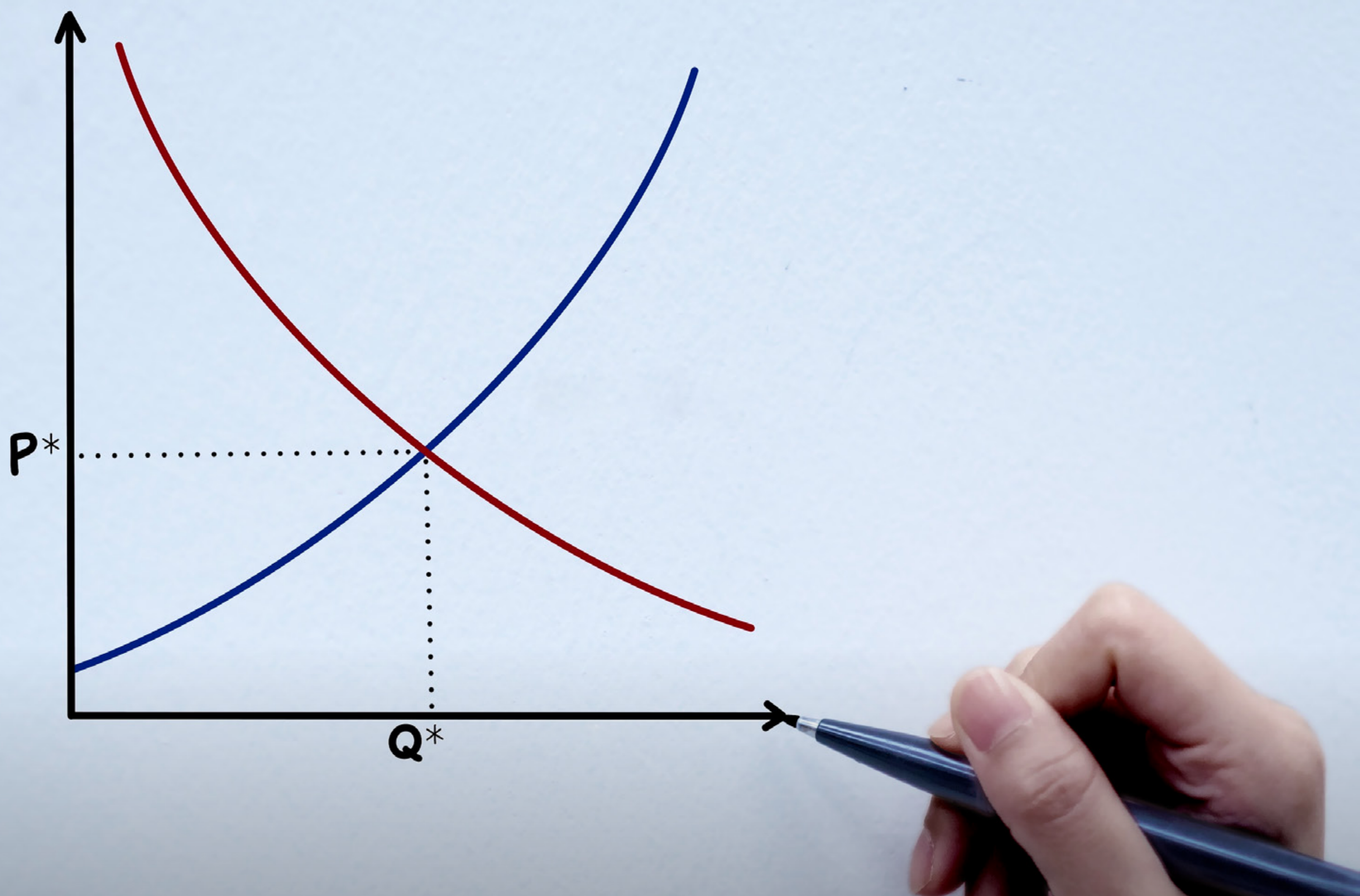
ECONOMIC DEMOCRACY AND MARKET POWER



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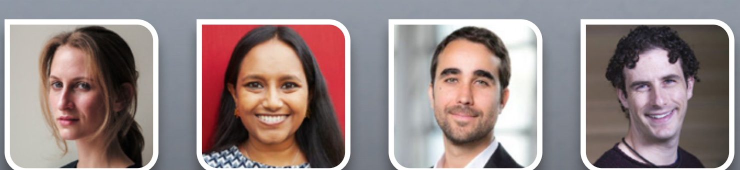

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I. INTRODUCTION

Dissatisfaction with the present state of corporate capitalism has reached something of a boiling point. Global business elites are finally responding to years of simmering discontent, exemplified by social movements like Occupy Wall Street and by progressive presidential candidates' proposals calling for more aggressive antitrust and regulatory policies. The fundamental purpose of the corporation – long defined by the shareholder value paradigm – is being revisited. Business leaders and policymakers seem to be summoning a reorientation of the corporation around *stakeholders*, rather than shareholders. The Business Roundtable, a group of nearly 200 chief executives of major U.S. corporations, broke with decades of corporate doctrine in April 2019 when the group distanced itself from the shareholder value standard, issuing a statement affirming a "fundamental commitment to all our stakeholders." The official theme of this year's World Economic Forum in Davos was "Stakeholders for an Inclusive and Sustainable World;" the conference focused on imagining a new stakeholder-based capitalism.

Despite resounding calls to reorient the goal of corporate America around "stakeholders," the path forward is unclear. Is it enough to reinvigorate our existing antitrust laws and task them with protecting stakeholders in steadily concentrating markets? How does corporate governance, which currently epitomizes the shareholder value paradigm, need to change in order to engineer the reorientation toward stakeholders? Some, aligned with the "antitrust revival" are calling for break-ups here, there, and everywhere.[2] Others, unwilling to sacrifice the perceived efficiency and international competitive advantages of large monopolistic corporations, argue that companies with market power simply need to be more tightly regulated to ensure that their operations align with stakeholders' needs.[3]

In what follows, we cut a path through this thicket. We draw on the original motivations of antitrust to suggest a potential change to corporate governance: democratically include corporate stakeholders as a remedy for market power.

In arguing in the Senate for the Sherman Antitrust Act that eventually bore his name, Senator John Sherman declared, "If we will not endure a king as a political power, we should not endure a king over the production, transportation, and sale of any of the necessaries of life." In response to monarchies of the past, subjects of the crown called for democratization. Such democratizations transformed subjects of the crown into a sovereign people to whom the government was accountable. A similar democrati-

2 See, for example Tim Wu. *The Curse of Bigness: Antitrust in the New Gilded Age* (2018); Lina M. Khan. "The separation of platforms and commerce." *Columbia Law Review* 119, no. 4 (2019): 973-1098; Lina M. Khan." Amazon's antitrust paradox." *Yale LJ* 126 (2016): 710; Matthew Stoller. *Goliath* (2019); Elizabeth Warren. "Reigniting Competition in the American Economy." *Keynote speech at New America's Open Markets Program Event, June* 29 (2016).

3 Robert D. Atkinson & Michael Lind. *Big is beautiful: Debunking the myth of small business.* MIT Press, 2018 and Cowen, Tyler. *Big Business: A Love Letter to an American Anti-hero.* St. Martin's Press, 2019.

zation could reshape corporate monopolies by making corporations accountable to those over whom they hold market power. Such “economic democracy” is a potentially effective approach to market power that avoids some pitfalls of both the populist antitrust resurgence and the desire to support industrial scale in the form of “national champions” or “entrepreneurial genius.”

The current limited interpretation of antitrust is based primarily on “structural remedies,” such as break-ups and prohibitions of mergers, as well as top-down “behavioral remedies,” that proscribe and regulate certain forms of conduct. This approach may deter or prevent the most harmful conduct, but it relies upon either regulatory elites at competition enforcers or enforced competition to protect stakeholders. This limited interpretation also traps us in a dilemma. On one hand, if we choose to allow corporations to harness the benefits of scale, we are ruled by democratically illegitimate and economically distortive monopolies, or by technocratic and largely unaccountable regulators. On the other hand, if we choose to promote break-ups, we leave national governments as the primary source of economies of scale. Antitrust policies, distrusting government intervention, tilted towards the former horn of the dilemma, to the detriment of democracy. Democracy has suffered in two ways: there is a lack of democratic control over corporations, and undemocratic control of powerful corporations over government. Recent work has shown that antitrust policies have failed even in their limited aims of defending the welfare of consumers.[4]

It is the symptoms of this “divine right of capital” that leave people all around the world restless for change.[5]The primary manifestation of this discontent is the “antitrust revival” that has increasingly called for more break-ups and restraints on the power of dominant firms.[6] While break-ups may be effective in some cases (such as when the products separated have few synergies), there are many industries in which the “antitrust revival” approach strikes critics as both insufficient and excessive. These measures seem insufficient to those who doubt that break-ups will stop the rise of super-dominant firms in sectors ruled by network effects, like network technology.[7] These measures seem excessive to those who believe that break-ups in those areas may disrupt many of the benefits that flow from such network effects.[8] In fact, recent results from the economics literature suggest such scale economies may be primarily responsible, even more so than the deficiencies of antitrust policy, for the rise of market power.[9] If we could democratize market power itself, we could move beyond this stalemate.

What does it look like to democratize market power itself? “Stakeholder remedies,” as we will call them, require shifting the roles of the consumer and others currently targeted by corporate power. No longer passive recipients of market outcomes whose only option is to “exit” and buy another product, consumers and other stakeholders could be empowered with “voice” as active participants in the democratic governance of markets. In some cases where break-ups are either insufficient or excessive, a firm’s market power can be remedied by giving consumers, workers, and other stakeholders power over that firm. It is a simple idea and yet it holds the potential for resolving key tensions in competition policy and in our broader political landscape.

4 See for instance John Kwoka. *Mergers, merger control, and remedies: A retrospective analysis of US policy*. Mit Press, 2014 and Carl Shapiro. “Protecting competition in the American economy: Merger control, tech titans, labor markets.” *Journal of Economic Perspectives* 33, no. 3 (2019): 69-93.

5 Marjorie Kelly. *The divine right of capital: Dethroning the corporate aristocracy*. Berrett-Koehler Publishers, 2001.

6 See for instance Jacques Crémer, Yves-Alexandre de Montjoye, and Heike Schweitzer. “Competition policy for the digital era.” *Report for the European Commission* (2019) and Motta, Massimo, and Martin Peitz. *Challenges for EU Merger Control*. University of Bonn and University of Mannheim, Germany, 2019.

7 See for instance William E Kovacic. “Failed expectations: The troubled past and uncertain future of the Sherman Act as a tool for deconcentration.” *Iowa L. Rev.* 74 (1988): 1105.

8 See for instance K. Sabeel Rahman. “The new utilities: Private power, social infrastructure, and the revival of the public utility concept.” *Cardozo L. Rev.* 39 (2017): 1621.

9 Luis Garicano, Claire Lelarge & John Van Reenen. “Firm size distortions and the productivity distribution: Evidence from France.” *American Economic Review* 106, no. 11 (2016): 3439-79.

II. STAKEHOLDER REMEDIES

Imagine that a regulator discovers market power in an industry. Rather than taking punitive action against the dominant firm, we could give voice to those subject to the firm's market power. This remedy could take at least three possible forms: (i) representation at the board level for the relevant stakeholders, as in the German co-determination model, with the options to maintain a unitary board or adopt a supervisory board; (ii) a formal fiduciary duty and amendment of the legal goals of the firm as in the proposals for stakeholder capitalism or the model adopted by benefit corporations[10] but with additional enforcement mechanisms; or (iii) the right of the counterparties over which the firm holds power to an exemption from competition enforcement in order that they may interact collectively and cooperatively to counterbalance the power of the dominant firm.

There has been some limited experimentation with remedies along these lines already. In the context of the ASCAP and BMI performance rights organization settlements, music users such as radio and TV stations were given the right to take the collecting societies to court over rate-setting for music licenses. So, part of the settlement was specifically aimed at empowering counterparties, as part of a broader scheme to prevent the abuse of market power.[11] In the private settlement of the credit card cases, Visa and Mastercard agreed to engage with collective bargaining on the part of merchants, although Congress has not supported this exemption as a general principle.[12] A key difference between these efforts and what we would propose, however, is the democratic accountability of the institutions allegedly representing stakeholders. Just as labor unions, to qualify as representatives of workers, are required to hold elections and be fiduciaries for their members, so too any organization delegated representation through stakeholder remedies must itself be democratically accountable to those it purports to represent.

The Accountable Capitalism Act proposed by Senator Elizabeth Warren pushes in a similar direction. However, the proposed legislation is much broader in scope and coarser in its application. It uses corporate size as its trigger and primarily empowers workers. Our proposal could be a supplement or a modification to such legislation. We propose a more narrowly-targeted notion of economic democracy, which short circuits the endless back and forth between the defenders of scale and the opponents of market power. We do not need to take an inflexible position on whether "big" is bad or good, a curse or a blessing – sometimes it will be one or the other and most often it will be both. Instead, we zoom in on the key harm created by scale, market power, and consider how we can remedy this distortion in a way that is both efficient and fair.

This approach also takes us beyond the confines of the "competition primacy" paradigm that assumes more competition is better, even in industries inhospitable to competition. The remedy of breaking up companies follows naturally from this deconcentration framework but, with firms continuing to align themselves to a model of corporate governance premised on shareholder value, aiming for perfect competition requires constant, almost omniscient, vigilance on the part of the enforcer to counter the myriad strategies firms will use to insert a wedge between stakeholder welfare and corporate interests. Economic democracy addresses the key harm from market power: the abuse of dominance to exploit counterparties. Wherever the system allows such abuses of market power, they will take place. At best, competition can mitigate this, though sometimes at significant cost to efficiency.

Under our stakeholder antitrust model, consumers and other market actors need not rely exclusively on national governments whose constituency might align poorly with the set of consumers and workers of a multinational firm. Instead power is given to stakeholders when market power over them has been identified. It is analogous to John Kenneth Galbraith's conception of "countervailing power."[13] But there is a critical modification. Galbraith thought that countervailing power would be self-generating in the market. Here, we accept the insuperable collective action barriers, and sometimes legal barriers that prevent stakeholders from coordinating their power. It is necessary for the stakeholder remedy to be administered by the enforcer and for formal rights to be given to stakeholders who would otherwise lack the platform for pooling their countervailing power.

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10 Frederick Alexander. *Benefit corporation law and governance: Pursuing profit with purpose*. Berrett-Koehler Publishers, 2017.

11 The Department of Justice is currently reviewing these consent decrees (see here: https://www.justice.gov/atr/antitrust-consent-decree-review-ascap-and-bmi-2019) and concerns have been previously voiced by stakeholders that removal of the consent decrees would harm the interests of independent publishers and songwriters in favor of the most powerful music publishers (see here: https://futureofmusic.org/article/fact-sheet/ascap-bmi-consent-decrees).

12 Matt Stoller. *Goliath. The 100-Year War between Monopoly Power and Democracy*. New York: Simon & Schuster, 2019.

13 John Kenneth Galbraith. *American capitalism: The concept of countervailing power*. Vol. 619. Transaction Publishers, 1993.

Of course, the magnitude of these remedies would have to be modulated to the size of the market power found by the authority's investigation. Excessive voice for stakeholders over whom the firm does not hold significant power could be just as harmful as too little voice, as every stakeholder, if given too much power, will use it to exploit others. There are plenty of examples of worker cooperatives becoming protectionist guilds and of consumer cooperatives mistreating their workers. Only balanced and proportional representation of stakeholders consistently promises to improve over status quo remedies.

Measuring the degree of market power a firm holds over each of these counterparties is a substantial challenge, but is already a necessary component of every major antitrust investigation at present. In on-going formal economic work, some of us are working to determine quantitative standards for translating these measurements into the size of invoked remedies. There are many open questions. Often, the impact of market power on different stakeholders may differ widely, and the appropriate remedies may therefore vary depending on the case at hand.

In addition, there are tricky open questions about which externalities created by firms may be attributed to their market power and thus belong within the scope of a policy of stakeholder remedies. For example, some scholars, including some but not all the authors of this piece, see environmental externalities as principal harms of corporate power. The exact relationship between market power and the full range of externalities created by firms requires further research, as does who would be appropriate stakeholders in the case of such wide-ranging externalities.[14] Furthermore, firms would have the opportunity to propose other remedies that address the market power problem, such as aborting the proposed merger, if they prefer another solution over democratization.

Economic democracy widens the options available to companies. It offers greater possibilities when a company contemplates settlement, while also allowing for more ambitious enforcement as authorities need not choose between preserving purported synergies and addressing market power problems. For example, a merger with significant anticompetitive effects and efficiencies (e.g. *Alstom-Siemens*) should be subjected to an economic democracy remedy, not simply allowed to go through (or blocked).

III. RESOLVING TENSIONS IN CORPORATE REGULATION

This policy framework helps resolve several of the key divisions in the current debates about competition and corporate governance. One of the central divisions is between those who advocate the importance of scale (including defenders of big business in the U.S. and of national champions in Europe) and those who believe competition is more important. Economic democracy allows us to achieve scale while restraining the harm created by market power. Indeed it may actually encourage growth, by giving counterparties incentives to work with or buy from a large firm, knowing that their collaboration will not later be exploited. It is a complement to the idea that shareholders take only from the residual of firm profits because their investment is a commitment that allows all other stakeholders to engage with the firm and invest their labor and purchasing power and supplier relationships.[15]

Another tension is between those who seek nation state-based regulation (to secure democratic voice) and those who favor deregulation in the process of regulatory harmonization (to allow free cross-national trade). In our model, democratic voice is central, but is built around the consumers, workers, and other counterparties of a firm without fear or favor towards the arbitrary historical borders of any particular nation state. Instead of centralized, rigid, and historically-bound regulation by national government we can insert into the market decentralized, dynamic, and flexible regulation by stakeholders, underwritten by the regulatory force of the state but not primarily implemented by the state. In fact, a vigorous regime of economic democracy might eventually give rise to new forms of cross-national democracy that can address the many challenges that transcend existing governance institutions.[16]

A third point of discord is between the advocates of stakeholder capitalism and defenders of shareholder value. A common critique of stakeholder value is the difficulty in identifying which stakeholder interests are to be accounted for and how to balance conflicting interests.[17] Another criticism is that making company leaders responsible for stakeholders actually serves to remove accountability for management per-

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14 Michelle Meagher. *Competition is Killing Us: How Big Business is Harming Our Society and Planet - and What To Do About It*. Penguin Business September 2020

15 Colin Mayer. *Firm commitment: Why the corporation is failing us and how to restore trust in it*. OUP Oxford, 2013.

16 Colin Mayer. *Prosperity: better business makes the greater good*. Oxford University Press, 2018.

17 Michael Magill, Martine Quinzii, & Jean-Charles Rochet. "A theory of the stakeholder corporation." *Econometrica* 83, no. 5 (2015): 1685-1725.

formance, in a way that rarely benefits stakeholders themselves.[18] By contrast, our framework suggests a clear-cut resolution: the law already identifies which stakeholders are to be protected by acknowledging that firms have power over consumers, workers, and other stakeholders, so by giving these groups voice to represent themselves they will be able to counter corporate power in a way that goes beyond the ever-vague "exit options" promoted by defenders of shareholder value and without sole reliance on management incentives.

A final tension it resolves is between advocates of countervailing power, for example to allow workers to organize, and the advocates of aggressive antitrust enforcement. While both have long been important aspects of containing concentrations of economic power, there has long been a tension between them as some zealous antitrust advocates have been also skeptical of union power, while many advocates of unions fear antitrust laws will be brought to bear against them.[19] This framework combines the two seamlessly into a single, unified framework.

Further, democracy may, in some cases, be a more efficient economic response to market power than are break-ups, merger prohibitions or conduct restraints, although each of these will still play a role. The gradual transfer of voice to stakeholders is only a slight harm to companies that already need to account for stakeholder interests in their product design, pushing them to formalize and take these efforts more seriously. At the same time, it greatly enhances their democratic legitimacy and, if they wish to avoid stakeholder power, they can always shrink themselves and avoid accumulating market power.

IV. IMPLEMENTATION

There are many details of implementation that must be worked out. Difficult questions about the appropriate legal and economic design of the remedies remain. For example, which stakeholders will be given voice? Standard theory recognizes market power over consumers and workers. Will customers be given a seat on the board even if they are also competitors? What about when the government is a major customer? Are the rights to be granted indefinitely or would they be reversed on a showing of diminished market power or countervailing market power from a competitor? How are stakeholders to enforce their governance rights if they form a minority of the board, when currently only shareholders have a right to sue for breach of fiduciary duty? Should any complaints be directed towards the antitrust authority or towards a new kind of corporate regulator with an institutional setup better adapted to dealing with questions of corporate governance?

Furthermore, economic democracy on its own does not solve all problems. We cannot expect that stakeholders will perfectly understand how to protect their own interests in the absence of an infrastructure helping them to coordinate. Companies will continue to favor insider interests, even if an expanded list of insiders, and corporate power will be wielded to their benefit, possibly to the detriment of others. All stakeholders are not made equal – some have market power in their own right and may seek to use stakeholder empowerment to extract further rents, and probably need to be democratized themselves in line with awarding them representation (as discussed above regarding the banks in relation to Visa and Mastercard). The German approach of looking at relative market power may also be relevant in that context. In industries with very strong scale economies, even a firm making no profits will still exercise market power and would require subsidies to break even. In those cases, economic democracy can push in the right direction, but more extensive policies would be required to resolve deeper limitations of capitalism. For example, sometimes market power problems will spread beyond the boundaries of one firm and the remedy will have to be applied to whole markets. In such markets, the very nature of competition would change. In parallel to common ownership across shareholdings, common representation of stakeholders across the boards of all companies in a sector may raise its own challenges.

But well enforced and carefully implemented economic democracy is nonetheless a powerful remedy for market power deserving of further attention and exploration. It allows competition to operate within a market regulated not just by the state but by stakeholders themselves, redressing the imbalances that otherwise inevitably arise when companies exploit market imperfections to entrench their power. It also pushes us towards a broader conception of antitrust that has the potential to create a structural shift in the operation and expectations of business and the democratic management of the market economy. It is a natural and neglected next step that might allow us to move beyond our current stalemate in competition policy.

18 Lucian A. Bebchuk & Roberto Tallarita. "The Illusory Promise of Stakeholder Governance." *Available at SSRN 3544978* (2020).

19 On the former see Stoller, *Goliath* and on the latter see Brishen Rogers, "The Limits of Antitrust Enforcement," *Boston Review* April 30, 2018.