

Politics–business co-evolution paths: Workers' organization and capitalist concentration

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ABSTRACT

Most pre-crisis explanations of the various corporate governance systems have considered the separation between ownership and control to be an advantage of the Anglo-American economies. They have also attributed the failure of other countries to achieve these efficient arrangements to their different legal and/or electoral systems. In this paper we compare this view with a different approach based on the hypothesis that politics and corporate governance co-evolve, generating complex interactions of financial and labour market institutions. Countries cluster along different complementary politics–business interaction paths and there is no reason to expect, or to device policies for, their convergence to a single model of corporate governance. We argue that this hypothesis provides a more convincing explanation of the past histories of major capitalist economies and can suggest some useful possible scenarios of their future institutional development. Bayesian model comparison suggests that the co-evolution approach turns out at least as influential as the competing theories in explaining shareholder and worker protection determination.

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1. Introduction

The current crisis has marked a new end of the end of history in corporate governance.¹ Before, the crisis, like the earlier successes achieved by Japan and Germany, the recent success of the American economy and the revival of the British economy had attracted the attention of many economists and policy makers. The legal origins approach (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998; La Porta, Lopez-de-Silanes, & Shleifer, 1999) claimed that the Anglo-American success was rooted in the different common law and civil law traditions characterizing these countries well before the advent of capitalism. In common law systems, private owners, including the minority shareholders of contemporary large firms, could be

better protected. Another approach (Pagano & Volpin, 2005) had emphasized that the non-proportional electoral systems, prevalent in the Anglo-American countries, favored shareholders-friendly political coalitions. Legal and electoral reforms were advocated to change what was once upon a time an American exception into the general rule to be followed by all countries.

“American exceptionalism” has long been a puzzle for social scientists. However, the nature of the problem has somewhat changed over time. Becht and DeLong (2005) have observed that a century ago academics like Werner Sombart were intrigued by the exceptional nature of the United States in that it did not have socialism, while today academics are concerned about a different form of American exceptionalism: the negligible role of block holding in the United States.

Mark Roe (2003)'s contribution suggests an interesting link between the past “non-socialism” and the recent “non-block-holding” American puzzles: a tradition of very weak social democracy could explain the negligible role of block holding. According to Roe (2003), the higher the degree of social democracy, the stronger the tendency of employers to organize themselves into concentrated forms of corporate ownership with one or few major block holders. Fig. 1 plots the residuals obtained from the regression of the labour protection index and of the ownership

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¹ Hansmann and Kraakman (2004) have even described convergence to the Anglo-American model as the “end of history of corporate governance”. Other authors (see, for instance, Morck, Wolfenzon, & Yeung, 2005, and James, 2006) have argued that a variety of arrangements exist in modern capitalist economies, and that family groups are the prevailing form of organization in some countries. Bebchuk and Roe (2004) have emphasized the path-dependent nature of corporate governance.

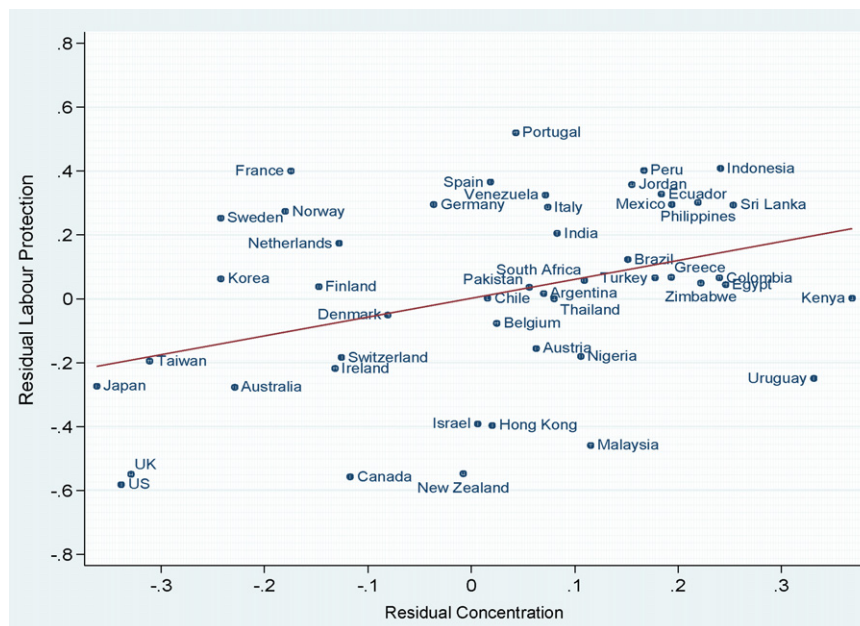


Fig. 1. Partial regression plot of labour protection index and ownership concentration (independent variable is per capita log GDP). Coef. = 0.5916 (p -value = 0.006).

concentration index over log per capita GDP for 47 countries.² As is apparent from the fitted regression line, there is a significant positive cross-country correlation between the degree of protection of workers' rights and the degree of corporate ownership concentration, even once the cross-country differences in per capita GDP have been considered. According to this figure, American exceptionalism is an extreme case of a general relation linking employee job protection with the degree of separation between ownership and control. In order to explain the positive relation between protection of workers' rights and corporate ownership concentration, Roe (2003) suggests that there is a causality relation running from employees' political rights (social democracy) to corporate governance forms.³ One form of American exceptionalism (no socialism) has influenced the other (little block holding).

Belloc and Pagano (2005, 2009) have argued that the relationship is more complex because the causation operates in two opposite directions. Forms of corporate governance, such as the degree of separation between ownership and control, influence the strength of workers' organization. When there is no separation between ownership and control, employees are more likely to seek protection against interference by the dominant block holders and their social circle, including their relatives and friends, who may otherwise monopolize the best jobs in the company. Thus, while social democracy may prevent the separation between ownership and control, conversely the existence of powerful block holders

² The data source for the labour protection index (which includes protection of labour and employment laws plus protection of collective relations laws) is Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004); GDP per capita in 2000 is from World Bank (2004); the ownership concentration index is from La Porta, Lopez-de-Silanes, and Shleifer (2006). See Section 3.2 for a more detailed description of the variables.

³ Roe (2003) presents evidence that countries characterized by stronger job protection and employees' political rights (stronger "social democracy") tend to have more concentrated corporate ownership forms. The causality relation is, however, not tested by the author. In similar vein, Mueller and Philippon (2011) argue that (family) concentrated ownership is relatively more common in countries where labour relations are hostile, while dispersed ownership is prevalent in countries characterized by cooperative labour relations. They also offer coherent empirical evidence using survey-based measures of the quality of labour relations and ownership structures data for 30 countries.

may favor some sort of reaction in terms of workers' protection. This relationship entails multiple co-evolution paths between ownership concentration (business) and workers' organization (politics): a certain degree of centralization of one side's interests may easily induce a corresponding concentration of the other side's interests (this view will be referred to hereafter as the *co-evolution approach*). As in an arms race, the interactions between business and politics can produce different degrees of organization in the owners' and workers' interests (Belloc & Pagano, 2009). In similar vein, Gelter (2009) argues that, seeking to re-balance the power of the weaker part, legislations lead to multiple configurations of the economy. Typically they couple weak shareholder with weak stakeholder legal rights and strong shareholder with strong stakeholder rights. Also in this perspective, there is no evident criterion to rank these two local optima.⁴ This approach can also be enriched by relating it to the recent Scartascini and Tommasi (2010) analysis of different degrees of institutionalization of politics. Also in their approach, the behaviors of the conflicting agents co-evolve, generating two stable equilibria – "congress" and "street" – which are somehow related to the concentrated and dispersed equilibria considered by Belloc and Pagano (2009). Scartascini and Tommasi point out how collective interests of different social groups are channeled either by the means of the democratic institutions (the case considered by the standard political economy literature) or by threatening to organize actions damaging other social groups. In their useful terminology, the arms' races between workers and owners, considered in our paper, generate different models and degrees of institutionalization of politics.

Unlike the co-evolution approach, the other two approaches (the *legal origins* and the *electoral systems approaches*) make a ranking among the different systems of corporate governance, suggesting consequent measures for public policies. In one case the separation between ownership and control and the determination of employment protection are explained on the basis of "better" corporate laws that stem from different legal origins;

⁴ Moreover, according to Ecchia, Gelter, and Pasotti (in press) the legal protections of minority shareholders and employees influence each other and tend to produce a complex variety of institutional arrangements.

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