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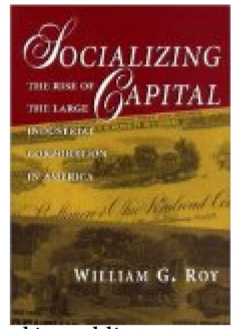
William G. Roy. *Socializing Capital: The Rise of the Large Industrial Corporation in America.* Princeton, N.J.: Princeton University Press, 1997. xv + 338 pp. $35.00 (cloth), ISBN 978-0-691-04353-1.



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This book is extraordinarily ambitious and wide-ranging in its treatment of a very significant topic. At times Roy focuses specifically on the merger wave of the 1890s, during which many large firms turned to public capital markets to facilitate mergers. But much of the book, and, from my perspective, the most interesting parts, take a much longer-term view, examining changes in property rights and the use of those rights by railroads, and then manufacturing firms, over the course of the century. Most of the central points of the book I think are correct and many of Roy's methodological points provide useful correctives to tendencies in business and economic history. There were sections of the book that I found insightful, bordering on brilliant. There were also sections of the book that I thought were unconvincing, and others that were simply wrong.

The central points of the book can be summarized as follows:

1. The large, widely-held manufacturing corporation is a social creation, not a natural entity.

2. The corporation as it exists today is historically contingent and developed from pre-existing forms. In particular, it evolved from the public corporation, used by the state to accomplish public purposes, and was given special privileges (monopoly, eminent domain, limited liability) in order to do so. The happenstance convergence of the economic crisis of 1837, the emergence of the railroad, and the power of the "anti-monopoly, anti-state" version of Jacksonian anti-corporatism privatized and democratized the corporation. Thus, the corporate form retained many of its privileges (limited liability, alienability of ownership) but made those privileges available to all through general incorporation laws. In doing so, the corporation lost its public purpose and its public accountability (as well as its claim to monopoly).

3. There existed historical alternatives. Manufacturing could have continued to be conducted in firms that were not corporations. The corporate form could have retained its public purpose and its public accountability. The state could have remained a more active economic player in its own right–owning railroads or banks or manufacturing as today the state owns highways. It could have developed a stronger regulatory apparatus, developing the capability to administer public enterprises and assure that those who received the privilege of incorporation fulfilled a public responsibility. In other words, the boundaries between public and private could have been drawn quite differently in many dimensions.

4. Manufacturing firms followed the incorporation practices of railroads because that was required by investment banking firms to get access to large pools of capital, not because the corporate form was demanded by manufacturers to coordinate increasingly complex, large-scale, high-throughput technology.

5. Manufacturing firms (the "trusts") turned to New Jersey's incorporation law in order to legalize collusive activities, not to coordinate increasingly complex, large-scale, high-throughput technology.

6. The corporation was privatized–lost its public use and public accountability–and the corporation was socialized–its securities widely owned but no longer controlled by owners–not because this organizational form was the most "efficient" way to organize manufacturing production. Rather, manufacturing firms embrace and continuing use of the corporate form was the result of

a "logic of power."

Roy uses several methods to make his case. He first presents a theoretical argument that a "social logic based on institutional arrangements, including power" (p. 6) is more useful for understanding the dimensions and dynamics of the economy than is an analysis based on "the logic of efficiency." The latter position he identifies with Chandler, and much of the book is cast as a polemic against Chandler. While I am very sympathetic to his historicizing and "de-naturalizing" of the corporation, I thought this framing of the issue was largely counterproductive. His presentation of Chandler sometimes bordered on caricature. Chandler's point is not that managers are concerned only with efficiency or that clever managers always pick the most efficient organizational design. His point is that it was only in firms where managers made choices that gave the firm a competitive advantage that the firm survived. But Roy ignores the role of competition. He argues that "efficiency theorists" are functionalists, simply providing an ex post rationalization of whatever happened to emerge. While he is certainly correct that some business history is functionalist, and neo-classical economic historians are apt to fall back on "best of all possible worlds" descriptions of whatever institutions exist, the competitive model does provide a story of why it is that we should think that those that survive are different from those that didn't; their survival is taken as an indication that they are better at competing. Thus, it would have been useful to explain how power influenced who survived the competitive process and how power determined the rules of the competitive process.

That is, it would have been useful to explain why the firms that survive the competitive process are not necessarily the most efficient. Instead, for the most part, Roy simply ignores competition as a significant force in capitalist economies, arguing that "the social arrangement that governed American industry could only vaguely be described as a market. American businessmen have always been aware that they share common interests at least as much as they compete over conflicting interests" (pp. 176-7). Roy is absolutely correct that American businessmen have often cooperated. But that does not mean that there is no market; it means that those who have been able to cooperate, and better yet, dominate cooperative agreements, are the firms that have survived and prospered. I would dispense with the word "efficiency" altogether. A more useful question is whether firms survived because they were good at inventing new, lower cost technology, good at getting workers to work harder, good at getting tax breaks from local governments, good at increasing demand for their product, good at getting access to others' property through eminent domain, good at getting cheap capital because of connections to investment bankers. Whether or not any of these particular attributes improves efficiency or is Good Thing for society as a whole (as if there is such a thing) is an altogether separate question.

Roy then turns to an econometric test of the "power" and "efficiency" explanations. He asks which industries were more likely to adopt the corporate form during the 1890s merger wave (which he measures by their use of publically-traded securities, thus excluding incorporated firms that were not traded on public exchanges). He finds that average size of the firm and capital intensity are significantly and positively related to an industry's use of publically-traded securities. He also finds that labor productivity was negatively related to the use of such securities and that industry growth rates were insignificant. He concludes from this that Chandler and "the efficiency theorists" are wrong. Size matters even when controlling for other things. Labor productivity is lower in "incorporated" industries, so it must not be that incorporation makes firms more efficient.

There are several problems with this analysis: he looks only at the 1890s and therefore conflates where the merger wave took place with where the corporate form endured. He groups "Chandlerian" causes of incorporation (growth and capital intensity) with effects (i.e. labor productivity); perhaps the negative relationship between productivity and incorporation reflects the need for organizational change in low-productivity industries? His unit of analysis is the industry, which groups together large and small firms, and he treats large industries and small industries equivalently. Are we surprised that there are no large firms in the hammock or lapidary works industries despite a faster rate of growth than electrical machinery (p. 30)? Chapter Two, which presents this econometric analysis, should be skipped entirely by anyone who has read Naomi Lamoreaux's *The Great Merger Movement* (and if you haven't read it, you should). Lamoreaux presents a much more convincing and complete econometric rejection of the Chandlerian contention that the merger wave of the 1890s was motivated by the need for vertical coordination of inherently high-throughput technology. Save your time for the more edifying chapters to come.

In Chapters Three and Six, Roy compares the history of public enterprise, the legal rights of corporations, and the emerging dominance of "socialized capital" in three states: New Jersey, Pennsylvania, and Ohio. He examines the evolution of the corporation from a tool used by states to encourage economic development and raise revenues to its emergence as a private agent, available to all through general incorporation statutes with no public responsibility or accountability. Roy argues that the differences in the experience of public investment during the canal and early railroad period, as well as the political interpretations placed on that experience, determined the rules under which corporations operated in each state at the end of the century. New Jersey had the most limited experience with public corporations, both quantitatively and qualitatively. It participated as an investor in the Camden and Amboy, and was able to keeps its taxes low as a result, but the railroad controlled the state rather than the other way around. Pennsylvania had both mixed corporations in which it invested and public corporations. Ohio had the most activist policy, both the most successful–the Ohio canal system developed the region and integrated it into the national economy–and the most spectacular failure when logrolling resulted in the expansion of public subsidization of canals and railroads and nearly bankrupted the state. Roy examines the implications of these different experiences for three aspects of corporate law: the permissibility of corporations owning other corporations, the powers of boards of directors (relative to shareholders), and the extent of limited liability. Roy finds that in all three aspects of corporate law, the experience with public and mixed corporations during the canal era shaped state attitudes such that New Jersey's corporate law was the most "privatized," allowing corporations broad flexibility in owning other corporations, giving power to corporate boards, and extending unlimited liability through both a general incorporation statute and special charters. Ohioans were at the other end of the spectrum, suspicious of the corporate form, retaining double liability and strictly limiting the activities of corporations to those for which they were chartered. Roy finds that these differences in corporate law led to differences in the importance of corporate capital in the three states. While some of this difference in corporate capital obviously reflects capital mobility–corporations with operations elsewhere chartered in New Jersey to take advantage of its lax laws–Roy's fundamental point is that business in Ohio was simply less likely to be organized within a corporation. Thus, he suggests, economic activity need not have taken place within the socialized corporation, or at least not within a corporation with no social responsibility. Where the state legislature was unwilling to confer such generous benefits on the corporation, businesses made do with other forms of organization.

This empirical conclusion supports Roy's argument that there were actually two distinct political responses to the canal crisis within the Jacksonian anti-corporate movement. One demanded more accountability on the part of the quasi-public corporation (i.e. more government), while the other demanded privatization (less government). Roy makes the interesting argument that the privatization ideology won out because it was self-fulfilling. Suspicion of the state led to weak oversight. With no oversight, projects were corrupt or failed; that failure was then interpreted as the failure of public investment (p. 74). But it is not clear from his comparison of the three states that strong state oversight was ever really in consideration. As he shows elsewhere in the book, the choices considered were either democratization of access to corporate privileges through general incorporation statutes or limitation of those privileges by statutes such as Ohio's requiring double liability and strictly limiting the activities of corporations to those for which they were chartered.

Here and elsewhere, Roy compares the choices made in the United States to those made in France where a strong and competent state apparatus was created. This comparative perspective, though presented more casually than those between the U.S. states, is often very helpful. Unlike the U.S. case where states competed with one another and were, therefore, forced into a prisoner's dilemma race to the bottom in terms of the social responsibilities of private actors, France was able to chart a very different course. Whether the "strong state" approach was one that could ever have emerged in the United States will, of course, be debated by many. But that is not Roy's point. The point is that there is nothing natural or inevitable about the present configuration of rights and responsibilities that constitute the corporation.

Chapters Four and Five examine the way that the railroad and investment banking influenced the construction of the corporation. Many of the generalizations he makes in his history of the railroads will not sit well with most economic and business historians. One could read these chapters and think that the railroads were a failure, both privately and publicly. For the most part, neither was the case. And the reader might understandably be confused when he presents Rockefeller's demand for railroad rebates as an example of how the railroads exercised power. But try to ignore that and focus on the his fundamental point. The financing of railroads was not simply corrupt, or political, or determined by power games among the major players (though all that was certainly the case). The development of institutions to finance railroads determined the set of institutions that industrial corporations could choose from when they needed to finance growth and short term operations. The structure of those inherited institutions favored concentrated over unconcentrated industries, favored incorporation and management-owner separation, perhaps favored some technologies, organizations of work, and regions over others. This point is important and profound. The evidence he gives in its support is not always well organized to make his point. But the challenge that he lays out is clear. The observed choices of corporations are not necessarily the optimal ones in a global sense. They are the choices corporations made given the incentives created by institutions created for a different purpose and as part of deeply politicized process.

Chapters Seven and Eight return to the merger movement of the 1890s. Roy correctly argues that it is wrong to see this period as one of a shift from a competitive market to an administered or monopolized one. U.S. firms had been cooperating to control prices in many industries throughout the nineteenth century. In fact, he argues, it is only with the emerging dominance of a "free market" ideology that the state makes the strong distinction, now taken for granted in anti-trust law, between contracts promoting trade and those in restraint of trade. Others will argue that there was a long-standing tradition in common law not to enforce contracts in restraint of trade. But there is also a long-standing tradition of allowing quasi-public organizations, such as guilds and corporations, to engage in behavior that we would today think of as monopolistic. Roy perhaps takes this argument too far when he says, "If governments did not enforce contracts between buyers and sellers, markets would collapse by the same sort of opportunism that wrecked the pools" (p. 190). While the current state of the economy in Russia reflects the underlying truth of this statement, we should also recognize that there is not the same inherent incentive to deviate from a mutually beneficial contract to exchange that there is with a contract to restrict output or fix prices. It is true that the state creates and enforces markets, but there is a difference between a self-enforcing contract and one that is inherently a prisoners' dilemma.

This chapter includes a very interesting section examining the interaction between the first use of the New Jersey incorporation statute and the terms of the statute. Roy not only shows that the writing of the statute was the result of a complex political process; he also shows that the way that it was used differed substantially even from the purposes of the first corporations for which it was written.

In these chapters, Roy presents the histories of particular industries, arguing that their use of the corporate form cannot be explained by changes in their technology (i.e. by managerial demand). The histories of the sugar and tobacco industries, familiar to business historians, are re-told in a new light. Rather, he argues, the desire for monopoly control and the expectation of financiers that the corporate form would be used led firms to incorporate. He also makes the interesting argument that the merger wave of the 1890s changed the expectations of investors so that "when a group of entrepreneurs wanted to establish a large-scale industrial enterprise, henceforth the standard procedure would be to mobilize the resources of the corporate institutions by recruiting investment bankers, brokerage houses, and the investment press in order to attract sufficient capital" (p. 254). Prior to the 1890s, it was deemed acceptable for Andrew Carnegie to operate his steel business as a limited partnership; after the merger wave of the 1890s investors, perceived non-corporate firms as higher risk. Trying to operate outside the corporate sphere was now a more costly choice, but only because the prior history had changed investors' (and investment bankers' in particular) ideas about how business had to be organized.

The comparison of the three states is intended to suggest that there were various paths that the development of the corporation could have taken. But since the corporation is now firmly ensconced in all three, a more overarching point is that competition between the three states limited the power of any individual state to determine the structure of the corporation. The three states are also relatively similar in terms of their level of economic development, industrialization, and integration into the national economy. A slightly different story might have been told, and Roy's argument made stronger, if he had looked at states that were less developed and continued to have more active state economic development policies throughout the century, including state investment in banks, railroads, and corporations. Did those states making post-bellum public investments in corporations demand public accountability? Or had the prevailing ideology of the private corporation so come to dominate by the second half of the century that even where there was substantial and direct state investment, the corporation was seen as an autonomous and privately responsible agent?

Roy makes several important methodological points that economic and business historians should heed. First, he emphasizes that actors can exercise power without power being the motivation for their actions. Individuals and groups exercise power when their actions determine the choice set or the constraints faced by others. I think this broad definition of power is very useful and would help economic and business historians to understand and analyze political movements, from late nineteenth century populism to late twentieth century resistance to free trade. But we also have to recognize that the exercise of power, defined this broadly, is not inherently a bad thing. For example, in a capitalist economy with strong patent protection, technological innovation gives the innovator power. Users of older technologies cannot simply continue to operate as they have in the past. This is the creative destruction that Schumpeter celebrated–and it really does destroy something that someone values. That's why the technocratic distinction between efficiency and distribution that economists cling to is silly. Any policy choice that has a significant impact on the "efficiency" of the economy will also have distributional consequences. That doesn't mean that we don't want technological change. Much of the time we probably do. But this perspective forces us to acknowledge that there are social decisions to be made, not simply private actors doing whatever they please, and that those social decisions require tradeoffs.

Second, this book will serve as an enormously useful corrective to the tendency among economists studying the firm, property rights, and institutions generally (a growing trend that is very healthy in and of itself) to follow Oliver Williamson's "In the beginning, there were markets" approach. Roy argues forcefully, and correctly, that both the market and the firm are social constructions. That does not mean that they are arbitrary or unreal. It means that their structure and their existence are the result of past political decisions and the outcome of social and political conflict. This is also a useful corrective to an approach that conflates the notion of the existence of a market with "rational" behavior by individuals. The existence of a market changes how rational individuals behave. Competitive pressure forces rational individuals to calculate more, and it increases the weight of monetary factors in those calculations relative to very real concerns for community and the quality of human interaction. Economic historians recognize this effect of the market on individual behavior when they can cast it in a positive light (see Sokoloff's 1992 work on the spread of markets and the rate of patenting, for example), but tend to downplay it otherwise (see Rothenberg 1992, for example).

Third, Roy makes an interesting case for an interplay between contingency and determinacy in the book. He argues for contingency in order to make the case that there is nothing natural or inevitable about the current institution of the corporation. The current configuration of rights and responsibilities that constitute the corporation is the result of highly contingent events in the past. But he does not accept the standard version of path dependence and raises questions that I have long thought were problematic with that approach. He makes clear that while the current construction of the corporation is contingent and path dependent in the sense that it would and could have been different if different events had occurred at key turning points (particularly during the 1830s canal crises), he does not see this as simply the result of chance. The key events were themselves the result of who had power at the time. This approach opens up a whole line of fruitful research in this area. Why was it that the response to the canal crisis was privatization rather than increased regulation? Why was it that some state constitutions were modified to limit direct involvement in economic activity and others weren't? These were explicitly political decisions that had long term economic ramifications. Understanding the political forces behind these decisions would be very useful. Roy also makes the point, applicable quite generally to the path dependence approach, that what matters is not simply the cost of shifting from one path to another (e.g. from one keyboard to another) but who bears that cost. If those who have the power to make the decisions about whether to switch paths do not bear the costs, then the switch will appear "costless" (see McGuire, Granovetter, and Schwartz, forthcoming).

In making the argument for the contingency of the corporation, Roy plays down some forces–powerful forces I am sure he would agree–that led to its current incarnation. On a mundane level, he downplays competition among states allowed by the federal structure that led to a spiraling down of public responsibilities for private actors. But on a more basic level, the transformation of assets from things that natural individuals own, use, and are responsible for to capital personified in the corporation, responsible no longer to the state and barely to its nominal owners, seems to me not a happenstance, contingent event. The corporation gives agency to capital. It's not for nothing that we call it a capitalist economy.

Finally, Roy's "de-naturalizing" of the corporation is a giant step forward for business history. So is his problematizing of the boundaries between private and public, the economy and the state, and the rejection of the dichotomy of an "interventionist state" and a "natural market." As Roy makes clear, the state creates the market, so it is meaningless to talk of it intervening in it. That language simply serves to de-legitimize some actions of the state relative to others. Finally, acknowledging that there are social choices to be made that influence how the economy will function in the future is important, and not simply for academics. Post-cold war ideology presents the corporation not only as natural but all-powerful. It is good to remind people that they can, through social and political action, make choices about how such social creations operate.

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