MICHIGAN
ROSS SCHOOL OF BUSINESS

Corporate elites and states after financialization

Jerry Davis
CRESC Seminar: Studying Elites
University of Manchester
24 April 2009

The golden era of the US corporate elite

"Any President who wants to run a prosperous country depends on the corporation at least as much as—probably more than—the corporation depends on him. His dependence is not unlike that of King John on the landed barons of Runnymede, where Magna Carta was born."

Fortune magazine, 1952

THE WALL STREET JOURNAL.
WSJ.com

BUSINESS | FEBRUARY 28, 2009

Citi, U.S. Reach Accord on a Third Bailout

Government Puts Itself on Hook for More Losses; Stake of Up to 36% Stops Short of Nationalization

By DAVID ENRICH and DEBORAH SOLOMON

Citigroup Inc. and the federal government agreed to a third rescue that will give U.S. taxpayers as much as 36% of the bank but expose their ownership stake to greater risk from the recession and housing crisis.

Friday's agreement shows how hard the Obama administration is trying to stabilize the U.S. banking industry without a full-fledged nationalization that would wipe out investors and leave the government in charge. But the deal will punish existing shareholders of Citigroup, who will see their stake diluted by 74%, and likely do little to change the awkward relationship between federal officials and management of the New York company.

Government officials don't see the latest agreement with Citigroup as a template for other rescues, though bank stocks fell on worries that the agreement will be cloned at other suffering U.S. financial institutions.

According to Citigroup executives, the Treasury Department and other banking regulators didn't try to squeeze new concessions from the New York bank. For example, the company wasn't pushed to make more loans, rein in foreclosures or curb executive pay beyond previously agreed or required levels, these people said.

Over the past several days, Treasury Secretary Timothy Geithner and other government officials discussed whether to require the removal of Citigroup Chief Executive Vikram Pandit, according to a person familiar with the discussions. But government officials concluded it was impractical to oust him, partly because of a lack of strong potential successors. A boardroom shake-up already is in motion, largely due to pressure from the Fed.

THE WALL STREET JOURNAL.
WSJ.com

BUSINESS | MARCH 30, 2009

Government Forces Out Wagoner at GM

Most of Board Gone, Too, After Threat to Withhold Bailout Cash; Chrysler Urged to Make Fiat Deal; U.S. Says Bankruptcy an Option

By NEIL KING JR. and JOHN D. STOLL

The Obama administration used the threat of withholding more bailout money to force out General Motors Corp. Chief Executive Rick Wagoner and administer harsh medicine to Chrysler LLC, marking one of the most dramatic government interventions in private industry since the economic crisis began last year.

The administration's auto team announced the departure of Mr. Wagoner on Sunday. In a summary of its findings, the task force added that it doesn't believe Chrysler is viable as a stand-alone company, and suggested that the best chance for success for both GM and Chrysler "may well require utilizing the bankruptcy code in a quick and surgical way."

The move also indicates that the Treasury Department intends to wade more deeply than most observers expected into the affairs of the country's largest and oldest car company.

After over a month of analysis, the administration's auto task force determined that neither company had put forward viable plans to restructure and survive. The verdict was gloomier for Chrysler. The government said it would provide Chrysler with capital for 30 days to cut a workable arrangement with Fiat SpA, the Italian auto maker that has a tentative alliance with Chrysler.

If the two reach a definitive alliance agreement, the government would consider investing up to $6 billion more in Chrysler. If the talks fail, the company would be allowed to collapse.

Research question:

~~WTF??~~

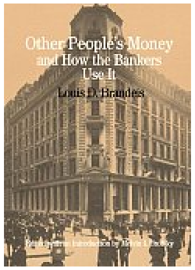
How have the links between corporate elites and the state evolved in the US?
What part does "financialization" play?

Outline of the talk

- Industry and finance capitalism in the early 20th century
- The evolution of local and national elite networks
- The rise of market-based finance and the end of "bank hegemony"
- Dense elite networks: conspiracy, or something more benign?
- Finance turns states from sovereigns to vendors
- Bespoke tailors, or prêt-à-porter?

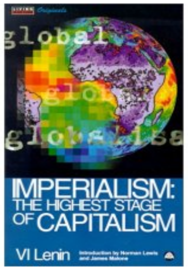
Industry and finance capitalism in the early 20th century

Social critics have linked bank-based corporate networks to economic control for a century



Louis Brandeis, 1914

"The practice of interlocking directorates is the root of many evils. It offends laws human and divine....It is the most potent instrument of the Money Trust"



V.I. Lenin, 1916

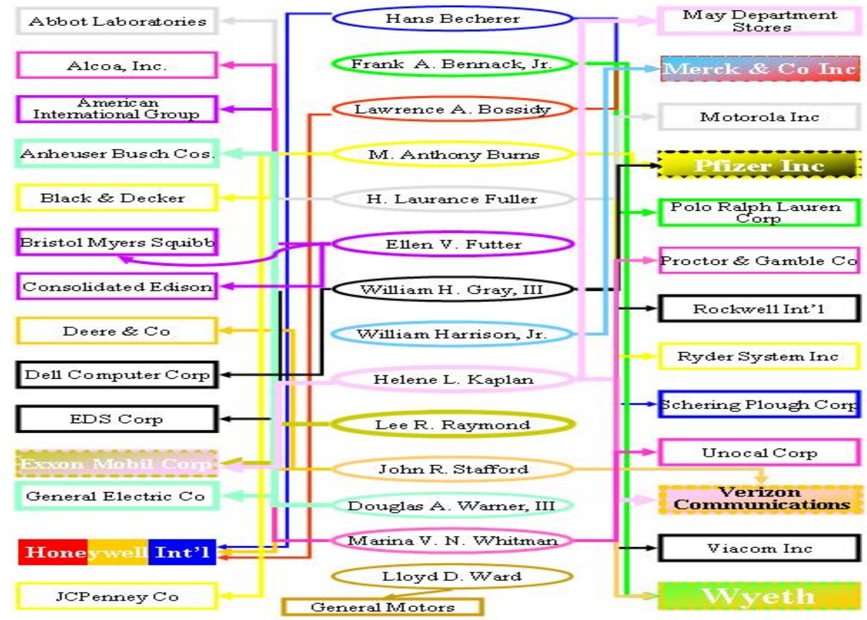
"A very close personal union is established between the banks and the biggest industrial commercial enterprises…through the appointment of bank directors to the Supervisory Boards of industrial and commercial enterprises, and vice versa "

On the verge of World War I, three American banks held dominant positions in the corporate network

- In 1912, JP Morgan's partners collectively held 72 directorships on 47 corporate boards
- First National of New York executives served on 49 boards
- National City Bank executives served on 48 boards

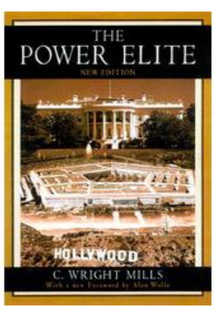
- 1914: in the face of populist pressure and imminent legislation, JP Morgan's men resigned directorships in 30 of their "subject" companies

JP Morgan Chase board, 2001: plus ça change…



Mid-century theorists linked business networks explicitly to political power

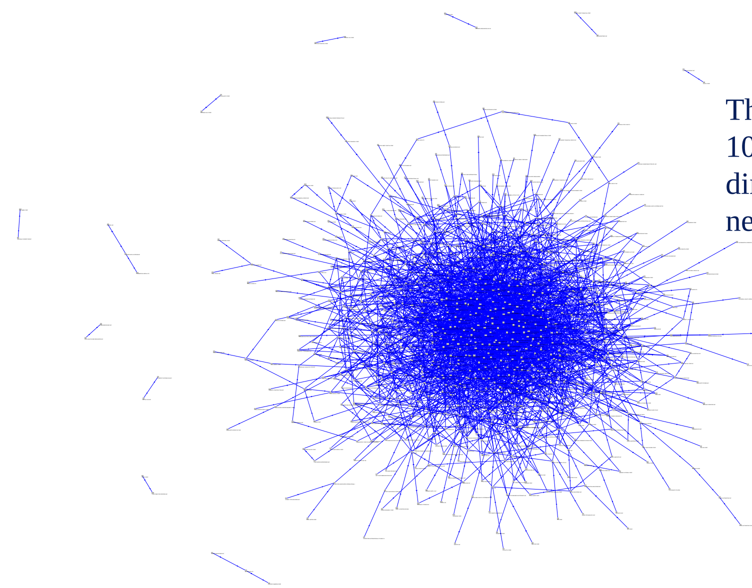
C. Wright Mills, 1956



"By the *power elite*, we refer to those political, economic, and military circles which, as an intricate set of overlapping cliques, share decisions having at least national consequences"

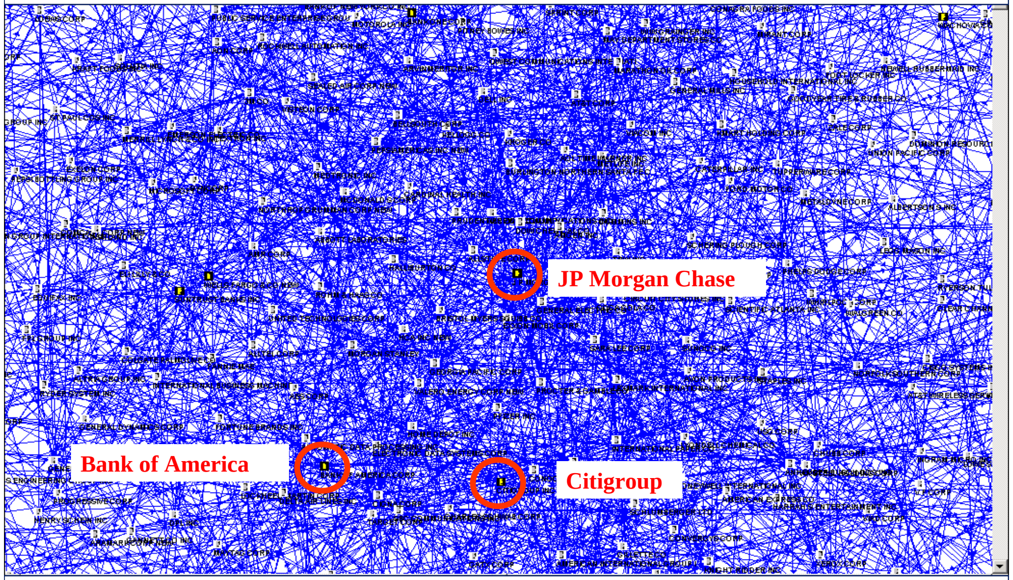
"As an elite, it is not organized, although its members often seem to know one another, seem quite naturally to work together, and share many organizations in common."

Network analysis shows that corporate elites really *do* all know each other…



The *Fortune* 1000 board of directors network

…and banks sit somewhere in the middle



The evolution of local and national elite networks

The 1920s stock market boom dispersed ownership in the largest US corporations

- Corporate ownership grew increasingly dispersed during the 1920s as retail investors poured into the stock market
- Number of shareholders in the US
  - 1924: 2.4 million
  - 1927: 5 million
  - 1930: 10 million
- By 1930, 44% of the 200 largest corporations lacked a single large ownership block, according to Berle and Means (1932)

Retail investors, AKA “widows and orphans”

Our Stockholders

The dispersion of ownership and the rise of the "managerial class"

- Dispersed ownership and the rise of professional managers created a new system of "managerialism"
- "The economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another. The organizations which they control have passed far beyond the realm of private enterprise--they have become more nearly social institutions."

Berle and Means, 1932

Did finance become irrelevant?

"Not 'Wall Street financiers' or bankers, but large owners and executives in their self-financing corporations hold the keys of economic power"
C. Wright Mills, *The Power Elite* (1956)

And yet…

The same New York banks were the most central firms in the national board interlock network for decades

1962

1. JP Morgan
2. Chase Manhattan
3. Chemical Bank
4. First National City Bank
5. Southern Pacific Railroad
6. Mellon Bank
7. Manufacturers Hanover
8. AT&T
9. Pennsylvania Railroad
10. Bankers Trust

1982

1. AT&T
2. JP Morgan
3. Chase Manhattan
4. Citicorp
5. IBM
6. General Foods
7. Chemical Bank
8. Bankers Trust
9. Manufacturers Hanover
10. Mobil

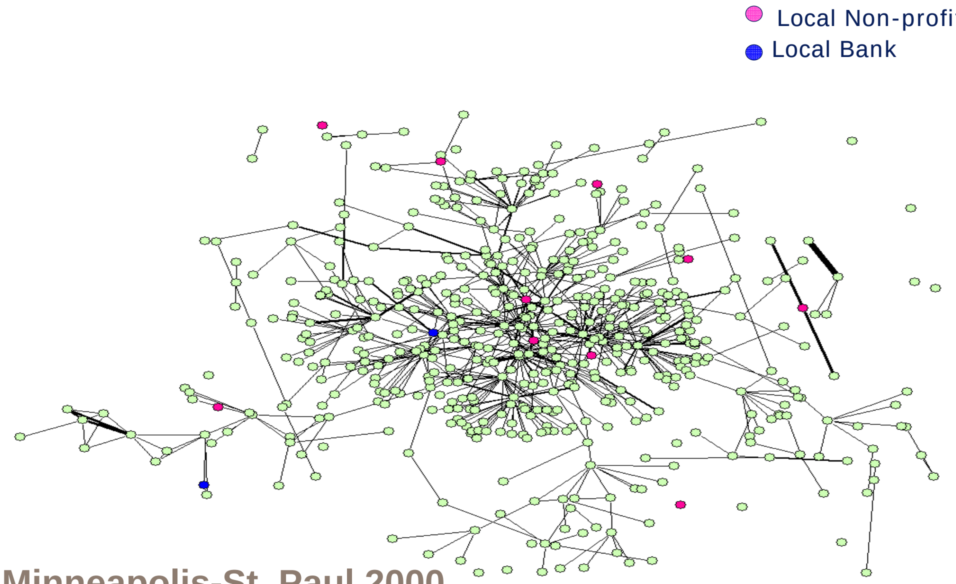
10 most central public corporations (eigenvector centrality).
Source: Mintz and Schwartz, 1985 (1962); Davis and Mizruchi, 1999 (1982)

In ~ every major city, local corporate executives staffed the boards of local banks…

- **Boston: Bank of Boston**
  - Computervision
  - Dennison Manufacturing
  - General Cinema
  - Gillette
  - Prime Computer
  - Raytheon
  - Wyman Gordon
- **Pittsburgh: Mellon Bank**
  - Air Products
  - Allegheny International
  - Alcoa
  - Joy Manufacturing
  - PPG Industries
  - Quaker State Oil
  - Sperry
  - US Steel

Data for 1986 from Davis (1991)

…creating relatively dense urban elite networks



Minneapolis-St. Paul 2000

The rise of market-based finance and the end of "bank hegemony"

"The coming death of commercial banks," ca. 1991

- Indicators of decline in traditional business included
  - Industry contraction: number of banks dropped from 12,380 (1980) to 7,926 (1994) due to bank closures and mergers
  - Declining significance of bank loans to corporations: bank loans share of corporate debt dropped from 20.5% (1980) to 14.5% (1994)
  - Alarmist claims by insiders: "The banking industry is dead, and we ought to just bury it" (Dick Kovacevich, CEO of Norwest)
- Reasons for decline include
  - More attractive (lower cost) alternatives for corporate borrowers (commercial paper, equity markets, etc.)
  - More attractive (higher return) alternatives for depositors (mutual funds, money market accounts, pension plans, etc.)

Q: What is the date of this article?

The New York Times
nytimes.com

Dingell's Sweeping Claims About Citicorp's Solvency

By MICHAEL QUINT

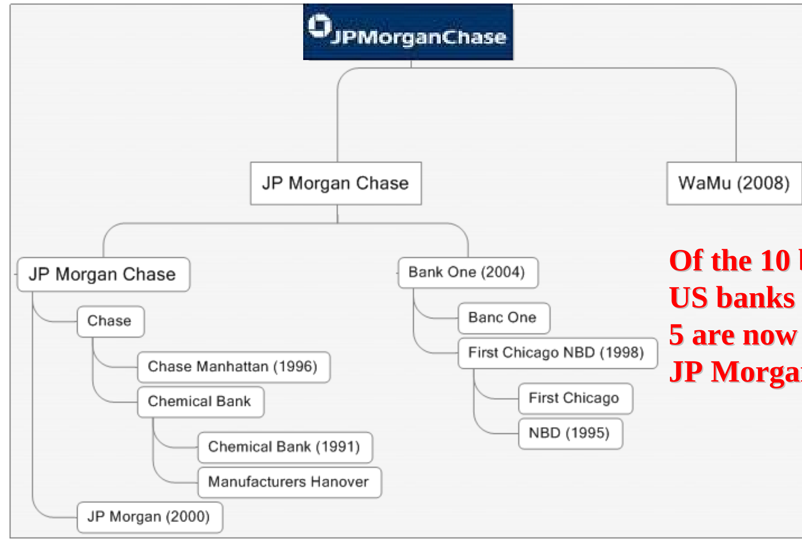
In a sweeping accusation that was quickly repudiated by a top banking regulator, Representative John D. Dingell asserted yesterday that Citicorp was "technically insolvent" and "struggling to survive."

The claims by Representative Dingell, Democrat of Michigan, were made at a hearing of the House Energy and Commerce Committee's Subcommittee on Telecommunication and Finance about granting banks authority to enter new businesses.

Mr. Dingell, who opposes the expansion of bank powers in the securities and insurance businesses, noted that Citicorp had lost money from its effort to expand in overseas securities markets and claimed that those losses had put the company in dire straits. He later asked Treasury Secretary Nicholas F. Brady, who was testifying at the hearing, whether Citicorp had been borrowing heavily from the Federal Reserve. Seidman's View

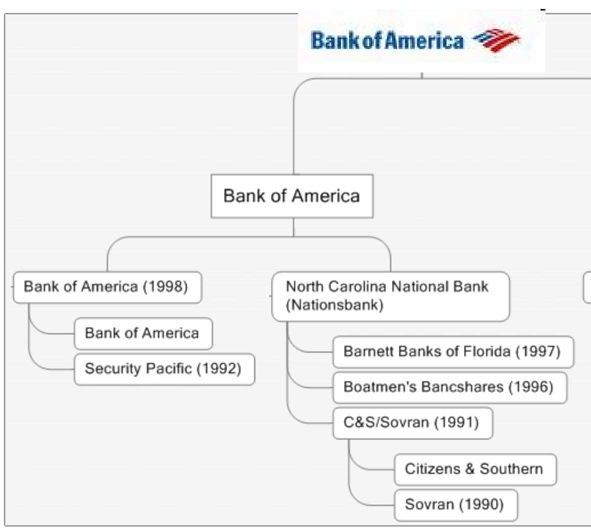
…plus ça change…

Bank consolidation since 1990:
How (almost) every New York-based commercial bank became JP Morgan Chase



Of the 10 biggest US banks in 1989, 5 are now part of JP Morgan Chase

Bank consolidation since 1990:
How North Carolina National Bank became Bank of America



Bank of America holds nearly 10% of all deposits in the US through its 5800 branches

Bank consolidation and centrality: Most central firms, 1962-2002

1962

1. JP Morgan
2. Chase Manhattan
3. Chemical Bank
4. First National City Bank
5. Southern Pacific Railroad
6. Mellon Bank
7. Manufacturers Hanover
8. AT&T
9. Pennsylvania Railroad
10. Bankers Trust

1982

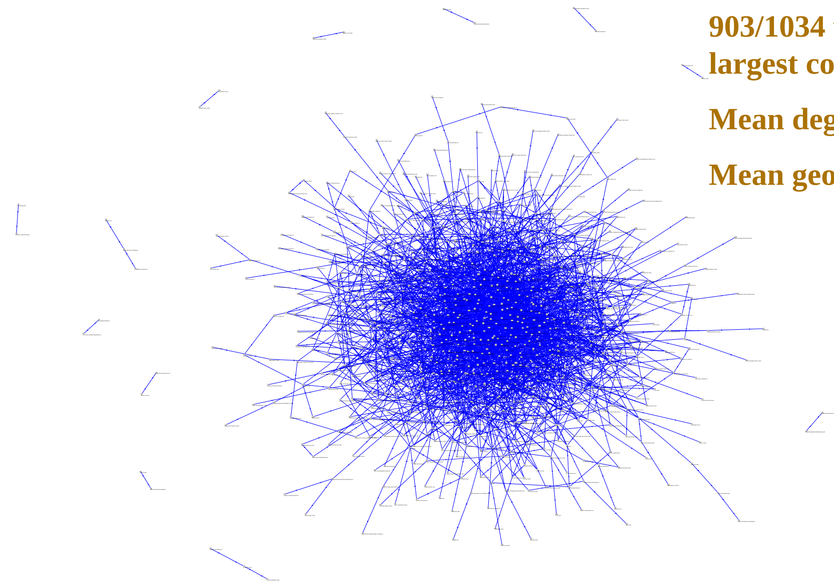
1. AT&T
2. JP Morgan
3. Chase Manhattan
4. Citicorp
5. IBM
6. General Foods
7. Chemical Bank
8. Bankers Trust
9. Manufacturers Hanover
10. Mobil

2002

1. Dell
2. Sara Lee
3. Verizon
4. Allstate
5. AMR
6. JP Morgan Chase
7. Pfizer
8. Morgan Stanley
9. Dow Chemical
10. Sears

Why all the elites know each other: conspiracy, or something more benign?

The *Fortune* 1000 in 2003



903/1034 firms in largest component

Mean degree: 7.9

Mean geodesic: 4.0

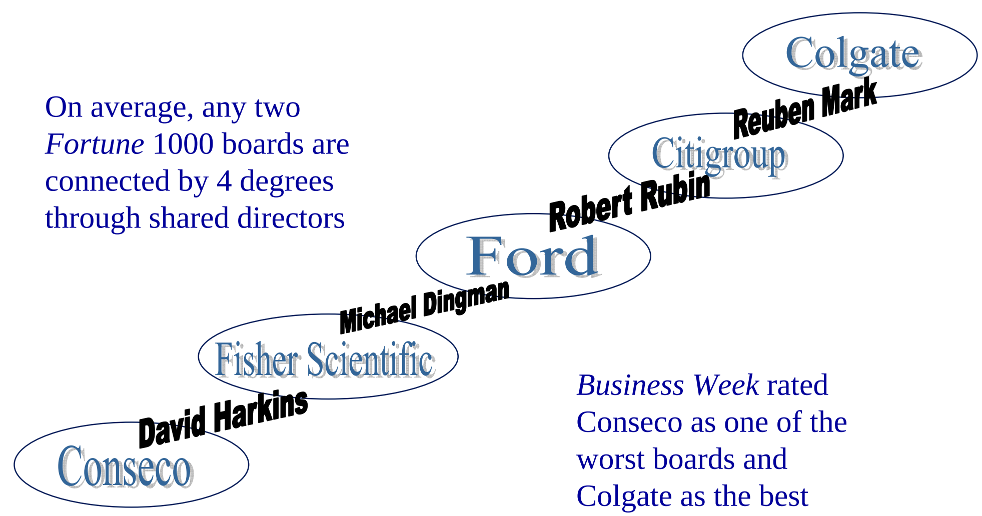
Six degrees of JP Morgan Chase:

Shortest paths from the Fortune 1000

Chase #	N of firms	Cumulative
1	34	4.5%
2	233	34.1%
3	374	81.8%
4	121	97.2%
5	17	99.4%
6	2	99.6%
7	2	99.9%
8	1	100%

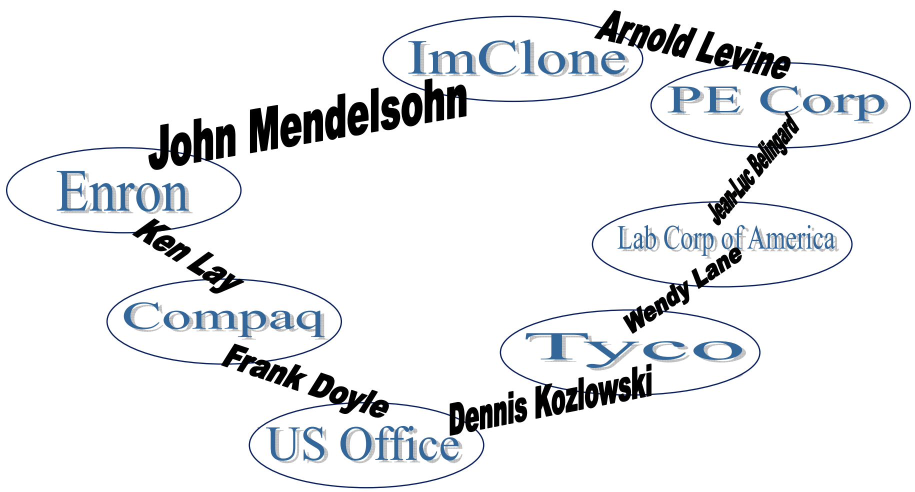
From worst to best in four steps

On average, any two *Fortune* 1000 boards are connected by 4 degrees through shared directors



Business Week rated Conseco as one of the worst boards and Colgate as the best

From worst to second-worst



A benign interpretation of the “small world of the corporate elite”

- Corporate directors really *do* all know each other, or have friends in common, with predictable consequences (contagion of practices; common political views; easier collective action)
- But: because of the “small world effect” and a few regularities in recruiting, this will be true even if all New York banks disappear, all prep schools are closed, and the Bohemian Grove it turned into an anti-globalist training camp by the Ruckus Society
- And: the “inner circle” is heavily populated with women and minorities, not white male bankers

Finance turns states from sovereigns to vendors

What do “post-industrial” corporations look like?

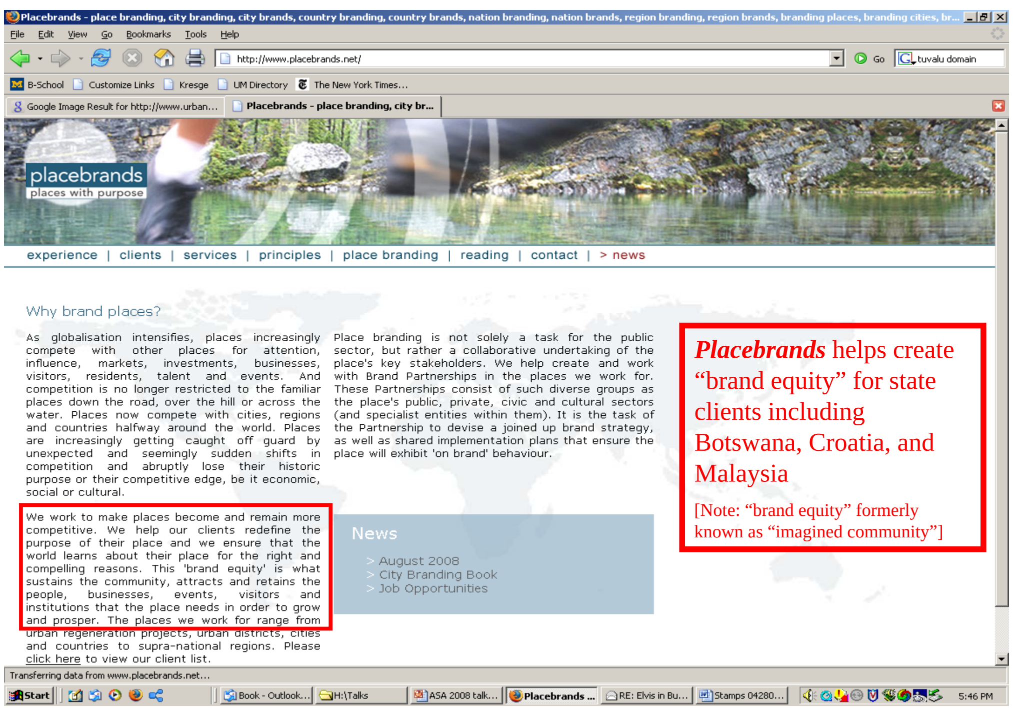
TOMMY HILFIGER

Headquarters:	**Hong Kong**
Incorporation:	**British Virgin Islands**
Annual meeting:	**Barbados**
Manufacturing:	**Mexico and China**
Stock listing:	**New York Stock Exchange**

What would states that emulated postindustrial corporations look like?

- Financially driven
- Attentive to their brand
- Focused on their core competence
- Skilled at outsourcing
- Ties to place are provisional

Tuvalu receives $2.2M per year (about 15% of GDP) from VeriSign for the use of its Internet domain name ".tv"



Placebrands helps create "brand equity" for state clients including Botswana, Croatia, and Malaysia

[Note: "brand equity" formerly known as "imagined community"]

WSJ.com THE WALL STREET JOURNAL ONLINE

September 30, 2004

Laundering Queries Focus on Delaware

By GLENN R. SIMPSON
Staff Reporter of THE WALL STREET JOURNAL
September 30, 2004

WILMINGTON, Del. -- Delaware's corporate-secrecy laws may be making it a haven for foreign criminal groups, prompting prosecutors in Eastern Europe and Russia to flood the Justice Department with requests for help in probes of Delaware shell companies.

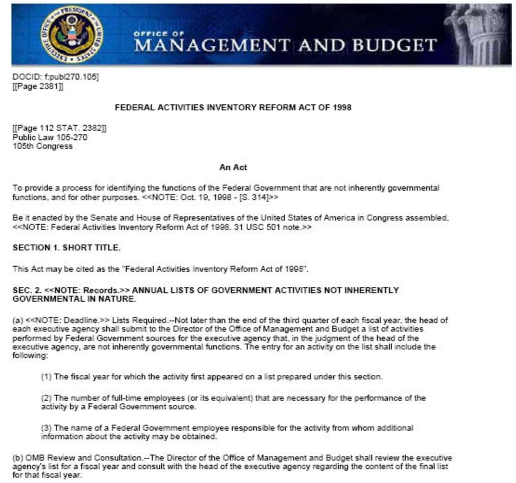
In the past four years, law-enforcement agencies in Russia, Hungary and a dozen other nations have made more than 100 formal requests to the Justice Department to go before the U.S. District Court in Delaware to obtain subpoenas to learn more about the companies. In many cases, foreign prosecutors say in their requests that they believe the companies are controlled by or connected to Eastern European criminals who use them to move money into and out of the U.S.

The cases also have connections to U.S. and foreign banks, and are generating concern among top U.S. regulators and law-enforcement officials that crime groups were able to penetrate the U.S. economy despite warning signs such as a $7-billion money-laundering probe at the **Bank of New York** in 1999.

Delaware allows anonymous incorporation over the Internet for Russian money launderers, making it the Amazon.com of financial crime

The ship registry for "Liberia" is operated out of an office park near Dulles Airport

How is the US government like Nike?



OFFICE OF MANAGEMENT AND BUDGET

DOCID: f:publ270.105]
[[Page 2381]]

FEDERAL ACTIVITIES INVENTORY REFORM ACT OF 1998

[[Page 112 STAT. 2382]]
Public Law 105-270
105th Congress

An Act

To provide a process for identifying the functions of the Federal Government that are not inherently governmental functions, and for other purposes. <<NOTE: Oct. 19, 1998 - [S. 314]>>

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, <<NOTE: Federal Activities Inventory Reform Act of 1998. 31 USC 501 note.>>

SECTION 1. SHORT TITLE.

This Act may be cited as the "Federal Activities Inventory Reform Act of 1998".

SEC. 2. <<NOTE: Records.>> ANNUAL LISTS OF GOVERNMENT ACTIVITIES NOT INHERENTLY GOVERNMENTAL IN NATURE.

(a) <<NOTE: Deadline.>> Lists Required.--Not later than the end of the third quarter of each fiscal year, the head of each executive agency shall submit to the Director of the Office of Management and Budget a list of activities performed by Federal Government sources for the executive agency that, in the judgment of the head of the executive agency, are not inherently governmental functions. The entry for an activity on the list shall include the following:

(1) The fiscal year for which the activity first appeared on a list prepared under this section.

(2) The number of full-time employees (or its equivalent) that are necessary for the performance of the activity by a Federal Government source.

(3) The name of a Federal Government employee responsible for the activity from whom additional information about the activity may be obtained.

(b) OMB Review and Consultation.--The Director of the Office of Management and Budget shall review the executive agency's list for a fiscal year and consult with the head of the executive agency regarding the content of the final list for that fiscal year.

- The Federal Activities Inventory Reform Act of 1998 ("FAIR Act") encourages all Federal agencies to hire private contractors for tasks not "inherently governmental"
- The number of Federal employees declined by 350K under Clinton
- The definition of "inherently governmental" has proved flexible…

Government tasks that can be (and have been) outsourced in the US

- Operating prisons
- Collecting taxes
- Hiring other contractors and investigating charges of contractor fraud
- Interrogating prisoners at Abu Ghraib
- "Aggressively" protecting diplomats:

"We cannot operate without private security firms in Iraq. If the contractors were removed, we would have to leave Iraq."
-Patrick F. Kennedy, Under-Secretary of State for Management

States today:
Bespoke tailors, or prêt-à-porter?


HONG KONG
NO SURPRISES
One of the world's most service oriented economies, Hong Kong offers a world-class regulatory regime, transparent business practices, and a level playing-field.
With manufacturing operations now dispersed across Asia, Hong Kong has evolved into the financial, management, transport and logistics hub for the Chinese mainland and the wider region.
With change sweeping Asia's economies, Hong Kong continues to offer a stable currency and a sound business environment.
As the stakes are raised higher and higher in the global economy, these are winning attributes.
香港貿易發展局
Hong Kong Trade Development Council