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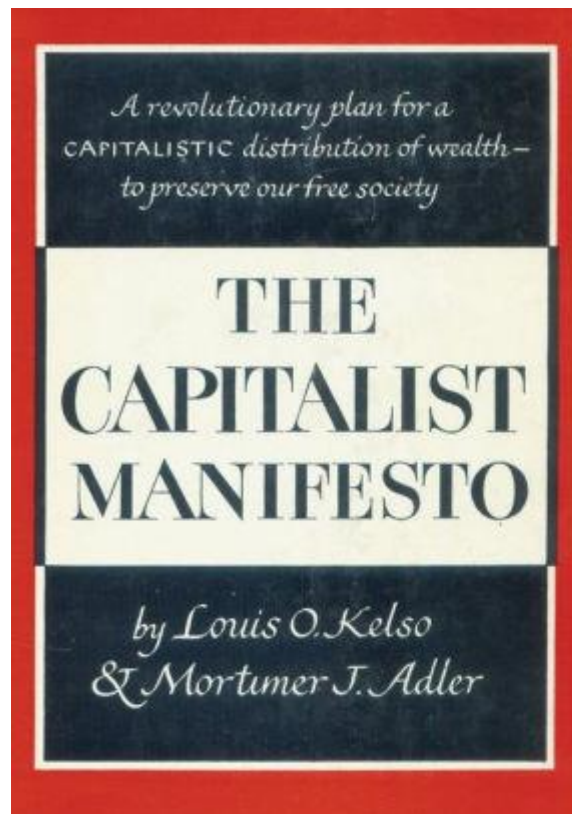

THE
CAPITALIST MANIFESTO

by Louis O. Kelso
and
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11 Measures Aimed at Broadening the Ownership of Existing Enterprises

EQUITY-SHARING PLANS

Profit-sharing, including the variety of pension plans most commonly used today, is fairly widespread. It is promoted by corporate income tax deductions for contributions paid into these plans.

Until the transition to Capitalism has reached the point where a predominantly capitalistic distribution has supplanted a predominantly laboristic distribution of our nation's wealth, it will be necessary to retain the steeply progressive income tax in order to prevent the sterilization of dangerous amounts of purchasing power that would take the form of savings in excess of capital formation.

Of itself, the income tax does not tend in the slightest degree to broaden the diffusion of the ownership of capital. It relieves existing capitalists of a large portion of the wealth their capital produces, but it does not make new capitalists. But where deductions against such heavy income taxation are permitted for contributions to plans resembling our present profit-sharing—particularly stockbonus—plans, the income tax can be made to have a significant effect in bringing about the transition to a completely capitalistic economy. This can be done within existing tax rates.

To recognize the importance of these devices, it is necessary to distinguish between *profit-sharing* or pension plans, which are merely designed to supplement income to be spent by households on consumption, and *equity-sharing* plans designed to make new capitalists. Only the latter can be significant in broadening the capital-owning group within the economy. Equity-sharing plans reach their maximum usefulness where they are of such magnitude that the income from the equities accumulated for an employee can make a significant addition to his worker income. So far as the creation of new capitalists is concerned, the usefulness of an equity-sharing plan is severely impaired if the arrangements are such that, when the employee obtains his portion of the trust, the equities are sold and the proceeds spent on consumer goods.

Where equity-sharing plans are so designed that a man who begins as a worker becomes, at the end of some years, an owner of a substantial capital interest, such plans can make a positive contribution toward transforming mixed capitalism into Capitalism. They can do this without subjecting businesses to more severe tax surgery than

they are at present accustomed to.

Requiring mature corporations to pay out to their stockholders the entire earnings of corporate capital (a subject we will discuss later) would greatly improve the effectiveness of equity-sharing plans where funds are invested in the equities of mature corporations.

Equity-sharing plans should not be built around the concept of retirement, as that is currently understood in our "full employment" economy. The objective should be to build permanent, diversified capital estates—estates that will enable the new capitalists to shift their participation in production from the employment of their labor to the employment of their capital.

There is a profound difference in principle between laboristic profit-sharing and capitalistic equity-sharing. The former provides only an income or supplement to income for the worker to live on when he ceases to earn wages. The latter enables the worker gradually to shift, over the period of his employment, from absolute dependence on toil as the source of his income to dependence, in a substantial degree, on his ownership of a capital interest. Such a capital interest, if not impaired by estate or inheritance taxes (except where its size, as a matter of public policy, is monopolistic), would also provide income for the individual's heirs upon his death.

MODIFICATION OF DEATH TAX LAWS AND GIFT TAX LAWS

For reasons which we have already discussed—primarily the tendency of the ownership, or at least nominal ownership, of capital to increase in a geometric progression—an industrial economy finds it necessary, from time to time, to counteract excessive concentrations of economic power in certain households. It does this through steeply graduated death taxes and gift taxes. Little, if any, thought seems to have been given to the fact that while this eliminates one type of concentration, it promotes others. At most, the effect of these taxes upon the concentration of ownership of capital in particular families from generation to generation is to limit personal ownership without promoting a diffused ownership of capital.

Let us explain. Very large personal fortunes are, of course, eventually reduced by gift and estate taxes, although the assistance of competent tax counsel can postpone and greatly minimize the impact of such levies. Franklin Roosevelt answered criticism of the socializing effect of the federal estate tax by saying (in 1939) that while the government collects its tax in cash, the business organizations established and nurtured by deceased capitalists still remain. What President Roosevelt neglected to observe was that the necessity of raising cash to pay such taxes frequently results in the sale of a

closely held business to a former competitor.

The present form of our death and gift taxes aggravates the concentration of capital ownership in another way. Where it is otherwise impossible by long-term trusts and other astute devices to avoid the decimating effect of death and gift taxes, large capital holdings today are transferred to tax-exempt foundations. In most cases, such bequests are a kind of compulsory charity. The establishment of charitable trusts is more often traceable to the tax laws than to genuinely charitable motives. As contrasted to the quiet martyrdom of paying federal estate taxes in the 77 percent bracket (in addition to state inheritance taxes), the establishment of a "personal foundation" permits some use of one's imagination in disposing of a fortune.

Today there are over 7,300 charitable foundations in the United States with assets of over five billion dollars. The number is increasing at a rapid rate. When they are viewed in the light of the objective of the capitalist revolution (*i.e.*, the diffused private ownership of capital), these foundations are subject to the following criticisms.

They in effect convert concentrated *private* ownership into concentrated public ownership. In legal theory, as well as in legislative contemplation, the holdings of charitable foundations are public property. It should, therefore, be acknowledged that the transfer of productive wealth to charitable foundations gives a huge impetus to state control over capital. The establishment of tax-exempt foundations therefore promotes socialism and works against Capitalism.

As great fortunes further accumulate in these tax-exempt sanctuaries, their use has become increasingly subject to legislative scrutiny. The funds of foundations do not perform the function of private property. They do not provide a means by which individual households in the economy can, through ownership of capital, par-ticipate in the production of wealth to a degree beyond the capacity of mere labor.

Before proposing changes in the death tax and gift tax laws of the federal government to make them serve the cause of Capitalism, we must consider the importance of these laws to federal revenue. The present rates of the federal estate tax progress from 3 percent on the first $5,000 of the tax base (after various exclusions) to 77 percent on estates over ten million dollars. Federal gift tax rates are about 25 percent less, and state inheritance tax and gift tax rates are in general substantially less. Nevertheless, in 1956, the federal estate and gift tax collections together accounted for only about 1.5 percent of the revenue of the federal government. Hence the contribution

these taxes make to the support of government is not sufficient to deter modifying them if doing so would significantly promote the transition to Capitalism. The same holds for state gift and inheritance taxes.

Several points emerge when we examine the use of gift and estate taxes in terms of the theory of Capitalism. As we will show presently, there is no question that these laws can be modified to promote the transition to Capitalism. Let us keep in mind, however, that while it is of vital importance to reduce unworkable concentrations of capital ownership, it is of equal importance to promote the inheritance of viable capital interests by families and dependents.

John Stuart Mill once expressed the view that estate tax laws should, as a matter of public policy, fix a limitation upon the amount an individual may inherit, leaving him in a position where if "he desires any further accession of fortune, he shall work for it." This would not be entirely applicable under Capitalism. The usefulness of Mill's formula diminishes as the gulf between the capacity of capital and that of labor to produce wealth widens. Under Capitalism, if a man should desire "further accession of fortune," it would only be through the ownership and husbanding of highly productive capital that he could have a significant chance of success.

To promote the transition to Capitalism, estate and gift tax laws should be modified in the light of the following considerations. The end to be encouraged is the acquisition of viable capital interests, lying within reasonable limits fixed by public policy. *Hence the tax incidence should be tailored to the size of the recipient's capital holding, not to the size of the donor's estate.* The tax deterrent should be nonexistent or light upon gifts or bequests that help to broaden the private ownership of viable capital holdings. Estate and gift taxes should be heavy upon gifts or bequests which either fail to promote this fundamental policy or which work against it by promoting excessively concentrated ownership of capital.

Many considerations would enter into the legislative deliberations necessary to fix the lower limit of capital holdings to be recognized by law as *viable* capital holdings. Within limits, this minimum might vary with the number of persons in a household. It might be measured by market value appraisal, or it might be measured by yield, or by both.

Many considerations will also enter into the legislative deliberations required for drawing the line between capital holdings that are viable (and so are to be legislatively encouraged) and holdings that are monopolistic (and so are to be discouraged).

Some comment is needed on the significance of such limitations. The specification of the minimum size of a *viable* capital holding would be in effect a legislative determination that a capital holding of at least this size (assuming wise diversification and reasonable husbanding) is sufficient to support a household of a given size in comfort. The specification of the level at which a capital estate is to be regarded as *monopolistic* would be a legislative determination of the point beyond which concentration of the ownership of capital by a single consumer unit operates to exclude others from participating in the production of wealth to an extent capable of providing a viable income. These laws should be framed to encourage the accumulation of capital by households in submonopolistic amounts.

We have used the word "monopolistic" to characterize capital estates which, in the determination of Congress or state legislatures, are so large that they tend to exclude some households in the economy from participating in production to an extent that results in their having a viable income or decent standard of living.[79] This, to be sure, is a use of the word "monopolistic" that is somewhat different from the sense in which it is customarily employed. However, in the theory of Capitalism the concept of *monopolization of participation in production* is just as critical as that of *market monopolization.*

Market monopolization is destructive of free competition, without which there can be no just, objective, and impartial evaluation of the contributions to production. Monopolization of participation in production is destructive of the right of every household to participate in production in order that it may participate in distribution. Precisely because excessively large capital holdings represent monopolization of participation in production, the form of distribution in our mixed economy must be predominantly laboristic and be governed by principles of charity and expediency rather than of justice.[80]

[79] For legislative purposes, some determination of a decent minimum standard of living would have to be used in arriving at a determination of the limit at which a capital holding of a consumer unit of given size shall be regarded as monopolistic. The national median income, for example, might be used for this purpose in estimating how large capital holdings could become before menacing the right of those participating in production only as workers to supplement their insufficient incomes by capital earnings.

[80] The principle of just distribution operates to establish a direct relationship between contribution to production and receipt of income out of production. Those who do not participate in production cannot justly receive any part of the primary distribution of the wealth produced. Monopoly enters the picture when the participation in production by some, through their excessive ownership of capital, excludes others from the opportunity to participate in production or to participate adequately. But we should also bear in mind that the greater the diffusion of capital ownership, the higher will be the tolerable limit of concentration of capital ownership in particular households. We can best see this by co nsidering the extremes. Where the productive capital of an economy

is owned by only a handful of the total number of households, a very severe limit on concentrated capital ownership will be required to prevent the almost monolithic growth of capital in the hands of a few families. At the other extreme, we can at least imagine a society in which the ownership of capital by all households is substantially equal and increases at a uniform rate. In such a society no limit whatsoever would be required to enable all households to participate in the production of wealth *at any level of national income, however high.* The significant point of this imaginary case is that, as the transition to Capitalism progresses, progressively greater individual holdings may accord with public policy

In addition, such monopolization is largely responsible for making the private ownership of capital increasingly illusory or nominal. If we were at present to give monopolistic private ownership its full rights, the immediate result would be so violent a maldistribution of income that we would be on the verge of complete economic collapse. Hence, from sheer economic expediency, if for no other reason, we must in our mixed economy deny such monopolistic private ownership its full rights. In doing so, we simultaneously dilute the property rights of all owners of capital. In fact, we must attenuate those rights to an extent that almost constitutes an alienation of the property, and certainly leaves it private property in a nominal sense only.

So much for the fundamental concepts to be used in modifying our present gift and estate tax laws in order to promote Capitalism. What is the essence of the modifications proposed? It is that gifts and bequests which facilitate the creation of viable capital holdings *should be wholly free of tax.* The revenue loss, as we have noted, would be small. The benefits to the economy would be great. On the other hand, gifts and bequests which facilitate the creation of monopolistic capital holdings should be steeply taxed—sufficiently so as to render them nonexistent in our economy. The effect of gifts and bequests would be measured *after the gift or bequest.* If the recipient household owned less than a monopolistic capital holding *after* the gift or bequest, it would be free of tax. If its capital holding exceeded the monopolistic limit after the gift or bequest, that part in excess of the limit would be progressively and steeply taxed.

This would place transfers of capital holdings by gift or bequest to households without viable capital interests or having holdings below the level of monopolistic size, on a parity with gifts to charity. There would be no occasion to discourage gifts or bequests of noncapital property because of the size of the recipient's holdings of either capital or noncapital property, *except insofar as gifts of noncapital property might be used as a disguise for creating monopolistic capital holdings through gifts or bequests of noncapital property.* There can be little doubt that wise and reasonable donors or testators would prefer this means of disposing of capital estates to the kind of empty,

shotgun charity that is encouraged by the existing tax laws.

One further modification of the gift and estate tax laws remains to be considered. It would have special applicability to large, closely held businesses. Provisions similar to the income tax provisions of the equity-sharing type already discussed could be designed for the gift and estate tax laws to enable equity interests in closely held businesses to be distributed to employees through nondiscriminatory equity-sharing plans. Such dispositions would be given tax exemption under the gift and estate tax laws similar to the exemptions now available for contributions to charitable corporations.

Owners of large, closely held businesses are now faced with the alternatives of the 77 percent bracket or an elegantly contrived charitable foundation. Is there any doubt that many of these, given the choice, would prefer to make capitalists of their employees, if gift and estate tax exemptions enabled them to do so? For a relatively slight loss in federal revenue, since no tax is collected on the vast tax-inspired gifts to charity that are prevalent today, a great acceleration in the broadening of the capital base could be achieved, and in a manner that would promote the diffused private ownership of capital instead of a socialized control of it.

What we have just said should not be construed either as impugning the motives of those who establish charitable foundations, or as questioning the traditional forms of charitable donation to religious and educational institutions, or the giving of alms to the needy. These traditional charities have never been a serious problem in the United States, and it is generally felt that they function best when they are supported by widespread small contributions. These legitimate charities can serve their purpose without causing the erosion and alienation of private property in capital, as the vast general-purpose foundations cannot.

The need for charity in an economy is largely a measure of the failure of the economic system to achieve a balanced participation in production and thereby to avoid a maldistribution of wealth. Thus, for example, if every household in the economy could afford to pay in full for the education of its members, the full expense of which is conceivably a part of a decent standard of living, then charitable contributions to educational institutions for the support of their teaching functions would be unnecessary and out of place. On the other hand, the traditional charities which take care of the destitute and incompetent will always remain indispensable, though even here success in eliminating destitution will minimize their task.

It is quite a different matter with the vast general-purpose

foundations. Allowing for all the good they do, we cannot overlook the fact that they contribute substantially to preventing the number of capital-owning households from increasing at a rate that keeps pace with that of technological advances in the production of wealth. These foundations represent the best use their donors could make of their vast capital interests in the light of corporation laws, tax laws, and economic policies which are incompatible with the principles of Capitalism. Under such conditions, as we have observed, these foundations constitute a menace to the institution of private property. That fact, together with the necessity that the equity capital concentrated in them should be widely diffused among private owners, requires a reappraisal of the gift and estate tax laws that now encourage the formation of such foundations or charitable trusts.

MODIFICATION OF PERSONAL INCOME TAX LAWS

Since about half of the revenue of the federal government is provided by the payment of personal income taxes, a far more cautious study of this proposal is required than in the case of the estate tax and gift tax proposals outlined above. We should try to discover the extent to which personal income tax deductions might be safely permitted to allow for transfers of wealth that facilitate the broadening of our economy's capital base. Within certain limits, it might thus be possible and advisable to place such transfers on a parity with contributions to charity, so far as the personal income tax laws are concerned.

The laboristic distribution of wealth in our mixed economy has necessitated a shockingly heavy progressive income tax. This tax can unquestionably be used to help establish the balanced participation in production that Capitalism envisages as ultimately achievable through diffused individual ownership of capital. Until the capitalist revolution is well advanced, the adoption of permissive deductions, within reasonable limits, for transfers of wealth that aid in broadening capital ownership might be far wiser than rate reductions.

TERMINATING DELIBERATE GOVERNMENTAL PROMOTION OF CONCENTRATION OF OWNERSHIP AND OF MARKET MONOPOLY

As we have seen, most of the efforts to "make capitalism work" are in fact devices for combining a predominantly laboristic distribution of wealth with a predominantly capitalist production of it. Many of these "expedient practices" are not merely un-Capitalistic in their failure to bring about a widely diffused private ownership of capital, but in fact are anti-Capitalistic in directly contributing to the concentrated ownership of capital. One example of this is the "five-year amortization of emergency facilities" program used extensively during the Second World War, again during the emergency following

the Korean outbreak, and in the period since the termination of the Korean hostilities.

The theory of this program is that, while the government may in time of emergency need quick additions to plant capacity, loss may result to the investor if the emergency period is short and does not enable him to derive the benefit he would normally expect from the new capital equipment or facilities. To compensate for this risk, the government extends to selected businesses the privilege of deducting the "certified" cost of the new facilities against income taxes over a five-year period. The ordinary economic life of capital instruments as recognized for income tax purposes is frequently much longer than five years. It varies for periods up to twenty-five years for certain types of plant facilities and even for some types of manufacturing equipment. The effect, therefore, of the special statutory privilege is that of "an interest-free loan by the Government to the taxpayer claiming amortization allowances."[81]

The theory is that a taxpayer corporation which receives a "certificate of necessity" from the Office of Defense Mobilization for accelerated amortization of new capital equipment would not be willing to construct the additional facility in question without this added stimulus. The fact of the matter is that the all-out effort to promote "full employment" has eliminated the slumps in recent years, and the industries to which such certificates have been granted have generally been the most basic, highly productive industries in the peacetime economy as well as in the wartime economy. By June 10, 1957, 38.3 billion dollars of accelerated amortization certificates had been granted under the Revenue Act of 1950. On the 38.3 billion dollars of new capital formation thus inspired, 23.1 billion dollars of rapid depreciation was authorized.

There can be no question of the propriety of granting an interest-free government loan for new capital facilities to General Mo-

[81] See the memorandum prepared by the Staff of the Joint Economic Committee, dated May 28, 1956, on *Implications of Recent Expansion of Special Amortization Program,* p. 10.

tors, for example, if the nation's immediate safety depends upon it. If the same physical or military result *could not* be achieved by means which at the same time created new businesses owned by new capitalists, or if this extraordinary advantage *could not* be made contingent on fulfilling the requirement that the newly formed capital be accompanied by a concurrent increase in new private owners of capital, then the program might be justified in its present form. But the only consideration taken into account by this program is *new capital formation* resulting in new productive capacity. No thought

has been given to the possibility of using this program to create new owners of capital in the process of increasing productive capacity by stimulating the formation of new capital.

Since 1950, such stimulation has increased the concentrated ownership of the capacity to produce wealth, principally in industries in which the ownership is already highly concentrated, to the extent of 38.3 billion dollars. This massive quantity of capital formation has resulted from a government policy that is exactly the opposite of what the policy should be in order to broaden the base of capital ownership and maintain freely competitive markets. Instead of using the power of government to increase the number of owners of highly productive capital investments, we have used it to increase the present concentration of ownership.

Other examples can be cited to show how government and industry work together to boom up the expansion of capital, which is good, while concentrating its ownership, which is bad. Our great corporations, General Motors, General Electric, United States Steel, Ford Motor Company, and many others, are showered with praise for their boldness in announcing that over the "next *x* years, we will spend *y* billions in capital expansion." In each case, the import of the announcement is that a corporation is going to place in operation an enormous additional quantity of the most potent wealth-producing factor in history. Almost none of these announcements contemplates any increase in equity capital by any method other than the investment of earnings withheld from the existing owners. Even where new equity capital is involved, almost none of it comes from households that are not already large owners of capital.

There are still other ways in which government policies encourage further concentration of ownership in our mixed capitalistic economy. The policy of legislative and administrative support for jurisdictional rules, excessive job classification, work limitation rules, and infinite varieties of "paid unemployment" in industry, all in the interest of "full employment" and a laboristic distribution of wealth, tends to encourage and promote the concentration of ownership rather than its diffusion. These practices increase operating costs to a point at which they can be absorbed only by the most heavily capitalized businesses, since they divert a large portion of the wealth produced by capital from the owners of capital to workers. The ultimate effect is to discourage new business enterprises, and thereby to impede potential new owners of capital from becoming capitalists.

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