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Finance and the Origins of Modern Company Law

Paddy Ireland

‘Of all the branches of law, company law is perhaps the one least readily understood except in relation to its historical development’

L.C.B. Gower, *Gower’s Principles of Modern Company Law*

Company Law and the Joint Stock Company

There has long been a tendency to regard the rise of the business corporation as a phenomenon in little need of explanation. As early as the 1930s, one scholar was describing it as ‘the story of an economic necessity forcing its way slowly and painfully to legal recognition’¹ and another was arguing that until British law made the corporate privileges freely available in the mid-nineteenth century ‘full economic development was impossible’.² More recently, but in similar vein, a group of prominent legal scholars have described the ‘common structure’ and ‘underlying uniformity’ of the corporate legal form as ‘induced by the economic exigencies of the large modern business enterprise’, before going on to suggest that so indispensable are its key features – separate legal personality, limited liability, transferable shares, delegated management and shareholder primacy – that ‘corporate law everywhere must, of necessity, provide for them’.³ The suggestion is that the rise to dominance of the corporate legal form in its current form was essentially economically determined, the product of technological advances and the efficiency-enhancing imperatives of market forces. This belief underlay recent claims that we had reached ‘the end of history for corporate law’ and that corporate law around the world is converging on a standard shareholder-oriented model of the corporation.⁴ The effect of this story of economic inevitability and ‘evolution to efficiency’ is, of course, to naturalise and de-politicise the corporate legal form as currently constituted, immunising it from serious critical examination and evaluation. This paper argues that, contrary to this account, history shows that far from being a product of (more or less) inexorable economic forces, the corporate legal form, as developed for businesses, was, in the specific form we know it, a political construct, developed in large part to accommodate and protect the interests of *rentier* investors.

The Corporate Legal Form and the Joint Stock Company

The corporate legal form was first developed in the nineteenth century for application to joint stock companies (JSCs). The distinguishing features of the JSC as an organisational form were outlined by Adam Smith in *The Wealth of Nations* when he contrasted them with what he called ‘private copartneries’ – the ordinary partnerships that were the dominant form of business association at this time. Private ‘copartneries’ or partnerships were characterised by small memberships made up of people with trust and confidence in one another, by an overlap of ownership and management, and by partners most of whom played an active part in the

¹ B C Hunt, *The Development of the Business Corporation in England 1800–1867* (Harvard, 1936), p.13

² H A Shannon, ‘The Coming of General Limited Liability’, *Economic History*, vol. II, (1931), p.12

³ Reinier Kraakman et al, *The Anatomy of Corporate Law* (Oxford, OUP, 2004), pp.1,215.

⁴ Henry Hansmann & Reinier Kraakman, ‘The End of History for Corporate Law’, *Georgetown Law Journal*, vol. 89 (2001), pp.439–68.

running of the firm. By the end of the eighteenth century, the principles of partnership had come to be regarded as the natural foundation of business associations and were embodied in a developing body of law based on mutual agency (so partners could bind one another), joint asset ownership (partners were joint owners of the partnership property), and unlimited liability, which meant that all partners, including 'dormant' or 'sleeping' partners who provided finance but took no active part in the running of the firm, were held joint and severally liable for partnership debts.⁵ For passive investors who opted to become partners in search of better returns than those to be had from loans to industry (which were capped by usury laws) and government debt, unlimited liability in particular posed a real threat. The prevailing view, however, was that by ensuring that success was rewarded and failure penalised, the law of partnership not only accorded with the natural principles of justice and the laws of the market, but operated in the public interest by ensuring that firms were run productively and efficiently. The 'partnership system of commerce', it was argued, was the foundation of British economic success.⁶

By contrast, JSCs were based around a capital fund and had many more members than ordinary partnerships. Moreover, the interest of these members in the firm tended to be largely, if not wholly, financial. The 'proprietors' of JSCs, Smith wrote, 'seldom pretend to understand anything of the business of the company; ... and give themselves no trouble about it, but receive contentedly such half yearly dividend or yearly dividend as the directors think proper to make to them'. It followed that JSCs were characterised by a significant separation of ownership and management and by (more or less) freely transferable shares. Indeed, it was in significant part the size, nature, and changing character of their memberships that made the possession by JSCs of corporate privileges (corporate status, limited liability) so desirable if not indispensable. As this suggests, the JSC was the precursor of today's large public corporation and was from its inception a vehicle for not only productive activity in sectors where capital needs were beyond the reach of ordinary private partnerships but, as Smith indicated, for *rentier* money capital investment. As *The Times* later put it, the JSC was 'a system of dormant partners' in which 'the sole bond of connexion between the proprietors [was] ... money'.⁷ However, the violation by JSCs of the 'natural' and just principles of partnership, not least the inefficiencies associated with their separation of ownership and management, made them controversial. Thus Smith sought strictly to circumscribe the circumstances in which JSC formation should be facilitated. 'Exemptions from the general law [of partnership]' should be granted and JSCs formed only where the capital required was beyond the capacity of a private partnership, where the risks were unusually great, where the operations of the business could be reduced to a routine, and where there was an identifiable public benefit.⁸

In empirical reality, in the eighteenth and early nineteenth centuries the line between the private partnership and the JSC was far from clear cut. Although growing numbers of firms

⁵ See William Watson, *A Treatise of the Law of Partnership* (London, 1794); Neil Gow, *A Practical Treatise on the Law of Partnership* (London, 1823).

⁶ 'In the scheme laid down by Providence for the government of the world, there is no shifting or narrowing of responsibilities, every man being personally answerable to the utmost extent for all his actions': J R McCulloch, *Considerations on Partnerships with Limited Liability* (London, 1856), p.10.

⁷ *The Times* 9/11/40

⁸ Adam Smith, *The Wealth of Nations* (1776), edited by R H Campbell & A S Skinner (Oxford, OUP, 1976), vol 2, p.741.

emerged which clearly resembled Smith's JSCs – large memberships, a separation of ownership and management, relatively freely transferable shares – many of them were nevertheless more in the nature of 'extended partnerships' than 'pure' JSCs.⁹ Crucially, many of their shareholders had more than a purely financial interest in the firm and were involved in management or the monitoring of management. Moreover, restrictions on share transfers remained common, as did residual shareholder liabilities, and there was still no developed market for JSC securities. As a result shareholders remained in various ways, 'connected' to companies, something reflected in the tendency, which continued well into the nineteenth century, to regard JSCs as types of (large) partnership. In the jargon of the day, they were 'public, rather than 'private', partnerships. This notion found expression in the continuing identification of all JSCs, incorporated and unincorporated, with their members, and conceptualisation of them as aggregates of individuals. If they incorporated, the act of incorporation was seen as creating a separate legal entity, but the resulting 'body corporate' was simply seen as the company's members merged into a single legally distinct body. This was reflected linguistically in the use of plural verbs and pronouns to describe them: a company was a 'they' rather than an 'it'.¹⁰ It also found expression in the continuing conceptualisation, partnership-style, of JSC shares as equitable interests in the assets of companies and of shareholders as asset-owners, and in the tendency to treat both incorporated and unincorporated JSCs as governed by the law of partnership except where the latter had been 'superseded' or 'limited and restrained' by the granting of corporate privileges or status.¹¹ In short, there was nothing at this time resembling a developed and comprehensive corporate legal form for joint stock companies clearly distinguishable from that provided by the law of partnership. As Samuel Williston later observed, 'as to the points which belong exclusively to the conception of the business corporation [rather than to the conception of the corporation in general], the law has been formed very largely since 1800'.¹² This underlay the continuing perception of 'JSC law' as a branch of the law of partnership. Thus, as late as the 1870s, Nathaniel (later Lord) Lindley was still entitling his treatise – the leading partnership text of the second half of the century – *The Law of Partnership, including its application to JSCs*.¹³

Limited Liability and the Rise of the *Rentier* Shareholder

Radical change was prompted by the emergence of joint-stock railway companies populated by thousands of members many of whose interest in the companies concerned was entirely financial. From the 1830s and 40s, both the judiciary and legislature made more and more modifications to the law of partnership as it was applied to JSCs in order to accommodate and protect the growing number of *rentier* shareholders. The most celebrated changes were, of course, the introduction by legislation of incorporation by mere registration and, more controversially, of general limited liability in 1844 and 1855.¹⁴ It is clear from the lively debates which took place in various Parliamentary Committees, Royal Commissions and local

⁹ See Mark Freeman et al, *Shareholder Democracies?* (University of Chicago Press, 2012).

¹⁰ Paddy Ireland, 'Capitalism Without the Capitalist', *Journal of Legal History*, vol. 17 (1996), p.41.

¹¹ Charles Wordsworth, *The Law Relating to Railway, Bank, Insurance, Mining and other Joint-Stock Companies*, (2nd ed., London, 1837).

¹² Samuel Williston, 'History of the Law of Business Corporations Before 1800', *Harvard Law Review*, vol 2, (1888).

¹³ Nathaniel Lindley, *The Law of Partnership, including its application to Joint-Stock Companies*, (4th ed., London, Maxwell, 1878).

¹⁴ Joint Stock Companies Act 1844, 7 & 8 Vict., c.110; Limited Liability Act, 18 & 19 Vict., c.133.

business communities that there was little pressure from industry itself for either of these changes. Indeed, there was considerable hostility from industrialists to the introduction of limited liability in particular.¹⁵ As economic historians have observed, in most manufacturing industries JSCs were simply not needed – the capital requirements were modest - and in those sectors where the capital requirements were beyond the reach of ordinary partnerships, Parliament regularly granted corporate privileges to facilitate JSC formation.¹⁶ Even after incorporation with limited liability was made freely available, for many years the organisational forms of British industry changed relatively little: unincorporated, unlimited liability firms continued to dominate. The ‘dramatic’ legislative and judicial changes effected to the law relating to JSCs ‘had little to do with the financial requirements of manufacturing industry’ and were driven less by technological or productive imperatives than by the needs of the growing number of *rentier* investors seeking profitable outlets for their money capital. It is, perhaps, not insignificant that more and more MPs and judges were themselves becoming rentier investors in JSC shares at this time.

The rise of the *rentier* investor fuelled a series of speculative booms in JSC promotion in the first half of the nineteenth century. These booms were marked by widespread fraud and invariably ended in collapses. For many years, however, the misery caused to the growing number of commercially ignorant, vulnerable (and greedy) *rentiers* elicited little public sympathy.¹⁷ Eventually, however, as investment in JSC shares spread amongst the middle classes and following yet more high-profile frauds, a Parliamentary committee recommended that, in the interests of shareholder protection, JSCs be compelled to incorporate and their formation and operation be regulated. The resulting Joint Stock Companies Act of 1844 Act did not, however, succeed, in part because it continued mistakenly to assume that *rentiers*, when provided with information, would take steps to protect themselves. Nor did it successfully broker a marriage between industry and finance: there was no rush from industry to form JSCs and by the 1850s the volume of money capital seeking investment outlets offering good secure returns was greater than ever. The result was a radical change in strategy. In 1855 general limited liability was introduced and the following year the regulatory approach of the 1844 Act was abandoned and replaced by a much more permissive legal framework. It was, as Cottrell says, a ‘sharp’, ‘dramatic’ and ‘total’ liberalisation which marked a ‘victory for the investing classes over the industrialists’, shifting risk and responsibility from shareholders and turning many of the principles of partnership on their head. The controversial new regime, its advocates hoped, would prompt the formation of JSCs, generate new investment outlets for *rentiers*, and operate for the benefit of the country as a whole by ensuring that idle capital was deployed productively. In the event, as Cottrell says, the problem of finding higher yielding but reasonably secure investment outlets ‘was not solved by the introduction of limited liability . . . [for] manufacturers generally neither took immediate advantage of the change in the law nor complained about a shortage of capital’.¹⁸

¹⁵ See J B Jeffreys, *Trends in Business Organisation since 1856* (PhD, University of London, 1938).

¹⁶ See P L Payne, *British Entrepreneurship in the Nineteenth Century* (London, Macmillan, 1974). ‘Because manufacturing concerns continued to be organised as private partnerships, industrialists for the most part were not affected by either the slow reform of the law or hostile legal doctrine’: P L Cottrell, *Industrial Finance* (London, Methuen, 1980), p.42.

¹⁷ See the editorials in *The Times*, 9/10/1840; 22/10/1840.

¹⁸ Cottrell, *op. cit.*, n.16, pp.41-47.

The changes to the law of partnership as it applied to JSCs were, however, by no means all legislative. A string of judicial changes were also made, again aimed largely at accommodating and offering protection to the *rentier* investor. The 1840s, for example, saw the abandonment of the doctrine of mutual agency¹⁹ and the development of a reformulated doctrine of ultra vires which sought to protect shareholders from their own greed and to make *rentier* investments in JSCs more secure.²⁰ Amidst these changes both the JSC share and the nature of the JSC shareholder were also re-conceptualised. Throughout the eighteenth and early nineteenth centuries, shares in both incorporated and unincorporated JSCs were regarded as equitable interests in the assets of companies – as ‘shares’ in the literal sense. Accordingly, shareholders were regarded as the owners in equity of those assets, from which it followed that if a JSC owned land, its shareholders had an interest in real estate, with all the legal consequences that flowed from this. From the 1830s, however, the rise of the railways generated a rapid growth in pure *rentier* investment in shares and the emergence of a developed market for them. With this the courts began to reconceptualise JSC shares as mere rights to profit – forms of intangible property quite separate from the assets of the company.²¹ Henceforth, there were two quite different pieces of property: the tangible assets owned by ‘the company’ (now regarded, at least for these purposes, as a property-owning entity separate from its shareholders irrespective of the company’s legal status) and the shares, intangible rights to profit, owned by the shareholders. As part of this process, JSC shareholders were themselves gradually re-conceptualised – as ‘investors’ rather than ‘partners’; as inactive, finance-providing, ‘money capitalists’ rather than active, asset-owning, ‘industrial capitalists’. Although for many years, policymakers continued to assume, or hope, that shareholders would at least monitor managers even if they didn’t actually engage in management, the law increasingly recognised that they now stood outside the company and the process of production. Indeed, both in the legal framework regulating JSCs and in actual practice, there was a gradual reduction in the rights of shareholders and a gradual transfer of management rights to directors.²² For JSC shareholders, *The Times* commented, companies were ‘means of making money’ not only ‘in idleness’, but ‘in compulsory idleness’, because in ‘public partnerships’ of this sort, ‘the proprietors are excluded from ... control and all intimate knowledge is kept back from them’.²³

The Emergence of the Modern Doctrine of Separate Corporate Personality

These processes underlay the growing detachment, both conceptually and in economic reality, of shareholders from companies. Conceptually, this detachment was encapsulated in a subtle change in the wording of the Companies Acts. The Joint Stock Companies Act 1856 permitted seven or more persons to ‘form *themselves*’ into an incorporated company, clearly implying that the company was made of its shareholders. They *were* the company in the same way that a partnership was its members. By contrast, the Companies Act 1862 permitted

¹⁹ *Burnes v. Pennell* (1849) (1849) 2 HLC 49. See also the development of the doctrine of constructive notice: *Ernest v Nicholls* (1957) 6 HLC 401.

²⁰ *Colman v Eastern Counties Railway* (1846), 10 Beaver 1. See also Paddy Ireland, ‘Property and Contract in Contemporary Corporate Theory’, *Legal Studies*, vol. 23 (2003), 453.

²¹ *Bligh v Brent* (1837) 2 Y & C 268. It made no difference whether the company was incorporated or not – *Watson v Spratley* (1854) 10 Ex. 222. See Ireland, *op. cit.*, n.10.

²² See Freeman et al, *op. cit.*, n.9.

²³ *The Times* 9/10/1840. See also Edward Cox, *The Law and Practice of Joint Stock Companies* (London, 1856).

seven or more persons to 'form a company', implying that the company was an object external to them; a 'thing' made *by*, but not *of*, them.²⁴

This conceptual detachment – what Gower refers to as the 'complete separation' of company from shareholders²⁵ – was not finally concluded, however, until the final decades of the century. The main source of the delay was the persistence of residual liabilities on shares. Originally, JSC shares not only carried high denominations, they were only partly paid up. The uncalled capital provided companies with a source of new capital and acted as a comfort to creditors. It also meant, however, that there were continuing links between companies and shareholders, and, indirectly, between shareholders and creditors. In the closing decades of the century, these links were all but severed as share denominations fell and the residual liabilities on shares were eliminated. This too was a process which was again facilitated and legitimated by the courts and legislature. The result was that by the outbreak of World War One, the *de jure* regime of limited liability had become a *de facto* regime of no-liability.²⁶ JSC shareholding had come to entail not only little or no responsibility but no liabilities either. Shares had been (re)constituted as Janus-faced, hybrid legal forms which mixed rights *in rem* with rights *in personam*, enabling shareholders, who had retained their residual control rights, to enjoy some of the key proprietary privileges of owners at the same time as they enjoyed the responsibility- and liability-free privileges of creditors.²⁷ They really did now benefit, as Adam Smith had put it, from a 'total exemption from trouble and from risk' beyond the money they had spent on their shares.²⁸ JSC shareholding had now come to take its modern form, comprising ownership of an unencumbered, free-standing right to revenue, external to the process of production and entailing no particular obligations, contractual or otherwise, either to the company itself or to outsiders. Shares had become instruments for the appropriation of the profits of industry divorced from responsibility or function.

The elimination of residual shareholder liabilities eroded the remaining links between shareholders and companies, concluding their conceptual detachment. The last quarter of the nineteenth century saw the emergence of the doctrine of separate corporate personality in its modern form, with its 'complete separation' of shareholders and companies. 'The company' now came to be seen as not as its members merged but as a reified, de-personified, property-owning legal person, an 'it', a 'real' entity. Indeed, by the close of the century so far had the law relating to JSCs departed from partnership principles that 'company law' had emerged as a legal category in its own right.²⁹ Crucially, however, although shareholders were no longer regarded as the owners of the company's assets and had given up nearly all their management rights, they had retained their residual control rights and this led them to come

²⁴ See Ireland, *op. cit.*, n.10.

²⁵ Gower and Davies, *Principles of Modern Company Law* (9th ed., London, Sweet & Maxwell, 2012), 35-38

²⁶ Acheson, Turner & Ye, 'The character and denomination of shares in the Victorian equity market', *Economic History Review*, 65, 3 (2012) pp 862- 886; Paddy Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility', (2010) 34 *Cambridge Journal of Economics*, 837.

²⁷ See Paddy Ireland, 'Corporate Schizophrenia: The Corporation as a Separate Legal Person and an Object of Property', forthcoming.

²⁸ Smith, *op. cit.*, n.8, p.741.

²⁹ In the late 1880s, Lindley split his treatise (*op. cit.*, n.13) into two separate books, one on the law of partnership, the other on company law.

to be seen as the 'owners' of the now fully de-personified company/corporation.³⁰ The interests of 'the company/corporation' thus came to be seen as synonymous with the interests of its shareholders. In this way, not only did corporations come to be seen as de-personified legal persons *and* as objects of property, irresponsibility had been firmly built into the corporate legal form. The no-obligation, no-responsibility, no-liability nature of corporate shares permits shareholders and their institutional representatives - part-insiders (possessors of residual proprietary rights), part-outsiders (creditors) – to enjoy income rights without needing to worry about how the dividends are generated.. As Harry Glasbeek says, the shareholders in corporations 'have little financial incentive to ensure that the managers involved behave legally, ethically, or decently . . . [because] in law, [they] are personally untouchable. . . ' ³¹

Extending separate corporate personality

The significance of these developments grew in the late nineteenth and early twentieth centuries. Firstly, the number of JSCs began significantly to increase. In some sectors, this was the result of technological imperatives and efficiency considerations (capital needs, economies of scale etc), but in most it was underlain by the desire of businessmen to eliminate competition. The 'Great Depression' of 1873–96 saw firms in the most advanced capitalist countries all suffering from chronic overproduction, severe price cutting and falling profits. Their response was to try to fix output and prices, initially through Trade Associations, cartels, trusts and other similar arrangements and, when these failed (as they usually did), through mergers in which large numbers of firms (often unincorporated, unlimited liability partnerships) amalgamated to form large incorporated, limited liability, joint stock companies. These processes continued in the inter-war years, generating what Leslie Hannah has called the 'rise of the corporate economy'.³² Once again, the traditional economically determinist account of the rise of the JSC, with its underlying narrative of a politically neutral 'evolution to efficiency', is seriously wanting.

At the same time as the number of JSCs grew, the corporate legal form began to be used by business firms of all types. Those responsible for the passing of the Companies Acts 1844–62 clearly intended that they be used by JSCs and only by JSCs, and for many years, as intended, generally only JSCs incorporated and acquired the privilege of limited liability under the Acts. From the 1880s, however, confronted with the economic difficulties associated with the 'Great Depression', more and more unincorporated sole traders and small partnerships began to incorporate, using 'dummy' shareholders to comply with the minimum requirement of seven members. The legitimacy and legality of this practice was questioned however, and matters came to a head in the celebrated case of *Salomon v. Salomon & Co Ltd*. Salomon converted his one-man firm into a limited company, complying with the 1862 Act's requirement of seven members by giving single shares to his wife, daughter and four sons. He also took steps to ensure that he was a secured creditor of the firm by issuing debentures to himself. He later sold these to try to save the struggling firm, but to no avail. The company folded and its assets were insufficient to meet the company's debts. The liquidator stepped in and sought to make Salomon personally liable for the company's debts. Refusing to treat Salomon and

³⁰ See Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership', *Modern Law Review*, Vol 62 (1999), 32.

³¹ Harry Glasbeek, *Wealth by Stealth* (Toronto, 2002), p.129

³² Leslie Hannah, *The Rise of the Corporate Economy* (London, Methuen, 1976).

his company as genuinely separate entities, both the Court of Chancery and the Court of Appeal found in the liquidator's favour. 'The object of the whole arrangement', Lord Lindley argued, was 'to do the very thing which the legislature intended not to be done': Parliament had never contemplated the extension of limited liability to sole traders. Interpreting the Companies Act 1862 literally, however, the House of Lords insisted that Salomon had complied with the requirements of the Act: the company had seven members, had been properly formed, and should be treated as a completely separate entity. 'The company', argued Lord Macnaghten, 'is at law a different person altogether from the subscribers to the memorandum.' In this way, the radical separation of company and shareholders, developed in the specific context of joint stock companies populated by large numbers of passive *rentier* shareholders, came to be applied – 'calamitously', according to Otto Kahn-Freund³³ – to one-man and other small, 'private' companies – companies which were, in reality, nothing more than incorporated individual proprietorships and small partnerships. It was not long before nearly all significant business enterprises were becoming incorporated, limited liability companies.³⁴

Equally importantly, when in the inter-war period corporate groups began to emerge for the first time, in significant part as a result of continuing attempts by businessmen to suppress competition, the *Salomon* principle was formalistically extended to subsidiary companies with little or no discussion. Parent companies came to be regarded as completely separate entities from the subsidiaries they controlled (and often wholly owned), and, as such, entitled to the protection of the laws on limited liability. The application of limited liability to corporate groups was, as Philip Blumberg says, a 'historical accident'³⁵, but it has made possible – and, indeed, encouraged – the construction of complex groups of companies, each of which is a separate legal person whose shareholders (often simply one or more other companies in the group) benefit from limited liability. This remains the case even when a parent company has complete effective control of a subsidiary whose directors may be the nominees or even the same persons as the directors of the parent.³⁶ The rigid application of the *Salomon* principle, coupled with *de facto* no-liability shareholding, has thus greatly extended the scope for opportunistic behaviour, further institutionalising corporate irresponsibility. Indeed, it has played a vital role in shaping the economic landscape in which we live.

Today, the economically most powerful firms are not single JSCs but (multinational) 'enterprises' made up of groups of corporations. The legal existence of these enterprises, which are often multinational in nature, is only very partial, the various companies in the group generally being regarded as separate legal entities with their own assets, accounting systems, contractual obligations, tortious liabilities and so on. As a result, in principle, those contracting with, or suffering tortious damage by, one company in the group have no rights against the other companies in the group – although the organisation as a whole is usually co-ordinated by a single management team. The resulting corporate structures are often very complex, involving subsidiaries, cross-holdings joint-ventures and the like, though it is usually the same

³³ *Salomon v. Salomon & Co Ltd.*, [1897] AC 22; Otto Kahn-Freund, 'Some Reflections on Company Law Reform', *Modern Law Review*, vol. VII (1944), 54.

³⁴ Paddy Ireland, 'The Rise of the Limited Liability Company', *International Journal of the Sociology of Law*, vol. 12 (1984), 239.

³⁵ Philip Blumberg, 'Limited Liability and Corporate Groups', *Journal of Corporate Law*, vol. 11 (1986), 573.

³⁶ Blumberg, *ibid.*, p.605.

mechanism that is at work: direct or indirect control over a sufficient portion of the shares issued by the subsidiaries or sub-subsidiaries. Crucially, these structures make it possible for enterprises to pick and choose where they locate different parts of their activities, introducing competition among states for the creation of favourable legal and regulatory environments. The resulting inter-state competition reaches its apotheosis with tax laws as enterprises use transfer pricing to locate profits in low-tax jurisdictions and states trade their sovereignty in the legal marketplace.³⁷

The Joint Stock Corporation and Finance Capitalism

From their inception, then, JSCs were vehicles both for the facilitation of production in sectors where the resources required were beyond the reach of small partnerships and for *rentier* financial investment. When the corporate legal form (company law) was constructed in the nineteenth century, it was aimed as much at accommodating and protecting these *rentier* investors as it was at meeting industrial and technological needs. Its form was shaped as much by the political power of these financial interests as bit was by economic imperatives. Given the financial origins of both the JSC economic and corporate legal form – now combined, with modifications and added complexities, in the modern multinational enterprise – we should not perhaps be surprised at the recent financialization of corporate governance and contemporary capitalism. Financialization is, in certain important respects, inherent in the JSC – an organisational form which ‘transform[s] the actually functioning capitalist into a mere manager’ and the ‘owner of capital into . . . a mere money-capitalist’ whose interest in the firm is purely pecuniary – and thus in the corporate capitalist economy.³⁸

Nor is it surprising that in the developed capitalist world the late nineteenth and early twentieth centuries – the period that saw the ‘rise of the corporate economy’ and of the JSC as the dominant organisational form in industry – are associated with the rise of ‘finance capitalism’. In Germany, this was the central focus of the work of Rudolf Hilferding; in the US it was the central focus of the work of Thorstein Veblen. With the rise of the joint stock corporation, Veblen argued, ‘industry’ – the technical processes concerned with the efficient production of useful goods (what Veblen referred to as the ‘use of the industrial arts’) – had fallen under the control of ‘business’, which was concerned with making money rather than things. For Veblen, ‘business’ in this context meant ‘finance’.³⁹ Increasingly, he argued, industrial processes were being managed not primarily to enhance productive efficiency and maximise output, but to secure pecuniary gains for the owners of financial property. One result of this – and of the rapid growth in the number of and markets for corporate securities – was what Veblen called the shift from a ‘money economy’ in which product markets were dominant to a ‘credit economy’ where capital markets were dominant.⁴⁰ Another was that money-making seemingly became increasingly disconnected from what is now referred to as the ‘real’ economy. Large fortunes were made not from improving productive techniques but from the creation of corporate securities (fictitious capital) – from the capitalisation of presumptive revenue

³⁷ See Jean-Phillipe Rob, ‘Globalization and the Constitutionalization of the World-Power System’, in Rob, Lyon-Caen & Vernac (eds), *Constitutionalization of the World-Power System* (forthcoming, 2015).

³⁸ Karl Marx, *Capital*, Volume 3, chaps 23 & 27.

³⁹ F G Hill, ‘Veblen, Berle and the modern corporation’ (1967) 26 *American Journal of Economics and Sociology* 279, at 281.

⁴⁰ T Veblen, *The Theory of Business Enterprise* (New York, 1904).

streams and subsequent manipulation of their market values. With the corporate revolution, the problems associated with joint stock companies and the intangible revenue rights that they spawned – fraud, financial manipulation, speculation – which had hitherto been confined to the relatively small joint stock sector of the economy, were generalised. Worse still, Veblen argued, the pursuit of financial gain by business, often led to the ‘conscientious sabotage’ of industry by corporations using their monopoly powers to reduce output and fix prices at artificially high levels – ‘manoeuvres [which] were disserviceable not only to community but to concerns as going business organisations’.⁴¹ Far from furthering productive efficiency, he concluded, the rise of the modern joint stock corporation and the domination of industry by finance was impeding it.⁴² ‘Business enterprise’ and ‘particularly American business enterprise’, he argued, ‘habitually looks to the short run’. Managers were sacrificing long-term productive gains in favour of ‘an enhanced rate of earnings for the time being’.⁴³ The short term financial interests of the ‘absentee owners’ of industry were often best served by obstructing productive activity and conspiring against the full use of the ‘industrial arts; by ‘deranging and retarding’ the industrial system’.⁴⁴

The economic crisis of the 1930s and the emergence of the managerial corporation saw the power of finance wane. Since the 1970s, however, with the re-concentration of previously dispersed shareholders in institutions, the collapse of the Bretton Woods system, and the rise of global financial markets and the ‘market for corporate control’, the power of finance not only over corporations but over nation states has been re-asserted. When Hyman Minsky wrote in 1967 that capitalism is ‘essentially a financial system’, one suspects that few would have agreed with him.⁴⁵ In recent decades, the work of people like Minsky, Marx, Hilferding and Veblen, which looked somewhat outdated during the *trente glorieuses*, has suddenly begun to look rather percipient again. Indeed, it arguably casts serious doubt on the wisdom of contemporary strategies for reforming and improving corporate governance by trying to make *rentier* shareholders act more like proper ‘owners’. The highly financialized capitalism in which we now live looks not like a deviation from ‘normal’ capitalism – a distortion of the production-oriented capitalism of the post-war ‘golden age’ - but like the natural state of a capitalism founded on JSCs and the corporate legal form as currently constituted. The corporate legal form was not the product of inexorable and beneficent economic forces, of evolution to ever greater productive efficiency, it was a political product shaped in significant part by financial interests.

⁴¹ See Joseph Dorfman, *Thorstein Veblen and his America* (New York, Viking Press 1934), pp. 227–8.

⁴² Veblen described these processes in *Absentee Ownership* (1923; New York, Viking Press edition, 1945). See also T Veblen, *The Engineers and the Price System* (New York, Huebsch, 1921).

⁴³ Veblen, *Absentee Ownership*. op. cit., n.40 above, p.214.

⁴⁴ Veblen, *Vested Interests and the Common Man*, (1919, Capricorn Books edition, 1967), pp.97–8, 105.

⁴⁵ Hyman Minsky, ‘Financial Intermediation in the Money and Capital Markets’, in Guido Pontecorvo, Robert P Shaw & Albert G Hart (eds), *Issues in Banking and Monetary Analysis* (New York: Holt, Rinehart & Winston Inc, 1967), 35.