on workers, and the firm sees payments to workers less like a pure cost. This permits modeling of firm behavior if an internal approach is used to change the firm's decision-making.

As the form of the objective function suggests, changes to the wage level  $w$  and changes to the firm's level of regard for shareholders as opposed to workers  $s$  can each be used to induce the firm to take particular production decisions.<sup>271</sup> If a macroeconomic crisis has brought prices and wages out of

269. See, e.g., WALTER NICHOLSON, MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS 346 (8th ed. 2002). For a generalized version accommodating an infinite number of inputs, see ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 137 (1995).

270.  $s = \frac{c_S - c_L}{c_S}$

271. Note that the model may not capture important aspects of codetermination. Although codetermination gives workers a voice on the corporate board, it does not appear to be addressed to

alignment and is causing the firm to make suboptimal production decisions, changing the firm’s orientation can improve the firm’s decisions.

Differentiating with respect to  $K$  and  $L$  to find the maximum gives marginal products of capital and labor of:

$$R_K = r \tag{2}$$

$$R_L = s\omega \tag{3}$$

The intuition is that the firm will continue to rent out capital until the marginal return from capital is equal to the rent. The firm will continue to hire new labor until the marginal return from labor is equal to a fraction of the prevailing wage level, with the fraction given by  $s$ , which captures the firm’s degree of concern for shareholders as opposed to workers.

The ratio of the marginal product of capital to the marginal product of labor at the optimal level of capital and labor is thus dependent on  $s$ :

$$\frac{R_L}{R_K} = \frac{s\omega}{r} \tag{4}$$

Assume a Cobb-Douglas production function and a competitive market for the firm’s goods<sup>272</sup>:

$$R(K, L) = AK^\alpha L^\beta \tag{5}$$

The maximization conditions then become:

$$R_K = \alpha AK^{\alpha-1} L^\beta = r \tag{6}$$

$$R_L = \beta AK^\alpha L^{\beta-1} = s\omega \tag{7}$$

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monetary wages, in theory or in practice. See Simon Jäger, Benjamin Schroeder & Jörg Heining, *Labor in the Boardroom* 33 (Nat’l Bureau of Econ. Rsch., Working Paper No. 26519, 2020) (“[O]wner representatives always retain the majority of board seats in the German codetermination system (and in other countries with codetermined boards. Even theories that do grant minority factions some real authority . . . would do so only in matters unimportant to capital[—]a domain that plausibly excludes wage setting.”). German codetermination coexists with other mechanisms that address wage levels, such as sectoral bargaining by trade unions.

272. This aligns with a Cobb-Douglas production function combined with a competitive environment for the firm’s goods. The assumption of a competitive market for the firm’s product ensures that the firm’s production decision will have no impact on prices. If the firm can influence prices, the analysis becomes more complex. If economic actors expect price levels to increase in the future, they will be more likely to spend and invest now. Expected inflation is thus a useful tool for managing a macroeconomic crisis, and deflationary pressure is a problem. If the firm “overproduces” in a noncompetitive market, it could create deflationary pressure. This would support a “switching” approach, in which firms move back to a pure shareholder focus during periods of good economic performance. See Section IV.B.2. In that scenario, consumers in a recession would reasonably expect production to decrease and prices to increase when the recession was over, leading them to spend now instead of later.



Dividing (7) by (6) and rearranging terms permits computation of the capital intensity of labor:

$$\frac{K}{L} = \frac{\alpha s w}{\beta r} \quad (8)$$

As would be expected, the firm will use more labor relative to capital the more it values the payments to workers. As  $s$  goes down, reflecting more of a worker orientation, the ratio declines.

For a concrete example, set  $\alpha = \beta = 0.25$ , and  $A = 100$ , so that the firm's revenue function is:

$$R(K, L) = 100K^{0.25}L^{0.25} \quad (9)$$

This gives maximization conditions and capital intensity of:

$$R_K = 25K^{-0.75}L^{0.25} = r \quad (10)$$

$$R_L = 25K^{0.25}L^{-0.75} = s w \quad (11)$$

$$\frac{K}{L} = \frac{s w}{r} \quad (12)$$

Solving (12) for  $K$  and plugging into (11) gives:

$$25 \left( \frac{s w}{r} \right)^{0.25} L^{-0.5} = s w \quad (13)$$

Rearranging terms gives  $L$  as a function of  $s$ ,  $w$ , and  $r$ :

$$L = \frac{625}{(s w)^{1.5} r^{0.5}} \quad (14)$$

Plugging into (12) and rearranging terms gives  $K$  as a function of  $s$ ,  $w$ , and  $r$ :

$$K = \frac{625}{(s w)^{0.5} r^{1.5}} \quad (15)$$

This permits calculation of shareholder profits and total wages as a function of  $s$ ,  $w$ ,  $r$ :

$$profits = \frac{2500}{(s w r)^{0.5}} - \frac{625}{s^{0.5} (w r)^{0.5}} - \frac{625}{s^{1.5} (w r)^{0.5}} \quad (16)$$

$$total\ wages = \frac{625}{s^{1.5} (w r)^{0.5}} \quad (17)$$

Using these formulae for various combinations of  $s$ ,  $w$ , and  $r$  gives:

	<u>A</u> $s = 1$ $w = 1$ $r = 1$	<u>B</u> $s = 1$ $w = \frac{1}{3}$ $r = 1$	<u>C</u> $s = \frac{1}{3}$ $w = 1$ $r = 1$
<i>K</i>	625.0	1082.5	1082.5
<i>L</i>	625.0	3247.6	3247.6
<i>R</i>	2500.0	4330.1	4330.1
<i>Shareholder Profits</i>	1250.0	2165.1	0.0
<i>Total Wages</i>	625.0	1082.5	3247.6

These figures illustrate the points in the main text. First, the external mechanism of wage reductions (moving from A to B) just induces the same corporate decision as the internal mechanism of changing the firm's orientation (moving from A to C).

Second, reorienting the firm can be a particularly efficient way to inject funds into the economy during a crisis. Shifting the firm's governance orientation to move the firm from scenario A to scenario C causes a 1250.0 decline in shareholder profits, but places an additional 2622.6 (= 3247.6 – 625.0) into worker hands.

Third, although reorienting the firm and lowering wage levels can both be used to induce the same production decision, the mechanisms are not identical in their effects. Scenario B and Scenario C entail the same production decision, but differ in their allocation of value as between shareholders' profits and workers' wages. As discussed in the text, preserving worker wages would likely do more to stimulate the economy than preserving shareholder profits.

