crimination as competition policy problems that, in an international trade context, provoke tension between the pursuit of competition and the industrial policy temptations that motivate individual nations. The issue in each case is whether the traditional structures and practices with which antitrust is concerned can occur on an international scale. The answer of course is yes; indeed, such concerns can arise on an international scale even when they do not raise domestic concern, as in the case of export cartels formed by members of a competitive domestic industry. Scherer's point is that it simply makes no sense to have an integrated world economy without a central world competition policy, just as it would make little sense to have no antitrust enforcement in the United States except that practiced by the 50 states themselves.

Indeed, Scherer points out the powerful analogy with the formation of the world's first continental-scale common market, created by the American states under the Constitution of 1789. Arguments promoting the benefits of free trade and world-level competition policy seem much less controversial when projected against the backdrop of free trade among the states than when viewed through the lens of nationalism.

Throughout the book Scherer takes his examples chiefly from the experience of the U.S., Japan, German, and Great Britain, and the EEC. He does not attempt to deal in any depth with the competition and trade policies erumpent in Eastern Europe, and he ignores entirely the worldwide trend among developing nations to privatize state monopolies and to adopt antitrust laws. In the latter case, there is an important nexus with international trade in that (for tradable goods and services) freer trade would often serve the interests of consumers better than attempts at antitrust enforcement.

Chapter 5 contains Scherer's policy proposals, which are concerned chiefly with the establishment and gradual empowerment of an international antitrust enforcement agency within the World Trade Organization (formerly the GATT structure) in Geneva. Although contorted and timid in an effort to achieve political feasibility, these naive proposals rest on the belief that effective international antitrust enforcement can be achieved through gradual (over seven years) strengthening of the jurisdiction and power of an arm of the World Trade Organization. Scherer would create a new International Competition Policy Office (ICPO) within the WTO. Individual countries would be required to assist the ICPO in gathering information about and enforcing sanctions against, for example, unregistered international cartels.

In my view Scherer is unduly optimistic. The prospects for an effective international antitrust agency are about the same as for an effective international standing army. This is not 1789; countries do jealously guard their sovereignties. Scherer's own description of the effort to integrate competition policies within the EEC illustrates the difficulties. And even if nations could agree to adopt an international competition policy, a policy they could agree on is unlikely to do consumers much good. Proponents of industrial policy have behind them powerful economic interests seeking protection from competition. Proponents of free trade find support among the economic interests that would gain from increased exports. But with the possible exception of antitrust lawyers, there is no significant economic interest group in favor of antitrust enforcement.

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Strong managers, weak owners: The political roots of American corporate finance. By MARK J. ROE. Princeton, N.J.: Princeton University Press, 1994. Pp. xvi, 324. $24.95. ISBN 0-691-03683-7. *JEL 95-0549*

Where do economic institutions come from? One view is that they are the result of natural economic evolution; if a more efficient allocation is possible then the economic institution to implement it will somehow arise. Mark Roe forcefully presents an alternative view. The operation and structure of institutions is determined by laws which are the outcome of a political process. Thus political factors can play a crucial role in determining a country's institutions. Roe uses the

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significant differences between financial institutions in the U.S. compared to Germany and Japan and the effect this has had on the governance structure of corporations to illustrate his thesis.

In their seminal book *The Modern Corporation and Private Property*, Berle and Means pointed out that there was a separation of ownership and control. In theory, managers had a fiduciary duty to serve shareholders' interests. However, the size and scope of twentieth century corporations and the large number of shareholders this typically led to meant that in practice managers had a great deal of autonomy. Roe suggests that this separation between ownership and control was not a result of natural economic evolution but rather a deliberate political choice by the U.S. to have weak financial intermediaries which were prevented from playing an active role in corporate governance. In contrast, in Germany and Japan, financial institutions were allowed to develop in a very different direction. In particular, they could hold significant amounts of firms' equity and were able to provide an effective counterweight to strong managers and ensure that shareholders' interests were pursued.

Having contrasted the economic and political paradigms for the development of institutions, the book explains the historical development of U.S. financial institutions. There has been a long political tradition in the U.S. of eliminating concentrations of financial power. In a report on the Second Bank of the United States, John Quincy Adams wrote "Power for good, is power for evil, even in the hands of Omnipotence" (Timberlake 1978, p. 39). Andrew Jackson vetoed the renewal of the bank's charter in 1832 and this veto was not overturned. Throughout the nineteenth century the U.S. banking system was highly fragmented and unlike every other industrializing country the U.S. failed to develop large banks with extensive branch networks. This was largely due to the political influence of the numerous small banks which feared they would be put out of business if forced to compete with large banks. The National Bank Act of 1864 granted limited powers to banks and was interpreted as confining each to a single location. When the question of whether banks could hold equity arose, the Supreme Court ruled that because the Act had not specifically granted this right they could not. In the twentieth century the political influence of small banks again prevented the development of a nationwide banking system which could play a strong corporate governance role. In particular, the Glass-Steagall Act made explicit the prohibition against banks holding equity.

The other institutions which could potentially have developed a large equity stake in a firm and offset the power of its managers were insurance companies, pension funds, and mutual funds. Insurance companies were prevented from holding equity after a scandal in 1905 led to the Armstrong investigations by the New York state legislature. The purpose of this restriction was to prevent insurance companies from gaining too much power and influence. It effectively amounted to a nationwide ban as New York state insurance law was very influential in the industry. The desirability of diversifying holdings led the 1940 Investment Act to restrict the proportion of a firm's equity that a mutual fund could hold. Also the desirability of prohibiting insider dealings led to regulations which made it undesirable for mutual funds to become involved in corporate governance. Roe argues that although pension funds could potentially play an important corporate governance role, the fact that firms' pension funds are controlled by their managers means they are reluctant to do this. Any firm's fund that interfered in another firm's affairs could expect that its own affairs might be subject to the same type of interference.

Roe points to the development of banks and other financial institutions in Germany and Japan as evidence of how differently things could be in the U.S. In these countries political influences were different and banks and other institutions have been allowed to concentrate equity holdings and play a significant role in disciplining managers. The separation of ownership and control is arguably much less important.

The final part of the book asks the question how the U.S. should reform its current system in the light of the analysis presented. Roe suggests that the choice between a U.S.

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style system and a German or Japanese style system is not of first order importance. In recent decades, German and Japanese corporations did exceptionally well while U.S. corporations stagnated. This has not always been the case and the reverse has often been true in the past. The author does think that a more flexible system in the U.S. which allowed both systems to coexist would provide useful information because a horse race between the two would allow us to determine which type of system is superior in particular circumstances.

Roe's case is persuasive but not overwhelmingly so. The U.K. presents an interesting contrast to the U.S. It has a similar separation of ownership and control in corporations but very different financial institutions. In particular, the banking system is concentrated and although the Bank of England has wide powers of intervention there are no explicit restrictions on the activities that banks may undertake. Insurance companies have also not been barred from playing an important governance role but have not. Some of these issues are addressed briefly but, for the thesis that political factors are of primary importance to be completely convincing, more is needed. After all, the political nature of the U.K. situation is very different yet the separation of ownership and control seems to be similar to the U.S. If it is historic traditions and customs in the U.K. that led to the separation of ownership and control why could it not be the same factors in the U.S.?

This criticism is beside the point, however. The major contribution of Roe's book is the question it asks and the style in which it is answered. He does establish that the view that economic institutions arise from natural economic evolution is incomplete and that politics plays an important role. As a student learning traditional neoclassical economics I always found it difficult to grasp precisely what the difference between economics and political economy was. Roe's analysis provides a good example. In conclusion, I think the book will be very influential and deservedly so.

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Economic politics: The costs of democracy. By WILLIAM R. KEECH. New York: Cambridge University Press, 1994. 236 p. $49.95. ISBN 0-521-46206-1.

This book presents an interesting analysis of macroeconomic policy making in democratic political regimes. The costs of democracy referred to in the title are the potential political inefficiencies in macro policy-making deriving from the existence of representative democracy where the relation between voters and politicians takes the form of a principal-agent problem. The book is a good survey of a large body of literature studying the relations between political institutions and macroeconomic policy making and performance. Does democracy lead to inefficiency in macro policy or to extreme, pathological macroeconomic outcomes? Or are there mechanisms that guarantee that these costs of democracy are minimized? In answering these questions, the author concentrates on the institutions and the empirical evidence on the United States.

The author starts in Chapter 2 with a survey of the alternative macroeconomic approaches and stresses the fact that there is no consensus paradigm about the right macro theory and the economic effects of monetary and fiscal policy. Next, he considers, in Chapters 3 and 4, the two leading models of how politics might affect macroeconomic policy: the political business cycle approach and the partisan approach. According to the first model, politicians are opportunistic and are just concerned about maximizing their probability of re-election; therefore, they will try to manipulate monetary and fiscal policy before elections to stimulate the economy so as to maximize their chances of re- election. In the partisan view, politicians are ideological, represent different constituencies, and follow macro policies consistent with their ideological priors. So, relatively left-wing (right-wing)

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