CHAPTER 3

The Decentralizing Revolution, 1968–1989

Totalitarianism and centralization reached their apogee during World War II (1939–1945), but the tide turned with the German and Japanese defeats. As empires dismantled, the number of independent states increased and international trade recovered at the instigation of the United States and the GATT. Economic growth picked up worldwide, at least in the countries where industry was already quite developed before 1929. Gradually, as the state and regulatory bodies weakened, domestic markets gained more freedom and the number of democracies increased worldwide.

Undeniably, during the post-war period, states experienced their strongest internal growth due to the development of the welfare state and the associated tax system. But, this internal expansion of states did not challenge the trend towards market liberalization.

The main heritage of the previous period of triumphant totalitarianism remained the consolidation of the USSR as a big power. It had traded its participation to the victory of allied democracies for the expansion of its Euro-Asian empire which, at its maximal reach, covered almost half the world, including its satellites and allies. The conflict between the Allies and the Axis Powers thus gave way to the cold war.

As a consequence, the second twentieth century only really began with the implosion of the Soviet Union and the collapse of communism which marked the sudden and "mysterious triumph of capitalism"[1] over its last surviving opponent since 1917: centralizing socialism.

But everything had begun some twenty years earlier when other shocks had suggested that the world was at the dawn of a new era. 1973 marked the end of the golden age of the post-war economic recovery. The fourfold rise in oil prices decided by the OPEC, the international cartel of oil-producing countries, and the tenfold increase of 1979 that interrupted temporarily the secular downtrend in oil prices, affected severely the economies of oil-importing countries, especially Europe and Japan, which slid into stagflation. This began our era of economic weakness but also of technological and organizational upheavals: it was a time of accelerating opening of national economies thanks to advances in communications and information techniques, of changes in economic policy conceptions, of liberalization and deregulation, of privatizations and break-up of conglomerates.

The last years of the twentieth century saw a clear reversal of all the trends established between 1873 and 1960. These new directions were almost the exact opposite, the inverted reflection, of all those that defined the first twentieth century: de-concentration and disintegration of existing companies, decrease in their average size, dismemberment of heterogeneous states and proliferation of small states, collapse of the last empires, replacement of totalitarian regimes by democracies and development of individualist and anarchist trends supplanting Communist and Fascist mass ideologies, increased control over company managers by owners/stockholders and over state leaders by voters/taxpayers in place of corporatism and dirigisme, economic

1. This expression was first used by Paul Krugman in "Capitalism's Mysterious Triumph," *Nihon Keizai Shimbun*, 1998.

opening to the outside world and tougher competition in lieu of state protectionism and collusion. The international monetary order of fixed and managed exchange rates conceived in Bretton Woods in 1944 collapses, unable to resist the growing trade of goods and services and the international liberalization of capital flows, and is soon replaced by floating currencies.

This announced the return of international markets and a global economy. From that point of view, the world is as open and cosmopolitan in 1999 as in 1890 or 1913. For instance, the ratio of merchandise trade to GDP fell from 15.5 percent in 1913 to 9.9 percent in 1960 before bouncing back to 16.7 percent in 1980 and 17.1 percent in 1990. At the same dates, this ratio was 19.9, 14.5, 21.6 and 24 percent in Germany, 14.4, 10.0, 19.3 and 15.9 percent in Italy, 29.8, 15.3, 20.3 and 20.6 percent in the United Kingdom and finally 6.1, 3.4, 8.8, 8.0 percent in the United States.[2]

The dates of all the deep transformations mentioned above are centered around the early 1970s. Given the extent of the changes that they saw, the two decades that followed the trend reversal of 1973 can only be compared to the 1873–1914 period which was marked by the centralizing revolution and the collapse of the economic, social, intellectual and political universe of the nineteenth century.

The evolution of the second twentieth century is the exact opposite of the first. It consists of widespread decentralization and the dismemberment, the fragmentation, of the largest public and private organizations. These transformations directly affect both the firms and the states, thus inverting the secular race for expansion of the size of hierarchies. These changes in the organization of the political and economic relations also modify profoundly the individuals' position in the society, in terms of their relations with both other individuals and the state. It is a decentralizing, democratic, individualist revolution.

2. Robert C. Feenstra, "Integration of Trade and Disintegration of Production in the Global Economy," *Journal of Economic Perspectives*, Autumn 1998.

Already announced in the late 1960s by the success of the anarchist and libertarian ideologies then considered as a consequence of the spectacular baby boom of the post-war period and a logical but turbulent reaction of the young generations attracted—and paradoxically frustrated—by the general increase in wealth, it had in fact much deeper and solid roots.

Underlying technological factors combined to form what some historians and economists call "the third industrial revolution." This revolution relies on the new phenomenon of creative disintegration, explains the striking comeback of the individualist civilization and offers new growth prospects. From an organizational standpoint, the world has taken a quantum leap backward to the pre-1873 era, to the liberal nineteenth century.

THE THIRD INDUSTRIAL REVOLUTION

The revolution that began in the 1960s is in some respects the perfect reflection of that of the 1880s as the mergers and restructurings that it generates make the headlines and worry public opinion. But this is only the tip of the iceberg, the tree that hides the forest. The underlying movements in organizational structures are the exact opposite of what the most spectacular mergers suggest. In fact, they only concern very few companies in specific sectors that have reached their maturity through revolutionary technical advances in other areas of the economy and that are now faced with overcapacity.

Indeed, statistics show that there is a faster increase in the number of small- and medium-sized companies. Instead of inducing multinational gigantism, the Third Industrial Revolution has resulted both in market globalization and a decrease in companies' average size. It is the revolution of small-scale organizations, contrary to what many of our contemporaries believe, as they only follow this trend from a distance in the press and on television.

The Misinterpretation of Mergers

The best analysis on this issue has been made by Michael Jensen, one of the top specialists in the theory of the firm and finance, and a Harvard Business School professor. As was the case during the previous revolutions, a number of ancient activities and companies were made obsolete overnight by technological advances. As the demand for their products and services has declined, they have ended up with much greater production capacities than the markets could absorb. Some of these companies thus had to disinvest or disappear to reduce the overall production potential either through restructuring or through bankruptcy.

But this is only the destructive side of the revolution. The creative side materializes in a burgeoning of new firms, generally small-sized, and shows stunning growth rates.

As Jensen wrote:

> Since 1973 technological, political, regulatory, and economic forces have been changing the worldwide economy in a fashion comparable to the changes experienced during the nineteenth century Industrial Revolution. As in the nineteenth century, we are experiencing declining costs, increasing average (but decreasing marginal) productivity of labor, reduced growth rates of labor income, excess capacity, and the requirement for downsizing and exit. The last two decades indicate corporate internal control systems have failed to deal effectively with these changes, especially slow growth and the requirement for exit. The next several decades pose a major challenge for Western firms and political systems as these forces continue to work their way through the worldwide economy.[3]

And indeed, with the obsolescence of many sectors and big companies, their leaders are faced with a major challenge: switching from expansionary policies and market share conquest to capacity-reducing

3. Michael C. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *Journal of Finance*, July 1993.

policies, disinvestments and eventually the redeployment of workers and capital into other activities. These strategies are neither thrilling nor rewarding. As big companies' internal management mechanisms—and the behavior they generate—do not easily lend themselves to such an exercise, resistance is strong. One of the ways to reduce production capacities is for the top company in a sector to buy the others and replace their leaders to accelerate the reduction in production, investment and labor volumes.

Technical advances give birth to new industries and lead to the creation of new companies, but paradoxically they also result in mergers in traditional sectors in order to make their collapse less harmful than with plain bankruptcies. As these long-established firms have experienced several years of strong growth and intense expansion, their restructuring is not aimed at making them even bigger but rather removing excess labor and capital resources that are now necessary to the growth of the new activities.

New technologies always generate overcapacity and unavoidable restructurings in the most ancient activities; they do not necessarily increase the ideal size of a company. Technical advances can be of many types: some require big companies while others are most adapted to low production volumes and small workforces.

There is no economic law suggesting that technical advances must always increase the optimal size of a company. And although this ideal or average size tended to grow during the first twentieth century, there is no reason why it should do so today or in the future.

As a consequence, although technological revolutions are always accompanied by waves of restructuring, they can equally result in an increase or a decrease in firms' size depending on the circumstances and the type of innovation. People tend to focus on the mergers induced by the revolution and believe that they necessarily lead to a larger size of all the organizations because the media themselves focus the attention on the largest and thus oldest firms—those precisely that needed to change their strategy and reduce their capacity and the

scope of their activities. We keep in mind also the evolution of the Second Industrial Revolution of the 1880s and 1890s, which resulted in the formation of giant corporations. If we combine these two phenomena—the current wave and the memory of the past one—it seems that we are facing a new era of gigantism. But this is wrong as the Third Industrial Revolution is one of disintegration and contraction of firms' size.

The crisis of the 1970s saw the development of many new technologies which added to the existing technical advances such as radial tires, aluminum and plastic wrappings, fiber optics, personal computers, communication satellites, digital techniques for the transmission of sound and images, enhanced telecommunications capacities with new data compression methods, and cellular phones, among many others.

These innovations were accompanied by organizational transformations in companies, reducing the economic advantage that big units with large workforces benefited from. On the contrary, they favored the decentralization of small units thanks partly to more efficient and lower cost telecommunications. This also favored the development of more adaptive "just-in-time" production techniques, "virtual" companies and various forms of sub-contracting. Large-scale hierarchical bureaucracies based on the early-century military model lost their advantage to smaller and more mobile units.

At the same time, the opening of international trade and the progress in a certain number of developing countries increased substantially the world supply of more traditional products generally using poorly-qualified workers. Once again, the eldest companies tended to be the first to migrate towards low labor-cost locations, and this movement accelerated with the collapse of the autarkic communist systems and their inclusion into world markets.

This resulted in a sharp increase in labor productivity and widespread overcapacity in traditional businesses. Excess capacity has four major causes.

First, these technological advances increase substantially the production capacities for a certain capital stock and a given organization. Thus, the power of microprocessors has been growing to such as extent that, with no increase in the quantities demanded, this change implies that excess production capacities must fall by about 90 percent. Logically, prices decrease to stimulate demand, but this is not enough to reduce this new surplus.

Second, technical advances generate overcapacity indirectly by making obsolete traditional goods and services. This is why Wal-Mart spells death for old-line department stores, just like Promodès and Carrefour do with non-specialized convenience stores.

Third, competitive intensity encourages all producers to equip themselves with new technologies, which prompts overinvestment that will only leave very few of them surviving at the end of the process. But none of them could accept to lose this competitive race without even having run it. Otherwise, they would not be entrepreneurs. A good example of this is the Winchester hard disk drive industry. Between 1977 and 1984, venture capitalists invested over $400 million in 43 of these hard disk producers and initial public offerings of common stock infused additional capital in excess of $800 million. In mid-1983, the capital markets assigned a value of no less than $5.4 billion to these companies. Yet, by the end of 1984, this amount had plummeted to $1.4 billion as market openings had been limited by new technical advances in the meantime. Investors and entrepreneurs had been lured by incompatible and unrealistic growth forecasts. The only solution left was to reduce the capacity surpluses accumulated during the period of euphoria.

Fourth, as was the case in the merger wave of 1890–1905, the economic outlook accelerates the ongoing trend. Recessions or economic crisis intensify the movement resulting from technical advances:

> Sharp falls in production costs and prices resulted in widespread overcapacity—this problem was exacerbated by the fall in demand

> brought about by the recession and panic of 1893. Although attempts were made to eliminate overcapacity through pools, associations, and cartels, not until the capital markets motivated exit in the 1890s' mergers and acquisitions (M&A) boom was the problem substantially resolved. Capacity was reduced through the consolidation and closure of marginal facilities in the merged. During the decade from 1895 to 1904, more than 1,800 manufacturing firms merged into only 157 consolidated corporations.[4]

The current revolution takes place in very similar circumstances. The tenfold increase in oil prices between 1973 and 1979 disrupted companies' equilibrium conditions—to different extents depending on the sector studied, thus inducing widespread redistribution of labor and capital between the various sectors and companies. The macroeconomic policies conducted to curb two-digit inflation succeeded in about ten years but only at the cost of rather deep recessions, unknown of since World War II. The firms who invested massively during the euphoria of the 1960s to bet on new technologies were suddenly saddled with massive production capacities that markets could no longer absorb.

Indeed, in an industry in excess capacity, where demand does not match the increased production volumes resulting from technical advances, prices tend to fall and companies' profitability deteriorates. When endemic losses accrue, bankruptcy is a major threat. Against these conditions, suppliers have to leave the market through internal restructuring to reduce capacity, bankruptcies or a buyback and subsequent restructuring by the new owners and leaders. This latter solution is easier to implement for newcomers than by the existing managers who conducted the policies which brought about overinvestment and overcapacity. Often, outsiders are the most capable of changing radically the existing policies.

4. Michael C. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *Journal of Finance*, July 1993.

Bankruptcy or Restructuring: Which Is Best?

Downsizing is difficult to implement as stockholders' internal control is often insufficient to impose the necessary policy changes to the managers who often abhor reducing the size of their company and modify substantially the strategy that they have developed and conducted. This is the "agency" problem that all the companies of which ownership is very diffused are faced with: the salaried company manager does not always share the same interests as the owners/stockholders. The former benefits directly from the development of the company and even more than from large profits. The CEO is better paid in a big firm or group than in a small firm. His numerous and qualified assistants make his work much easier for him. His social prestige depends on the size of the company even if profits are meager.

On the contrary, stockholders do not benefit from the never-ending expansion of their company: what really matters is the profit they get from their property. However, if there are many stockholders each holding only a very small fraction of the company's capital, their direct control on the manager's strategy is quite limited. Managerial democracy is imperfect and imposes itself only very slowly. As a consequence, the manager can make his interests prevail over those of the shareholders during rather long periods. For instance, he will prefer to reinvest the company's profits in new—even though low-profitable or unprofitable—investments rather than redistribute them to the stockholders as the latter course of action may curb its ambitions and limit its power. Thus, companies running on public savings are generally the scene of a conflict between prestigious growth policies and profitability policies.

And the conflict worsens in times of overcapacity:

> In industry after industry with excess capacity, managers fail to recognize that they themselves must downsize. The tire industry is an example. Widespread consumer acceptance of radial tires meant that worldwide tire capacity had to shrink by two-thirds (because radials

> last three to five times longer than bias-ply tires). Nonetheless, companies like GenCorp (maker of General Tires) invested heavily in aggressive R&D and marketing programs for their tire business. The response by the managers of individual companies was often equivalent to "This business is going through some rough times. We have to make major investments so that we will have a chair when the music stops." But increased investment seems not to be the optimal response for managers in a declining industry with excess capacity.[5]

Taken to its extremes, this inefficiency of internal control can either cause bankruptcy or trigger a stock sell-off that will drive the share lower and thus leave the company vulnerable to a takeover through which new stockholders buy on the cheap a minority or majority controlling interest and appoint a new board of directors. As it is not a prisoner of previous policies, the new board can make the cost-cutting and size-reducing efforts that were specifically requested by the new owners. Actually the new management is itself interested in increasing the value of the firm as it often gets stock options. The company is thus reformed by reducing its overcapacity.

Sales volumes are crucial to the profitability and survival of companies with high fixed costs. If ten firms share a market and the overall demand in that sector falls by 50 percent, each firm's demand also declines by 50 percent at first. Sales decrease and that is quite enough to convince the firms to cut their prices to limit the damage. The decline can be so dramatic that the selling price falls below the average cost, which implies a loss for the company. However, if the sector has reached its maturity, the price war will be limited, as no company can expect to encroach upon its opponents' market shares given the trust relation with their ancient clients. The sector's balance can only be restored by a number of failures. But the bigger the company, the bigger the social and political drawbacks of a failure (the "too-big-to-fail" argument). These businesses will thus ask for the state's support

5. Michael C. Jensen, "A Revolution Only Markets Could Love," *Wall Street Journal Europe*, January 3, 1994.

and subsidies, try to target other markets or use any other method to avoid the worse. But these techniques often consume resources, including human capital resources, that could have been better used elsewhere.

In some cases, a survival instinct drives the firm to restructure by itself, especially when the manager's compensation is officially tied to stockholder wealth creation. He is thus tempted to increase this value by all means possible, whatever the other human or social costs. For instance, in the post–cold war era of 1991, U.S. defense contractor General Dynamics Corporation appointed a new chairman and CEO, William A. Anders, and a new management team as the company faced declining demand in an industry saddled with excess capacity. General Dynamics stock significantly under-performed the industry and the market, and stockholders had lost 59 percent in the four years prior to his appointment. Anders negotiated a contract that guaranteed him a substantial compensation, total independence, a large pension on leave and a package of General Dynamics stocks and options that were worth respectively $1.4 million and $1.9 million on the day he signed.

From 1991 to his departure two years later in 1993, Anders's strategy was to reduce production capacities, liquidate some of the existing activities and restructure the company totally. From a reference level of 100 in 1991, General Dynamics stocks surged to 653 in December 1993, generating $4.5 billion in stockholder wealth, which represented a dividend-reinvested return of 553 percent. In their financial study, Jay Dial and Kevin Murphy estimated that between $2.3 and $3.5 billion of that wealth increase resulted specifically from Anders's policy.

This example shows that industries having reached their maturity can create wealth through a reduction in production capacities rather than growth. It also underlines the influence of financial packages on the CEO's management policy. In this case, Anders's very lucrative contract was so specified that he did not have to try and increase the

company's size, strengthen his position and secure future income. The only target he had to aim for was to turn around the company. Being handsomely paid to do so, he could focus on this problem and leave as soon as it was solved. And so he did. On the contrary, many salaried managers prefer to maintain the company's size and secure their position whatever the cost, and often to the detriment of stockholders.

While company growth is usually a good omen in new activities with growing demand, it often means that resources have been wasted and that the group is losing money in old-line sectors where demand is eroding.

But a turnaround requires that the most ancient shareholders, who have always left uncontrolled managers do as they wanted, pull themselves together and suddenly change their tactics. This rarely happens, especially in companies with numerous stockholders or with reciprocal shareholdings that protect managers from stockholders' demands for returns.

In fact, the most convenient solution is to be taken over by a company governed by an efficient and ambitious manager (the target's stock price is low because of the losses or the low profitability) who will sell whatever can be and rationalize the firm by reducing its staff and incidentally the sector's overall capacity.

And indeed, most M&As only "work" when they are followed by restructuring and staff cuts, by the closing down of the less profitable plants and a refocusing on the main activities. After that, the restructured company is more specialized than the original as it is smaller now that it has got rid of secondary activities and surplus capacities. It is often sold by the new owner, as the acquisition is often followed by divesting.

A study on divesting after acquisitions showed that out of 271 acquisitions made between 1971 and 1982 in the United States, 44 percent of the companies acquired had been divested by 1989. This proves that the main purpose of the acquisition was to change the

policy conducted by the management of the targeted firm and not to diversify.[6]

In general however, people find it difficult to understand this mechanism and its social utility. Jensen cites the example of the late nineteenth century political protests against the authors of these reforms that the media and politicians nicknamed "the Robber Barons." The same is true today: people are often scandalized by the shareholders' and managers' wealth that they deem "excessive," as well as by their alleged "short-termism" or short-sightedness in the pursuit of profit, while workers are laid off. For superficial observers it just looks as if workers wealth was simply confiscated and transferred to shareholders and managers.

Because of the economic complexity of all these strategic maneuvers, there is great misunderstanding about the mergers and the recent wave of takeovers and restructurings. Obsessed by the immediate impact of these operations, most commentators do not analyze the broader industrial dynamics. For instance, they note that the joint company resulting from the takeover of a big firm by another is, obviously, larger than any of its components. They generalize this immediate observation and conclude hastily that there is a general trend towards upsizing. But they disregard the more discrete creations of small companies, the spin-offs and the efforts made by the governing company managers to downsize their firms and refocus on their key sectors.

The occasional observers of these large-scale maneuvers only see the most spectacular, but like Fabrice at Waterloo in Stendhal's novel, they never get the big picture. Indeed, this is neither their target nor their job.

They also believe that the purpose of these restructurings is to

6. Steven N. Kaplan and Michael S. Weisbach, "The Success of Acquisitions: Evidence from Divestitures," *Journal of Finance*, March 1992. See also Patricia L. Ansliger, Steven J. Keppler, and Somu Subramaniam, "Après les fusions, les scissions," *Expansion Management Review*, September 1999.

make a lucky few richer—the shareholders—by robbing all the others—the laid-off workers, but this conclusion is also erroneous. There is thus a complete misunderstanding about industrial trends and mergers.

Other recent proofs that the trend is now to downsizing are the dissolution of large conglomerates and the studies estimating the wealth creation resulting from companies' re-specialization, that is their refocusing on their core business.

THE SURPRISING EXTINCTION OF CONGLOMERATES

Remember the extraordinary vogue for conglomerates and the enormous prestige of their managers in the 1960s? At the time, it seemed that the key to prosperity was to build large industrial groups, regrouping various activities according to strategies that were codified in the Boston Consulting Group's famous strategic matrix. But since then, the trend turned towards reengineering, downsizing and refocusing on core business. The time to purchase "portfolios" of diversified activities, administered by non-specialized managers that are supposed to be as competent to work in the banking, automotive and telecommunications sectors and in volume retailing is no more.

The mergers of the 1960s resulted in vast gatherings of companies with very contrasted specializations. The basic principle was that if managers were especially talented for management, they could use their gift for almost any type of production. In other words, the manager of a bank could also administer an airline, a press agency or a steel company.

This is an extreme version of the ideology of the administrative executives who first appeared in the U.S. railway companies in the late nineteenth century. According to this conception, the management techniques were the same whatever the product.

Managers used their "internal" capital market, self-financing some of their acquisitions with the cash flow surplus resulting from other

operations within their group (for instance, conglomerates in the United States, keiretsus in Japan, big banks with majority interests in several sectors in Germany and the highly nationalized banking sector under the leadership of the Finance Ministry and Treasury in France). It seemed that internal financing was more efficient than external financing, where the company tapped the market by various means such as floating bond, the issuance of new stocks or bank credit. The group's strategy merely consisted in reallocating the cash flow surplus of its most mature companies towards its promising newly born businesses.

Managers were thus supposed to be universally competent and more capable of reallocating their investments towards portfolios of activities or firms than financial market participants. But the atmosphere has changed so much since then that it is now difficult to explain the origin of the astonishing conglomerate boom of the 1960s.

It is quite unlikely due to the extraordinary superiority of a few managers given the extent of the move: why would the number of competent managers suddenly soar, and why then precisely? But on the other hand, the hypothesis of the superiority of internal capital markets appears vindicated by the stock market appreciation of companies that had announced diversified acquisitions in sectors with no direct link with their key competence. Could so many Wall Street investors have been wrong about their true interests in valuing diversified conglomerates beyond their real value?

In a recent article, finance specialists R. Glenn Hubbard and Darius Palia from Columbia University provide an explanation for the vogue of conglomerates.[7] They explain the financial market's confidence in those conglomeral operations, reflected in an increase in the buying company's stock price, by the superiority of internal financial markets on external financial markets, at the time.

7. "A Reexamination of the Conglomerate Merger Wave in the 1960s: An Internal Capital Market View," *Journal of Finance*, June 1999.

Admittedly, the functioning of external financial markets—stock markets—is imperfect given that information does not circulate easily, financing is scarce, and competition is limited by various regulations (for instance, the forced use of intermediaries such as stockbrokers—although their number is considerably limited by the law—or the legislation regulating stock market listings and public issuance, which are only two of the many obstacles to takeovers). But there remains an alternative that can prove a little more effective: internal financing within industrial groups. A group active in a wide variety of sectors and owning several companies showing cash flow surpluses will reallocate them into the other firms of the conglomerate with cash flow deficits but highly-profitable investment projects. The group's management team is often better informed of the quality of the projects than external investors who put their money in stocks, especially if financial reporting is still limited.

The same is true of countries under development or with incomplete financial structures and imperfect financial markets, such as Japan or Korea. In these countries, large industrial groups (keiretsus and chaebols) systematically use internal corporate financing. There is no need then to finance the company on very imperfect capital markets.

Such was the view of Harold Geneen, one of the most representative figures of the conglomeral universe and manager of International Telegraph and Telephone (ITT), which ranked among the world's largest diversified groups in the 1960s.

> In picking and choosing what companies to acquire [. . .] with our expertise in management and our access to greater financial resources add something to that particular company [. . .]. In most instances, we kept the same management and introduced the company's managers to the ITT system of business plans, detailed budgets, strict financial controls, and face-to-face General Managers Meeting.[8]

8. Harold Geneen and Alvin Moscow, *Managing*, Doubleday, 1984, pp. 206–207.

This means that internal financing was more developed because it was better informed and more reliable than market financing. This also shows that the takeovers of the targeted firms were not disciplinary sanctions: the idea was not to replace a faulty management team and impose new and more wealth-creating strategies, but rather to give to those well-managed firms a financial advantage that they could not obtain by themselves, and moreover to give them the benefit of a centralized managerial control using the methods of private business planning.

Looking at a vast sample of diversification acquisitions conducted in the 1960s, the authors confirmed that the capital gain created is a consequence of the superiority of internal financing and not a disciplinary sanction taken against the management of the targeted firms.

Much on the contrary, in the 1980s and 1990s, companies conducting diversification acquisitions lost money. Conversely, the companies who resold subsidiaries or divisions with activities too distant from their core business saw their stocks pick up sharply.

This marks a fundamental shift: it means that external capital markets became more efficient than the group's internal market over the last decades. This evolution coincides with the various deregulations, the opening of financial markets on the outside world and the increased competition resulting from increasingly cheaper real-time communications, which are the new dominant trends of the past years.

The accuracy of this analysis was also confirmed by studies underlining the still decisive role of internal financing within vast diversified industrial groups in developing countries where financial markets are notoriously imperfect. Subrahmanyam & Titman and Khanna & Palepu thus report the current existence of many vast conglomerates in India, contrary to the structure of the American and European industry, especially since economic opening and modernization of financial markets on both sides of the Atlantic.[9]

9. Avanidhar Subrahmanyam and Sheridan Titman, "The Going Public Decision

Undeniably, this is a good example of the new signification that mergers and acquisitions took, and of the transformations that companies' industrial structures underwent when economies entered the second twentieth century. The trend towards centralization was replaced by the trend towards downsizing although the M&A turbulences that accompanied both may seem identical in the eyes of superficial observers.

Re-specialization and Wealth Creation

Recent mergers confirm that the trend is towards de-diversification and refocusing. They take place in sectors poorly concentrated internationally or nationally and having reached their maturity with market growth rates lower than the country's GDP growth—such as bank, insurance, and pharmaceuticals. As such, their purpose is not to upsize the company but rather to restructure it by reducing the workforce and obtain a more "normal" concentration rate. The economy's financial outlook also has its importance when stock markets are on the rise.

The type of merger depends on the underlying context, for instance new or old industries, economic recovery or slump. They do not all have the same purpose and do not meet the same needs.

The conglomeral merger wave saw upsizing and diversification until its collapse in the 1970s and was followed by a totally different M&A trend in the 1980s and 1990s, when very aggressive management teams started buying exaggeratedly diversified and poorly-profitable firms to resell them piecewise, to cut them into smaller pieces. In other words, to reduce their size.

The aim is opposite that of the 1960s. It was the time of the "chop shop" or company-cutting for the sake of efficiency and profitability.

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and the Development of Financial Markets," *Journal of Finance*, 54, 1999, and Tarum Khanna and Krishna G. Palepu, "Why Focused Strategies May Be Wrong for Emerging Markets," *Harvard Business Review*, July–August 1997.

Suddenly, "small was beautiful." It was the shareholder's value, the external financing on financial markets, that motivated this desire to refocus on core business, to reduce the field of action of the manager who thus re-specialized in a particular trade. Once again, the shareholders' return was the company's top priority as it had become crucial for its functioning.

The downsizing trend gained momentum. Wealth was created by this fragmentation as it removed the excess infrastructures of companies and their costly and unprofitable equipment. Takeovers and piecewise sales of big companies' divisions intensified as they created wealth by improving the average productivity rate. Now, the total production of ten small independent firms was much greater than when they all belonged to the same conglomerate.

A number of recent studies have estimated the wealth created by these company breakups that also resulted in re-specialization. We have already mentioned the spectacular experience of General Dynamics, but there are many other such examples of substantial wealth gains following de-diversification and refocusing. For instance, Constantinos Markides underlines how companies' business policies shifted between the 1960s and 1980s. Over the first period, one percent of the 500 largest U.S. firms re-specialized while 25 percent diversified. But the trend inverted in the 1980s with 20 percent re-specializing and 8 percent diversifying. And most companies that had re-specialized benefited from stock premiums exceeding normal profitability.[10]

This phenomenon is still hard to understand for the public opinion and the authorities who strongly believe in the axiom that economies of scale are always present so that upsizing always generates

10. Constantinos C. Markides, *Diversification, Refocusing, and Economic Performance*, MIT Press, 1995. These results were confirmed by more recent studies such as Herman Desai and Prem C. Jain's, "Firm Performance and Focus: Long-Run Stock Market Performance Following Spinoffs," *Journal of Financial Economics*, October 1999, which conclude that the spin-offs on financial markets generate more capital gains when they represent a respecialization rather than when they correspond to a simple resale with no specialization strategy.

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productivity gains. This idea was fixed in people's minds by seventy years of successful Fordism.

That is why the raiders and the other actors of takeovers and restructurings are so misunderstood. They are often viewed as unable to create "real" wealth and willing to sell off the family jewels, to disperse the existing capital without ever increasing it.

But organizational conditions have changed. Wealth creation through de-diversification is a form of creative disintegration, which has been the dominant trend of the recent years. This downsizing phenomenon concerns both the states and the firms, and gives renewed importance to individuals.

THE RETURN TO SMALL SIZE: CREATIVE DISINTEGRATION

Undeniably, the most striking feature of the late twentieth century was the creative disintegration that resulted from the downsizing of private and public organizations. Companies restructured and re-specialized. States reduced their internal dimensions and often dismantled. Transformations in all organizational structures stimulated the return of individualism which had been announced by anarchist movements and confirmed by the triumph of democracy worldwide. Although the society entered the era of post-Fordism, the previous concepts remained fixed in people's minds.

The pursuit of large size had been the industrial leitmotiv—the organizational credo of the first twentieth century. But it was justified only under particular technological conditions. It was replaced in the 1960s–1970s by the concept of "small is beautiful." For example, in the 1950s and 1960s, mainframe computers were big and costly and could only be bought by large firms and large-scale public administrations. But the invention of the personal computer (PC) gave households and craftsmen the same calculation power. Obviously, they could not buy and amortize cumbersome mainframes nor pay for the large space necessary to store such machines as easily as factories em-

ploying thousands and producing several thousand units per month. These high-performance equipments thus had to become smaller and less costly for small firms to buy.

This need was met with the advent of miniaturization, which came as an answer to a progressively more individual than collective demand because of the disintegration of big structures (for reasons that we will study later on). In other words, it is the downsizing of productive organizations that fueled the demand for miniaturization, that was soon met by equipment producers.

Downsizing was everywhere. Craftsmen now had the calculation power that only organizations with thousands of employees, such as the Defense Ministry and insurance companies, could previously afford. Big companies thus lost one of the sources of their productivity advantage on small companies: their exclusive access to high-performance equipments. A very large economic literature has tried to explain this new industrial divide. Small and then micro-companies burgeoned in the new IT and communications services sectors of Silicon Valley, but also in more traditional steel and textile industries of northern Italy.

Economies of scale are no longer a decisive competitive advantage. Size does not matter that much anymore. On the contrary, in these conditions, it becomes a handicap as it is harder (and more costly) to build a cooperation between thousands of employees than among a few dozen colleagues (or less) that the manager of the micro-company will meet every day. Small is more efficient.

It follows that the large business groups, the most heterogeneous conglomerates, are outclassed by smaller-scale companies focused on a core business, and thus more specialized. The small organization perfectly illustrates Adam Smith's theory of the origin of wealth. It is better to be smaller and more specialized than big and diversified.

Despite that, the mergers and acquisitions of the 1990s were often viewed as the expression of an upsizing desire and of the economies of scale made possible by the development of international markets.

Many observers would thus conclude wrongly, but with the appearance of a straightforward logic, that global markets are good for companies because they enable to sell larger quantities of goods and thus to reduce average production costs. Thus, the first company that reaches this advantageous size is more competitive, and those that do not are threatened of extinction insofar as their costs, and consequently their prices, remain higher than the others. In the end, there will only remain one firm in each sector: the world company such as Coca-Cola, IBM, or Microsoft. Yet the misfortunes recently suffered by some of these firms that are among the largest and the most famous should arouse skepticism about the absolute advantage that their big size is supposed to offer them.

World Company or Downsizing?

The biggest area of misunderstanding is undoubtedly companies' growth and globalization. When asked about the motives of the contemporary M&A wave, most people answer that the general opening of markets to the outside world and the worldwide competition resulting from both the removal of tariff barriers and the decline in transportation costs, inevitably force firms to upsize. First, to be active worldwide and second, to benefit from the economies generated by big dimensions ("economies of scale" or "economies of scope"). And the mergers and acquisitions that have intensified in many sectors only confirm this opinion.

More than thirty years ago, in 1968, Jean-Jacques Servan-Schreiber wrote a world-acclaimed book in which he warned Europeans to beware of the "American Challenge" in the form of the "dynamism, organization, innovation, and boldness that characterize the giant American corporations." But in fact this issue had been regularly mentioned in economic literature since the beginning of the century, and more especially, by Joseph Schumpeter who considered that big com-

panies' higher wealth-creation capacity and better quality of management gave them an incomparable advantage on smaller firms.

As a consequence, Servan-Schreiber advocated an industrial policy for Europe consisting of choosing 50 to 100 firms which, once they would be large enough, would be the most likely to become world leaders of modern technology in their fields. They would be the "European champions," a continental and more ambitious version of the French so-called "national champions" which were in such favor with the ministries and governments. Many politicians still dream of that and it is what most of my PhD students answer when I ask them the origins of the contemporary M&A wave: large-scale organizations are a source of creativity and competitiveness in a world economy.

Yet, David B. Audretsch wonders what would have become of the U.S. computer and semiconductor industry if IBM had been selected as the U.S. national champion, say around 1980, and had thus received public assistance to protect it from the competitive threat of Apple, Microsoft and Intel.[11] Would the United States have become the world leader in these industries in the 1990s? Apparently, the conditions of success have changed dramatically since the 1950s, when Charles ("Engine Charlie") Wilson of GM could still proclaim that "what is good for General Motors is good for America." The industries' structure has shifted from stability and concentration to instability and downsizing.

The specialists of this issue have indeed noted a trend reversal in the mid-1970s which now encouraged companies to downsize.[12] At first, it may seem that this is a general move towards the post-industrial society, the service economy, as services notoriously face smaller economies of scale and can be provided by small companies. But in fact the trend is even clearer in the industry than in the service sector.

11. *Innovation and Industry Evolution*, MIT Press, 1995, p. 185.

12. Zoltan J. Acs and David B. Audretsch, *Small Firms and Entrepreneurship: An East-West Perspective*, Cambridge University Press, 1993. Gary Loveman and Werner Sengenberger, "The Re-emergence of Small-Scale Production: An International Perspective," *Small Business Economics*, 1, 1991.

And it affects all countries. For instance, if we consider the proportion of small firms (with less than 500 employees) in the overall economy, we note that this percentage has risen from 30.1 percent in 1979 to 39.9 percent in 1986 in Great Britain. Similarly, in northern Italy, the share of companies with less than 200 employees increased from 44.3 percent of the overall economy in 1981 to 55.2 percent in 1987.

And it is interesting to imagine the worldwide consequences that a policy based on Servan-Schreiber's approach could have had by looking at the figures of the share of the total industrial production that came from the 100 largest firms of the most developed countries during the century.[13] According to this study, the percentage rose between 1918 and 1970 and eventually declined in 1990, from 22 to 33 then 33 in the United States, from 23 to 22 then 21 in Japan, from 17 to 30 then 23 in Germany and from 17 to 40 then 36 in Great Britain. A policy of national champions would have handicapped the United States just like it slowed French growth.[14]

This brings us to a double conclusion: there is no inexorable law ruling business concentration, and if a trend did materialize during the two first thirds of the century, it saw a complete reversal during the 1970s.

If you are still not convinced, there is also the example of the car industry which is viewed as the best illustration of a mass industry benefiting from unlimited economies of scale. It is the sector in which the advantages of upsizing, of the use of global suppliers and of worldwide production is supposed to lead companies inexorably to concentrate into an ever-smaller number of firms. We are regularly told that there will soon be just enough space left for only five producers in the world.

And yet, as John Kay underlined in a newspaper article, the con-

13. John Kay and Leslie Hannah, "Myth of critical mass," *Financial Times*, 1999.
14. See Elie Cohen, *L'Etat brancardier: politiques du déclin industriel*, Calmann-Lévy, 1989, and *Le Colbertisme high-tech*, Pluriel, Hachette, 1992.

centration in the world car industry has been declining since the beginning of globalization.[15] In 1969, the three largest manufacturers in the world—General Motors, Ford and Chrysler—produced one car out of two. In 1996, this fraction had fallen to one out of three or 36 percent of the total. In 1969, there were nine "mega-manufacturers" each producing one million cars a year. In 1996, there were fourteen. In 1969, these nine companies held 84 percent of the market against only 66 percent in 1996. If we define a key producer as one who realizes at least 1 percent of the world sales, then there were 15 in 1969 but 17 in 1996. Whatever the angle under which we look at these figures, we get the same broad picture: the car industry is increasingly less concentrated. The frequent alliances, mergers and acquisitions by which ailing firms were taken over by their rivals were not enough to stop the de-concentration wave. And this trend is deep-rooted. The highest concentration rate in the sector was reached in the early 1950s, when three quarters of the world car production was handled by U.S. companies.

We have thus been living with false ideas for half a century. It takes time to perceive and appreciate fully new realities, and hindsight is needed to conclude a reversal of the existing trends. The supposed advantage of big dimensions and mass production is now considered as an outdated view.

And these restructurings concern not only the private organizations but also the public organizations, the states, considered as political firms.

State Fragmentation and Secession Wars

The conglomeral state is now selling the non-core businesses through which it provided non specific, non "regalian" services. Like private companies who downsized and refocused on their core businesses, the

15. "Globalisation, dimension et avantage compétitif," *Le Figaro*, June 26, 1998.

state collected more money by selling these firms than by keeping them. The value—or productivity—of these newly independent firms was higher than what it would have been if they had remained parts of a single giant enterprise consisting of all public sector's industrial and commercial stakes. Unaware of these mechanisms, many opponents to privatization accused the authorities of selling the nation's heritage cheaply to put up with immediate financial needs. But, gradually, people discovered that the firms performed much better once privatized than before.

And this move concerned not only public business firms, but also the states proper, which are giant organizations with all the characteristics of firms except that they are (supposedly) non profit-making. In a similar way, they tried to reduce their external dimensions. Regionalist and separatist claims led to the atomization of the states and to secession—or independence—wars. The growth rate of the newly independent states was often higher than when they were the provinces or regions of a larger country, and this was yet more evidence of the economic efficiency of downsizing.

After World War II, the "world industry of states" tended to decentralize much like the other industries, despite the bipolar influence of the two superpowers at the apogee of the cold war.

The number of nation-states in the world skyrocketed from 74 in 1946 to 195 in 2000. In the language of industrial organization economics, this corresponds to an "atomization" of the population of the firms concerned. Indeed, the steady decrease of the economic weight of the United States in the world economy, and the subsequent collapse of the Soviet Union, transformed the structure of the sector from a duopoly into an atomized competititve structure of small firms, the rivalry of a great number of small- and medium-sized states competing together.

And indeed, most of the new states were very small-sized firms. In 1995, 87 out of the 192 states existing in the world had less than 5 million inhabitants. And among those, 58 had less than 2.5 million

inhabitants, and 35 had less than 500,000 nationals. More than half of the world's countries (98 nations) have a smaller demographic dimension than the state of Massachusetts: its population was estimated to 6 million inhabitants in 1990, which represents the median dimension of the state enterprise in the world.

The average demographic size of a state also decreased from 32 million inhabitants in 1946 to 29 million in 1999, despite the world's demographic boom that on the contrary tended to increase the population of the average state.

The atomization of the state industry was partially caused by the disintegration of the empires that essentially took place during the decolonization of Africa and Asia, but also more recently in the Soviet empire when the USSR imploded.

Most colonized territories winning their independence between 1945 and 1965, apparently under the pressure of nationalist uprisings, united into a vast cartel of Third World countries which organized a head-on confrontation with the imperialist West. Denouncing the neocolonialism of the Western world, they tried to spark a North-South economic and political clash while establishing a shared and common management of the world. The duopoly of the cold war turned into a poor/rich duopoly, a sort of Marxist class conflict between nations. But these conceptions faded away in the 1980s when the Third World cartel imploded and disintegrated like the other large geopolitical entities and alliances.

Besides the struggle of the colonized people or their elite, the loss of prestige of European powers during World War II has often been put forward to explain the quick collapse of colonial empires.[16]

But the decolonization wave must also be understood as a movement serving the obvious interests of the Western countries. As Pik Botha underlined, speaking about the end of apartheid in South Africa—a kind of domestic decolonization—"in the end it was simply

16. Touchard and Alii, op. cit., p. 478.

too costly."[17] And most of the European empires had come to that conclusion long before.

Thus, the United Kingdom voluntarily decided to grant independence to its colonies, and in 1962, De Gaulle anticipated the longing for independence of the French colonies in sub-Saharan Africa.

Another reason that is suggested is the increased cost of colonization for the Western powers due to the growing opposition of colonized people and their longing for independence—the guerrillas and the revolts. But in the past, many other rebellions had been quelled or ended in bloodshed.

Finally, another factor to take into account was the decreasing interest in colonization, both in purely economic terms with the reopening of international markets and in political terms with the decrease of the optimal dimension of a nation.

Whatever the virtue of the other hypotheses, both the new creation of small states and the disintegration of the existing empires can mainly be explained by a series of economic factors such as the development of global markets thanks to the liberalization of trade, but also by the growing social cost of the national tax systems in a world of free movement of goods and people. It is difficult to heavily tax specialists that can easily find a job in other nations or to tax capital that can instantaneously migrate towards more taxpayer-friendly countries. Thus, for a given tax base which remains unchanged, states' taxation capacity tends to diminish. But lower receipts also means lower spending, and first of all, those dedicated to minorities which are far from the center of power (the outlying territories and the colonies) and then the border regions. Assuming that the cost of the public services offered to citizens increases with the geographical distance from the center, large countries are at a disadvantage compared to small ones.

17. Quoted by Ronald Wintrobe, *The Political Economy of Dictatorship*, Cambridge University Press, 1998, as an epigraph of chapter 8.

States chose their demographical and geographical dimension by performing an arbitrage between the economies corresponding to the spreading of the cost of a public good over a larger population on the one hand, and the increasing cost of the supply of these same collective goods to a population that is more heterogeneous when it grows, on the other hand.[18] Hence the diminution of the optimal geographical and demographic dimension of a nation when the cost of the state resources (taxes) increases.

But the domestic dimension of the state, the share of its nation's production—estimated by its spending in the country's overall production—also tended to reverse its trend. That reversal was hesitant at first, but presented by many governments as their new medium-term target.

The reason behind that drop in public interventions—also visible in the broad privatization of public sector firms—was that the cost of the capital invested in that sector had become higher than the likely profits—economic and political profits.[19]

That change in the public sector's balance reflects in the impact of public spending on the growth of national economies. Like private investments or labor, public production contributes to growth by guaranteeing the safety of goods, people and contracts, and by developing material facilities, education and health systems.

There is a level of this spending that maximizes growth.[20] Below it, the productivity of public spending is very strong—higher than its costs. Above it, it diminishes and becomes lower than the costs, which means it is socially unprofitable. And it seems that this is what is happening now. As a result, the impact of public spending on a country's economic growth turns from positive to negative when the dimension of the public sector exceeds its optimal level.

18. I developed more precisely the example of national defense in *Euro Error*, Algora Publishing, 1999.

19. See my article "Nationalization, Privatization, and the Allocation of Financial Property Rights," *Public Choice*, 1993.

20. See the references quoted in *Euro Error*, Algora Publishing, 1999.

Basing their analysis on the example of Canada, economists Johnny C.P. Chao and Herbert Grubel—the latter being a member of Parliament in British Columbia at the time—showed that the effects of public spending on growth have recently inverted.[21] From 1928 to 1960, the increase in public spending as a percentage of the domestic product was accompanied by an acceleration of the growth pace. On the contrary, over the next period from the 1960s to 1996, the correlation became negative: when the percentage of public spending in the domestic product increased sharply, growth slowed down. Admittedly, one could argue that this phenomenon is due to the recent inelasticity of public spending. During the first period, public spending eroded when growth slowed down, with spending adapting to resources, while in the last few years, spending proved incompressible, even in a context of economic slowdown, thus resulting in a negative relation between economic growth and the importance of the state, measured by its share in the domestic product.

But that change must also be explained. Another possible interpretation is to assume that the productivity of public spending changed in the '60s. While before the larger dimension of the state helped to improve economic growth, the same effect is now obtained through the reduction of the dimension of the state. Grubel drew the conclusion that the optimum dimension of the state had been reached in the early '60s, with a share of domestic product close to 27 percent, and had been exceeded since then. But we believe that the optimum dimension itself has changed. Ever larger until the '60s, every increase in spending brought the optimum closer and improved the performance of the economy. Smaller from the '60s on, the dimension of the state introduced a new situation, in which every rise in spending pushed the economy further away from the optimum and reduced growth.

21. "Optimal Levels of Spending and Taxation in Canada," *The Independent Institute*, 1999.

In *Euro Error*, I already provided empirical measures supporting the view of an optimum dimension of the state in the economy. The conclusion we can draw from the study of Chao and Grubel, and above all from the numerous breakups of states and firms, is even more precise: it seems that the optimum dimension changed with time and that it is decreasing since two or three decades.

These changes in the determinants of nation-states' optimum dimension account for the centrifugal and secessionist tensions which are seen everywhere. Not only in Russia and in the Balkans, but also in Spain, Italy, France, Belgium, the United Kingdom—which has just taken a few decisive steps towards regional autonomy—and even in China, Japan and the United States. Decentralization, a limited form of independence, spreads throughout Europe.[22] It also illustrates the efforts to downsize management units.

Finally, because of the newly born organizational, communication, and information economics, large states are left with almost no decisive advantage over smaller ones. Their comparative advantage declines like that of large firms. Companies in small nations or even micro-nations can be as efficient as in large countries because global markets allow them to reach the minimal size that gives them maximal efficiency although the national market is very small.

These factors fuel the disintegration process of the largest and least homogeneous nations. Regional or cultural minorities can now afford a secession because political frontiers no longer need to coincide with those of economic markets. The access to a large domestic market is no longer a major advantage for a firm, as most domestic markets are largely open. The exceptional advantage that the United States enjoyed at the time of the first Ford and the invention of the production line—the large size of its internal market—disappeared during the last decades of the century. The globalization of trade thus fuels the pro-

22. John Newhouse, "Europe's Rising Regionalism," *Foreign Affairs*, January–February 1997.

independence and secessionist trends, and makes them realistic from an economic as well as political point of view. It favored the wave of political disintegration, independence (or secessionist) wars and the return of nationalism.

Federalism is merely an intermediate solution in this devolution process and only if the initial pattern is that of centralization and not a multiplicity of nations like in Europe, in which case federalism tends to reduce diversity and generate centralization instead of decentralization—the precise opposite of what is needed.

Parties and Trade Unions: From Mass to Networks

This broad downsizing trend also affected non profit-making firms such as associations, trade unions and political parties. Data about political parties are notoriously viewed as unreliable, but all the comments of the last decades suggest an exodus of their members. The activist parties, the mass parties of the interwar period or the immediate post-war period, all turned more or less quickly into parties of executives and notables, into vote-getting organizations which only rally ahead of the elections. At the same time, mass demonstrations tended to weaken. Parties became coordination networks for electoral campaigns, very much like integrated firms that decentralized, turned into networks with more or less loose relations between subcontractors and other suppliers or ally with similar firms in other countries.

Yet, there are more accurate and quantitative studies about the evolution of trade unions. All conclude that trade unions are faced with a "crisis" or at least an exodus of members. Henry S. Farber and Alan B. Krueger, two specialists of labor economics, studied this continued flood in the United States.[23] They underlined that the unionization rate of wage earners in the non-farm private sector had fallen from 21.7 percent in 1977 to 15.6 percent in 1984 and 11.9 percent

23. "Union Membership in the United States: The Decline Continues," *NBER Working Paper*, number 4216, November 1992.

in 1991. At the same time, this rate increased slightly in the public sector but not enough to offset the decline in the overall rate for the whole non-farm working population from 23.8 percent to 19.1 percent and then 16.4 percent. At the end of their analysis, the authors conclude that this evolution could not be explained by the change in the sectoral structure of the economy, in which the traditionally strongly-unionized sectors would disappear to be replaced by traditionally poorly-unionized sectors. The reason would rather be wage earners' lower interest in trade unions.

The same assessment was made in Western Europe. In a file collected by Janine Goetschy and Danièle Linhart all the authors reported an exodus of members since the mid-seventies.[24]

> The 1980s saw a disaffection for trade unions in most of these countries. . . . [it is] a major turning point in the history of trade unionism in France, Great Britain, Ireland, Italy and the Netherlands.[25]

In France, trade unions lost a quarter of their members (around one million people) during 1975. In 1985, the unionization rate had shrunk to a mere 14 percent and is said to have even collapsed below 10 percent in 1990. In the Netherlands, trade unionism shed more than 10 percent between 1979 and 1986, falling to 25 percent. In the United Kingdom, three million members out of twelve million were lost and the unionization rate thus eroded from 53 to 43 percent. In Ireland, that rate is reported to have decreased from 44 to 36 percent over the same period.

But Germany, Austria and Scandinavia proved more resilient. Outside Europe, the Japanese trade unions experienced a crisis much earlier. While the unionization rate peaked at 55 percent of the working population in 1949, it fell to 35 percent in the seventies and eventually to 29 percent in 1985.

All trade unions went on a diet, a downsizing, at least as intense

24. *La crise des syndicats en Europe occidentale*, La Documentation française, 1990.
25. Jelle Visser, "Survol européen" in *La crise des syndicats en Europe occidentale.*

as in business firms. And the decline is not over yet as it was recently reported in the *Financial Times*.[26] From 1985 to 1995, Sweden was the only country to see its unionization rate increase from 83.8 to 91.1 percent although it was already the highest in the OECD. In all the other countries—France, the United States, Japan, New Zealand, Germany, the United Kingdom and Australia—the unionization rates fell further, sometimes by 15 percent or more in the states that were the most unionized initially, such as Australia or New Zealand.

Although the explanatory factors are numerous and distinct, the general trend remains the same: like the other large organizations, trade unions were forced to downsize.

Smaller organizations and less developed hierarchies left a larger room for individual decisions. On the whole, the general wave of organizational atomization seen in the second twentieth century deeply altered social relations, the place of each individual in the society and its relations with the authorities. While he was predominantly subordinated to the organizations at the beginning of the period, the individual returns as a citizen and a sovereign consumer of public services at the end of the period.

26. Robert Taylor, “Collective Responsibility,” September 13, 1999.