1-1-1998

The Limits of National Diversity: The Origins and Future of the Modern Corporation

Kristine Grigorian
Michael Murff
Robert Shull

Follow this and additional works at: https://scholarsarchive.byu.edu/sigma

Recommended Citation
Available at: https://scholarsarchive.byu.edu/sigma/vol16/iss1/3

This Article is brought to you for free and open access by the All Journals at BYU ScholarsArchive. It has been accepted for inclusion in Sigma: Journal of Political and International Studies by an authorized editor of BYU ScholarsArchive. For more information, please contact scholarsarchive@byu.edu, ellen_amatangelo@byu.edu.
The Limits of National Diversity: The Origins and Future of the Modern Corporation

By Kristine Grigorian, Michael Murff, and Robert Shull
Edited by Professor John Griffin

Do nation-states still represent democracy’s great hope? Or are they in decline? After a century of adolescence marked by state-building and aggressive colonial expansion, Western nations grew up into an era of world wars. Since this tragic time, some argue, both the powers of and faith in national government have diminished. In our day, giant multinational corporations with tens of thousands of employees working around the globe have arisen as powerful nationless actors in the international sphere. Currency traders and securities markets punish nations that fail to do their bidding.

While some embrace this changed world, others fear this globalization of business interests as a threat to democratic sovereignty. These scholars warn against the new skepticism of government (Berger and Dore 1996, 9). A truly autonomous private sphere, they argue, should be distrusted because there are no guarantees of the civil liberties so dear to democratic societies. If implemented correctly, democratic government brings liberty and prosperity and propels the ascent of science and spread of technology. Without government-funded research centers and higher education, for example, would the technology of today have been developed by the private corporations of yesterday? The skeptics of globalization argue that the circumscription of corporate power not only preserves the liberty of the people and the diversity of national practice—preserved by the people’s free choice of policy—but is justified because the origins of private power themselves lie in the public sphere.

This paper evaluates the national diversity argument by taking seriously this last, important claim: namely, that corporate institutions and the private power they generate are based on public origins, public foundations, and public choice. The paper does so by examining a brief history of the corporation, together with a history of the capital markets critical to its birth, to determine just how closely these important economic institutions are wed to national history and the mechanisms of state power. The paper argues that corporate legal innovation and institutional development have always been governed by extra-national processes. Those who reduce the shape of private forces to national politics fail to see how the modern corporation is both a product of and transcendent of the modern nation-state.

ORIGINS OF CAPITAL MARKETS AND CORPORATIONS

Securities markets, the first modern institution of capitalism, developed well before the formation of nations or nation-states (Ayling 1986, 44). Already in 1305 there was a type of money lending

activity in France, although the first modern form of
the stock market originated in Amsterdam about
1550 (Kent 1973, 111). The London Stock
Exchange first traded stocks informally in 1620. All
these markets developed before the treaty of
Westphalia was signed in 1648, which ushered the
nation-state onto the international stage.
From the beginning, market innovations
tended to spread regardless of language, cultural or
political boundaries. The trading of stock began in
Amsterdam. Men of commerce in other countries
soon imitated this Dutch institution. London openly
imitated and then modified the Dutch practice of
trading stock such as in 1714 when John Freke post-
ed a list of stocks and their prices on the door of
Jonathan’s Coffee House for the public to see
(Braudel 1982, 97-106). This practice soon spread
to other nations. The first German exchange was
founded in 1568 (Ayling 1986, 6; Gowdy 1982, 6).

However, not until about 1815 after the Napoleonic
wars spread the knowledge of stock markets did this
largely barter-and-goods exchange develop into a
ture securities market.
In contrast to markets, the early precursor to
the corporation, the joint-stock company, was a dis-

}

tinctly political innovation spread by distinctly
political ambitions. The earliest joint-stock compa-

ries were colonial companies, designed to influence
and control territories targeted by absolutist states
such as Russia and Holland, as well as mercantilist
nation states such as England (Kindleberger 1993,
191-3). The largest joint stock companies became
very powerful as the government granted monopoly
 privileges to them and then used them to develop
and subdue large territories such as India and parts
of Africa. Later in the 19th Century, colonization
was the chief impetus behind the adoption of limited
partnerships and the modern form of the corpora-
tion in powerful, industrializing nations such as
Germany (Koberg 1992, 35-153).

Nevertheless, the early corporate economy
flourished outside the political realm, even if in
dubious circumstances. For example, in the 17th
and 18th centuries a vast majority of companies
were never legally incorporated. Some traders used
old charters or charters from bankrupt companies to
start new ones. These companies themselves fre-

ently became bankrupt or were used to swindle
investors (Morgan and Thomas 1969, 37).
Sometimes such scandals caused widespread finan-
cial panic. As these illegal companies began to
flood the market and steal investors from the bigger
joint stock companies, states were forced to re-
examine the corporate economy as a vital interest.

Government regulation soon curbed the
growth of joint-stock companies. Governments
became alarmed at financial panic, which had the
potential to shake them to their foundations, and
drew up plans to closely regulate all companies. An
important early regulation was the Bubble Act of
1720, which prohibited unchartered companies from
trading their stock or assuming other privileges of
incorporated entities. The English Parliament
passed this law on June 23, 1720, and in the same
year the French passed a similar law that required
rigid standards for licensing (Werner and Smith
1915, 98). Nevertheless, despite these efforts mer-
chants and stock jobbers found tricks to circumvent
legal strictures, and a large number of businesses
flourished outside the law. From the beginning, pri-

tate initiative wrestled the joint stock company
from its early political origins into a largely
ungoverned—and most definitely publicly undeter-
mined—realm.

A TWIN BIRTH: THE MODERN CORPORATION
AND THE MODERN NATION-STATE
The modern nation-state developed after the
rise of the joint-stock company and the stock mar-
ket; however, the modern corporation was born
joined at the hip with the modern nation-state.
Although the Treaty of Westphalia ushered in the
era of the nation-state, it was not until after the
French Revolution that the nation-state was trans-
formed into its modern form, with greatly expanded
powers to tax, conscript and regulate. The modern
form of the nation state included strong national
bureaucracies governed by administrative law, pop-
lar nationalistic loyalties, and a comprehensive
national legal code administered by a nationally-
organized legal system.

Although the development of the previously
discussed monetary institutions was largely inde-
dependent from the nation-state, the development of


2 For an interesting discussion of institutional transfer, see E. Powell. 1915. The evolution of money markets
1385-1915. London: London Financial News. The Royal Exchange was the most successful of the early stock
markets because of conducive British political climate. merchants from Amsterdam, Antwerp, Hamburg, Paris,
Bordeaux, Venice, and Vienna all met in London to conduct their business. Powell cites an observation of a then
prominent merchant, “at every turn a man is [reminded] of Babal, [owing to] such confusion of tongues.”
the modern corporation, with limited liability and non-concessionary incorporation procedures, was not. These innovations required the institutions of state ushered in by the Napoleonic Code to function properly. As the new institutions of state spread, so too did a new era for the corporation. Throughout the 19th Century, both in young nation states such as the United States and Japan, and in the older European countries with older laws and ideas, the corporate economy flourished like never before. Just as during the old era, modern times were marked by borrowing of ideas and laws across national boundaries.

So with the new institutions of state came new institutions of economic organization. France provides an excellent example. During the French revolution the Paris bourse (stock exchange) was closed and public companies were discouraged. After Napoleon's rise to power, companies were once again allowed to form according to the new commercial code (Cameron 1961, 30). This commercial code, established in 1808 with the Napoleonic Code, allowed for three types of companies that had never before been established: the societe anonyme, societe en nom collectif, and the societe en commandite. The societe anonyme (S.A.) was the first modern company that granted limited liability to owners, and a modification of the societe en nom collectif that imitated the S.A.'s practice of share trading led to the first widespread, non-concessionary system of incorporation (Freedeman 1979, 47-65). Incorporation was no longer a privilege granted by the government; it was open to anyone who followed the rules.

As the modern nation-state became a model for the rest of Europe and the world, so too did the modern corporation. The liberalized French system was mimicked by many other European nations, especially those that had been conquered by Napoleon. Fearful of being left behind, England also liberalized incorporation. In 1825, the English Parliament repealed the Bubble Act, and gave companies the right to freely incorporate again in forms much like those found in France. The Companies Act of 1856 accelerated the process, and in the 1860s France liberalized the incorporation of S.A.'s themselves (Cameron 1961, 35). By this time the old joint-stock companies had faded into the pages of history and companies began to adopt the basic governance forms found in today's corporations.

Even as the corporation became standard throughout Europe, nations continued to borrow innovations from one another. Of course one of the most important innovations that was copied was limited liability. By the 1870s, all major European powers had laws for limited liability corporations. Much of this national law was directly copied. In fact the French law was adopted word for word by Spain in 1869. In 1870 the North German Confederation did the same thing. Over less than a generation, the French law was imitated by Belgium, Italy, Portugal, Sweden, and Austria (Cameron 1961, 35-40).

Not all countries followed this same dynamic. In the United States, the right of incorporation had been reserved for the states in the Constitutional Convention, but this power was not widely used by the state legislatures. Only 200 companies had been incorporated by the turn of the century. During this time, state legislatures were accused of corruption in using the incorporation power. As a consequence, several states liberalized their incorporation laws, allowing companies to be incorporated without specific legislative approval. North Carolina (1792) led the way, and was soon followed by Massachusetts (1799) and New York (1811) (Henn and Alexander 1983, 25).

Institutional transfer proceeded in the U.S. just as in Europe, but by a different and even stronger mechanism. Some states, especially the smaller ones, began to liberalize their laws even further in an effort to gain tax revenue by enticing companies to incorporate in their state. As soon as one state liberalized their laws, another state would follow suit to keep businesses from incorporating elsewhere. Thus, competition drove liberalization to extreme degrees (Romano 1993, 65).

A key step in the development of this competitive dynamic was the decision by the Supreme Court that states could not prevent businesses incorporated in other states from doing business in their state. In Paul v. Virginia, the United States Supreme Court decided that under the interstate commerce clause a state had no power to exclude a corporation from doing business in its state if that corporation was chartered elsewhere. This decision meant that corporations could shop for the most advantageous incorporation laws, basing their decision solely on the governance advantages of those incorporation laws. Corporations did not have to worry about regulatory penalties from other states where they planned to do their actual business (Romano 1993, 26). Competitive pressures arising from Paul v. Virginia thus took away regulatory autonomy. Gone were states' powers to fully regulate the charters of those companies doing business in their economies.

Nevertheless, the role of the state in the growth of the modern corporation in the U.S. should
not be underestimated. The growth of U.S. capital markets, a key prerequisite to the growth and spread of the modern corporation, was highly dependent on public action. Favorable government treatment of the railroads and public investment dollars in such large technologies spurred some of the most important examples of equity financing during the 19th century. What is perhaps more important, government sales of bonds to finance the Civil War greatly increased the volume of American securities markets. The buying and selling of bonds provided a huge boost to markets, an effect that was mimicked elsewhere, such as with the London Stock Exchange during the Crimean War.

We see, therefore, that the state played a critical role in the development of the modern corporation. Innovations in state-building and government not only brought on the institutional innovations required for the birth modern corporation, but state action greatly accelerated corporate growth and development.

The Limits of National Choice

The modern corporation is a product of rules that came about with the innovations and procedures of modern state-building. However, the corporation was spread by extra-national imitation of rules and practices across national boundaries. The new nation states pushed each country to develop far more independently, organizing domestic interests and institutions according to their own peculiar patterns of national choice. Nevertheless, the autonomy nations exercised over the development of this critical institution of capitalism, the modern corporation, was limited.

One of the key ways the corporation has spread is through legal harmonization. Each nation-state has its own rules and regulations by which companies organize themselves and act. While the laws are not always the same and each nation has its peculiarities, nations have established common ground so that businesses can carry on trade. Today, legal harmonization of corporate code continues, providing a key pressure in many countries toward integrating their economies into the world economy.

An excellent historical example of this process of harmonization is Japan. During the Meiji Restoration of 1868, several of the daimyo or local rulers overthrew the Shogun and returned power to the Emperor Meiji. One of the important changes the reformers made was to bring the laws and regulations in alignment with those of the western nations with whom Japan had been doing business. Western nations had demanded that Japan update its commercial code so that foreign businesses could understand and compete—or sanctions would follow. Japan complied (Hirschmeir and Yui 1981, 73).

Like Japan of the 1860s, today only a nation-state that is willing to be punished economically can disregard the pressure to harmonize.

Harmonization can quickly lead to legal standardization, or institutional convergence, and history shows us how. The United States’ experience, far from being an exception, might point the way here. Much like the dynamic that developed after Paul v. Virginia, there might well come a time, if it is not already here, when companies will begin to choose which country they wish to incorporate in. It will not matter in what country they incorporate because they will be able to do business anywhere on the globe. Then nations will begin to liberalize their own laws and encourage companies to incorporate so that they will gain tax revenue and retain some modicum of control over such corporations. Eventually the dynamic that is seen in America could be seen throughout the entire world. Modern corporate law, although once the product of national politics, has never been absolutely determined by it; in the future, what influence nation states retain over the rules of the corporation could very well largely disappear.

Conclusion

Those who interpret the global economy either as an illusion that hides the true, national origins of private power, or as a new threat to political choice and democracy, misinterpret the lessons of history. Those lessons show that although the nation-state and the modern corporation were born at the same moment and as consequences of similar innovations in state-building, law and administration, the dynamic of institutional change and transformation that both preceded and followed the birth of the corporation was often extra-national. Legal harmonization and institutional transfer have always limited national diversity and with it national choice of institutional possibilities—although these forces have never eliminated these ideals. In other words, the forces of globalization have been with us since the beginnings of the modern age, and will undoubtedly continue, possibly intensifying. Whether this spells the end of nation-states and their traditional roles in the global economy is still an unanswered question. History does teach us that if the future is like the past, national autonomy will at least be limited.
ABOUT THE AUTHORS

Kristine Grigorian, Michael Murff, and Robert Shull wrote this paper as part of a research project with Professor John Griffin in the summer of 1997.

Kristine is a junior in political science from Armenia. She is a Russian minor and plans to attend law school upon her graduation and to eventually become a corporate lawyer.

Michael is a political science major whose interests include the study of global financial markets and governments. During his free time he enjoys skiing and spending time with his wife Clementine. He plans to attend law school upon graduation.

Robert, a native of Kansas City, is a senior in political science who will go to law school after he graduates this April (as long as Dr. Magleby gives him a B- or better on his senior paper!)

WORKS CITED


