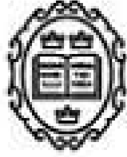

The Impact of the Corporation on classical Economic Theory

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THE IMPACT OF THE CORPORATION ON CLASSICAL ECONOMIC THEORY *

Adolf A. Berle

Introduction, 25. — Preliminary: Some measurable fact-phenomena, 27; size and scope of large corporate activities, 27; distribution of ownership, 28; change in wealth-holding, 28; source of and power over capital, 29. — I. The shift from "capitalist" control, 30. — II. The immutability of classical economic principles, 31; competition, 32; maximization of profit, 33. — III. Stockholders derive what influence they have from social-political, not from entrepreneurial, factors, 37.

In 1932 the thesis was presented by myself and Gardiner C. Means that the growth and functioning of large corporations introduced certain elements not adequately taken into account by classical economic theory.

One such element was the shift of management function away from entrepreneurial "capitalist" owners and to administrators; another, that there was in process an inevitable alteration in the position of shareholders, changing the traditional logic of property as respects "ownership" of these corporations. As these trends continued, the shift would have increasingly greater effect.

Continued observation thereafter indicated increasing intrusion of at least three other developments: (a) the competitive process was changing in quality, impact and effect; desire for market-power increasingly was becoming the controlling consideration; (b) formation and control over application of capital was increasingly ceasing to be individual and (where not carried on by the state) was increasingly becoming a function of the large corporations. Capital formation itself was increasingly effected by corporations through price rather than through personal savings, in view of corporate capacity to include as part of its price not only depreciation allowances but also an item of profit not designed for distribution to stockholders; and (c) finally, the role of the stock and securities markets as sources and allocators of capital was declining, notably in the case of risk capital and markets for equity stocks.

As corollary, large corporations increasingly would come to be regarded, and to regard themselves, as part of a political-economic system rather than as classical merchant adventurers.

* As example, see, among other recent books, Robin Marris, *The Economic Theory of Managerial Capitalism* (New York: Free Press of Glencoe, **1964**).

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Properly, these propositions are now reviewed by economists. So, of course, they should be. Particularly, the neoclassical school of economic thought rejects the idea that any change in theory is required by current phenomena.

To this writer, the neoclassically oriented critiques of the propositions mentioned above seem not to take adequate account of the factual results of the flood-tide of institutional development which carries the bulk of the burgeoning industrial evolution. Scant heed is paid to the vast (the word is used advisedly, not rhetorically) changes in productive and commercial processes. Too little attention is paid to the changes in quantity, quality, content and distribution of the resulting ownership interests. In neoclassical theoretical analysis, there has been a natural, though unhappy, tendency to use classical economic terms and phrases (accurate when used to describe conditions of half a century ago) as though their then-content accurately describes today's processes.

No one denies that the bases of the present system are "capitalist" in origin. But to assume from that historical fact that "capitalism" is the same system as that prevailing, let us say in 1900, is about as relevant as to assume that a modern motorcar is essentially the same as a fringed surrey because both have four wheels and transport passengers. Still less is it sound to conclude (as does Professor Peterson) [1] that merely because the American economy is mainly dependent on "voluntary, self-supporting private enterprise," that fact "largely precludes serious departure from the other principal features of capitalism as traditionally viewed." That proposition involves an attempt to maintain that "capitalism" as classically understood has not evolved to the point of change, despite the huge volume of factual, technical and statistical evidence to the contrary.

The writer does not hold himself responsible (despite Peterson's inclusion of them) for all projections, deductions, speculations which have been drawn from the phenomena of corporate development by a growing number of observers and commentators, though all are interesting, some are important, and few can be safely ignored. This essay deals merely with the salient points of Peterson's neoclassical thesis. These appear to be:

1. No significant alteration has occurred in the location of managerial responsibility or in the ownership-control thereof, requiring change either in economic theory or its application.

2. In any case, the fundamental of capitalism remains un-

1. *Supra*, p. 9.

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changed: the motivation and practice of corporations remains that of profit-maximization, and they remain controlled by competition and cognate market forces so that significant intrusion of social motive is and must be of negligible effect.

3. No significant change has occurred in the institution of "property" as represented by stock held by stockholders, and the stock markets in substantial measure retain their capital allocation function.

His conclusion appears to be that investment, production and distribution, and the position of ownership are all motivated, carried on and maintained in the traditional way. For neoclassical economists, business remains as usual. Given the facts, I think they are wrong.

Preliminary: Some Measurable Fact-Phenomena

As preliminary, it is not inapposite to call attention to a few statistically measurable phenomena in all three fields. If stereotypes of economics, musty or otherwise, are being demolished, their destruction has been accomplished by observable fact rather than by "wayward" commentators.

A. Size and scope of large corporate activities [2]

For the year 1963, the 500 largest industrial corporations had combined sales of $245 billions; these accounted for about 62 per cent of all manufacturing sales in the United States. (The largest of these 500, General Motors, accounted for $16,500,000,000; the smallest, $86 millions.) Surrounding most of the giants is a penumbra of nominally independent but actually captive, or dependent, or market-controlled companies whose market decisions and behavior move more or less along lines determined by the central large-scale corporation. This multiplying factor does not show up in the figure given. Few fair-minded scholars would deny that big corporations dominate the manufacturing scene. Obviously, in greater concentration, large corporations even more markedly dominate the transportation, public utility and communications industries.

In all the 500 largest corporations (there are a handful of atypical exceptions such as Du Pont, Ford, Time, Inc., and some smaller oil companies) and a number of the smaller corporations (whose market percentage is relatively statistically small), "control"

2. *Fortune*, LXIX (July 1964), 179 ff.

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is atomized among large stockholder lists ranging from a minimum of several thousand to a maximum of more than a million. This process of atomization is not complete, but it is continuously going forward.

B. Distribution of ownership [3]

The total number of individual stockholders is estimated at between 17 and 20 million individuals (more probably the lower figure). In addition, financial institutions (pension trust funds, mutual investment funds, fire insurance companies and others) have substantial holdings of stock; these are held for a far larger number of individuals who derive income or other benefits through these institutional conduits. An extremely rough estimate of the number of these individuals would add not less than 25 million more to the figure (this is a drastic underestimate) though they appear as pension trust beneficiaries, etc., and not as individual stockholders.

C. Change in wealth-holding [4]

The over-all change in the property system forecast more than thirty years ago has gone far towards reality. At the close of 1963, total personally-owned wealth in the United States was estimated by the economic department of the First National City Bank (on the basis of Federal Reserve and National Bureau of Economic Research statistics) at $1,800 billions. The largest item, $550 billion, consisted of corporate stock. The other items were: $200 billion of life insurance company reserves, United States securities, corporate bonds and the like; and $375 billion of liquid assets such as cash and bank deposits. These three items total about $1,125 billion — just under two-thirds of the total personally-owned wealth. (The balance consisted of owner-occupied homes and personally-owned durables.) *Nearly one-third of all personally-owned property, apparently, now consists of stock, representing ownership of the corporate system.* More, indeed, if the individually-owned indirect holdings of stocks, bonds and securities, held chiefly through pension rights and fiduciary institutions, are included. Further, if anyone cares to follow the statistics over the past two decades, it will be apparent not only that personally-owned wealth has absolutely increased, but also that the elements of its make-up have undergone

3. New York Stock Exchange estimates. These are the results of sampling surveys; a certain caution is indicated. The estimates do, I think, give fair indication of the order of magnitude.

4. See first National City Bank (New York), *Monthly Economic Letter*, July 1964, p. 78.

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a major change as stock increasingly replaces personally-owned "things." The word "revolutionary" in its current, rather weakened, sense is not inapplicable to that change.

D. Source of and power over capital

Finally, though Peterson pays disproportionately little heed to this, a more striking shift has occurred in the method of accumulating and the decisions governing the application of, capital. More than 60 per cent (probably converging this year toward 65 per cent) of all capital entering industrial corporations is internally generated by accumulating depreciation allowances and undistributed profits — both items being produced by charging to the consumer prices sufficient to permit such accumulations. Another 20 per cent of such capital is derived from bank credit extended directly by commercial banks or industrial corporations, presumably in anticipation of such accumulation. Only the balance — not more than 20 per cent at best — and probably closer this year to 15 per cent — is derived from personal "savings." These conceivably might be material for classical risk-taking, decision-making or other capitalist application by their owners. Factually, they are not. They go overwhelmingly into intermediate institutions such as savings banks which perform this function, and are not applied to risk-capital investment. So much of this item as goes into equity or risk capital operations is largely devoted to a single group of industries — communications (such as A.T.&T.) and public utilities; in these industries rate regulation does not permit accumulation of capital through price to the same extent as in the case of nonregulated industries.

Against this background of facts, the neoclassical critique must be tested. The facts themselves cannot seriously be questioned. Meticulous scholarship might change the figures by a few billions or an insignificant percentage. The problem is whether change from an aggregate of small-scale individual family-or-ownership-directed enterprise into the conditions indicated by these and like facts entails change or modification of classical economic theory. Since economic theory is in preponderant measure dependent upon assumed motivations, to maintain an unchanged theory must involve assumption that the motivations and possibilities of action thereon are substantially similar under present conditions as those prevailing before its development.

Peterson feels there is "slender base" for assuming any change. It may properly be suggested that there is even slenderer base for

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assuming these motivations or possibilities of action thereon have remained the same.

I. The Shift from "Capitalist" Control

It would seem today merely whimsy to deny that decision-making control had shifted, away from the "entrepreneur group" of owners who manage, protect and maximize their profits and capital, into the hands of more or less professional corporate administrators. So much so, in fact, that space need not be wasted on extended argument. Any other result (state ownership aside) would be impossible. Save in the diminishing number of enterprises whose founding adventurer or his family still holds an aggregate block of stock sufficient to dislodge a management if they are displeased, stockholders physically cannot, and by law are not permitted, to enter the decision-making process. Further, save in exceptional circumstances (the A.T.&T. may be one such), corporations as a rule do not need and often do not want to have recourse to their stockholders for additional capital. It is maintained, with truth, that the opinions of stockholders do have influence; that stockholders at meetings can raise "pertinent and sometimes embarrassing questions, sometimes with devastating effect" [5] and that they constitute a substantial special public, some of whom at least scrutinize the management. Yet sporadic and only occasionally effective use of this scrutiny does not add up to "control" or anything approaching it. At best, the scrutiny is a variety of post-audit. This is an instance of an old word ("control"), apt in the days of plutocratic 1890's, used by neoclassicists in quite different sense as applied to the discontinuous, occasional, quasi-political corporate processes of corporate government today. Practically its entire content now is that stockholders like to see dividends and market values rise, and, disliking the contrary, complain, seek to find the causes, on extremely rare occasions organize changes, when there is trouble.

In considerable personal experience, the writer has not encountered any situations in which a direct decision to apply (or withhold) capital from a given development, or to enter or refrain from entering a new field, has been decided by stockholders. One need not jump to the conclusion that the administrators of corporations are therefore "irresponsible." But again their responsibility differs in content. They are responsible to the impersonal institutional collective known as "the company"; they are secondarily responsible to the direct desire of stockholders at any given moment

5. Peterson, *supra*, p. 22.

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to enhance their immediately tangible take or to have losses explained. Stockholders act like an unorganized, usually inert, political constituency. They are a "field of responsibility" — far, indeed, from an entrepreneurial controlling force.

Nor has the situation been materially changed by the practice of endeavoring to make corporation administrators into stock owners through option or other plans. More often than not these plans are endeavors to soften the impact of income taxes or spread out the high pay of productive years to take care of the administrator's declining years. Rare indeed is the corporate administrator who decides a corporate problem differently because he has ownership of or option to buy a block of his company's shares.

II. The Immutability of Classical Economic Principles [6]

Less impressive is Peterson's second proposition, namely, that since our economy is dependent on "voluntary self-supporting private enterprise," this fact "precludes departure from its other principal features." [7]

6. Classical economists equate economic laws to laws of physical science: men will always act in the same way under the same conditions. Specifically, they will seek to use their labor and their savings or capital to obtain the greatest available profit.

Let us assume this is true. Even on that assumption, at least two powerful variables at once appear.

What is "available" will be determined by the surrounding structure of law and mores.

Interest on loaned money, for example, was not generally available under the medieval system.

Mid-twentieth century development has erected a whole structure of mores and laws precluding or forbidding or endeavoring to prevent results of the competitive system in great areas. The community apparently regards these results as so undesirable (or possibly, so costly) that it is prepared to risk higher prices rather than endure them. It is impossible not to conclude that the available choices are restricted and, even with a self-interest motivation, they have changed.

"Profit" depends on desire. Under medieval mores it was likely as not to include progress toward salvation in the next world; this is why savings were perhaps more often applied to building cathedrals and churches than to constructing profit-making installations.

The argument is made more extensively in my book, *The American Economic Republic.* (New York: Harcourt, Brace & World, Inc., 1963).

Neoclassical economics, even if it accepts as immutable the classical premise, must take account of two major variations: (a) that huge institutions are different from individuals and that choices available to individuals within large institutions differ from those available to individual owner-entrepreneurs; and (b) that the mores, politics, and systems of laws built thereon demand results which do not logically flow from the competitive system, certainly as carried on by large institutions, and which shift the application of the self-interest theory.

To the classicist, any interference with his "natural laws" is assumed to invite disaster. In America at least these disasters seem not to have occurred and there is no substantial evidence that they will.

7. *Supra*, p. 9.

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The proposition must be interpreted broadly; as it stands, it is merely bizarre. The American economy was perhaps more dependent on "voluntary self-supporting private enterprise" in the days when monopolies were tolerated than it now is. Private enterprises voluntarily (and enthusiastically) moved into and endeavored to create monopoly situations and to free themselves from competitive restraints (to which we must later pay a little attention). The proposition has to be clarified by adding "under a competitive system." Within limits, addition of the phrase is justified. A powerful structure of antitrust law, Federal trade administration, Department of Justice enforcement, and supporting legal rules in many fields does maintain a version of the competitive system.

Peterson argues, accurately, that under the system "private" (in the sense of non-statist) enterprise must constantly pay attention to obtaining revenue greater than its costs and will seek as great a margin of revenue over costs as can be got. The argument thus runs that the primary object of a corporation must and can only be to maximize its profits, since it is constrained by the forces of competitive conditions. It may not, indeed it cannot, therefore, allow itself luxury of expenditures for social purposes beyond an insignificant margin when profits are healthy. Broadly this is true; but again, the conceptions applying have changed their content.

A. Competition

Let us begin with "competition."

The first object of competition in the case of large-scale units is to establish that degree of market control, or of equilibrium with other units selling in its markets, so that satisfactory profits may be reaped. One result is the prevalent phenomenon of the "administered price" whose behavior, we are learning, differs considerably from classical patterns. This is not the content of older, classically-described competition. It may, but frequently does not, mean selling in the highest market or buying in the lowest. Sometimes it means pricing to assure entry into, or continued holding of, a particular market sector, though at the time higher prices may be available elsewhere. It may, and very often does, mean low profit or non-profit to increase a market sector, or to fend off some large opponent ambitious to take over. More often its motive is to maintain equilibrium in a market satisfactorily shared with a few colleague-competitors. One may refer to the excellent study by Ralph Cassady, Jr. entitled, *Price Warfare in Business Competition: A Study in Ab-*

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normal Competitive Behavior.[8] The subtitle is accurate. Price competition, beyond the narrowest margin, commonly is abnormal behavior; it breaks out when equilibrium is disturbed or threatened; then it partakes of the nature of an international conflict.

"Competition" at present thus is more often determined by considerations of market power than by those brought to mind by the ancient word. Normally, a state of price equilibrium reasoned satisfactory to all hands is reached, leaving marginal areas only in which the struggle for a customer (or alternatively, the struggle to buy supplies) can be carried on. Most of the time a "live and let live" policy prevails, tacitly, lest there be violation of antitrust laws. The full competitive battery is unmasked only when a newcomer seeks to upset the equilibrium, barging into a reasonably occupied field, or a companion company becomes dangerously aggressive. In great areas, this rarely happens. Factually, if the antitrust laws and state scrutiny were withdrawn, the competitive system would cease to exist in all major lines within a very few years.

Unhappily also for Peterson's argument, a vast sector of the American economy is not, even theoretically, within the classical economic system. Most of wages, all transport, all communication, all utilities, most agricultural products, petroleum and great sectors of metals operate under a system of fixed, not competitive prices, and of regulated monopoly, or of legally-maintained competition. The enterprises involved are *soi-disant*, private and voluntary; they are actually vast collectives. They are expected to be self-supporting; they are not state-owned; but where not licensed monopolies, they are not in full degree competitive and their markets are in large measure guaranteed; the number of economic forces bearing on them is vastly reduced. Behavior of large-scale enterprise, under these conditions cannot on the empirical evidence available, be fairly assimilated to the "market place behavior" posited by the old theory. There are, it is true, elements of similarity. They are under a degree of restraint, partly by market forces, often by state action. But the impact, the degree, and the results of these restraints have changed.

B. Maximization of Profit

Maximization of profit, it is said, is the prime driving force of corporations now as always in the case of business. Agreed.

8. Occasional Paper No. 11, Bureau of Business and Economic Research, Graduate School of Business Administration, Michigan State University (East Lansing, Mich., 1963).

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Classic (and neoclassical) theory assumes that this fact excludes possibility of significant use of the corporate assets and mechanism for social purposes. Both indeed add that such use not only cannot but should not be made. The corporation's significance is thus limited to that of a profit-seeking unit, having the same motivations and acting in the same way as the classical entrepreneur-business-man. Fundamentally a good deal of this is true. Inaccuracy in using the general concept as guide to assumed motivations and behavior of the corporation arises from the changed state of fact. Maximization of profit in the case of giant corporations not only may, but usually does, mean acting quite differently from the small-scale firm; thus the content of the phrase has changed.

Ably-run corporations think of themselves as perpetual, as dependent on maintaining long-range position and as responsible for meeting market demands (which they hope to increase) for an unlimited future. Their policies thus require and include long-range planning, for periods of five to twenty years ahead. At any given moment, they will sacrifice a portion of immediate profit for long-range position. This takes many forms: tieing up capital to assure future source of supply, foregoing immediate profit for better position in any given market; hazarding resources in experimental operations (some of great size) whose profit potential is undemonstrated, campaigning for a changed tax-position — to take only a few. Of course, they hope the policies adopted will eventually "pay off" in revenue dollars, or in added percentage of market, or otherwise, but the time-dimension is changed. On any given occasion this may mean not buying in the cheapest market and not selling in the dearest; not taking immediate opportunity, but seeking the distant rainbow. And so on ad infinitum. Though the profit motive is regnant, it is modified in application, timing and direction by all manner of companion considerations.

Not least among these considerations is a lively appreciation by corporate administrators of the capacity of the state to step in when public dissatisfaction (wholly unconnected with their profits) threatens intrusion through political process. Most really large corporations can, immediately, take measures diminishing costs — for example, transferring, or consolidating company-owned towns, and abandonment of same, dropping overboard unpromising lines of activity, breaking substantial competitors, retiring older employees, but are restrained from doing so by considerations of general welfare or public relations. Clearly they expect their ultimate situation to be better than if they pursued the last dollar of profit. One need

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not, therefore, deny that a form of "profit maximization" is involved. But the results, market-wise, substantially modify the uncomplicated predictions of classical economists. Elaboration here is impossible: the situations are at once too varied and too fundamental. Enough to say that, when a certain size and degree of market control has been attained, crude following of classically assumed patterns would probably involve the corporation in difficulties with the public, with labor, with the antitrust laws, with legislative and executive authority — though they could make immediate gains. Refusing them is, perhaps, profit maximization — but reinterpreted in the light of modern reality.

Corporate size and concentration is here a powerful, probably a determinative, element. Size extends business decisions from the purely economic into fields of social movement carried on by political action and reaction. An individual trader need think only of himself. A collective trader whose stockholders number hundreds of thousands and whose customers run in millions must think politically as well. Rudimentary political science as well as market economics must be taken into account. Every modern state has assumed responsibility in whole or in part for general economic conditions, and for tolerability of those conditions for most, if not all, its citizens. For a large corporation, the premises on which the state will act and what action it can and is likely to take can never be ruled out.

This suggests that the "instruction in Elementary Economics" contemplated by Peterson must take in much more territory than that envisaged in his paper.[9] It must do more than "take account of the choices, of all people among all goods, of the scarcities of all resources, of all alternative ways of using them," and must endeavor to enlarge the corporation's "worm's eye view" of the forces bearing on it. Factually many, perhaps most, corporate administrators do take elaborate account of these forces, and often maintain expensive staffs for that precise purpose. Most of them realize that at any given moment the "choices of all people" may be determined by monopsonic policies of government (as in defense industries), by power-relations with labor, by currency and credit factors determined by the Federal Reserve Board, even by currents of public thought. The corporate operations may include working out price and wage relationships under the guidance of the Secretary of Labor or even the White House; currents of future need in national defense; plans to supply shifting population; relationships with the Depart-

9. *Supra*, p. 13.

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ment of Interior or the Department of Agriculture to assure supply; maintenance of regional economic stability in conjunction with local authorities — to name only a few. All of which suggest that the elements of economic "control" posited by classicists and neoclassicists need considerable elaboration.

While necessity of this reappraisal is at least partly a consequence of the size of the corporation, it also results from a modern political-economic factor which now is constant and must never be overlooked. In most developed (and a good many underdeveloped) countries of the world — and certainly in the United States — public opinion and political processes no longer tolerate the results flowing from pursuit of the purely economic and competitive processes to their logical end. The community more often than not prefers continuous employment and stability to the minor price-advantage tossed out by competition. Political action will be invoked against unduly low wages, against undersupply of an essential product, against unemployment, perhaps even against oppressive price fluctuations. In blunt, the state, energized by democratic processes, is always a factor, actual or potential. The "entire range of alternatives on the other side of the market in which it sells and buys"[1] are only some and not necessarily the most determinative elements in the supposed "controls" relied on by classical and neoclassical theory.

This brings us to a brief observation on the progress of the "corporate conscience." (To economists, the phrase is oddly romantic: to lawyers, it is ancient and familiar history and therefore by them better understood. Because a corporation is an artificial legal, and not a human, being, it was held in old common law courts to have no "soul" and therefore no "conscience"; it could not validly take an oath; it was not amenable to moral considerations, and so forth.) Corporations are composed of and managed by men. Each of the administrative group does have a conscience and thus consensus does influence corporate action. In substantial measure, as Peterson rightly says, the "corporate conscience" does have a great deal to do with performing the supply function well, with honesty, upright dealing, and observance of applicable laws. But these same managers have also absorbed the idea that corporations (for better or worse) are also held responsible by an appreciable sector of opinion for some at least of the social conditions proceeding from their operations — also that, if offensive, these conditions may bring into action the powerful machinery of the state. If corporate

1. *Supra*, p. 13.

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managers do not themselves know this, their public relations departments tell them so. The "corporate conscience" may be little more than a lively appreciation of possible consequences either of direct violation of ethics or of social results not tolerable to the community, but it is nonetheless real for all that. Where there is a superior management, its "conscience" transcends this, anticipating rather than remedying deficiencies. Deliberate sacrifice of the firm's long-run prosperity is, to be sure, highly unlikely if not unethical. But one result of a corporate conscience may be the devising of means or even the seeking of governmental or other measures — for example, pension trust funds or even (as in the case of oil) stabilization arrangements — making possible attainment of the desired conditions without that sacrifice. Of this sort of corporate activity there is a very great deal. The law indeed goes farther — it approves and encourages a limited amount of direct corporate philanthropy — though this is less important perhaps than other areas in which the "corporate conscience" has come to be an active force.

III. Stockholders Derive What Influence They Have from Social-political, Not from Entrepreneurial, Factors

The place of the stockholders as residual recipient of profits deserves a final word. Here classical (and neoclassical) theory reaches romantic heights. It insists on having owner-risk-taking-entrepreneurs. The seventeen million stockholders are nominated for the role — no other candidates presenting themselves in the corporate spectrum. Ironically, the facts refuse to write the appropriate script. This writer, believing that control function has shifted away from "ownership," sees little necessity for maintaining the fiction of "owner-entrepreneurship" in the corporate picture, or even substantial reason for having the institution. In any case, willy-nilly, we have not got it. To the contrary, we have, essentially a new form of property.

Desire to discover an "owner-entrepreneurship" or "risk-taking" function in stockholders is basically (I think) an emotional desire to find some functional justification for having stockholders at all. A couple of generations ago, they pulled their weight in the economic boat because they saved, and invested their savings, at hazard of risk and with hope of profit in productive enterprise: in other words, supplied risk capital. They also chose, supervised, contributed to, and controlled management. This justified their existence in classical theory. Solid argument could be made for it. As of today, it is

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probably true that stockholders have saved (or have inherited past savings). But, as we have noted, these savings no longer are a major source of capital. At best, not over 2 or 3 per cent (often less) of new risk-capital actually entering industrial enterprise in each year is supplied from this source. In overwhelmingly large part, personal savings devoted to buying of stock are used, not to furnish capital to enterprise but to buy out the holdings of some prior stockholder. Nym buys General Motors stock from Bardolph, who bought it from Pistol, who bought it at 10,000 removes from the heirs of Sir John Falstaff — who did, in fact, invest some money in an original issue of common stock of General Motors at its birth. Nym's purchase is still, quaintly, called "investment" — the word having, as usual, changed its content.

The only facts we know are that Nym's money never did get to General Motors and never will; further, that a half-century having elapsed, Nym's purchase no longer has crucial connection with maintaining General Motors' capacity to acquire new capital by selling new issues of stock. An element of such connection is present — especially in the public utility industry — but so tiny as to be almost invisible. Factually, the stock buying and selling processes carried on through the exchanges have sentimental rather than functional connection with General Motors. Nym's "risk-taking" is the risk of the stock market price fluctuations, completely different from the risk Sir John Falstaff may have taken when he paid good money into the treasury of the nascent motor car enterprise. It is almost though not wholly true that the process is completely independent. The relation is about that of the buyer of a sweepstake ticket to the owner of a race horse whose performance determines the lottery prize — little more. No real reason exists to believe that the entire stock exchange process releases significant amounts of capital for true investment in enterprise, though there may, of course, be a small slop-over margin. Commonly, however, when Nym buys Bardolph's General Motors stock, Bardolph does not finance a new enterprise with the proceeds. He turns around and buys Standard Oil of New Jersey — and so on in millions of transactions.[2]

Dr. Paul Harbrecht has been considering a theory that the stock markets have developed a separate, more or less closed, system of property-holding and exchange, and that this system is essentially

2. The argument has been fully made and need not be repeated. See Berle, "Modern Functions of the Corporate System," *Columbia Law Review*, LXII (1962), 433.

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independent from the actual productive process. Prima facie, there is a good deal of evidence to support the theory. Since, as we have seen, the corporation does not need the stockholders' savings, and the stockholder has no management function — merely vague and occasional quasi-political influence — the classical justification for him as source of capital, or as investment risk-taker, let alone as entrepreneur-manager, simply disappears. He toils not, neither does he spin. He merely expects dividends from capital operation, and an unearned increment of value as the corporation compounds the return on withheld profits ploughed back into the business.

Justification of the stockholder's position, if there is one, therefore, must be found oustide classical or neoclassical economic theory. I believe there is such justification though the base is politico-social rather than economic. There are solid values in having men and families attend to their own problems and develop their own lives. That requires that they should have a form of wealth — giving them capacity to choose their ways of consumption, and their manner of living, and power to make their own application of such wealth to their own conception of life. Passive property, like stock, does enable men to do this. Yet it is at once apparent that this justification is valid only in direct ratio as stock is widely distributed among the entire population — ideally, among all of it. As such distribution goes forward, there is measurable addition to the capacity for self-determination of each holder. Further, as the entire organism of the American economy expands, and as capital values increase, an increasing number of Americans — ideally, all of them — become joint heirs of the system's productivity.

That this distribution is gradually occurring is evident. Thirty years ago only a tiny number of Americans held this form of property (or, for that matter, any income-producing property at all). Today, as we see, 17 millions or more hold some of it directly. Tens of millions more hold it indirectly. The distribution is still not good; 1 per cent of the population of the United States still holds a wholly lop-sided preponderance of it. Yet, quite clearly, progress is being made — though more progress has to be made if the vanished economic justification for such property is to be adequately replaced by its only visible alternative — the social justification.

Simultaneously, one notes, the stock markets, save in vestigial trace, have ceased to be allocators of risk-capital and have become allocators of passive property — irrational, but conceivably capable of development into social institutions no less useful than the great life insurance companies and savings banks.

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I do not see, therefore, that Peterson's third point stands up, or indeed that his observations are really relevant to the problem in hand. The supine stockholder is protected by an elaborate system of law — chiefly administrative. Indeed he is (and ought to be) very well satisfied with his position. Until, of course, some revolutionary rises to ask him why he should be permitted to have it, especially if a great many others do not. Then it might be remembered that in great parts of the world, including the fascist as well as communist countries and to some extent semi-socialist Britain, his position has been eliminated overnight (as in Russia) or vastly reduced (as in Nazi Germany) or taken over (as in Britain) or sometimes quietly eroded.

Where the stockholder is maintained in his position — as the United States is endeavoring to do — the fact is not proof of the "deep-rootedness" of "traditional capitalism." Rather it results from tenacious holding of an American ideal of individual capacity to choose his own way of life, and of a system giving individuals enough disposable wealth to implement their choice, and from realization that for these ends this form of distributed wealth, however supine and passive, is a useful if not an essential tool.

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