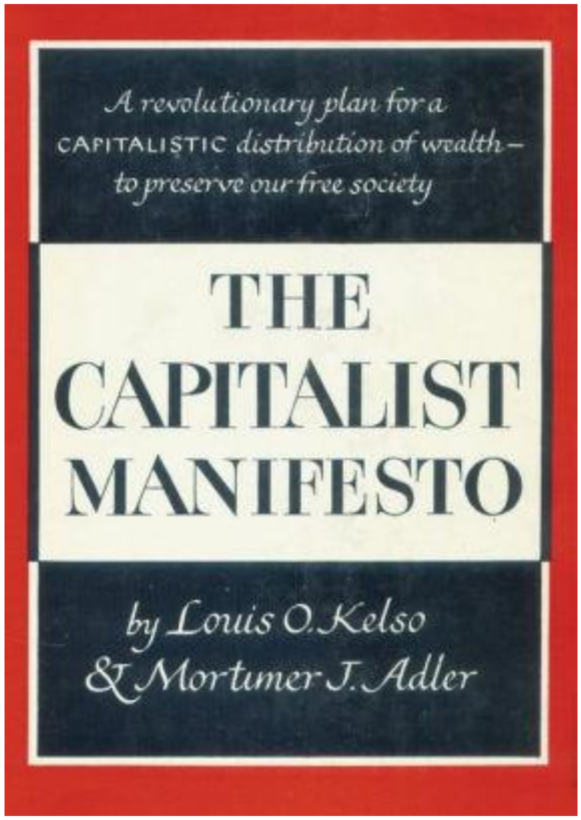
THE GREAT IDEAS ONLINE

May 2019 *Philosophy is Everybody's Business* № 994



THE CAPITALIST MANIFESTO

by Louis O. Kelso
and
Mortimer J. Adler

12 THE MODERN CORPORATION AND THE CAPITALIST REVOLUTION

CORPORATIONS IN THE PRESENT MIXED ECONOMY

The modern corporation has proved a matchless form for associating together the productive powers of workers (including technicians and managers) and the productive power of capital. This cannot be better evidenced than by the fact that the largest, most complex, and most productive businesses are, for the most part, conducted in the corporate form.

From the point of view of the theory of Capitalism, the corporation is an ideal instrument for assembling the capital owned by many households in aggregations of such size as to permit production to be carried on in the most efficient and least toil-consuming manner. Within a single corporation, any amount of capital owned by any number of shareholders may be combined with the managerial, technical, and mechanical skills needed to carry on production in the technologically most advanced manner.

Mixed capitalism, however, misuses the corporation. Instead of using it to diffuse the private ownership of capital among the households of the society, it diffuses the wealth produced by capital to those who should, but *do not*, own capital. Its method of doing this is governed by principles of charity and expediency.

The laboristic distribution of capitalistically produced wealth is, to be sure, not confined to corporate business. For example, collective bargaining agreements, which raise wages far above their competitive level, are becoming as common with unincorporated businesses as they are with corporations. Nevertheless, the use that is made of corporations to carry out a laboristic distribution of wealth gives the corporation first place among the redistributive agencies of our mixed economy.

The corporation facilitates a laboristic distribution of wealth in the following three ways.

(1) It is subject to a graduated income tax that is levied only upon the wealth produced by capital. The federal government and most states levy such taxes on corporations doing business within their respective borders. These taxes provide about half of the revenue of the federal government. They constitute a

smaller, but still important, source of state revenue. They are, therefore, a basic source of income for the redistributive programs which are operated directly by the state, such as the subsidization of submarginal agricultural enterprises, and the numerous programs that are designed to promote full employment.

(2) Corporations are the largest employers of organized labor. By a web of federal and state laws that have largely eliminated the free play of competitive forces in the fixing of wages, wages have been raised to a height far above the economic value of the work for which they are paid. This is probably the most direct method of diverting the income due to owners of capital to the owners of labor.

(3) Corporations are not merely permitted indefinitely to plough back the wealth produced by their capital. They are constrained to do so by the effect of the steeply graduated personal income tax on the dividends received by their larger stockholders. Though the benefits of this involuntary investment by stockholders are to some degree vaguely reflected in the increased market value of the stockholder's shares, this is a fragmentary and frequently elusive substitute for receipt by the stockholder of the full return on his capital. These withheld dividends, to which stockholders would be entitled if their property rights in equity capital were fully respected, are the primary source for the formation of business capital. The instruments which are brought into production by such newly formed capital in turn become sources of new income to be disposed of under government supervision in accordance with the redistribution policies of mixed capitalism. So entirely distorted have our views become that we admire the restraint of a labor union which demands no more than all the increased wealth produced by improved or additional capital instruments. It is becoming common for collectively bargained wage increases to outrun the "productivity increase."

In our partly capitalistic and partly laboristic economy, the modern corporation has thus become an instrument for a distribution of wealth that is predominantly laboristic. It has served as a device for attenuating the property rights in capital, and for almost alienating that property from its owners. In the early years of its existence, it was an ideal vehicle for the concentration of effective ownership in stockholders. But as the concentration grew and brought on depression after depression, it became impossible to permit a full return to the owners of capital of the wealth produced by their capital. Failing to recognize that private property in capital in an industrial society eventually becomes untenable unless its ownership is broadly diffused, our mixed economy settled upon the other alternative. It brought about the erosion of private property in concentrated holdings of capital through the diversion of the wealth such capital produces, from the stockholders who own it to the mass of workers who need it and whose use of it provides a mass market.

CORPORATIONS IN THE TRANSITION TO CAPITALISM

In the operation of our great corporations today, the wealth produced by capital is divided by reference to considerations of expediency. Some goes to supplement the wages labor really earns; some, to pay the double tax on wealth produced by capital; some to provide a major portion of new capital formation. A trickle is returned to the nominal owners—the stockholders.

In a completely capitalistic economy, the division would be made on the basis of the relative contributions made to production by the owners of capital and the owners of labor. Effective property in capital would replace the present merely nominal property in capital. The truth that capital is the major producer of wealth would correct the illusion that labor is the major producer of wealth. The fact that the productiveness of capital constantly increases (relative to that of labor) with advancing technology would eliminate the pretense that the productivity of mechanical labor is increasing. The major contribution made by capital to the output of wealth would be reflected in the return to capital of a major portion of the wealth produced. The conflict between the concentrated ownership of capital and the right of all households to participate effectively in production would be resolved by a widely diffused private ownership of capital.

A business corporation is an association of workers of various talents and capacities with capital instruments and working capital *for the purpose of producing wealth*. In a completely capitalistic society, business corporations would be the basic vehicle of Capitalism itself, whereas under mixed capitalism, they are the basic vehicle for the expedient or charitable distribution of income and the alienation of property in capital.

To effect the transition from mixed capitalism to Capitalism, business corporations should, therefore, be reformed and reconstituted with the following objectives in mind.

(1) *The revitalization of the property of stockholders in the capital immediately owned by their corporation.* As we will point out later, the essence of this lies in the return to stockholders of all the wealth produced by their corporate capital.

(2) *The greatly expanded use of present corporate income taxes as instruments for diffusing private ownership of capital.* The increased use of equity-sharing plans, already discussed, would be a prime application of this principle.

(3) *The reduction and eventual elimination of corporate income taxes as the transition advances and the economy approaches "capitalistic balance."*[82] The corporate income tax is justifiable in a mixed economy where the wealth produced by capital must be largely distributed to labor in order to prevent the collapse of the economy. It would not be justifiable where 90 percent, or more, of the national income can be distributed to the owners of capital property where its ownership is widely diffused and where the national policy is to encourage the shift of the burden of production from labor to capital. At the end of the transition, only personal income taxes would be levied, for only in this manner can all households be treated for tax purposes with proportionate equality.

(4) *The regulation of business corporations by government in accordance with the principles of Capitalism.* This envisages the extirpation of the capitalistic heresy of *laissez-faire*. As long as government regulation is designed to encourage the broadest diffusion of private ownership of capital, to restrict government itself from owning capital,[83] and to give full effectiveness to private property in capital, the regulation of business by government diminishes rather than increases

[82] The economy approaches "capitalistic balance" as it approaches the point at which the diffusion of private ownership of capital is so broad that the wealth produced by capital can be fully distributed to the owners of capital.

[83] Under Capitalism, the only justification for government ownership of capital is the sheer technical physical impossibility of private ownership. The public roads are an example. Freedom in an industrial society is dependent upon the widely diffused private ownership of economic power (the power to produce wealth) as a check to inevitably concentrated political power. Every attempt by government to unite in itself political and economic power should be subjected to this test. The frequent attempt to justify government's engaging in the production of wealth on the grounds that particular projects are "too large" for private industry is absurd, as we will show.

the power of political office holders. The use of political power to regulate the economic system, so that economic power remains widely diffused, vested in private property, and protected in its property rights, can never endanger individual freedom.

(5) *Government regulation of business corporations so that, on the one hand, they may grow to such size as to enable them to employ fully the most advanced techniques of production; and so that, on the other hand, they will not become so large as to impair free competition in the markets affected by them.* As we will point out later, there is no reason to assume today that such middle ground of corporate size does not exist in every case except that of public utilities, *i.e.*, industries in which free competition is not feasible for technological reasons. If and when an instance is found in which efficient techniques of production cannot be employed unless a business is of such size as to impair free competition, such an industry has by this very fact become a public utility. The number of such instances are few today, and there is every reason to believe that the advance of technology will reduce the number rather than increase it. In all cases, however, the government regulation of corporations should try to see that growth in the size of a corporation is accompanied by the broadening of its ownership.

(6) *The employment by government of all reasonable and proper powers to carry out the transition to Capitalism.* When the transition has been effected, government should employ its regulatory powers to maintain balance between the diffusion of private ownership of capital and the perpetual increase in the proportion of the total wealth produced by capital. The principles which should underlie all such regulations are (a) the protection of property; (b) the maintenance of free competition in all markets; and (c) the discharge of the obligation of government to assure all households of the opportunity to participate in production to an extent sufficient to provide them with a viable income.

RESTORING EFFECTIVE OWNERSHIP OF CAPITAL TO THE STOCKHOLDERS OF BUSINESS CORPORATIONS

The essence of property in productive wealth is the right to receive its product. Legal recognition of this right would consist in the legal requirement that the entire net income of a mature corporation during or immediately after the close of each financial period be paid out in dividends to its stockholders. Some allowances would have to be made for the need of relatively undeveloped new corporations to plough in capital in order to survive, as well as for the needs of any business for working capital and contingent reserves. Failure to apply the laws of private property to the capital owned by stockholders permits corporate managers in effect to hire capital at a price dictated by themselves.[84]

The voice of the stockholder is ineffective unless he receives the entire product of his capital and then determines, by his own affirmative action, whether he will return any part of such earnings to the corporation as a further investment of capital. No other conceivable arrangement can force corporate management to justify its performance from time to time before stockholders, just as

84 That the right to receive the income of capital is the essence of property in capital is an undisputed legal proposition. It has never been more tersely stated than by Chief Justice Fuller of the United States Supreme Court in the case which held unconstitutional an income tax of 2 percent, thus making necessary the 16th Amendment to the Constitution. The Chief Justice, delivering the opinion of the court, said: "But is there any distinction between the real estate itself or its owners in respect of it and the rents or income of the real estate coming to the owners as the natural and ordinary incident of their ownership?... As, according to the feudal law, the whole beneficial interest in the land co nsisted in the right to take the rents and profits, the general rule has always been, in the language of Coke, that 'if a man seized of land in fee by his deed granteth to another the profits of those lands, to have and to hold to him and his heirs... the whole land itself doth pass. For what is the land but the profits thereof?'... A devise of the rents and profits or of the income of lands passes the land itself both at law and in equity." *Pollock v. Farmers' Loan & Trust Co .*, United States Supreme Court Reports, 1895, Vol. 157, p. 429 ff.

holders of political office must justify theirs from time to time before the electorate.

Government without the consent of the governed is despotism. Benevolent or paternalistic care of the interests of the governed does not lessen the despotism. If the governed are men, not children, they are entitled to take care of themselves through processes of self-government in which they express their consent by exercising a voice in their own affairs. Nothing could be more a man's own affairs than the disposal of his own property. For the management of a corporate enterprise to dispose of what rightfully belongs to its stockholders without their free, present, and affirmatively expressed consent is despotism, and it remains despotism no matter how benevolent or wise management is in acting for what it thinks to be the "best interests" of its stockholders.

In the political sphere, those elected to public office are expected to exercise the powers of government, and should be allowed to do so without the interference of the electorate. In a representative democracy, the citizens do not exercise these powers directly. They delegate them to the men of their choice. But while the citizens do not themselves perform the technical tasks of government, they do retain the ultimate power of government through the choice of their representatives and through the constitutional acts by which they give or withhold their approval of the policies and conduct of the officials who hold office at their pleasure.

Analogously, those who hold the offices of management in large corporate enterprises have, in theory at least, been selected because of their technical competence for the tasks of management. They should, therefore, be expected and allowed to perform these tasks without interference from the stockholders. Corporate management must be responsible not only for the day-to-day operation of the corporation's business, but also for long-term policies and planning which involve the future capital needs of the corporation. But the ultimate control of the corporation should rest with those who own it, not with those who merely run it.

That ultimate control, which belongs to the stockholders by their right of property, cannot be exercised by them if they have no power beyond saying who shall sit on the corporation's Board of Directors. For the stockholders to exercise ultimate control over their property, they must also be able to say how *all* the wealth produced by that property shall be disposed of. To give them such control, which by right should be theirs, would not invade the professional or technical sphere of management. It would simply make management responsible to their principals, the owners, as the officers of government are responsible to their masters, the citizens. It would reconstitute the corporation by creating it in the image of constitutional government. Just as government with the consent of the governed made popular sovereignty effective and barred the way to all dictatorial usurpations of power, so management with the consent of the owners would make private property effective in corporations and would bar the way to all usurping alienations of property.

Once the laws of private property are applied to the property rights of stockholders, the power and effectiveness of the stockholder's voice in corporate affairs will give him the control he should have. The burden of explaining long-range plans and of making a convincing case for them before stockholders will be thrown upon management. The task of educating stockholders in the affairs of corporations—an indispensable requirement in a society of capitalists—will be placed upon management. Stockholders will have the incentive to become knowledgeable about the activities of their corporations. The stockholder's present apathy to corporate communications cannot be overcome as long as he feels that the economic effect upon him will be the same whether he scrutinizes them meticulously or wholly disregards them. But if the stockholder's hand is restored to the economic throttle of the corporation, his decisions will then affect the return upon his capital, and he will be attentive.

It is hardly necessary to point out that a modification in personal income tax laws would be required if corporations are compelled by law to pay to stockholders the income which their capital produces. One guiding principle of such statutory amendments in the early phase of the transition should be that the revenue of government ought not be increased as a result. With that kept constant, the tax burden on a stockholder, after he has been made to assume his proportionate share of the corporation's income tax, should not be increased.

The proposed reconstitution of the corporation is indispensable to the restoration of the rights of private property held in corporate form. The restoration of such rights would go a long way toward effecting the transition from our present mixed capitalism to a completely capitalistic economy. Even during the transition, it would cauterize the dangerous concentrations of irresponsible power that are now uncontrollable growths in our economy. But in the economy that will emerge when the transition to Capitalism is completed, it is of the utmost importance that the corporation should be an instrument of private property and completely responsive to the rights of property. A society of capitalists without an effective franchise vested in the rights of property would be as much a hollow mockery as a society in which all men are citizens but without the rights of suffrage.

FINANCIAL EFFICIENCY IN BUSINESS CORPORATIONS VS. TECHNICAL EFFICIENCY

The application of the laws of private property to such property in its corporate form has other implications. At present corporations are permitted to withhold the income due stockholders *ad infinitum*, so long as it is employed in new capital formation for the corporation. In many of our greatest corporations, it is this illegitimate power, rather than their superiority of production techniques or management, which has catapulted them to the magnitude of competition-destroying monopolies.

It is a tenet of Capitalism that technological progress must never be impeded or slowed down. The goal of Capitalism is the most efficient production of all the wealth that is needed—with the least human toil. Such *technical efficiency* is desirable without qualification or limit. *Financial efficiency*, however, is another matter. From the point of view of Capitalism, the fact that the techniques and capital of a particular corporation are superior in productiveness does not justify management in forcing stockholders to remain quiescent with a minute share of the income to which they are entitled, while the residue is used by management to give the corporation market dominance. Financial efficiency, according to the theory of Capitalism, should always be subordinated to the primary objectives of the economy.

In acting to bring about the capitalist revolution, as well as in regulating a completely capitalistic economy, government should not hesitate, therefore, to prohibit corporate conduct which thwarts the diffusion of capital ownership or which impairs market competition, merely because the financial efficiency of the corporation would thereby be impaired. Increased financial efficiency is generally a gain made at the expense of other participants in production. Increased technological efficiency is a gain which reduces toil.

Admittedly, these principles would not be as easy to administer as they are to state. This does not, however, lessen their soundness as principles. Practical instances of their application will be discussed later as we examine other proposals for accomplishing the transition to Capitalism, such as the credit financing of the formation of new capital under the ownership of new capitalists.

OTHER CHANGES AFFECTING BUSINESS CORPORATIONS

In an economy in which most new capital formation has its source in income withheld by corporations from their stockholders, corporate giantism and the disappearance of free competition is a matter of course.[85] Where it is recognized, however, that the same financial means that are now used to finance consumption can be used to finance new capital formation, the link between adequate formation of new capital and the continued concentration of ownership of capital is broken.

We will discuss the underlying principles of this proposal in Chapter Thirteen. But in the present connection it should be pointed out that our mixed economy has gone so far in fostering corporate monopolies that in the early phases of the transition to Capitalism the program of financing new capitalists should direct a predominant share of new capital formation into new enterprises owned by new capitalists. The restoration of free competition requires an increase in the number of competitors in hundreds of markets.

We have called attention to the fact that the accelerated amortization provisions of the federal revenue laws have been deliberately used to increase the concentrated ownership of capital. Such use impedes the transition to Capitalism. To effect that transition accelerated amortization might be used in exactly the opposite way to promote directly the diffused ownership of capital and to restore competition to markets which have fallen under the control of oligopolies. The same differential treatment, guided by the same economic principles, might be employed in fixing the depletion rates in extractive industries.

At all times, regulatory procedures designed to broaden ownership of capital and to promote freely competitive markets would have to be employed in such a manner as to give free play to the competitive forces that weed out technologically inefficient, mismanaged, or otherwise submarginal businesses. Such weeding out is essential to technological advance and the reduction of toil. It is indispensable to a healthy capitalistic economy.

85 See "Profit Margins at General Motors," a background study by the American Institute of Management, published in *The Corporate Director*, July, 1956, Vol. VI, No. 3.

In disposing of war plants, in the development of atomic energy as a source of industrial power, in making military expenditures, in breaking up monopolistic combinations under the antitrust laws, in making expenditures in those few instances where it is proper for government to own and operate capital instruments (such as the public roads), and in purchasing military equipment, buildings to house public offices, supplies, etc., government should act to promote Capitalism, not to prevent it. War plants should not be disposed of in a manner calculated to foster increased concentration of ownership or decrease market competition. Where such plants now belong to the government, their transfer to private ownership presents an opportunity to bring into existence new, privately owned businesses under the ownership of new capitalists.

It seems certain that atomic energy will be the basic source of industrial power for the production of wealth in the future. Atomic energy can be harnessed to produce wealth with only minute contributions from subtechnical and submanagerial labor. Large amounts of capital formation will be needed to realize the potential benefits that atomic energy holds in store for mankind.

Here is a case in which the officers of government, under our mixed economy, are in a position to fuse their political power with the vast economic power that is inherent in government ownership of atomic energy plants. But under Capitalism government would have here a magnificent opportunity to guide the development of great wealth-producing capital instruments into widely diffused private ownership. Any atomic plant that can be directly built and financed by government is *per se* capable of being built by private corporations owned by new capitalists, *on condition that the credit facilities of government are used to assist them if private credit facilities are not available or adequate.*

In each of these instances, the policy of government, in seeking to diffuse and broaden the ownership base and to establish free competition, should be cautious to go no further in diverting new capital formation away from the giant corporations than is necessary to restore competitive markets and to bring about a workable diffusion of ownership. Although only a minute number of stockholders are at the present time dependent upon the capital of these corporations for their participation in production, the number will grow as the transition to Capitalism is effected. An expanding number of households will look to their ownership of equity interests in these corporations as their primary means of participating in production and in the resultant distribution of income. Our largest corporations have gone far beyond the size dictated by mere *technological efficiency*. They have long since passed the point where their continued growth would promote technological efficiency. On the other hand, regulation should not impair their service to their stockholders as an effective means of participating in production.

THE GREAT IDEAS ONLINE
is published weekly for its members by the
CENTER FOR THE STUDY OF THE GREAT IDEAS
Founded in 1990 by Mortimer J. Adler & Max Weismann
Max Weismann, Publisher Emeritus
Elaine Weismann, Publisher and Editor
Phone: 312-943-1076
Mobile: 312-280-1011
Ken Dzugan, Senior Fellow and Archivist

A not-for-profit (501) (c)(3) educational organization.
Donations are tax deductible as the law allows.