

**CORPORATIONS AND SOCIAL COSTS:  
THE WAL-MART CASE STUDY**

Benedict Sheehy  
Lecturer  
School of Law  
University of Newcastle, Australia

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*ABSTRACT: This article examines the role of the corporate vehicle in the creation of social costs. The article identifies some of the political commitments and philosophies behind the differing notions of corporations. Social costs are those activities which result from business activity and cause uncompensated harm to society. The founding contribution to the law and economics discussion by Ronald Coase is given a thorough treatment. The paper next, turns to the dominant explanation of corporate structure, namely the law and economics model developed expounded by Easterbrook and Fischel. It then applies the theoretical discussion in a case study of the world's largest corporation, WAL-MART, Inc. It next examines the relation of social costs and corporate legal structure. It concludes with some recommendations for corporate reform.*

## 1) INTRODUCTION

Social costs of business activity have been a concern of economists, politicians, lawyers, business people and society at large for decades. Through the passage of time, our awareness of the nature, extent or dimensions, and incremental and accumulating impact of social costs has increased dramatically. Various approaches to the problem have been suggested from governmental regulation, to cessation of activities, to free markets.

Regardless of one's underlying commitments, it cannot be denied that with respect to the most significant social cost—the threatened habitability of the planet—the current approaches are failing.<sup>1</sup> Yet despite our knowledge of the impending disaster and its causes, to date there has been very limited success in coordinating efforts address it.<sup>2</sup> From this failure, it may be argued that indeed there may be other social costs which have yet to be clearly identified which are, nevertheless, accumulating and possibly with significant consequences.

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<sup>1</sup> UNEP Climate Change makes it clear that there is indeed a climate change problem caused by human activities and that the consequences could be drastic. <http://climatechange.unep.net/>

<sup>2</sup> The most recent failure of coordination has been the failure of the United States of America and Australia to sign the Convention and Kyoto Protocol. See latest information on this matter at <http://unfccc.int/resource/convkp.html> For a discussion of the problem as a coordination problem, see Katharina Holzinger, "Aggregation Technology of Common Goods and its Strategic Consequences: Global Warming, Biodiversity and Siting Conflicts," 1 EUROPEAN J. OF POLITICAL RESEARCH 40 (2001).. Ecological economists has been making an effort to do address environmental problems resulting from perspectives promoted by their discipline. For a helpful introduction to ecological economics and its relation to law, see Douglas Kysar, "Sustainability, Distribution and the Macroeconomic Analysis of Law," 43 B.C.L. REV. 1 (2001).

This study considers some of these social costs which at present are only poorly identified and not much studied. Social costs are the negative by-products of commercial activity not paid for by the beneficiaries of the activity. Instead, these negative by-products or “costs” are borne by the rest of society—hence, “social costs.” They are the costs to others or society at large of the conduct of business. As will be discussed, social costs often involve coordination problems—problems that can only be solved by people coordinating their efforts rather than simply acting as individuals seeking their own interests. Obviously, the previously mentioned matter of climate change is one such matter. Another less obvious one arises from business activity, and particularly through the corporate vehicle.

In considering corporations in society, one must have an idea of the nature of the corporation, ideas about the nature of society, and the role of law, business, people and corporations in the composition and functioning of society. From a corporate law perspective, one needs to consider who counts as a member of the corporation: whether it be shareholders, directors, managers, employees and other suppliers, or possibly even including society at large. Corporate law must consider the coordination of all of these elements of society and the costs imposed on society. The focus of this article is the social cost—i.e. the cost to the people who make up society—of the activity of large corporations. In order to create an informed context for the discussion, all of these issues will have to be addressed.

To avoid creating an argument based on mere speculation about social costs and corporations, the second part of this study will be a case study of Wal-Mart. The study will attempt to answer the question: Are there significant social costs which are poorly identified and not well studied associated with large corporations? This question is becoming increasingly important as a consequence of globalization, which is driven largely by corporations and which has significantly increased corporate power. Multinational corporations and their investors have been implicated in the inhumane and devastating policies known as Structural Adjustment Programs promoted by the World Bank, the International Monetary Fund, and the manifestly unfair trade policies of the

World Trade Organization.<sup>3</sup> The great power of these corporations is not being used for the betterment of society,<sup>4</sup> and so it is incumbent upon scholars to study and consider carefully the activities of these members of society.

This study will examine critically theories of the corporation, then the views and theories of Ronald Coase, a leading economist and thinker on social costs. Next, it will turn to a critical review of law and economics analysis of corporate law. This law and economics perspective will be used since its descriptive power, particularly in corporate law, is widely accepted.<sup>5</sup> In order to understand the law and economics perspective, it will be necessary to analyse its presuppositions, and then see how these approaches produce outcomes consistent with their presuppositions. Finally, it will apply this critical analysis to the activities of the specific business that serves as the case study, Wal-Mart, by identifying the social costs, and determine what, if any, relation there is between these social costs and the corporate vehicle-corporate law.

The study has identified a number of poorly considered social costs created by Wal-Mart. Furthermore, for various reasons, it will be shown that these social costs tend to fall outside of the traditional law and economics paradigm, and so fail to be considered as matters of corporate law. Finally, the study will conclude with some suggestions for both further law reform and directions for future study.

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<sup>3</sup> JOSEPH STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* (2002) is a thorough-going and stinging indictment of the IMF and to a lesser degree of the World Bank, of which Stiglitz himself served as chief economist. Stiglitz comments are mostly restricted to the investors. The investors, however, are those who invest on behalf of corporations in hedge funds, futures and options to limit the exposure of their corporate sponsors. STIGLITZ 128-130, and NOAM CHOMSKY, *PROFIT OVER PEOPLE: NEOLIBERALISM AND GLOBAL ORDER*, (1999) discusses the collusion if not control exercised by international financial interests and multinational corporations over the IMF and World Bank as part of the Washington Consensus, 19-20. Further he discusses the WTO as charged with the task of exporting American values. 65-72.

<sup>4</sup> Much of Chomsky's work is a sweeping review and analysis of the involvement of corporations in the political system of the United States of America. Chomsky shows how the corporations have corrupted government and subverted democratic processes to serve their own interests. See for example, 38-39, 61 and the trend he refers to as the "corporatization of America." 132. See as an other example, the role of MNC's in thwarting private enterprise in Singapore, in Tan Yoock Lin, *Legal Change and Commercial Law in Singapore*, in *EAST ASIA—HUMAN RIGHTS, NATION – BUILDING, TRADE*, (1999) ALICE TAY, ED., 29.

<sup>5</sup> Gary Minda, "The Jurisprudential Movements of the 1980's" 50 OHIO ST. L.J. 599 (1989)

The study is limited to the discussion of a single case. Because of the innovative nature of the study, there is limited data available for broader study. In addition, at this stage in the research, it is the author's opinion that a deeper study, identifying more specifically, and identifying a higher quantity social costs is more important or helpful than a broader more general discussion. Accordingly, the generalizations which can be made from this study are limited. It does not purport to be suitable to all jurisdictions, nor to all corporate models, nor to all industries. It is the study of a specific multinational retail sales corporation, which happens to be the largest corporation in the world.<sup>6</sup>

## 2) HOW TO READ THIS ARTICLE: DIMENSIONS OF THE DISCUSSION

At the outset, I believe it is necessary to identify the main belief sets forming the backdrop for this discussion. In his fascinating and comprehensive analysis of academic legal debate, Professor Gerald Wetlaufer observes that, “conversations and arguments are less easily understood, less easily learned, less productive, less conclusive, and sometimes less civil than we might think it reasonable to expect.”<sup>7</sup> He comments, “We hear a great many arguments in which it seems that people ought to be convincing one another but, in fact, are not. We see arguments that fail to persuade, disagreements that never end, and, all too often, partisans who neither understand nor respect their adversary's positions.”<sup>8</sup> Few of those engaged in the dialogue would disagree with this comment; hence, his analysis of the underlying philosophical commitments which are the cause of this inability to communicate within the academic legal community are worth identifying, for improving an understanding of the intractability of the advocates of the various positions presented in this article.

Wetlaufer identifies a “Master Paradigm” in which most legal dialogue is conducted. That paradigm is liberalism—views of individualism, autonomy, freedom, and that the

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<sup>6</sup> Details discussed in detail in Part 6.

<sup>7</sup> G. Wetlaufer, “*Systems Of Belief In Modern American Law: A View From Century's End*” 49 AM. U.L. REV. 1 2 (1999)

<sup>8</sup> Id, at 2.

role of the state is the protection of the individual and those freedoms. This view includes commitments to: rights discourse, a particular version of rule of Law, notion that public and private spheres are distinguishable realities, and that state action is appropriate only in the public sphere.<sup>9</sup> Any discussion which does not bow to these primary commitments is simply dismissed. Within this larger paradigm, there are two main schools of thought that have relevance to this discussion. They are the Legal Realists and their most important successors, the Law and Economics scholars, and the Legal Positivists. Whereas the Legal Realists see law as nothing more than the conventions of a society, changeable, measurable, instrumental in achieving specified objectives, having no particular commitment to method, the Legal Positivists see law as an objective, independent first principle. More contentiously, at least in the strong version, the Legal Realist Law and Economics scholars see all value and morals as nothing more than the cash amount a person is willing and able to pay.<sup>10</sup> Furthermore, Law and Economics, at least the neo-classicist scholars view justice as the mere maximization of aggregate wealth.<sup>11</sup> Any notion of redistribution or movement of costs other than as placed by the market is inefficient diminution of wealth maximization.<sup>12</sup>

Legal Positivists, by way of contrast, view law as an independent endeavour, an independent discipline with its own set of norms, methods of analysis and values. Legal Positivism carries with it commitments to philosophical positivism, utilitarianism, and classical liberalism.<sup>13</sup> As well, it holds to notions of justice as fairness, Aristotelian notions of corrective and distributive justice, and practical reason.<sup>14</sup> It sees moral knowledge as both possible and objective.

The law and economics scholars clearly belong to the Legal Realist tradition and clash with the Legal Postivists. Before coming to any conclusion concerning the matters

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<sup>9</sup> Id, at 9.

<sup>10</sup> Posner, cited in Wetlaufer, supra n. 7 41 n. 144. For criticism of Posner's views on this matter, see Whitney Cunningham, "*Testing Posner's Strong Theory of Wealth Maximization*" 81 GEO. L. R. 141. (1992)

<sup>11</sup> Id, at 38.

<sup>12</sup> Wetlaufer, supra n. 7 38.

<sup>13</sup> Id, at 46.

<sup>14</sup> Id, at 47.

discussed in this article, it is important to consider the validities of each frame of reference, regardless of which set of *a priori* commitments one finds oneself drawn to. As is most often the case in such debates, neither has a corner on the truth and so it behoves all disputants to consider the contribution of the other.

Wetlaufer proceeds to identify ten dimensions of prior commitments which set the legal debate into different directions. These dimensions are:

- (1) the fairness and legitimacy of the existing order;
- (2) prime values and projects (e.g. law is to: facilitate wealth maximization, creation of a just society, or ensure order);
- (3) focus and center of attention;
- (4) human nature and social existence;
- (5) the nature and consequences of language;
- (6) the nature of knowledge and the possibilities of reason and objectivity;
- (7) the relationship between law and other disciplines;
- (8) interpretive strategies and forms of argument;
- (9) the possibility of the rule of law; and
- (10) the consequences of speaking against either of the above.<sup>15</sup>

One's various commitments along the above ten dimensions primarily determines what one finds, and what one finds acceptable among various possible outcomes.

#### a) Ten Dimensions and the Law and Economics Discussion

Among the commitments Wetlaufer discusses, we can identify the following dimensions as critical to this discussion: (1) the fairness and legitimacy of the existing order; (2) prime values and projects; (3) focus and center of attention; and (4) human nature and

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<sup>15</sup> Id, at 60

social existence. As will be discussed in more depth later in this article—concerning the value assumptions of the law and economics movement—the law and economics discussion is decidedly in favour of the status quo, see efficiency and wealth maximization as the prime value and project, is focused on individual wealth and rights, and denies the existence of any such thing as society. As a discipline, law and economics’ commitment to neo-classical economics, incorporates by default the assumptions of neo-classical economics.<sup>16</sup> One of the hallmarks of neo-classical economics is its commitment to radical individualism. Individuals are the only legitimate subject of study as society is nothing more than a collection of individuals.<sup>17</sup>

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<sup>16</sup> Charles Pouncy, “*Economic Justice and Economic Theory: Limiting the Reach of Neoclassical Ideology*” 14 J. LAW & PUB. POL’Y 11 (2002), See also Cunningham, *supra* n. 10. See Daniel Hausman, *The inexact and separate discipline of economics*, (1996).

<sup>17</sup> Pouncy *id.*

### 3) CORPORATIONS

To understand the corporation, its role in society and the problem associated with controlling its social costs, there needs to be a brief discussion of the nature of the corporation and corporate theory. The nature of the corporation can be explained by a review of some of its historical developments, and a brief examination of some of its models.<sup>18</sup>

In its early form, the joint-stockholder corporation would have passed liability for social costs onto the shareholders. This potential passing of liability to shareholders may have had a significant impact on corporate behaviour and subsequent corporate development if tort law had been more mature and social costs more clearly identified. Interestingly, it should not be supposed that social costs were invisible. Indeed there were high rates of worker injury and death; the courts, however, placed no liability on the corporate owners for such injury.<sup>19</sup> Society had to bear these costs for the benefit of industrialization, which benefit was a benefit primarily to the entitled classes. As a theory popular in the late 19<sup>th</sup> and early to mid-20<sup>th</sup> century, the main social costs identified were smoke and other visible industrial atmospheric discharges which the law deals with as a matter of mere nuisances between neighbours.<sup>20</sup>

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<sup>18</sup> The issues of corporations and corporate models are discussed in Benedict Sheehy, “*Scrooge – The Reluctant Stakeholder: Theoretical Problems in The Shareholder-Stakeholder Debate.*” Forthcoming: 12 U. OF MIAMI BUS. L. R. (2004) and Benedict Sheehy, “*The Importance of Corporate Models: Economic And Jurisprudential Values And The Future Of Corporate Law.*” 2(3) DEPAUL BUS. & COMM. L. J. (2004) (Forthcoming). For a masterful analysis of the history of corporate models and a critical consideration of the claims to innovative insights made by neo-classical corporate law and economics study see William Bratton, “*The New Economic Theory of the Firm: Critical Perspectives from History,*” 1 STANFORD LAW REV. 1471-527 (1989), in THE LAW OF THE BUSINESS ENTERPRISE: SELECTED ESSAYS, SALLY WHEELER ED., OXFORD READINGS IN SOCIO-LEGAL STUDIES (1994) 117-179.

<sup>19</sup> *Hutchinson v. York Newcastle Rly* (185) 5 Exch. 343

<sup>20</sup> See cases cited by Coase “*The Problem of Social Costs,*” 1 J. OF LAW AND ECON., 1 (1960). This view of atmospheric pollution is still evident in international atmospheric litigation such as between the USA and Canada concerning acid rain, and other contaminants. *United States vs. Canada*, Arbitral Tribunal, Montreal 16 April 1938 and 11 March 1941; *United Nations Reports of International Arbitral Awards* 3 (1947) 1905; AMERICAN JOURNAL OF INTERNATIONAL LAW 33 (1939) 182, and 35 (1941) 716. The issue of externalities, coordination and economic analysis in a transboundary problem is given an in depth treatment in Franz Xavier Perrez “*The Efficiency Of Cooperation: A Functional Analysis Of Sovereignty,*” 15 ARIZ. J. INT'L & COMP. LAW 515. 527-42 (1998)

### a) Concession Theories

Concession theorists note that the corporation owes its existence to a governmental concession. In the beginning, governments delegated and granted trading rights to corporations.<sup>21</sup> Corporations were permitted to carry on only those activities authorized in the concession granted by the government. The limits of the concession were set out in the articles of incorporation or constitution of the corporation. Given this concessionary nature of the corporation, the government retained certain rights concerning the governance and operation of the corporation.<sup>22</sup>

The roots of this view are in the corporation's history. In the concessionaire view, the corporation is an entity different and separate from the shareholder/ investors. It is often referred to as the legal fiction or corporate personality theory. In its essence, this model focuses on such characteristics as the corporation's legal identity, independent of the parties involved in either management, investors, or employees. It also highlights the corporation's legal rights and responsibilities as a legal person who can sue in its own right and be sued, pay taxes, and otherwise subject, independently of its members, to the laws of society.<sup>23</sup> In this view, the corporation is a concession granted by the government to a group of would be investors.<sup>24</sup> As a concession from the government, the corporation continues to be subject to the government's will. If one accepts a concessionaire view of the corporation, it is easier to see the argument for stakeholder involvement or at least for government regulation such as limiting social costs such as

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<sup>21</sup> JANET DINE, *THE GOVERNANCE OF CORPORATE GROUPS*, (2001), 21

<sup>22</sup> An interesting, peculiarly Australian view which may be viewed as an offshoot of the concessionaire theory is "constitutionalism." As argued by Australian corporate law scholar, Stephen Bottomley, "[corporations] themselves are systems in which power and authority, rights and obligations, duties and expectation, benefits and disadvantages, are allocated and exercised.... Each company is a body politic..." Stephen Bottomley, *"From Contractualism to Constitutionalism: A Framework for Corporate Governance"* 19 SYDNEY L. REV. 277. Dine observes that the concessionaire view is susceptible to the criticism that the corporation is no more than a mere fiction. If it is not made up of the solid, physical shareholders, acting in concert to create a common enterprise, the corporation has no more substance than a mere idea. Further, while it may explain the foundation of the corporation, concession theory fails as an operational theory. It does not explain by whom or how the corporation is to be run. Nor yet does it set any limits on state involvement. Indeed a pure concession view allows the corporation to be a mere instrument of the state. Dine, *id.*, 24.

<sup>23</sup> David Millon, *"Theories of the Corporation,"* DUKE L.J. 201(1990).

green house gas emissions permitted to a particular corporate entity. As a governmental concession, the corporation owes duties back to the government. This obligation, however, does not extend automatically, beyond government into a general duty to society.<sup>25</sup> The concessionaire model of the corporation in the historical context allows social costs as unfortunate consequences to be borne by society for the benefit of the investor.

i) Political entity

In a variation of the concession theory, some corporate theorists focus on the corporation's political character. Its political characteristics are its constitutional foundation setting up internal control structures similar to governments, its power, its decision making processes, the need for managers to balance competing interests, and such broader concerns as implied by the Corporate Governance movement. Some scholars draw in further political implications from this model such as the democratic principle that those effected by decisions should have voice.

Social costs in this model are viewed much as social costs in all political decision making. They are part of the society. The issue in corporate law, of course, is who makes this "corporation's society"? Is it investors and directors only, or does it include employees and other suppliers, or society at large. Perhaps the most important benefit of the model is the acknowledgement of the corporation as a powerful, political entity. Although currently out of fashion because of its connection to the concession theory,<sup>26</sup> it may yet have some life.<sup>27</sup>

ii) Communitarian

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<sup>24</sup> Gregory Mark, "Some Observations on Writing the Legal History of the Corporation in the Age of Theory," in LAWRENCE E. MITCHELL (ED.), *PROGRESSIVE CORPORATE LAW* 67, 68-69 (1995).

<sup>25</sup> DINE, *supra* n. 21, at 21

<sup>26</sup> Jennifer Hill, "Visions and Revisions of the Shareholder," 48 AM. J. COMP. L. 39 56 (2000).

<sup>27</sup> See, for example, ANDREW FRASER, *REINVENTING ARISTOCRACY: THE CONSTITUTIONAL REFORMATION OF CORPORATE GOVERNANCE*, (1998).

These views—concessionaire and political views—are subsumed in the communitarian model of the corporation.<sup>28</sup> Communitarians argue that the corporation is a community, political entity, granted a separate identity by the government, participating in society at large with its own independent rights, privileges, duties and obligations. Accordingly, it should be responsible for its social costs, just as every other rights bearer in society.

b) Contractarian Theories<sup>29</sup>

Contractarians view the corporation as a form of contract between its members. This theory posits the corporation as a private matter between individuals and accordingly, places no additional duty on the corporation than that which exists on each, separate individual involved in the corporation. The corporation, as nothing more than a collection of individuals, is a private matter and as such should be subject to the least possible government interference.

The roots of this theory go back historically to an era when the characteristics of the modern corporation—particularly, limited liability—had not been created. This model of the corporation comes from corporate origins as the joint-stockholder company. In that model, the corporation is simply another partnership-like arrangement in which the shareholders are essentially owners, liable for the debts of the company.<sup>30</sup> The corporate vehicle is a convenient private financial arrangement,<sup>31</sup> which allows entrepreneurs to invest jointly in enterprises too large or too risky to undertake on a single investor basis. This model is often called the aggregate model and in it, the directors are the agents of their principals, the shareholders. It is discussed primarily as the aggregate model, meaning that the corporation is nothing more than the aggregate of the individual members.

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<sup>28</sup> LAWRENCE E. MITCHELL ED., PROGRESSIVE CORPORATE LAW (1995).

<sup>29</sup> There are other approaches to the analysis of corporations as voluntary collectives. See for example Paula J. Dalley "To Whom It May Concern: Fiduciary Duties And Business Associations" 26 DEL. J. CORP. L. 515 45 (2001).

<sup>30</sup> See, for example, Margaret Jane Radin, "The Endless Problem of Corporate Personality," 32 COLUM. L. REV. 643 (1972).

<sup>31</sup> See Morton Horwitz, "Santa Clara Revisited: The Development of Corporate Theory," 88 W. VA. L. REV. 173, 204 (1985); D. Gordon Smith, "The Shareholder Primacy Norm," 23 J. CORP. L. 277, 302-03 (1998). The aggregate theory of the corporation was seen as hostile to both state regulation and to the burgeoning management corporation. See Bratton, supra n. 18, at 1471, 1489.

The economic contractarian model, as distinguished from the legal contractarian model traces its origins at least as far back as the economist Ronald Coase.<sup>32</sup> Coase first proposed that the corporation is a type of firm.<sup>33</sup> By describing the corporation as a firm, Coase means that this type of organization operates as a more efficient means of production than the market, and it does this, he claims, by grouping people and inputs together, combining tasks in one enterprise and thereby lowering transaction costs.<sup>34</sup> In this model, there is a direct connection and related accountability between the contracting parties: the capital provider-shareholders and the managers. As economist Milton Friedman has famously put it “He [an executive] has a direct responsibility to his employers. That responsibility is to conduct the business in accordance to their desire... to make as much money as possible.”<sup>35</sup>

Contractarians reject the notion of the corporation being a body independent of the shareholders and in fact reject the very idea of corporation. It is merely a nexus of contracts. Logically, it cannot have obligations distinct from the obligations of its individual members. Therefore, the notion of corporate social responsibility—as distinct from the responsibilities of the individual shareholders—is a non-sequitor. It is simply a logical contradiction.

In the contractarian view, as Millon explains it:

state corporate law provides the terms of the contract by which shareholders purchase management's undivided loyalty to their welfare... to the extent that

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<sup>32</sup> Bratton makes the argument that this view of the corporations goes back to the nineteenth century. Id.

<sup>33</sup> Coase supra n. 20. But see, Bratton id.

<sup>34</sup> Coase op. cit discussed as the source of the 1980's nexus of contracts theorists in Millon, supra n. 23, at 229-232. Note Joo's discussion of the difference between economists' understanding of contracts and legal understanding contracts, in Thomas W. Joo “*Corporations Theory And Corporate Governance Law: Contract, Property, and the Role of Metaphor in Corporations Law*,” 35 U.C. DAVIS L. REV. 779, 789-804. This issue for economic contractarians is: How the owner-shareholder principal can control and limit the manager-agent sufficiently to minimize “managerial opportunism” or “agency costs”. They find answers in the markets for capital, corporate control and management skill, and secondarily in the body of corporate law. Bottomley, supra n. 22, at 285-287. The issue first was given its modern analysis by Berle and Means.

<sup>35</sup> Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at SM17.

management's pursuit of shareholder welfare threatens nonshareholder interests, workers, creditors, and other affected nonshareholders are free to bargain with shareholders (through their agents) for whatever protections they are willing to pay for. This view assumes that feasible (that is, not excessively costly) contracting strategies exist for correction of the harmful external effects of shareholder/management activity and, perhaps, that such effects are relatively uncommon.<sup>36</sup>

Social costs, therefore, are simply those things that parties not party to the corporate contract have failed to bargain for. Many advocates of this view fail to recognize that markets are inevitably incomplete, do not exist for many social costs, and accordingly, cannot be considered an appropriate or sufficient solution to social costs.<sup>37</sup>

Social costs in this model are part and parcel of this group's business activities, and as such, those who complain about them should be subject to the same constraints and bargaining positions as any other member of society, including those contracting together forming the corporate contract. The core contractors are the shareholders and thus their interests should be the focus of corporate concern. This focus leads to the related contractarian model known as the shareholder primacy model.

### c) Criticisms of the Models

The contractarian model has number of shortcomings. Critically, it fails to explain the most significant feature of the corporation: that is to say it does not account for limited liability.<sup>38</sup> Nor do contractarian models adequately address other corporate rights such as

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<sup>36</sup> David Millon "New Directions In Corporate Law Communitarians, Contractarians, And The Crisis In Corporate Law," 50 WASH & LEE L. REV. 1373, 1379 (1993).

<sup>37</sup> B. Greenwald and J.E. Stiglitz "Externalities in Economics with Imperfect Information and Incomplete Markets" 101 (2) QUARTERLY J. OF ECONOMICS, 229-64 (1986). Social costs are defined by some commentators as those things for which no market exists. See discussion of Section 4 Costs below.

<sup>38</sup> Dine notes the state involvement in creating the limited liability aspect of corporations. This grant of limited liability is what made corporations such an attractive option for conducting business (*Eley v. Positive Government Life Assurance* (1876) 1 ExD 88.) and essentially what gave rise to their dominance in commerce. *supra* n. 19, at 4. The explanation that this would eventually have been contracted for, according to Dine, is not supported by the facts. One solution proposed by scholar Michael Whincup, "Inequitable Incorporation--The Abuse of a Privilege", 2 COMPANY LAW 158, 158-60 (1981). The English law still rests on the decision of the House of Lords in *Salomon v. A. Salomon & Co.* 75 L.T.R. 426 (1897).

the right to hold property and the right to freedom of expression, which rights are held by the corporation independently of its members.

An important aspect of some social costs, as we shall see, is that they arise precisely because of inabilities to contract. Markets will always be incomplete, and accordingly, to suggest that social costs are a mere problem of contracting suggests a failure to understand the nature of the problem (to address social costs in the market would require new types of property to be created and distributed) and the nature of markets as incomplete along with other market failures.

The univocal focus on efficiency<sup>39</sup> supported by contractarian models brings the question of why efficiency should be set as the prime value. As Millon observes:

References to efficiency simply beg the underlying question of why efficiency should provide the sole normative criterion. As a society we have not embraced the market as a totalizing model for the definition of rights and responsibilities.<sup>40</sup>

Furthermore, this focus on the bottom line always creates a strong incentive to externalize costs, increase production, and thereby increase profit.<sup>41</sup> As Horrigan observes:

financially based shareholder focus... allows corporations to externalize the costs of maximizing stock prices onto everyone except the stockholders' the includes employees, the environment, consumers, suppliers and the community at large.<sup>42</sup>

Contractarians are focused on internal corporate activity and apply a cost-benefit analysis to a relatively narrow range of items that are more susceptible to numeric measurement.

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<sup>39</sup> Contractarians' efficiency focus follows closely on the economists' view that creating wealth is the sole objective of corporate activity. Any increase in wealth is a social benefit, and permits turning a blind eye to the distribution of that wealth or the costs of producing that wealth.

<sup>40</sup> Millon, *supra* n. 36, 1386.

<sup>41</sup> See Kaldor-Hicks theory discussed Dine, *supra* n. 21, 9 and ROBIN MALLOY LAW AND MARKET ECONOMY, (2000) 154-155.

<sup>42</sup> Brian Horrigan, "Fault Lines In the Intersection between Corporate Governance and Social Responsibility," 25 UNSW L.J. 515 (2002) 550.

Critics of the concessionaire model, such as Easterbrook and Fischel, note that people will choose to associate in manners suitable to their interests, regardless of government recognition. Accordingly, they claim that such things as limited liability would have been contracted for had the government not granted it through legislation. Further, concessionaire critics point to the non-existence or fictional nature of the “body” of the corporation. Where is the “concession,” or “community” apart from the freely contracting members? To have anything more or other than the individuals is non-sense, in the most literal sense of the term.

Ultimately, we are left with Hart’s observation: “a survey of competing theories of ‘the corporation’ leaves one to conclude that none has survived intact.”<sup>43</sup>

#### d) The Ideological Divide

Underlying this war of models is a much deeper ideological conflict. Contractarian advocates start from the idea that people are isolated autonomous rights bearers. Included among their *sui generis* rights is the right to decide how to dispose of their property rights and in the case of the corporation, their property rights as shareholders. They view the corporation as a nexus of contracts between private individuals in which the government has no business.

Communitarian advocates, by way of contrast, view the individual as set in a context, and that context is a social context. They view liberty as having positive duties. From their perspective: “Liberty is empty without taking into account those primary needs upon which adequate conceptions of individual dignity and human flourishing depend.”<sup>44</sup> They view the corporation as a social body, as a member of society, and a significant member at that. They emphasize the power and effects of corporations in society. In addition, communitarians are, in Millon’s words, “skeptical about the practical efficacy

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<sup>43</sup> Quoted in Eric Orts, “*The Complexity And Legitimacy Of Corporate Law*” (1993) 50 WASH & LEE L. REV. 1565, 1570.

<sup>44</sup> Millon *supra* n. 36, 1382-3.

of contract as a mechanism by which nonshareholders can protect themselves ex ante from... harmful effects.”<sup>45</sup>

As Millon frames the debate “what does set communitarians apart from contractarians is the communitarians' strong skepticism toward the baseline presumption that contract alone should specify the terms of corporate governance relationships.”<sup>46</sup> At a fundamental ideological level, contractarians and communitarians are divided. Contractarians believe that justice is manifest in the status quo and the only legitimate interests are those bargained for. : “For communitarians,’ as Millon puts it “justice does not require endorsement of the existing distribution of wealth and bargaining capability. They seek instead to reform corporate law so as to foster individual dignity and promote societal welfare.”<sup>47</sup> Such deep ideological debates are not about to be settled on the basis of superiority of models.<sup>48</sup>

The importance of how one understands the corporation should not be underestimated.<sup>49</sup> If one views it as a government franchise, the government has a right to control it, and society has a right to demand certain behaviours of it, including internalizing social costs. If, however, one views the corporation as a mere official recognition of a spontaneously occurring organization of individuals, there is no justification for governmental interference. The simple fact that some individuals have decided to come together to conduct business does not suddenly or automatically give the government the right to interfere in the private affairs of its citizens, and certainly to placing additional obligations on the individuals who form the corporate contract.

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<sup>45</sup> Id 1380

<sup>46</sup> Id 1381

<sup>47</sup> Id 1386. In Millon’s review of Chayes’s theories, he summarizes the issue at a personal level: “Having induced nonshareholders to rely on legitimate expectations of fair dealing, shareholders therefore may forfeit the right to insist on contract terms guaranteeing profits at the expense of others.” David Millon, “The Ambiguous Significance Of Corporate Personhood: Working Paper No. 01-6 January 2001 Washington & Lee Public Law and Legal Theory Research Paper Series, 23.

<sup>48</sup> See Wetlaufer, discussed supra n. 7.

<sup>49</sup> See Sheehy, supra n. 18.

Perhaps most significantly, regardless of the model one accepts or what view one takes of the corporation, any political positivist analysis makes obvious the observation that corporations have grown in terms of their power. Their economic might and control over resources is astounding. No less than fifty of the world's largest one hundred economies are corporate bodies, and studies indicate that the control of these bodies tends to be concentrated in the hands of a very small number of people.<sup>50</sup>

e) Shareholder primacy

The model of the corporation in vogue at the present is a variant of the contractarian model, known to business scholars as the shareholder primacy or profit maximization model.<sup>51</sup> This view is that the corporation's objective or *raison d'être* is to produce the greatest profit. Although various reasons are advanced as to why shareholders of all the corporation's suppliers should be privileged above all others, none is particularly convincing, at least in larger corporations.<sup>52</sup> In order to do so, it must have high revenues and low costs. In other words, it must be efficient. This use of the term efficiency is important and should be distinguished from the similar but different use of the term efficiency as used by economists. To economists efficiency means making the most

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<sup>50</sup> For a listing of the world's 100 largest economies in 2000 which shows ranking and identifies the corporations see the list compiled by the Policy Research Institute at Corporations.org <http://www.corporations.org/system/top100.html> For an insightful analysis of corporate power in law and society, see Roger Cotterell, *The Sociology Of Law*, (1992) 123-130. Leading Australian corporate law scholar, Paul Redmond observes: "Adolph Berle's claim 40 years ago that corporate law would become the constitutional law of the new economic state no longer seems fanciful, if it ever did. The distinctive social issues posed by the corporate ascendancy need to be addressed..." P. REDMOND, COMPANIES AND SECURITIES LAW: COMMENTARY AND MATERIALS, 3<sup>RD</sup> ED, (2000), vii.

<sup>51</sup> M. Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," 14(3) J. OF APPLIED CORP. FIN. 8-21(2001). Smith, "The Shareholder Primacy Norm," 23 J. Corp. L. 277, 302-03 (1998). Henry Hansmann And Reinier Kraakman "The End Of History For Corporate Law" January 2000 Yale Law School Working Paper No. 235; NYU Working Paper No. 013; Harvard Law School Discussion Paper No. 280; Yale SOM Working Paper No. ICF - 00-09 [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=204528](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=204528) For some criticisms identifying the flaws of shareholder primacy model, Mirsch, Michaels, and Friedman, "Clean Models v Dirty Hands" Why Economics is Different from Sociology," In ZUKIN AND DIMAGGIO EDS., STRUCTURES OF CAPITAL: THE SOCIAL ORGANIZATION OF THE ECONOMY, (1990), Prentice, "Aspects of Corporate Governance Debate," in PRENTICE AND HOLLAND EDS., CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE (1993).

<sup>52</sup> Jennifer Hill, "Public Beginnings Private Ends: Should Corporate Law Privilege the Interests of Shareholders?" 9 AJCL 21 (1998).

effective use of resources in creating the maximum product possible from those resources. Business scholars mean creating the maximum profit from the resources.

While both scholars deal with money as the main resource, the difference is in the means to or view of the end product. The economist is concerned with both internalities and externalities, and so, how these things are accounted for whether public or private is irrelevant. The business scholar, however, sees a great distinction between internalities and externalities. For the business scholar, the greater the negative externalities, the greater the positive internalities or “profit” and hence the more attractive the enterprise appears to be. Getting more of the costs outside of the corporation, or in other words, the more one is able to externalize the negatives the more profitable, or desirable what remains is. Hence it is only logical to observe that increased activity of business corporations and increased negative externalities are correlated phenomena.

#### 4) COSTS

The next important discussion concerns the notion of costs. At its most basic level, the existence of a thing precludes the non-existence of that same thing. This mutually exclusive existence-non-existence condition creates what economists refer to as an externality. That is, each condition creates an inevitable anti-condition or “externality.”<sup>53</sup> Externalities are either positive (beneficial) or negative (harmful). When the externality is negative, it is called a cost. Costs are the negative impact or loss of any activity or thing.

Externalities are explained by Cooter and Ulen as a problem that occurs when “the utility or production functions of different people are interdependent,... [imposing] benefits or costs upon each other, regardless of whether or not they have agreed” and are

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<sup>53</sup> Interestingly, some calculations indicate that the total economic production of activity on the planet results in a net loss once all “externalities” are factored in. Accordingly, the terminology of “externality” has been questioned. Kysar, *supra* n. 2, 35. The problem of externalities in economics was first identified by A.C. PIGOU, *THE ECONOMICS OF WELFARE* 149-79 (1920).

externalities “because the costs or benefits are conveyed outside of a market.”<sup>54</sup> As noted in the Introduction to this article the topic is social cost—i.e. the cost to the people who make up society.

There have been a number of approaches to the problem of social costs. One approach to social costs has been to increase private property. Hardin’s famous article “The Tragedy of the Commons”<sup>55</sup> is often cited as the proof positive of the impossibility of preserving the environment without private property rights. In his startling article, Hardin observed that when people had unlimited access to communal property or “commons”, their overuse of the commons led to its demise. By way of contrast, Hardin observed that private property is maintained at sustainable levels. From this observation, Hardin concluded that the best way to preserve things held in common is to break up the commons, destroying public property rights and create private property.<sup>56</sup>

Hardin’s argument has been adopted as a model for much economic thought and subsequent policy; however, as we have seen, social costs are mounting in both quantity and seriousness of consequence.<sup>57</sup> This conclusion too should cause us to re-examine Hardin’s approach. Hardin’s analysis is based on the usefulness of common property rights, or more accurately, the results of holding property in common. The general analysis, however, fails to acknowledge that the destructive impact of common use only occurred once the profit motive was introduced.<sup>58</sup> In other words, as long as people are

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<sup>54</sup> ROBERT COOTER AND THOMAS ULEN LAW AND ECONOMICS 2<sup>ND</sup> ED. 139 (1997).

<sup>55</sup> Garrett Hardin. "The Tragedy of the Commons," 162 SCIENCE, 1243-1248, 1246 (1968). Available on line at <http://www.sciencemag.org/cgi/reprint/162/3859/1243.pdf?ijkey=W762Xr9TwfD4g>

<sup>56</sup> The discussion which ensues ignores that property is a social construction, meaning that property is whatever a society decides to recognize and value. Examples of property can include honours, offices, and humans. See M. WALZER, SPHERES OF JUSTICE: A DEFENCE OF PLURALISM AND EQUALITY, (1983), 7-9. See, or course, Aristotle’s discussion of such in NICHOMACHEAN ETHICS, (1980) trans. by D. Ross, Bk. 5, Ch. 2, 3.

<sup>57</sup> Hardin was an internationally recognized authority on population control and policy. It is worthwhile to note that he was not blind to the coordination problem in pollution control matters and indeed it was one of his concerns in writing his piece. See for example, his discussion in *Tragedy*, supra n. 55.

<sup>58</sup> D. Feeny et al “The Tragedy of the Commons: Twenty years later” in (18) 1 HUMAN ECOLOGY.(1990) 1-19. See the discussion in Ortega Santos, Antonio. 2000. "Commons: Past and Present, in Mediterranean Societies: Property Rights and Modes of Use." Presented at "Constituting the Commons: Crafting Sustainable Commons in the New Millenium", the Eighth Conference of the International Association for the Study of Common Property, Bloomington, Indiana, USA, May 31-June 4 <http://dlc.dlib.indiana.edu/archive/00000320/00/santosa040800.pdf>

using goods in common for their own sustenance needs, they are more than willing and able to manage property communally.<sup>59</sup> Once, however, the ability to profit is introduced, the over-exploitation of the resource occurs and some form of control over the exploitation of the resource appears necessary. Still, whether that control is best done by means of privatization or some other regulatory regime, remains unclear.<sup>60</sup>

Other criticisms of Hardin's view have been developed.<sup>61</sup> For example, scholars have noted that Hardin's assumption that the only rational behaviour is to increase material consumption without regard for leisure, cultural or intellectual activities.<sup>62</sup> Further, Hardin equates self-interest with certain ideas about private property, individual freedom, and the utility of maximizing wealth in the free market system. In essence, Hardin's thesis is "that people cannot work out sustainable ways to utilize common-property resources on their own"<sup>63</sup> and therefore, all property must be given over to private control. Hardin's thesis has been a critical in supporting corporate domination of more and more of the commons, for if individuals cannot organize the commons as common property, more private property must be created, and those with the capital to accumulate the property have the social obligation, one could argue, to do so. It is a basic justification for corporate domination of the world.

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<sup>59</sup> Cooter and Ulen note the example of Icelandic pastoralists limiting the number of animals permitted into the summer pastures. *Supra* n. 54, 148. But this phenomena was common in feudal England and with the land use practices of the Scottish crofters as well. Cooter and Ulen's analysis is helpful in stipulating the particular conditions conducive to the common approach, and contrast it with the over use of oyster beds in New England. However, their analysis does not go far enough to include the profit motive. For a broader consideration of the notion of public good which challenges the basic assumptions of the non-rivalrous consumption and non-excludability criterion, see Katharina Holzinger "The Provision of Transnational Common Goods: Regulatory Competition for Environmental Standards," In COMMON GOODS: REINVENTING EUROPEAN AND INTERNATIONAL GOVERNANCE, ED. A. HÉRITIER. (2001). Boulder, CO.

<sup>60</sup> COOTER AND ULEN, *supra* n. 54.

<sup>61</sup> For a sophisticated analysis of the coordination problem and response from economists known as ecological economists, see Kysar, *supra* n. 2. Pierre Lasserre and Antoine Soubeyran "A Ricardian Model of the Tragedy of the Commons" Working Paper No. 20-01 (February 2001) <http://www.economie.uqam.ca/cahiers/wp20-01.pdf>

<sup>62</sup> On the importance, valuing and meaning of these and a theory of goods in general, see WALZER *supra* n. 56.

<sup>63</sup> Paul B. Trawick "Successfully Governing the Commons: Principles of Social Organization in an Andean Irrigation System," 29 HUMAN ECOLOGY, 1, 2 (2001).

Another approach to costs has been legal. Traditionally, law has been the way of dealing with problematic costs between people. Either through legislation or by common law, law has been able to resolve property rights disputes through its various principles and doctrines. These principles include notions of justice and rights, and the doctrines include the doctrines of nuisance, causation, and rights *in rem* and *in personam*. More recently, law and economics have been combined to develop an economic analysis of traditional legal problems. A leader in this new discipline of law and economics<sup>64</sup> is the University of Chicago economist, Ronald Coase, to whose analysis we now turn.

a) Coase' Theory on Social Costs

Coase's landmark article "The Problem of Social Costs"<sup>65</sup> is an elegant argument, concerning cattle herdsman and farmers, doctors and confectioners, and neighbours of adjoining properties. His article is an effort to demonstrate that people will resolve their disputes smoothly regardless of what the law says. Essentially, Coase argues that where people can bargain, they will bargain for the rights that will bring them the best return on their investment, and further, that where they can do so in a costless environment without legally imposed liability structure, they will do so creating from an economic perspective, the most efficient use of resources and maximum level of production.

Coase correctly identifies the issue as "should A be allowed to harm B or should B be allowed to harm A?" Coase is also correct in his analysis: from an economic perspective, Who gets the right to harm is irrelevant.<sup>66</sup>

To make his point, Coase examines the case of *Bryant v. Lever*<sup>67</sup> in which the court had to decide the rights as between neighbours. Should a neighbour who had been using his chimney for several years without problems have the right to continue to do so? Or should the other neighbour be permitted to stack wood on top of his house for his own

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<sup>64</sup> Minda, supra n.5 604

<sup>65</sup> Coase, supra n. 20 1.

<sup>66</sup> This perspective is what is so foreign to lawyers and most people. Both legal and traditional thinking is that it does matter who does what do whom. This issue from this perspective is who caused the harm, and that person is the one who should pay for damage. COOTER AND ULEN, supra n. 54.

benefit although causing the neighbour's chimney to smoke? Coase said the issue should be resolved by the economics of the situation.

From Coase's economic perspective, the problem is caused in part by each party—the one party by lighting his chimney and the other party by stacking wood. He suggests that the case should be solved by looking at the economic costs and economic benefits generated by the activities, and then engaging in transacting so as to produce the most efficient outcome. Causation is not the issue—the issue is permitting activities which make the most of the resources.

Coase points out that:

The reasoning employed by the courts in determining legal rights will often seem strange to an economist because many of the factors on which the decision turns are, to an economist, irrelevant. Because of this, situations which are, from an economic point of view, identical will be treated quite differently by the courts. The economic problem in all cases of harmful effects is how to maximise the value of production.<sup>68</sup>

The court's analysis of *Bryant v. Lever* was based on the doctrine of lost grant. Lord Cotton identified the legal issue as identifying rights in order to trace causation and to identify in turn whose right preceded whose. This activity he recognized is as an ultimately a fruitless exercise. From the legal perspective then, the issue becomes a matter of pragmatics. The law solves the problem by drawing an arbitrary line, calls it the "doctrine of lost grant" and finishes the case.

Coase's comment about this legal solution is humourous. He writes: "the 'doctrine of lost grant' is about as relevant as the colour of judge's eyes."<sup>69</sup> But the legal doctrine embodies old solutions to problems only relatively recently recognized by economists. To explain this legal result in terms meaningful to an economist, one would say that to follow the line of causation all the way back in history to the right associated with the

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<sup>67</sup> 4. C.P.D. 172, (1878-1879), cited in Coase, *supra* n. 20, 11. Coase's assumption is that all activity is to be measured against or valued by its relation to production.

<sup>68</sup> Coase *supra* n. 20, 17.

<sup>69</sup> *Id.* 15.

original owners and then trace them forward through title is to increase information costs exponentially and fail to appreciate bounded rationality of the human condition. Coase has failed to address one of law's benefits: the reasoning for legal rules, and in this case, limited information and information costs, undetected externalities, the incremental nature of some externalities, and the fundamental fairness required for a society to continue peacefully. For the economist, the role of law is solely to define legal rights and provide predictability.<sup>70</sup> These legal rights and institutions permit people to act in self-interested ways without regard for the non-legally enforceable (property) rights of others.<sup>71</sup> Economics fails to appreciate much about law and the society it promotes.<sup>72</sup>

In Coase's hypothetical world, aside from property rights law is irrelevant because it does not add to efficiency and hence does not add to overall social product. People resolve their disputes on the basis of the dollar value of an activity. Which activities should be undertaken are determined on the basis of the total social value of potential production. This calculative exercise, argues Coase, should include total social costs. Imposition of liability by law makers should be avoided as creating legal liabilities increases transaction costs. Reallocation in a society with legally imposed liability schemes impairs achieving increased social production because the parties are forced to expend greater effort to reallocate the resources.

Given the importance of his insight and the remarkably broad application his theory has found, it is unfortunate that Coase has identified only one of the assumptions of his model: that it works only in a zero-transaction cost environment.<sup>73</sup> Had he considered

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<sup>70</sup> Id 21.

<sup>71</sup> Id. 31. Cooter and Ulen note this as the costs of non-cooperative legal rules in their example where instead of relying on competitive legal rules, by coincidence, a cattle rancher and corn farmer get married. Supra n. 54, 80

<sup>72</sup> Robin Malloy attempts to address this problem in his book, *Law and the Market Economy* by discussing semiotics, although his success in doing so may be questioned.

<sup>73</sup> Despite the acclaim his article received, subsequent studies have put his views into doubt. More recent studies suggest he may not be correct. See for example, Dan Usher, "*The Coase theorem is tautological, incoherent or wrong*," 61 *ECON. LETTERS* 3, 3 (1998). Cooter "*Coase*" in the *NEW PALGRAVE DICTIONARY OF ECONOMICS*. Andrew Halpin "*Disproving The Coase Theorem?*" working paper of the author at University of Southampton School of Law. Paper available on line at [http://papers.ssrn.com/sol3/Delivery.cfm/SSRN\\_ID424820\\_code030813140.pdf?abstractid=424820&mirid=2](http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID424820_code030813140.pdf?abstractid=424820&mirid=2)

other assumptions, his theorem may have contributed to a much deeper, more broadly socially beneficial outcome and included more forcefully the social costs he considered. Having limited his discussion of the phenomena of social costs in private transactions and his explanation of assumptions to the zero-transaction costs environment, he draws the economic conclusion that the initial allocation of rights is unimportant. His argument, however, is meaningless in the real world—and interestingly, this criticism is not a criticism with which he would disagree.<sup>74</sup> As he explains, economic analysis has a different objective, to which we turn next.

b) Coase's Recommendations: Private vs. Public

For Coase, the public-private distinction is irrelevant. The issue is maximizing overall social product. Coase suggests that the appropriate level of analysis in nuisance is total social product and rights, not things such as factories, smoke and homes.<sup>75</sup> The issue for Coase is: “one of choosing the appropriate social arrangement for dealing with the harmful effects. All solutions have costs.”<sup>76</sup>

Coase identifies three alternative social arrangements or orderings of production: government, the private firm, and do nothing. He allows that at times government may more efficiently deliver services, but to him, the central distinction is that government has the power to seize private property.<sup>77</sup>

Coase's analysis has broad implications for law. In matters of nuisance or social costs, traditional legal analysis gets it wrong. As he puts it “the belief that it is desirable that the business which causes harmful effects should be forced to compensate those who suffer damage is undoubtedly the result of not comparing the total product obtainable with alternative social arrangements.”<sup>78</sup> As he observes: “The proper procedure is to compare the total social product yielded by these different arrangements. The comparison of

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<sup>74</sup> Coase argues that economic argument needs to be more focused on reality.

<sup>75</sup> Coase *supra* n. 20, 45-46.

<sup>76</sup> *Id.*, 20.

<sup>77</sup> *Id.* 19.

<sup>78</sup> *Id.*, 42.

private and social products is neither here nor there.”<sup>79</sup> But there are a number of highly problematic assumptions inherent in his approach in which all is merely a matter of the transaction of property rights. We turn to discuss these assumptions next.

### c) Coase’s Assumptions

Consider, for example, that Coase’s transaction of property rights approach fails to address adequately the problem of non-identified commons, and people without resources to pay for things or rights they value. All of Coase’s examples deal with individuals who have property—i.e. wealth. Coase does not deal with those who do not have sufficient resources.

Furthermore, Coase does not seem to consider that private firms do the equivalent of government seizure when they utilize the commons by their externalities. Such activity is equivalent to seizure of the commons. Additionally, the only value is the economic value, or more accurately, the revenue generating possibilities of the property. There is no discussion of fairness or such things as happiness that make life worthwhile, known to economists as “psychic income.”<sup>80</sup>

Further, Coase does not look at the non-monetized costs. What are the costs to the comfort of the family without a chimney? Put differently, what is the value of the individual and individual rights in a society. Consider, for example, that perhaps the family will be more susceptible to illness, or if it is forced to move, the members may suffer from increased insecurity and not be able to make an adjustment socially, at school or at work. He does not discuss the fact that a person with more assets has more mobility, and so has more alternatives, and ultimately a stronger bargaining position than someone

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<sup>79</sup> Id, 36.

<sup>80</sup> Lester C. Thurow, “*Psychic Income: Useful or Useless?*” 68(2), THE AMERICAN ECON. REV., Papers and Proceedings of the Ninetieth Annual Meeting of the American Economic Association. (May, 1978), 142-145. Stable URL: <http://links.jstor.org/sici?sici=0002-8282%28197805%2968%3A2%3C142%3APIUOU%3E2.0.CO%3B2-A>

who is poor.<sup>81</sup> He does not seem to identify the problem faced by people without the alternative of moving, or not having cash to buy the right to have a chimney extended to stave off the cold of winter, nor yet the unfairness some economic outcomes may impose on the parties.

#### d) Criticisms of Coase<sup>82</sup>

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<sup>81</sup> Coase alludes to the further problem of unequal parties bargaining with each other when he states “What payment would in fact be made would depend on the shrewdness of the farmer and the cattle raiser as bargainers. Supra n. 20, 5

<sup>82</sup> There are many criticisms of Coase that could be included. Perhaps the most penetrating criticism, particularly of Coase’s view that private property rights are the best solution to social costs is V.V. Chari and Larry E. Jones, “A Reconsideration of the problem social cost: Free riders and monopolists” 16(1) ECONOMIC THEORY 1 (2000).

For purposes of brevity and focus the criticisms discussed in the body of the paper are only those with the most direct bearing on the matter. In thinking about Coase, however, one must consider the broader issues which Coase’s hypothetical world fails to address such as who values and transacts public goods and how? A dollar value on public goods does not address the actual value received by the public from the public good. Take for example, Coase’s rancher and farmer. What is the value to the public of a herd of cattle as opposed to a field of corn? The considerations are not what Coase has identified: again, his analysis is far too limited in its perspective. In his example there are also the problems of methane gas produced by cattle, as well as the pollution to streams from their wastes. Further, the production of cattle increases the demands on the land for producing cattle feed and reduces the land available for other uses. Nor yet does it take account for the fact that cattle grazing accounts for 35% of the erosion of the planet’s arable land. Similarly, corn production requires consideration of the costs and benefits of monoculture agricultural production. The inputs of energy to create fertilizer, pesticides, herbicides, as well as the destruction of the soil by compaction of the soil and monoculture itself need to be considered. Furthermore, each of these facets of corn production have long term, environmental effects such as algae blooms in significant areas of the ocean, dying rivers and the exhaustion of the soil requiring the removal of land from agricultural use. The marginal utility of land is a more difficult calculation as it includes not only the above mentioned factors but also change will be forced in production as a result of depletion of the world’s petroleum resources, loss of productive land due to global warming and increased demand for food production resulting from the world’s population doubling over the next fifty years. Society needs to make hard decisions about whether more cattle feed for the inefficiencies of wealthy beef eating consumers or more efficiently for food for the rest world needs to be produced. Such concerns are, of course, the complexities that concerned Keynes. See Anna Carabelli and Nicolo De Vecchi, (2000) “*Individuals, Public Institutions and Knowledge: Hayek and Keynes*,” IN P.PORTA, R. SCAZZIERI, A.SKINNER (EDS), KNOWLEDGE, SOCIAL INSTITUTIONS AND THE DIVISION OF LABOUR, 232.

Given the immense amount of information needed to be collected, processed, analyzed, not to mention the matters of probability, and uncertainty, suggest that economic analysis alone is not sufficient to rely on. The costs of error in such calculations are too great to imagine, and accordingly, it may be appropriate to look to some other tools or values in preserving the planet.

Thus, the inability to calculate these goods suggests that Coase’s view of the matter while interesting and helpful at a micro-level is of next to no use at a macro level. Coase does address some of these objections such as the overall damage of activities directly and such non-economic values as poor people needing food, (supra n. 20, 24) the value of social peace by preventing nuisance by using reasonable care and not waiting until there is complaint --quoting with approval from the case of *Andreae v. Selfridge and Company Ltd*; (Id. 23) however, the “Coasean” tradition, (See his Nobel Lecture) like the Pigovian tradition he complains about, (Id. 17) has been taken to mean something else.

<http://www.nobel.se/economics/laureates/1991/coase-lecture.html>

As noted, Coase's work has received wide acclaim. Indeed, he has been awarded the Nobel Prize in Economics for his work. Due to its pervasive use and citation, it merits a careful and thorough criticism. Despite its general acceptance, Coase's work has not been received with equanimity in the legal, economics, or law and economics communities.<sup>83</sup> Among the most trenchant of the criticism are those raised by Cooter in his article "The Costs of Coase."<sup>84</sup> Cooter notes, among other criticisms, that Coase's examination is limited exclusively to one-on-one strategic game situations. This limitation is critical for a number of reasons.<sup>85</sup> First, and perhaps most importantly, such strategic games are zero sum. In such games, no rational player is willing to give up more in order to resolve the solution and so the problems posed are in fact, intractable.<sup>86</sup> Accordingly, there is no rational solution.

Coordination problems are those types of problems that require coordination of differing and conflicting interests among parties who together form a united whole. Coordination problems make up the vast majority of society's problems including social costs—yet Coase's solution does not address these either. Finally, Cooter notes that Coase operates on a very optimistic assumption, that despite the aforementioned intractability caused by the rationality assumption, people will cooperate. As Cooter puts it, the opposite and more realistic assumption is a pessimistic one, one which he calls the "Hobbes Theorem."<sup>87</sup> In Hobbes' view of society, people will fight rather than share. Where such is the case, Coase's theory is useless beyond its value as an intellectual exercise.

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In fact, Coase does not claim that his paper is about the irrelevance of liability in a situation which is free from transaction costs. Nor is his paper about irrelevance of the initial allocations of rights. Rather he identifies the point of his paper clearly and quite contrary to these various interpretations. He suggests that the goal of his article is to "indicate what the economic approach to the problem should be." It is not prescriptive of the total approach. In his own words, the point of his paper is that while "it would clearly be desirable if the only action performed were those in which what was gained was worth more than what was lost. But in choosing between social arrangements... we should have regards for the total effect. This, above all, is ... [the] approach which I am advocating."

<sup>83</sup> There is empirical evidence that the Coase theorem is incorrect. See note 73 supra. How counterfactual evidence is dealt with is a particular problem for economics and challenges its claims to be a science. See Hausman, supra n. 16.

<sup>84</sup> Robert Cooter "The Cost of Coase," 11 J. OF LEGAL STUDIES, 14 (1982).

<sup>85</sup> Id.

<sup>86</sup> Id.

<sup>87</sup> Id. Cooter develops a valuable normative theorem concerning the role of law from his Hobbes' Theorem. He writes: "the normative Hobbes theorem: Structure the law so as to minimize the harm caused by failures in private agreements." Cooter and Ulen, supra n. 54, 90. This theorem's importance to the

If one accepts Coater's criticism, it leads to Coase's second ordering of production, namely, a dominant role for government. It is government's job to coordinate diverse interests, not private individuals who have their own means—money, power and violence—to impose their “solutions” on the rest of society.<sup>88</sup> In other words, social costs are no longer a mere concern of bargaining as between two individuals, nor yet a smaller group of easily identifiable individuals. It is a matter to be dealt with exactly by such mechanisms as liability created by law. This conclusion is controversial because Coase's thought and neo-classicism in law and economics, discussed next, is usually used to support the opposite conclusion—namely, that private orderings are preferable to any and all government orderings.

## 5) LAW AND ECONOMICS

### a) The L&E Model of the corporation

In the last decades of the twentieth century Corporate law has been dominated by Law and Economics.<sup>89</sup> Easterbrook and Fischel's “The Economic Structure of Corporate Law”<sup>90</sup> is a monumental work in the intellectual landscape of both Law and Economics (L&E) and corporate law. It quite clearly sets out the agenda of the corporation and makes a coherent normative argument for rationalizing, selecting and developing corporate law along a single path.

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matter will be discussed below as structuring law to minimize social costs, and hence, reform corporate law along these lines.

<sup>88</sup> See for example, matters raised by HAROLD DEMSETZ OWNERSHIP, CONTROL AND THE FIRM, (1988) 261-81 and in particular, his criticism of Block. This point, of large scale coordination problems being particularly intractable with respect to externalities is the topic of V.V. Chavi & Larry Jones, “A reconsideration of the problem of social cost: Free riders and monopolists” (2000) 16 *Economic Theory*, 1. They observe “In large economies with decentralized systems, problems caused by externalities lead to outcomes far from the efficient level.” 19. Although somewhat technical in parts, it is clear that the issue of incomplete markets for externalities discussed by Coase, that the market solution is simply not viable.

<sup>89</sup> Minda supra n. 5.

<sup>90</sup> FRANK H. EASTERBROOK AND DANIEL R. FISCHEL THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991)

As they state in the preface “we conclude that corporate law has an economic structure that increases wealth of all by supplying the rules that investors would select if it were easy to contract more fully.”<sup>91</sup> They spend the balance of their work examining the general principles of corporate law and the specific rules that support that conclusion. Generally, they argue that corporate law is what investors would select if they were given the opportunity to contract, namely, efficiency leading to wealth maximization. Their attention is drawn to and focused upon the economic explanations of corporate law’s principles and rules. The crux of the dilemma from their perspective is finding a balance between the ability to raise funds and the ability to control management.<sup>92</sup>

Easterbrook and Fischel start their explication of corporate law with a few short answers for their would be critics. They state that large corporations, including multinationals one assumes, are the product of success in satisfying investors and customers.<sup>93</sup> In other words, the corporations that exist, exist because they are the best. It is a robust view of survival of the fittest, the most worthy survive and grow, the weaker, inferior ones die. It suggests that the large corporation deserves its place and power because it is the best at what it does, or possibly, that it is most suited to the environment in which it exists.

They explain their approach as positive (i.e. descriptive) rather than normative (i.e. prescriptive), although they admit to straying into the normative realm on occasion. This approach is reasonable within their assumptions: where the corporate structure is supposed to reflect the investors’ wishes, and where the investors’ wishes produce the greatest efficiency and hence the greatest good for society, the laws indeed should reflect those assumptions. Indeed, as argued here, that law “should reflect those assumptions” demonstrates that at times, economics cannot but be normative. Where it has identified the goals and within its own limited framework, the best way to achieve those goals, to pursue other means is simply perverse.<sup>94</sup>

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<sup>91</sup> Id, Preface, vii.

<sup>92</sup> This is a contemporary version of the A. Berle and G. Means concern resulting from the separation of “ownership” and management. A. BERLE AND G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY*. REV. ED. (1968).

<sup>93</sup> Id, 4.

<sup>94</sup> Pouncy, *supra* n. 16.

## b) Assumptions of the L&E Theory of Corporate Law

Easterbrook and Fischel, state that they accept only one assumption—the assumption of implied investor consent. Therefore, they argue that they are engaging in a strictly positive exercise. They are merely describing the corporation as they find it, and reject any theoretical starting point. Interestingly, before one can make sense of their argument, one needs to understand their theory. Both their economic theory as subscribers to neo-classical economic theory and their theory of the corporation are quite developed and wide ranging.

Fellow law and economics scholar, Robin Malloy, identifies the following five assumptions as forming the basis of neo-classical law and economics:<sup>95</sup>

- i) people are rational and therefore act in their own self-interest. This position suggests that the appropriate role of central planners is minimal, and that the aggregate of these individual self-interested choices is the best for society.
- ii) People have complete and perfect information, and that the current distribution of education is appropriate.
- iii) Free movement to follow economic opportunity is available and appropriate to all people and that the effects of dislocation are not relevant.
- iv) Free market and competition are desirable and the outcome of competition is desirable, and
- v) The current distribution of wealth is accepted because it came about by just means and furthermore, any re-distribution would be unfair or inequitable.

These neo-classical economic assumptions are fundamental to Easterbrook and Fischel's work. As applied to law, corporate law, and legal theory, the main tenets of their theory are that:

- efficiency is the primary objective of law,

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<sup>95</sup> LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE, (1990) 53-5.

- the market is the most efficient method of resource allocation, not government imposed distributions,
- corporations are the best vehicle for coordinating resources,
- utility can be equated wealth not social justice, happiness or civil peace,
- only those with wealth sufficient to be investors need be concerned or consulted about resource allocation in production,
- increasing the wealth of those with wealth is the fundamental principle of economic activity,
- all other forms of wealth such as environmental wealth including biodiversity and clean environment, or social wealth like psychic income, cultural heritage and knowledge are unimportant,
- concerns of distributive justice are irrelevant, and
- the future of the planet and interests of future generations should be subjected to the appropriate present value calculations subject to present value discounting, which is a discounting of the value of the future.

Once one accepts all of these tenets underlying their theory, one is free to move on with the authors, “free of theory,” to examine corporate law as it is. As they have it, investor choice is optimal “because the choices do not impose cost on strangers to the contracts, [and so] what is optimal for the firms is optimal for society.”<sup>96</sup> As they put it, having dealt with the preliminaries—the corporate contract,<sup>97</sup> limited liability and voting in the introductory chapters of their work—they “arrive at the relation between shareholders and managers which holds center stage for the rest of this book.”<sup>98</sup>

Easterbrook and Fischel define the corporation as an “extra-market, team method of production with certain costs and benefits. Corporations are a finance device and are not

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<sup>96</sup> Easterbrook supra n. 54, 6-7.

<sup>97</sup> Reading Joo’s work, examining “economic contract” and “legal contract” supra n. 34 alongside Easterbrook and Fischel’s work is an invaluable exercise which sheds considerable light on the confusion and consequent complexities and conundrums created by confounding economic and legal understandings of the term “contract.”

<sup>98</sup> EASTERBROOK supra n. 54, 90

otherwise distinctive.”<sup>99</sup> As it is the investors who bear the risk of loss, so too, they should have the benefit of the reward.<sup>100</sup>

Further concerning this nexus of contracts model, they observe, that corporate law is designed to support:

The complex arrangements of many sorts that those who associate voluntarily in the corporation will work out among themselves. The form of reference is a reminder that the corporation is a voluntary adventure, and that we must always examine the terms on which real people have agreed to participate.<sup>101</sup>

Accordingly, “the role of corporate law at any instant is to establish rights among participants.”<sup>102</sup> The corporation is a wonderful finance tool in which every individual has complete bargaining freedom to buy and sell what he or she likes at prices that reflect the value of those things to each party. Working within their model, they are certainly correct.

### c) Criticisms of the L&E Model

Given this nature of the corporation and the values of freedom of contract to many people, it is undoubtedly true that from a normative perspective, corporate law should reflect what the parties would contract, and that corporate law should be guided by the parties and not the regulators.<sup>103</sup> This particular view of the corporation and the interested parties leads them to the interesting conclusion that the goal of the corporation is a matter of complete indifference. As they put it: “what is the goal of the corporation?... who cares?”<sup>104</sup> Since all are free participants, all should be free to do as they choose. Risk bearers get residual claims, non-risk bearers get fixed returns. Should those who have fixed returns prefer the residual claim, it is a rather simple matter for any

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<sup>99</sup> Id 10.

<sup>100</sup> Id 11.

<sup>101</sup> Id 12.

<sup>102</sup> Id 14

<sup>103</sup> Id 15.

<sup>104</sup> Id 35-36. Although they do not spell it out in their text, Easterbrook and Fischel are following Coase’s ideas on liability and allocation of rights. Who has what rights and liabilities is irrelevant in the quest to increase overall social wealth. Whatever arrangement has the greatest level of production is best, and Coase argues, that left to themselves without transaction costs, market players will find that arrangement on their own.

one of them to simply withdraw their fixed return investment, switch and invest in the residual claim.<sup>105</sup>

Their justification for an economic analysis of corporate law is correct as far as it goes. As they observe, the same pressures affecting the shape of markets are the same pressures that affect the structure of corporate law.<sup>106</sup> Although not identified by the authors, one assumes they are referring to competitive pressures arising from efficiencies. It is unfortunate that they fail to identify the pressures as surely the market's pressures include such things as: strategic behaviour, desire for power and dominance, defensive behaviours, inefficiencies caused such behaviours, and efforts to maximize profits by externalizing as many costs as possible. Had they done so, their analysis of corporate law would have been significantly more valuable and their analysis of the corporate law and normative conclusions would have been much more nuanced and they would have had to address at least some of the social costs which are of concern to this article.

Easterbrook and Fischel acknowledge social costs but find they are best dismissed from an analysis of corporate law. They write:

We do not address optimal ways to deal with pollution, bribery, plant closings, and other decisions that have effects on people who may not participate in the corporate contract. Society must choose whether to conscript the firm's strength (its tendency to maximize wealth) by changing the prices it confronts or by changing its structure so that it is less apt to maximize wealth. The latter choice will yield less of both good ends than the former.<sup>107</sup>

They may be correct about their conclusion—although they provide neither evidence nor argument—if there is no middle ground, and if, as they suppose the soviet experience is the only alternative and that it has indeed failed.<sup>108</sup> Their suppositions about wealthy

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<sup>105</sup> Assuming of course that the only investment one has is financial, or alternatively that a “contractor” such as a telemarketing employee has sufficient funds on hand to permit them the simple switch to investing in dividend bearing shares the dividends of which would replace his or her income from telemarketing.

<sup>106</sup> Id 8.

<sup>107</sup> Id 38. Again, like most law and economics scholars, Easterbrook and Fischel fail to explain why the particular goods they focus on should dominate the discussion and society as a whole. See Walzer, *supra* n. 56.

<sup>108</sup> See Harvard economist, Jonas Kornai, “*What the Collapse of Socialism does and does not mean.*” 14(1) J. OF ECON. PERSP, 27-42. One also must remember that the soviet government accomplished a level of

firms in light of experience are questionable. “Wealthy firms provide more jobs, ... better working conditions and clean up their outfalls... [etc.]”<sup>109</sup> One of the banes of the increasingly dominant multi-national corporations is their failure in each of these areas as they increasingly look to lower costs by moving to poor countries where they do none of the supposed wealthy firm activities.<sup>110</sup>

Although they claim that they are not panglossian, one is hard pressed to find a better term with which to describe them.<sup>111</sup> As they view it, corporate governance is really only a matter of better-defined property rights. They make the assertion, without argument,

No rearrangement of corporate governance structures can change this [social costs]. The task is to establish property rights so that the firm treats the social costs as private ones, and so that its reactions, as managers try to maximize profits given these new costs... to view pollution... or other difficult moral and social questions as governance matters is to miss the point.<sup>112</sup>

But these social costs are precisely the point and the current model is precisely a significant cause of the problem.

Finally, they ignore a number of important issues. In their analysis, the big corporation is big because it is fittest for survival, they ignore 1) merger and acquisitions which often simply absorb the success of other’s ability to innovate, produce and market, 2) undervaluing the actual contribution of a business to the community—corporate raiders look for corporations with sufficient capital to meet potential corporate liabilities which are often simply sustainable practices, 3) stealth, deceptive, strategic behaviour and efforts to create monopolies, 4) luck in timing: right place, right time, 5) the role of right

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industrialization in 70 years that the west required more than 200 years to accomplish. While some may see this as an argument in favour of communism, it is intended as cautionary and a source for a bit of humility in the capitalist societies. See Chomsky’s discussion of this error with respect to SE Asia and Latin America, in Chomsky *supra*, n. 3, 32-35, and discussion 92, 93.

<sup>109</sup> Id 38.

<sup>110</sup> STIGLITZ *supra* n. 3.

<sup>111</sup> Indeed a book review of their work in the Harvard Law Review is titled, “Dr. Pangloss meets the Coase Theorem.” (1992) 105 *Harv. L. Rev.*, 1408.

<sup>112</sup> Id 39.

connections, and 6) the anti-social, un-ethical behaviour of many corporate founders and successors.<sup>113</sup>

So far, we have developed an understanding of Social Costs as those costs that are borne by non-parties to activities, and particularly, income generating activities. Further, we have seen that the traditional Social Cost analysis as developed by Coase has viewed the problem as solved by individual participants in a market setting rather than through law. We have noted that Coase's analysis of Social Costs fails to address coordination problems, being those problems that involve solving conflicting interests in using goods. Further, we have seen that because of its commitment to neo-classical economics, law and economics tends to view the objective of law narrowly as maximizing wealth and to disregard public good. In this context corporations and corporate law are about fulfilling the interests of the parties privy to the corporate contract. It is generally assumed that there is but one interest and that is increasing the efficiency of corporation, and in particular, in the business sense of efficiency increasing internal profits—that is, by increasing externalities, the social costs. This analysis allows the author to suggest that corporations increase social cost. To test this hypothesis, we will now examine a particular case.

## 6) CASE STUDY

Perhaps the best way to understand the nature of the problem of uncontrolled social costs created by the Law and Economics supported nexus of contracts model of the corporation, is by way of a case study. The world's largest corporation is Wal-mart.<sup>114</sup> Its corporate structure is made up of six retail divisions and five specialty divisions.<sup>115</sup> It

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<sup>113</sup> The history of such behaviour is well documented from J.P. Morgan's kidnapping of couriers of competitors, to Microsoft's continual legal battles concerning its anti-trust activities. Some of these antics are noted in MAURY KLEIN, *THE LIFE AND LEGEND OF JAY GOULD* 80-86 (1986).

<sup>114</sup> Charles Fishman, "*The Wal-Mart You Don't Know: Why Low Prices have High Costs*," 77 *FAST COMPANY MAGAZINE*, 68. (Dec. 2003)

<sup>115</sup> Wal-Mart Stores, Inc. website [www.Wal-Mart.com](http://www.Wal-Mart.com)

is a publicly traded corporation listed on the NYSE and two other exchanges. Majority shareholders include three family members, and a number of institutional investors.<sup>116</sup>

Wal-Mart was started in the 1950's by Sam Walton, apparently a small time store owner, in Bentonville, Arkansas, U.S.A.<sup>117</sup> It started as a small department store, growing into a small regional chain, and then growing and spreading first through the southern United States of America, and then throughout the rest of the country. It has now moved beyond its national focus and operates internationally.

In most recent 12 month period sales were \$256.3 billion in the U.S.A., and \$47.5 billion internationally.<sup>118</sup> It has 3,566 stores in the USA<sup>119</sup> and 1,494 in Mexico, Puerto Rico, Canada, Argentina, Brazil, China, South Korea, Germany and the U.K.<sup>120</sup> and plans to expand to every market which could sustain it and protect its profits. Wal-Mart employs 1.5 million employees<sup>121</sup> of whom more than 1.0 million are “associates” i.e. sales clerks. At least 30% of Wal-Mart employees are part-time.<sup>122</sup> Full-time at Wal-Mart means 28 hours or more per week. Nearly 10% of all imports from China to the USA are imported by Wal-Mart, being of a value of about \$12 billion.<sup>123</sup> In the period 1995-2000 12% of the growth in productivity of the American economy is believed to have resulted from Wal-Mart.<sup>124</sup>

The effects of Wal-Mart and other big-box stores is not well researched nor well documented. Although a recent spate of articles has started to draw attention to the

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<sup>116</sup> Yahoo Finance Quotes & Info. Wal-Mart Stores, <http://finance.yahoo.com/q/mh?s=WMT>

<sup>117</sup> Described as a “backwater” in Jeff Randall “Wonderful world of Wal-Mart” Friday, 21 February, 2003 BBC News UK Edition. <http://news.bbc.co.uk/1/hi/world/americas/2787951.stm>

<sup>118</sup> Randolph T. Holhut, “*The Wal-Martization of the American Economy*” April 26, 2004, 10(2) THE AMERICAN REPORTER 351. Its profits were \$6.67 billion, or about 2.3% of sales—not an impressive figure for retail or most industries.

<sup>119</sup> Wal-Mart Stores, Inc. website [www.Wal-Mart.com](http://www.Wal-Mart.com)

<sup>120</sup> Id.

<sup>121</sup> Id.

<sup>122</sup> Shils, “Measuring the Economic and Sociological Impact of the Mega-Retail Discount Chains on Small Enterprise in Urban, Suburban and Rural Communities” Section “Wages” 95. Shils observes that as full-time is considered 28 hours per week or more, the 30% part-time is an “exceedingly conservative figure.” Id.

<sup>123</sup> Fishman, supra n. 114, 68

<sup>124</sup> McKinsey & Co. study, cited in Fishman id.

issue,<sup>125</sup> perhaps the only thorough study was done in 1997 by the leading expert on big-box stores, Edward Shils, Director Emeritus of the Wharton Entrepreneurial Centre, at the University of Pennsylvania.<sup>126</sup> *The Shils Report* is a landmark study of the social costs of this form of retailing. In his study, which Shils sub-titled: “Measuring the Economic and Sociological Impact of the Mega-Retail Discount Chains on Small Enterprise in Urban, Suburban and Rural Communities”, Shils examined the impact of these big-box stores on the communities in which they are located. Shils’ study focused is on two big-box stores: Wal-Mart and K-mart. The main dynamics that drew Shils’ attention were the effects on the traditional structure of the labour market in the communities, and how it worked before and after the location of a big-box retail outlet within a 10-15 mile radius. Our examination of the social costs of corporations will begin with those identified by Shils. After considering Shil’s comments, the article will turn to examine a broader group of social costs. Given the innovative nature of the study it was not possible to utilize previously compiled lists. Social costs include, breakdown of functioning communities, undermining markets, impoverishment of workers, harm to democratic institutions of government, damage to culture, damage to efforts promoting cooperation and conservation, and environmental pollution. The list was compiled on the basis of observations concerning activities and hypothesis of costs of those activities by corporations in general and in certain instances, as will be clear in the discussion, by Wal-Mart in particular.

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<sup>125</sup> Brooklyn College sociology professor’s Sharon Zukin, “We Are Where We Shop” Nov. 28, 2003 *The New York Times*, Anthony Bianco, Wendy Zellner, Diane Brady, Mike France, Tom Lowry, Nanette Byrnes, Susan Zegel, Michael Arndt, Robert Berner, and Ann Therese Palmer, “Is Wal-Mart Too Powerful?” *Business Week*, Oct, 6, 2003, Jack Z. Smith, “Up against the Wal-Mart,” *Star-Telegram* Dec. 5, 2003; “The Wal-Mart Effect,” *Los Angeles Times* 3 part series of Nov. 23-25, 2003; Randolph T. Holhut, “The Wal-Martization of the American Economy” April 26, 2004, 10(2) *The American Reporter* 351; Charles Fishman, “The Wal-Mart You Don’t Know: Why Low Prices have High Costs,” (Dec. 2003) *Fast Company Magazine*, Vol. 77, 68. John Rausch “The Cost of Cheap Goods” *Catholic Herald* (Nov. 20, 2003). David Olive “Values outsourced -- What are the social costs of the Wal-Mart economy?” Oct. 18, 2003 *Toronto Star*. Jim Hopkins “Wal-Mart’s influence grows” 29 January 2003 *USA TODAY* Zukin’s research is contained in her book, *Point of Purchase: How Shopping Changed American Culture* (2003). Andy Rowell, “Welcome to Wal-World: Wal-Mart’s Inexhaustible March to Conquer the Globe” (2003) 24 (10) *Multinational Monitor*.  
<http://www.multinationalmonitor.org/mmm2003/03october/october03corp2.html> See also Carol Bowlby, *The Invention of Modern Shopping* (2001).

<sup>126</sup> Another expert on Wal-Mart is Kenneth E. Stone of Iowa University; however, his focus is how to stay in business if Wal-Mart moves into the area. His main criticism of Wal-Mart can be found in *Metropolis* July 1997

a) Community impact

Traditional western communities have thriving commercial centers. These centers are composed of a mix of retail, commercial and office space. The majority of the commerce in these centers is transacted through small businesses. These businesses tend to be highly involved in the community, create employment which pays sufficiently to sustain a reasonable standard of living, pays taxes, and are innovative, community building in the sense of promoting ideas of individual ability, responsibility and an entrepreneurial spirit.<sup>127</sup> Indeed, small business is often described as the “backbone” of an economy and a community<sup>128</sup>—at least in a market economy.

Shils draws attention to the effects of shifting labour opportunities from the downtown urban areas to suburban big-box retailers. When labour opportunities disappear communities fall apart. When people do not employ their time with productive activities such as working in a commercial center, they turn to other unproductive activities. Effected malls and commercial areas tend to display levels of vacancy from 30%-40% after a superstore moves into the radius. These vacancies represent significant losses of small businesses and mid-level incomes.<sup>129</sup> Further, when vacancies increase and employment decreases, vandalism, petty crime, and drug use increase.<sup>130</sup>

Thus, when Wal-Mart establishes a retail outlet, detrimental community effects can be expected. These effects include decreased community involvement, decreased community building efforts, decreased small business, decreased labour opportunities, and increased commercial vacancies.

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<sup>127</sup> Shils supra n. 122, 95.

<sup>128</sup> Id, 95. The importance of small business to the Australian economy and the negative impact of big business and big box stores in particular on Australian economies, is discussed in detail in Amanda Gome “*The Decline of Small Business.*” And Amanda Gome “*What’s Holding Small Business Back?*” BRW roundtable: the decline of small business, 06 May 2004 26(16) BRW MAGAZINE, 40-52.

<sup>129</sup> Id, 102.

<sup>130</sup> Id, This vacancy and downward spiral in a center is a phenomena that first occurred in the 1960’s and 70’s as suburbs were created in greater numbers. The socio-economic problems of gutted city centres has yet to be resolved.

## b) Supplier Social Costs

Another social cost imposed by big-box stores results from the demands Wal-Mart places on suppliers. Having Wal-Mart as a customer has both advantages and disadvantages. On the one hand, the business' sales increase dramatically. On the other hand, the stress on the business increases exponentially as profit margins dip dramatically

The pressure Wal-Mart place on suppliers is enormous. Wal-Mart requires its suppliers to drop prices annually by as much as 5%.<sup>131</sup> There are different responses to this type of pressure. In some instances, Wal-Mart has driven its suppliers out of business. In other instances whole industries, such as the orange industry in the USA, have suffered severe adverse effects.<sup>132</sup> Another common response is for a business to cannibalize itself. This cannibalization occurs when a business is forced to undercut its own products in other markets (often much more profitable markets) or give up markets in order to supply Wal-Mart. In other words, it is a zero-sum situation in which the change in business from a profitable market to Wal-Mart has no net gain to the supplier: it is pure loss.<sup>133</sup> And the cost involved is borne solely by the business supplying Wal-Mart, not only through the cannibalization, but also in the cost of shifting production resources from one product to another. Businesses contract with Wal-Mart for different reasons, including being unable to compete, and not having sufficient or complete information as to how Wal-Mart deals with its suppliers.<sup>134</sup>

Interestingly, Wal-Mart's suppliers are not free to talk to the press about their experiences for fear of retaliation or in their terms "being in the penalty-box."<sup>135</sup> One executive colourfully analogized his supplier relationship with Wal-Mart as "getting into the

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<sup>131</sup> Fishman, reporting information from Bain & Co., on of the top management consulting firms in the world. *supra* n. 114, 8

<sup>132</sup> *Id.* Given the particular nature of these problems, it is exceedingly difficult to get information. Usually when businesses go bankrupt or even just out of business the information concerning causes is lost along with the other information management may have had. Stiglitz notes this with respect to re-structuring in various countries and the resultant need to work with officials of governments not previously in favour with IMF administration. STIGLITZ *supra* n. 3.

<sup>133</sup> Fishman *supra* n. 114.

<sup>134</sup> As one supplier put it, "you talk softly when you talk to God in Bentonville." *Id.*

<sup>135</sup> *Id.*

company of version of basic training with an implacable drill sergeant.”<sup>136</sup> The stresses of these pressures applied to the business are borne by management and employees.<sup>137</sup> Every person involved in the business from top management on down to the part-time floor workers are required to meet much more exacting standards—computer driven standards. Humans are driven particularly hard to meet inflexible, to the second, machine driven standards.<sup>138</sup> Given the cost cutting, the exacting standards, and the huge value of the contracts, a business simply cannot afford to fail its contractual obligations—regardless of how unreasonably and stringently enforced. To fulfill the demands of the low profit margins workers at all levels are forced to take on more responsibility and given less resources. This process combined with the environment of low tolerance increases the level of stress and stress-related problems increase dramatically.<sup>139</sup>

### c) Labour Social Costs

A May 2004 study released by the University of California, Berkeley entitled “The Hidden Public Costs of Low-wage Jobs in California”<sup>140</sup> identifies low pay in retail as a serious cost to the public. Interviews with one of the study’s authors identified Wal-Mart as costing California’s taxpayers \$86.0 million annually as a result of under-paying its employees.<sup>141</sup> They are paid minimum wage and then not permitted to work more than

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<sup>136</sup> Schils supra n. 122.

<sup>137</sup> See For Example the Survey conducted by Australian Recruiters and reported *Australian CPA April 2000*

[http://www.cpaaustralia.com.au/03\\_publications/02\\_aust\\_cpa\\_magazine/2000/16\\_apr/3\\_2\\_16\\_13\\_news.asp](http://www.cpaaustralia.com.au/03_publications/02_aust_cpa_magazine/2000/16_apr/3_2_16_13_news.asp) See for example, the Thompson HR Report Issue 295, April 2003, “Managers Cause Workplace Stress,” 6, <http://www.cpd.com.au/cpdnews/hrreport/Archive/HR295.htm>.

<sup>138</sup> This difficulty of humans working to machine driven rates and rhythms has been recognized as a problem in assembly line labour but appears not to be recognized when it comes to working with computers. The exception is among fighter plane pilots whose human cognitive ability is at times insufficient to deal with the complexities of computer flown aircraft resulting in air crashes. See for example, study “*Optimized Visual Interfaces for Combat Pilots*,” by David Bookstaber, former USAF pilot and Electronic Systems Center Scientist <http://bookstaber.com/david/opinion/PilotInterfaces.pdf>

<sup>139</sup> Id.

<sup>140</sup> Carol Zabin et al, “*The Hidden Public Costs of Low-wage Jobs in California*” Prepared for The National Economic Development and Law Center, May 2004 <http://laborcenter.berkeley.edu/livingwage/workingpoor.pdf>

<sup>141</sup> Zabin, id. Wal-Mart has issued a response to the study denying the validity of Zabin et al’s study, *Contra Costa Times*, August 3, 2004. The authors of the study reply to those criticisms, indicating among other things where Wal-Mart’s statement is “in complete contradiction with facts.” Arindrajit Dube and Ken Jacobs, *Hidden Cost of Wal-Mart Jobs Response to Wal-Mart’s Statements*, August 3, 2004 at 1. Interestingly, Wal-Mart claims that the employment figure used by the study’s authors (44,000) is incorrect

28 hours per week.<sup>142</sup> This cap on hours worked permits Wal-Mart to avoid costs such as health insurance it may otherwise be forced to incur. Obviously, the employees are not earning sufficient wages to live.<sup>143</sup> Under-paying employees has a number of consequences. Whereas prior to the arrival of the big box store, competing employers used to pay a living-wage, once big-box stores arrive, smaller employers can no longer do so as they are driven to cut costs or go out of business altogether.<sup>144</sup> Wal-Mart's size and correlated impact on the labour market wages are driven down throughout the area, as small businesses close and their better paying jobs are lost.<sup>145</sup>

Further, because of low wages Wal-Mart employees must look elsewhere for supplemental income. Such supplemental income can come from the state,<sup>146</sup> other part-time jobs, the underground economy, or illegal activities. These activities in turn have the further consequences of additional stress, and less time to spend engaging in other non-income generating activities “psychic income” that reduce stress and make life

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and actually should be 60,500. if this is the case, the actual cost is \$118.2 million.

[http://laborcenter.berkeley.edu/lowwage/walmart\\_response.pdf](http://laborcenter.berkeley.edu/lowwage/walmart_response.pdf)

<sup>142</sup> Rausch supra n 125.

<sup>143</sup> This is one of the main points of Zabin et al's research, supra n. 140. Based on detailed payroll data Wal-Mart provided in the course of a sex discrimination lawsuit, we found that its average wages were \$9.70/hr in 2001, and that 54% earned under \$9/hr.... We found a 31% wage penalty for working at Wal-Mart. Rausch calculates that the average employee earns \$8.23 per hour but earns only \$13,861 per annum because of corporate policy, supra n 115. Holhut states “‘Nearly half of its ‘associates’ ... make less than \$15,300- what the federal government considers the poverty level for a family of three. It also controls how many of its associates achieve full-time status” supra n. 118. This later observation, of course, is simply a management decision concerning the costs of full-time staff and the needs of the corporation in terms of staffing. Where the corporation can provide better profits to the shareholders by keeping full-time staff to a minimum and so avoid paying benefits and increased wages, it may well be argued that management has a duty to do so. Wal-Mart employees are required to wait for 6 to 24 months before being able to buy health insurance. In recognition of the fact that it is not paying a living wage, in California it provides direct access to community social workers to provide such goods as food stamps, health insurance and other state-funded assistance. Holhut, supra n. 118. Traditionally, small business has provided these goods to employees. Shil, at 94. For an interesting account of this issue in the USA SEE BARBARA EHRENREICH NICKEL AND DIMED—ON (NOT) GETTING BY IN AMERICA (2001)

<sup>144</sup> Holhut observes the recent fight by food union workers in the state of California against Wal-Mart which in comparison was paying its employees one half of what they unionized workers were earning. Supra n. 118.

<sup>145</sup> This point is clarified in the response of Dube and Jacobs, supra note 141, where the authors point out that rather than creating new jobs, “The reality is that Wal-Mart jobs primarily *substitute* for other retail jobs – many that pay substantially higher.” At 3. (Italics in original). They continue “Allowing for such small net losses or gains in jobs would not meaningfully alter the estimates of public costs – which is driven primarily by the fact that Wal-Mart pays about 30% less in wages than large retailers overall, and 23% fewer Wal-Mart workers are covered by job-based health insurance.”

<sup>146</sup> Wal-Mart in California provides a hotline to the local welfare office for employees. Id.

enjoyable and worthwhile. This situation is exacerbated by Wal-Mart's refusal to pay for certain over-time activities which refusal has formed the basis for a class-action against it by some 65,000 employees.<sup>147</sup>

Wal-Mart's equity decisions also seem suspect. For example, while 72% of its workforce is female, only 33% of its management are female. Currently, it is subject to a class-action lawsuit on behalf of 1.5 million female former employees for sex discrimination.<sup>148</sup>

Furthermore, Wal-Mart has taken a defiantly anti-union stance. It maintains an active anti-union response team of 70 people ready to descend on any Wal-Mart where employees are considering unionizing.<sup>149</sup> It attempts to inoculate employees against unions by threats<sup>150</sup> rather than by providing competitive benefits. By way of contrast, a successful anti-union strategy which worked for various Japanese auto manufacturers has been to provide competitive pay and compensation packages. The result for these employers has been to make them the employer of choice for many workers.

Wal-Mart employee dissatisfaction is high. This fact is evidenced by an employee turnover estimated at 44% per year.<sup>151</sup> Such dislocations have a high social cost.<sup>152</sup> When people lose employment, even when it is low paying, they lose a sense of security,

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<sup>147</sup> Wal-Mart employees are required to participate in some activities before the stores open etc. which are unpaid. Wal-Mart is currently subject to more than 40 lawsuits in the USA on the issue of unpaid over-time work. Rausch supra n. 125. Details are available on one of the attorney's websites. See <http://www.lieffcabraser.com/walmart%20lawsuit.htm> See also, "Wal-Mart faces class-action over off-the-clock work" 6 November, 2003 *USA TODAY*

<sup>148</sup> Id. The action was certified as a class action, a significant step in class-action lawsuits which recognizes a cause of action. The certification was made by Judge Jenkins on June 21, 2004. For a copy of the certification order see <http://64.81.247.237/staticdata/walmartclass/classcert.pdf> For information on the case, see the class-action web site dedicated to the case at [http://www.walmartclass.com/walmartclass94.pl?wsi=0&websys\\_screen=walmartclass\\_casedevelopments](http://www.walmartclass.com/walmartclass94.pl?wsi=0&websys_screen=walmartclass_casedevelopments)

<sup>149</sup> Id.

<sup>150</sup> Holhut observes "Wal-Mart is resolutely anti-union and has perhaps the most aggressive union-busting operation of any major U.S. corporation." Supra n. 118.

<sup>151</sup> Id.

<sup>152</sup> See, for example, discussion in Booth, A. and Zoega, G. "Quitting Externalities, Employment Cyclicity and Firing Costs." CEPR Discussion Paper no. 1101. London, Centre for Economic Policy 1994. Research. <http://www.cepr.org/pubs/dps/DP1101.asp>

and stability.<sup>153</sup> The loss of a job undermines one's sense of well being and dramatically increases stress, depression and related socially damaging behaviours including excessive alcohol consumption and gambling as people attempt to deal with stress. These costs are passed on into their close communities of friends and family.<sup>154</sup>

In summary, Wal-Mart's low wage policy drives down prices in the labour market. It off loads its operating costs onto the state and other businesses. It damages the well-being of employees by eliminating opportunity to access psychic income generating activities, and increasing stress resulting from employee turn-over. Further, its equity and over-time policies, and anti-unionism are manifestly opposed to the well-being of its labour force.

#### d) Democracy

Wal-Mart harms democracy by unduly influencing the political process needed to get development permissions, by funding promotional school materials, by controlling which reading materials and products get supplied to consumers,<sup>155</sup> by anti-competitive pricing,<sup>156</sup> by its anti-unionism (discussed above) and by misusing tax-payer largess intended to assist local communities stay alive and keep their economies thriving.<sup>157</sup> A

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<sup>153</sup> M. A Dew, L. Penkower, & E.J. Bromet, "Effects of unemployment on mental health in the contemporary family." BEHAVIOR MODIFICATION, 15(4), 501-544 (1991), Canadian Mental Health Association Newfoundland and Labrador Division *Coping with Unemployment*. (2002).. <http://www.infonet.st-johns.nf.ca/cmha/resource/publications/gcwu/cwu.html> L. E. Waters, & K. A. Moore, "Coping with economic deprivation during unemployment." 22 J. OF ECONOMIC PSYCHOLOGY,, 461-482 (2001).

<sup>154</sup> P. Voydanoff, "Unemployment: Family, strategies for adaptation." IN C. R. FIGLEY & H. I. MCCUBBIN EDS., STRESS AND THE FAMILY, II-COPING WITH CATASTROPHE (1983). 90-102. L. Jones, "Unemployment and child abuse." 71(10), FAMILY IN SOCIETY, 579-588 (1990).

<sup>155</sup> Holhut notes Wal-Mart controls 15% of the market for magazines and books. Supra, n. 118.

<sup>156</sup> Anti-competitive pricing is selling goods for less than competitors at prices which may cause a loss for the purpose of driving a competitor out of business. After the competitor is gone, the prices are usually raised to even higher levels. Wal-Mart has engaged in these activities. See litigation under the Robinson-Patman Act and discussed on [www.lawmall.com](http://www.lawmall.com)

<sup>157</sup> Referred to in the literature as "corporate welfare." See for example, Ches Baragwanath, & John Howe "Corporate Welfare Public Accountability for Industry Assistance" Centre for Employment and Labour Relations University of Melbourne Discussion Paper Number October 2000 [http://www.tai.org.au/Publications\\_Files/DP\\_Files/DP34SUM.PDF](http://www.tai.org.au/Publications_Files/DP_Files/DP34SUM.PDF) A study documenting Wal-Mart's receipt of these funds see Philip Mattera, Anna Purinton, Jeff McCourt, Doug Hoffer, Stephanie Greenwood & Alyssa Talanker "Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money to Finance

major research study released in May 2004 was able to document receipt by Wal-Mart “[of] more than \$1 billion in such subsidies from state and local governments to Wal-Mart; the actual total is certainly far higher.”<sup>158</sup> These subsidies were designed to promote new businesses in communities for the purposes of benefiting the community. The main subsidies the researchers were able to document are: free or reduced-price land, infrastructure assistance, tax increment financing, property tax breaks, state corporate income tax credits, sales tax rebates, enterprise zone (and other zone) status, job training and worker recruitment funds, tax-exempt bond financing, and general grants.<sup>159</sup>

Together these activities undermine a community’s ability to organize itself to pursue its best interest. This set of activities is particularly pernicious as the community’s opponent is a powerful organization quite able to organize itself and keep its consumers community in the dark without good information for the purposes of its own, self interested profit motive.

Despite all its ubiquitous statements to the contrary, consumer interests are not the ultimate concern. Clearly, corporate profit is. Where an entity absorbs such wealth and power, it works not only to maintain but to increase its position. This tendency is a phenomenon identified by economists in the economic realm as an effort to control a market by means of monopoly. Wal-Mart is open about its intentions to continue its growth (noted above).

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*its Never-Ending Growth.*” May 2004 Good Jobs First, Washington, DC

<http://www.goodjobsfirst.org/pdf/wmtstudy.pdf>

<sup>158</sup> Mattera et al, id, in the executive summary that their research “documents more than \$1 billion in such subsidies from state and local governments to Wal-Mart; the actual total is certainly far higher, but the records are scattered in thousands of places and many subsidies are undisclosed.” The same \$1 billion figure is offered by Barbara Ehrenreich, “*Wal-Mars Invades Earth*” NY TIMES July 25, 2004.

<sup>159</sup> Mattera id.

Further, Wal-Mart reduces expression by its dominance of the market. Consumers are free to choose whatever they like, provided Wal-Mart has agreed to provide it. This restriction of consumer options harkens back to Henry Ford's comment: "They can have any colour they like so long as it is black."

Wal-Mart has launched an attack on diversity of opinions—which form the basis of democracy—by the restrictions it places on authors and artists who wish their goods to be distributed as widely as possible, and given Wal-Mart's dominance as a distributor, such wide distribution would include being sold in Wal-Mart stores. This aspect of the problem of democracy is dealt with in greater detail in the next subsection.

#### e) Cultural Control

Wal-Mart, because of its buying power, and buying practices as demonstrated above, can and does dictate to its suppliers. It does so as well with respect to its consumers—it seeks only those products which it can sell in vast quantities—literature without depth but much popular appeal and movies and other entertainments with the same qualities. Based in Bentonville, Arkansas, a conservative backwater of the Southern USA,<sup>160</sup> it is a product of a conservative world-view. This background continues to inform its buying decisions and what it will permit consumers to purchase at its outlets. It has refused products which have a particular level of sexuality. For example, Wal-Mart has refused to print photos taken by consumers where the subject of the photo has been nude, and further, refuses to stock certain contraceptives.<sup>161</sup> Further, it has insisted music lyrics be changed or simply refused to place the product.<sup>162</sup> It refuses to stock magazines such as Maxim, In Style and Sports Illustrated Swimsuit<sup>163</sup> and hides the magazine covers of Glamor, Cosmopolitan and Redbook.<sup>164</sup> Essentially, this is the fear in all democracies:

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<sup>160</sup> Supra n. 106.

<sup>161</sup> Bianco et al, note Wal-Mart's refusal to stock Preven, a morning after pill on the basis that it does not want to subject its pharmacists to the moral dilemma of dispensing abortion pills. Supra n. 125.

<sup>162</sup> Bianco et al supra n. 125. Also discussed in more detail by anti-Wal-Mart activist, Al Norman. See story at <http://www.netaxs.com/~adredd/normantext.html>

<sup>163</sup> "Wal-Mart banishes bawdy mags; Retailer takes Maxim, Stuff and FHM off the shelves, citing complaints over racy contents." May 6, 2003 CNN Money [http://money.cnn.com/2003/05/06/news/companies/walmart\\_mags/](http://money.cnn.com/2003/05/06/news/companies/walmart_mags/)

<sup>164</sup> Bianco, et al supra n. 125. notes this, quoting Wal-Mart general merchandise manager, Gary Stevens, "There's a line between provocative and pornographic. I don't know exactly where it is." The statement is

that the tyranny of the majority will suppress the views of the minority—in this case, the fear of the minority who control Wal-Mart that the majority may oppose the political agenda they wish to advance through Wal-Mart.<sup>165</sup>

f) Foreign, “outsourced” social costs

A broader perspective includes the activities of manufacturers who supply Wal-Mart with the goods it desires to sell. In order to produce cheap goods, manufacturers must use the cheapest methods. Basic economic theory suggests that one can substitute inputs and still obtain the same outputs or goods desired. So, for example, if a manufacturer wishes to produce good *A*, it can pay *X* amount of capital plus *Y* amount of labour to produce *n* quantity of goods. Alternatively, it can manufacture *n* amount of good *A* with *X+I* in capital and a corresponding decrease in labour of *Y-I*.

In China, where Wal-Mart purchased \$12 billion of its goods for the USA market,<sup>166</sup> the cost of labour at its factory suppliers is \$0.13 per hour.<sup>167</sup> Workers must work 13-16 hours per day, seven days per week.<sup>168</sup> The working conditions are described as “sweatshops” and those working to provide Wal-Mart with its low cost goods are forced to work in conditions that consistently are rated among the worst.<sup>169</sup> The argument that these conditions are an improvement over unemployment are ingenuous<sup>170</sup> as it is not

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reminiscent of Justice Potter Stewart, of U.S. Supreme Court who famously stated: “I shall not today attempt further to define pornography...but I know it when I see it.”, *Jacobellis vs. Ohio*, 1964. while clearly the justice was struggling to define the issue for the good of the American public, in the early 1960’s with the information provided by a bevy of lawyers and specialists, it seems odd that a merchandiser seems to think it his role presumably with nothing more than his parochial wisdom informing him as to what the public should be exposed to. The exclusion seems to include various political and social commentaries, such as those found in the arts, as noted by the Dead Kennedys, a punk band.

<sup>165</sup> No research was conducted for this study to determine whether Wal-Mart’s cultural control has extended to restrict the literature accepted for sale Wal-Mart stores reflects a particular political party.

<sup>166</sup> Fishman supra n. 114.

<sup>167</sup> Rausch supra n. 125.

<sup>168</sup> Id.

<sup>169</sup> Charles Kernaghan, Director of National Labor Committee, and NGO that monitors sweatshops. Cited in Rausch. A different perspective on the value of such jobs in third world economies is offered by Eugene B. Mihaly “*Multinational Companies And Wages In Low-Income Countries*” 3 J. SMALL & EMERGING BUS. L. 1 (1999).

<sup>170</sup> The position in favour of trickle down economics in developing economies is well argued, in Mihaly id, Stiglitz, indicates that the argument for trickle economics has lost credibility. Supra n. 3. The failure of trickle down economics to work even in the country most friendly to the notion, the USA, has formed the

clear that unemployment is the only alternative, nor that local businesses and the local economy and environment would not be better off investing in itself and providing products for local consumption.<sup>171</sup>

Further, in order to keep production costs low, a manager must look for every means possible for externalizing costs. One way of doing so is by not treating wastes properly before discharge or simply dumping them directly without any treatment whatsoever.<sup>172</sup> While these costs are passed on to the local and national communities in developing countries where the manufacturing is done,<sup>173</sup> the benefit is passed on to the American consumer who receives under-priced goods. These factories are using the oldest technologies in order to take advantage of the cheaper labour inputs in producing low cost goods that they must produce in order to keep Wal-Mart as a customer.

It is truly a no win situation. To not produce is to not have money in the economy necessary to live but to have a habitable, clean environment. To produce, however, requires incurring great social costs. Further, because of market power, the vast majority of the economic benefits of trade are passed on to the USA while the majority of the costs and great damage of which stay with the people and the environment of the developing nation.

A secondary set of externalities arises from this trade. While at one time, economists insisted that trade benefited all of society, the rising tide theory—a rising tide raises all ships and hence, all people in a growing economy will benefit—is no longer the received wisdom.<sup>174</sup> As Professor G. Kent put it, “The rising tide of trade supposedly will lift all ships. But it may be that instead, as the critics suggest, it lifts only yachts, and swamps

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basis for a proposition that every American be given USD\$80,000. BRUCE ACKERMAN AND ANNE ALSTOTT, *THE STAKEHOLDER SOCIETY* (1999), 3-5.

<sup>171</sup> Observed by STIGLITZ id.

<sup>172</sup> Scott Holwick, “*Transnational Corporate Behavior and Its Disparate and Unjust Effects on the Indigenous Cultures and the Environment of Developing Nations: Jota v. Texaco, a Case Study*” 11 *COLORADO J. OF INTER’L LAW AND PO.*, 183-221 (2000). This off-loading of pollution is denied by free trade advocates.

<sup>173</sup> Wal-Mart purchased \$12 billion of its goods in China in 2003. *Supra* n. 115

<sup>174</sup> Sheldon Danziger & Peter Gottschalk, *Do Rising Tides Lift All Boats? The Impact of Secular and Cyclical Changes on Poverty*, 76 *AM. ECON. REV. PAPERS & PROC.* 405 (1986).

vessels that are leaky and decrepit.”<sup>175</sup> This consideration is important in two respects. First, by diverting resources to production for export, local markets are disrupted and new pressures are put on participants (including local villagers and local vendors) in that market. These pressures are largely uncompensated as the participants in those markets are not benefited much by trade. By way of contrast, those controlling production for export may be benefiting dramatically. This fact leads to the second consideration. Trade for export may increase significantly inequities in a local economy exacerbating per-existing tensions and further up-setting community orderings. While the discussion here is not a defence of the status quo, where such changes occur, at times a gradual approach may be less disruptive as communities have time to adapt.

Another social cost down-loaded on foreigners results not from the production impacts, but from the demand side, the retailing model. The social costs identified as USA bound in this article will likely occur but as amplified by the conditions found in the foreign context. For example, Wal-Mart’s damage will hit countries like Japan hard. Japan’s commercial sector is predominantly made up of small retailers.<sup>176</sup> Where Wal-Mart enters a market like the Japanese, severe dislocations of small retailers and the related social disruption should be anticipated. Again, the benefit of the foreign subsidiaries is directed to the USA parent,<sup>177</sup> leaving the disruption outward in the foreign context and the benefit inward in to the USA investors.<sup>178</sup>

It should not be considered that Wal-Mart will alter its business strategy as a result of these social costs to foreigners. Wal-Mart’s market saturation in the USA, has led it to

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<sup>175</sup> George Kent “Food Trade and Food Rights” (2001) 3 UN Chronicle On-line Edition, <http://www.un.org/Pubs/chronicle/2002/issue1/0102p27.html>

<sup>176</sup> 58% of retailers are small, family owned businesses. [Wal-Mart's Foray Into Japan Spurs A Retail Upheaval](#); *As Giant Confronts Barriers, Local Competitors Rush To Emulate Its Methods; Balking at the '10 Foot' Rule* Sept. 19, 2003 NY TIMES.

<sup>177</sup> That the parent – subsidiary relation is established to benefit the parent corporation should be uncontroversial.

<sup>178</sup> This comment is not that non-USA investors are not benefiting from the profits of Wal-Mart. Rather, that the majority of investors are USA institutional investors, whose clients are largely USA based corporations and other citizens.

plan to continue its strategy in other markets.<sup>179</sup> Thus it should be anticipated that these social costs will continue to be imposed on countries outside the USA.

In sum, the production of goods demanded by Wal-Mart forces overproduction with maximum social costs in poorer countries. This overproduction causes considerable environmental harm, social dislocation, sweatshops, and disruption in local market conditions. Further, the greater part of the benefit goes to the few wealthy in control of the production process and the USA consumer. The cost goes to the foreign country and the majority of its people.

g) Consumerism

Wal-Mart's approach of increasing by supplying goods in large or bulk size creates its own special set of problems. For example, Wal-Mart decided to use pickles to create an impression of incredibly cheap prices.<sup>180</sup> It pressured a supplier of high quality pickles—if you don't want to do this, we won't be able to do business with you any longer—to produce gallon<sup>181</sup> jars of pickles for less than \$3. The net result was a dramatic increase in sales at very low margins, increased demand on farmers and all pickle producers, undermining its high quality pickle market it had built up over the years, and eventually contributing to the supplier's bankruptcy. Perhaps worst of all, as an executive at the former pickle supplier observed: "They'd eat a quarter of a jar and throw the thing away when they got mouldy. A family just can't eat them fast enough."<sup>182</sup>

This problem—promoting over-consumption in a world of limited resources, currently reeling under the environmental costs of its consumption habits—is nothing short of moronic. Americans are the most over-weight people on the planet, spend more money per capita on diets, consume more goods per capita than anyone else on the planet, and Wal-Mart's strategy, effectively, is to promote further over-consumption by underpricing more goods. Basic economic theory indicates that when goods are under priced

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<sup>179</sup> Bianco supra n. 125.

<sup>180</sup> Story from Fishman, supra n. 114.

<sup>181</sup> Just under 4 litres.

<sup>182</sup> Fishman supra n. 114.

they are over consumed. We need look no further than Wal-Mart to see the truth of this principle. While Wal-Mart is not the creator of consumerism,<sup>183</sup> its dominance creates a large responsibility to inform consumers about the real costs. By under-pricing, Wal-Mart is misinforming the consumer encouraging over-consumption, and to do so in the planet's current state is nothing less than perverse.<sup>184</sup> Because of its market dominance, a strong argument can be made for it bearing considerable corporate responsibility to inform consumers about costs by pricing correctly.

#### h) Environmental Costs

The environmental costs imposed by Wal-Mart's model, alluded to above with respect to developing nations, are vast both abroad and in the USA.<sup>185</sup> Indeed they are certainly so extensive as to beyond the scope of this particular study. Therefore, only a single example will be examined. Consider, for example, the matters of packaging and transport. Wal-Mart requires extensive packaging of goods. Each individual item must be packaged, and wrapped, placed in boxes, placed on pallets each of which in turn are wrapped, shipped locally first and then often from overseas. Almost all packaging is discarded immediately by the consumer as it is largely without benefit, it is often made of plastics which are in turn made of limited and highly polluting petro-chemicals which

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<sup>183</sup> Thinking about this can be traced at least as far back as economist Thorstein Veblen who noted the efforts of the poor to imitate the consumption patterns of the rich. See David Korten, *When Corporations Rule the World*, 2<sup>nd</sup> ed. (2000) discussion on the creation of consumerism in Western culture. See also, STEVEN MILES, *CONSUMERISM: A WAY OF LIFE* (1998), and MATTHEW HILTON, *CONSUMERISM IN TWENTIETH-CENTURY BRITAIN: THE SEARCH FOR A HISTORICAL MOVEMENT* (2003). The idea that equates consumption with happiness comes from economic theory. The principle of unlimited growth being desirable from an economic perspective see discussion in Kysar, supra n. 2, 29-32. See discussion in Wolfenden, "Homo economicus: Fantastic fact or factual fantasy?" 1(2) *ETHOS-A JOURNAL OF GLOBAL ETHICS*. (1998) The dominance of economic discourse in public policy is becoming a common complaint. See, for example, Kysar, id. 66 and references therein.

<sup>184</sup> See discussion of ecological economics, which is an effort to integrate the seemingly obvious fact of limited planetary resources with economic theory, and the challenges faced in both that project and law and economics, in Kysar, n. 2.

<sup>185</sup> Consider, for example, the recently settled lawsuit *United States of America v. Wal-Mart Stores Inc., Western Builders Inc. et al*, filed in the Western District of Arkansas Fayetteville Division. While this externality has been caught by the Environmental Protection Agency and settled by a payment of a \$1.0 million fine as is accepted in regulatory law there are certainly many others not being caught. In this instance, the infraction resulted from Wal-Mart's failure to monitor its contractors in the construction of new stores. It is interesting to note that Plaintiff alleges in paragraph 8 of the complaint that Wal-Mart is opening between 100 and 200 new stores annually. Of the 17 infractions in the complaint, 9 give approximate sizes of the development. The average size of the development is 22 acres. If calculated at

require the use of other toxic chemicals which have their own environmental and human health costs. The costs for the manufacture of packaging is openly acknowledged not to include the true costs.<sup>186</sup>

Further, it can hardly be argued that the actual environmental costs of burning fossil fuels—creating greenhouse gases—for the transport over land is factored into the transportation costs of goods to market. Greenhouse gases already are costing hundreds of billions of dollars and are increasing exponentially.<sup>187</sup> Further, sea-going cargo is shipped on container vessels that burn the dirtiest fuel produced by refineries. An average vessel produces emissions that are equivalent to 350,000 automobiles.<sup>188</sup> These environmental costs are not factored into the costs simply because they are not charged to the vessel operators. The world's container fleet has increased five fold over the last twenty years with no world body effectively addressing these issues.<sup>189</sup> Of course, because the analysis in this study has been focused on Wal-Mart Stores, Inc. as a retail sales corporation, the vast majority of issues related to the manufacture, over-consumption, and disposal of consumed goods has not been addressed.

i) Wal-Mart's Position

Wal-Mart is not blind to criticism of social costs or the idea of the good corporate citizen. As it states on its website:

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the minimum of 100 stores, Wal-Mart's expansion amounts to 2,200 acres per year.

<http://www.epa.gov/compliance/resources/cases/civil/cwa/walmart.html>

<sup>186</sup> Even the simple disposal problem associated with packaging has not been adequately resolved, let alone the pollution caused in its production. Efforts to deal with this are most advanced in the EU with its Producer Responsibility legislation. Directive 85/339/EEC. Updated report Commission Of The European Communities, "Proposal For A Directive Of The European Parliament And Of The Council amending Directive 94/62/EC on packaging and packaging waste." Brussels, 07.12.2001, COM(2001) 729 final, 2001/0291 (COD) available at [http://europa.eu.int/eur-lex/en/com/pdf/2001/com2001\\_0729en01.pdf](http://europa.eu.int/eur-lex/en/com/pdf/2001/com2001_0729en01.pdf)

<sup>187</sup> These costs are the reason that the insurance industry has begun lobbying for action against global warming. Sharon Beder notes that Reinsurers Association of America claims "insurers paid \$57 billion for weather-related losses in the first half of the 1990s compared with \$17 billion for the whole of the previous decade. Sharon Beder, 'Insurers Sweat Over Global Warming', (August 2001) *Engineers Australia*, 41.

<sup>188</sup> Russell Long "Where There's Smoke, There's Pollution," February 21, 2004, NEW YORK TIMES.

<sup>189</sup> The International Maritime Organization, the UN's body for marine environmental pollution has yet to consider emissions as a treaty item. Its problems in creating treaties that are effective in controlling marine environment pollution are great. See discussion in Benedict Sheehy, "Does International Marine Environment Law Work? An Examination of the Cartagena Convention for The Wider Caribbean Region." (Forthcoming) 12(3) GEORGETOWN INTERNATIONAL ENVIRONMENTAL LAW REVIEW.

Wal-Mart Stores, Inc. believes each Wal-Mart store, SAM'S CLUB and distribution center has a responsibility to contribute to the well being of the local community. Our more than 3,400 locations contributed more than \$150 million to support communities and local non-profit organizations.<sup>190</sup>

It goes on to describe how the funds are allocated and various recognitions it has received for its contributions. Do these contributions fulfill its social responsibility, or compensate fully the community for social costs? Lee Scott, the President and CEO offers "Wal-Mart paid \$4 billion in U.S. federal income taxes in fiscal year 2004" which he sees as another measure of the corporation's contribution to society.<sup>191</sup> But it is difficult to see why avoiding criminal sanctions for not paying taxes should be seen as contributing to society. Further, it must be remembered that the tax bill is the absolute minimum that the corporation could be forced to pay, having been prepared by the most competent and aggressive tax specialists Wal-Mart could buy.

Business ethicists, who see corporate activity as falling into their domain, note six areas which can be considered as corporate social costs. They note the effect on the community, representation of minorities and women, how corporations treat their employees, environmental protection, foreign stakeholders, and customers.<sup>192</sup> Interestingly, in the last five years that Business Ethics Magazine has been auditing and compiling lists, Wal-Mart despite being the number one corporation in the world in terms of size, it has never been listed among the 100 most ethical corporations even in the USA. In other words, it has not matched its size achievement in terms of internalizing its correlative social costs.<sup>193</sup>

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<sup>190</sup> [www.Wal-Mart.com http://www.Wal-Martstores.com/wmstore/wmstores/Mainnews.jsp?BV\\_SessionID=@@@@2067494055.1084159707@@@&BV\\_EngineID=ccchadcldkemelcfcfcfkjdgoodglh.0&pagetype=news&categoryOID=-8771&catID=-8248&template=DisplayAllContents.jsp](http://www.Wal-Martstores.com/wmstore/wmstores/Mainnews.jsp?BV_SessionID=@@@@2067494055.1084159707@@@&BV_EngineID=ccchadcldkemelcfcfcfkjdgoodglh.0&pagetype=news&categoryOID=-8771&catID=-8248&template=DisplayAllContents.jsp)

<sup>191</sup> "It's my Wal-Mart" 2004 Annual Report.

<sup>192</sup> See [www.business-ethics.com](http://www.business-ethics.com)

<sup>193</sup> "100 Best Corporate Citizens," BUSINESS ETHICS MAGAZINE, 2004. For an interesting recent development, see the International Standards Organization's initial work on corporate Social Responsibility. *Working Report on Social Responsibility, April 30, 2004.*

All of the forgoing leads to the question of the causes or nature of the problem. Clearly, one cause is the information asymmetry. As noted above, in the pickle sales example, the goods were being sold at a price that was “incredible.” It is incredible: literally it is not credible to sell goods at that price, because as we have seen, the actual price is considerably higher. Quite simply, the price did not factor in all the costs. The information was not passed on to the people. Where people have the information, there is evidence to suggest that people prefer not to have those consequences.<sup>194</sup>

Another aspect to the problem is the focus on wealth creation and in particular, profit making. Where profit is the sole objective, other abilities, such as broader community cooperation is diminished or lost.

## 7) CORPORATE VEHICLE AND SOCIAL COSTS

Wal-Mart is not culpable in either business terms, nor except as identified in the actual, pending and potential lawsuits, in legal terms.<sup>195</sup> Further, it is a darling of the stock market.<sup>196</sup> The question is whether this matter of social costs is a problem resulting from the corporate form or merely a matter unique to the mega-retail discount giants? If it is the latter, then it is simply matter of regulation concerning the size of retailers. If it is the former, it requires further consideration and analysis.

The corporation’s role in this situation is not self-evident. If one accepts the corporation as a mere nexus-of-contracts, one can escape from the reality of Wal-Mart’s damage

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[http://www.iso.org/iso/en/info/Conferences/SRConference/pdf/Working%20Report%20on%20SR\(Apr30\).pdf](http://www.iso.org/iso/en/info/Conferences/SRConference/pdf/Working%20Report%20on%20SR(Apr30).pdf)

<sup>194</sup> There is a considerable consumer and social lobby against Wal-Mart because of the damage it causes to society. This consumer reaction and the damage caused to communities by Wal-Mart is noted by Stiglitz, supra, n. 3, 68. See for example, anti-trust lawyer, A. Person’s website, and Al Norman’s work. Further work is being done in Australia as the damage of big-boxes is becoming known. A search of google.com produced 1,690 hits for “stop Wal-Mart.” No activist groups attempting to bring Wal-Mart to localities were found but many opposing it. On the law and economics perspective of the consumer-merchant information asymmetry and views of regulatory intervention, see Bailey Kuklin “*Self-Paternalism in the Marketplace*” 60 U. CIN. L. REV. 649 (1992).

<sup>195</sup> Concerns about the legality of its monopolist business strategies and anti-union activities are noted by U.S.A. lawyer, A. Person on his website [www.lawmall.com](http://www.lawmall.com)

around the world, simply claiming as Easterbrook and Fischel would have it, that it was all voluntary and therefore not in need of any regulation.<sup>197</sup> If one chooses, however, to acknowledge the reality of the widely disseminated detriment caused to the socio-economic landscapes in the developed nations and in the third world, which additionally bears the social costs—namely, the harsh reality faced by the workers in the sweatshops and the environmental damage created, one can see a very significant role caused by corporations.

The corporate structure serves as a vehicle for raising funds and coordinating production. By shielding its participants, investors, directors and other controllers alike from the consequences of their actions—in this case, their social costs—the corporation makes it much easier to engage in activities that on a personal level one would find unacceptable.<sup>198</sup>

The corporate form permits and encourages the concentration of wealth and power—in Easterbrook and Fischel’s terms: “[it is] the firm’s strength (its tendency to maximize wealth).”<sup>199</sup> It enables corporate controllers and investors to exploit the weaknesses of the market for their own advantage, as Easterbrook and Fischel implicitly acknowledge in their statement: “The task is to establish property rights so that the firm treats the social costs as private ones, and so that its reactions, as managers try to maximize profits given these new costs.”<sup>200</sup> The weaknesses of the market susceptible to exploitation are those market failures, noted above, information asymmetry and externalities, which permit the corporation to benefit without being able to force the corporation to bear the costs. By creating an entity that is focused exclusively on finance and wealth generation without concern for the other consequences of its activities, law has created an entity that will maximize its use of externalities for which it has no liability, in order to maximize its

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<sup>196</sup> On a scale of 1-5, with 1 being a strong buy recommendation, a sampling of analysts give it a 2. See analysis on Yahoo Finance pages. <http://finance.yahoo.com/q/ao?s=WMT>

<sup>197</sup> Although society does not condone, or law permit all voluntary transactions. This is the concept of inalienability in Calabresi & Melamed’s theory of property.

<sup>198</sup> This is the problem of role specific ethics and discussed in the ethics literature surrounding corporate failures and white collar crime.

<sup>199</sup> Supra n. 90 at 30.

<sup>200</sup> Id at 39.

internal profits and wealth creation. In the Wal-Mart case study, the strategy of employing the greatest number of part-time employees without benefits, anti-unionism, imposition of social costs on China all work to increase profits. These strategies are implementations of the incentive scheme facilitated by the corporate form.

The corporation facilitates this minimization or externalizing of costs by offering a legal shield to insiders—the beneficiaries of the corporate form—from the true costs of the activities from which they intend to profit. In a worst case scenario from the perspective of insiders, a corporate bankruptcy, neither directors nor officers, nor shareholders, nor creditors, nor employees will be liable for all the costs created by the corporation where the corporation has acted in accordance with the law regardless of the quantity or quality of those costs. In such a worst-case scenario, the corporation acts as a shield and all that is lost are its assets and share value.

A worst case scenario from the perspective of outsiders, those bearing the social costs, is not by any means a corporate collapse.<sup>201</sup> A corporation which continues to operate, destroying the environment, poisoning employees, undermining societies is certainly the worst. In other words, the worst case scenario for society is the opposite of a corporate collapse-corporate survival.

Furthermore, given the incentive structure in the market, being tied exclusively to profits, there is no incentive to internalize any costs. In what can only be described as a perversion of social good, corporate incentives are the exact opposite. To the extent that a director, officer or manager can externalize a cost and so increase profits, there is a reward for doing so. Thus with the combination of a structure providing a shield from consequences and an incentive structure for externalizing negative consequences it cannot but be supposed that corporations will act in exactly the manner of Wal-Mart.

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<sup>201</sup> The media attention to corporate collapse cause many to infer that such an event is a worst case scenario. While a large corporate collapse causes disruption to the economy and to the lives of employees and suppliers, certainly some of the externalities discussed in this paper are greater concerns.

Further, with its power over the market and control of information, the corporation will exploit the information asymmetry between it and other market participants. The corporation is not required to disclose much about the majority of its activities, and as seen in the case of Wal-Mart, will tend to be intensely secretive about many of its activities.<sup>202</sup> It does not want competitors to utilize the information to its disadvantage. More importantly, the corporate form will continue to facilitate profit making when people do not understand the consequences of its activities. Again, the corporate structure and the incentives discussed above are designed to support this approach. This strategy has been employed by big tobacco, automobile manufacturers, and oil companies. It is as if these latter lessons have not been learned by society; instead society has accepted continued corporate harm merely instituting a non-smoking campaign while corporations increase the toxicity of tobacco, accepting automobiles as status symbols instead of transportation while automobile corporations manufacture more dangerous and environmentally damaging vehicles (SUV's, sport Utility Vehicles), and accepting increased greenhouse emissions as petroleum corporations join in the promotion of increased burning of fossil fuels by supporting vehicle manufacturers campaigns for larger vehicles.<sup>203</sup>

To address the information asymmetry, some scholars have begun advocating triple bottom line accounting. Whereas the corporate focus on economic results has led to exclusive focus on financial reporting, this approach to accounting requires corporations to provide information on social costs not just monetary profits. While this may well be a step in the right direction, unless there is a dramatic reform in the economic structure of the corporation tying such measures to profit they are unlikely to have much effect.<sup>204</sup> Furthermore, given the incomplete nature of markets, it will never be possible to account for all costs in a market regime. Accordingly, for those committed to both a market economy and accounting for social costs, another mechanism needs to be developed for attaching cost to benefit, and deducting the former from the latter for purposes of

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<sup>202</sup> Fishman supra n. 114.

<sup>203</sup> See the connection between the automobile, petroleum industries and related safety matters in Gregg Easterbrook "The 50-Cent-a-Gallon Solution" 25 May 2004 THE NEW YORK TIMES.

accurately stating the position of the corporation. As Coase would say, “choosing... arrangements we should have regards for the total effect.”<sup>205</sup> Where such an accounting has been done, it has led to the conclusion that current economic activity, contrary to the supposed benefit indicated by ever increasing GDP figures, is in fact a net loss to life on the planet.<sup>206</sup>

Another effort to address corporate social costs has been reflected through the Corporate Social Responsibility movement. This movement’s advocates promote triple-bottom line accounting, corporate governance and higher levels of personal responsibility. This recommendation of increased liability where property rights are inappropriate or ineffective, is in accord with the recommendations of law and economics scholars.<sup>207</sup> One example, of this increased liability, it may be argued is the recent Sarbanes-Oxley legislation, which places the onus on corporate insiders to support the figures presented to the public, is an effort of just such a sort. The problem with this approach is one not unique to the problem of social costs or corporate law: it is a problem with law in general. Law tends to be post facto, fixing things after they have gone wrong. So, where a corporate insider chooses to support a false statement, such falsehood may not be discovered until it is too late (as in the case of Enron) and the insider has disappeared with the profits, or destroyed some aspect of the environment, or created some other social cost.

While the benevolent view of the market advocated by Adam Smith may have been appropriate for his day of small entrepreneurs and minimal obvious social costs, the environmental and social carnage caused by a single corporation like Wal-Mart is beyond anything he could have imagined, let alone advocated.<sup>208</sup> With our increased understanding of the ecology of the planet and the forces in society, it is inappropriate to continue to permit corporations with their current structural immunities and perverse

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<sup>204</sup> Efforts of ethical investment funds or Socially Responsible Investing are an exception, but the size, coordination and influence of these institutional investors is not known.

<sup>205</sup> See supra n. 82.

<sup>206</sup> See Kysar, supra, n. 2.

<sup>207</sup> Guido Calabresi and A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 1090 HARVARD L. REV., April 1972.

incentive structures to destroy the very thing we humans value most: a thriving society in a clean environment.

## 8) CONCLUSION

Sociologist Sharon Zukin has identified the broad-based negative effect of big-box stores. She opines:

I think stores like Wal-Mart are bad for the world... and bad for the local communities, because they suck up the buying power without creating the dynamism for local economies to grow.... Local economies grow on the basis of new products, growth in production, growth in jobs and lots of local merchants. But with one store you just don't get that.<sup>209</sup>

Her view, which summarizes much of the argument in this article, would lead to the conclusion that the social costs are overtaking the utility of the neo-classical law and economics model of the corporation.

To a certain extent, the issue is a coordination problem—the particular type of problem that faces parties when more than a single value is involved. This type of situation, as demonstrated above, is not susceptible to a Coasean analysis. It requires collective action, governmental intervention, and where governments have been co-opted by corporations, some type of change in corporate legislation to address the issue.

One aspect or cause of coordination problems are the concerns that parties bring to their everyday concerns and work. As Stiglitz, the former chief economist for the World Bank observes: “The typical central bank governor begins his day worrying about inflation statistics, not poverty statistics; the trade minister worries about export numbers, not pollution indices.”<sup>210</sup> In other words, humans tend to focus on the matters under their

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<sup>208</sup> As Stiglitz observes, Smith himself was aware of market failures. *Supra* n. 3, 219.

<sup>209</sup> Zukin, *supra* n. 125.

<sup>210</sup> 216.

immediate control without worrying or making efforts to coordinate their efforts with others. This natural tendency is particularly worrisome where it effects people at the centres of power, such as the governors of central banks failing to coordinate with others in similarly located centres of power, let alone ignoring the ecology which sustains human life and the economy in the first place. Yet if social costs are not successfully addressed because of a failure to resolve the coordination problem, the world will become a much more difficult place to inhabit, at least for the human species. Ironically, the corporate structure, which is such a significant creator of social costs, facilitates coordination within itself. It is able to do so because of its single focus on profits and so suffers to a much lesser degree the coordination problem. The corporation's strength in this regard may yet be helpful in solving the problem of social costs where it could be turned to that end.

Regardless, these problems of coordination and dramatically increasing social costs, it may make sense to look at corporate law reform. Such reform should follow on our experience with business, where corporate directors have been granted power on the basis of financial performance, perhaps directorships of the other important social costs should be developed. An empowered, informed, incentivized, and accountable director of ecology, for example, sitting on the board of directors, or a similarly created directorship of labour<sup>211</sup> could potentially reduce significantly the related social costs resulting from a corporation's profit making activities.

A law and economics approach provides two directives: normatively, that the social costs of the corporate vehicle must be internalized and positively: that rational self-interested actors will act only according to their knowledge. Where that knowledge includes social costs, and where the incentive structure is appropriate, a more effective means of internalizing externalities and hence minimizing these social costs will lead to appropriate pricing.<sup>212</sup> Appropriate pricing permits the market to appreciate the costs associated with actions and preferences, and so to make better choices concerning the

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<sup>211</sup> Such as is found in the GmbH in Germany.

<sup>212</sup> Some suggestions are canvassed in my "*The Importance of Corporate Models*" supra n. 18.

allocation and use of the planet's resources. This approach to addressing the market failure caused by information asymmetry and the corporation's concerted effort to exploit consumer ignorance is certainly not an easy agenda; however, given the consequences of failure to address the issues, continuing current practices is simply not an option.

The larger question of this article has been: How well does the Law and Economics contractarian model describe the corporate activity and deal with social costs? Our answer is clearly, not well at all. This suggests further research and the possibility that working with a concessionaire model may yet be a more successful manner for addressing the increasingly grave social costs created by corporate activity.

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