



A Lecture on Capitalism and Democracy in the Age of Rising Concentration

Christian Reiner and Christian Bellak

The LBS Working Paper Series “LBS Working Papers” aims at presenting applied research completed by LBS faculty, outstanding graduates and partners. Topics include subjects taught and researched at LBS’s degree programs (1) International Business Administration, (2) International Management and (3) Leadership and Banking, Finance and Compliance. Successful master graduates will be invited to publish condensed versions of their theses.

This text may be downloaded only for personal research purposes. Additional reproduction for other purposes, whether in hard copies or electronically, requires the consent of the author(s), editor(s). If cited or quoted, reference should be made to the full name of the author(s), editor(s), the title, the working paper, or other series, the year and the publisher.

Editor: Christian Reiner, Christian.reiner@lbs.ac.at
Lauder Business School
Hofzeile 18-20, 1190, Vienna, Austria
www.lbs.ac.at

About the Authors

Christian Reiner works as a senior researcher and lecturer at the Lauder Business School. His research interests include applied empirical research in innovation, industrial and regional economics.

Christian Bellak is an economist at the Vienna University of Economics and Business. He is mainly interested in bi- and multilateral trade agreements, determinants and effects of foreign direct investment, policy evaluation as well as the method of meta-analysis.

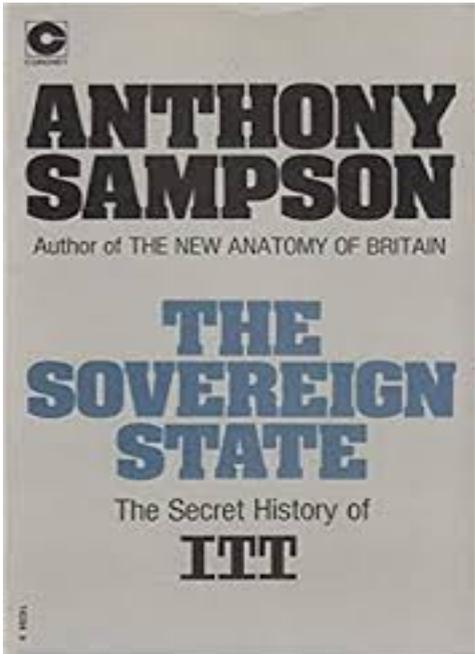
Abstract

Preliminary remark: This is a rather unusual working paper since it contains presentation slides and not the typical “paper”. Yet, we believe that the slides speak largely for themselves and the topic is too important to let the presentation get dusty in a digital drawer on our PC. We presented the slides in a lecture at the Vienna University of Economics and Business on the 28th April 2020.

After the end of Communism around 1990, the world seemed to enter a historical period dominated by liberal democracy and a neoliberal stance towards competitive markets. Thirty years later neither democracy nor competition can be taken as self-evident elements of political and economic life. Autocratic tendencies, not just in the periphery but also in the economic core and rising market concentration in North America and Europe (although to a lesser degree), are new stylized facts of our time. This motivates to think again about the relationship between democracy and capitalism, a classical question not least since John Stuart Mill, Karl Marx and Joseph Schumpeter. The presentation slides in this working paper provide a firm-level analysis of the economic and political power of companies. It is argued that current competition policy regimes are probably too narrowly focused on market power and efficiency and neglect the wider implications of rising concentration for democracy and the stipulated equality of citizens in the political process. A well-equipped, competent and impartial public sector combined with a social welfare system are often considered as relevant factors to defend democratic principles and fend off the danger of a plutocracy based on the accumulation of corporate assets in the hands of an economic elite.

Capitalism and Democracy in the Age of Rising Concentration

Christian Reiner & Christian Bellak
2020



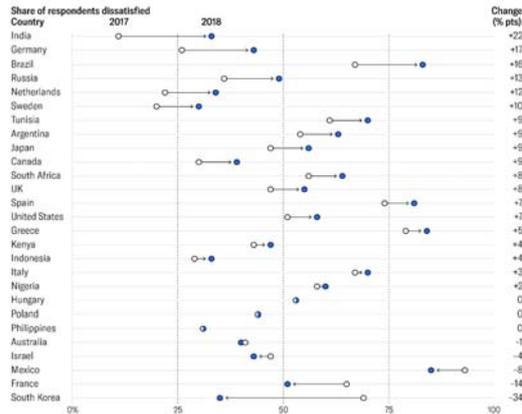
Military coup against Allende, Chile 1973



The state of Democracy

Dissatisfaction with Democracy Has Increased Globally

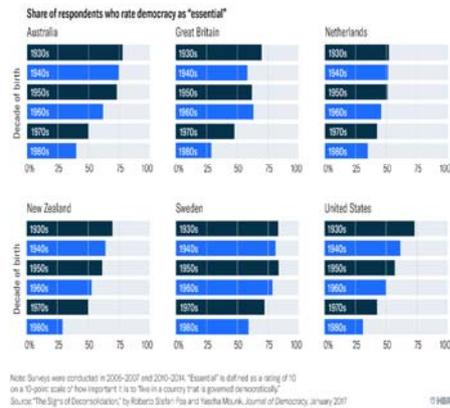
A 2018 survey of more than 30,000 people from 27 countries finds that, by a 51% to 45% margin, a majority of respondents were dissatisfied with how democracy was working in their country. In most of the nations polled, the dissatisfaction share increased from 2017.



Source: "Many Across the Globe Are Dissatisfied with How Democracy is Working" by Richard Wake et al., Pew Research Center, 2018

Young People Are Less Likely to Say Democracy Is "Essential"

A series of surveys conducted since 2005 in countries with strong democratic traditions of government reveals a pattern of younger people seeing less of a need to live under democratic rule.



Note: Surveys were conducted in 2005-2007 and 2010-2014. "Essential" is defined as a rating of 10 on a 10-point scale of how important it is to "live in a country that is governed democratically."
Source: "The Sign of Discontentment" by Roberts Sieder-Fox and Yaela Muzik, *Journal of Democracy*, January 2017

3

Preliminaries I: Definition Capitalism

- The **new Oxford dictionary defines capitalism** as “an economic and political system in which a country’s trade and industry are controlled by private owners for profit.”
- Is capitalism democratic?

That’s simply **not democracy**. (Archon Fung in Harvard Business Review)

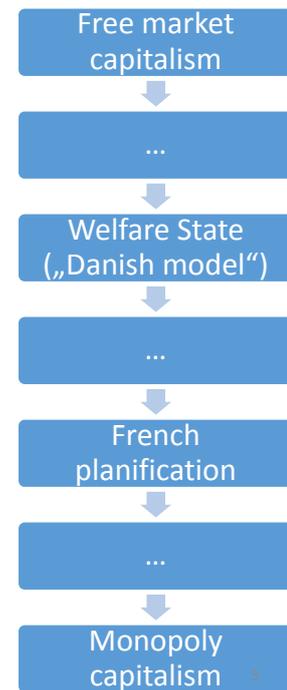
- Is free market equal to capitalism?

No. Capitalism is not naturally meant to support the free market. The market is an exchange mechanism that is legally and culturally produced and secured by the state. (Isabelle Ferreras in Harvard Business Review)

4

Preliminaries II: Definition Capitalism

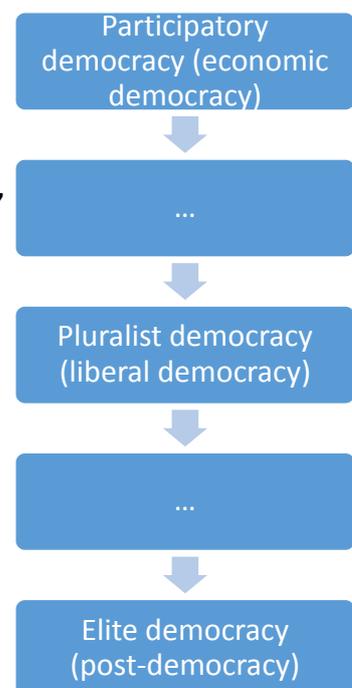
- According to Marx and Schumpeter, free market economies with a dominance of small firms give way to monopoly capitalism.
- Indeed, even the ordoliberal tradition posits that free markets are not a stable equilibrium but one which must be constantly re-established and defended by the public.



Preliminaries III: Democracy

According to American political scientist [Larry Diamond](#), **democracy consists of four key elements:**

- a political system for choosing and replacing the government through free and fair [elections](#);
- the active participation of the people, as citizens, in politics and civic life;
- protection of the [human rights](#) of all citizens;
- a [rule of law](#), in which the laws and procedures apply equally to all citizens.



Democracy and capitalism

- The idea of the democratic process is based on the equality of all citizens (**one person one vote**) and politicians should respond to the preferences of the population.
- Corporate power distorts the political process and regulatory activities of the state because **resource availability and elite networks shape political outcomes** instead of power by the people granted at the ballot box:

“The energy and innovative drive pass away from the democratic arena and into small circles of a politico-economic elite.” Colin Crouch, Post-democracy (2003)

7

Focus of the lecture

- **Firms do not appear in the definition of democracy.**
- **But firms are the core institutions in capitalism.**

What is the **link between firm behavior** (as the core institutions in capitalism) and the **quality of democracy**?

The answer put forward today will focus **on issues of concentration / bigness of firms** as one important link.

8

Outline

1. Conceptualizing the power of firms
2. What is the evidence on the economic power of firms?
3. Explaining the increase in economic power of firms
4. **Why is increasing concentration of firms a potential threat to democracy?**

9

1. Conceptualizing the power of firms

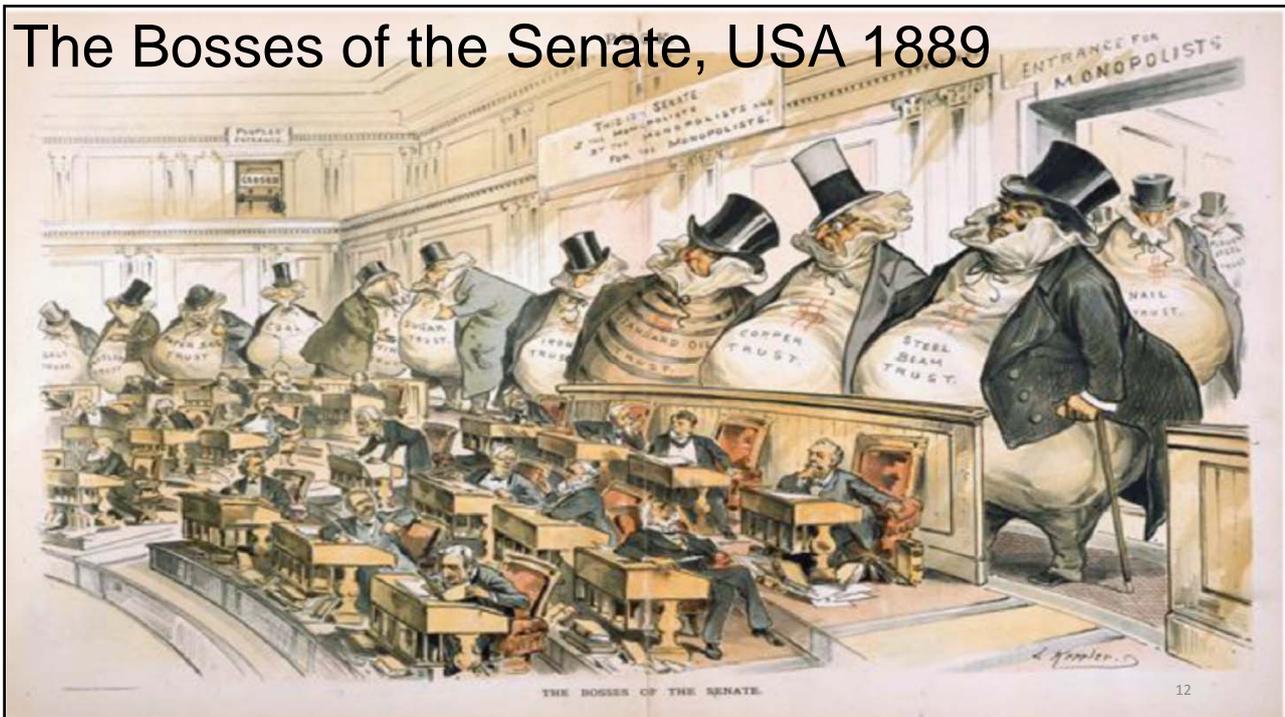
10

Power of firms in economic thought

- Smith (1776), Marx (1867ff), Cournot (1838), Bertrand (1883), Robinson (1933), Chamberlain (1933), Schumpeter (1943), Rothschild (1947)
- Yet, Adam Smith's (1776) work was **neutralized in the neoclassical theory** of the firm (Zingales 2017)
- Standard economic theory focuses on **efficiency aspects** of market power (Chicago School)
- More **progressive strands of thinking** add to economic power the possibility of political power (post-Keynesian economics, Marxian economics)

11

The Bosses of the Senate, USA 1889



12

The multifaceted power of firms

Market size (globalization), technology (IT)

Market power (MP)

A firm can influence the price of the good it sells (power on the output market- monopoly power); focus of competition policy: mark ups, concentration

Economic power (EP)

Monopoly power + monopsony power (power on output and input markets – intermediate goods and factors of production)

Economic size (ES)

Relative and absolute size of a company as measured by direct, indirect and induced VA, employment, exports, positive externalities, perceived strategic importance (too big to fail)

Locational mobility (LM)

What are the firm's costs of spatial relocation? How credible is the threat of offshoring? (locational competition, exit-option)

Political power (PP)

A firm (or a group of firms) can influence the political process

$$PP = f(EP, ES, LM)$$

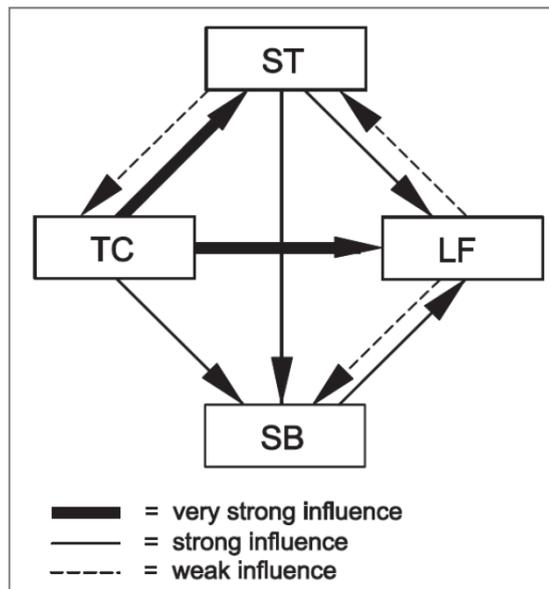
$$\frac{\partial PP}{\partial EP} > 0, \frac{\partial PP}{\partial ES} > 0, \frac{\partial PP}{\partial LM} > 0$$

Direct PP: Lobbying, revolving doors,...

Indirect PP: Media, inequality,...

13

Heterogeneity of firms' power



Rehmschild (1995)

ST = State; TC = Transnational Companies; SB = Small Businesses; LF = Labor Force

14

Economic power and political power

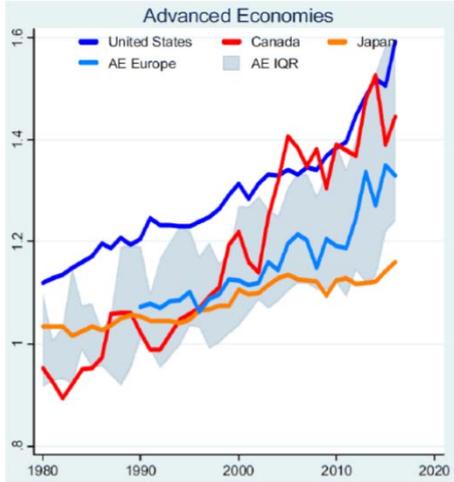
	Economic power	No economic power
Political power	<ul style="list-style-type: none"> • Oil companies • Microsoft • Automobile companies • Banks 	<ul style="list-style-type: none"> • Cambridge Analytica • Think tanks • Manufacturing firm in the periphery • Media (?)
No political power	<ul style="list-style-type: none"> • Supermarket chain(?) 	<ul style="list-style-type: none"> • Hairdresser

15

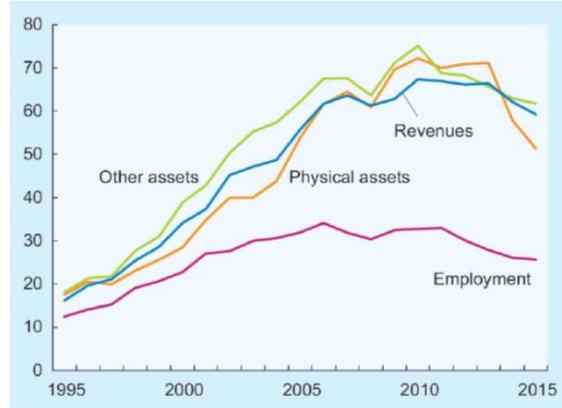
2. What is the evidence on the economic power of firms?

16

Rising mark-ups and concentration



Díez et al (2018), Fig. 6, linkes Panel



UNCTAD (2017), Fig. 6B-2.1

17

Market concentration in the US



Economist.com

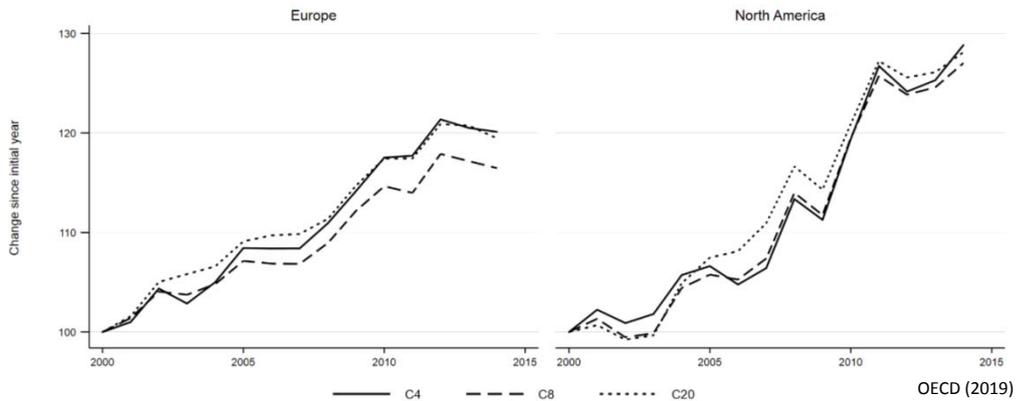
18

Profits and concentration: US vs EU



Gutierrez and Philippon 2018

CR4/8/20 in North America vs EU, 2000-2014



The countries for Europe include BE, DE, DK, EE, ES, FI, FR, GB, GR, HU, IE, IT, LV, NL, NO, PL, PT, SI, SE, and for North America include CA and US. Included industries cover 2-digit manufacturing and non-financial market services. Concentration metrics reflect the share of the top 4, top 8 and top 20 firms in each industry. **The graphs can be interpreted as the cumulated percentage changes in levels of sales concentration for the mean 2-digit sector within each region.** For instance, in 2014 the mean European industry had 20% higher CR4 sales concentration compared to 2000.

Cross-shareholdings (horizontal shareholdings)



<https://www.economist.com/finance-and-economics/2016/09/17/stealth-socialism>

21

3. Explaining the increase in economic power of firms

22

Which factors explain the rise in economic power?

Digital technologies

(platform companies, superstar firms, network externalities)

Globalization

(TNC, market size, economies of scale, locational competition, regulatory competition)

Rise in economic power

(concentration, mark-ups, profits)

Rent seeking

Lax enforcement of competition law

23

Platform companies

- Definition: Platforms **connect two groups of economic agents**: sellers/buyers, drivers/riders, readers/advertisers, etc.
- They act as a **matching device**, allowing each side of the market, or at least one side of the market, to find the best agent on the other side – that is, the one that generates the highest profit.
- **Nature of competition** may differ markedly from standard competition (due to size and externalities) -> new challenges for competition policy.

Comparison of the worlds most valuable companies

2018 (2Q)		2007 (4Q)	
Company	Market Cap (\$Billion)	Company	Market Cap (\$Billion)
Apple	910	Petrochina	720
Amazon	825	Exxon Mobil	510
Alphabet	775	General Electric	370
Microsoft	760	China Mobile	350
Facebook	560	I&C Bank of China	340
Tencent	480	Microsoft	330
Alibaba	475	Gazprom	330
Berkshire Hathaway	465	Royal Dutch Shell	270
JP Morgan Chase	355	AT&T	250
Exxon Mobil	350	Sinopec	250

24

Superstar firms

- Many industries have become **“winner take most/all”** due to globalization and new technologies (quick scaling due to digital platforms).
- Superstar firms are large firms with a **superior productivity capturing a larger share of the market** and thus raising concentration
- Superstar firm model suggests that rising concentration and market power are **based on merit and not on rent seeking** (Van Reenen 2018)
- Sectoral dimension: The superstar effect is particularly marked in the **digital economy**
- Superstar firms are more efficient and their growth raises consumer surplus but **problems of bigness remain**
 - Superstar firms may become lazy incumbents in the future, trying to entrench their position via rent seeking activities and acquisition of potential rivals
 - Superstar firms business model's are perhaps not that efficient after all: tax avoidance, exploitation of workers, appropriation of private data

25

Extractivism 21st century



<https://www.economist.com/news/leaders/21721656-data-economy-demands-new-approach-antitrust-rules-worlds-most-valuable-resource>

26

The ambivalent role of globalization

- Reduction of monopoly power due to **foreign competition**
- Companies become larger due to larger markets and economies of scale (**New Trade Theory**)
- **Increase in the political power** of firms because of locational competition (exit option) and rising firm size
- Positive attitude of competition policy towards M&A in order to foster the international competitiveness of domestic companies

27

4. Why is increasing concentration of firms a potential threat to democracy?

28

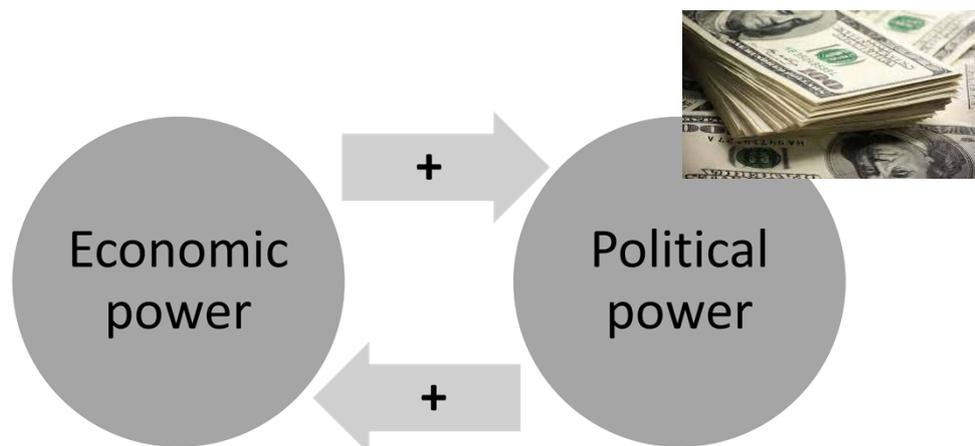
Economic power and democracy

- Vanhanen (1990): The **more centralized power-resources** are, the easier it is to suppress the majority population and restrict democracy
- Acemoglu and Robinson (2006): Societies with a **greater equality in wealth** are characterized by greater interdependencies; repression by the wealthy elites is more costly
- Democracy is more likely to be established if the **elite is large and diverse** (Przeworski 1986,...) – procedural uncertainty is accepted
- Wealthy elites will oppose democracy as long as the costs suppressing the population are below the **costs of redistribution due to democracy** (Petersen 2013)

High concentration of resources reduces the likelihood of democratic reforms and destabilizes existing democracies.

29

The Medici Vicious Circle (Zingales 2017)



30

Economic elites and political power

- Economic elites (i.e. large firms) have the power and the need (!) to influence **politics** (Zingales 2017):
 1. If the ability to influence the political power increases with economic power, **so does the need to do so**, because the greater the market power a firm has, the greater the fear of expropriation by the political power.
 2. The more an economy becomes winner-take-all, the bigger the incentives to corrupt the political system to gain a small, but often decisive, advantage.

31

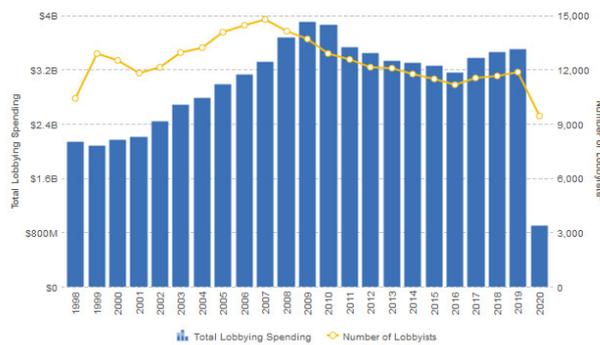
Examples of the (partly subtle) transfer of economic power into political power

- **Networks** (effort to reduce the size and power of the U.S. government; Koch brothers. "Corporations need some friends in Congress").
- **Exchange** or movement of people ("experts") between private and public sector: complex regulatory environment: regulatory capture, sue the regulators! etc.
- **Collective action**: *"Business must learn the lesson...that political power is necessary; that such power must be assiduously cultivated; and that when necessary, it must be used aggressively and with determination"* (Powell Memo, 1971)
- Acquisition of **media outlets**
- **Hide crucial information** (DuPont)
- ...
- Direct **lobbying** (see below): money is used only in the marginal cases
- **Campaign finance**
- **Corruption**

32

Lobbying in the US and the EU

Lobbying expenditures, US (real USD)



<https://www.opensecrets.org/federal-lobbying/summary?inflation=y> [27.04.2020]

Lobbying in Brussels

- It is estimated that there are **over 25,000 lobbyists** working in the European quarter, most of whom in the service of corporations and their lobby groups.
- Conservative estimates suggest that **over €1.5 billion is spent every year** on lobbying targets like the European Commission, the European Parliament, the Council of Europe, and Brussels offices of national governments.
- 90% of TTIP related meetings were with **corporate lobby groups**, 10% with **NGOs and trade unions**

Corporate Europe Observatory (2017, 2019)

33

Economic history of DE (vs US)

- US: **1890 Sherman Act**; DE: **1897: cartel contracts** were declared as legally binding contracts; legal charges against violations of quota or price agreements became possible
- A number of conservative (ordoliberalism) and socialist legal and economic scholars argued that **business cartels played a crucial role in the rise to power of the Nazi regime**; extreme form: fascism is the expression of big business (monopoly capitalism)
- Because of this, the US demanded the adoption of an effective antitrust law after WWII → Economic deconcentration should stabilize the new democracy
- An alternative interpretation (Hobsbawm 1994)
"(...) The point about really big business is that it can come to terms with any regime that does not actually expropriate it, and any regime must come to terms with it. (...)

34

Political access and firm value (Brown and Huang 2017)

- There were **2,286 meetings** (with < 50 participants) between corporate executives and federal government officials at the White House during the period from January 2009 through December 2015
- We find that corporate executives' meetings with key policymakers are associated with **positive abnormal stock returns**.
- Following meetings with federal government officials, firms receive **more government contracts** and are more likely to receive regulatory relief.
- Investment of these firms also becomes **less affected by political uncertainty** after the meetings.

35

Special role of the media industry

- In the US, 6 corporations own 90 percent of the media.
 - Determinants of concentration: family ties, (corporate) wealth, lax competition policy etc.
 - Determinants of de-concentration: low entry costs, public subsidies for small and independent media outlets etc.
- **Democratic and societal dimension** (impacts public opinion, fake news, hate speech, protection of data privacy, targeted advertising in election campaigns)

While objective news coverage is vital to democracy, **captured media** can seriously distort collective decisions. (Corneo 2005)

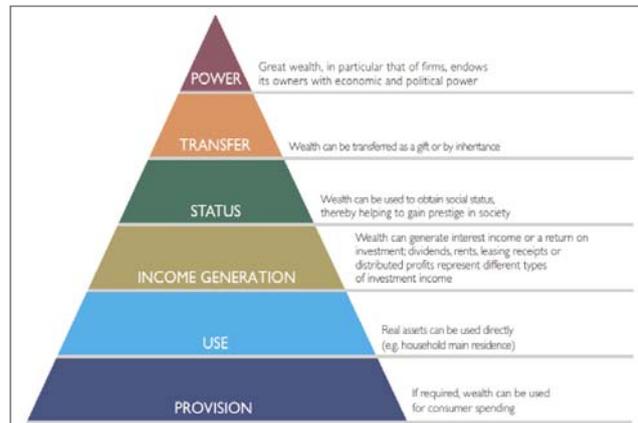
Media might secretly or openly **collude with interest groups** in order to influence the public opinion.
- **Examples:** ownership of outlets (e.g. Washington Post); **Fox News channel:** "In short, it is a propaganda organisation, not a 'for profit' news organisation."
<https://mainlymacro.blogspot.com/2017/09/economists-show-how-fox-news-changes.html>

36

Inequality and democracy

- Gilens and Page (2014) find strong evidence for **economic-elite domination** of the political process
 - Proposals supported by 90% of the voters were no more likely to be passed than proposals supported by 10%
 - But if the rich were in favor of a policy, it got passed

Functions of wealth



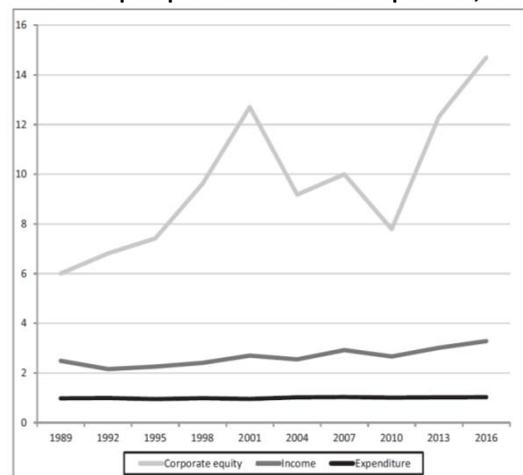
<https://www.oenb.at/en/Monetary-Policy/Research/inheritance-is-key-to-the-concentration-of-wealth.html>

37

Market power and inequality

- Comanor and Smiley (1975): About **50% of the wealth hold by the richest few percent** of the US households are due to monopoly gains
- Gans et al. (2019): Because firm ownership is more skewed than consumption, increased mark-ups increase inequality and monopoly power acts to **transfer resources from low to high-income households**
- Autor et al. (2017) and Bertelsman Stiftung (2018) find evidence that the rising concentration due to superstar firms is associated with a **decline in the labor share** because they are more capital-intensive

Ratio of top 20 per cent to bottom 60 per cent, US



Source: Gans et al. (2019)

38

Summary

39

Summary I

- Power of corporations to **shape the rules of the game** has become stronger due to higher concentration
- **Globalization and new technologies** have ambiguous effects; evidence so far suggests that their net effect leads to a rise in the power of firms.
- Conceptually, we need to **disentangle the impacts of concentration on democracy from the impacts on efficiency** (e.g. limited net-welfare effects of mergers of firms in terms of efficiency gains) and on equity.
 - Rising concentration poses a threat to democracy - even if the firms gain market power as a result of superior efficiency.
 - *Companies that grow large through innovation are no less likely than those that grow large by merger to turn to anticompetitive practices.* (Lamoreaux 2019)
- **Usual indicators of concentration market power** only partly capture the relevant aspects.

40

Summary II

- Competition policy can support democracy by **deconcentrating power** and by offering choices for consumers and firms
- Until the 1980s antitrust was interpreted in the US as the **economic democracy of markets**; this changed with the **Chicago school of antitrust** in the 1980s: antitrust was recalibrated for efficiency with a laissez faire gloss (Fox 2017) – *Differences between US and EU comp. policy?!*
- Petersen (2013) finds **no significant positive effect of anti-trust laws on the level of democracy**. Because existing antitrust laws are designed to promote economic efficiency rather than to prevent economic concentration.
- Under the name of **competitiveness**, governments occasionally support concentration and try to **overrule competition authorities**.

41

Summary III

- **Social welfare systems** may be more likely to deal with the issue of bigness of firms than **neoliberal systems** because ...
 - ... distributional concerns of market outcomes are more likely to be addressed than in other systems
 - ... countervailing powers / social partnership are part of the system of institutions, such as:
 - Trade unions (social partners) (yet have lost considerable influence since the 1970s);
 - There is maybe also a role for more democracy within hierarchies: more participation of employees within firms (codetermination). Yet, as of now there are no signs that there are efforts to strengthen this role – rather, on the contrary.
 - Media (but high concentration)
 - Public financing of political parties
 - ...the public sector is more likely to act as a strong administrative state due to the higher availability of resources and a less negative image of the state

42

(Selected) Literature

43

- Acemoglu, D., Robinson, J. (2006): The economic origins of dictatorship and democracy. Cambridge University Press.
- Bertelsmanstiftung (2018): Unternehmenskonzentration und Lohnquote in Deutschland. Eine Analyse auf Branchenebene zwischen 2008 und 2016, Gütersloh.
- Brown, J., Huang, J. (2017): All the President's Friends: Political Access and Firm Value. NBER Working Paper, 23356.
- Crouch, C. (2004): Post-democracy. Polity Press.
- Corneo, G. (2005): Media capture in a democracy: The role of wealth concentration. In: Journal of Public Economics, 90(1-2), 37-58.
- Gans, J., Leigh, A., Schmalz, M., Triggs, A. (2019): Inequality and market concentration, when shareholding is more skewed than consumption. In: Oxford Review of Economic Policy, 35(3), 550-563.
- Gutierrez, G., Phillipon, T. (2018): How EU markets became more competitive than US markets: A study of institutional thrift. NBER Working Paper 24700.
- Lamoreaux, N. (2019): The problem of bigness: From Standard oil to Google. In: Journal of Economic Perspectives, 33(3), 94-117.
- OECD (2020): Industry concentration in Europa and North America. OECD Productivity Working Paper, 18.
- Petersen, N. (2013): Antitrust law and the economic promotion of democracy and economic growth. In: Journal of Competition Law & Economics, 9(3), 593-636.
- Reiner, C., Bellak, C. (2018): Editorial: Die Macht von Unternehmen im neoliberalen Kapitalismus. In: Kurswechsel, 1, 3-19.
- Reiner, C., Bellak, C. (2018): Die (neue) Macht der Unternehmen. Drei Essays über Marktmacht in Europa, Monopson und offene Forschungsfragen. LBS Working Paper, 4.
- Rothschild, K. (2005): New worlds – New approaches. A note on future research strategies. In: Kyklos, 58(3), 439-447.
- Sampson, A. (1973). The Sovereign State: The Secret History of ITT. Hodder and Stoughton.
- Zingales, L. (2017): Towards a political theory of the firm. In: Journal of Economic Perspectives, 31(3), 113-130.

44