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## Commitment & Esteem

- **Commitment** (Colin Mayer) and **Esteem** (Pettit) are two aspects of human nature that are relevant to understand all sorts of human institutions and organizations.
- Human evolution involves that commitment and esteem play a central role in human affairs. Moreover, the esteem derived from the **commitment to non-human persons** is likely to be a universal outcome of the evolution of our species.
- A naive view of evolution, paralleling the utility maximizing individual of **neoclassical theory**, would only emphasize the role of the **selfish gene** and would be unable to explain the evolutionary emergence of commitment and esteem.
- The esteem for individuals showing commitment **to non**-( and often super-) **human entities** has marked the most important achievements and the most tragic failures of our species.

## Sacrifices and group personalities

Individuals feel like being part of a single organism because:

- 1) cultural diversity and cultural evolution make groups real selection units.
- 2) selection favors groups with ideologies esteeming individuals according to their commitment to the group.

The group is treated **an independent entity characterized by a super-human personality**, pre-existing and going beyond individual lives. The personality of the group and the nature of its "fiduciaries" change from group to group but it does usually involves rules consistent with the superior community interests.

When **Cortes** went to Mexico, different ethnic groups where ready to sacrifice themselves in war to capture people to sacrifice to their super-human entities dictating their cruel laws.

## Laws as Persons

In (Plato Crito) Laws are Persons asking Socrates:

*"……since you were born, nurtured, and educated through our means, can you say, first of all, that you are not both our offspring and our slave, as well you as your ancestors?"*

The rule of law requires Socrates to accept the death sentence and not to escape from jail. The laws of the community are seen **as an independent corpus** whose will must be respected for the welfare of the community. Even if Athens was a model for democracy its rules share Aztec Gods superiority to individual fates.

Humans regard **the commitment** to a superior person expressing the rules of the community as the basis their **self-esteem**. Only on this evolutionary basis, **sophisticated legal systems and our democracies** could be built.

## LEGAL PERSONALITY AND THE RULE OF LAW

- If the power of all the individuals, including that of the present ruler, is constrained by the rule of law, **the State must be an independent person.** It must be able to have powers and liabilities and rights and duties **transcending the particular person acting on its behalf.**
- The State must be a **corporation (an independent corpus)** whose potential immortality guarantees the continuity of the laws, allowing the individuals to interact with each other under certain rules.
- A similar mechanism characterizes other institutions such as Churches Monasteries, Universities etc. . They are all independent legal persons. **As the Aztec priests,** their temporary rulers are supposed to identify with community missions, defining their (legal) personality and shaping the nature of rules that they produce.

## Chartered Corporations

Chartered corporations, such as the East ndian or the Hudson Bay companies erged from the need **to decentralize** the orderings of the National States. For distant missions abroad, rules could not be efficiently set and enforced by the central state.

The corporations became **independent legal persons** able to own goods and stipulate contracts. Their assets were separated from the assets of shareholders which were liable for the debts of the corporation only for the amounts that they had invested.

Since a (legal) person **cannot contract with itself (**or sue itself in court) chartered corporations were responsible for for **settling disputes** internal to the corporation and could build a system of internal rules (a forbearance corollary,Hodgson).

## MONOPOLY AND INSTITUTIONAL INFRASTRUCTURE

- The first chartered companies had commercial monopolies on enormous territories. Such regulations were later seen as an obstacle to free markets.
- However the Sovereign and the Company struck a deal such that the company was paying for the institutional infrastructure necessary to have markets and, in exchange, it could get some monopoly profits. And they shared with the Nation the commitment to the expansion of some political power.
- All the institutions that we have considered had an independent personality justified (directly or indirectly via a charter) by a well defined mission (defense or conquest of a territory, diffusion of the faith, education).

## The Business Corporation

- The chartered corporations made it clear the advantages that firms could derive from having an independent legal personality. They paved the way to **free incorporation**.
- The limited liability of the shareholders allowed unprecedented funding possibilities. The corporation, endowed **with its own assets and its potential immortality**, could make lasting contracts with the other persons. Many contracts and litigations were replaced by the acts of the corporation internal private ordering.
- **By decentralizing legal personality the State also decentralized the public ordering.**

According to **L. FULLER**, also the employer may find it convenient to have a ***"LEGAL SYSTEM IN MINIATURE"*** and an internal rule of law.

*" If the employer disregards his own rule, he may find his system of law disintegrating and without any open revolt, it may cease to produce for him what he thought to obtain from it."*

## Fuller: the fall from the *Legal Nirvana.*

- Fuller defined law as ***the enterprise to subject to rules human behavior.***
- This enterprise is **too costly** when it is carried out by a centralized ordering.
- The costs of Law can and are in fact decreased by **decentralizing its enterprise** to a plurality of orderings.
- Unions, Churches and Universities have **their internal orderings.** Firms, and in particular corporations, can also have their internal **private orderings.**

There is **no *Legal Nirvana:* completeness, unity and consistency can possibly be the aim of a legal ordering but they cannot be taken for granted. Legal orderings emerge from a complex process involving several institutions.**

## Fuller's Journey

Costly centralized public orderings.

The firm as decentralization of public orderings

## Coase: the fall from the *Economic Nirvana*.

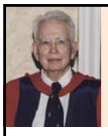
- **Coase** observed that in the world of ***pure economics*** all decisions were coordinated by prices at zero costs.
- In this world firms would not exist. We would live in what became later the world of the "***Coase theorem***".
- In ***the world of the Coase theorem*** all possible externalities, including those related to economies and diseconomies to scale would have been **internalized by market transactions.**
- **Firms, state regulation and other arrangements** can only appear in a word where no alternative institution is available at zero costs.

There is **no *Economic Nirvana*: all institutions are costly. (Paper with Vatiero, next Joie issue).**

## Coase's Journey

Costly decentralized market transactions.

The firm as centralization of market transaction



## A joint Journey?

Costly decentralized market transactions.
Costly centralized public orderings.

The firm
as as centralization of market transaction
and
as decentralization of public orderings

## 3 (+1) Columns for the Cathedral.

- Property rules (low transaction costs).
- Liability rules (intermediate transaction costs)
- Negligence rules and criminal law (high transaction costs or inalienable assets).

- Another Column:

Private orderings and corporate governance.

Both Calabresi and Williamson involve a fundamental transformation that makes monopoly and competition two different stages of the same relations.

## Calabresi's Fundamental Transformation:

Because of the high number of possible accidents, negotiations occur after individuals have "disinvested" in specific accidents.

**Ex-Ante Competition**

↓

**Ex-Post Bilateral Monopoly**

↑

**Ex-Post Transactions under Courts Supervision.**

## Williamsons's Fundamental Transformation:

Because of the high number of possible events, negotiations occur after individuals have invested in specific assets.

**Ex-Ante Competition**

↓

**Ex-Post Bilateral Monopoly**

↑

**Ex-Post Transactions under Firms' Governance.**

## Ex-ante contractual Incompleteness

Calabresi and Williamson

↓

## Ex-post Verification Capabilities.

Calabresi — Williamson

↓ ↓

Public orderings. Independent Agents.

Fuller-Coase Emergence of the Firm.

Private Orderings. Employed Agents

## The Law-Economics Marriage

Remember that in Calabresi's Cathedral a Fuller-Coase marriage can be easily celebrated.

The corporation can be seen as a child of the marriage embodying the genes of both parents:

a centralization of market transactions

a decentralization of the public ordering.

Both processes require the formation of an autonomous legal entity.

The main feature of the corporation is not a common property of non-human assets but a system of common liabilities and of centralized power which, inter alia, allows an internalization of a Calabresi-type judicial function.

## Hart's non-fundamental transformation:

Lacking courts' verification, ex-post bargaining is not constrained by competitive markets.

**Ex-Ante Competition**

↓

**Ex-Post Bilateral Monopoly**

↑

**Ex-ante competitive exchanges of property rights .**

## GM-Fisher Body: an hold-up story?

- Much literature sees the reason for the existence and growth of firms in common ownership of machines and plants which avoids hold-up problems.
- A typical example, given in this literature, is the GM-Fisher Body vertical integration when Fisher-Body was holding-up GM which wanted to expand production facilities
- Fisher increased its short-term profit by failing to make the investments required by GM in a plant located near GM production facilities in Flint, Michigan.

## Top management with a judicial function.

GM growth required the adjudication of the responsibilities among individuals cooperating in production.

Example: Kettering vs. the production production and the failure of the copper-cooled (air-cooled) engine.

*The role of Alfred Sloan:*

- Separation between top management and management of division
- No horse trading in the central offices.
- Top management with a "judicial function" adjudicating rewards and liabilities.

## A different interpretation.

- The transition from open body to closed body.
- Road-holding: fit between car body and engine.
- Unlike airplanes and boats, the body and engine of the car became co-specific.
- Unified liability towards customers and internal adjudications of liabilities.
- Sloan's "internalization" of the judicial function.

## The usual view of the degenerate child

- Many economists (such as Demsetz) have seen the corporation as generated by high transaction costs: they make it convenient to centralize contracts in the corporations.
- However, the corporation is seen as degenerate child of the market: its powerful incentives are lost and manager's incentives are not aligned with the goals of shareholders.
- Remedies: incentives, such as stock-options, could re-align managers' incentives with the interest of the corporation.

## Posner: advantages of the degenerate child

- The business corporation ended up by having a legal personhood similar to that of other public organizations.
- It had an inner dynamism superior to other organizations whose personalities were restricted to a territory (national states and their bodies) or to a specific mission (universities), or which required faith in particular beliefs (churches).
- The business corporation has no territorial limitation, no specific mission, and no faith constraining its opportunities.

## Posner: disadvantages of the degenerate child

- However, territory, mission and faith do not simply constrain personalities; they also define their identities.
- This may be particularly important in the case of non-mortal legal persons. In spite of their non-mortality, these can only live if some mortal individuals identify with them.
- This identification is much easier if the non-mortal person has a well-defined identity.

In the case of Posner the corporation stems from a decentralization of legal personality to a half-person that can be sold and bought on the market. The bench marks for degenerate child are the public bodies that generated it.

## Degenerate parents!

- If the corporation was generated by costly markets and/or by costly centralized orderings, there are no perfect parents.
- Degenerate parents generated degenerate children.
- There is no perfect bench-mark to which the corporation should be compared.

We are always comparing imperfect solutions.....

## Business Corporations as half-persons

Iwai says that *the business corporation is a half-person.*

- **Like a person** it can commit itself to rules and internal orderings, make contracts and enhance its reputation. And indeed its potential unlimited life should mark its superiority with respect to physical persons.
- However, **unlike a physical persons and unlike other legal persons** such as Nation-States, Monasteries, Universities etc it can be treated as a thing to make money and can be bought and sold in the market **as a thing.**
- But things **are hardly compatible with persons**. They cannot command much **esteem** for people committed to them and they cannot make **commitments** that real people are going to trust.
- If the **thingness** of the corporation invades **all its personality**, then even its economic advantages fade away.

## Keeping degeneration under control

Shareholders have long term advantages from the fact that as a person the corporation can take commitments with other parties.

However, they can also gain from selling the corporation as a thing to new owners who do not honor these commitments.

For some time two different institutional arrangements could keep the degeneration of the corporate personality under control.

## THE ORIGINS OF THE AMERICAN CORPORATE MODEL

- At the time of the second industrial revolution, thanks to two major revolutionary conflicts (independence war and secession war), the US had already fought successfully against the old European aristocracy and the slave-owning American farmers of the South.
- The development of large firms happened in the framework of **a strong democracy.** Large block holdings, present in more than one firm, were seen with suspicion by early antitrust authorities, (Sherman and Clayton acts). Pyramids were dismantled by F.D. Roosevelt by the means of appropriate fiscal policies.
- This "exceptional" early dispersion of capitalist interests made it less important to concentrate workers' interests in strong unions and in social democratic parties.
- A *dispersed equilibrium* emerged.

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## The American anti-degenerative medicine

The American dispersed equilibrium has encouraged investment in human skills of professional managers, the diversification of ownership, and the concentration of large amounts of capital in corporations.

By contrast, it has provided only very mild incentives for the human capital of owners and workers. The absence of family control and the extension of managerial hierarchies have allowed the growth of large corporations.

**Ownership dispersion (and weak unions) and the independence of management have allowed managers to make commitments on behalf of the corporation. In this way the corporation could not be easily treated as thing and could often act as a reliable person.**

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## Evolutionary roots of the European Corporations

- The European countries (with possible exception of Switzerland) followed a different path: at the time of the second industrial revolution, their societies were hierarchical and still permeated by **aristocratic privileges.**
- No democratic authority could limit the concentration of the power of the capitalist dynasties occurring with the second industrial revolution.
- A social-democratic reaction concentrated also workers' interest.
- A *concentrated equilibrium* emerged in all these countries.

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## European anti-degenerative medicines

- This distribution of rights entailed a stronger incentive for owners (and their heirs) to invest in the human capital necessary to run firms.
- At the same time, employment protection creates conditions favourable to firm-specific investments also for some workers.
- The personality of the business corporation is saved from its "thingness" by the identification of the corporation with the fate of the family's dynasty and by the countervailing powers of the unions. German codetermination system is an example of this type of anti-degenerative medicine.

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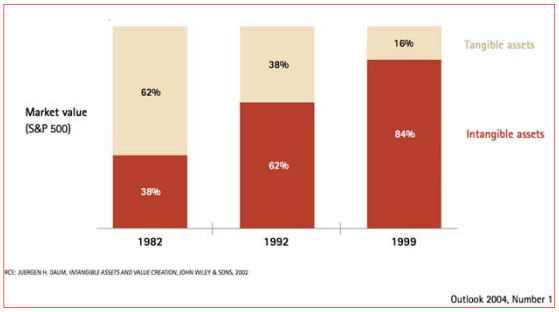
## THE FAILURE OF ANTI-DEGENERATIVE MEDICINES

- The financialization of the economy involves a failure of the anti-degenerative medicines of corporate personality.
- Financial pressure makes managers of Anglo-American corporations treating the corporation as a thing from which they have to extract the maximum value for their shareholders, even when they have taken as persons commitments with other stakeholders.
- Financial pressure has the same effect on European family dynasties that can sell their assets to raiders that break the commitment that they have taken with other stake holders. The weakening of Unions makes these moves much easier.....
- However, the change that is taking place cannot be understood without referring to another related change of modern capitalism.....

## 1982-1999: La great mutation of corporate capitalism



## Intellectual monopoly capitalism

- Big corporations have moved from being rich in machines (and numerous skilled workers) to being rich in intellectual monopoly. Patent, copyrights and trade marks have now become the lion's share of big corporations assets and they are a distinctive characteristic of a new form of intellectual monopoly capitalism.
- The 1980 Bayth Doyle Act and the 1994 TRIPs agreement (an annex to the institution of the WTO) have allowed a massive privatization of knowledge.
- Corporations have exploited the huge economies of scale and of scope that arise when knowledge becomes a private input. They have also been able to decentralize production to firms in low labor cost countries without the fear that knowledge could be used by their competitors.

## The Knowledge-Economy Paradox.

- **The non-rival nature of knowledge,** which could in principle favor small, and even self-managed, firms, **is used to create artificial economies of size which make a cheap acquisition and the defense of property rights possible only for big business.**
- Absent knowledge privatization, the need to provide incentives to invest in human capital would be an argument favoring the labor-hiring-capital solution.
- Because of the monopolization of intellectual capital the knowledge economy can become the **most unfriendly environment for small labor-managed firms and an ideal setting for big corporations, giving a partial solution to the anti-commons problem (Deakin).**

## Vicious and virtuos *circles*

The monopolistic ownership of intellectual property encourages investment in the skills necessary to improve the knowledge that one owns. The skills that are developed make it even more convenient to acquire and produce more private knowledge.

Other individuals may be trapped in vicious circles of under-investment in human capital where the lack of intellectual property discourages the acquisition of skills and the lack of skills discourages the acquisition of intellectual property.

## Commodification of knowledge Financialization of the economy

**Commodification of knowledge** ⇄ **Financialization of the economy**

The **commodification of kwowledge** allows the firm to be traded as a thing of financial markets (not equally possible for knowledge embodied in human beings).

In turn, **the financialization of the economy** induces companies to commodify their intellectual capital because they need to attract cheap finance.

## Knowledge-intensive things

- The "intangible" corporation has become an irresponsible thing. Thanks to strong IPRs, production can be outsourced and many stakeholders have lost rights in the corporation.
- Since its profits derive mainly from intellectual monopoly , the knowledge intensive corporation is also a litigation-intensive one. As a shareholders' thing the corporation is ready to find all the possible ways to defend and expand the knowledge, disembodied from the workers, that it also owns as a thing.
- The main advantage of legal personality lies now on the possibility of assembling large packages of complementary knowledge and partially overcoming the anti-commons tragedies arising from knowledge privatization. This partial solution of the anti-commons problem comes together with an even greater monopoly power of the modern corporation.

## New Charters for New Monopolies?

- Old corporations had a monopoly on a limited (but fairly vast) territory. New corporations have a monopoly on a limited (but increasingly large) field of knowledge.
- In the case of old corporations a charter guaranteed the consistency of corporation's monopoly power with national interest that was the colonization of new lands.
- Should we have a charter that makes the monopoly power of corporations consistent with the aim of advancing the frontiers of knowledge and developing the skills of the workers?
- Or should we refer to a later stage of the history of the chartered corporation when their monopoly power was limited and state undertook the task of managing the institutional infrastructure of the colonies?

## Intellectual Monopoly

- Intellectual property is a temporary intellectual monopoly, restricting temporarily the liberty of others to use the good .
- This restriction involves always some **inefficiency** but it may be compensated by the incentives that the acquisition of a monopoly gives to the producers of new knowledge (**incentive effect**).
- However, against this positive incentive effect, one should consider the negative effect that intellectual monopoly has on the intellectual investments of other firms (**blocking effect**).
- Observe that when "intellectual property" is enforced with greater vigor, the **incentive** effect is **immediate** whereas the **blocking** effect comes **later**.
- One can still argue that corporations give a partial solution to the anti-commons problem that would arise if their rights on intellectual property were dispersed among different owners. However, the investment blockage arising from their concentrated monopolistic power may still be sufficient to provoke a stagnation of the global economy.

## IPRs as global tariffs

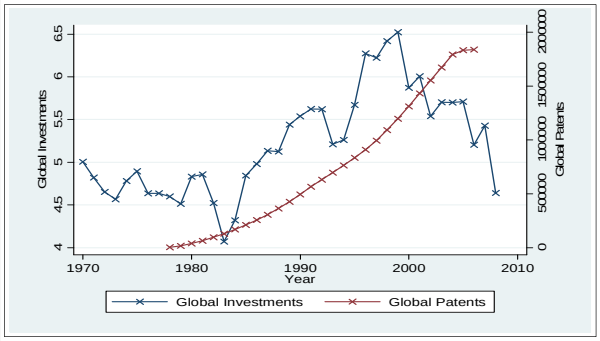
IPRs can be seen as global tariffs.

While a tariff limits the imports of the good in a single country, an IPR involves that the good cannot be produced by other firms and in other countries.

IPRs involve a new type of specialization and international division of labor in which countries may be forced not to specialize in the areas where they do not own IPR.

Countries and firms with substantial packages of IPR do relatively better than those deprived of technology ownership. However, the overall effect is an increasing global famine of innovative investment opportunities.

## Global Patents and Investments.




## Dynamics of Intellectual Monopoly Capitalism

- The overall restriction of investment opportunities generates a dynamic process shown in the preceding figure (joint work with Filippo Belloc).
- In the figure of the preceding slide, we can observe a total world increase of investments for about five years after the TRIPs but, after this initial phase, a continuous decline starting in 1999 and culminating with the recent global financial crisis.
- The interactions between productive forces and production relations is likely to have produced two different dynamics of *Intellectual Monopoly Capitalism*, the first characterizing the roaring nineties and the second the much less glamorous first decade of the new millennium. And the 2008 financial crisis was more due to a famine of good investment opportunities than to a saving glut……

## Improving corporate personality

One remedy for the increased *thingness* of the corporation is to decrease the power of shareholders and the pressure of financial markets.

A complementary policy is to weaken corporate intellectual monopoly . More knowledge in the public space and more knowledge embodied in workers are likely to make corporations more committed to people and less responsive to financial markets.

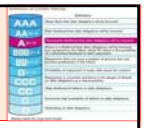
Weakening intellectual monopoly may improve:

corporate personality and its capability to commit and the esteem for the people committed to them.

the global economy by opening innovative new investments opportunities for a non-rival good such as knowledge.

wealth distribution between the few, owning technological trajectories, and the many have-nots.

## Stopping the chartering reversal



- Corporations started with a charter granting them a monopoly. Business corporations were supposed to face competitive conditions and charters were supposed to be unnecessary.
- New intangible-intensive corporations have substantial monopolies but no charter limiting their power. Traded as things in financial markets, their profitability dictates charters to States specifying what they can and cannot do to compete for their investments.
- This chartering reversal should be stopped. It is not only undermining the global economy but also our democracies which, together with corporations, are becoming things run by financial markets.
- Democracies must regain the status of full persons, capable of commitment, and must also regain the esteem of their citizens.