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Political Origins of Corporate Governance [*].

Abstract

Most capitalist societies emerged from feudal relations and, in most countries, rules of dynastic succession moved from agrarian sectors to the ownership and control of large firms. However industrial workers (and, sometimes, managers) proved to be better than serfs at organizing a resistance against dynastic privileges. In most European countries, unions and social democracy were an important factor in the democratization of European societies, which emerged as a reaction to the exclusive powers of the new industrial aristocracy. The Unites States were a remarkable exception to this path. In the U. S., the establishment of a strong democracy preceded the growth of big business and the power of the capitalist dynasties was politically and culturally constrained. Whereas a variety of European "aristocratic political origins" tended to move the economy towards a "concentrated equilibrium" with large block holders and strong unions, the American "democratic political origins" set the conditions for "the Berle and Means public company": managerial power emerged in a "dispersed equilibrium" with fragmented ownership and weak unions.

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1. Introduction.

The recent good performance of the American economy has had an effect similar to that of the earlier successes of the Japanese and the German economies in the eighties and nineties. There has been a rush to imitate her institutions and, in a particular, the public company. In this case, the pressure has been particularly strong. Some authors have claimed that we have reached "the end of history for corporate law" or, in other words, an inevitable universal convergence towards the Anglo-Saxon model (Hansmann, Kraakman (2004). Other authors (Aoki 2000, Bebchuk and Roe 2004, Pagano 2006, Schimdt and Spindler 2004) have claimed that, for a rich variety of reasons, the development of corporate ownership and governance systems is likely to be path-dependent and, to explain the persistent plurality of corporate systems,[1] have focused on the complementarities existing among different domains of the economic system.

In this paper we build on this last stream of the literature. We try to integrate the arguments put forward in Roe (1994) and (2003), developing some of the points contained in Belloc and Pagano (2005). We seek to support the hypothesis that different political and social origins have shaped the corporate governance systems of different countries.

As argued by Roe (2003), different political conditions such as social democracy set limits on the corporate governance systems. However, different corporate governance systems can generate different political reactions. For instance, social democracy can be seen as a set of political conditions impeding the separation between ownership and control and the development of the public company. At the same time, social democracy can be seen also a reaction to a concentrated family-based corporate governance system. In Belloc and Pagano (2005) we show that causation runs both ways: from politics from corporate governance and vice versa. In general, politics and corporate governance are likely to co-evolve.

[1] An ample overview of the corporate governance systems of the different countries see the essays contained in Morck 2005. Corporate systems with concentrated ownership are considered in Morck (2006).

Is there, however, a moment in history that has been decisive in shaping this process of cumulative causation?

In this paper we try to provide more evidence in favour of the idea that the process was, in the end, shaped by its "political origins"[2]. By "political origins" of a country we mean the political conditions that existed when "big business" emerged in that country. We will distinguish between "democratic" and "aristocratic" political origins and we will advance the hypothesis that these origins pushed the system in two different directions.

If a robust democratic system has already emerged by the time of the development of the large enterprises, the concentration of economic power is likely to be limited by political action. Also the power of the unions faces similar limitations. Moreover, in this situation, neither the employers nor the workers have a strong incentive to balance the concentration of power of the other side. In this sense a "dispersed equilibrium" is likely to have "democratic origins".

By contrast, "concentrated equilibria" are likely to have "aristocratic origins"[3].

If, by the time of the development of the large capitalist enterprises, a robust democratic system has not yet emerged, the unchecked concentration of power of the capitalist dynasties may go well beyond their private wealth. In this case, union's and social-democratic power are likely to arise as a counterbalance and be an important ingredient in a late democratization of society. The end-result of this process may be that both workers and employers find the motivation of the concentration of their own interests in the high degree of concentration of the other side and this equilibrium may be rather stable.

The paper is structured as follows.

The following section considers the different collective action problems faced by owners, managers and workers when they try to obtain safeguards for their specific investments. There can be complementarities or trade-offs among these safeguards, often leading to arms' races and to multiple equilibria that are characterised by different incentives to invest for each social group. The third section focuses on two idealized cases of "democratic" and "aristocratic" origins

[2] This expression is meant of be equivalent to "political roots" appearing in the subtitle of the classic 1994 book by Mark Roe, which is an important ingredient of our story.
[3] In section 4 we will see that has been a considerable variety of aristocratic political and social origins.

and on the mechanisms by which each type of "political origin" may select a particular type of equilibrium. In section 4 we consider in detail how that mechanism may work in the considerable European variety of "aristocratic origins" and in the unique case of American "democratic origins". In section (5) we criticize the hypothesis that there is presently a single "anglo-saxon" model of corporate governance common to U. K. and to U. S. In the final section we extend our argument to other contemporary capitalist economies.

2. Safeguards for specificity and collective action.

In a recent paper, Oliver Williamson (2006) observes that labour markets and financial markets share an important characteristic, which distinguishes them from intermediate product markets: in both cases, the individuals who make specific investments face, at the same time, a collective action problem.

Information asymmetries characterize both cases. However, according to Williamson, the asymmetric information problem is more serious in the case of the relationship between shareholders and directors and involves that the latter can easily collude with top-management. The integrity of delegation of decision-making, which is the most remarkable advantage of the public company, would be lost if shareholders have to re-balance information asymmetries in a way similar to that characterising the relationship between the workers and their representatives. Thus, according to Williamson shareholder democracy can easily degenerate into oligarchy.

In our view, the main difference between the collective action problems, faced by workers and shareholders, is related to the inseparability between human capital and its owner. The problem of "absentee ownership" is obviously less severe in the case of human capital. Even very absent-minded individuals cannot be really absent when their human capital is being used by others. Unsurprisingly, information asymmetry between workers and union leaders is less severe than that which may emerge between shareholders and directors.

Besides the impossibility of absentee ownership, the human capital of an individual is also characterized by the fact that others cannot own it. For this reason, the ownership of human capital is also characterized by two other restrictions. On the one hand, all the human capital of an individual must be concentrated in the hands of that individual. On the other hand the ownership of different individuals must be dispersed among them. The ownership of shares is, for this reason, potentially more concentrated and more dispersed than that of human capital. One does not need to own all the shares of a firm in the same way in which we have to own all the shares of own human capital. At the same time, one can be owner of shares of different firms while, in modern societies, it is impossible to own percentages of other human beings.

If we focus our attention only on the fact that we must concentrate the ownership of all our human capital, whereas we may disperse the ownership of shares, we reach Williamson's conclusion: the collective action of the shareholders is harder to overcome than the collective action problem of the shareholders.

However, also the opposite may be true. The ownership of capital cannot only be dispersed but also can be more concentrated than that of labour. From this point of view, shareholders can overcome their collective action problem more easily than the workers. There are many ways in which owners can concentrate their ability to control capital well beyond what would be allowed by their personal wealth. One of them has recently attracted much attention in the literature: the possibility of building pyramids by which, in a long cascade, some firms control other firms[4].

Within certain limits, there may be no trade-offs between employers' and workers' safeguards. Both of them can contribute to high levels of investments and to efficiency. However, after a certain limit, a trade-off among these safeguards will exist. Moreover, in many cases, the safeguards that are necessary to protect the investments of one group of individuals will depend on the level of safeguards that are achieved by the others. Weak safeguards for both capital and labour and robust safeguards for both factors may define the key ingredients of

[4] See Morck, Wolfezon and Yeung (2005)

two self-sustaining equilibria, which are analogous to the high and low armament equilibria arising in a standard arms' race game[5].

Also non-owning managers need safeguards for their specific investments in human capital. Managers are often required to make "second-order" specific investments to govern the relations arising from the specific investments of other agents[6]. In the case of these specific investments, the general purpose rules and enforcement, which govern "public markets", may be inadequate. Managers are required to set up and to rule private orderings, which are "specifically" designed to deal with these specific investments.

Managers could try to achieve an "efficiency frontier" where, given a certain level of their own specific investments, the investments of the other individuals (workers and shareholders) are stimulated as much as possible by using appropriate safeguards. However, also in these cases, at least along this efficiency frontier, some trade-offs are likely to arise. If workers have strong safeguards in their jobs, managers may lack the authority to carry out their plans and to safeguard their own specific investments in human capital. Vice versa, an excessive authority of managers may easily jeopardize workers' specific investments. Similarly, arrangements, such that shareholders can fire or sue the managers very easily, may give strong safeguards for financial investments but they may discourage the (second-order) specific investments of the managers. Vice versa, if managers' have a high degree of job security, their specific investments in their company may be encouraged but their security may scare shareholders who may find it too difficult to get rid of an opportunistic manager.

Since the ownership of capital can be more concentrated or more dispersed that that of labour-power, we cannot a priori say which factor may more easily overcome its collective action problems and, eventually, gain more safeguards at the expenses of other factors. There is, however, an interesting asymmetry.

The control of capital can be concentrated by the means of ordinary market transactions well beyond that of labour-power and, thanks to devices such as pyramids, also well beyond the wealth of the richest families. Thus, in the absence of political constraints, when economies to scale favour large scale enterprises, the ownership of capital will be easily concentrated in few hands by the means of

[5] See Belloc and Pagano 2005.
[6] This point is developed in Pagano (2000).

ordinary market contracts. By contrast, labour interests cannot be concentrated by using simple economic transactions. A collective action problem must necessarily be solved. For this reason, "political origins" do matter.

A strong democracy may find the unilateral concentration of economic wealth in few dynasties unhealthy and set limits to the process of concentration of economic power in few hands. This may also limit the incentives of labour to organize to balance the concentrated interests of the owning dynasties.

By contrast, if a strong democracy is absent and there is a widespread acceptance of dynastic rules few families can easily rule large enterprises. In this case, after some time, a social democratic reaction is likely to take place with the result that both the interests of the owners and of the workers achieve a very concentrated representation.

Only if a democracy was well established at the time when large enterprises became so important for economic development, the concentration of interests of capital owners could be tamed. The "Berle and Means Corporation" may require fairly uncommon "political origins".

3. Aristocratic and Democratic Origins of Corporate Governance.

In this section, we will consider two idealized extreme cases of "democratic" and "aristocratic" political origins (whereas in the following section we will try to refer to some real life historical processes).

The case of "aristocratic origins" can be schematized in this way. Society had been used for a long time to a concentration of political and economic power in the hands of few families (the royal family and the aristocracy). The rule of dynastic succession had been accepted as the legitimate way of transmitting political and economic power and upward mobility was strongly discouraged: individuals were supposed to fill the same social roles of their parents and upward mobile individuals were often despised[7]. When large firms became the best suited for economic development, the new industrial aristocracy, which controlled them even beyond the means of their considerable wealth, was not challenged by an established democracy. The new industrial giants were embedded in a society where, in spite of numerous rebellions, dynastic power was still widespread and accepted as legitimate. Capitalist dynasties could increase their power thanks to their own wealth and to the accumulation of capital that large-scale firms allowed. They could also extend their control beyond their wealth thanks to pyramids and other financial arrangements. Members of the large owning families served as managers of the firms. Small shareholders had no chance to fire these "dynastic" managers and professional managers were confronted with a socially exclusive wealthy group, which enjoyed a " de facto" tenure thanks to its family links. Faced with the concentrated interests of capitalist dynasties, workers reacted by concentrating their interests into unions and social-democratic parties.

The story of "democratic origins" can be told in an analogous way. In this case society's wealth was relatively dispersed and political power was handled (often excluding the large majority of society) only by the means of some democratic mechanism. The rule of dynastic succession had been removed from the political arena (even if it was widespread in the economic arena which was dominated by small firms). Individuals were not supposed to fill the same social roles of their parents and upward mobile individuals commanded high social esteem. When, in many sectors, large firms emerged as the most efficient form of organization, the extension of dynastic rule to these organizations met the opposition of large part of society. Smaller owners were scared to be out competed by large organizations, minority shareholders were ready to defend their rights, professional managers felt cheated by the role that family connections had in their careers and, most important, the politicians, who had gained their offices by the means of democratic competition, felt threaten by the power of the new industrial aristocracies. Industrial dynasties were not allowed to increase their power beyond the limits of their wealth and faced a sharp choice between the advantages of asset diversification and those of concentrated control. In absence

[7]According to Ernest Gellner (1983) these social and cultural barriers characterized all ancient agrarian societies. Industrialization was associated to cultural homogenization and nationalism that allowed individuals to be more horizontally and vertically mobile. On Gellner's contribution to political economy see Pagano (2003).

of dynastic concentrated control, also workers' incentive to concentrate their power in unions was rather weak. In this situation, professional managers became the rulers of "Bearle and Means" corporation.

There are several reasons for which different political origins could entrench each system of corporate governance. We will focus on two reasons that stem from the analysis carried out in the preceding section.

The first reason is considered by Mark Roe's theory (2003) that relates concentrated control with social democracy.

Even if the growth of strong unions and social democracy may have been, initially, stimulated by the pre-existence of concentrated private dynastic power, their formation makes the persistence of this power more likely. Once strong unions exist, professional managers are more likely to be captured by the interests of the workers. Shareholders need to concentrate their interests to balance the safeguards and rights, which the workers may obtain. A "concentrated equilibrium" may arise where both the workers and the majority block holder have strong safeguards, while managers (and often minority shareholders) and have weak safeguards.

By contrast, a "dispersed equilibrium" may arise if the concentrated control of the large firms is not allowed to arise. In this case a fair internal labour market may weaken the incentive to unionize. In this equilibrium, even if the weakness of the unions may be also an effect of the dispersion of the ownership, owners can delegate control to managers because unions are weak. This "disarmament equilibrium" generates the implicit conditions, necessary for the high degree of managerial independence, which characterize the "Berle and Means" corporation.

The second reason for which the dispersed and concentrated equilibria may be rather stable has to do with the "specificity argument" that we have considered in the preceding section.

Different political origins favour safeguards and rights that, in turn, stimulate particular specific investment, biasing technology in a certain direction[8]. Rights and safeguards stimulate specific investments and, in turn, sunk specific investments favour the organization of vested interests, reinforcing these

[8] On this two ways relation between technological characteristics and property rights and organizational form see Pagano (1991). Earle, Pagano and Lesi (2006) estimate that the direction of causation from ownership, organization, and organizational form to technology turns out to be stronger than the reverse

safeguards and rights. Thus, self-reinforcing multiple organizational equilibria may arise from the interaction between the nature of the factors that are used and the allocation of property rights and may define different paths of institutional and technological change

For instance, a "concentrated equilibrium" creates strong safeguards for the members of the owning family to make specific investments in the firm and, because of the "counterbalancing" safeguards, also workers may have some similar incentives. By contrast, in this equilibrium managers have weak incentives to make these specific investments.

At the same time, the existence of these specific investments makes both family owners and workers more willing to increase their security in the organization. The opposite argument holds for professional managers who may not claim appropriate safeguards for their specific skills because, in absence of these safeguards, they have invested negligible amounts in firm-specific human capital.

The distribution of rights tends to generate complementary technologies, which entrench the status quo.

Because of these two mechanisms (and because of some of other mechanisms such as those considered in Morck, Wolfezon, Yeung 2005), aristocratic and democratic origins can entrench corporate governance systems in a "concentrated" or "dispersed" equilibrium.

However, in our argument, "concentration" and "dispersion" are referred only to the organization of the interests of owners and workers. In terms of the size of the firms, the implications may be rather different. A "concentrated equilibrium" may well be characterized by firms that tend to be smaller than those characterizing a "dispersed equilibrium". Even if family dynasties may have numerous means to expand their control well beyond the limits set by their wealth, there are limits to this type of expansion. In frequent cases, the only possible way to keep the firm under control may be to limit its size and, often, its efficiency.

4. The Classic Model and the American Exception.

Most countries have gone through a laborious transition from the feudal order, typical of agrarian societies, to some form of capitalist organization. At the time of the second industrial revolution, when large firms started to become dominant in some sectors, the residual political prestige of the aristocracy and the aristocratic aspirations of the bourgeoisie were still evident. In this broad picture, the United States has been an important exception.

With reference to the scheme, considered in the preceding chapter, there is a striking asymmetry. While the case of aristocratic origins covers many historical cases, the case of democratic origins includes only one case. Indeed, there are so many historical cases of aristocratic origins that contrasting a stylized classic general model of aristocratic origins to the American experience has obvious limitations.

With the exception of the U. S., in all the other major capitalist economies, large organizations had aristocratic origins in the specific sense outlined in the preceding section: at the time of the second industrial revolution, when large firms became important, aristocratic dynastic succession had still a strong legitimacy in the society, cultural class barriers were strong and accepted and the aristocracy had still a disproportionate influence in political affairs. A process of democratization was usually taking places in these countries but, unlike the case of the U. S., this process was heavily influenced by the various roles that the landed aristocracy had had in the process of capitalist development.

In his classic book, Barrington Moore (1973) pointed out that the behaviour of the landed aristocracy was rather different in the industrializing European countries.

In England a strong landed aristocracy was the leading factor in the initial phase of the process of modernization. It was open to some integration of other wealthy individuals and adopted a positive attitude towards the process of industrialization. It was the most important force in the “puritanic revolution”, leading eventually to the establishment of a constitutional monarchy. However, because of the flexibility of the British aristocracy, all sorts of dynastic privileges had a strong legitimacy at the time of the second industrial revolution. Members of the families, belonging to the proper aristocratic circles, were controlling firms well beyond their financial possibilities and a proper non-class biased managerial career was rather difficult. On the other side of the social divide, class barriers gave strong incentives for the development of strong unions and of socialist politics. For a long time, a "concentrated equilibrium" characterised British firms. We will consider, in the following section, in which sense this equilibrium has disintegrated and whether it is legitimate to talk of an "anglo-american" model of corporate governance. For the moment, we can observe that, in spite (or, perhaps, because) of the metamorphosis of the British aristocracy, it is appropriate to consider Britain as an evident case of "aristocratic origins" of corporate governance.

Whereas the aristocracy became an important active force in the British economic and political transformation, the French aristocracy continued to rely on traditional feudal privileges. In England, a mutating aristocracy carried out the process of modernization against the king. In France, with the support of an emerging bourgeois class and of a growing centralized bureaucracy, the king imposed modernization on a static aristocracy. French absolutism rather than British aristocratic parliamentary democracy was the prevailing trend before the French revolution, which, in some respects, completed the work of the Bourbons. While the French revolution gave a democratic turn to the modernization of France, the post-Napoleonic reaction implied that, at the time of the second industrial revolution, class barriers and aristocratic political privileges were still important in France[9]. In order to get top managerial jobs, proper manners and good family connections mattered more than abilities and hard work. Workers reacted to class barriers by forming unions and engaging in various rebellious activities.

France and England had taken different paths to democratization and modernization. However, at the time of the second industrial revolution, both countries were still characterized by a pervasive political power of the aristocracy and by a widespread acceptance of dynastic privilege. In both countries, most individuals, who were excluded from this system of privileges, started organizing in unions and socialist parties while many professional managers had little autonomy and power in their firms.

The weight of the aristocracy in other European countries, which industrialized later, was even heavier. In England the landed aristocracy adopted

[9] In the Restoration period a Bourbon King reigned again (1815-1830) and, even after, for a long time, the aristocracy commanded a considerable social prestige.

many entrepreneurial habits. The opposite relation held in Germany. "In nineteenth-century Prussia the members of the bourgeoisie who became connected with the aristocracy generally absorbed the latter's habits and outlook." (Moore 1973 p. 37). Because of this behaviour, by the second half of the nineteenth century, the process of democratization was non only incomplete but also very uncertain. Not surprisingly, the resulting German "concentrated equilibrium" took a much more authoritarian, and sometimes tragic, path.

In spite of the numerous differences, all these countries shared the disability of the political system to tame the power of new industrial dynasties associated to the growth of big business. The challenge to this power could only come, later, when the individuals who were excluded from these privileges could organize their interests. The only exception[10] to this general pattern was the U. S.:

Since the early beginnings, the British North American colonies had been a refuge from aristocratic and ecclesiastical authority. Moreover by the time of the second industrial revolution, the United States had undergone through two major democratic revolutions: the war of independence and the civil war. With the major exceptions of the Afro-Americans and of pre-Colombian populations, the U. S. approximated the democratic origins considered in the preceding section.

From the beginning, the Constitution was shaped by the idea that only an appropriate system of checks and balances can support individual freedom or that, in Madison's words, "Ambition must be made to counteract ambition"[11]. "A properly designed state, the Fathers believed, would check interest with interest, class with class, faction with faction and one branch of government with another in harmonious system of mutual frustration" (Hofstadter 1967, p. 8).

The "Fathers" were aware that an adequate mechanism of reciprocal guarantees should not rely only on the Constitution. In their view, it was also important that economic power was not concentrated in few hands. Jefferson's democracy relied on a society where wealth was diffused among educated farmers[12] and where economic power could not be monopolized. In this vein, as early as 1832, President Andrew Jackson confronted the power of the Bank of the

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[10] In the (rather extreme) words of Tocqueville (1994, p. 222; the last revised edition of his book was in 1848): "No great democratic republic. It would be an insult to republics to use that name for the oligarchy which ruled France in 1793. Only the United States presents this new phenomenon".
[11] Federalist number 51 quoted by Hofstadter (1967).
[12] Hofstadter (1967, Ch.II)

United States. He vetoed the recharter of the Bank and won a populist presidential reelection campaign in defense of the "humble people of society" against "exclusive privileges" (Hofstadter p. 60). The free soil ideology, allowed by the moving western frontier, offered the material arguments to sustain freedom and widespread small ownership and, with Abraham Lincoln, generated the unifying feeling of the Union against the pro-slavery States of the South. Lincoln insisted that the new Territories should offer "homes for free white people" and that this could not be if slavery was planted within them. Slave States were places for poor white people "to remove from, not to remove to".[13]

The victory of the Union implied that the slave-owning landed aristocracy lost its power in the United States. After the civil war, no variety of landed aristocracy had a relevant role in the political and economic organization of American society. By the time of the second industrial revolution, the distrust for concentrated economic power was already well rooted in the U.S. society.

At the beginning of the nineteenth century, President Theodore Roosevelt could apply the antitrust law against Morgan and Rockfeller. The Sherman act, which had already been promulgated in 1890, could be used against both business combinations and workers' unions (for the first years the latter was the prevailing application). In this way, Roosevelt could continue a battle, which could, somehow, remind the confrontation of President Jackson with the Bank of the United States. President Theodore Roosevelt was frightened by big business more for political than for economic reasons. "He was not a small entrepreneur, worrying about being squeezed out, non an ordinary consumer concerned about rising prices, but a big politician facing a strong rival in the business of achieving power". (Hofstadter p. 60 p. 222).

Big business was accepted as a necessary development of the second industrial revolution. The problem, faced by Roosevelt, was how to make big business and the growing power of the unions compatible with democracy. Theodore Roosevelt believed that the survival of independent political power implied that both capital and labour should accept the regulation of the State. "Because he feared the great corporations as well as the organized workers and

[13] Lincolm's Peoria Speech quoted by Hofstadter (1967 p.112). The point, that slavery should not be extended to new territories, could unite all the anti-slavery individuals independently of the fact that they were abolitionists or "Negrophobes".

farmers, Roosevelt came to think of himself as representing the golden mean" (Hofstadter p. 60 p. 217). Both concentrated powers had to be tamed and, somehow dispersed. However, in the case of business, the dispersion of the power of the owners was not intended to limit the size of the firm.

Even if with different tones, the American political tradition, started by Jefferson and Jackson, continued also with President Wilson and, later, with President Franklin Delano Roosevelt. In his 1912 electoral campaign Wilson clarified even better in which sense the power of big business should be tamed, maintaining that the real danger where not "the existence of the great individual combinations" but the "combination of the combinations". "What we have to do - he said- is to disentangle this colossal community of interests..........to pull apart, and gently but firmly and persistently dissect." The asymmetric nature of this dissection became very clear in the 1914 Clayton Act. Section 6 of the Clayton Act blocked the possibility to apply antitrust law against labour:

" The labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help..........."

By contrast, with respect to the Sherman act, the Clayton act reinforced the bite of antitrust action against big business. According to section 7 of the Act, the ownership by one corporation of stock of another was forbidden whenever "the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially used to lessen competition, or to tend to create a monopoly".

Many years later (in 1957), considering the U. S. vs. Dupont antitrust case (related to the acquisition of the 23 per cent of GM in 1917-19, few years after the Clayton act) the Supreme Court of the United States furnished a definitive interpretation of the limitations concerning the acquisition of stocks. The Supreme Court clarified that the anticompetitive circumstances, due to the acquisition of stock could emerge much later the moment the acquisition. The acquisition of stock could be challenged at any time (as in this case many years after the acquisition) and, moreover, the threat of limiting competition could arise independently of the good or bad intentions of the agents and could be applied to both vertical and horizontal acquisition (the U. S. vs. Dupont case concerned a vertical acquisition). Even if section 7, in the words of the dissenting Mr. Justice Burton[14] had been a "sleeping giant", the threat of waking up Wilson's creature contributed to his explicit goal to "gently but firmly and persistently dissect" the "combinations of combinations".

Indeed, the act pushed the wealthy owners of stock towards two extreme choices. One option was to disperse their stocks and have little control in each one of them. The other option was to concentrate their stock in one business and enjoy the benefits of control and forgive the advantages of diversification. The first option was often considered to be safer for the offspring of the entrepreneur while the second was more appropriate for initial innovative entrepreneurship and temporary take-overs of inefficient managerial firm to be resold on the market. "Democratic origins" inhibited the possibility of choosing an "intermediate solution" that was so typical in the "aristocratic origin countries": the possibility of diversifying in related business without losing control. In those countries, with the help of political power and financial institutions and with the use of pyramids, a new industrial aristocracy could keep its power and could profit by forms of "tunnelling"[15] .

The anti-dynastic nature of the American model of corporate governance was even more clearly spelled out by President Frank Delano Roosevelt who denounced the "economic royalists" who gathered other people' money. He could, again, vindicate a coherent line in the "American political tradition". "The country is going through a repetition of Jackson's fight with the Bank of the United States - only a far bigger and broader basis" (Quoted in Roe 1994 p. 40).

Roosevelt denounced the "economic royalists" who "gathered other people's money" to "impose a new industrial dictatorship" and who, *by devices such as*

[14] Mr. Justice Burton, one of the Justices dissenting with the majority decision of the cour observed that "The Court's decision is far reaching. Over 40 years after the enactment of the Clayton Act, it now becomes apparent for the first time that Section 7 has been a sleeping giant all along. Every corporation which has acquired a stock interest in another corporation after the enactment of the Clayton Act in 1914, and which has had business dealings with that corporation is exposed, retroactively, to the bite of the newly discovered teeth of Section 7". A critical evaluation of the statement that Section 7 has been a "sleeping giant" is contained in (1958).

[15] The term "tunnelling" is introduced by Johnson, La Porta, Lopez-de-Silanes and Shleifer (2000) and refers to the act of transferring value from one pyramid firm to another of the same group. Tunnelling lifts assets and income from lower to higher firms (which are controlled by the family) and moves losses and liabilities in the opposite direction. Morck, Wolfezon and Yeung (2005) observe that it is analogous to what multinationals do with transfer prices to avoid taxes.

holding companies, have taken unwarranted economic power (Roe 1994 p. 40). This "Economic Royalism" of the very few was leading to a form of "private socialism". Roosevelt believed that only the fragmentation of finance could lead to the kind "dispersed equilibrium" considered in the preceding section and avoid the danger of "government socialism". He claimed:

"I am against against private socialism of concentrated economic power as thoroughly as I am against government socialism. The one is equally as dangerous as the other; *and destruction of private socialism is utterly essential to avoid government socialism." (Quoted in Roe p.39).*

The first Roosevelt administration associated pyramidal business groups with corporate governance problems, market power, and an objectionable concentration of economic power. The double (and multiple) taxation of dividends paid by one firm to another (intercorporate dividends) was explicitly included in the 1930s as a part of a package of tax and other policies aimed at eliminating United States pyramidal business groups (Morck 2004). The programme, which was, already, spelled out in Wilson's Clayton act became effective. The destruction of the private socialism, made by the pyramidal business groups became an irreversible characteristic of American corporate governance and, in this way the "Berle and Means public companies", characterized by the separation of ownership and control, became an exceptional characteristic of its economy.

One could trace the social and political roots of America society in "Jefferson's educated farmers" with their respect for religious tolerance and their exit from any form royal or dynastic rule and claim that these roots had been strong enough to create conditions of democratic origins for big business. The impact of "Lord and peasant in the making in the modern world"[16] had taken many ways outside America. Only in the case of the U. S., the growth of their big business was not conditioned by one form or another of aristocratic origins and the timely fragmentation of finance and ownership could eventually lead before the Second World War to a "dispersed equilibrium".

As we anticipated in the preceding section, this equilibrium was dispersed in terms of ownership but was characterised by the largest firms of the World.

[16] This is the subtitle of Barrington Moore (1973).

Dispersion of ownership and centralized managerial control implied that firms could grow beyond the limitations due to the financial (and often "political") means of the controlling family. It was more than true that the policies, rooted in the American social and political origins, were not against big business but against the concentrated power of their owners. In many cases, checking this power was necessary to make big business really big.

5. An Anglo-Saxon model?

In much economic and political literature, there is a great emphasis on an Anglo-Saxon or Anglo-American model (sometimes also related to the common law legal origins that these countries have shared[17]). The analysis of the preceding section, stressing the importance of "aristocratic and democratic political origins" has rather put some emphasis on "American exceptionalism" with respect to the numerous countries that had some form of "aristocratic origins".

Given this variety of aristocratic origins, there is no doubt that the type of political origins that has characterised Britain has contributed to push her closer to the American model than the other European countries. It is enough to mention only few of the many similarities between the two countries. They shared a common history, have a common language and the British puritanic revolution had an important impact on the nature of the "American Soul". Moreover, both countries were characterized by the remarkable stability of their democratic political institutions.

However, in this section, we will try to argue that, in spite of these similarities, the different political origins had a strong impact and that Britain's partial and late shift to a model of "dispersed equilibrium" is consistent with our story.

According to Chandler, in the last half of the nineteenth century "came into being a new economic institution the managerial business enterprise, and a new subspecies of economic man, the salaried manager. With their coming, the world

[17] See, for instance, La Porta, Lòpez-de-Silanes, Shleifer and Vishny (1998).

received a new type of capitalism - one in which the decisions about current operations, employment, output, and the allocation of resources for future operations were made by salaried managers who were not owners of the enterprise" (Chandler 1990 p. 2). While, according to Chandler, the coming of managerial capitalism made the U. S. one of the two most important actors of the Second Industrial Revolution (the other one being Germany), Britain - the main actor of the First Industrial revolution - became a late industrializer in many of the new industries. In Britain, the commitment to the model of personal capitalism, that had been so successful at the time of the first industrial revolution continued. While long-term profits based on long-term growth were a goal on which the managers and the major investors of the American (and German) managerial firms could agree, the families owning the British firms often preferred to pay out earning in dividends rather than using them to make the extensive investments required to move into foreign markets or to develop new products in related industries. "Because their firms grew slowly and because they hired only a small numbers of managers, the founders and their families remained influential in the affairs of the enterprise and so affected dividend policy." (Chandler, 1990 p. 595). By contrast, the long-term growth of American Firms helped the managers to gain strong job rights in their firms. "Such a goal not only helped to assure tenure for the senior executives, but it also enhanced the opportunity for advancement for the more junior managers". (Chandler, 1990 p. 595). British firm did not provide similar opportunities to non-owning managers. The key managerial positions were usually reserved for the owning family. Social and family ties were more important than competence to advance in managerial ladder. There were few opportunities for junior managers while no job security similar to those of American firms could be given to senior executives. According to Chandler, the organisational capabilities that were so important for the firms of the second industrial revolution stagnated and Britain lost her economic leadership[18].

Julian Franks, Colin Mayer and Stefano Rossi (2005, p. 605) qualify this account given by Chandler. They argue that, at beginning of last century, the dominance of British families was more evident in terms of control than in terms of ownership.

[18] In this respect, Florence (1953) gives a vivid picture of the persistence of the British aristocratic roots in corporate governance. In 1930rties there was still a massive presence of peers in the Directorates of the British companies.

They argue that at that time: "The observations on the dominance of families in the running of firms are a reflection of their board representation rather than their ownership. Board participation by families became disproportionate to their ownership stakes. There were good reasons for being concerned about this development. The divergence between ownership and control undermined the efficient running of corporations as documented by Chandler."

However, the capital of the families got so diluted that some of the usual "continental" defences against take-overs emerged. The British corporate governance system "for a brief period in 1950s and 1960s began to resemble that of Continental Europe" (Franks, Mayer and Rossi 2005 p. 164). Eventually the overwhelming political preponderance of the City blocked that solution. "It was therefore the financial sector that prevented the United Kingdom from drifting into a Continental-style corporate structure with dual-class shares, pyramids and limitations on take-overs...... The financial sector also prevented the corporate sector from erecting the takeover defences, in particular poison pills that became common place in the United States. (Franks, Mayer and Rossi 2005 p. 164)". Eventually, Britain ended up with a corporate system with a limited family ownership but with a financial sector much more concentrated and powerful that that existing in the United States. Financial fragmentation remained a distinctive U. S. characteristic.

The divide between American and British Corporate Governance becomes even wider when we consider the role of trade unions and the system of social protection. Because of the aristocratic origins of its industrial society, British workers developed immediately (Thompson 1968) a strong sense of class identity and very powerful trade-unions. After the last World War, while the degree of concentration of ownership was quickly decreasing, British Trade Unions held their centralized power as well as their political strength. They had even the capability of provoking the fall of a government (as it happened in 1974 when the miners' strike caused the end of Edward Heath's government). Thus, in the sixties and the seventies ownership had become dispersed while unions' power was highly concentrated. This "disequilibrium" was also associated with conflictual industrial relations and low productivity and, somehow, confirms Roe's (2003) hypothesis that dispersed ownership may incompatible with strong unions. This disequilibrium lasted until the 1980ties when Margaret Thatcher weakened the powers of the Unions - a policy that, after 1997, has not been substantially reversed by Tony Blair. In this way, Britain has settled to a new equilibrium where a system of partial dispersion of ownership meets a partial weakening of the powers of the unions. This "new equilibrium" makes, at the moment, Britain the economy closest to the U. S. in terms of employment protection and ownership dispersion. However the closeness is too recent and the divide between the two countries is still too wide to talk about a unique "Anglo-Saxon" model of corporate governance. At the moment, the aristocratic and democratic origins of the two models continue to be relevant.

6. The relationship between politics and corporate governance.

The U. S. and Britain define only one segment of the line describing the inverse relation between dispersion of ownership and employment protection in all the OECD countries. Roe (2003) observes that countries with strong “social democracies” and characterized by strong employees’ rights tend to exhibit a strong and concentrated corporate ownership structure. This empirical finding turns out robust to a variety of proxies for the degrees of “social democracy” and of ownership dispersion (Roe, 2003, and Belloc and Pagano 2005). Figure 1 plots an index of employment protection against an index of ownership dispersion[19] for a sample of 20 OECD countries.

As it is apparent from the fitted regression line, there is a significant negative cross-country correlation between the degree of protection of workers’ rights and the degree of corporate ownership dispersion.

[19] Given a sample of ten medium-sized firms with stock market capitalization in 1995, *Ownership* is an index that equals one if there is no controlling shareholder and zero otherwise. *EPL* stands for employment protection legislation and is averaged over the period 1993-2002. More detailed information on the variables can be found in Belloc and Pagano (2005).

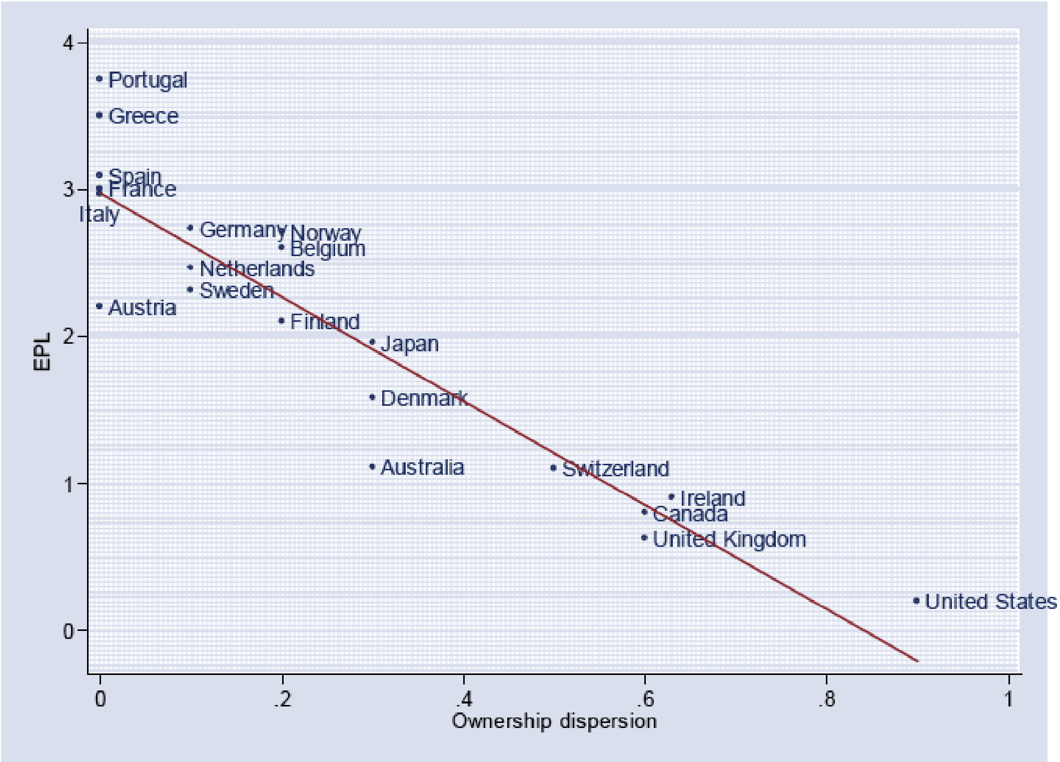

Fig. 1: *Employment protection and ownership dispersion*

Continental Europe and Japan cluster in the North-West quadrant (strong employment protection legislation and concentrated ownership), the extreme positions being occupied by France, Greece, Italy, Portugal, and Spain[20]. At the other extreme (with the lowest degree of protection of employees' rights and the highest degree of ownership dispersion) is placed the US.

A possible interpretation of this phenomenon is offered by Roe (2003), which suggests a causality relation that moves from the current political conditions of capitalist countries to corporate governance forms. In Roe's approach, the separation of ownership and control, which characterises many American large firms, is not due to "better" corporate laws that protect minority shareholders and, even less to the different legal origins which characterize the different countries. In his view, it is rather due to the absence of a "social democratic" political pressure that, in absence of strong and present owners, would induce managers to collude with employees.

In Belloc and Pagano (2005), we stress the importance of a second direction of causation that moves from corporate governance forms to politics. Family dynastic-based

[20] Also Nordic countries, like Sweden, which have in the past years had a fairly dynamic economy, occupy the North-Western quadrant. The high ownership concentration of Sweden and its relation with social democracy are discussed in Hogfeldt (2004).

systems of corporate governance may induce social democratic reactions while the latter are weaker in systems where management jobs are open to a large section of the population. This second direction of causation implies the possibility of processes of cumulative causation whereby initial political conditions, influencing the system of corporate governance, re-shape the political and economic environment in a highly path-dependent way. "Political origins" (or "political roots" to use the subtitle of the classic 1994 Roe book) may then play an important role in setting these different patterns of cumulative causation.

In this paper we have speculated that "democratic" political origins have pushed the U. S. to tame the concentration of ownership and to limit (more indirectly than directly) a social-democratic reaction and the creation of strong safeguards in favour labour. In the case of "aristocratic origins", common to the other European countries, this concentration of ownership took place and generated a wide variety of "social democratic reactions".

However, we have seen that, in the case of England, the process can be partially reversed. A country with a governance system characterized by "aristocratic origins" may move towards an equilibrium that is the closest to that prevailing in the United States. Thus, while this paper has emphasized the exceptionalism[21] of the U. S. democratic origins, it is certainly possible (even if far from easy) for countries to betray the fate "dictated" by their "political origins". In the introduction, we mentioned how strong is the attraction of the U. S. model for other countries and, in the first section of this paper, we argued that different corporate models were associated with different safeguards, which could stimulate different types of investment and production activities. Referring to fig. 1, can one argue that this variety of models of capitalism is going to be squeezed, like England, towards the U. S. extreme?

Perhaps, a global economy may force countries to converge to a unique model independently of their "aristocratic" or "democratic" origins or, in other words, globalization may imply the "end of history of corporate governance" because models different form the (Anglo?-)American model will be inevitably out competed.

However, one can also argue that a global economy entails that each country may specialize in those sectors where the safeguards of its corporate governance system are more appropriate. It is likely that both forces (and many others) are at work in the global economy. At this stage, it is difficult to say whether globalization implies disregarding or rediscovering political origins.

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[21] Becht and De Long (2005) introduce their interesting paper by considering the two (related) sources of American exceptionalism:
"A century ago European academics like Werner Sombart worried why the United States was exceptional in that it did not have socialism. Today we academics worry about a different form of American exceptionalism: why is there so little block holding in the United States?"

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