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The public role of corporations: power and accountability in a constitutional democracy

Ethical Annotation #4

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1 | The issue

What are the role and tasks of corporations in society? What are their rights and what are their duties? These questions are the subject of constant debate. A few recent examples that illustrate the issues may be useful here.

Corporations are increasingly being called on to account for their role in solving social problems. For example, during the negotations for the formation of a new Dutch government, columnist Marike Stellinga complained in a national newspaper, *NRC Handelsblad*, about the business lobby that she considered focused solely on getting money and favours. 'The government will certainly invest in the green economy, but I would really like to hear from the business community about how many billions they are committing to immediately. From their own pockets.'[1] Such expectations are ubiquitous. A report in the *Volkskrant* suggested that the business community is outperforming the government when it comes to the transition to sustainable thinking and acting.[2] Businesses are also quickly pointed at when it comes to solving other social problems, from anti-discrimination policy and the integration of minorities to housing shortages and healthy ageing. These expectations suggest that businesses also (partly) have a *public task*.

Corporations are also regularly criticised for their behaviour when their actions have a negative impact on *public interests*. The more power corporations have, the more frequent such clashes are between their private profit objective and public interests. A prominent example is the regular public outcry about corporate tax avoidance. Research by the Stichting Onderzoek Multinationale Ondernemingen (SOMO) has shown that the Dutch treasury loses 3 billion euros annually due to tax avoidance by multinationals.[3] Another example is the top incomes of CEOs, which are a recurring topic of discussion: should corporations, from a social point of view, contribute to a fair distribution of income?[4] Meanwhile, the recovering economy is leading to little or no increase in ordinary wages, and the labour income ratio is historically very low (with 70% of benefits paid to labour and 30% to capital). After the Dutch cabinet had been formed, there was a further reduction in corporate taxes, reportedly following pressure from corporations that threatened to move their headquarters otherwise.[5] Finally, the growing power of business to influence public interests is illustrated by recent discussions on the extent to which the 'big 5 tech corporations' (Apple, Google, Facebook, Amazon, and Microsoft) are able to combine market power and data power. This gives them an unprecedented grip on the daily lives, consumption patterns, and privacy of citizens. Once again, this raises the question of whether competition rules should be adjusted to curb their power.[6]

All these and other discussions are indications that corporations are not simply 'private' institutions. The political theory of constitional democracies divides society into a private sphere, in which individuals are free to organise their own lives as they see fit, and a public sphere of (semi-)

1 www.nrc.nl/nieuws/2017/04/04/formatie-bedrijven-kom-ook-wat-brengen-7859955- a1553113.
2 www.volkskrant.nl/4462415.
3 www.somo.nl/nl/grote-bedrijven-kleine-lasten-3.
4 www.volkskrant.nl/economie/topbestuurders-aex-bedrijven-zijn-weer-meer-gaan- earn-to-mean-5-million-euro~a4475375.
5 www.nrc.nl/nieuws/2017/10/13/hoge-winst-laag-loon-nieuwe-machtsorde-zichtbaar-in-regeerakkoord-13483754-a1577191.
6 www.economist.com/news/leaders/21721656-data-economy-demands-new-approach-antitrust-rules-worlds-most-valuable-resource.

public institutions that guard the public interest. Normally, corporations are classified as private institutions, free to focus on profit or any other private objective. But does this status still fit with an institution as powerful and overloaded with public expectations as the modern corporation? Or are corporations perhaps (also) *public* institutions with public responsibilities? The latter question will be central to this Annotation. To answer it properly, we must first define what a public institution is. A public institution has three characteristics.[7]

**CHARACTERISTIC 1:
COLLECTIVE EFFECTS**

When someone does something that affects the interests of all (in a particular political community, such as the Netherlands), we can qualify their actions as public. From this point of view, the prime minister's statements are by definition public. If, on the other hand, I sing loudly in the house, it only bothers my family. That action affects only a few people and is therefore private. Between these two extremes, we can draw a sliding scale from actions that affect only one person (entirely private) to actions that affect everyone (entirely public). A corporation may affect 'the whole collectivity' to a greater or lesser extent.[8] The actions of larger corporations clearly have strong collective effects, as the examples we started with illustrate. But why is this so? This question will be central to section 2 of this Annotation.

**CHARACTERISTIC 2:
COLLECTIVE INTEREST**

Having a collective effect is a necessary but not sufficient condition for an institution to qualify as public. The collective effect must take place in the context of exercising a collective interest. A public institution promotes a public interest, a private person only private interests. This can be further explained by the difference between objectives and constraints. A private person only has private goals (I want to play sports today, or I want to clear out my attic), which they can pursue under publicly defined restrictions (I have to obey the traffic rules on the way to the sports club). Within these restrictions, private individuals are free to determine and pursue their own goals. This freedom is characteristic of the private sphere. For public institutions, on the other hand, *restrictions become goals*. A public institution has the objective (mission statement) of formulating and realising certain public interests (e.g. drawing up and enforcing traffic rules). Do corporations have a public task assigned to them? That question will be central to section 3 of this Annotation.

**CHARACTERISTIC 3:
COLLECTIVE ACCOUNTABILITY**

The third characteristic arises in response to the first two. If an institution promotes public interests, it must do so within a certain structure of authority. If private individuals contribute to the collective interest, they do so at their own

7 Some philosophical discussions of the distinction can be found in the work of Benn and Gaus (1983), Weintraub (1997), and Geuss (2001). In relation to corporations, the private/public distinction is discussed by Ciepley (2013); McMahon (2012), and Orts (2013).

8 The economic literature expresses this in terms of 'collective action problems'. A problem that affects all can only be solved by collective action. NB: Sometimes individuals or groups do not influence the collective interest on their own, but collectively. No newspaper is in itself a public institution; but the newspaper sector as a whole (together with other media) does constitute a sphere of public opinion formation, which is of collective importance for the functioning of the constitutional state. Exactly the same can be said about the business sector (Singer 2015; Blanc 2016).

discretion. If that goes well, fine. But where it goes wrong, a 'real' public institution must step in and correct it. Such an institution has enforcement powers, ultimately because the government has a monopoly on the use of force. And it is precisely because of this possibility for coercion that such an institution — at least in a constitutional democracy — has a legally formulated and democratically controlled conception of its task. This is so that the institution does not just do what its employees personally think is in the collective interest but does what has been formulated as such by the community as a whole. The first two characteristics combined therefore make the third key characteristic necessary. Where public interests are affected, public accountability must also be organised. Otherwise, we are dealing with a 'quasi-public' institution, which does have collective effects and serves collective interests but is not embedded in the public accountability chain.

From the point of view of constitutional democracy, this is problematic. *If* corporations are found to be public institutions on the basis of the first two characteristics, *then* their power must also become a *constitutional* subject. The rule of law is based on the limitation of public power for public purposes, which are defined by law. Power meets counter-power (think of the separation of powers within the government) and becomes democratically legitimised. If corporations are (partly) public institutions, their power must also be constitutionally limited. In section 4 of this Annotation we discuss what the requirements of constitutional democracy are and what the application of those requirements to corporations would mean.

If corporations are found to be public institutions on the basis of the first two characteristics, then their power must also become a constitutional subject.

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2 Collective effects: the creation of a special kind of legal person

To understand why the actions of corporations — especially large, multinational corporations — can have such strong, collective effects, we need to understand how corporations are legally structured. This section gives an overview of the basic legal structure of corporations and how it has evolved historically.

A corporation is a legal person. However, it is a special kind of legal person, with far-reaching privileges granted to it by law. These privileges are rights that allow corporations to dramatically increase the scope of their action, compared to normal individuals, and also to influence the behaviour of public institutions in a direction that is beneficial to them. Individuals can act alone, such as when they buy a loaf of bread from the baker. They can also act collectively without being a legal entity, for example when they march as a crowd (temporarily) together to the town hall to protest. It is only when cooperation between people in a group takes a more permanent shape, and acquires a legally recognized status, that it is called a legal person. Such a legal person can therefore act as if it were an individual and, moreover, *independently* of the individuals who founded it, who are its members or who own its shares: the legal person can enter into contracts in its own name, using its own property, etc. This makes it possible for groups of people to structure their activities in an organised way, where they would otherwise have to redefine the rules of their cooperative venture at every occasion. This is practical both internally (people know what they have can expect from each other) and externally (third parties know what they can expect from the organization). Legal organisation creates additional capacities to act and thus, as we have seen, power. To make this possible, however, the law must permit this, i.e. there must be a right that a previously non-existent entity be treated the same as a natural person. This is why legal persons are also called legal *fictions*.

In the European Middle Ages, this construction was widely used by the rival powers of Church and King for functions approved by them. The first legal entities were monastic orders, universities, cities, and guilds: groups with great powers in medieval society. This variety of legal persons is refered to in the English language by the term *corporations (latin: universitas)*. This concept has a broader scope than 'business'. It encompasses all group associations that have legal status as legal persons. Some legal entities have members (such as non-profit associations) but others do not (such as charitable foundations). The state is also itself such a legally organized group person, a corporation.

The business corporation is one species of this larger genus of corporations. Unlike a non-profit association, a business corporation has no members and, unlike a charitable foundation, has a profit motive and can issue shares. Its legal personality has specific characteristics that will prove important in the political discussion. N.B. from here on I use the term 'corporation' as a convenient shorthand for this specific form, the business corporation.

The modern corporation is an invention of the seventeenth century, with the Dutch East India Corporation (VOC) and the British East India Corporation (EIC) as precursors. These were founded for public purposes, and became quasi-public institutions because they were not merely trading corporations but also engaged in governing the colonies. What makes these and later corporations unique compared to other legal entities lies in the combination of specific characteristics that make them an attractive construction for investors. Five characteristics are of primary importance.[9]

1. Firstly, the assets of a corporation are shielded from those of the investors in the corporation. If a personal creditor of a shareholder cannot recover his claim from this shareholder, then this creditor cannot hold the corporation liable for the debt. The corporation's property is shielded from that of its shareholders, and thus all shareholders can be sure that the corporation will not be ruined because of the personal financial problems of one of them. The invested capital can fully benefit the common cause.[10]

2. As a mirror image of this, a creditor of the corporation also has no recourse regarding corporation debts to the personal assets of one of the shareholders — an attractive feature for shareholders, who wish to protect their personal assets. This allows a corporation to take on business risks in the knowledge that none of the investors will ever be liable should the risk prove too great. Both characteristics together erect a wall between personal assets and corporate assets.[11]

3. In addition, none of the investors can withdraw the capital invested in the corporation with their own hands.[12] At most, they can resell their share (see below), but the capital remains invested in the corporation. This also increases the security of the other investors, compared to a partnership, where partners can withdraw their assets (liquidation).

4. A corporation has a board that is elected by investors. It is incorrect to say that the investors are[13] the 'owners' of a corporation, despite this term being commonly used to refer to them in everyday conversations; they can, on the basis of their right of control, try to influence the board's policy-decisions towards whatever direction they want. This contrasts with the position of investors in another legal entity, the charitable foundation, where this control is absent. This feature, too, makes the corporation more attractive to investors.

5. Finally, the shares are transferable, so investors have the flexibility to sell their shares and thus regain cash, while the corporation retains the security of the assets. Share sales can be done privately or publicly, and this distinguishes the two dominant forms: private and public (listed) corporations.

9 In a general sense, see Kraakman et al. (2009: 5-16) and Ciepley (2013: 143-45). In the literature, the features mentioned here are known as 1) entity shielding, 2) limited liability, 3) asset lock-in, 4) delegated management, and 5) transferable shares.
10 Hansmann, Kraakman, and Squire (2005).
11 Hansmann and Kraakman (2000).
12 Blair (2003).
13 They are merely owners of a share, i.e. a right to receive dividend payments (at the discretion of the board!) and the election of the board. The corporation itself owns assets, but it is not itself subject to a property claim; it is a person (cf. a natural person owned by another is a slave) (Stout 2012).

These legally guaranteed rights are privileges. They are exceptions to the normal property rights of individuals. Corporations are allowed to ring-fence their assets whereas individuals may not. Historically, this has allowed an unprecedented *pooling* of capital for organised purposes, with the ability to take risks on a scale unimaginable for most individuals. The exploitation of economies of scale in the production of industrial goods is at the root of Western prosperity. This became possible through the legal innovation of the corporate structure described above. However, if a corporation wants to behave irresponsibly, the same innovation offers plenty of room to do so. Somewhat provocatively, one can say that the corporation is an application of socialist principles: it involves the socialisation of property (means of production) at the level not of a country but of a private organisation, without those who manage that property also putting their own property at risk.[14]

Historically, these privileges were counterbalanced by a requirement: they were granted only for specific, publicly determined purposes. Only the sovereign could establish corporations, by royal *charter of incorporation*. However, this changed at a crucial point in history when, in the 1840s, laws were passed in many countries that freed the incorporation of a legal person from substantive public purpose reviews by the state. Since then, the incorporation of a corporation has become an administrative formality. This change in the law (brought about by careful lobbying from commercial interests[15]) led to an explosion in the number of corporations. The business corporation soon became the dominant form of doing business, pushing individuals (sole proprietorships, self-employed persons) and unincorporated groups (partnerships) to the economic margins. The answer to the question of what goals corporations should pursue was thus placed 'at arm's length' and no longer considered a government issue. The corporation, originally a (quasi-)public institution, was privatised. The underlying legal construction remained, however, and thus the ability to raise capital in one legal-economic entity, operate on a large scale, gain economic as well as political power and generate collective effects (positive and negative).

At the end of this history, we seem to be dealing with a hybrid institution, which is *empowered* in its legal structure in many respects but whose mission is left to the private individuals who establish and staff a corporation. Or is that conclusion premature?

14 Ciepley (2013: 146).
15 Ireland (2010).

The market can be seen as a sphere that as a whole has a public function.

3 Collective interests: corporations in the market

In this section, we will consider whether corporations should be seen as institutions that serve a public interest. To do so, we must look at the context in which corporations operate: the market. The market domain and corporations relate to each other like a game and its players. We will first examine the nature of the game itself: is there an overarching public objective that is 'engraved' in the rules of the market? If the answer is 'yes', it would mean that corporations, as market players, are also serving a public interest. To investigate the function of the market, we turn to the field of business ethics.

THE PUBLIC FUNCTION OF THE MARKET

The discipline of business ethics investigates the question of whether corporations (and their managers) have moral responsibilities, and if so, what these are and what the grounds for them are. There are two theories that combat each other fiercely and together cover an important part of the field in business ethics: the *shareholder theory* and the *stakeholder theory*. Strikingly, both theories see corporations as private institutions which have a moral responsibility (although they each give a totally different interpretation of what this means). This shows nicely how dominant the private paradigm is. From a critique of this debate between the two theories, we can construct whether and if so why the market can be attributed a public function.

The first theory is the so-called s*hareholder theory*. Milton Friedman's essay 'The Social Responsibility of Business is to Increase Its Profits' is and remains its best-known exponent.[16] In this view, which is also propagated by other economists,[17] the management of a corporation is an agent acting solely on behalf of the shareholders. Management should serve the interests of the shareholders by maximising the profit of the corporation (within the limits set by the law) and thus the value for shareholders. This sounds like a purely economic perspective that is focused on maximum financial value. However, it is important to take Friedman's moral undertones seriously. If managers of corporations start spending the money of the shareholders on good causes, then Friedman maintains, they are in fact behaving like socialists (who also spend other people's money...). The morality here is that of a *fiduciary duty* on the part of managers to spend the money entrusted to them by investors in the latter's interests.

The competing theory, *stakeholder theory*, holds that the corporation has to represent the interests of a broader set of stakeholders, and, where they conflict, balance them.[18] Different stakeholder theories present different ideas about who these stakeholders are; some limit this to employees and providers of capital other than shareholders (e.g. banks). Here, the moral idea is that they provide 'inputs' just as much as share-holders and should therefore also be represented by the corporation's management.

16 Friedman (1970).
17 Jensen and Meckling (1976); Jensen (2002).
18 Donaldson and Preston (1995); Freeman et al. (2010).

Other variants extend this to anyone whose interests may be affected by the corporation's actions, such as customers, suppliers, the local, national or even global community and the environment. The moral idea here is that of the 'all-affected principle': everyone whose interest is affected by a decision should have a voice in that decision.

Stakeholder theory has been widely criticised, the common denominator being that it is so vague. For instance, it is not clear how to determine who the stakeholders are, nor is it clear how their interests should be weighed. In practice, this vagueness can lead to managers explaining every business decision as 'a fair weighing of all the interests involved', without a serious possibility for checking or criticising this. Another problem is that if one takes the theory literally, and includes all stakeholders, there is inevitably too much inclusion. After all, the interests of competitors are also (negatively) affected by business decisions, but these should not be included in the weighing of interests. The same applies to the interests of criminals and terrorists.[19] Conversely, interests in other areas will be undervalued: after all, a corporation will touch on interests that are now often not adequately represented by any group of stakeholders (such as the environment and future generations). Again, this shows that a different theory is needed to make a good selection of stakeholders.

Stakeholder theory implodes under pressure from this problem. To clarify this, a theory is needed that goes beyond stakeholder theory.[20] Two potential paths are conceivable: backwards, to shareholder theory, or forwards, to a different theory that conceptualises the broader consideration of interests more carefully.

The first path is led by economists who argue that the best way to do justice to all interests involved is to require managers to put the interests of shareholders first. This 'enlightened value maximisation' theory, like the original shareholder theory, puts the maximisation of shareholder value first, but it is enlightened in the sense that it achieves a broader, societal goal: the maximisation of 'collective welfare', the prosperity of society as a whole.[21] The underlying idea is that the interests of shareholders alone are not safeguarded by contractual obligations (e.g. in the case of employees) or legal regulation (e.g. in the case of the environment). Shareholders only come into play when the interests of all other stakeholders are safeguarded. A corporation that is able to honour all those contractual and legal interests and still leave something for shareholders is the best for everyone. In fact, this takes us back to Adam Smith's eighteenth-century idea of the *invisible hand*, which is summarised in the slogan of his contemporary, Mandeville: 'private vices, public benefits'.[22]

In the marketplace, everyone acts in their own self-interest, and that does not always look good; selfishness and greed are leading for individuals (*private vices*). At the collective level, this leads to incentives for productive enterprise that create the greatest possible prosperity (*public benefits*).

19 Jensen (2002); Heath (2006).
20 Orts and Strudler (2009).
21 Jensen (2002); Kraakman et al. (2009): 28-29; Easterbrook and Fischel (1991).
22 Smith (1994); Mandeville (1988).

The enlightened theory is nothing more than its application to the relationships between the stakeholders involved in a corporation.

A second path opens up as soon as we realise that in reality such a coincidence of private and public benefit often is a form of wishful thinking. After all, the idea of the invisible hand presupposes that there is no market failure. The social optimality of the market, as expressed in the image of the *invisible hand*, presupposes that a number of crucial conditions are met, such as none of the parties having market power (so they cannot influence the price and thus overcharge), all parties having perfect information about products (so they are not cheated, for example by buying a defective product), and there are no negative externalities (unpriced costs or damage caused by the market players to third parties). In practice, market failure occurs frequently unless the government monitors the rules of the game and enforces these conditions through regulation. Only then does the market, through a combination of regulation and private competition within those regulatory frameworks, produce maximum collective welfare.

Based on these insights, business ethicist Joseph Heath has argued that we can replace the stakeholder theory in business ethics with a theory of market failure. The idea is simple: where government is unable to regulate, it is the moral duty of market participants to refrain from exploiting opportunities for market failure. In his approach, we can see corporate moral responsibility as a form of *fair play*. Even if the referee is too far away to catch you, you should not tackle your opponent. Competing is fine, but not by using methods that violate the rules of the game.[23] So Heath agrees with shareholder economists that the market serves a social purpose (maximum collective prosperity), but he shows that the best way to achieve that purpose by broadening the focus of managers's decisions beyond maximising shareholder value. Where market failures are pervasive, the maximisation of shareholder value must be combined with a form of moral self-restraint so that opportunities for market failure are left unexploited.

Ostensibly — both for shareholder theorists and for the alternative theory of market failure — we are still entirely in a *private* framework: that of moral obligations towards market participants, compliance with which is not enforced by government. This is characteristic of business ethics as a whole. But we will argue next that once market failure is introduced, this private focus is untenable.

THE PRODUCTION OF MARKET FAILURE

The key point in making this shift is this: the market can be seen as a sphere that as a whole has a public function. This follows directly from the acceptance — by both proponents of the enlightened shareholder approach and proponents of the stakeholder or market failure approach — that its purpose is to create the greatest possible *collective* welfare. This imposes a purpose on the game: the market is not an end in itself (*l'art pour l'art*) but

23 Heath (2007, 2014).

an instrument for a collective purpose. One can see the market as analogous to a theatre performance hired by the general public (all of us as citizens) and staged for us in order to bring us prosperity.

This position is not undisputed. So-called libertarian positions in political philosophy argue that the market is a domain of freedom, where everyone is free to act on the basis of their property rights, just as in other parts of the private sphere.[24] According to such libertarians, market players should therefore also be allowed to do things that harm their personal welfare, if they feel like it. So we should not look at the market from a public perspective at all and wonder whether it is producing maximum welfare gains. Nor should we intervene publicly (as, for example, competition law now does) to prevent market failure where the market is unable to do so itself. In the following discussion, we will not consider this position. Anyone who accepts a certain degree of public regulation of the market accepts that the market has a public objective: welfare maximisation.

However, this does not mean that the market players are themselves public agents. We have seen that according to the invisible hand idea, the players themselves must keep their own interests in mind rather than the greater public interest, precisely in order for the market to function. The price mechanism and the associated imperative of competition enforce this motivational structure. In the market, people are free to decide for themselves what products to offer and with what strategies. Of course this freedom is curtailed by the fact that market agents must survive in the face of competition. One is not as free as in other parts of the private sphere, where such systemic pressures are absent. However, it remains the case that in the marketplace, freedom serves the purpose of giving players the space to determine for themselves what is best for their *private* gain. It is not possible to call those private purposes into question.

Heath's introduction of market failure changes this diagnosis. We have seen that *to the extent that there is a market failure and to the extent that the government does not solve it through regulation*, market players have to make moral judgements about their private welfare maximisation on the one hand and preventing market failure on the other hand. However, this is a balancing of public interests, and that means that market parties are taking the place of public institutions.

The concept of 'externalities' (also called external effects) provides a good example. When will global industry have internalised all pollution externalities? When it manages to limit global warming to 1 degree? To 2 degrees? 3 or 4? This is an eminently political question, which the economic framework cannot solve for us.[25] The manager must become a politician to answer it. So Heath's theory is correct where it states that there is a need for such a broader consideration, using the concept of market failure. However, it is somewhat over-optimistic about the gains to be made from that diagnosis compared to the vagueness of the *stakeholder* approach.

24 Nozick (1974). For a recent defence of economic freedoms, see Tomasi (2012). For a non-libertarian variant of the same idea, see Hussain (2012).
25 Claassen (2016).

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The various forms of market failure require quite a bit of interpretation. *Market players are not essentially public actors, but they are put in this role where there is a market failure*. The market could thus be a (public) domain with purely private players, but this would only be true if market failure did not exist and/or any form of market failure could be adequately resolved by the government. This is not the case, and therefore market players — as long as the situation of market failure persists — are public actors.

Is this a necessary situation? It is common to hear statements such as 'market failure is inevitable' and 'regulation is impossible'. Such statements, however, conceal the fact that these two factors are not fixed data. While a world without any market failures is utopian, it matters a great deal how widespread the problem is. And, crucially here, the market players can influence this. They themselves are the central players in the 'production of market failure' and thus in the creation of a market in which they are *de facto* public players. To explain how this can happen, two further things require explanation. On the one hand, there must be systemic reasons why market actors *want to* produce market failure; on the other, we need to explain the means by which market actors *can* produce market failure.

The systemic reasons lie in the same competitive pressures that make market actors look for innovative products and successful strategies to stay ahead of their competitors. This pressure also makes them exploit market failures (despite the moral condemnation this elicits from the wider public). After all, they achieve a competitive advantage by doing so. exploiting a market failure gives an advantage to individual players because they can use the gap between individual (individual profit maximisation) and collective interests (social welfare maximisation) as long as they are not prohibited from doing so. Externalising costs (e.g. by passing on environmental pollution to third parties) and creating entry barriers for new market players are well-known examples.[26] All this provides enough motives to produce market failure. And what applies to market failure (the horizontal dimension, competitive advantage in relation to competitors) also applies to government influence (the vertical dimension). One can also achieve great gains by influencing the rules of the game, by making sure that regulating public bodies establish rules that are in one's own interest. The players themselves — when they gain the power to do so — can try to write the book of rules. Protests from one's moral conscience can be put to rest by the thought that everything that is not prohibited by law must be considered permissible in the competitive struggle ('sailing close to the wind').

Understanding why market actors would want to produce market failure, the next question is: how do they get the *means* to do so? We have already answered that question in the previous section. Corporations — as legally privileged entities that constitute a specific category of market actors — have the necessary resources by virtue of the legal structure described in that section, which allows them to pool capital and power in one centralised structure. Corporations can thus produce market failure and at the same time hinder government regulation to combat this market failure. There are so many market failures because there are corporations (in their current form).

We can now take the threads of sections 2 and 3 and put them together to conclude that corporations have the first two of the three characteristics of public institutions (see section 1 for those characteristics). Since the third core characteristic, collective accountability, is missing in the current situation, we can thus characterise corporations as quasi-public institutions. Should this intermediate status be repaired? Should corporations be subject to the accountability requirements imposed on public bodies in constitutional democracies?

Should corporations be subject to the accountability requirements imposed on public bodies in constitutional democracies?

26 Robé (2011: 64-65).

4 | Collective accountability: a constitutional perspective

The analysis of corporations given so far suggests that their role in today's economy confers upon them at least great quasi-public power. They exercise this power internally over employees, sometimes resulting in excesses, and externally over other *stakeholders*.[27] This raises the question of how corporations can be subjected to the requirements of the rule of law. In the Netherlands, this constitutional perspective is not present or is hardly present in public debates or in the media. In the United States, this is different because of the greater role of the Constitution and the interpretation of the Supreme Court in the political culture. A number of high-profile cases concerning the granting of fundamental rights to corporations have brought the debate to a head there.[28] Here, we will look at what the requirements of a democratic state under the rule of law entail and whether, and if so how, corporations can meet them.

We can distinguish four core constitutional ideas, each of which is linked to a central task: legitimising the exercise of power by public institutions over private citizens. In a constitutional democracy, the exercise of power is legitimised simultaneously by various mechanisms. The four key ideas are constitutional techniques for managing the potentially dangerous concentration of public power:

- Binding power to the *law* (principle of legality): public power is not personal power but is power based on an authority established by law. The mandate of the law rather than the arbitrary wishes of s individuals bind powerholders in office;
- Binding power to *fundamental rights*: fundamental rights that are valid (in moral terms) before public decision making and which no public body may violate;
- Organisation of a *balance of power*: concentration is limited by the separation of the three powers (legislative, executive and judicial), with each counterbalancing the other. Access to an independent judge is an important part of this;
- *Implementing democratic mechanisms of accountability*: through these, those in power and their decisions are evaluated on a regular basis and can be removed from office; and citizens can have a say in ongoing decisions.

Providing a catalogue of all possible strategies of the rule of law would be going too far. Here it is sufficient to see to what extent these four core constitutional are potentially applicable to corporations.

Firstly, there is the theme of being bound to the law. Corporations, like states, are bound by their mandate, but in the case of corporations, as we have seen, this mandate is primarily private. The text of the articles of incorporation, and thus the purpose of a specific corporation, has been up to private initiators since the reforms in the

27 Anderson (2017).
28 US Supreme Court *Citizens United v Federal Election Commission* no. 08-205, 2010; US Supreme Court *Burwell v Hobby Lobby* no. 13-354, 2014.

nineteenth century discussed earlier. Public laws do prescribe how a corporation should act internally (rules of corporate governance), but they allow for a wide variety of objectives. Other public laws regulate and thereby impose external constraints, but as we have seen, all kinds of public interests not covered by regulation are still importantly influenced by corporate decision-making. One can of course plea for strengthening such public regulation, although there is much scepticism as to whether this (especially in a globalised context) is asking too much of weakened nation states. A more radical form of binding corporations to the law, of course, would be reinstating the old idea that only publicly mandated corporations should be able to exist. This would mean abolishing business 'as we know it'. Assuming that this is unfeasible and/or undesirable are there more viable strategies, which, while leaving the basic form of corporations intact bind their powerto constitutional democratic norms?

A second type of restriction on the power of corporations can be based on fundamental rights. This may sound strange, because fundamental rights were originally seen as applying only to the relationship between states and citizens: only an abuse of power by the state was described as a violation of fundamental rights. However, it is increasingly recognised that fundamental rights also have a 'horizontal effect': citizens can also violate the fundamental rights of other citizens. With regard to corporations, this idea has been extensively discussed in the international context in recent years. The United Nations, for example, has adopted the *UN Guiding Principles on Business and Human Rights*, a document in which protection against human rights violations by corporations is central.[29]

New forms of democratic accountability are also being thought about and discussed. Some expect much from processes of democratic deliberation that take place between corporations and civil society, institutionalised in overarching forums in which corporations make decisions with NGOs and other representatives.[30] Others are more sceptical about the extent to which such constructions can offer a real alternative to the classic public channels of democratic decision making.[31] Important questions remain unanswered, for instance about the representativeness of corporations and NGOs and about the relationship between such alternative forums and public channels.

Last but not least, there is the question of the balance of power. There is no strict analogy in economics to the *trias politica* at the political level, i.e. the idea of dispersing sovereign power over separate legislative, executive and judicial bodies. Nevertheless, a dispersal of power is implicit in the rules of corporate governance, which assign certain powers to a board of directors, others to the supervisory board, the shareholders' meeting, the works council, etc. Empirical research also presents the balance between these bodies as a balance between the power of the different *stakeholders* that are involved in governing corporations.[32]

29 Kolstad (2009); Wettstein (2012); Hsieh (2015); Santoro (2015); Brenkert (2016); Arnold (2016).
30 Scherer and Palazzo (2011); Scherer, Baumann-Pauly, and Schneider (2012).
31 Hussain and Moriarty (2014); Hussain and Moriarty (2016).
32 Gourevitch and Shinn (2005); Aguilera and Jackson (2003).

An entirely different application of the idea of a balance of powers can be found in the recent book by Utrecht-based economic historian Bas van Bavel.[33] He argues that capitalist societies throughout history have always gone through cycles in which markets initially emerged and prosperity grew, but after a period of prosperity stagnation set in and markets increasingly closed. The turning point is reached when economic elites have accumulated so much capital that they are able to bend the political and economic rules of the game to their will. In his view, it is a social balance between market players and non-market players that characterises the upswing, and an imbalance that marks the downturn. Non-market players are all kinds of associations, guilds, professional associations, foundations and trade unions, which counterbalance the market power of a winning group of dominant market players. Strengthening them could preserve the openness of the market.

These suggestions deserve further elaboration and study — but hopefully it will be sufficient to establish that the programme of viewing corporations through the lens of the traditional characteristics of a constitutional democracy can be fruitful. Although corporations do not feature in manuals on democracy or the rule of law, there is every reason that they should do so.

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33 Van Bavel (2016).


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5 Conclusions

Power is an inevitable part of living together. It makes no sense to be ‘against the exercise of power’, just as it makes no sense to be against the weather. Power corrupts (‘power corrupts, and absolute power corrupts absolutely’, as Lord Acton said) and therefore deserves counter-power. This requires constitutional thinking: how do we construct the power game in such a way that every power is kept in balance? The exercise of power by corporations is no more or no less problematic than the political exercise of power, and therefore deserves a similarly serious treatment. But this requires that we first realise that economic power cannot be sufficiently controlled by the market mechanism itself; and that the problem is therefore public in nature. When we think of threats to the rule of law, we usually think of issues such as the independence of the judiciary, the position of refugees, or violations of privacy and other infringements of fundamental rights. But it is strange that we do not think of the role of corporations. This Annotation will hopefully help to change that perception.

FURTHER READING

- The idea that corporations currently fall between the private and the public sphere in a problematic way is clearly set out in **Ciepley (2013)**.

- An argument that corporations are public actors can be found in philosophical form in **McMahon (2012)**, from the perspective of law in Greenwood (2013), and from the perspective of political economy in **Crouch (2014)**. A philosophical critique of 'private government', with its focus on power in the internal dimension (position of workers), is provided by **Anderson (2017)**.

- There is a large amount of literature on 'political CSR': the idea that corporations have a specific political corporate social responsibility. For overviews, see **Heath**, **Moriarty**, and **Norman (2010)**; **Néron (2010)**; **Scherer and Palazzo** (2011); and **Whelan (2012)**.

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