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# Expertise, the Administrative State, and Corporate Governance: a Comment on Koppl

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This essay draws on an ongoing book project called *The Corporation and the Twentieth Century*.

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I am grateful to have this opportunity to comment on—or maybe I should say riff on—*Expert Failure*, the wonderful new book by my old friend Roger Koppl. The book argues “that there is a market for expert opinion whose structure determines the reliability of experts and the power of non-experts” (Koppl 2018, p. 37). Because Koppl takes a Hayekian view of what a market is, he sees a market as inherently about learning. Competition—in the true sense of entry unrestricted by legal rights of exclusion—is not only about levels of price and quantity but also about what we know. This is salient and crucial when the product itself is—what we know. Economics and epistemology are interpenetrated.

*Expert Failure* is thus a critique of the view, common among intellectuals as well as people on the street, that expertise, and indeed science, consist in privileged access to the truth. (Economic corollary: if truth is a pre-existing resource that certain people are technologically best equipped to dispense, then maybe truth is a natural monopoly like water or sewer, and maybe truth should be centralized and regulated.) The privileged-access view is at least as old as Plato (or maybe even Socrates, Koppl tells us), and it was especially prominent in the United States among the Progressive intellectuals of the late nineteenth and early twentieth century, a group to whom I will return. As Koppl understands, however, science and expertise are not about dispensing truth; they are about groping toward truth, through a social process of competition among conjectures (Popper 1963).

Because he came at the theory of expertise from the study of forensic evidence and testimony, Koppl tends, quite appropriately and usefully, to frame expertise in terms of an individual presenting a judgment or opinion. Of course, promulgating an opinion almost always takes place in some bureaucratic context—children are taken away from a parent because an expert decrees it. Koppl is worried about the

validity of the expert’s opinion, but at the same time he is also concerned about the discretion the expert enjoys within the bureaucratic system. An expert exercising discretion is an instance of the rule of men (and nowadays women) rather than the rule of law. A system with wide discretion for experts is a lawless system. Yet, as we know from Max Weber, a bureaucracy is a system of rules and depersonalized roles. The flunky who came to the door to take the kids away had no discretion; she was just following the rules.

Because I approach expertise from the perspective of organizations—hierarchies as well as markets—I am interested in the nexus between expertise and administrative organization. Koppl considers this to some extent in his chapter on the entangled deep state. Central planning, he says, is “an extreme form of expert failure” (Koppl 2018, p. 221). Not only do central planners enjoy a monopoly on “planning advice,” they are also big players with discretion, and they actually tell people what to do rather than merely advise them. I want to think a little more about the organization of, and about and the origin of, “expert” bureaucracies of the sort implied by central planning, using examples from the Progressive era. This will allow me to think a bit about the administrative state (if not necessarily the entangled deep state), including the issues that Koppl (and Hayek) raise about corporate governance.<sup>1</sup>

## ORIGINS OF THE ADMINISTRATIVE STATE.

It is certainly true that Progressives favored the rule of experts over what Koppl calls a polyarchy. Koppl points to the views of Woodrow Wilson as typical of the Progressive desire to turn government functions over to a hierarchical administrative structure controlled by experts. One should note that along one dimension, however, the Progressives were actually trying to substitute the rule of law

(or at least the rule of rules) for the rule of men. When Wilson says that “[a]lthough politics sets the tasks for administration, it should not be suffered to manipulate its offices” (1887, p. 210), his target is actually the system of political patronage—a polyarchy?—that had dominated American government throughout the nineteenth century. That was the nineteenth-century “deep state” (Balogh 2009). In the abstract, a system of politically neutral bureaucrats sounds better than a decentralized federalism of rent-distributing ward healers. But as Randall Holcombe (2002, p. 156) and others have argued, the rise of the federal civil service actually created a new political constituency with its own interests, notably in increasing the size of government.

The ultimate polyarchy is the sphere of private action—“the market.”<sup>2</sup> The American founders, like Madison in *Federalist* 10, very much wanted to preserve the sphere of private action against what they considered the problem of “faction,” and they looked for the solution to faction in negative restraints: separation of powers; checks and balances; individual rights.<sup>3</sup> It was these restraints that Progressive thought wished to sweep aside, thus moving resource allocation increasingly from the private sphere to the political sphere. “This is what Progressives everywhere meant when they claimed that the mere negation of power was not enough. The focus of politics turned from constitutions to administration” (Rodgers 1998, p. 54). In this respect, Progressive thought encouraged and provided intellectual backing for what, as we will see, was already happening in the federal political economy of the era.

The sweeping away of individual rights was a central theme of Herbert Croly’s *The Promise of American Life* (1909), one of the foundational documents of Progressive thought (Nichols 1987). In a world in which negative restraints like individual rights were to be cast aside, how would the problem of faction be resolved? How would competing interests be adjudicated, not only in the political arena but in day-to-day activities? Progressive thought had an answer to this question: modern science. As Richard Adelstein (2012, p. 11) has pointed out, if one rejects the strategy of caring for and cultivating an unplanned order, the only alternative is deliberate planning of some sort. Planning requires a common goal; it requires an information system to construct the plan; and it requires a system of control to see to it that the plan is executed. Science could supply all of these—even, perhaps surprisingly, the common goal. The proof of this, the Progressives believed, is that the large industrial firms of the era were successfully applying science to engineering and management.

American industrial firms were indeed attempting to systematize management in the late nineteenth and early twentieth centuries. And we might well think about these efforts as “scientific,” even if not in the sense in which the Progressives understood the term. In Europe, production could draw on reservoirs of long-established craft skills, but American manufacturing faced a different problem, both because the extent of the market was expanding rapidly and because American firms needed to rely on relatively unskilled (increasingly immigrant) labor. In effect, American firms had to substitute organization for skilled labor; management had to specialize in devising and maintaining systems of mass production that could be staffed by the unskilled. Systematic—ultimately “scientific”—management emerged out of these efforts to design production and organizational systems. Simplifying the tasks of workers with time-and-motion studies, what Frederick Winslow Taylor and his cohorts are popularly known for, was in fact but a small part of this effort (Chandler 1977, pp. 172-181; Litterer 1963).

This work was scientific in a very real sense: it was an example of trial-and-error learning. Standardization and the formalization of principles were not inputs to this process; they were the results. Flushed with their success, however, the proponents of scientific management, and the Progressive intellectuals who looked to them for inspiration, saw matters otherwise. For them, scientific management was “scientific” in that it applied formal methods in order to discover hidden truth. As captured in the catchphrase of Taylor’s colleagues and competitors Frank and Lillian Gilbreth (1920), the goal of scientific management was to discover the One Best Way to solve any organizational problem. It followed that, by applying scientific methods broadly to social organization, politics could insulate itself from the demands of faction without resort to pesky negative restraints. If there is one best way to solve every problem, then we can simply entrust social decision making to experts armed with scientific knowledge. If there is one best way to solve every problem, even the issue of conflicting goals disappears, since who could disagree with the scientifically correct course of action?

Scientific management was widely influential in Progressive thought, most often walking hand in hand with a belief in the virtues of bigness and centralization. Croly believed that free competition led to waste and that efficiency required centralization. It also required science. “The necessary increase in efficiency can ultimately be derived from only one source—from the more comprehensive and more

successful application to industry of scientific methods and of the results of essentially scientific research” (Croly 1914, p. 397). Surprisingly, even Louis D. Brandeis agreed. Along with Woodrow Wilson, whose principal economic advisor he became, the future Supreme Court Justice was among the few Progressive intellectuals enthusiastic about a world of small economic units, a world he wished to promote at the expense of efficiency if necessary (McCraw 1984). Yet Brandeis had begun reading the work of Taylor; and when he was retained by a group of shippers to fight a rate increase the railroads had requested from the Interstate Commerce Commission, he brought forth a parade of top efficiency experts to testify that the roads needed scientific management not higher rates (Brandeis 1912). (According to one expert, the roads could save \$1 million a day.) This was not merely lawyerly strategy; Brandeis was a true believer (Adelstein 2012). Like Croly and others, he saw scientific management as the silver bullet for aligning conflicting interests. And like Croly, he was surprised and hurt that labor unions didn’t agree.

The reasons for wanting to move economic activity out of the private sphere and into the political sphere were not merely an ideological matter, of course: there were tangible interest at play as well. At the heart of the Progressive movement was the desire to overrule the allocations of the private order so as to redistribute rents to favored groups like agriculture, organized labor, and White Anglo Saxon Protestants generally. Thus, in effect, the Progressives wanted the same kind of rent management as the political bosses of the nineteenth century—they just wanted the allocations to be “scientific” and to benefit a different set of constituents. The fear that open competition, including free immigration, would harm favored groups was at the bottom of the fervor for eugenics among the Progressives (Leonard 2016). In large measure, this desire for redistribution tracked the Public Choice landscape of the era. We can see this in an example Koppl mentions: railroad regulation. Citing Posner, Koppl tells us that the Interstate Commerce Commission was “captured” by the railroads—a clear instance of expert failure. Expert failure it was, but the story is a bit more complicated.<sup>4</sup> So is the meaning of “capture.”

At the state level, the U. S. in the early nineteenth century was highly regulated in ways that protected incumbent interests (Hughes 1977). Because of high transportation and transaction costs, and to some extent because of the U. S. Constitution, the federal space was far less regulated. With the coming of canals, the railroads, and the telegraph, an altered economic geography began knitting the country

together economically, drastically changing the federal political economy. Railroads were the first flashpoint. Because they are high-fixed-cost industries, railroads cannot cover their total costs if they price at marginal cost. There were two solutions to the problem: collusion to raise rates above marginal cost and price discrimination. As it always does without government support, collusion failed.<sup>5</sup> But although there was intense competition on trunk lines whenever there were alternative routes to ship long distances, many localities were served by only one road, and the railroads could thus raise short-haul rates on routes with few alternatives.<sup>6</sup>

Since the railroads had become essential to the livelihoods of vast numbers of farmers and producers of raw materials, however, the pricing policies of the roads carried significant distributional implications. Both sides wanted the federal government to intervene: the roads wanted help in policing cartels, and the shippers wanted to prevent both cartels and rate discrimination. The legislative collision of a railroad-oriented Senate bill with a shipper-oriented House bill resulted in the Interstate Commerce Commission in 1887, a train wreck that pleased no one. Gabriel Kolko (1965) famously argued that the legislation was the work of and redounded exclusively to the benefit of the railroads. More recent scholars think otherwise; indeed, if anything it was the short-haul shippers who benefited most from the legislation (Gilligan et al. 1989).

However weak the commission was, it nonetheless represented in embryonic form a solution to political conflict over rents that would be repeated many times in American history and that would lead in aggregate to the administrative state: if legislation cannot satisfy multiple clients, keep the legislation vague and let experts—a commission—sort things out. Overt and more-or-less transparent distributional conflict is thus relocated to a more-specialized administrative arena. Wide discretion for bureaucratic experts is one possible result. Gridlock is another.

The railroad problems of the nineteenth century had revolved around overbuilding, fragmentation, and rate wars, which the Interstate Commerce Act had done little to ameliorate. By the early twentieth century, the problems were quite different, even if political opinion had not yet caught up with the change. During the prosperous years in the recovery from the depression of 1893, private-equity syndicates backed by Wall Street investment houses like J. P. Morgan and Kuhn, Loeb—“communities of interest,” in the lingo of the day—had emerged to reorganize and rationalize the railroads, creating a rail system that was begin-

ning to impress foreign visitors for its scope and efficiency. It was a time of growth, in which the roads invested heavily in improvements such as double-tracking, rail yards, and stations rather than new routes (Neal 1969). As the roads now had enough market power to cover fixed costs, rebates were no longer important to them, and they increasingly saw themselves as the victims of powerful shippers wanting concessions. With the support of railroad interests, Congress passed the Elkins Act in 1903 to outlaw rebates, a law that unsurprisingly proved difficult to enforce.

This was also a period of inflation, driven by increases in the world stock of gold. Shippers, who saw their rates increase as a result, continued to agitate for rate regulation by the ICC. Penned by the ICC itself, the Hepburn Act of 1906 expanded the commission and granted it the power to set “just and reasonable” maximum rail rates whenever a shipper or competing railroad complained. The meaning of “just and reasonable” the legislation declined to elucidate. As shippers instantly complained the minute their rates were raised, the short-term effect of the legislation was to freeze rail rates at their 1906 levels, which were not much higher than 1899 levels. The longer-term effect was to stunt the flow of capital into the railroad industry (Martin 1971, pp. 128-136).

During World War I the roads were nationalized as the United States Railroad Administration, with William Gibbs McAdoo (Woodrow Wilson’s son-in-law) as its first director general. After the war, the railway workers union, which had benefited greatly from nationalization, wanted to keep the railroads under federal control with a buyout of private owners; McAdoo asked Congress to keep his Administration in business for at least another five years. The new Republican Congress had other ideas. The roads would be returned to private ownership, but the ICC would be conferred unprecedented regulatory authority over them.

Like its predecessors, the Transportation Act of 1920 was a compromise (Boies 1968, pp. 608-613; Hoogenboom and Hoogenboom 1976, pp. 84-118). Shippers wanted a return to the pre-war system of maximum-rate regulation, plus additional controls and interventions; the railroads, as always, wanted pooling—minimum rates not maximum rates—to solve the fixed-cost problem; and unions wanted a labor board to mediate disputes. The House and Senate produced conflicting bills, which the conference committee reconciled by deferring all the hard choices to a greatly amplified ICC. The commission gained the power to fix not only maximum rates but also minimum rates—indeed, any rates it liked. The relatively simple price-ceiling scheme was trans-

formed into a complex system of administered prices. In addition, the ICC was instructed to consolidate weak lines into the stronger ones, something the railroads had long before discovered was a bad idea. The commission was told that it must approve not only all extensions of service but all abandonments as well. A new Bureau of Finance within the ICC would approve all securities offerings.

This worked every bit as badly as one would expect. Local knowledge lay with the railroads, who had little incentive to cooperate with the commission. Yet the commission had to approve virtually every significant business decision the roads were making. As a result, the commission became a bottleneck: in fiscal 1928, for example, the rate-making division had to decide 469 rate cases and 548 finance cases (Hoogenboom and Hoogenboom 1976, p. 99). Even though almost all of these decisions were actually made by staff bureaucrats, the commissioners were nonetheless so absorbed in this process that they had no time for thinking broadly about railroad policy. The commission was unable to formulate a coherent approach to measuring costs let alone standardize accounting practices (Miranti 1989). When the ICC attempted to execute its mandate to consolidate the railroads, based on ideas from William Z. Ripley of Harvard, it was quickly overwhelmed by a mountain of information and contradictory counterproposals (Hoogenboom and Hoogenboom 1976, pp. 106-107). It did nothing. In general, indeed, the commission simply muddled through and capitulated to the superior local knowledge of the railroads. At this point we might say that the commission had been “captured” by the railroads. In fact, important commissioners like the Progressive reformer Joseph Eastman, a protégé of Brandeis, never saw eye to eye with the roads. The ICC was simply victim of the phenomenon Oliver Williamson (1975, p. 14) calls information impactedness. That is what capture really means. It is the form that expert failure assumes when the job of allocating resources, not just the job of handing out opinion, is moved into the political sphere.

## THE CORPORATE GOVERNANCE OF EXPERTISE.

In writing about the entangled deep state, Koppl naturally thinks about the role of business, and cites Hayek’s views on corporate governance—views that may surprise many readers. In an essay first published in 1960, most of which is devoted to an argument against “corporate social responsibility” that is very much in the spirit of the better-known article by Milton Friedman (1970), Hayek decries “the com-

plete separation of management from ownership, the lack of real power of the stockholders, and the tendency of corporations to develop into self-willed and possibly irresponsible empires, aggregates of enormous and largely uncontrollable power” (Hayek 1967, p. 311). Hayek also warns of the dangers of allowing corporations to hold stock in other corporations, which permits a pyramiding of holding companies: an apex company can hold controlling stock in daughter companies, which can in turn hold stock in other companies, and so on down the line, providing the owner of the apex company with control of vast resources that are mostly owned by minority shareholders.

Economists reading this will immediately associate these concerns with the work of Berle and Means (1932), which, as everyone knows, was the first important articulation of the agency problem between managers and stockholders. Berle and Means noticed for the first time that American corporations were increasingly being run by professional managers and no longer by their owners. Stockholding had become diffuse, reducing the incentive for stockholders to exercise control and giving managers free rein to pursue their own interests at the expense of those stockholders. As is true of a good many things everyone knows, however, all of this is wrong. Berle and Means were far from the first notice or worry about the separation of ownership from control. Their famous book was in fact arguably the culmination of a longstanding Progressive discussion of corporate governance that prominently included Woodrow Wilson, Louis Brandeis, and the sometime railroad expert William Z. Ripley<sup>7</sup> (Wells 2010). More significantly, Berle and Means were not in fact concerned with agency problem between managers and stockholders (Lipartito and Morii 2010).

In the nineteenth century, large enterprises—mostly railroads—were financed almost entirely with debt, giving investors no say at all in running those enterprises. As capital markets developed in the early twentieth century, equity became a more common investment vehicle, and many corporations gained significant numbers of small minority shareholders. But as was well understood, most corporations were nonetheless controlled by powerful blockholders. In some cases these were the founders or their families; in other cases, investment houses like J. P. Morgan named directors and kept a watchful eye. Brandeis’s most famous work, *Other People’s Money* (1914), was aimed precisely at control by investment banks. For all these writers, the problem wasn’t that managers failed to act in the interest of owners: they all believed that managers were dispassionate experts not out for their own gain.<sup>8</sup> The problem was the separa-

tion of (minority) ownership from the control of (majority) ownership. Progressives were not always united on whether minority shareholders even mattered. The real problem was that strong blockholders would act in their own interests (maximizing shareholder value) rather than in the “public interest.” In a sense, the problem was *too much* owner control.

Like Hayek, the Progressives opposed pyramiding, which they saw as another mechanism for exploiting minority shareholders, through what is now called *tunneling*: moving resources from one subsidiary to another. Present-day finance theorists understand that exploiting minority shareholders in this way is not free. Investors can always vote with their feet; and to the extent that corporations are opaque or otherwise give investors reasons to fear adverse tunneling, that fear will be priced in and will raise the corporation’s cost of capital. This is not to say that so-called investor protection rules might not be a valuable public good. An equilibrium in which investors do not fear exploitation and demand a lower premium may be a better equilibrium than one in which they do anticipate exploitation and insist on a higher premium. Private organizations like the New York Stock Exchange typically adopted various kinds of investor protections, though it was easy enough to trade on the curb or through investment banks. As De Long (1991) has argued, investment houses like Morgan were substitutes for investor protection in a world of relatively unsophisticated capital markets.

Contrary to what Koppl suggests (pp. 227-228), the jury in the finance literature is still out on whether there is a lot of negative tunneling in the world (Khanna and Yafeh 2007). There can also be positive tunneling. Especially in regions with underdeveloped market institutions, tunneling within pyramidal business groups can be a mechanism for entrepreneurial investment and technology transfer. In effect, business groups can provide the institutional structure that weak states lack (Langlois 2013). At the same time, of course, it is in precisely these kinds of economies that pyramidal groups can become crucial partners in the rent-distributing political coalition that North, Wallis, and Weingast (2009) call the natural state. Indeed, most of the world’s pyramidal business groups are in emerging economies (Colpan et al. 2010). Large pyramidal groups do also thrive in some rich liberal democracies like Canada and Sweden. Here too, however, rent distribution may be part of the issue. In Sweden, for example, concentrated business-group control over the economy arises from a bargain with the dominant Social Democratic Party, which needed to

keep capital in the country in order to generate the resources necessary for its social programs (Högfeltd 2005).

Pyramids began to rise in the U. S. in the early century, especially in the 1920s. In railroads, holding companies, notably the elaborate pyramids of the Van Sweringen brothers in Cleveland, emerged as a way to circumvent regulation by the 1920 Railroad Act (Bonbright and Means 1932, p. 226). Most pyramids were in the utility sector, where state laws required all utility companies to be chartered in the state of operation, leading to complex ownership structures with a bizarre geographical dispersion (Neufeld 2016). All of these pyramids collapsed in the Great Depression; and, inspired by the work of Brandeis and of Berle and Means, the New Deal made their demise permanent (Kandel et al. 2013). The U. S. became one of very few countries in the world to tax intercorporate dividends, and rules promulgated by the Securities and Exchange Commission made it almost impossible to acquire a subsidiary without buying out all the minority shareholders. By the time Hayek called for outlawing pyramids, the U. S. had already eliminated them for all intents and purposes. The closest thing we have to a pyramidal business group today is Berkshire Hathaway.

Already by the 1920s, businesses had become alert to the agency problem between all workers—not just management workers—and the goal of maximizing equity value. Many sought to channel into widespread equity ownership the ferment for investment that Liberty Bonds had generated during the war. If workers owned a piece of the company, they would take a more proprietary interest in their jobs; and if they had a share of the profits, they would be less likely to unionize. AT&T was the leader in attracting wide minority ownership. In 1931 it was the mostly widely held stock in the world, with more than 600,000 shareholders.<sup>9</sup> In addition, AT&T created a well-publicized Employee Stock Ownership Plan. Others quickly followed suit, and by 1928 more than 300 firms had set up an ESOP, with 800,000 participants and \$1 billion invested (Ott 2011, pp. 156-157).

Characteristically, Brandeis and Wilson saw the issue in moralistic terms. “Most men are individuals no longer so far as their business, its activities or its moralities, is concerned,” Wilson told the American Bar Association in 1910. “They are not units but fractions; with their individuality and independence of choice in matters of business they have lost also their individual choice within the field of morals.”<sup>10</sup> Wilson’s individualism extended to the arena of corporate social responsibility. “Corporations do not do wrong,” Wilson told the ABA. “Individuals do wrong, the individuals who direct and use them for selfish and illegiti-

mate purposes, to the injury of society and the serious curtailment of private rights. Guilt, as has been very truly said, is always personal. You cannot punish corporations” (Ripley 1927, p. 4). That is to say, Woodrow Wilson held exactly the same theory of corporate social responsibility as Hayek and Friedman.<sup>11</sup>

After World War II, the individualism of the minority investor was still under threat, albeit now from professional managers controlling retained earnings rather than from powerful blockholders and investment banks. Although there probably remained greater blockholder control in large firms than has been popularly believed (Holderness 2009), it is nonetheless the case that many blockholders became bankrupt during the Depression, and tight financial regulation, high personal income-tax rates, and eventually the capital controls of Bretton Woods made it costly to operate through financial markets and relatively cheaper on the margin to allocate resources within firms. Retained earnings skyrocketed, and American corporations held three times as much cash relative to assets in the middle years of the century as they did in the 1920s or the 1980s (Graham and Leary 2017). Postwar Progressives considered the cash to be in good hands: control by expert managers was both inevitable and desirable (Galbraith 1967). Nor should managers employ the retained earnings to maximize shareholder value. That would only lead to short-sighted investment decisions instead of the kind of farsighted planning at which managers excel.

It was in this context that Hayek was writing in 1960. He was explicitly influenced by the ideas of the financial consultant Louis Kelso, perhaps the leading post-war advocate of the ESOP. Writing with the philosopher Mortimer Adler in 1958—under the unprepossessing title *The Capitalist Manifesto*—Kelso argued for what we now think of as the shareholder-value principle, though with a midcentury twist that would amuse and astound present-day holders of Apple and Amazon. Living in a world of regulated and repressed financial markets, Kelso and Adler couldn’t imagine why stockholders would want capital gains. “Corporations are not merely permitted indefinitely to plough back the wealth produced by their capital. They are constrained to do so by the effect of the steeply graduated personal income tax on the dividends received by their larger stockholders. Though the benefits of this involuntary investment by stockholders are to some degree vaguely reflected in the increased market value of the stockholder’s shares, this is a fragmentary and frequently elusive substitute for receipt by the stockholder of the full return on his capital” (Kelso and

Adler 1958, p. 218). The solution: make the dividend decision a choice for every individual stockholder. Corporations would have to disgorge all their retained earnings unless the stockholder explicitly permitted reinvestment.

Within a couple of decades, of course, the Bretton Woods system would collapse under the weight of the Vietnam War inflation, bringing in train the collapse of much of the system of financial regulation and repression. As they had in the early century, strong blockholders, in the form of private equity, could operate once again, and they began to unmake the managerial structures of the middle part of the 1900s (Langlois 2003). Mainstream finance theory quickly ensconced the principle of shareholder value, which, like Kelso and Adler (and Hayek), it saw as threatened by the power of professional managers wielding retained earnings (Jensen 1986). In contrast to the Progressives, modern finance theory saw large blockholders as working in the interests of minority shareholders to increase share value. And instead of a hokey investment gimmick, modern theory argued for removing anti-takeover defenses (and other pro-management legal arrangements) in order to allow true competition to discipline (expert) managers. This, it seems to me, is the real Hakeyan (and Kopplian) solution to the problem of corporate governance. Let expert would-be managers compete in the market for corporate control.

## NOTES

1. This essay draws on an ongoing book project called *The Corporation and the Twentieth Century*.
2. There is too often a tendency to “refer to ‘the market’ as if it were an institution parallel with, and alternative to, the government as an institution. The government is indeed an institution, but ‘the market’ is nothing more than an option for each individual to choose among numerous existing institutions, or to fashion new arrangements suited to his own situation and taste” (Sowell 1980, p. 41).
3. In Federalist 10, Madison says this. “By a faction, I understand a number of citizens, whether amounting to a majority or minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community.” Madison argues that faction cannot be eliminated—there is no such thing as a common public interest. Faction can only be curbed by constitutional restraints.
4. “The railroads supported the enactment of the first Interstate Commerce Act, which was designed to prevent railroads from practicing price discrimination because discrimination was undermining the railroads’ cartels” (Posner 1974, p. 337). As we will see, the roads supported one version of the bill, but for different reasons, and they didn’t get their way. In 1877, the railroads very much wanted price discrimination; it would not be until the twentieth century that they opposed rate discrimination. I should add that Posner is actually arguing against the “capture” theory in favor of the kind of Public Choice account I offer here.
5. “In no other industry,” writes Herbert Hovencamp (1991, p. 1039), “have attempts at both legal and illegal cartelization been so persistent, widespread, systematic, or ultimately doomed to failure.”
6. This is an example of what is now called Ramsey pricing: charging higher prices for products inelastically demanded and lower prices for products elastically demanded. It is an efficient solution to pricing in a multi-product context in the face of high fixed costs (Baumol and Bradford 1970).
7. Ripley was in fact a man of many interests. His widely influential first major work used cranial measurements to argue that there was not just one Aryan race in Europe but three: Teutonic, Alpine, and Mediterranean. Of the Jewish “race” he warned that this “swamp of miserable human beings ... threatens to drain itself off into our country” (Ripley 1899, p. 372).
8. “No better principle in carrying out business has yet been worked out than to find able men and give them the completest latitude possible in handling the enterprise” (Berle and Means 1930, p. 60).
9. Of course, AT&T had an additional reason to acquire minority ownership: to fend off state ownership, which had happened in virtually every other developed country. By becoming the classic “widows and orphans” stock while paying dependable higher-than-market dividends, AT&T could bribe a constituency that had significant overlap with its rate payers (Lipartito and Morii 2010, pp. 1056-1057).
10. Reprinted as “Before the War: How Things Looked Then,” chapter 1 (essentially a preface) in Ripley (1927, p. 3).
11. Needless to say, Wilson believed it should be illegal for one corporation to hold stock in another. In this respect, Wilson’s views on corporate governance generally are essentially the same as those of Hayek.

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