# The Coming of Post-Industrial Society


*DANIEL BELL*

IN the post-industrial society, there will be an enormous growth in the "third sector": the nonprofit area outside of business and government which includes schools, hospitals, research institutes, voluntary and civic associations, and the like. Yet with all that, the business corporation remains, for the while, the heart of the society. About 55 percent of the gross national product originates in the business sector; about 60 percent of gross private domestic investment is made by business firms for new plant and equipment annually.[1]

[1] All the data is from the *Statistical Abstract of the United States* (1971).

When we speak of the corporation in any familiar sense, we usually think of the industrial giants and of the "magic number" 500 that *Fortune* magazine has popularized. And there are clear reasons for this focus. Actually, there are, in round numbers, about 1,500,000 corporations in the United States. But if we break down the total, they are distributed in this fashion:

Retail and wholesale trade—450,000
Finance, real estate, and insurance—400,000
Services—200,000
Manufacturing—195,000
Construction—115,000
Agriculture and mining—45,000

If we take the manufacturing sector as the prototype of industrial America, we find that these 195,000 corporations have about $500 billion in assets. But about 192,000 corporations (or 98 percent of the total) are under $10 million in asset size, and this group of 98 percent of all corporations owns only 14 percent of all industrial corporate assets. Slightly more than 500 firms, with more than $25 million in assets, account for 83 percent of all corporate assets; 200 firms, each with more than $250 million in assets, account for 66 percent of all industrial assets, while 87 firms, each holding more than a billion dollars in assets, account for 46 percent of the total $500 billion assets.

These 500 industrial corporations, which, in 1970, employed 14,600,000 workers, or more than 75 percent of all employment in manufacturing, symbolize a degree of power which has been a source of recurrent concern for public policy. This concern is evident, once again, today, but for reasons far different than those, say, of thirty years ago, when a firm such as General Motors would spend millions of dollars for thugs, tear-gas, and guns to fight the violence of labor organizing. The concern for public policy, summed up in the phrase "social responsibility," derives from the growing conception of a communal society and the limits which a polity may have to impose on economic ventures that generate unforeseen consequences far beyond the intentions, or powers of control, of the initiating parties.

Over the last few years, there has been a notable change in public attitudes toward the corporation. Only twelve years ago, writing in Edward S. Mason's magisterial compendium on *The Corporation in Modern Society,* Eugene V. Rostow could comment:

> "In reviewing the literature about the current development of [the large, publicly-held] corporations, and about possible programs for their reform, one is struck by the atmosphere of relative peace. There seems to be no general conviction abroad that reform is needed. The vehement feelings of the early thirties, expressing a sense of betrayal and frustration at a depression blamed on twelve years of business leadership, are almost entirely absent."[2]

The reason for that tolerant and even benign attitude toward the corporation in the 1950s is not hard to find. Apart from the general sense of social peace induced by the Eisenhower administration (a peace maintained, in part, by the mobilization of the sentiments of society against an external enemy), a new and seemingly satisfactory conception of the role of the corporation in the society had arisen.

For seventy-five years, going back to 1890 when Congress passed the Sherman Antitrust Act, the corporation had been viewed with populist suspicion because of its size. Size, in the American lexicon, means power, and the bigness of business


was perceived as both an economic and political threat to democracy. Economic size was equated with market power, or the ability to control (within limits) the price of products offered for sale. Large-scale assets were equated with undue influence, either in a local community or state, or in the nation itself.

But in the more than half century's experience with antitrust, a new economic sophistication had been developed. One was the important distinction between size and market control, and the realization that the two are not completely related. The two biggest manufacturing companies today are Standard Oil of New Jersey and General Motors, with $19.2 billion and $14.1 billion respectively in assets. GM has about 55 percent of United States' automotive production; but Standard Oil, though larger than GM, has only about

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[2] E. V. Rostow, "To Whom and for What Ends is Corporate Management Responsible," in *The Corporation in Modern Society,* ed. Edward S. Mason (Cambridge, Mass., 1959), p. 59.

9 percent of domestic oil refining and an even smaller percentage of production.

Size, clearly, is not a good predictor of market control. Market control is measured by "concentration ratios," i.e. the sales of the largest four companies, in a product line, as a percentage of total product sales. But it seems reasonably clear that, since the turn of the century, the concentration ratios have gone down considerably and that, in most industries, there is not increasing concentration but rather a ceaseless flux.[3]

But the more important shift was a change in ideology. The idea took hold that "size" was less relevant than "performance." Performance itself is an elusive criterion. It embraces the idea of receptivity to innovation; willingness to expand capacity (one of the chief charges by liberal economists in the 1940s against such "monopolistic" industries as aluminum and steel was that they were unwilling to expand capacity); the reflection of increased productivity in better quality, higher wages, and steady, if not lower, prices; and similar indices of responsiveness to the needs of the society.

The clearest mark of performance was growth. The fear of the 1930s, after all, was stagnation. Liberal economists such as Alvin Hansen had predicted, in fact, that the economy had achieved such a state of "maturity" that there was no longer the possibility of expansion. The facts belied these fears. New technological frontiers opened up after the war; and the large corporations took the initiative.

A vigorous, large company could present its case to the public that size was immaterial, so long as the corporation displayed those hallmarks of dynamism that added up to "performance." In fact, as J. K. Galbraith argued in his book, *American Capitalism,* size was an asset because it enabled the large corporation to underwrite technological progress.

> "It is admirably equipped for financing technical development. Its organization provides strong incentives for undertaking development and for putting it into use. . . . The power that enables the firm to have some influence on price insures that the resulting gains will not be passed on to the public by imitators (who have stood none of the costs of development) before the outlay for development can be recouped. *In this way market power protects the incentive to technical development.* (Italics in the original.)"[4]

Here was a strong and sophisticated defense of bigness by the criterion of performance. And, to a considerable extent, the ideology of American business in the postwar years became its ability to perform. The justification of the corporation no longer lay primarily in the natural right of private property, but in its role as an instrument for providing more and more goods to the people. Because the corporation seemed to be performing this role adequately, criticism of it did, indeed, become muted, so that by the end of the 1950s the corporation had established a new legitimacy in American life.

#### THE NEW CRITICISM

Today that legitimacy is being challenged, or at least the tolerant and benign attitude toward the corporation has receded. The paradox is that the ground of the new criticism is no longer size or bigness (though some old populist echoes persist), but performance itself. A feeling has begun to spread in the country that corporate performance has made the society uglier, dirtier, trashier, more polluted, and noxious. The sense of identity between the self-interest of the corporation and the public interest has been replaced by a sense of incongruence.

Any issue that becomes ideological becomes

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[3] The stereotype that the big company has a big market share is obviously supported by many examples. Only it is refuted by even more. If one looks at the "symbolic" examples of concentration, it is quite clear that in no industry today is concentration at a comparable level with the period after the great wave of consolidations, from 1898 to 1902. As pointed out by Professor Segall of the University of Chicago: In 1900, International Harvester produced 85 percent of the nation's harvesting machines. In 1902 National Biscuit controlled 70 percent of the biscuit output. In 1901, American Can turned out 90 percent of its industry's output. In 1902, Corn Products had 80 percent of its industry's capacity. In 1902, U.S. Leather accounted for more than 60 percent of leather output; Distillers Securities provided more than 60 percent of whiskey output; International Paper produced 60 percent of all newsprint. In 1900, American Sugar Refining refined virtually all the sugar in the country. For a comprehensive discussion of the contemporary degree of concentration see M. A. Adelman, "The Two Faces of Economic Concentration," *The Public Interest,* no. 21 (Fall 1970).

[4] John Kenneth Galbraith, *American Capitalism: The Concept of Countervailing Power* (Boston, 1952), pp. 91, 93.

distorted. The facts of spoliation of countryside and the reduction of various amenities are obvious; the reasons less so. One evident cause is the sheer increase of numbers of persons in the society and a change in social habits. Take, for example, the national parks: in 1930, the number of visitor-days (one person staying twelve hours) was 3 million in a population of 122 million; by 1960, it was 79 million, in a population of 179 million; and in 1968, there were 157 million visitor-days in a population of 200 million. The results are described vividly in an account in *The New York Times:*

> "Yosemite, only a day's drive from San Francisco and Los Angeles, is generally considered the most overcrowded park. Congestion reaches its peak on major holidays and this Labor Day weekend was no exception.
>
> "The constant roar in the background was not a waterfall but traffic. Transistor radios blared forth the latest rock tunes. Parking was at a premium. Dozens of children clambered over the rocks at the base of Yosemite Falls. Campsites, pounded into dust by incessant use, were more crowded than a ghetto. Even in remote areas, campers were seldom out of sight of each other. The whole experience was something like visiting Disneyland on a Sunday."

Moreover, if we take pollution of the air and water as the criterion of social ill, then clearly all sections of the society are at fault: The farmer who, by seeking to increase food production, uses more nitrate fertilizer and thus pollutes the rivers of the country; the individual automobile

owner who, seeking greater mobility, spews noxious gas into the atmosphere; the Atomic Energy Commission which, in seeking to expand nuclear power, may be responsible for thermal pollution of the waters; and the corporation whose smokestacks emit smog-creating gases in the air, or whose waste products pollute the lakes.

But if one takes the attitude that everyone is to blame—and simply ends with the moral exhortation for each person to restrain his behavior—then one misses the important point. Such a situation itself points to the fact that the allocative mechanism of society, the proper distribution of costs and resources, is not working. In a free society, the socially optimal distribution of resources and goods exists where the market reflects the true economic cost of an item. But where private costs and social costs diverge, as A. C. Pigou pointed out fifty years ago, then the allocation of goods becomes skewed. When the owner of a factory has no incentive to take account of costs to others of the pollution he generates because these costs are not charged to him, factory output (or automobile mileage in the case of a car owner) will be at a higher level than is socially optimal.

The growing problem for modern society is this increasing divergence of private costs and social costs (what economists call technically an "externality," because such costs are not "internalized" by a firm in its own cost accounting). But along with this awareness there arises, too, the question whether the strict conception of costs—and return on investment—that is the rationale of the accounting procedures of the firm is at all adequate today. In other words, perhaps the older definition of "performance" is too narrow. The question that then arises involves, not just the "social responsibility" of any particular corporation, but the "rightness" of the broader pattern of social organization and of the social goals of the society. And, to the extent that the corporation has been the institution integral to the existing pattern, it becomes the starting point of a new inquiry.

Perhaps we can see the quite radical difference between these two perspectives by setting up two models, which I shall call the *economizing* mode and the *sociologizing* mode, as polar extremes within which the actions of the corporation can be estimated and judged.

#### THE ECONOMIZING MODE

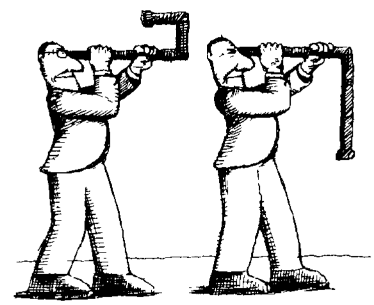
Beginning little more than 150 years ago, modern Western society was able to master a secret denied to all previous societies—a steady increase of wealth and a rising standard of living by peaceful means. Almost all previous societies had sought wealth by war, plunder, expropriation, tax-farming, or other means of extortion. Economic life, in the shorthand of game theory, was a zero-sum game; one group of winners could benefit only at the expense of another group of losers.

The secret mastered by modern Western society was *productivity,* the ability to gain a more than proportional output from a given expenditure of capital, or a given exertion of labor; or, more simply, society could now get "more with less effort or less cost." Economic life could be a non-zero-sum game; everyone could end up a winner, though with differential gains.

In the popular view, productivity was made possible by the introduction of machinery or, more specifically, the discovery of new forms of power, mechanical or electrical, hitched to an engine. Clearly much of this view is true. But productivity, as a concept, became possible only through a new "supporting system" which dictated the placement of machines in a new way. To put the matter less abstractly, modern industrial society is a product of two "new men," the engineer and the economist, and of the concept which unites the two—the concept of efficiency. For the engineer, the design of a machine and its placement vis-à-vis other machines is a problem of finding the "one best way" to extract maximum output within a given physical layout. The economist introduces a calculus of monetary costs, within the framework of relative prices, as a means of finding the most appropriate mix of men and machines in the organization of production.

Modern industrial life, in contrast with traditional society, has been revolutionized by these innovations. The new sciences have introduced a distinctive mode of life. We can call it *economizing.* Economizing is the science of the best allocation of scarce resources among competing ends; it is the essential technique for the reduction of "waste"—as this is measured by the calculus stipulated by the regnant accounting technique. The conditions of economizing are a market mechanism as the arbiter of allocation, and a fluid price system which is responsive to the shifting patterns of supply and demand.

Economics itself, over the past one hundred years, has developed a rigorous and elegant general system of theory to explain the relative prices of goods and services and of the factors in production, the allocation of those factors to various uses, the level of employment, and the level of prices. With economics comes a rational division of labor, specialization of function, complementarity of relations, the use of production functions (the best mix of capital and labor at relative prices), programming (the best ordering of scheduling of mixed batches in production, or in transportation), etc. The words we associate with economizing are "maximization," "optimization," "least cost"—in short, the components of a conception of rationality. But this conception of rationality, it should be pointed out, was intended by its utilitarian founders as a rationality of *means,* a way of best satisfying a given *end.* The ends of life themselves were never given; they were seen as multiple or varied, to be chosen freely by the members of society. Economics would seek to



satisfy these choices in the "best way," i.e. the most efficient means possible in order to "maximize" satisfaction.

For an understanding of the economizing mode, this distinction between rational means and a plurality of ends must be emphasized. Modern industrial society, being a liberal society, has never felt the need to define its ends or to establish priorities within some set of ends. It has always eschewed such collective decision-making. No conscious social decision was made to "transform" society two hundred years ago. No conclave met, as in a French constituent assembly or an American constitutional convention, to declare a new social order. Yet it is quite clear what the new goals of the new industrial society were to be—the ends that became "given" all involved the rising material output of goods. And other, traditional modes of life (the existence of artisan skills and crafts, the family hearth as a site of work) were sacrificed to the new system for the attainment of these economic ends.

Commonplace as this history may be, the singular fact needs to be emphasized. Unlike political change, no one "voted" for these decisions in some collective fashion, no one assessed (or could assess) the consequences of these changes. Yet a whole new way of life, based on the utilitarian calculus or the economizing mode, gradually began to transform the whole of society.

**THE CORPORATION: A NEW SOCIAL INVENTION**

Productivity is a technique, steadily rising output of goods is an end; for the two to be realized they have to be institutionalized in some renewable system of organization. That institution was the corporation.

Much of economic history and some of economic theory has focused on the entrepreneur as the singularly important person who, sensing new opportunities, breaks the cake of custom and innovates new areas of economic life. Much of contemporary sociological theory has dealt with the manager as the faceless technocrat who runs a routinized operation. But to understand the corporation, one has to turn not to the entrepreneur (and the myths about him) or the manager (and the caricatures that are drawn of him), but to a figure historically and sociologically intermediate between the two—the organizer.

The church and the army have been the historic models of organizational life. The business corporation, which took its present shape in the first decades of the twentieth century, was the one new social invention to be added to these historic forms. The men who created that form—Theodore N. Vail who put together ATT, Walter Teagle of Standard Oil of New Jersey, Alfred P. Sloan of General Motors—designed an instrument which coordinates men, materials, and markets for the production of goods and services at least cost with the best possible return on capital investment. They did so by introducing the idea of functional rationality, of *economizing*, as a new mode of ordering social relations.

Of the three, only Alfred P. Sloan has put down directly the principles he employed. His account, *My Years with General Motors*, is fascinating, and one can take his sketch as prototypical of the corporate mode of mid-century America. The most striking aspect of Mr. Sloan's book is its language. Sloan's key terms are *concept, methodology,* and *rationality*. Throughout the book, Sloan uses these terms to explain the innovations he made in General Motors: "Durant had no systematic financial methodology. It was not his way of doing business." "The spacing of our product line of ten cars in seven lines in early 1921 reveals its irrationality." "In product variety only Buick and Cadillac had clear divisional concepts of their place in the market."

The language is not an accident or an affectation. It is surprising only to those who associate such language with the academy and not with the analytical necessities of organization. The language derives in part from Sloan's training as an engineer (he took a degree at MIT in 1895); but more, it derives directly from the revolution in organization that Sloan introduced: the initiation of detailed planning, of statistical methods and of financial controls. In explaining why he relied on market research and forecasting rather than salesmen's intuition, he remarked: ". . . In the automobile industry you cannot operate without programming and planning. It is a matter of respecting figures on the future as a guide." [5]

The reasons for the success of General Motors can be attributed, in simplified fashion, to two elements: A market strategy based on a "clear concept" of product lines and an organizational form which combined decentralization of operations with coordination of policy.[6] The organizational structure of General Motors is commonplace now, and has been widely copied by most large corporations. At the time of its innovation, it was a novelty. Stated most simply, the principle of organization is to have a complete breakdown of the costs of each unit, and to exercise control of operating divisions through stringent budgets. Before the system was instituted, divisions in GM sold their parts to other divisions (e.g. a battery division to a car division) on the basis of cost plus a predetermined percentage. But the corporation at the top did not know which units were profitable and which not. "It was natural for the divisions to compete for investment funds," Sloan wrote, "but it was irrational for the general officers of the company not to know where to place the money to best advantage."

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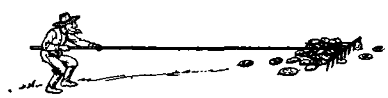
[5] Alfred P. Sloan, Jr., *My Years with General Motors* (New York, 1964), pp. 135-136.

[6] This market strategy and organizational form allowed GM to come from behind to oust Ford, a genius at production techniques, from the leading position in the market. In 1921, Ford had 60 percent of the car and truck market and almost complete control of the low-price field. Chevrolet, GM's entry in the low-price field, had only 4 percent of the market. To meet Ford head-on in price competition would have been suicidal. Sloan's strategy was not to undercut the Ford price but to *top* it somewhat, seeking to skim off that layer of buyers who would be willing to go to a higher price on the assumption they were getting a better car. By successive "upgrading" of items, largely through annual model changes, GM won the larger share. In effect, GM countered "style" with "utility" and won.

What Sloan did was to treat each division as a separate company, with the corporate group at the top acting as a "holding company," and to measure the performance of each division by the rate of return on investment consistent with attainable volume. The rate of return is thus a measure of performance and a means of ranking each division, not on the basis of its absolute profit alone, but on the rate of return on capital invested. The measure, in short, is the margin of



profit multiplied by the rate of turnover of invested capital. Through these measures, the corporate group at the top could determine how to allocate the corporation's money in order to achieve a maximum return for the whole.

All aspects of corporate policy became subordinated to that end. In specifying the corporation's philosophy, Sloan was explicit:

> "To this end we made the assumptions of the business process explicit. We presumed that the first purpose in making a capital investment is the establishment of a business that will pay satisfactory dividends and preserve and increase its capital value. The primary object of the corporation, therefore, we declared, was to make money, not just motor cars. Positive statements like this have a flavor that has gone out of fashion; but I still think that the ABC's of business have merit for reaching policy conclusions." [7]

The economizing system of each corporation locks with each other to create a social system. Earnings per share of common stock becomes the balance wheel around which the system turns. If the earnings of a firm drop, it may find it difficult to attract capital, or may have to pay more for capital vis-à-vis other firms. Thus, the allocation of capital in the economy follows the same principle as it does within the corporation. Locked thus into competition, the degree of freedom of any single corporation to break away from this measuring rod—the rate of return on investment—is limited. Any change in the system has to be a change in the entire system.

Profitability and productivity, thus, are the indices of corporate success. They are the tests of meeting the demands of the marketplace and the demand for the efficient distribution of resources within the firm and between members of the society. This is the rationale for the *economizing* mode for the corporation, as for the economy.

#### LIMITS OF THE ECONOMIZING MODE

The theoretical virtue of the market is that it coordinates human interdependence in some optimal fashion, in accordance with the expressed preferences of buyers and sellers (within any given distribution of income). But what ultimately provides direction for the economy, as Veblen pointed out long ago, is not the price system but *the value system of the culture* in which the economy is embedded. The price system is only a mechanism for the relative allocation of goods and services within the framework of *the kinds of demand* generated. Accordingly, economic guidance can only be as efficacious as the cultural value system which shapes it.

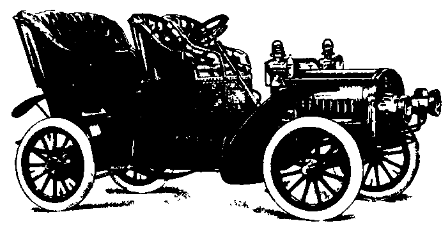
The value system of industrial society (communist as well as capitalist) has been centered around the desirability of economic growth; and the cultural value of Western society, particularly American society, has been the increase of private-consumption economic goods. There are, however, three drawbacks (at least) to this system.

The most important consideration is that it measures only *economic* goods. But as E. J. Mishan has pointed out, and as a once popular refrain once had it, "the best things in life are free." Clean air, beautiful scenery, pure water, sunshine, to say nothing of the imponderables such as ease of meeting friends, satisfaction in work, etc.—they are "free goods" either because they are so abundant that there is little or no cost, or because they are not appropriable and saleable. Such free goods contribute greatly to our total welfare. But in our present accounting schemes, priced at zero, they add nothing to the economist's measure of wealth. Nor, when they disappear, do they show up as subtractions from wealth.

The second consideration is that growth, as measured by our present economic accounting, tends to generate more and more "spillovers" which become costs borne directly by other private parties or distributed among the society as a whole. These are what economists call "externalities." Externalities (or "external costs"), as

[7] Sloan, op. cit., p. 64.

economists define the term, is the unintended or unplanned impact, the "fallout" on Third Party C (and often D, E, and F, as well), of a private transaction between parties A and B. The result is a social cost (though frequently a social benefit, too). The most obvious example of a social cost is air pollution—the result, in part, of the increasing number of private cars in the society. In every elementary economics textbook, air was once the classic illustration of the "free good." Yet the irony is that in the next thirty years one of the most scarce resources we may have (in the sense of proportionately sharply rising costs) will be clean air. The costs of automobile disposal are not charged to the automobile owner; similarly,



the costs of salvaging a depressed coal mining community are not charged to the companies selling the competing fuels which may have driven coal off the market.

The third problem with the economizing mode is that the value system of American society emphasizes, as the primary consideration, the satisfaction of individual private consumption; the result is an imbalance between public goods and private goods. In the popular psychology, taxes are not considered as the necessary purchase of public services that an individual cannot purchase for himself, but as money "taken away from *me* by *them*." Taxes, thus, are not considered as an addition to welfare, but as subtractions from it. This is reinforced by politicians who claim that taxes are too "high" (but by what standard?) rather than asking: Are there needs which can be met only by public goods, and what are the taxes buying?

Thus, if one is trying to assess welfare (or the quality of life) in some optimal fashion, the problem is not only the simple commitment to economic growth, but the nature of the accounting and costing system of the economizing mode which has served to mask many of its deficiencies. Our fascination with Gross National Product is a good illustration.

**GNP, PRIVATE COSTS, AND SOCIAL COSTS**

Conventionally we measure economic welfare primarily through the figures of Gross National Product. GNP was a marvelous economic concept. Developed largely by Simon Kuznets and his colleagues at the National Bureau of Economic Research in the late 1930s, it first came into government use in 1945 and is the basis of the framework of the United States National Economic Accounts. These accounts allow us to sketch the macroeconomic levels of activity in the society, and through them to measure economic shortfalls, the potentials of full employment revenues and the like, as a means of deciding on economic policy. But there are several drawbacks as well, particularly if we are concerned not only with wealth but the welfare of the society.

GNP measures the value of goods and services bought and sold in the market. But the measure itself is only "additive." It does not discriminate between a genuine addition to welfare and what, in effect, may be a subtraction but is counted as an economic plus. Thus, in the conventional example, the output of a steel mill is a value added to GNP. But if the steel mill pollutes a lake, and then uses additional resources to clean up the lake, that new expenditure is also added to GNP. Similarly an increase in environmental deterioration over time would not show up as a decline in real output because the flow of benefits from the environment is not counted as an output to begin with (e.g. the usability of a lake or river for swimming). But expenditures designed to reduce environmental deterioration would show up as increased real output.

More important, however, is the fact that in assessing *public* services we do not have a means of estimating actual benefits or values. In items that are sold in the market, such as automobiles or clothing, we have market prices as the value individuals place on the products. But how do we value publicly provided services such as health, or education, or protection? Our accounting system does so only by the "input" costs, not by the output values. Thus the "output" of police services is measured by salaries paid to members of the police department, the costs of police cars, etc., not by the social and economic value of crimes prevented or violators apprehended; the value of health services is measured by the costs of doctors' fees and drugs, not by the reduction of time lost on account of illness; the value of education is measured by the cost of teachers' salaries, equipment, etc., not by the value imputable to the gain in pupil knowledge.

This is a central problem in the question of how much money should be spent on "public goods." People grumble over taxes, but there is no way, at present, of showing that the benefits received for these services may be far greater than the costs. And while there is no way of knowing, it is likely that public services of this kind are "under valued," and therefore less appreciated.

The second limitation of the accounting system, which derives from the growing existence of externalities, is the divergence between private and social costs. The idea of social costs is an old one, going back one hundred and fifty years to the socialist economist Sismondi. But it was not until about fifty years ago, when A. C. Pigou wrote his *Economics of Welfare,* that the phenomenon of social costs was integrated into the conceptual system of neoclassical equilibrium economics. Pigou pointed out that the investment of additional resources may throw costs "upon people not directly concerned" such as the "uncompensated damage done to surrounding woods from railway engines." [8]

But for almost half a century, this idea of divergence between private cost and social cost was almost completely neglected. Now with the rising concern with environmental spoliation, the second-order consequences of technological change and the increase in "externalities," the problem has moved into the center of social policy. In the next decade one of the major social questions will be the determination of who is to pay the costs of such externalities, and how the amounts will be assessed. Which costs ought to be borne by the parties that generate the costs, and which, legitimately, should be borne by the society as a whole, will be one of the most difficult questions in the political economy of the future. What we have now is only the beginning awareness of the problem. What we lack is a genuine total cost matrix which, for particular instances, would be able to assess the costs and benefits of particular actions and policies.[9]

#### THE SOCIOLOGIZING MODE

Important as all these issues are, they do not go to the heart of the matter, which is that the economizing mode is based on the proposition that *individual* satisfaction is the unit in which costs and benefits are to be reckoned. This is an atomistic view of society and reflects the utilitarian fallacy that the sum total of individual decisions is equivalent to a social decision. Yet the

[8] In his book, Pigou gave dozens of examples of similar "disservices": the destruction of neighborhoods by the construction of factories in residential districts; the costs to the consumers of competitive advertising; the increase in expenditures for police and prisons because of the rising sale of liquor; the overrunning of a neighbor's land by rabbits originating from game preserves; the costs of diplomacy and armies because of the rise of foreign investments, etc.

In this country the theme was elaborated by John Maurice Clark of Columbia, who, in his *Economics of Overhead Costs* (1923), drew a distinction between social and market values and between social and market costs. For Clark, as Allan Gruchy points out, the business concept of cost excluded many important social costs such as communal health hazards, unemployment, and other costs associated with business fluctuations. Clark's concern was to bring commercial efficiency closer to social efficiency, and with making the economic system account for social values, clean air, scenic beauty, etc., as well as market values.

[9] I do not minimize the technical and political difficulties of establishing such a matrix. Let me provide a "homely" example of a problem which, many years ago, first brought the social cost problem to my personal attention.

In New York City when I was a boy, snow was removed from the streets by the hiring of extra trucks which would cart mounds of it away and dump it in the river. Many years later, Paul Serevane, who was the Commissioner of Sanitation, ordered the men to push the snow into the middle of the streets, where it was churned into slush by passing cars. Perhaps he did it because the costs of hiring trucks had gone up exorbitantly, or because he wanted to demonstrate an outstanding record in office so that he could run for mayor. The sanitation department showed a commendable record of economy. But (as I figured out from the records of the Industry and Commerce Association), after each snowfall the cleaning and dyeing bills in the city went up substantially, because the passing cars would splatter the clothes of the innocent bystander.

Now, which was the "rational" solution? One could say that Serevane's method was highly irrational, because it passed the costs of snow removal onto the backs of the unfortunate pedestrians, and if the cleaning and dyeing bills were higher than the cost of hiring additional trucks, it was truly a misallocation of resources. Yet one could also say that if the trucks had been hired, direct city expenses would have been increased and taxes would have to go up, increasing the resentment of the taxpayers in the city, so that the system of "Russian roulette" whereby a random group of bystanders bore the costs might have a greater "political" rationality than economic cost-benefit analysis.

aggregate of individual decisions has collective effects far beyond the power of any individual to manage, and which often vitiate the individual's desires. Thus, every individual may value the freedom and mobility which a personal automobile provides, yet the aggressive effect of so many autos on the roads at once can lead to clogged transportation. We might all accept, in the abstract, the principle that the automobile has become a vehicle of uglification; yet lacking a social decision about which alternative modes of transportation might best serve an area, I might have, willy-nilly, to go out and buy a car. Each of us, individually, may see the consequences of an individual action, but lacking a social mechanism to assess it, we become helpless, drift, and thereby accelerate it.

In effect, in contrast to the economizing mode of thought, one can specify—I apologize for the heavy-handed clumsiness—a sociologizing mode, or the effort to judge a society's needs in more conscious fashion,[10] and (to use an old-fashioned terminology) to do so on the basis of some explicit conception of the "public interest."

Two fundamental questions are involved.

First, the conscious establishment of social justice by the inclusion of all persons *into* the society. If the value system of a society is made more explicit as a means of guiding the allocative system (pricing) of a society, this value system must also establish, however roughly, the "right" distribution of income in the society, the minimum income available to all citizens, etc.

The second is the relative size of the public and the private sector. Economic goods, to put it in textbook fashion, are of two types, individual and social. Individual goods are "divisible"; each person buys the goods or services he wants—clothes, appliances, automobiles—on the basis of free consumer choice. Social goods are not "divisible" into individual items of possession, but are a communal service—national defense, police and fire protection, public parks, water resources, highways, and the like. These goods and services are not sold to individual consumers and are not adjusted to individual tastes. The nature and amounts of these goods must be set by a single decision, applicable jointly to all persons. Social goods are subject, therefore, to communal or political, rather than individual demand.

A man cannot ask for and individually buy in the marketplace his share of unpolluted air, even if he were willing to pay extra for it. These are actions that have to be taken in coordinated fashion through public channels. We can assign the costs of air pollution to its source, whether industrial, municipal, or individual, in order to force culprits to reduce the pollution, or we can use the money for remedial measures. In the same way, the laying out of roads, the planning of cities, the control of congestion, the organization of health care, the cleaning up of environmental pollution, the support of education—all these, necessarily, become matters of public policy, of public concern and often (though not necessarily) of public funding.

To say, in effect, that the public sector of the society has to be expanded, is not to assume, naively, that the failures of the market will now be remedied. Each arena has its own problems, and the beginning of political wisdom is to recognize the ineluctable difficulties in each. Public decision-making can easily be as irrational and counter-productive as private decision-making. The major sociological problem ahead will be the test of our ability to *foresee* the effects of social and technological change and to *construct alternative courses* in accordance with different valuations of ends, at different costs.

#### VARIETIES OF PLANNING

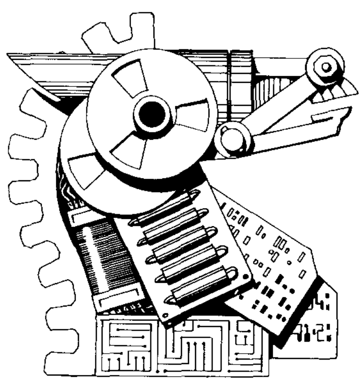
A considerable amount of planning goes on already. Every major corporation today necessarily operates in accordance with a one-year fiscal plan and a five-year market strategy in order to meet competition or to expand its size. Each company plans singly and each introduces its own new technologies—yet no one monitors the collective effects. The same is true of the planning of various government agencies. In considering social effects, one finds this kind of planning unsatisfactory.

The first flaw is the fallacy inherent in single-purpose planning itself. Most engineers, develop-

[10] One can say, theoretically, that the price system could manage the problem, e.g. when the costs of individual congestion became high it would then become profitable for alternative modes of transportation to compete with the private car. But the price system, in this instance, relies on *trial and error* to assess the result. The difficulty is that such assessments, *after the fact,* are likely to be futile—an enormous amount of resources would have been misallocated, and a preemptive "system" of transportation will have been established. Under such a system, clogged highways will eventually result in the building of more highways.

ers, industrialists, and government officials are single-purpose planners. The objective they have in mind is related almost solely to the immediate problem at hand—whether it be a power site, a highway, a canal, a river development—and even when cost-benefit analysis is used (as in the case of the Army Corps of Engineers) there is little awareness of, and almost no attempt to measure, the multiple consequences (i.e. the second-order and third-order effects) of the new system.

The second is the failure to make the necessary distinction between, as Veblen put it, the technological and institutional processes, or, in the terminology used by a panel of the National Academy of Sciences, between the "technologies" and "the supporting system." The automobile, the SST, pesticides, drugs—all these are technologies



in the physical engineering sense of the term. The support system is the organization of production and distribution, or more generally the economic and legal matrix in which the technology is embedded. The simple point is that there is no "technological imperative," no exact one-to-one correspondence between a particular technology and a specific supporting system. As Jack Burnham pointed out in a pungent way: "When we buy an automobile we no longer buy an object in the old sense of the word, but instead we purchase a three-to-five-year lease for participation in the state-recognized private transportation system, a highway system, a traffic safety system, an industrial parts-replacement system, a costly insurance system. . . ." [12]

[12] Jack Burnham, *Beyond Modern Sculpture,* (New York, 1968). If one asks what a sculptor is doing in discussing the automobile system, his argument is cast in the context of the disappearance of "objects" in contemporary society and its replacement by "systems."

One may, therefore, depending on the problem, seek to change either the technology (the gasoline engine) or the support system (unrestricted private use of the roads). But what this allows us to do is to compare alternative modes, at alternative costs, and to design better systems to serve social needs. This, in turn, suggests a need for national "technology assessment." [13] With few exceptions, the decision about the future use of a technology today is made by the economic or institutional interests who will primarily benefit from it. But as the panel of the National Academy of Sciences argues: "Decisions concerning the development and application of new technologies must not be allowed to rest solely on their immediate utility to their sponsors and users. Timely consideration must be given to their long-term sacrifices entailed by their use and proliferation, and to potentially injurious effects upon sectors of society and the environment often quite remote from the places of production and application."

In rather inchoate fashion, assessment and decisional systems already exist in the federal government. The Federal Water Pollution Control Administration, the National Air Pollution Control Administration, and the Environmental Control Administration, all are empowered to make studies of consequences; but they have less power to establish controls. Some agencies, such as the Atomic Energy Commission, both promote new technology (e.g. nuclear power) and assess the consequences. But what may be needed are *independent* boards to make assessment and propose remedial actions to the executive or to Congress. Whatever the final structures may be, it is clear that some social decision mechanisms will have to emerge in the next few years to make such assessments of second-order effects of

[13] The idea of "technology assessment grew largely out of the studies of House Science and Astronautics Committee under the leadership of Congressman Daddario. Two panels, one in the National Academy of Sciences and one in the National Academy of Engineering were set up to test the feasibility of the idea. The National Academy of Sciences Panel, under the direction of Harvey Brooks, agreed that assessment was possible and proposed a number of ways in which the process could be implemented in government. The Engineering panel undertook three studies—of subsonic aircraft noise, of computer-assisted instruction, and of multi-phasic health screening—to further this idea. Both reports on Technology Assessment were published by the House Committee in July 1969.

technological and social change. New and large powers will be vested in administrative boards. New and complex tasks will confront the Congress.

And for the private corporation, a new principle in the relation of corporations to public policy will soon be emerging. Just as it has been public policy to provide tax inducements to help corporations expand plant capacity (by investment credits, or more rapid depreciation allowances), so it will be public policy to provide tax penalties either to force corporations to bear the burdens of social costs generated by the firm, or to favor an alternative technology or supporting system if the social costs can be minimized by the alternative system or the social benefits enhanced. Given the collective effects of private decisions, this involvement of public policy in corporate policy is inescapable.

Just as we may be moving into technology assessment, so we shall have to cope with social assessments as well. For example, the social map of the United States was redrawn after World War II by the rapid expansion of the suburbs and the extraordinary rise in suburban home ownership. But all this was made possible only as a

matter of public policy: by federal guarantee of mortgages; by low down payments by veterans (often as litle as 10 percent down on a purchase price) so that "owning" became cheaper than renting; and by the policy of permitting the deduction of interest payments on mortgages from income taxes. But no one questioned the existing "support system" of large numbers of small developers creating tracts of unattached houses in mechanical grids.

There can be, let us say, three alternative models of suburban development: one, a pattern of detached homes with private walkways and separate garages; the second, a set of "cluster houses" with the sharing of common auxiliary facilities (e.g. garaging); and third, high-rise apartment houses with large green spaces. Each of these developments has vastly different "social costs" which are borne by the community, not by the developer (the pattern of roads, auxiliary land use, the location of schools, etc.). Yet these social costs are rarely, if ever, taken into consideration. There is no "total cost matrix" to make a buyer aware of what the alternative styles could cost him in terms of the secondary costs he and the community would have to pay as a result of his choice. Nor has public policy ever sought to make such a determination.

Now, I am arguing that consumers should be required to take one or another of the patterns. But intelligent public policy—because it is public monies that are facilitating this social change—should inquire into the alternative total cost matrices of the different patterns, and of the consequences of maintaining or changing existing institutional patterns of home building and development. It is not a matter of "interference" or "non-interference" in the society; *any* action (including non-action) is bound to strengthen or weaken one or another vested interest. It is a matter of making the choices and consequences explicit.

## THE CORPORATION AS A SOCIOLOGICAL INSTITUTION

In traditional corporate law, property is defined as things (*res*), but the major lesson which corporations have learned in the last thirty years is that a corporation, while producing things, is made up of people, and that one cannot treat people—at least managerial and white-collar personnel—as things.

Corporations are institutions for economizing; but they are also ways of life for their members. Until the early years of the twentieth century, the life of most Americans was bounded by the isolated small town, the church, and the family. The small town has virtually disappeared; the church has lost much of its emotional hold on people; and the tight bond between family and occupation, which gave a unity to life—the family farm, the family business, or the family occupation which the son inherited—has been sundered. The breakup of that traditional way of life, and the consequent sense of uprootedness and disorientation, is the source of what sociologists call *anomie*.

Emile Durkheim, the French sociologist who coined that term, thought that for *anomie* to be resolved there must be a group which could provide a sense of kindredness and common purpose for its members. Political society, he thought, was too amorphous and too distant. The answer, he said, lay in the occupational group, the profession, which could provide a new ethic for society. One of Durkheim's chief expositors, Elton Mayo of the Harvard Business School, thought that this purpose could be most effectively realized in the business corporation.

For a significant number of persons, this has necessarily become the case. The "four wishes" which the late sociologist W. I. Thomas thought were basic to human experience—the wish for security, for new experience, for response, and for recognition—can for these men only be obtained within the corporate milieu. Much of this led, twenty years ago, to the creation of the derogatory expression, "the organization man," as signifying a new kind of conformity. If the image were meant to suggest that previously men had been free and individualist and now were uniform and identical, the history was mythical and the irony was simply a new ideology. For life in the small town had been largely narrow and bigoted—one has only to recall Sinclair Lewis's *Main Street*—and the world of organizations offered an authentic, fresh challenge and opportunity. Corporations can be forces for conformity; and they can equally be arenas for personal initiative.

A business corporation, like a university, or a government agency, or a large hospital—each with its hierarchy and status system—is now a lifetime experience for many of its members. Necessarily, therefore, it can no longer be an instrument satisfying a single end—in the case of the business corporation, only turning out its goods and services—but it has to be a satisfactory way of life for its members. It not only has to satisfy the customers; it has to be agreeable to its "self."

A business corporation, however, is subject to different constraints, and has a somewhat different ethos, from a university or a government agency or a hospital. Corporations, unlike the other three, are competitive and have to be profitable. (And the profits, moreover, are often a major support—through taxes—of the other three.) Even so, if we set up a continuum, with *economizing* at one end of the scale (in which all aspects of organization are single-mindedly reduced to becoming means to the goals of production and profit) and *sociologizing* at the other (in which all workers are guaranteed life-time jobs, and the satisfaction of the work force becomes the primary levy on resources), then in the last thirty years the corporation has been moving steadily, for almost all its employees, toward the *sociologizing* end of the scale. One has only to note, in the rising percentage of "fringe benefit costs," the index of that shift—vacations, disability pay, health insurance, supplementary unemployment benefits, pensions, and the like.

All of this, historically, was inescapable. To the extent that the traditional sources of social support (the small town, church, and family), have crumbled in society, new kinds of organizations, particularly the corporation, have taken their place; and these inevitably become the arenas in which the demands for security, justice, and esteem are made. To think of the business corporation, then, simply as an economic instrument is to fail totally to understand the meaning of the social changes of the last half century.

### THE BALANCE OF OBLIGATION

When one uses the phrase the "social responsibility" of the corporation, one is not indulging in rhetoric (though many corporate officials are), or thinking of *noblesse oblige* (which fewer corporate officials do), or assuming that some subversive doctrine is being smuggled into society (as some laissez-faire economists suggest), but simply accepting a cardinal socio-psychological fact about human attachments. Unless one assumes that loyalty and identification are simply monetary transactions, or that employment is simply a limited relation of service-for-payment, then the corporation is a social world, with social obligations to its members, as well as an economizing instrument competitively providing goods at least cost to an economic world of consumers.

But what is the balance of obligation, and how far can one go in either direction? Perhaps the best way of trying to deal with this question is to confront some questions which have already emerged or which may be emerging in the next decade.

*Satisfaction on the job.* The trite observation from the "human relations" literature of twenty years ago was that a man more satisfied with his job was likely to have higher morale and be more productive. Thus, the mechanical layout of work, set down by the engineer, was modified to take into account the findings of industrial psychologists and sociologists. The increase in costs could be justified by the more than proportional increase in productivity.

But what if a change in job patterns increases satisfaction but does *not* increase productivity? What is the corporation to do? The conventional answer is that primary obligation of the corporation is to profits and that marginal increases in costs can only be justified by marginal increases in productivity. But let us take a variant of this problem. When a corporation hires more women, and these women ask for child-care centers to be paid for and maintained by the company, is it obligated to do so? The question is not just of treating such centers as a necessary cost to attract female labor when one has a tight labor market, but of a change in social values which would permit women who want to work to go back to work during the years when their children are young. A child-care center is a necessary component of job satisfaction for young women, even though it may add costs to a company far beyond the "gains" in productivity from such women. Does the conventional principle still hold?

*Minority employment.* Does a corporation have a special obligation to take on a larger proportion of persons from minority groups which have suffered historical disadvantage—even if such persons are less able than a competitor for the job? And if the employment of such a person increases training costs and may lead to lower productivity? The problem, in principle, is no different from that of a university which may have to set aside a special quota and, sometimes, given the limited number of places, exclude "majority" group persons who on the formal criteria of merit (e.g. test scores, grades) may be more qualified. The question of merit versus social justice is, as most complex moral problems, a question of "right" versus "right," rather than right versus wrong. Where there is such a conflict of right, how does one balance one's obligations?

*Relative pay.* How does one decide what a man is worth? A pure market principle, of competing supply and demand, only reflects relative scarcities, but relative scarcity is not identical with social justice. In most American industry, a distinction is still maintained between blue-collar work, wherein a man is paid by the piece or the hour, and white-collar work wherein a man is paid by the week or month. A few corporations —IBM, Texas Instruments—have abolished the distinction, but not many have followed that lead. What is the rationale for this invidious status distinction?

Within the corporation itself, the differential between the lowest paid (often the common labor rate) and the average of the top executive group may be about 25:1 or higher. On what basis is this spread justified? The original rationale was the market. But increasingly the market becomes less relevant for the determination of the

relative differences between "grades" of labor and persons. Elliot Jaques, the English industrial psychologist, has sought to work out a principle of "equitable" pay on the basis of differential responsibility between jobs—as measured, for example, by the amount of independent time a man has to do a job and the degree of supervision. There may be other such "formal" systems. But because human beings want and need a clear rationale for the differences in reward among them, some principle of social justice for social distinctions will have to be articulated.

*Responsibility to a community.* An old problem, but one that recurs as increasingly the corporation becomes the way of life for its members. Beyond the payment of taxes, what obligations does a corporation have to the local community where it locates its plants and headquarters? What are its responsibilities in creating amenities and a more satisfactory social and cultural environment?

*Responsibility for the environment.* In the last few years, the corporation, along with the rest of the society, has learned that the environment cannot be treated as a "free good." How the costs are to be divided will be, as I have already indicated, one of the most difficult technical-political issues of the decade.

*The confrontation with moral issues.* The corporation, like the university, has always pleaded that on moral questions it is "value-neutral." As a corporation, its obligation is to seek the best return on investment. But value neutrality is no longer so easily possible. The difficulty arising from American private investment in South Africa illustrates the problem. In the classic morality tale of fifty years ago, the example was one of the local church which gained an income from properties on which brothels were located. The church could always claim a trade-off by arguing that it saved as many souls as it lost bodies. Such a calculus was never entirely convincing. A corporation's claim that it saves as many bodies as it loses souls is not likely to be more so.

What all this adds up to is that, on the continuum I have drawn of the *economizing* and *sociologizing* modes, the balance of attention shifts more and more to the latter. And, while on the particular questions I have cited which the corporation will face in the next decade, there are no exact answers or ready-made formulae, the standpoint from which the decisions will be considered will, more and more, be made from the sociological viewpoint.

#### THE TURNING POINT FOR THE CORPORATION

The question of "social responsibility" is, I believe, the crux of a debate that will become crucial in the next few years. One position has been put forth by Milton Friedman:

> "What does it mean to say that the corporate executive has a 'social responsibility' in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of his corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire 'hard-core' unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty. . . .
>
> "In a free-enterprise, private property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom." [14]

There are two different kinds of answers to Friedman. Both were given recently by Alden Clausen, the new president and chief executive officer of the Bank of America, the biggest bank in the world.

For Clausen, one crucial question is: In what social context does the corporation operate today? As an article in *Fortune* by John Davenport reported: "To keep this giant money machine profitably growing is the first business of Alden Winship (Tom) Clausen. . . . It is of some significance that . . . his thoughts turn often to: how to alleviate if not cure the blight now spreading at Hunter's Point and south of Market Street [in San Francisco]; how to crack the city's hard-core unemployment; how to cope with student unrest at Berkeley or down the peninsula at Stanford."

In defending these objectives, Clausen confronted directly the views of Friedman. As the article in *Fortune* reported:

> "At the moment Clausen and his associates are less interested in modifying their bank's capital structure than in charting a course through a period when capitalism itself is under intense attack. . . .
>
> ". . . Business, he argued, has to concern itself with nonbusiness problems today if it wants to be around tomorrow. The Friedman view is okay in the short pull. But in the long pull, nobody can expect to make profits—or have any meaningful use for profits—if the whole fabric of society is being ripped to shreds.
>
> "There is, equally, a different question, apart from social expediency: Below the surface of this clash of views, there lies an important but

[14] From "The Social Responsibility of Business Is to Increase Its Profits," in *The Sunday Times Magazine* (September 13, 1970). The argument is elaborated in Friedman's book, *Capitalism and Freedom*.

seldomly explicated or confronted question about the nature of the corporation. Friedman sees the corporation as fundamentally an 'artificial person' and the corporate manager as simply an agent of individual shareholders. Clausen sees the corporation as having a kind of life of its own, and hence having a certain freedom of choice in balancing its contribution to the long-range needs of the community against the immediate demands of owners."

And, as the writer John Davenport, himself a distinguished conservative, comments: There may be dangers lurking in Clausen's view of corporate autonomy, but there is surely something unrealistic in the view that society is just an atomized collection of individuals.[15]

The heart of the matter is the question of the nature of the corporation. Is the corporation primarily an instrument of "owners"—legally the stockholders—or is it an autonomous enterprise which, despite its particular history, has become —or should become—an instrument for service to society in a system of pluralist powers?

A classic debate on that question was initiated forty years ago in the pages of the *Harvard Law Review* by A. A. Berle and Merrick Dodd. Berle held to the view at the time (he later revised his views) that all corporate powers are powers in trust for the benefit of the stockholders. Dodd argued that legally such was the case, but the use of private property was deeply affected with a public interest and that the directors should be viewed as trustees for the enterprise as a whole —for the corporation viewed as an institution— and not merely as "attorneys for the stockholders." Berle responded that, since one could not offer "a clear and reasonably enforceable scheme of responsibilities to someone else," Dodd's proposal would place the control of the organization entirely in the hands of management. The problem, as he saw it, was: If there is not a prior legal statement of responsibility to the stockholders, how does one prevent management from exercising arbitrary social and political power, or from becoming overreaching and self-seeking?

This legal—and sociological—issue remains. Is the manager primarily a trustee for absentee investors? Or is the role of the manager, as Frank Abrams, when he was chairman of the board of Standard Oil of New Jersey, put it, to conduct his affairs "in such a way as to maintain an equitable and working balance among the claims of the various directly interested—stockholders, employees, customers, and the public at large"?

[15] John Davenport, "Bank of America Is Not for Burning," *Fortune* (January 1971).

#### PRIVATE PROPERTY OR PRIVATE ENTERPRISE?

The modern business corporation has lost many of the historic features of traditional capitalism, yet it has, for lack of a new rationale, retained the old ideology—and finds itself trapped by it.

Unhappy is a society that has run out of words to describe what is going on. So Thurman Arnold observed in connection with the language of private property—the myths and folklore of capitalism—which even thirty years ago was hopelessly out of date. *The point is that today ownership is simply a legal fiction.*

A stockholder is an owner because, in theory, he has put up equity capital and taken a risk. But only a minor proportion of corporate capital today is raised through the sale of equity capital. A more significant portion of capital comes through self-financing, by the success of the enterprise itself. In the last decade, more than 60 percent of the capital investment of the nation's 1,000 largest manufacturing firms was financed internally. Retained capital is the basis of the rise in net assets of large corporations. And the growth of retained capital is the product of managerial skill. (Equally, a large portion of new capital is raised by debentures, which become a fixed charge against earnings, rather than through floating equity or risk stock. Debentures hinge on the stability of the company and prospect of repayment—again a managerial problem.)

If one were to follow the logic of Friedman's argument, as he does—it is his strength and weakness that he always follows the logic of his argument, to the very end—one would have to outlaw or at least discourage self-financing. Under the "pure" theory of market capitalism, a firm risks a stockholder's capital and then pays back any profits—in the form of dividends—to its legal owners, the stockholders. If it seeks to risk that money again, it should ask those stockholders to reinvest that money, rather than withhold it from them and reinvest it by managerial decision. Friedman argues that it is only the "double taxation" (through corporate and personal income tax) of dividends that prevents such a desirable state of affairs from emerging. But I should say that such a state of affairs is neither desirable nor possible. Given the pattern of stock ownership today—particularly with the growth of mutual funds, pension funds, and trust funds—the stockholder is often an "in-and-out" person with little continuing interest in the enterprise. Such an in-and-out procedure may be a useful discipline for management and a measure of economic performance—but then it becomes a form of countervailing power, not ownership. True owners are involved directly and psychologically in the fate of an enterprise; and this description better fits the employees of the corporation, not its stockholders. For these employees, the corporation is a social institution which they inhabit. It is politically and morally unthinkable that their lives should be at the mercy of a financial speculator.

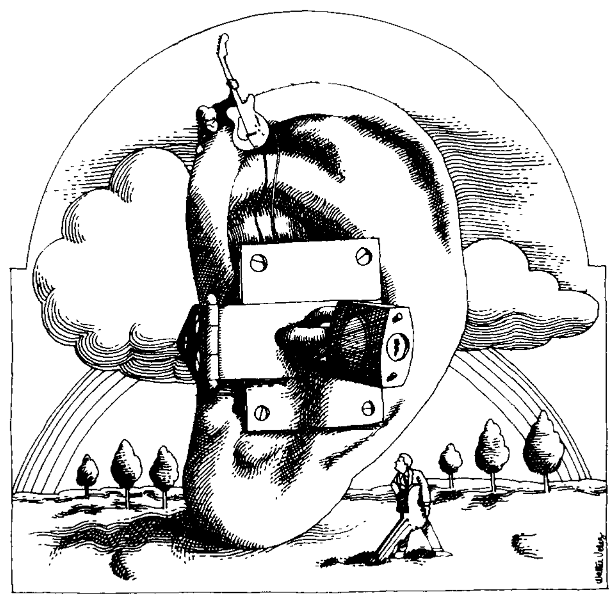
In other words, the corporation may be a *private enterprise* institution, but it is not really a *private property* institution. (If the assets of the enterprise are primarily the skill of its managerial employees, not machinery or things—and this is preeminently true in the science-based industries, in communications, and in the so-called "knowledge industries"—then property is anyway of lesser importance.) And if ownership is largely a legal fiction, then one ought to adopt a more realistic attitude to it. One can treat stockholders not as "owners" but as legitimate claimants to some fixed share of the profits of a corporation—and to nothing more.[16]

[16] There are about 31 million shareholders in the United States, most of whom have only a small holding in the enterprise. The New York Stock Exchange survey of shareownership (1970) showed that of 30,520,000 shareholders surveyed (out of a total of 30,850,000) about 12,500,000 had portfolios worth less than $5,000, and 6,400,000 had between $5,000 and $10,000. Thus a total of 18,900,000 shareholders, or 62 percent, had portfolios of less than $10,000.

Institutional investors generally now hold an increasing proportion of the outstanding equity securities of major American corporations. As of the end of 1970, the New York Stock Exchange estimated that $161.9 billion or 25.4 percent of all equity securities of companies listed on the Exchange were held by institutional holders. If one excludes unregistered mutual funds, investment partnerships, nonbank trusts and foreign institutions, the Exchange estimated that the total of all institutional holdings would exceed 40 percent. (I am indebted to Professor Philip Blumberg of the Boston University Law School for the data.)

#### THE MEANING OF A "CORPORATION"

What then is a corporation? If one goes back to the original meaning of the term, as a social invention of the late Middle Ages to meet some novel problems, a corporation was an instrument for self-governance for groups carrying on a common activity (artisan guilds, local boroughs, ecclesiastical bodies); it often had common economic assets, and its existence would persist beyond the lives of its individual members. Those who were "members" of the corporation were those directly responsible for its activities, those who were the legatees of the past members, and those chosen to carry on the work.



A business corporation today—like a university today—can be viewed in this original sociological conception of the term. Indeed, if one begins to look on the business corporation more and more on the model of the university, then the fallacy of ownership becomes more apparent. Who "owns" Harvard or the University of Chicago? Legally the "corporation," as composed by the overseers or the trustees. But in any sociological sense this is meaningless. The university is a self-selective ongoing enterprise of its members (administration, faculty, students, and alumni, with differential responsibilities and obligations) who seek to carry out its purposes with due regard to the interests of the particular community which constitutes the university—and also to the larger community that makes the university possible.

As a business institution, the "corporation" is the management and the board of directors, operating as trustees for members of the enterprise as a whole—not just stockholders, but workers and consumers too—and with due regard to the interests of society as a whole. But if this view is accepted, there is a significant logical corollary—that the constituencies which make up the corporation themselves have to be represented within the board of corporate power.[17] Without that, there is no effective countervailing power to that of executive management. More important, without such representation, there would be a serious question about the "legitimacy" of managerial power.

How such constituencies might be represented is a question to be explored. A dozen years ago, Bayless Manning, Jr., until recently the Dean of the Stanford Law School, sought to picture the corporation as if it were in law what it often is in fact, as a kind of "voting trust" wherein the stockholder delegates all his rights, except that of collecting dividends, to the directors. In order to establish some check on the board of directors, he proposed a "second chamber," an "extrinsic body," which would review decisions of the board where conflicts of interest arose—such as compensation of officers, contributions to other enterprises (universities, community efforts, etc.) not directly related to a company's business, clashes with a public interest, etc.

It is beyond the scope of this essay, and the competence of the author, to estimate the viability of these—or other—specific proposals. The problem is there; it is not going to go away; and discussion of possible resolutions is anything but premature.

#### FROM BITTERNESS TO BANALITY

As a debate on these issues continues, one important consideration should be kept in mind—the bitterness of one generation is often the banality of another. Who, today, gives a second thought to savings bank life insurance? Yet this idea, authored by Louis D. Brandeis in Massachusetts, was fought for five months in passage through the legislature and was marked by one of the bitterest fights ever witnessed on Beacon Hill. (One line of attack was that people would not voluntarily seek insurance, and that they would not take it out at all if the expensive system of soliciting by agents were done away with.) The issue gave Brandeis a national reputation, and eventually brought him to the Supreme Court. The reputation remained, but the issue itself soon faded.

The lesson, however, was not, and is still not wholly learned—reforms will never be as sweeping in their effects as their proponents hope, and the results will rarely be as damaging and apocalyptic as the opponents fear. Workmen's compensation was an issue that inflamed a generation of radicals and was fought by industry on the ground that it would relieve the workman of "individual responsibility" for his actions; yet who today would deny that industrial safety is a legitimate cost of factory operations?

Such reforms are always an expression of a revision—implicit or explicit—in the American "public philosophy." This kind of "revisionism" is inevitable as men and societies change, and as the dominant values assume a new shape. The private enterprise system has been the primary institution of Western society not because of its coercive power but because its values—economizing and increasing output of material goods—were congruent with the major consumer values of the society. With all its obvious imperfections the

[17] The growth of institutional holdings by political entities, such as municipal pension funds, colleges, foundations, churches, and other groups which are subject to direct political pressure may itself create a small force, in certain circumstances, for changes in corporate policy. Thus in the General Motors campaign initiated by Ralph Nader, Mayor Lindsay of New York instructed the trustees of the New York City pension funds to vote their 162,000 General Motors shares in favor of the Campaign GM proposals, as did Mayor White of Boston, Mayor Alioto of San Francisco, and the Wisconsin and Iowa state retirement funds.

At the same time, corporations have moved to widen representation on their boards. As of 1970, blacks have been elected to the Boards of Directors of such leading corporations as:

Chase Manhattan Bank
Commonwealth Edison
First National City Bank
Girard Trust Bank
International Business Machines
Pan American Airways
Standard Oil of Ohio
W. T. Grant
Columbia Broadcasting
Equitable Life Assurance
General Motors
Great Atlantic & Pacific Tea
Michigan Consolidated Gas
Prudential Life Insurance
Westinghouse Broadcasting

system "worked." Today, however, those values are themselves being questioned, not in the way socialists and radicals questioned them a generation ago—that they were achieved at the cost of exploiting the worker—but at the very core, the creation of more private goods at the expense of other social values. I return to a point made earlier that unlike the polity, no one, meeting collectively, "voted in" our market economy. But now votes are being taken.

It seems clear to me that, today, we in America are moving away from a society based on a private-enterprise market system toward one in which the most important economic decisions will be made at the political level, in terms of consciously defined "goals" and "priorities." The dangers inherent in such a shift are familiar enough to anyone acquainted with the liberal tradition. In the past, there was an "unspoken consensus," and the public philosophy did not need to be articulated. And this was a strength, for articulation often invites trials by force when implicit differences are made manifest. Today, however, there is a visible change from market to non-market political decision-making. The market disperses responsibility: the political center is visible, the question of who gains and who loses is clear, and government becomes a cockpit.

But to be hypnotized by such dangers is little less than frivolous. No social or economic order has a writ of immortality, and the consumer-oriented free-enterprise society no longer satisfies the citizenry, as once it did. So it will have to change, in order that something we still recognize as a liberal society might survive.

Whether such a change will represent "progress" is a nice metaphysical question that I, for one, do not know how to answer. This was a society "designed" by John Locke and Adam Smith and it rested on the premises of individualism and market rationality in which the varied ends desired by individuals would be maximized by free exchange. We now move to a communal ethic, without that community being, as yet, wholly defined. In a sense, the movement away from governance by political economy to governance by political philosophy—for that is the meaning of the shift—is a return to pre-capitalist modes of social thought. But whether this be progress or regress, it clearly makes it incumbent upon us to think more candidly and rigorously about our values, and about the kind of world we wish to live in.

THE NADER SYNDROME

"In a series of valuable reports, [Ralph Nader] and his associates have confirmed dramatically what earlier studies had demonstrated less dramatically—that governmental agencies established to regulate an industry in order to protect consumers typically end up as instruments of the industry they are supposed to regulate, enabling the industry to protect monopoly positions and to exploit the consumer more effectively. . . .

"You might expect Nader and his associates to draw the obvious conclusion that there is something innate in the political process that produces this result; that, imperfect as it is, the market does a better job of protecting the consumer than the political process. But no, their conclusion is very different: establish stronger agencies instructed more explicitly and at greater length to do good and put people like us in charge, and all will be well. Cats will bark.

"This failure to grasp the inner logic of the political process means that, despite Nader's excellent intentions, despite his admirable singleness of purpose, despite his dedication and despite his high repute, he has done and will continue to do great harm to the very consumers he seeks to aid."

Milton Friedman
*Newsweek*, February 19, 1973