Rents and Their Corporate Consequences
Author(s): Mark J. Roe
Source: *Stanford Law Review*, Jul., 2001, Vol. 53, No. 6 (Jul., 2001), pp. 1463-1494
Published by: Stanford Law Review

Stable URL: https://www.jstor.org/stable/1229547

REFERENCES
Linked references are available on JSTOR for this article:
https://www.jstor.org/stable/1229547?seq=1&cid=pdf-reference#references_tab_contents
You may need to log in to JSTOR to access the linked references.

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at https://about.jstor.org/terms

is collaborating with JSTOR to digitize, preserve and extend access to *Stanford Law Review*

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

Rents and their Corporate Consequences

Mark J. Roe*

Product markets are weaker in some nations than they are in others. Weaker product markets, and the concomitant monopoly rents, can affect corporate governance. They can do so directly by loosening a constraint on managers, thereby increasing managerial agency costs to shareholders—costs that shareholders would then seek to reduce otherwise. The monopoly profits can also affect corporate governance structures indirectly by setting up a fertile field for conflict inside the firm as the corporate players—shareholders, managers, and employees—seek to grab those monopoly profits for themselves. One would expect corporate governance structures, laws, and practices in nations with monopoly-induced high agency costs to differ from those prevailing in nations with more competition, fewer monopolies, and lower agency costs. And we might speculate that these rents when large and widespread could affect democratic politics and law-making: directly by making monopolists political targets (and political forces); and indirectly as the players inside the firm seek to capture those monopoly profits through political action, with political parties and ideologies (and, in time, laws and standards) that parallel the players' places inside the firm. Data from the industrial organization, finance economics, and political science literature is consistent.

INTRODUCTION 1464
I. WHAT ARE RENTS AND FROM WHERE DO THEY COME? 1465
  A. *Economics 101 and the Consumer Surplus* 1465
    1. *Competition to maximize consumer surplus.* 1465
    2. *The monopolist's rectangle* 1466
  B. *Who Owns the Monopolist's "Rectangle?"* 1466
    1. *Merely distributional?* 1466
    2. *Firms spend to get the monopolist's rectangle* 1467
    3. *But who is the firm?* 1467
II. CONSEQUENCES INSIDE THE FIRM IF RENTS ARE HIGH: I 1468
  A. *Slack for Managers* 1468
    1. *Agency costs: standard analysis* 1468
    2. *Why capital markets alone cannot tighten the slack* 1469

* Professor, Harvard Law School. Thanks for comments go to Stephen Bainbridge, Lucian Bebchuk, Margaret Blair, Victor Brudney, William Carney, John Coates, Einer Elhauge, Victor Goldberg, Jeffrey Gordon, Louis Kaplow, Reinier Kraakman, Michael Levine, Mark Ramseyer, Eric Talley, and participants in workshops at the law schools at Georgetown, Harvard, Virginia, and San Diego.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

3. *Agency costs from lowering value and agency costs from diverting value* 1470
4. *The double meaning of "rents"* 1470
5. *Agency costs: effects from employees.* 1471
6. *Higher agency costs and corporate governance* 1472
B. *Refinements* 1473
1. *Product markets do not perfectly control agency costs* 1473
2. *Fewer hostile takeovers in oligopoly settings* 1473
3. *Concentrated ownership as fitting with commitment strategies* 1475
III. CONSEQUENCES FOR POLITICS 1476
A. *Primary Consequences* 1476
1. *Of higher agency costs* 1476
2. *Of higher rents for the players to split* 1477
B. *Converse: Consequences When Product Competition Strong, Monopoly Weak* 1477
C. *Consequences for Labor Laws and Ownership Concentration* 1478
1. *Strong labor laws as fitting with strong ownership concentration* 1478
2. *Justice* 1480
D. *Causation's Direction* 1480
E. *Political Consequences when Globalization and International Competition Increase* 1481
IV. CONSEQUENCES INSIDE THE FIRM: II 1483
A. *For Ownership Concentration* 1483
B. *For Private Benefits of Control Theories* 1487
1. *Leaving control up for grabs* 1487
2. *Relative unimportance of private benefits when the monopolist's "rectangle" is large* 1488
3. *Twilight of the national monopolies* 1489
C. *For Coasian Bargains Between Employees and Owners* 1490
1. *The Coasian give-back* 1490
2. *Changing the market clearing wage* 1490
3. *Two labor pools* 1491
D. *For Going Public and Growing When Monopoly Trade-Offs Are Large: A Proviso* 1491
CONCLUSION 1493
APPENDIX 1494

INTRODUCTION

Industrial organization and corporate governance affect one another, sometimes fitting together as complements, sometimes clashing. Monopolistic (or oligopolistic) rents from weak competition in a democratic polity fit with concentrated corporate ownership and its supporting legal apparatus. And the converse is true as well: bruising product market competition and diffuse

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

ownership also fit together both with each other and with *their* supporting legal apparatus.

Some economies are less competitive than others. Weaker competition produces higher rents: monopoly profits above those needed to stay in business. These rents can affect firms, as the rents give managers slack and attract grabs by players inside the firm. And one might speculate that these rents, where large enough and widespread, affect democratic politics, as they must be divided up, and politics can be the arena where they are divided. In a nation where those rents are absent, one important task for politics—the division of widespread monopoly profits—is taken off the political agenda.

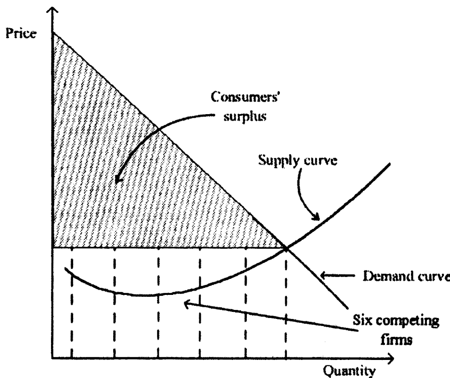
When rents are widespread, the players inside the firm have more room than they would otherwise have to contest the size of the corporate pie that each takes home. Moreover, shareholders would be acutely concerned about whether they would get most of the potential monopoly profit, or whether unconstrained managers, happy with extra slack, might lose it for them.

I begin with a model of industrial organization being established first, and I speculate on how differing degrees of competition affect corporate governance and ownership. I then speculate on how these could affect labor-oriented politics. (Later in the paper I relax the direction of causation.) Higher rents induce higher managerial agency costs for shareholders; higher agency costs induce shareholders to strengthen the inside-the-firm structures that keep higher agency costs within bounds. And higher rents plausibly provide the fuel for political parties, ideologies, and contests on how to divide up those rents in a national economy.

I. What Are Rents and From Where Do They Come?

A. *Economics 101 and the Consumer Surplus.*

1. *Competition to maximize consumer surplus.*



Graph 1: Competition and Consumers' Surplus

The source of the rent is readily identified. It comes out of the large consumer surplus that a competitive market would otherwise generate, and that the monopolist can, but a competitor cannot, appropriate for itself. Some consumers would pay a high price for the good, if they had to. But producers compete, and a

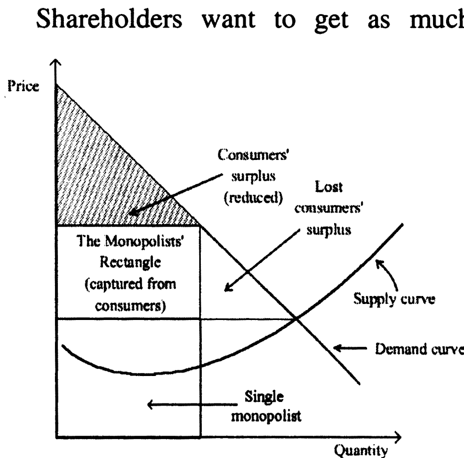
This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

competing producer would lower its price down to the point where it covers its costs and its normal basic profit. This result is laid out schematically in Graph 1, a stripped down version of the basic supply and demand curves.

2. *The monopolist's rectangle.*

When a single firm dominates a product market, and when competitive entry is impossible (or costly), the monopoly firm has reason to produce less and raise its price. It produces less so that it can raise its price by selling to the high-valuing consumers who pay more. Hence, the monopolist produces less, raises its price, and seeks the price-quantity combination that maximizes its monopoly profits. The monopolist shrinks the total consumers' surplus: some consumers never get the product, because it's priced too highly for them, and some consumers pay more than they would in competitive markets. Value moves from the wallets of the remaining consumers who still buy (at the higher price) to the monopolist's bank account. This transfer, sometimes called the monopolist's "rectangle," obviously due to its shape, is illustrated in Graph 2.

Shareholders want to get as much of those profits for themselves, preferring structures that induce managers to get those profits and put them in shareholders' pockets. And, when many firms cut back production and increase price, we could guess that they can affect basic issues in politics, as we speculate in Part IV. More firms have potentially high agency costs; those "rectangles," if many, yield a valuable pot for political players to contest; and that pot provides a basis for conflict and settlement that, although possible to accommodate inside the firm, is often divvied up nationally by political institutions. Let's keep our eye on the "rectangle," and on the players who want to grab a piece of it.



Graph 2: Monopoly: The Lost Consumers' Surplus and the Monopolists' "Rectangle"

B. *Who Owns the Monopolist's "Rectangle?"*

1. *Merely distributional?*

Standard economic analyses downplay the importance of the monopolist's rectangle: the rectangle "merely" represents a shift in income from the buying consumers (who might be rich, for all we know from examining the graph) to

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

firms (who might be struggling producers banding together in a cooperative, for all we know from examining the graph). The monopolist's core sin is to cut production and raise price, thereby denying the product to consumers who could pay what it would cost the monopolist to make it, but whom the monopolist refuses to serve so that it can raise its price to high-valuing consumers. The diminished consumers' surplus triangle is the loss, and the monopolist's sin in the standard analysis is in destroying that triangle, sometimes referred to as the "deadweight loss," not in grabbing the rectangle.[1]

2. *Firms spend to get the monopolist's rectangle.*

The classical idea that the monopoly rectangle is "merely" distributional was badly dented in recent decades in critiques from Richard Posner and Gordon Tullock. Firms anticipate these excess profits if they can acquire (or keep) a monopoly, and hence they spend to get (or to keep) that monopoly. In the limit case, they dissipate the distributional gain, spending it ex ante to acquire the monopoly or ex post to keep it.[2] One way of spending to get or keep those monopoly profits is spending on political organization.

3. *But who is the firm?*

These analyses are correct, and as far as they go I do not challenge them. But they view "firms" as black boxes, competing to get these rents. The "firm" is richer. Its owners are richer. The monopolist is richer. That monopolist is usually the "owner." Occasionally there are notations that the monopolist-owner can spend some of the monopoly profits on its inputs. So, in some oligopolies, labor, especially unionized labor, can get a piece of the monopoly profits for itself, in the form of wages higher than those of workers with similar jobs elsewhere.[3] For example, wages for members of the UAW (the United

1. For traditional statements of this view, see N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 318 (1998); PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 166, 173 (16th ed. 1998); FREDERIC M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 20-24 (3d ed. 1990).

2. *See* RICHARD A. POSNER, ANTITRUST LAW 11 (1976):

> But the traditional analysis was shortsighted. It ignored the fact that an opportunity to obtain a lucrative transfer payment in the form of monopoly profits will attract real resources into efforts by sellers to monopolize, and by consumers to prevent being charged monopoly prices. The costs of the resources so used are costs of monopoly just as much as the costs resulting from the [lost consumer surplus].

See also Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807, 809 (1975); Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224, 228, 232 (1967); *cf.* Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291, 302 (1974) (arguing that a society seeing high rewards as coming from rent-seeking and luck will differ from one that sees high rewards as coming from higher marginal product).

3. *See* RICHARD B. FREEMAN & JAMES L. MEDOFF, WHAT DO UNIONS DO? 52 (1984);

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

Auto Workers union) have typically been higher than those for similar assembly line workers elsewhere in the economy. Auto workers got a piece of the automobile industry's monopoly rent, especially before international competition among auto makers squeezed out much of that rent.

And it is this question—who gets the rent? (and by what means, political or corporate, do they get it?)—that I want to examine. Firms can be decomposed. They are made up of shareholder-owners, managers, employees, and customers. *These* players will *also* compete for the rents. It's not just firms competing against one another to get that monopolist's rectangle, but also players *inside* the firm—shareholders, managers, employees—competing to get a piece of that rectangle. The way they compete for the rents is reflected in corporate governance institutions inside the firm and, one suspects, inside the polity.

II. CONSEQUENCES INSIDE THE FIRM IF RENTS ARE HIGH: I

Consider first the corporate governance consequences of monopoly on a single firm.

A. *Slack for Managers*

We begin with managers, but will end with a more important inquiry, the implications of the relationships among *employees*, the monopolistic firm, and national politics.

1. *Agency costs: standard analysis.*

One would expect more monopoly to induce higher potential managerial agency costs in monopoly firms. The reason is obvious: the monopoly yields a bigger pot of value (bigger, that is, than the value an equivalent competitive firm would produce) into which managers can stick their fingers. The bigger the "rectangle," the bigger that pot.

Tightly competitive product markets can constrain managers: deliver a defective product and consumers buy a competitor's instead next time. That constraint may not always be tight, if all of the competitive firms are internally lax. But, obviously, product market constraints are lower, or nonexistent, for

W. KIP VISCUSI, JOHN M. VERNON & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 84 (1995); Thomas Karier, *Unions and Monopoly Profits*, 67 REV. ECON. & STAT. 34, 40-41 (1985); John E. Kwoka, *Monopoly, Plant, and Union Effects on Worker Wages*, 36 IND. & LAB. REL. REV. 251, 253 (1983) (showing a correlation between industrial concentration and higher wages). *But see* Leonard Weiss, *Concentration and Labor Earnings*, 56 AM. ECON. REV. 96, 114-15 (1966) (rejecting the relationship between concentration and higher wages).

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

managers of the monopoly firm.[4] And there's evidence that market concentration reduces productivity and that competition enhances it.[5]

2. *Why capital markets alone cannot tighten the slack.*

Capital markets constrain managers only weakly when product market competition is weak. Consider how capital market competition constrains managers: managers, the explanation runs, must go to capital markets for funds, and when they do, stock buyers penalize poorly-performing managers by demanding a higher rate of return and a lower stock price, creditors penalize those managers by demanding a higher interest rate, and in the limit case capital providers refuse to give those managers any new capital and the firm withers. More effective firms with more effective managers eventually replace it. (True, capital markets do not even tightly constrain every competitive firm: a firm not needing new capital is not immediately constrained. It can run down capital in place and use up retained earnings. In time it should wither, and the need to avoid that withering can motivate some players. But no rule of law says the players cannot accept that withering, especially if someone else pays for it.)

The capital market constrains the *monopolist's* managers more weakly than it constrains a competitive firm's managers. The monopolist's managers can more readily generate sufficient profits internally to pay for needed capital improvements. And as long as they leave *some* of the monopolist's "rectangle" on the table for the original capital providers, the monopolist's return on invested capital would *still be higher* than a competitive firm's would be.[6] Capital markets constrain the monopolist's managers strongly *not* when they dissipate monopoly profits, but when they dissipate so much that they need new capital *and* their return dips below the *competitive* return for capital.[7]

4. *Cf.* Oliver Hart, *The Market Mechanism as an Incentive Scheme*, 14 BELL J. ECON. 366 (1983) (arguing that increased product-market competition imposes more constraints on managerial behavior).

5. *See* Stephen J. Nickell, *Competition and Corporate Performance*, 104 J. POL. ECON. 724, 741 (1996), and sources cited therein; RAVI JAGANNATHAN & SHAKER B. SRINIVASAN, DOES PRODUCT MARKET COMPETITION REDUCE AGENCY COSTS? (Nat'l Bureau of Econ. Research, Working Paper No. 7480, 2000) (arguing that managers retain more cash in firms that have weak product market competition).

6. A refinement that does not change the story: Capital markets will bid up the stock price until the return equals the risk-adjusted competitive return. Posit that the competitive, risk-adjusted rate of return is 10% annually. In competitive industries, $100 of investment will return $10 each year. A monopolist builds, with a $50 investment, a monopoly that yields $10 annually. When the monopolist sells the firm to buyers who expect the monopoly to be retained, the buyers will pay $100. The *original* monopolist captures the $50 "rectangle." If agency costs were expected to diminish the firm's profitability to $7.50 (i.e., leaving $2.50 of monopoly profits for capital-providers), then outsiders would pay $75 for the firm, capitalizing the expected slack at $25.

7. The capital markets mechanism would, in textbook fashion, be this: When the firm

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

So, if the monopoly rate of return is, say, 25%, when worldwide capital markets demand a 10% rate of return (for this type of company, this class of risk, etc.), then capital markets constraints would starve the capital-needy firm if managers throw away enough that the expected return declines below 10%. But capital markets will not directly constrain the managers as they take, share, or squander the first 15% of the monopoly's return. That 15% cushion is the monopolist's rectangle, the potential excess profits that create the potential for managerial slack.[8]

3. *Agency costs from lowering value and agency costs from diverting value.*

Higher agency costs are important even if monopoly rents do not go, dollar-for-dollar, into managers' pockets. Managers, if insufficiently aggressive, may lose a large slice of the monopoly profits at only modest gain for themselves. Agency *costs* to shareholders could be high even if the managers' *gains* are comparatively modest.

Managers in the standard agency cost analysis tend to expand firms without regard to profitability. Their gain may be less than the shareholders' loss. The shareholders want a mechanism to make managers more profit-oriented. When product markets are weak, two of their mechanisms—product market competition and capital market competition—are compromised.

4. *The double meaning of "rents."*

Industrial organization rents—the monopoly—could be confused with rents from corporate control—the value that controllers can skim off from the firm with impunity. The two are important and related—modest *managerial* rents in making mistakes is a kind of controller's "skim" and they can yield large *monopoly* rent losses to the owners—but the two concepts, despite the fact that they use the same word, are neither identical nor even opposite sides

goes fully public, investors capitalize the firm's expected cash flows. These cash flows will be the competitive return, plus the additional monopoly profits before agency costs, minus the monopoly profits lost to agency costs. The original owner reaps the expected gains from the monopoly and suffers any expected managerial agency cost losses. Future shareholders capture any unexpected reductions in agency costs. The non-classical point here is that if the potential agency costs are high for a monopoly firm, then the original owner will often avoid that loss by not allowing the firm to go public.

8. More complicated scenarios amend, but do not change the bottom line that monopoly constrains less than competition. When the firm first sells its shares, the buyers capitalize the expected level of monopoly profits. If initially the buyers mistakenly expect that they will get most of those profits, they will lose money on their investment. But it's not necessarily so that managers will thereafter be constrained by capital markets. Even if they are capital-needy, if the expected return to new capital fits the market's rate of return, the initial investors would have lost money, but managers would still get new funds.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

of the same coin. A small managerial "rent" in, say, falling asleep at the wheel, could induce a huge monopoly "rent" loss to shareholders as the rectangle is lost for a small snooze.

5. *Agency costs: effects from employees.*

There's more. Employees can claim a share of the monopolist's "rectangle." Wages should be higher, hours shorter, the workplace potentially less friendly toward shareholder profitability. Their claims may be straightforward grabs, or may be justified by claims of fairness and just entitlements. (On whose backs and with whose sweat was that monopoly built anyway?)

Employees seeking a piece of the rectangle raise managerial agency costs. They seek their share of that rectangle in higher wages, in better working conditions and, sometimes, in corporate governance authority. German codetermination (via which labor gets half of large firms' board), for example, fits better with a weakly competitive market (where shareholders can split rents with incumbent employees) than with a fiercely competitive one (where rents for incumbent employees are smaller). Managers in the first instance have the task of refusing or modulating employees' demands, and for most managers the easiest action is to give employees a piece of the "rectangle," as long as it's a piece that would otherwise go to shareholders (and not to managers themselves). Conflict is costly, psychologically and otherwise, and settlement and persuasion can be hard. Managers are pressed by the people they work with for better conditions, more pay, and continued employment. Why should they favor distant abstract financial interests over the people they see every day? If others (i.e., stockholders) are paying, managers may well use what would otherwise be part of the stockholders' share to end the conflict, thereby buying labor peace.[9]

Labor's goals are frequently not at managers' expense but are goals that many managers would want, such as over-investing in a comfortable workplace, shorter hours, etc. Hence, managers and employees should often be on the same side in finding ways to take a part of that monopolist's rectangle for themselves. (Some monopolies are more susceptible to raising agency costs than others. Smokestack industries with large long-lived physical capital and heavy labor inputs have a higher potential for high agency costs than, say, high technology monopolies with short-lived capital, a short expected life, and different labor inputs.)

9. *See* Michael A. Salinger, *Tobin's* q, *Unionization, and the Concentration-Profits Relationship*, 15 RAND J. ECON. 159, 166 (1984) (arraying data showing that unions capture whatever long-run monopoly power exists in the U.S. economy); *cf.* Richard S. Ruback & Martin B. Zimmerman, *Unionization and Profitability: Evidence from the Capital Market*, 92 J. POL. ECON. 1134 (1984) (showing by way of event study that unexpected collective bargaining agreements lower equity value in the United States).

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

6. *Higher agency costs and corporate governance.*

We come now to the first corporate governance implications of monopoly: more monopoly begets higher managerial agency costs for shareholders because there is more to "grab" (by employees and, to some extent, by managers). Managerial slack is higher and less easily controlled (yielding a pot that is more easily "lost" by managers even when they cannot, or do not, "grab" it for themselves), and the market's other means to reduce agency costs, such as capital and product market competition, are weaker.[10]

One powerful means to reduce managerial agency costs is for the stockowners to act cohesively in a block. The blockholder can monitor managers directly, has greater incentives to do so (because it owns so much stock), has greater means to do so (because managers will pay more attention to a large stockholder than to a small one), and can get better information than can scattered shareholders (thereby making the monitoring potentially more effective). All else equal, blockholding should be higher where monopoly (or oligopoly) is higher; some American evidence corroborates this view.[11]

That is, the original owner has incentives to optimize corporate governance for shareholders, because, when considering whether and how to go public, he or she internalizes what managers will lose in agency costs thereafter. Rational

10. American firms in weak competitive markets display higher agency costs than those in more competitive markets. *See* GARY S. BECKER, THE ECONOMICS OF DISCRIMINATION 31-42 (1957) (stating that managers in monopoly industries indulge their preference to discriminate more readily than managers in competitive industries); Franklin R. Edwards, *Managerial Objectives in Regulated Industries: Expense-Preference Behavior in Banking*, 85 J. POL. ECON. 147 (1977); Timothy H. Hannan & Ferdinand Mavinga, *Expense Preference and Managerial Control: The Case of the Banking Firm*, 11 BELL J. ECON. 671 (1980) (arguing that office expenses and employment levels rise in banks in concentrated markets); Armen Alchian & Reuben A. Kessel, *Competition, Monopoly, and the Pursuit of Money*, *in* ASPECTS OF LABOR ECONOMICS 157, 159, 161 (Nat'l Bureau of Econ. Res. Rep. 1962) (same); sources cited *supra* note 5.

11. Management-controlled high-market-power firms in the United States historically showed the ordinary profitability of *non*-monopoly firms. But firms controlled by strong owners showed higher-than-normal profits when the firms had market power, but ordinary profits if the firms lacked market power. *See* John Palmer, *The Profit-Performance Effects of the Separation of Ownership from Control in Large U.S. Industrial Corporations*, 4 BELL J. ECON. 293, 298 (1973). Product markets and strong owners each constrain managers, albeit imperfectly. When monopoly power is high and ownership concentration low, these imperfect constraints are even more imperfect. *See id.* at 299. And "manager-controlled banks operating in noncompetitive markets ... spend more on items likely to be preferred by managers than do owner-controlled banks in the same situation." Hannan & Mavinga, *supra* note 10, at 671.

Monopoly could induce concentrated ownership via another channel. The manager or stockholder who "bestows" value on others in the firm gains a sense of personal graciousness, or enjoys working in a pleasant environment. The owner may keep control, *not to reduce* monetary costs, but so that the owner *can directly capture these social benefits*. *Cf.* Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. POL. ECON. 1155 (1985).

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

stock markets do not pay the owner for monopoly profits that will be lost to shareholders. If the original owner cannot build a structure that maintains these profits, he or she will lose them when taking the firm public. This potential loss gives the original owner an incentive to maintain block ownership, as that is oftentimes the best, or only, way to retain those monopoly profits.[12] Either the original owner retains the block herself, or she sells it intact to a new blockholder. Ownership does not separate from control.

B. *Refinements*

1. *Product markets do not perfectly control agency costs.*

The point is not that competition *perfectly* constrains managers to operate the firm solely for shareholders or that perfect control falls apart as soon as product market competition declines. Even in competitive markets, when the firm has made large fixed investments—in its physical plant, in trademarks, and in goodwill—managers can run this sunk capital down without product markets inflicting on them an immediate large penalty.

But product market competition affects managers, and less of it loosens the constraints on them. Most managers dislike seeing competitors taking away market share. A weak competitor's profits will decline; and then other corporate governance institutions such as the board of directors or incentive compensation or shareholder action will kick in.

Product market competition does not perfectly constrain managers to work for shareholders; but it constrains them somewhat, and its absence constrains them less, creating more slack for managers.

2. *Fewer hostile takeovers in oligopoly settings.*

Monopoly and oligopoly weaken managerial constraints and raise agency costs in another way beyond creating a bigger pot for managers and employees to seek. They do so indirectly, by making hostile takeovers harder to engineer.

If a firm is poorly managed for shareholders, the theory runs, its stock price will sag, and a takeover entrepreneur or another firm will see the opportunity to buy up the stock cheaply, fix up the firm's management, and thereby profit. But this scenario is harder to accomplish in an industry, or a country, where product market competition is weak. True, the slack is attractive to the offeror, but the offeror faces offsetting impediments when the target is in an oligopoly, impediments that it doesn't face when the target is in a fiercely competitive industry.

12. I note a monopoly-related exception below in Part IV.C.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

Oligopolists keep their price above marginal cost with understandings among the small group of players. With few players in the industry, the senior managers can know one another and trust that each will respect the oligopolistic pricing regime. They can thereby avoid a price war that would lower profits. For such oligopolistic pricing arrangements to survive, the firm's senior managers have to believe that the other one or two firms and their managers are going along, and are not secretly offering large rebates from the publicized list prices.

This aspect of the oligopolistic industry is unattractive to takeover entrepreneurs. A takeover entrepreneur thinking about targeting an oligopolistic firm (to tighten up the managerial slack, say) would have to think twice. It might succeed in tautening that slack, but it would risk upsetting the informal pricing understandings among the oligopolists. Takeover entrepreneurs would risk upsetting the "trust" developed among the handful of usually homogeneous senior managers in the industry. Destroying this trust would destroy shareholder value, weakening the value to shareholders of a takeover: if the price to shareholders of tautening slack is ripping the delicate fabric of inter-firm pricing understandings, the takeover might well be unprofitable for shareholders.[13] And the personality type that makes for a good takeover entrepreneur would be poorly suited for the "trust" and soft competition that oligopolists need to maximize their profits.

Monopolists can be poor targets for agency-cost-reducing takeovers for similar reasons. As long as the manager has built up understandings with the firm's inputs—that is, as long the manager has good relationships with employees—then shareholders face a downside from a hostile takeover. The offeror may upset the balance of understandings with employees; the takeover might tighten that managerial slack, but lose as much, or more, in destroyed relationships with employees.

While usually the players know enough not to take such risks, there are instances of takeovers aimed at tightening a firm in a weakly competitive industry that resulted not in tightening but in explosive labor relationships and destroyed shareholder value. Frank Lorenzo's takeover of Eastern Airlines, and the airline's demise due to incendiary labor relations, fits this bill.[14]

But when oligopolistic industries become more competitive, takeover opportunities increase. The old labor-management understandings of how to divide up the pie (really of how to divide up that "rectangle") cannot survive in

---

13. *Cf.* Mark J. Roe, *From Antitrust to Corporate Governance? The Corporation and the Law: 1959-1994*, *in* THE AMERICAN CORPORATION TODAY 102, 111-13 (Carl Kaysen ed., 1996).

14. To be sure here, Eastern had fiery labor relations even before Lorenzo's takeover. This risk to shareholders of destroying manager-employee trust is the reverse of the better-known "breach of trust" takeover phenomenon: some takeovers were arguably engineered to breach the trust between incumbent managers and employees, because market conditions had changed and shareholders no longer needed employee loyalty as much as they once did.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

strong competition. Shareholders have less to lose in such firms by upsetting the oligopoly's understandings, because those inter-firm understandings are fading as competition heats up. And any intra-firm labor-management understandings are becoming a cost, not a benefit, to shareholders, and shareholders may want to accelerate the intra-firm understandings' demise. The institutions and modus vivendi that were made possible by the slack from that monopolist's "rectangle" often give shareholders a fertile field for agency cost reduction. The history in the United States of takeovers increasing as industries moved from weakly competitive to more competitive (as in the airlines) is consistent with this view.

3. *Concentrated ownership as fitting with commitment strategies.*

Reduced competition can affect ownership through another channel. When product market competition is weak, vertical production relations are harder to manage, because a smaller number of suppliers must deal with a smaller number of outlets. When specific investments must be made without alternative use, the potential for holdup when one side is vulnerable rises. The vulnerable player cannot just switch to another supplier (or customer) because the smaller, less competitive numbers mean that another supplier might not be available. (But in a market with denser competition another supplier would be available.)

Diffuse ownership works less well in such settings. Informal understandings are needed when vertical relationships are important, but if owners are constantly shifting the relationships could be unstable and unreliable. But a large owner, especially a large individual or family owner with a reputation at stake and an illiquid ownership interest, can make these commitments more credibly than can temporary managers or an anonymous securities market. (Or, if a large owner is not possible, there would be more pressure for the firm to integrate all of the important vertical steps of production under one ownership roof.) Similarly, some markets require that commitments from owners to managers or employees inside the firm be high.

We can now see another explanation for ownership concentration. Fluid ownership markets cannot provide these commitments (either the productive ones just mentioned, or the pricing ones from the prior subsections, which are analogous). Moreover, when the owners cannot accumulate or keep enough capital to dominate the firm through pro rata ownership, they can be expected to use other devices, such as non-voting stock for the outsiders, or pyramids (whereby the controller owns a majority of one firm, which owns a majority of another and so on, until the owner ends up with, say, 51% control of the operating firm by owning only 10% of the overall capital). When commitments are valuable, these ownership structures will appear more often than otherwise.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

III. CONSEQUENCES FOR POLITICS

If a nation has many firms with monopoly rents, then we should expect two major corporate governance consequences: first, potential agency costs for shareholders will be higher than elsewhere and owners will try to tighten up to avoid those potentially heavier costs. Second, business will produce more rents for the players to split, and more value that managers could lose for shareholders. These corporate governance consequences, we could speculate, could have political correlates.

A. *Primary Consequences*

1. *Of higher agency costs.*

If agency costs are potentially higher inside the firm, shareholders should exhibit a high demand for public provision of institutions that would reduce agency costs. These might include statements of corporate fiduciary duties, related causes of action, incentive compensation (with facilitating tax laws), pro-shareholder norms, and so on.

But while the demand for these institutions *from shareholders* will be high, the resistance or at least non-support from the *other* players, who usually have more votes, will be substantial.[15] And public-regarding political players might see that enhancing shareholder institutions could demean national wealth. Certainly, it would be easy for them to see that enhancing shareholder wealth would shift wealth from consumers to the firm. And political players would often see that they could get more votes by pleasing the monopoly firm's employees than by pleasing its shareholders. Political parties might be organized around this concept. Supporting ideologies of fairness and justice could readily develop.[16]

Hence, if public provision of shareholder enhancing institutions is weak, the firm will seek more of these privately. These would include more concentrated stock ownership, more continued family control of firms through

15. This tension can be seen vis-a-vis incentive compensation in France: business interests call for favorable taxation of stock options to align managers with shareholders; socialist politicians block such changes. *See* sources cited in notes 36-40 in Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control,* 52 STAN. L. REV. 539 (2000). Where stock options are hard to digest, the concentrated owner can use incentive compensation via bonuses that would be hard for public markets to follow.

16. Consumers, presumably poorly organized politically or unsympathetic with owners' pleas, may end up losing more. But even consumers might be rationally indifferent if a) monopoly is unavoidable (because, say, the economy is too small to be competitive), and b) the only political issue is whether the firms' owners or their employees get the lion's share of the monopoly profits.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

several generations, and more tailoring of capital structure to reduce agency costs.

2. *Of higher rents for the players to split.*

Politics, when successful, settles conflict. The monopolist's "rectangle" is a fertile field for conflict, as the corporate players—owners, managers, and employees—stake their claims to part of that field. This enhanced potential for conflict inside the firm should, if such firms dominate an economy, raise the demand for political institutions that can settle this conflict.

Social democracy is one way to settle this conflict, by creating a collective sense of belonging and by regulating the firm to produce more equality and more employee voice in the firm's decisions. Workers feel they have more collective control over their destinies in the workplace, because they do. Corporatism is another way to reduce this conflict; centralized associations of employers, employees, and the government meet to hammer out bargains on wages, employment levels, and monetary policy. The corporatist associations thereby divide up those monopoly and oligopoly rectangles.[17] Social democratic parties represent incumbent labor as the political arm for employees to gather a "fair" share of the monopoly firm's rents. Indeed, monopoly power correlates, albeit weakly, with employment protection law.[18]

Owners have reason to "invest" in politics to keep those monopoly profits for themselves. In some democracies one would expect that they often lose, as other players (their employees, the unions, sympathetic bystanders) have more votes, inducing democratic politicians to seek their votes against the owners. Owners in a non-democracy or a weak democracy could win more often and have reason to resist full democracy. Whether this factor—protecting rents—describes why some resisted democratization in historically conservative dictatorial regimes in Latin America and Asia could be investigated.

B. *Converse: Consequences When Product Competition Strong, Monopoly Weak*

We can reflect the monopolistic scenario in a mirror. Imagine another nation, B, similar in all other respects to the nations just discussed in Section A except that B's major firms are *not* organized monopolistically. Imagine how the competitive consequences play out inside the firms and how the demand for social democratic and corporatist politics will be lower in B than in the nations in Section A.

17. *E.g.*, Charles S. Maier, *Preconditions for Corporatism*, *in* ORDER AND CONFLICT IN CONTEMPORARY CAPITALISM 39 (John H. Goldthorpe ed., 1984) (describing corporatism).

18. I statistically compared the OECD's job protection index, displayed in Table 1, *infra*, with the mark-up index from Table 3, in the Appendix. The two correlated, although not powerfully.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

Competition in nation B makes rents inside B's firms lower than those in A's. There are no monopoly "rectangles" (or they're smaller). With the rectangles gone (or reduced), managerial agency costs inside the firm are lower in nation B than in A. Shareholders can relax their most costly agency-cost control institutions, which might be concentrated ownership and tight shareholder control over managers. They can cut managers *a little* slack (because there are no monopoly rectangles that already cut the managers *a lot* of slack), by reducing the size of their large blocks so that they can garner the benefit of more liquidity and more diversification.

The monopoly rents for shareholders, employees, managers, and customers/consumers to fight over in the political sphere are smaller in this competitive nation B. The private manifestations of that struggle—unions and concentrated ownership—should diminish. The corporate law manifestations—opposition to shareholder wealth institutions from the non-shareholders—should diminish because there's less (or nothing) for the other non-shareholder players to capture out of those shrunken (or nonexistent) monopoly rectangles. And the political manifestations of that struggle should also be weaker. Hence, social democratic parties (as the political arm of employees' fight for a "fair" share of the rents) should, all other things equal, be weaker in nation B than in nation A.

C. *Consequences for Labor Laws and Ownership Concentration*

1. *Strong labor laws as fitting with strong ownership concentration.*

We can speculate further. Strong ownership concentration should result in a nation if its laws and politics are strongly pro-labor (actually if they're more pro-employees-with-jobs-in-place, because law-induced labor power does not always favor unemployed people looking for jobs). In Table 1, I array an OECD index of employment protection and a standard measure of ownership concentration in the world's richest nations.[19] Table 2 shows the strong correlation between the two. Graph 3 depicts the result. Similarly, a nation whose firms have a thicker packet of monopoly power should "predict" a nation with more protective labor law, because there are more of those monopoly rectangles from which to pay for those labor protections, and shareholders have the motivation to keep labor peace, so that they can keep getting their share of the monopoly profits.[20]

---

19. The index of employment protection is for the years 1985-1993, and comes from ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, JOBS STUDY: EVIDENCE AND EXPLANATIONS, PT. II: THE ADJUSTMENT POTENTIAL OF THE LABOUR MARKET 74 (1994); the index of ownership concentration comes from Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 474-80 (1999).

20. For this relationship, I regressed the employment protection index against the

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

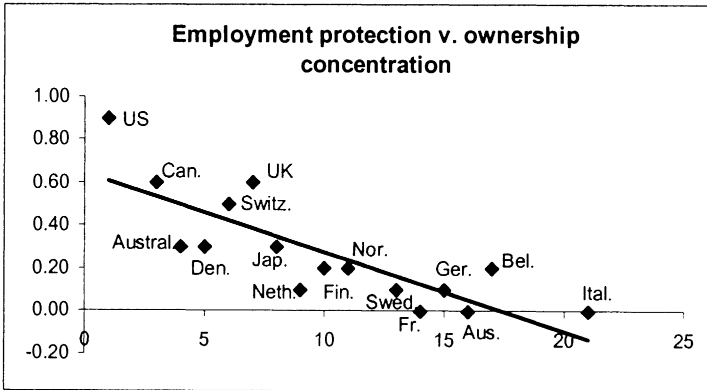
Table 1: Labor laws, strong and weak, and ownership concentration

Country	Employment protection (1=lowest)	Portion of mid-sized public firms without a 20% stockholder
United States	1	0.9
Canada	3	0.6
Australia	4	0.3
Denmark	5	0.3
Switzerland	6	0.5
United Kingdom	7	0.6
Japan	8	0.3
Netherlands	9	0.1
Finland	10	0.2
Norway	11	0.2
Sweden	13	0.1
France	14	0
Germany	15	0.1
Austria	16	0
Belgium	17	0.2
Italy	21	0

Table 2: Regressing ownership concentration on strong labor law

	Regression coefficient (t-statistic)	R-squared
Protection vs. concentration	-.03 (-5.23 *)	0.66

* Significant at the .0005 level.



mark-up index. While the sign was "as predicted"—higher mark-ups correlate with higher formal employment protection—that correlation was not statistically significant.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

2. *Justice.*

I have avoided arguing normatively about the monopoly, assuming thus far that the monopolist could be poor and the consumers rich. But that is unusual: the monopolist-owners are typically richer than the consumers. And their comparative wealth makes the anti-shareholder-value ideology more convincing to political bystanders who are not directly seeking a piece of that "rectangle." If the distributional question can be settled at low cost (not always an easy task), the efficiency price in distributing a high portion of the "rectangle" to employees would be low, or nonexistent.

Ownership concentration or other internal corporate reactions to offset any increased managerial agency costs will exist *no matter* whether the agency costs come as managerial slack or as higher employee demands. But once concentration is high and monopoly producers identifiable, envy will arise about the unfair distributional results. Ideologies that support redistribution and state control are more persuasive than they are in more competitive economies. And value can be redistributed from monopoly-owners to employees and the general public without burdening economic performance much (as long as the distributions themselves, and the decisions to settle how to redistribute, have low transaction costs and only affect monopoly profits, not basic competitive profits).

D. *Causation's Direction*

I have presented product markets as coming first, with uncompetitive product markets raising managerial agency costs, thereby both calling forth concentrated ownership and, I speculate, fueling labor-based politics in the democratic West. I illustrate this direction, and these effects on the corporate governance environment in Figure 1. Causation need not always run in that direction, starting from weak competition. If politics is social democratic and heavily favors employees with jobs in place, entrepreneurs might not

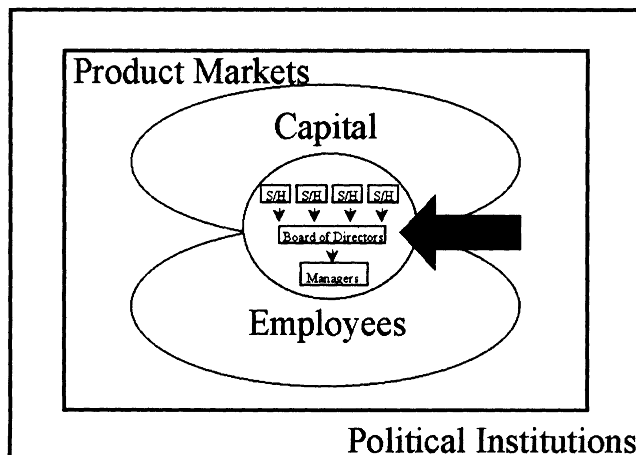


Figure 1. The corporate governance environment

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

enter industries to the point where profits would be fully competitive if they know that one key input, labor, must be paid accordingly. Politics could come first in another way: well-placed players could seize government levers to get themselves a monopoly, and from that monopoly could flow social democratic, pro-labor politics and concentrated ownership. Or social democratic governments may facilitate, or at least tolerate, monopolies, not breaking them up as long as some of their largesse—i.e., a piece of that rectangle—goes to the social democrats' constituencies.[21]

Politics can re-enter in another way: Political coalitions may make antitrust policy (and foreign trade policy) important and effective, thereby reducing pernicious (and perhaps even natural or skill, foresight and industry) monopolies. This was the American result but not a common one, especially in smaller economies. Here I simply examine the consequences of the result. If consumers don't win in the antitrust (and trade) arena and if monopoly profits in smoke-stack type industries are high, what, I ask, are the plausible consequential pressures on corporate ownership, labor laws, and basic democratic politics?

Thus, while for some nations at key times it's the product market that is settled first, it isn't that way for all nations at all times. A modest restatement of the paper's thesis would be that among the world's democracies we end to see two broad packages: 1) competitive product markets, dispersed ownership, and conservative results for labor, and 2) concentrated product markets, concentrated ownership, and pro-labor results.[22]

E. *Political Consequences when Globalization and International Competition Increase*

The smallness of a small, technologically developed country should induce more concentrated industry than otherwise. If industry is concentrated in that small nation, then monopoly rents rise. Monopoly rents induce decisions, both political and corporate, on how to divide up those monopoly rents. Owners may get them in the first instance, but they might not be able to keep them. Players want representation when the political decisions are made to divide up these rents. Social democratic ideology is a statement that the rents belong primarily to the employees.

---

21. Japan's Ministry of International Trade and Industry limited entry into key industries, facilitating oligopolies with lifetime employment for core workers. Nobuhiro Hiwatari, *Employment Practices and Enterprise Unionism in Japan*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 275, 290 (Margaret Blair & Mark J. Roe eds., 1999).

22. Another proviso: I do not seek here to explain all linkages across all time, only a plausible set of links for today's richest nations. For example, many developing nations have conservative politics, weak product market competition, and concentrated ownership. Two comments here: first, this "misfit" may explain some of the political tension in these nations. Second, when many firms in these nations reach the point where it makes economic sense for them to go public and diffuse their ownership, we could have a test of the theory.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

Hence, you'd expect *less* social democracy in *big*, democratic, technologically advanced countries. *And* globalization, by squeezing rents, changes what's up for grabs inside the firm. *Then,* by reducing what's up for grabs inside the firm, globalization weakens the social democratic parties and the polity's demand for the related corporate and labor laws.[23] So it's no accident in this framework that as global competition heats up, French corporate law gets challenged by official commissions not unlike the American Law Institute via reports that extol a more shareholder-oriented approach to the French firm.[24] Something similar has happened in the U.S.: regulation of some industries, like trucking, led to union employees capturing some of the monopoly rent. Deregulation wiped out the rents and the union's ability to grab a share of those rents for its members. As deregulation took off, union membership and power declined.[25]

We have now just traced out a linked explanation for the observation that globalization and increased competition are pressing social democratic ideologies in Europe. A socialist party in France is not nationalizing but privatizing. A former communist became prime minister in Italy and maintained private markets. A German prime minister fulminates against a huge hostile takeover, but lets it proceed, although predecessors blocked similar hostile takeovers. As even local firms in previously monopolistic markets face increasingly *international* competition, some via the European Union and the Common Market, those rectangles shrink, and there's less for the players inside the firm—managers and employees—to grab. Then the players' (that is, the employees' and the owners') demand for their political correlates declines, because there is less to grab (or protect), making political action less valuable. And hence social democratic parties should, all else equal, move to the right, as they have been.[26]

---

23. And it weakens shareholders' preference for concentrated ownership. Enhanced product market competition shrinks the rectangle, so that shrinking managers can grab from (or lose for) shareholders. And enhanced product market competition constrains managers more than monopoly. Hence, globalization should diminish ownership concentration and promote ownership separation. The Canadian experience is consistent: "[D]iffuse ownership is more commonplace in Canada subsequent to that country's free trade agreement with the United States." Randall K. Morck, *Introduction* to CONCENTRATED CORPORATE OWNERSHIP 1, 6 (2000).

24. *See generally* CONSEIL NATIONAL DU PATRONAT FRANÇAIS AND ASSOCIATION FRANÇAISE DES ENTREPRISES PRIVEES, THE BOARDS OF DIRECTORS OF LISTED COMPANIES IN FRANCE (1995) (the first Viénot Report); MOUVEMENT DES ENTREPRISES DE FRANCE AND ASSOCIATION FRANÇAISE DES ENTREPRISES PRIVEES, RECOMMENDATIONS OF THE COMMITTEE ON CORPORATE GOVERNANCE (1999) (Viénot Report II); PHILIPPE MARINI, LA MODERNISATION DUR DROIT DES SOCIETES 12 (1996) (Rapport au Premier Ministre, July 13, 1996) (legislative report to prime minister stating that the French corporate code's social interest duty mistakenly masks an allocation of power).

25. *See* Nancy Rose, *Labor Rent Sharing and Regulation: Evidence from the Trucking Industry*, 95 J. POL. ECON. 1146, 1163 (1987).

26. *Cf.* THE FEDERALIST No. 10 (James Madison) (arguing that the adoption of the federal Constitution would diffuse the political power of factions and thus leave less room

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

IV. CONSEQUENCES INSIDE THE FIRM: II

This analysis of rents has implications for current theories of corporate ownership structure.

A. *For Ownership Concentration*

A currently popular academic theory is that the quality of corporate law largely determines whether ownership will separate from control. While this theory seems quite helpful for understanding why ownership separation is difficult to maintain in, say, Russia, the transition economies, and many developing nations, it does less well in explaining weak separation in richer, democratic nations, some of which have quite good corporate law.[27] The agency cost theory I've offered here could pose an alternate explanation. Law might be fine, but if agency costs would be higher after separation, the founding owners would be reluctant to push separation. In statistics-talk, competitive conditions could be an "omitted variable" in the quality-of-corporate-law literature for some nation.

To see whether widespread monopoly correlated with ownership concentration (thus posing a potential alternate explanation for ownership concentration), I took a measure of monopoly power in heavy industries in the world's richest nations and compared this measure to ownership concentration in the same nations.

This comparison examines the world through a very crude lens, one designed just to provide us with a "reality check," not a conclusive demonstration. The heavy industries were the "usual suspects" for large factories, large firms, and the potential for large packets of market power: iron

---

for political rent-seeking, which is analogous to the claim here that increased global competition decreases monopoly rents and thus gives political factions less to expend their resources fighting over).

For now, integrating Europe economically makes it more competitive, increasing competition reduces the monopoly rectangles, and diminishing those rectangles takes away some of the fuel for social democratic politics. But it's possible that Europe is in transition and the end point might not be more competition and less monopoly. As Europe integrates, firms formerly confined to national boundaries may merge and, in time, yield a new weakly competitive continent to replace yesterday's weakly competitive nations. If this happens, then the fit outlined in this paper—social democracy, monopoly, and ownership concentration—could return to replace the now emerging fit of middle-of-the-road politics, competition, and growing securities markets. The cause could shift from that emphasized in this paper—monopoly—to politics. Some European politicians want more political integration to better implement a social democratic labor policy, a labor policy that fragmented nations in competitive markets cannot implement. *See Europe—A French Lesson*, ECONOMIST, July 1, 2000, at 47 (noting that some politicians favor "a 'social agenda' for Europe, including a five-year plan for modernising and reinforcing labor").

27. *See* MARK J. ROE, THE QUALITY OF CORPORATE LAW ARGUMENT AND ITS LIMITS (working paper, 2000).

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

and steel, machinery and equipment, metal products, motor vehicles, and petroleum refineries. I did not refine the crude index: that is, these were the first five industries I chose; none were added, deleted or adjusted.[28] Monopoly power was measured by the size of an industry's mark-up: if an industry could charge much more for its output than it paid for its input, then it had more monopoly power than a similar industry in another country that could not mark-up its prices as much over its costs. I compared this mark-up ratio to a standard measure of ownership concentration from the finance literature and measured concentration by counting the portion of the twenty firms just over $500 million in stock market capitalization that do not have a 20% blockholder.[29] The raw data is in Table 3 in the Appendix, and the statistical measures (which are significant) are in Table 4. The data, although quite unrefined, suggest a relationship between nations whose firms have more market power with ownership concentrations.

I also arrayed a standard measure of political position from the political science literature, one measuring a nation's governing party's "leftness" vs. its "rightness." High product market monopoly (or oligopoly) power also fits with a nation being more to the political left, although less strongly. The theory here is that widespread monopoly profits fuel distributional politics, as voters dislike the profits and power that the monopoly accords *and* as the widespread monopoly rectangles provides a pot of money that political players can allocate to the mass of voters and the firms' own workers.

These results hardly "prove" a causal relationship. The data is suggestive but crude. In a complex world, there are many causes and effects of institutions, histories, and cultures, and many economic features vie to influence corporate governance structure and political policy. I hardly mean that we have here captured *the* fundamental relationship among corporate governance structure, competition, and political orientation.[30]

---

28. I did not refine the index to weight it by the size of the industry in the economy. (An industry might not be a big part of the economy.)

29. The mark-up data comes from JOAQUIM OLIVEIRA MARTINS, STEFANO SCARPETTA & DIRK PILAT, MARK-UP PRICING RATIOS IN MANUFACTURING INDUSTRIES: ESTIMATES FOR 14 OECD COUNTRIES 18-19 (Org. for Econ. Cooperation and Dev. Econ. Dep't, Working Paper No. 162) (arraying mark-ups for 1970-1992); the ownership data comes from La Porta et al., *supra* note 19.

30. With fourteen nations in the test, a few nations that are strong in one direction might drive the results. Thus, the United States and Britain could be outliers, with strong competition and diffuse ownership. One could drop them from the sample, though, and get support for the relationship: the t-statistic loses significance, but the sign is as predicted even with the reduced sample. One could also take the largest firms in each nation to measure ownership concentration. This is (even) less accurate, because a) the largest firms in the small nations are not as large as the largest in, say, the United States (an apples to oranges problem), and b) perhaps the largest firms everywhere outstrip a normal family owner's capacity to keep control—i.e., when the capital requirements for monopoly are high enough, some firms must go fully public to gather that capital even though managerial agency costs will be the price. That aside, the large firms also provide a correlation, one that a) is

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

As I have noted, other features could explain the correlation. The less competitive nations tend to be civil law countries, the more competitive ones common law countries. Perhaps the legal system induces high (or low) quality securities markets and low (or high) ownership concentration. This possibility has been suggested.[31] Competitive conditions provides an alternative, or additional, explanation. The less competitive nations have historically also been social democracies; and social democratic politics affects the degree to which ownership can separate from control. This possibility has also been suggested.[32]

Elsewhere, I delineate the limits to legal variation as primarily explaining ownership variation in the developed West.[33] Social democratic politics probably explains much of the ownership variation that legal theory cannot handle. Here I raise the possibility of—but not proof of—a link between social democracy and a weakly competitive product market structure.

* * *

A few words on the data: antitrust aficionados will recall that the Hirschman-Herfindahl Index is a standard gauge of industry concentration, one used by the Justice Department to measure mergers' anti-competitive effects.[34] But there's no standardized *cross-country* calculation of HHI indices for the world's richest nations.[35] Also, industrial concentration—the HHI's measure —*generally* but not always correlates with high mark-ups. A modestly concentrated industry in one nation might get government support (such as an impermeable barrier to foreign competition) that yields heavy monopoly profits there, but a similarly concentrated industry in another nation may fail to get

---

stronger than that for the mid-sized firms, but that b) weakens more considerably when the United States and Britain are dropped.

31. *See* LaPorta et al., *supra* note 19.

32. *See* Roe, *Political Preconditions*, *supra* note 15.

33. *See* ROE, THE QUALITY OF CORPORATE LAW ARGUMENT, *supra* note 27.

34. *See* United States Department of Justice Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,573-5 (Apr. 17, 1997).

35. Similarly, a plausible test would match a monopoly power measure *firm-by-firm* with the specific firm's ownership concentration. But international firm-by-firm match-up data is unavailable. Much of the structure is nationally induced in reaction to the general competitive trend. Hence, firm-by-firm differences within a single nation may be shallow. If most industry is competitive, across-the-board weak labor rules and diffuse ownership structures might prevail. Similarly, if most industry is uncompetitive in a nation, across-the-board rules might induce shareholder ownership concentration and pro-labor rules even in the competitive fringe. To the extent that effects from industrial organization are felt inside firms from nationwide rules and patterns that arise from the general pattern, the firm-by-firm differences might pale by comparison.

Still, a plausible test of the theory would look at ownership structures in a single nation. Less competitive industries should see more instances of, say, the duPont family controlling General Motors, the Ford family controlling the Ford Motor Company, and Bill Gates controlling Microsoft. Even if the big effect is nation-wide, the "sign" of the size-corrected firm results should fit the theory here.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

enough support (because of a trade policy of keeping the market open) and, hence, fail to get those monopoly profits.

Industry profitability might be an alternate measure, because the more profitable industry is plausibly the less competitive one, but it too would suffer from some problems: Cross-country accounting is non-standardized. And if players capture a piece of the profit (in managerial slack or higher wages), then shareholder profits might *potentially* be high, but become dissipated as the other corporate players grab a high share. Accounting profits would fail to capture the dissipation.

Mark-up ratios *under*state monopoly power. If an input (like labor or management) grabs some of the monopoly profit, then this grab will show up as a cost and a *lowered* mark-up, despite that the monopoly profit (and real gross mark-up) is higher *but distributed to players inside the firm.* Since these inputs can probably only grab some of the potential monopoly profits, nations with high mark-ups probably have more underlying monopoly power. Moreover, mark-up ratios misstate monopoly power in one dimension: a wide but shallow capacity to raise price could be more valuable than a high-mark-up. (That is, the monopolist can raise price only slightly but can do so in an important industry. The mark-up measures the height of the monopoly rectangle, not its width.) A better index would measure the power of the firm to pull in revenue, even if some of that revenue is not returned to shareholders but is captured by managers or employees,[36] but that data isn't available (and may never be).

Available American data doesn't test all of the theory, but we can break the propositions down into two syllogisms and find confirming data. The argument here is that if (A) there's monopoly, then (B) agency costs should be higher than otherwise and (B') labor demands should be higher and (B") concentrated ownership would control some of those agency costs. Data shows that where there's weak competition (A), unions historically captured much of the monopoly profit (B'),[37] and unexpected collective bargaining agreements lowered shareholder value.[38] (If A, then B, B'.) Industrial concentration (A) correlated with increased wages (B').[39] Management-controlled high-market-power firms showed the ordinary profits of non-monopoly firms, while similar firms with strong owners showed higher-than-normal profitability.[40] More generally, weak competition yielded higher agency costs.[41] And, "manager-controlled banks operating in noncompetitive markets ... spend more on items

36. *See* P.A. Geroski, *In Pursuit of Monopoly Power: Recent Quantitative Work in Industrial Economics*, 3 J. APPLIED ECONOMETRICS 107, 111-12 (1988).

37. *See* Freeman & Medoff, *supra* note 3, at 52; Karier, *supra* note 3, at 40-41; Salinger, *supra* note 9, at 166.

38. Ruback & Zimmerman, *supra* note 9.

39. Kwoka, *supra* note 3, at 253.

40. Palmer, *supra* note 10, at 298.

41. Edwards, *supra* note 10.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

likely to be preferred by managers than do owner-controlled banks in the same [noncompetitive market]."[42] (I.e., if A, then B.)

Better data would relate ownership and monopoly on a firm-by-firm basis, calculate the potential monopoly profits before labor inputs (and before other inputs) took their share, would array the data across and inside the richer democratic nations, and would match ownership and monopoly year-by-year. This data does not. Data satisfying the above criteria is just not available now. Better data would have more observations so that alternative theories could be compared. This data is not deep enough to permit that kind of test. But we can say that we have a plausible hypothesis and that a crude cut at the data available shows a relationship: the more monopoly power there is in a nation's heavy industries, the more concentrated is its industrial ownership.

B. *For Private Benefits of Control Theories*

1. *Leaving control up for grabs.*

In recent years a powerful theory to explain corporate structures around the world has emerged and gained much respect. The theory gives corporate law, and its capacity (or incapacity) to protect minority stockholders from the depredations of controlling stockholders, a position of primacy. Hence, the theory has its attractiveness to lawyers (who might relish their primacy) and sometimes to finance economists (who might relish blaming a faulty legal system for failures around the world to develop modern economic institutions). Moreover, because law is malleable, it gives courage to those who seek to improve conditions, especially conditions in poorer transition and developing nations, because a program for betterment is made easy to outline.

The theory in summary form runs like this: A firm, when considering whether to go fully public, must account for the size of the private benefit of control. This benefit is the value that controlling stockholders can divert to themselves in related-party contracts that legal institutions fail to eliminate, in excess salaries or in a better life. When that benefit is large enough, the controller *must* hold onto control of the firm to keep those benefits. The controller cannot sell those benefits to diffuse stockholders; it might sometimes sell its whole control block, but it does so *only* to another controller who pays up front for the benefits that can be siphoned off later. If the controller sold out to diffuse stockholders, those diffuse stockholders would refuse to pay full pro rata value to the controller, because they'd fear that an outsider (a "raider") would buy up control and siphon off that benefit for itself. The controller would lose value, the theory runs, if it left control up for grabs.

---

42. Hannan & Mavinga, *supra* note 10, at 671.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

This private benefits of control theory can explain important features of corporate structure around the world.[43] In nations with awful legal systems—transition economies like Russia, Kazakhstan, and some developing countries come to mind—investors' inability to enforce even a simple contract, much less a complex corporate one, powerfully explains corporate results. But the theory applies less strongly to those nations in western Europe that have highly developed legal systems but have weakly competitive industry.

2. *Relative unimportance of private benefits when the monopolist's "rectangle" is large.*

We can now see an alternate explanation for western Europe's historically concentrated ownership and relatively smaller stock markets. When the monopolist's rectangle is large, "V", the total value that the firm can *potentially* yield to stockholders, is large. "B_{CS}", the smaller value that the controlling shareholder can shift out of V to itself away from minority stockholders, is smaller in relative importance. *Stockholders are more concerned about keeping V, the firm's total value for stockholders, as large as possible* (and keeping it for stockholders as a group), *and (relatively) less concerned about whether the controller can grab some of B_{CS} away from minority stockholders.* The potential loss of V was historically more important to stockholders in much of the wealthy West than the diversion of B_{CS}.

That is, where the "rectangle" is very large, the tug over who gets it and whether managers will keep it for shareholder can swamp the importance to shareholders of the intra-shareholder contest for the private benefits of control. In such settings, the private benefits of control theories explain less than they do elsewhere. Controlling shareholders' private benefits and corporate law's capacity to reduce them can account for ownership concentration in important settings, but not when managerial agency costs in diffusely held public firms are very high and reducible by a concentrated owner.[44]

---

43. *See generally* Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998); LUCIAN ARYE BEBCHUK, RENT PROTECTION AND THE EVOLUTION OF A FIRM'S OWNERSHIP STRUCTURE (Nat'l Bureau of Econ. Res., Working Paper No. 7203, 1999).

44. Stated more formally: Let A_M be the managerial agency costs to shareholders, costs that concentrated ownership avoids. Let C_{CS} be the costs to the concentrated shareholder in holding a block and monitoring (that is, the costs in lost liquidity, lost diversification, expended energy, and, perhaps, error). Let B_{CS} be the private benefits that the controller can grab and that law can control. When A_M is high (more specifically, when $A_M>C_{CS}$), *ownership will persist in concentrated form whether or not law successfully controls the private benefits that a controlling shareholder can siphon off from the firm.* But introduce A_M. If A_M is of non-trivial size, then the proceeds to the controlling stockholder, owning half the firm worth V, from selling his or her stock into the diffusely-held stock market would be $(V\text{-}A_M/2)$. Concentration persists if and only if $V/2+B_{CS}-C_{CS}>(V-A_M)/2$. Re-arranging: concentration persists if the net benefits of control $(B_{CS}-C_{CS})$ are more than the costs of diffusion $(A_M/2)$: $B_{CS}-C_{CS}>-A_M/2$. Or, rearranging, when $B_{CS}+A_M/2>C_{CS}$.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

3. *Twilight of the national monopolies.*

It's thus sensible that the private benefits of control literature is now reaching its zenith theoretically and empirically for Europe.[45] In prior decades, the monopoly "rectangles" made more of V, the value of the firm, up for grabs among European shareholders, managers, and employees. Managers could easily lose a good fraction of V for shareholders, because a) it was there, and b) they faced weaker product market and capital market constraints but stronger stakeholder claims.

In such a setting the private benefit of control for controlling shareholders, *might also have been an issue for dominant and minority shareholders, but it was relatively less important than the huge value of the enterprise that was in play and up for grabs among the state, the employees, and the shareholders.* As markets became more competitive, the amount of firm value that's up for grabs among all the players *has diminished*, making the amount that's up for grabs only between controllers and minority stockholders *relatively more* important now than it was before. And, as it became relatively more important, theoretical and empirical work should have followed, as they have.

Until now in Europe, it's plausible that the variability in value for shareholders if firm ownership diffused dominated the variability in the size of private benefits. Now that there's less monopoly-induced bargaining to grab the value in that monopoly rectangle, and less worry from shareholders that managers would lose that value, because strengthening competition makes less of it available for grabbing or losing as those monopoly rectangles shrink across Europe, we can finally focus more on the potential diversion among shareholders.[46] As the monopolies shrink, the social democratic politics that they supported recede, and technical issues such as the private benefits of control for shareholders come into sharper focus. The shrinking monopolies and the increasing competition allow technical corporate law, and private benefits of control, to play a more determinative role than previously. And as

---

Standard theory predicts diffusion when B_{CS}-C_{CS} is low or negative. But with A_M, diffusion won't occur *even if B_{CS} is zero.* B_{CS}, the controlling shareholder's private benefits, are unimportant in determining diffusion if A_M is very high. Only when $A_M \rightarrow 0$ do private benefits kick in as a critical determinant. ROE, THE QUALITY OF CORPORATE LAW ARGUMENT, *supra* note 27.

45. *See generally* Marco Becht & Ailsa Röell, *Blockholdings in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1998).

46. An analogous result occurred in the United States: shareholder wealth maximization institutions, such as the hostile takeover and incentive compensation, came to the fore starting around the early 1980s. It was then that competition in the U.S. economy, already moderately good and stronger than that in most other national economies, strengthened as foreign manufacturers "caught up" with the big U.S. firms and delivered competitive products into the U.S. heartland. Enhanced competition reduced the wiggle-room inside those already small rectangles, as the small rectangles shrank further. Corporate governance in managing the transition became more important, or at least more visible, than it had been.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

trade liberalizes and monopolies shrink, pro-shareholder institutions become more functional and pressures increase to improve them.[47]

C. *For Coasian Bargains Between Employees and Owners*

1. *The Coasian give-back.*

One might misapply a Coasian argument here. If employees gain more in wages from the monopoly firm, they will be pressed to give up something elsewhere, say in lower pensions, weaker benefits, more effort or less attractive working conditions. This countervailing pressure, although never absent and hence of some applicability, is weaker in the monopoly industry than in the competitive industry.

True, in a *competitive* industry, a firm paying an input more than its competitors pay must in the long run make that cost up somewhere. And the favored input has reason to charge less (or provide more) somewhere else in its package by working harder, providing higher quality, or something else. But in the *monopoly* industry, capital can continue to get a competitive rate of return, other inputs can be paid their market rates, and so on. The pressure for a long-run Coasian give-back isn't there.[48]

2. *Changing the market clearing wage.*

The pressure for a give-back is further weakened if much of a nation's economy is organized monopolistically (or oligopolistically). The *total* wage level throughout the economy is raised by the organization of industry and labor. If wages were raised inside the firm for a class of employees, the firm might want to hire more of the hardest-working or highest-quality employees in the economy. (To some extent it probably does this.)[49] But if the competitive

47. That pressures rise does not mean change will be immediate and full, because there's a strong element of path dependence in corporate law and corporate structures. Current rules and structures favor some incumbents, and these incumbents often have the motivation, and sometimes the political power, to slow down or even to prevent change. And sometimes it's inefficient to change structures until they wear out. Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999); Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996).

48. More precisely, consider the capitalization of agency costs in the initial public offering. The firm was originally expected to earn $25 on $100 in assets, the market demanded a 10% return, and the firm was valued at $250. Shareholders would thereafter *want* a windfall of $50 if managers reduced agency costs or employee expenses by $5 per year. But whether they reduce them or they don't, the firm can continue to finance itself as long as new projects have an expected annual return of at least 10%.

49. And in some bargains, labor will try to specify not only a higher wage but also a lower requirement of effort. Such has been done in British labor bargaining. *See* Nickell,

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

wage is made higher by legislation or national bargaining, then the firm can't get everything back in a Coasian give-back.

In effect, labor on one side and industry on the other array themselves as one big bilateral monopoly. And as is well known, the outcome of bargaining in a bilateral monopoly differs from that when the two sides have competitors to whom a disappointed party could switch.[50]

3. *Two labor pools.*

Third-party effects also weaken the Coasian pressure. When capital and the currently employed split that rectangle, they are not just affecting themselves but *other* labor players. Employees with jobs have reason to "grab" a piece of the rectangle and then, through political action, to make it harder for their bosses to fire them, so that they cannot be readily played off against the unemployed later on.

When the labor market is made more rigid, the currently *un*employed are less likely to enter the work force, those with dead-end jobs are less able to enter the mainstream, and the young and not-yet-employed are less able to easily break into the work force. These out-groups in the labor pool are made up of the kind of people who tend to be *under*represented politically, either because they do not vote or because they are not well-organized in groups that can affect political outcomes. They pay some of the price of the bargain, and they are not represented at the bargaining table.[51]

D. *For Going Public and Growing When Monopoly Trade-Offs Are Large: A Proviso*

Monopoly cannot always coexist with concentrated ownership: the monopolist must acquire size, and to acquire size it oftentimes needs to get access to capital beyond that which a single person, or a single family, can provide. Thus the locally maximizing decision for shareholders might be to allow agency costs to increase, by diffusing ownership, because growth (obtained by diffuse ownership) has been the only road to increased monopoly profits. This tradeoff in very large economies may induce more public

---

supra note 5, at 727 n.2.

50. *E.g.*, WILLIAM SHARPE, INVESTMENTS 77 (2d ed. 1981) (stating that the bargaining outcome between dependent actors—Robinson Crusoe with all the island's food and Friday with all its land—is determined not by a clean market-clearing price, but by "bargaining, . . . skullduggery, or even war").

51. In continental Europe, difficult-to-layoff rules impede firms from offering entry-level jobs. *See* Lawrence M. Kahn, *Wage Inequality, Collective Bargaining and Relative Employment 1985-94: Evidence from 15 OECD Countries*, 82 REV. ECON. & STAT. 564, 577 (2000) (concluding that union activity decreases low-skilled workers' employment prospects); Horst Siebert, *Labor Market Rigidities: At the Root of Unemployment in Europe*, J. ECON. PERSP., Summer 1997, at 37, 48-49.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

ownership than otherwise: to get the monopoly, the firm must grow, but to grow it must raise capital from outsiders. There is a monopoly effect on corporate structure in the large nation, but it differs from that in the small nation: the monopolist must pay in increased agency costs in order to get (or keep) the monopoly, because it must raise capital through diffuse ownership to maintain the size needed for supra-competitive profits. This tradeoff in favor of size and more diffuse ownership will be easier for shareholders in a nation like the United States where employee pressures are not as strong as they could be, and not as strong as they are elsewhere in the world.[52]

This pressure to grow even if agency costs increased may have once been more important in the United States than in, say, Sweden, where the controller could keep control and still have the scale needed for market monopolization. But even in the United States, that period of weaker competition may have been the closest the United States came to being somewhat "social democratic." Statements of managerial goals cited stockholders as a primary constituency, along with employees and consumers.[53] And one saw controllers in oligopolistic industries hanging on to control for quite some time. The Ford Motor Company and the Ford family, and General Motors and the duPont family (and maybe IBM and the Watson family), come to mind.[54]

In any case, while this size effect is the most serious qualification to the general thesis of monopoly-induced ownership concentration, this demand-for-size effect on ownership structure just means that we have more than one dimension in a full analysis. But the undertow of monopoly as fitting with

---

52. Formally: if $\exists A_M$, and $\exists V_D$,, the added monopoly potential from diffusion (or any added value from diffusion), then concentration persists if and only if $V/2+B_{CS}-C_{CS}>(V-A_M+V_D)/2$, When $V_D-A_M \rightarrow 0$, B_{CS} again becomes a primary determinant. But when V_D or A_M is large in relation to the other, it, and not necessarily B_{CS}, can drive the diffusion decision.

53. *See* FRANCIS X. SUTTON, SEYMOUR E. HARRIS, CARL KAYSEN & JAMES TOBIN, THE AMERICAN BUSINESS CREED 64-65 (1956), in which leading economists state a managerialist philosophy for the time, and, I'd argue, a justification for the prevailing oligopoly structure: "[C]orporation managers . . . [are] responsib[le] to consumers, to employees, to stockholders, and to the general public . . . , each . . . equal[ly]; the function of management is to secure justice for all and unconditional maxima for none. Stockholders . . . are entitled to a fair return on their investment, but profits above a 'fair' level are an economic sin." Several of the authors were leading economists; Kaysen had a special focus on oligopoly. *See* CARL KAYSEN & DONALD TURNER, ANTITRUST POLICY (1959). Although even back then the interests of stockholder were not submerged to those of the other players (as they are in other nations), "fair" profits fit with an economist's prescription for an oligopolistically-organized industry. An "oligopoly-conscious" managerial creed would give managers discretion to invest and expand, encouraging them to "plow" earnings back into the firm. And indeed the "creed" so recommends. SUTTON ET AL., *supra*, at 85, 87. *Cf.* SANFORD M. JACOBY, EMPLOYEE REPRESENTATION AND CORPORATE GOVERNANCE: A MISSING LINK (UCLA Working Paper, 2000).

54. Monopolies with diffuse ownership might persist here and there in a nation that generally has few of them if the corporate institutions are built for the average, competitive firm, with high pro-shareholder value institutions. Then the occasional monopoly can free-ride, garnering for its shareholders the network externality.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

social democratic politics and concentrated corporate ownership that controls agency costs is there.

CONCLUSION

When product market rents are high, managerial agency costs to shareholders are high. They are high for two reasons: managers will have more slack, and employees will expect a piece of the monopoly rent, which managers may be ready to yield to them.

Sometimes these increased managerial agency costs are the "price" that shareholder-owners have to pay to get and keep their monopoly profits. But when they can, the owners would like to reduce those agency costs. They have more reason to try to rein in managers and reduce the agency costs when managers have lots of value to keep for shareholders (or to give up to the other players). To rein them in, and to divide the pie more in their favor, owners will tend to keep their ownership concentrated, as concentrated ownership is often their best means to control managerial agency costs.

And owners will need direct representation at the national political level, where some of the spoils will be divided. In the political arena, one can speculate, social democratic ideologies could more easily arise and be viable, because they are paid for out of the monopolist's excess profits, not out of competitive profits. Moreover, because owners will find concentration of ownership more valuable than otherwise, this concentrated ownership probably induces counter-ideologies and organizations that seek to constrain the rich owners.

These product market and political currents become reflected in legal structures: nations with less competitive economies have had weaker shareholder primacy norms in their corporate laws, and more pro-employee results in their labor laws. As nations with anti-shareholder norms and corporate rules become more competitive through customs unions and single-currency areas, pressure on these norms, on these corporate law and labor law rules, and on the old politics rises, as it has been doing. As product competition increases, managerial agency costs inside the firm decrease. The rectangle that managers can grab—or give away—diminishes. Political conflict over dividing that rectangle also diminishes as the pot to divvy up shrinks. Managerial agency costs inside the firm also diminish, thereby decreasing owners' demand for concentrated ownership (as their next best means to rein in agency costs) and their willingness to allow ownership separation increases. One can readily speculate that the three—social democracy, concentrated ownership, and much monopoly (or conservative politics, diffuse ownership, and fierce product competition)—tend to move in tandem.

This content downloaded from
149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms

APPENDIX

Table 3: Mark-up measure of monopoly in heavy industry (1970-1992)

Country	Metal products	Machinery & equipent*	Iron & steel	Petroleum refineries	Motor vehicles	Unweighted average minus 1	Widely-held at 20% for mid-sized public firms
United Kingdom	1.03			1.07		.050	0.60
United States	1.09	1.06	1.10	1.03	1.09	.074	0.90
Sweden	1.13	1.07	1.10		1.15	.113	0.10
Japan	1.11	1.09	1.19	1.04	1.17	.120	0.30
Denmark	1.15	1.12				.135	0.30
Germany	1.20	1.06	1.14		1.15	.138	0.10
Finland	1.19	1.14	1.18	1.11	1.14	.152	0.20
France	1.18	1.12	1.16	1.19	1.13	.156	0.00
Belgium	1.08		1.25			.165	0.20
Canada	1.16	1.15	1.25		1.14	.175	0.60
Australia	1.17	1.17	1.14	1.35	1.08	.182	0.30
Italy	1.39	1.19	1.17		1.02	.193	0.00
Norway	1.15	1.10	1.33		1.21	.198	0.20
Netherlands	1.13	1.16	1.40		1.12	.203	0.10

* The OECD data is incomplete, lacking data for some industries such as U.K. machinery & equipment. Some cells are blank because the industry is too small in that nation.

The OECD mark-up data is from Martins et al., *supra* note 29; the securities market ownership concentration data comes from La Porta et al., *supra* note 19.

Table 4: Regressing mark-up measure of monopoly on ownership concentration (from last three columns of Table 3)

	Regression coefficient (t-statistic)	R-squared
High mark-up vs. strong securities markets (from Table 3)	-0.10 (-1.94*)	0.24

*Significant at the .10 level (one chance out of 10 of relationship being random).

This content downloaded from 149.10.125.20 on Wed, 30 Mar 2022 19:29:41 UTC
All use subject to https://about.jstor.org/terms