Corporate Social Responsibility without Corporate Suicide

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LOUIS O. KELSO AND PATRICIA HETTER

# *Corporate Social Responsibility without Corporate Suicide*

*We can save private enterprise only by extending capital ownership and income to all. The authors offer a detailed plan which is already in operation in eighteen companies and in various stages of negotiation by fifty others.*

The U.S. business corporation, which produces most of the private sector's output, is "plainly in trouble," as James Roche, former General Motors board chairman, admitted in 1971. To an extent that would probably be horrifying if the dimensions of dependence were fully known and the implications understood, the corporation is being kept alive by boondoggle, the continuous purchase and subsidy by the government of virtually everything that business produces, from breakfast food to bombs, financed by ever more oppressive taxes and deepening, irreversible debt. Renewed, stepped-up boondoggle infusions are responsible for those periodic spurts in employment, output, orders, and other indices widely hailed as swallows heralding the return of spring. Nor can the good-news machine in Washington, which every administration uses to manufacture confidence in its economic policies, quite conceal the fact that the foundations of the economy are disintegrating.

Although boondoggle as an expedient is much more ancient than the Great Depression, its function and purpose in today's economy are primarily to maintain full employment, as Congress is charged to do by the Employment Act of 1946. In the 1971 debate over the $250-million federal loan to shore up Lockheed (as reported by Washington correspondent Robert Sherrill in the July 30, 1972, *New York Times Magazine),* then-Treasury Secretary John Connally was driven by Senator William Proxmire's questions to admit that the real intention behind certain military and de-

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"I no longer know whether I'm part of the problem or part of the solution."

fense expenditures was to create jobs. This is a motive that policymakers prefer not to acknowledge, for once a project is identified as boondoggle, its moral legitimacy is destroyed.

Proxmire argued that the loan was not a subsidy but downright welfare. There would result "no benefit, no quid for the quo," the Senator said, since Lockheed would not be required to perform.

*"What do we care whether they perform?"* Connally reportedly replied. "We are guaranteeing them basically a $250-million loan. What for? Basically so they can hopefully minimize their losses, so they can provide employment for 31,000 people throughout the country at a time when we desperately need that type of employment. That is basically the rationale and justification."

## *The two-factor theory*

The idea behind the Employment Act of 1946 is that the outtake of each individual or family *from* the economy should be based directly on the productive input each makes *into* the economy. This idea—the very heart of the Puritan ethic—is morally and economically sound. Unhappily, the Act interprets the input-for-outtake morality in preindustrial terms, as if labor input were the only kind of productive input there is—the only kind that is real or legitimate. The framers of the Employment Act were oblivious of the fact that with the Industrial Revolution, it became increasingly clear that *things* are productive in the same senses that people are. It was all very well for Captain John Smith to issue an order to the colonists of Jamestown (whose capital equipment consisted of the hand tools they were able to stow aboard ship and an abundant supply of raw, uncultivated land): "He that will not work, neither shall he eat." Imposing the same duty on the people of a technologically advanced industrial economy is more difficult and less rational.

Captain Smith, unlike Congress, did not have to contend with the twentieth-century business corporation. The corporation presides over not one, but two factors of production. Under its aegis labor and capital are marshalled to produce an almost infinite variety of goods and services in accordance with a strategy that seeks to maximize profits and minimize costs. The easiest costs to minimize are labor costs. This is accomplished mainly through technology. Through accelerating technological change, labor input is squeezed out and capital input increased; tasks otherwise performed by human hands, muscles, and brains are shifted to land, structures, and machines. New kinds of goods and services that cannot be produced by labor alone are developed and brought forth. Thus technological change alters the input mix. Each new



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unit of output is produced with relatively more capital input and less labor input. And in this process, which goes on continually in every enterprise in the economy, decade after decade, the labor power of millions of workers is gradually made redundant. The income distribution system supporting consumption breaks down, and with it the Puritan-ethic morality in its one-factor, labor-centered form. The economy grows progressively more unworkable. To save the situation, Congress trundles in the classic economic *deus ex machina,* boondoggle. Through boondoggle purchases and subsidies, employment is maintained, giving the appearance of the Puritan ethic, if not the reality.

The lesson here is that if corporate management so operates business that it fails to enable the potential customers to earn the money to buy its output, government must step in and close the purchasing power shortfall. But the government's attention is focused solely on one factor of production, labor, the only factor owned by the masses of individuals who vote. By subsidizing with the people's money and credit anything and everything that provide employment and profits, the government attempts to compensate for the corporation's own defective operating strategy, which, combined with conventional methods of corporate finance, not only does not explain how the vast majority of people will get the money to spend but does explain why they do not and cannot.

## *The rich get richer*

Conventional corporate finance, the process by which new capital is brought into production, assures with clinical precision that all newly formed capital will end up being owned by the same 5 percent of families who already own virtually all existing capital. These families spend relatively little of their stream of income on consumer goods—the ultimate reason for all economic production. Through their capital ownership, they gain vastly more income than they can spend even if they maintain a life-style that seems out of the Arabian Nights to families holding down two or three jobs in order to meet the payments on their cars and household appliances.

Thus corporate management puts incremental productive power into the hands of those who have virtually no potential unsatisfied consumer needs and wants but have only the desire to increase their productive hoard *ad infinitum* as a hedge against any economic disaster that might befall, no matter how remote. It fails to put productive power into the hands of the growing millions who make up the vast consumer markets on which business depends. Each man kills the thing he loves, said Oscar Wilde. That is certainly true of corporate management. For though management loves customers and goes looking for them all over the globe, in the executive suites at home it is effectively engaged in killing them off. Through cost minimization, it slaughters its employee constituency. Through routine finance, it freezes and even reduces its potential stockholder constituency. And then it wonders why customers are on the endangered species list, and why only the chambers of commerce seem to have a good word for business.

Behind the growing clamor for "corporate social responsibility" is a general feeling that our economic problems originate with and in the corporation; that the business corporation is somehow responsible for the poverty, insecurity, alienation, and violence that are making life increasingly difficult and hopeless even in nations that not so long ago thought of themselves as "affluent." Management itself is beginning to feel responsible—even guilty. But the critics have yet to come up with a concept of corporate responsibility that business can live with. A viable concept must not conflict with the basic logic of business. For if the corporation's ability to produce goods and services in the most rational and economical way and management's own motive for doing so are destroyed, the poverty and violence to come will make our troubled present seem like a golden age.

## *Sops or self-help*

There are only two basic alternatives from which to choose:

*Alternative I.* Instead of waiting for the government to redistribute corporate profits (along with middle-class incomes and the proceeds of growing government debt) through boondoggle employment and other expedients, corporate management can channel profits directly to the needy. It can dedicate the resources of the corporation to the alleviation of hunger, insecurity, illness, loneliness, and boredom; to the provision of more jobs, dwell-



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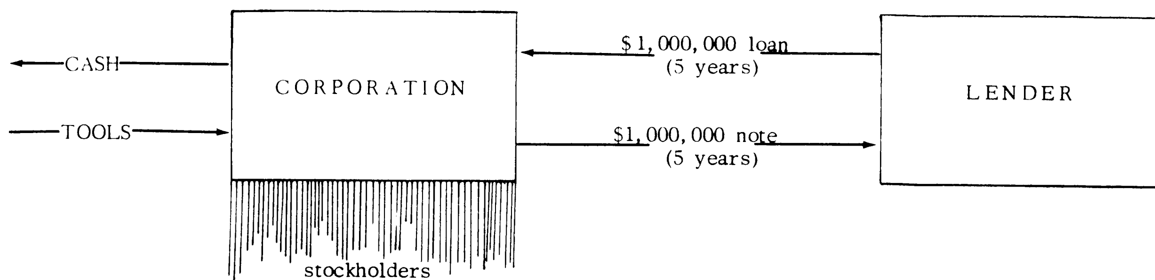


Model I **Conventional Corporate Finance**

ings, education, vocational training, medical care, dental care, psychiatric treatment, marital counseling, legal aid, hot meals, babysitting facilities, environmental housekeeping, and thousands of other services and products that the needy will soon think up and demand as fundamental human rights. In a word, management can use the corporation to fight the *effects* of the poverty that the corporation's own defective strategy causes and perpetuates.

This alternative repudiates the private-property principle of distribution (outtake based on input) and substitutes the *need* principle of economic communism: "to each according to his need." In adopting it, management would exchange the private-property, free-enterprise system—the basis of the freedom millions of Americans over the centuries have risked or given their lives to preserve—for a system indistinguishable in principle, and ultimately in reality, from the bleak, repressive scarcity economies of the USSR and its imitators. The corporation would slowly be merged into the government as its new welfare arm, and we would complete the currency-ravaging process by which we disguise welfare as wages.

*Alternative II.* We can correct our defective corporate strategy by beginning to finance new capital formation in ways that will enable the 95 percent of Americans who own little or no capital to acquire it, legitimately and effectively. In other words, we can extend to an expanding shareholder constituency the everyday business logic that historically has been used for the benefit of the few. The purpose of finance, as Simon Kuznets has pointed out in his book *Capital in the American Economy: Its Formation and Financing,* is to enable business to acquire the ownership of capital instruments before it has saved the funds to buy and pay for them. New capital is normally expected to pay off its formation costs within a reasonable period of time. This is what "feasibility" means in the business world. Exactly the same opportunity must be made available to capital-less families and individuals if they are to raise their income-producing power (their productivity) adequately through the operation of the economy itself. The economically highly productive can buy their own housing, food, entertainment, medical care, education, and whatever else they need or want. Corporate management can stick to doing what it likes to do and has always done best: producing goods and services at a profit for customers with adequate purchasing power. This alternative will eventually restore the free-enterprise system, the health of the business corporation, and perhaps American self-esteem as well.

## *Financing and concentration*

About 98 percent of corporate growth in the U.S. economy is financed either through current cash flow or borrowings repaid out of cash flow. The process may be represented by Model I.

Management first prepares a feasibility study to show that the newly formed capital will pay for itself within an acceptable period of years; it presents the feasibility study, together with a loan request, to a bank or other lending source. When the loan is made, the corporation gives back its note—let us assume a five-year installment note bearing a market rate of interest. The interest on the note is deductible from state and federal corporate income taxes, but the principle must be repaid in after-tax corporate dollars.

This technique, which has the same effect as financing directly from internal cash flow, explains the relentless concentration of ownership and income; for when the new capital is paid off, the incremental productive power represented by additional land, structures or machines is owned by



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the same small, stationary stockholder base (the top 5 percent of wealth-holders) who already own virtually all the U.S. economy's productive assets. The only other conventional financing method is sale of new stock for cash. But as this stock is sold only to those with enough capital to buy it, the result is the same. Ownership of new productive power is concentrated in those who are already excessively productive. In short, the logic used by business in investing in things that *will pay for themselves* is not today available to the 95 percent of Americans born without family capital ownership.

## *Employee Stock Ownership Plan*

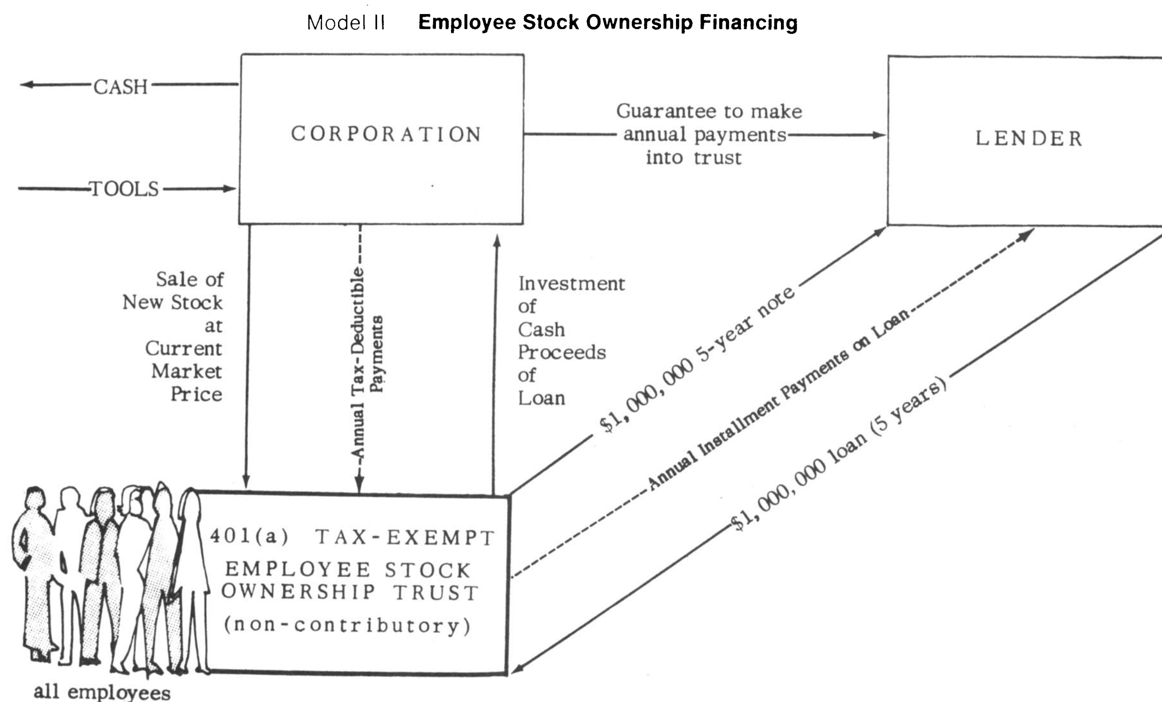
But techniques that broaden the stockholder constituency simultaneously with the financing of corporate growth do, in fact, exist. The most basic is designed to provide capital ownership for corporate employees *without invading their paychecks or savings.* This method can and is being used under present federal and state tax laws. It is called Employee Stock Ownership Plan (ESOP) financing.

Again, let us assume that a corporation wants to make a $1-million plant addition. Management has done its feasibility study and presents it to a lending source with a loan request. However—and this is a radical departure from conventional finance represented by Model I above—management requests that the loan be made not directly to the corporation, in which case the principal would be repaid in after-tax earnings, but directly to an employee stock ownership trust, which gives its note to the lender. The committee that manages the trust directs the investment of the loan proceeds in newly issued stock of the corporation itself, the shares being sold at their fair market price at the time of the transaction. The corporation guarantees the lender that it will make annual payments into the ESOP trust of amounts sufficient to defray principal and interest installments. These payments, within specified limits, are tax deductible under Section 401(a) of the Internal Revenue Code. In economic theory, as distinguished from tax theory, such payments represent merely a high payout of the wages of capital for the benefit of the participants in the trust. This technique is shown in Model II.

This technique not only makes beneficial stockholders of all corporate employees in proportion to their relative compensation but enables the corporation to finance its growth through pretax dollars. If all factors are considered and the technique is carefully used, it will not, except briefly, dilute the equity of existing shareholders in a profitable enterprise, but in fact, over a reasonable period of years, will enrich it. By this method management *can raise employee incomes without raising costs.*

The American economic dream has always been, and still is, the opportunity to acquire a personally owned capital estate capable of yielding a viable private income. ESOP financing techniques can be

Model II **Employee Stock Ownership Financing**



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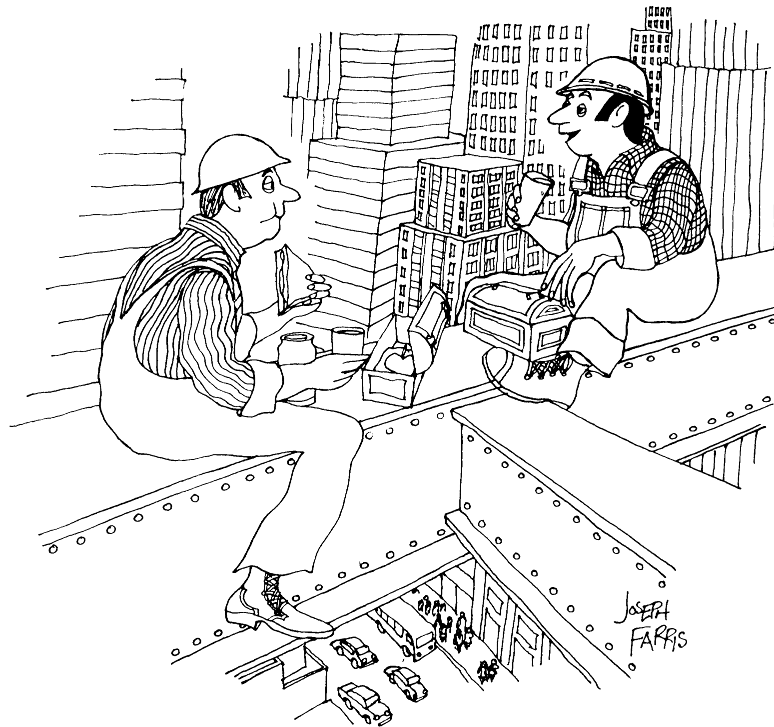


"I took advantage of a technical adjustment in the market and diversified my portfolio to include six percent Gulf and Western debentures of 88, the new issue of Treasury 7s and ... "

used today by most business, financial, and service corporations to finance their growth, acquisition, and structural changes. With legislative revisions, ownership of viable capital holdings by all, whether employed or not, or by governments could be achieved within a reasonable period of time.

Two-factor economics makes it clear that our economic problem is not what one-factor (labor-centric) thinkers assert: an inequitable distribution of income. It is an *inequitable distribution of productive power,* from which an *unworkable* distribution of income results. The solution to this problem is not a compulsory "incomes policy" enforced by government redistribution and economic controls. It is a strategy by which the corporation broadens its stockholder constituency, beginning with its own employees, while making a high payout of its net income—the wages of capital—and depending upon credit, eventually pure credit, to finance corporate growth and the growth of its shareholder constituencies. This is an incomes policy planned as a "participation in production" policy and administered by corporate management, one adapted to both its own special needs and those of society. It is a strategy that conforms to the private property principle of outtake according to input, which is the basis not only of a market economy but of our morality as well. Adopted by enough corporations on a wide enough scale, such a strategy would eliminate the purchasing power insufficiency which makes redistribution necessary in the first place.

Corporations that produce a plenitude of the high-quality goods and services that are the difference between squalor and comfort; corporations that make it possible for all individuals and families to enjoy adequate and secure streams of income by linking them through ownership to the productive power of capital; corporations that pass on to their employees, stockholders, and customers the fruits of technological advance in the form of rising incomes, more leisure, better products, lower prices and a higher quality of life in general; corporations that perform these same services for citizens of the developing economies through building broader shareholder constituencies in the host countries and thus bring to them a sharing of technological know-how and trade—such corporations will more than fulfill the proper social destiny of the corporation. They will also avert the growing danger that the corporation itself will be annexed by a total-toil state, its managers put to administering ever vaster and more wasteful boondoggles simply to satisfy an obsolete interpretation of the Puritan ethic.



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