Marquette Law Review

Volume 18
Issue 1 *December 1933*

Article 2

1933

Critique of a Revision of Some Fundamental Economic Concepts

Theodore M. Ave-Lallemant

CRITIQUE OF A REVISION OF SOME FUNDAMENTAL ECONOMIC CONCEPTS

THEODORE M. AVE-LALLEMANT

I. INTRODUCTION

PROFESSORS Adolf A. Berle, Jr. and Gardiner C. Means conclude their valuable treatise on "The Modern Corporation and Private Property" with a Book (the fourth) on "Effects of the Corporate System on Fundamental Economic Concepts." The concepts treated, as requiring revision because of the effects of the corporate system upon them, are the following: Private Property, Wealth, Private Enterprise, Individual Initiative, the Profit Motive, and Competition. In the final chapter (Chapter IV of Book IV), the concept of the corporation is treated as a new and, presumedly, also fundamental economic concept. It is this revision of fundamental economic concepts and the grounds upon which it is predicated that will be made the subject of critical examination in this paper.

The following questions call for an answer: (1) Is it true, indeed, that the existence of a fully developed corporate system necessitates a modification or revision of the fundamental economic concepts named? (2) Is the revision proposed by the authors as thorough a revision as they seem to think it is? (3) If a revision of the concepts under consideration is indeed necessary, in any measure, is the mere existence of the corporate system alone a sufficient guide to the scope and character of the revision called for?

In the Preface to their treatise, the authors say that the observations recorded in the concluding Book "must be set aside from the data contained in the foregoing study. From any given body of material, each individual must draw his own conclusions; these are likely to be as diverse as the minds of the men who study them." (Page vii.) This statement is undoubtedly true in so far as it purports to be merely a statement of fact. But, to this writer's reading, there seems to lie in it an implication which at least appears to suggest an apologetic reflection. If the results reached by different men on the basis of the same material are divergent results, we may *explain* this divergence by the diversity of "the minds of the men who study" the material. That would be a psychological explanation of the fact of diversity in the results. The authors have, indeed, rendered a service to the readers of their study by facilitating for them a psychological explanation of the conclusions they profess to have reached. Their own conclusions, they declare, are "set down because it appears to them proper that the deductions and speculations of the students working in the material should be recorded alongside their views as to the underlying facts. In some sense they permit discounting the fact data by exhibiting the bias of the writers, making judgment of their fact-finding truer." Still, with all necessary allowances made for the, psychologically explainable, "diversity" and "bias" of the authors' minds, the major question of the logical validity of their "deductions and speculations" remains for examination. The discussion presented in this paper is wholly directed to an examination of the logical validity of the deductions and speculations presented in the concluding Book of the treatise under review.

II. The Authors' Method of Revision

The authors contend that, by the application of "the traditional logic of property" and of "the traditional logic of profits," the science of economics and the science of the law have obtained divergent results. They conclude that, "when such divergent results are obtained by the application of the logic of two major social disciplines to a new fact situation, we must push our inquiry still further back into the assumptions and concepts of those disciplines." (Page 345.) In the preceding three Books of the treatise, they have inquired diligently enough into the "assumptions and concepts" of the science of law, with respect to rights and obligations under the corporate system. In the Fourth Book, they turn to an examination of the "assumptions and concepts" of the discipline of economics.

The conclusions which the authors have reached through that examination will receive our attention. If other men, studying the same material, should reach divergent conclusions, the supporters of each of the divergent views may, if they wish, take refuge in a psychological explanation of the divergence of views, accounting for their diversity by the diversity of the minds of the men who have studied the same factual data. Important as may be the consequences of the diversities of minds however, the more important cause of diversities in results is to be found in the differences in the methods with which different disciplines approach the same material. The authors themselves have recognized this, where they compare the interests and the approach to the facts of the economist and of the man of the law, respectively. (Page 340, the first paragraph.) But even there they have not, as it seems to the writer, drawn the distinction properly and clearly; for they seem to attribute to the economist interests and presuppositions which are not *the* distinctive interests and presuppositions *of his science,* however much they may be those of the economist as individual and as citizen. Of that point more will be said later; for before we enlarge upon this point we must take note of even more fundamental presuppositions that seem to underlie the authors' own revisionistic impulses.

Professors Berle and Means declare, page 345, in what will prove to be the crucial chapter (Book IV, Chapter III, treating of "The Inadequacy of Traditional Theory") that, "underlying the thinking of economists, lawyers and business men during the last century and a half has been the picture of economic life so skillfully painted by Adam Smith. Within his treatise on the 'Wealth of Nations' are contained the fundamental concepts which run through most modern thought." Now, there is no question of the truth of the first sentence as a statement of fact: the "picture of economic life so skillfully painted by Adam Smith" has not lost its fascination for its readers, economists and others. Where the authors are in error is in their second sentence, that is, in the methodological implications—also revealed in other sections of the chapter—which in themselves are indefensible. Within Adam Smith's treatise on the "Wealth of Nations," they say, *"are contained* the fundamental concepts which run through most modern thought." (The italics are the writer's.) That statement may be true enough as a simple statement of fact; the issue for debate arises over the methodological implications which the statement, by the evidence of what follows, is made to carry. For there is the implication that the said "fundamental concepts" are contained in Adam Smith's treatise because they have been put into it in and by "the picture of economic life" which he has "so skillfully painted." The implication of that, again, is that, if it proves that the "picture of economic life" must be re-painted, because of changed conditions and changed relationships in the economic life, the "fundamental concepts" of economic science must also be refashioned. This implication the authors explicitly pronounce; for they say (page 345) that the concepts and terms delivered to us by Adam Smith "have ceased to be accurate, and therefore tend to mislead in describing modern enterprise as carried on by the great corporations. Though both the terms and the concepts remain, they are inapplicable to a dominant area in American economic organization. New terms, connoting changed relationships, become necessary."

It would be going too far if one were to attribute to the authors *an explicit avowal* of the belief that in and by a skillful re-painting of economic life—as the authors have accomplished it for "a dominant area in American economic organization"—we should *eo ipso* be accomplishing a refashioning of "fundamental economic concepts," more accurate and better applicable to the changed conditions and changed relationships painted in the new picture. However, such conclusions on method are clearly enough suggested in their text. Fortunately, this implied conclusion has not wholly vitiated the authors' analysis of the "fundamental economic concepts" which they have examined; on the other hand, the present writer finds that, just in so far as he cannot accept this analysis as valid and conclusive, its unacceptability is due, precisely, to the vitiating influence of the methodological assumption indicated. With a view to critical correction, reference may here be made to a very fine essay by Professor John Dewey on "Qualitative Thought" (pages 93-116 in his collection of essays and addresses entitled "Philosophy and Civilization" 1932), in which the difference between description and analysis and between thought sufficiently refined for qualitative description and the more sharply defined thought of conceptualized analysis is clearly and brilliantly set forth.

III. Private Property

The first "fundamental economic concept" which the authors undertake to revise is the concept of *Private Property*. When we examine this revision we shall see how much the authors' analysis is affected by qualitative description, by the "picture" of economic life with its changing conditions and changing relationships.

"When," they write, "Adam Smith talked of 'enterprise', he had in mind as the typical unit the small individual business in which the owner, perhaps with the aid of a few apprentices or workers, labored to produce goods for market or to carry on commerce. Very emphatically he repudiated the stock corporation as a business mechanism, holding that dispersed ownership made efficient operation impossible. * * * Yet when we speak of business enterprise today, we must have in mind primarily these very units which seemed to Adam Smith not to fit into the principles which he was laying down for the conduct of economic activity. How then can we apply the concepts of Adam Smith in discussing our modern economy?"

Two distinct criticisms must be brought against this statement. There is, in the first place, the criticism, already indicated, of the unjustifiable assumption that *description*, the "picture of economic life," in and of itself does or should determine the content of concepts, which, properly, is determined by the processes of *analysis*. The practical purport of this criticism is that the "fundamental economic concepts" developed or utilized by Adam Smith may well have been adequate for the conceptual analysis of the economic life which he was describing; it may equally well be that they are adequate—we are not for the present deciding whether they are or not—for the conceptual analysis of the economic life of today, which differs so greatly, in its conditions and in its relationships, from the economic life of Adam Smith's time.

The second criticism is directed against a mixing of two lines of thought which, unawares to the authors, it seems, has crept into the discussion. Adam Smith, they say, "emphatically * * * *repudiated the stock corporation as a business mechanism,* holding that dispersed ownership made efficient operation impossible." And, again, they declare that "we must have in mind primarily these very units which seemed to Adam Smith not to fit into *the principles which he was laying down for the conduct of economic activity.*" Now, to *describe and explain* what a stock corporation represents as a business mechanism, is one thing; to *repudiate* it as a business mechanism, is a very different thing. To describe and explain the principles which *are,* as a matter of fact, followed in the conduct of economic activity is one thing; to lay down principles which *should be* followed is, again, a very different thing.

For a picture of the changes in conditions and relationships which have made our contemporary economic life so greatly to differ from the economic life of Adam Smith's time, we have to go to the First Book of the authors' treatise. This Book treats of "Property in Flux" and concentrates on the "Separation of the Attributes of Ownership under the Corporate System."

Concordantly with the theme and thesis of their treatise, the authors contend that, with the emergence and development of the corporate system, "there has resulted the dissolution of the old atom of ownership into its component parts, control and beneficial ownership." (Book I, Chapter I, page 8—this chapter treating of "Property in Transition.") In the sixth, and concluding, chapter of Book I (this chapter treating of "The Divergence of Interest Between Ownership and Control"), this contention is more sharply defined, in the following language:

"The foregoing chapters have indicated that the corporate system tends to develop a division of the functions formerly accorded to ownership. This calls for an examination of the exact nature of these functions; the inter-relation of the groups performing them, and the new position which these groups hold in the community at large.

"In discussing problems of enterprise it is possible to distinguish between three functions: that of having an interest in an enterprise, that of having power over it, and that of acting with respect to it. A single individual may fulfill, in varying degrees, any one or more of these functions." (Page 119.)

Even at the risk of being charged with carping criticism, one must point out a certain looseness in the use of terms which occurs in the first paragraph just quoted. Properly speaking, functions cannot be "accorded to ownership." "Ownership" is a relation between a person (the owner) and a thing (the thing owned, the property). Now, relations cannot be bearers of function; relations do not "function," whereas the terms of the relation, in this case a person (as owner) and a thing (the property) can and do "function." The meaning, of course, is clear from the context. The functions in questions have been accorded to owners, not to ownership.

Criticism of the statements contained in the second paragraph quoted just above is more weighty and of greater consequence; it is far from being merely carping criticism.

"Having interest in an enterprise," the present writer would say, is not a function but a relation, precisely that relation among possible relations which we describe as the relation of ownership. Again, "having power over" an enterprise, is not a function but a relation. It is, moreover, a relation which, by definition under existing and accepted law, is implied in the relation of ownership. Ownership of a thing, the law holds, implies the power of disposal over that thing. Even to say that ownership of a thing "confers" power over it, would, so it seems to the writer, put clarity of thought and expression in jeopardy. Ownership, being a relation, cannot function in "conferring power" any more than in any other way.

The third "function" enumerated is, then, the only real function to be considered. Of course, the function of "acting with respect to" an enterprise, is a very comprehensive function. By implication here and by explicit statement in other parts of the treatise, the authors by definition have quite unwarrantably restricted the function of "acting with respect to an enterprise" to certain types of action. The types of action to which such action has been restricted by them are the actions of "management" and of "control." This is an unwarranted restriction; for, clearly, if a person who has an interest in an enterprise avails himself of the services of the security market for the liquidation of his interest, he certainly is acting with respect to the enterprise. The authors even admit expressly that by the possibility and the threat of such liquidation the owner exercises a not inconsiderable "control" over the enterprise. If a shareholder sells his entire interest in an enterprise, he alters his relation thereto by divesting himself of his interest in it. If he buys additional shares, he increases his interest and thereby, again, alters his relation to the enterprise. Both his purchase of additional shares and the sale of his shares—or the threat of the sale of them—represent an exercise of the power of control over the enterprise which his ownership implies.

This restriction of the function of "acting with respect to an enterprise" which the authors have chosen is, however, a condition prerequisite to the upholding of the declared thesis of their study. The thesis of the book, already stated above, is to show that, through the emergence and the development of the corporate system, "there has resulted the dissolution of the old atom of ownership into its component parts, control and beneficial ownership." (Page 8.) The contention is made that "the corporate system" has "attracted to itself a combination of attributes and powers" which as a matter of fact as well as a matter of (moral) right and law (natural as well as customary and positive?) are "attributes of ownership."

The thought here runs to the effect that the owner of an enterprise manages that enterprise (if so he does) and has a right to manage it by virtue of his relation of ownership to the enterprise in question. That thought represents the traditional logic of property and the writer cannot see that Professors Berle and Means have abandoned it in their revision of the fundamental concept of private property. If there is to be (or should be) a revision of that concept, this revision will have to be both more radical and more logical than the revision offered by Messrs. Berle and Means. As a matter of fact, a sufficiently radical and logical revision entails a reading of the relation between Rights and Functions which is the direct inverse of the reading of that relation by the traditional logic of property. As the traditional logic of property reads that relation, *Functions flow from Rights.* According to a contrary (not the contradictory) reading of that relation, *Rights flow from Functions.* Or, to put the same thought in another way, the traditional logic of property holds that when the relation of ownership is established (howsoever) between a person and a thing, and the rights of ownership *vested upon* or *embodied in* the person of the owner, the right to perform the function of "acting with respect to" (for example, managing) the enterprise is thereby also vested upon or embodied in the person of the owner. *Per contra,* according to the revised logic of property here suggested, if the performance of the function of managing an enterprise is assigned to a person, for the best of all reasons, his capacity for the performance of the function, that person must, and will, *command* certain rights in keeping with the rights of his office and required in support of the proper performance of his duties thereunder. In other words, while his rights may, perhaps, not *flow from* his function—in the sense that, in the opposite view, functions are said to flow from rights—he must *command* the necessary rights or fail in his function.

The adherence of Professors Berle and Means to the traditional logic of property, their avowed repudiation of it notwithstanding, is clear by the evidence of the following passage (Book I, Chapter VI, pp. 119-120):

"Before the industrial revolution the owner-worker performed all three functions named above, as do most farmers today. But during the nineteenth century the bulk of industrial production came to be carried on by enterprises in which a division had occurred, the owner fulfilling the first two functions while the latter was in large measure performed by a separate group, the hired managers. Under such a system of production, the owners were distinguished primarily by the fact that they were *in a position* both to manage an enterprise or delegate its management and to receive any profits or benefits which might accrue. The managers on the other hand were distinguished primarily by the fact that they operated an enterprise, presumably in the interests of the owners. The difference between ownership and management was thus in part one between position and action. An owner who remained completely quiescent towards his enterprise would nevertheless remain an owner. His title was applied not because he acted or was expected to act. Indeed, when the owner acted, as for instance in hiring a manager or giving him directions, to that extent the owner managed his own enterprise. On the other hand, it is difficult to think of applying the title 'manager' to an individual who had been entirely quiescent.

"Under the corporate system, the second function, that of having power over an enterprise, has become separated from the first. The position of the owner has been reduced to that of having a set of legal and factual interests in the enterprise while the group which we have called control, are in the position of having legal and factual powers over it."

This separation of functions—more properly put, this partial divestment of the owner of one of his relations to the enterprise, or, still better, this modification of his relation thereto, and the establishment of a new, or more intimate, relation between the enterprise and a new group of persons (management and control)—is made by the authors the basis of their revision of the concept of private property. As already pointed out above, their revison takes a "picture of economic life" as its starting-point.

"To Adam Smith and to his followers," they write, "private property was a unity involving possession. He assumed that ownership and control were combined. Today, in the modern corporation, this unity has been broken. *Passive property*,—specifically, shares of stock or bonds,—gives its possessors an interest in an enterprise but gives them practically no control over it, and involves no responsibility. *Active property*,—plant, good will, organization, and so forth which make up the actual enterprise,—is controlled by individuals who, almost invariably, have only minor ownership interests in it. In terms of relationships, the present situation can be described as including:—(1) "passive property," consisting of a set of relationships between an individual toward the enterprise but almost no effective powers over it; and (2) "active property," consisting of a set of relationships under which an individual or set of individuals hold powers over an enterprise but have almost no duties in respect to it which can be effectively enforced. When active and passive property relationships attach to the same individual or group, we have private property as conceived by the older economists. When they attach to different individuals, private property in the instruments of production disappears." (Pages 346-347.)

Now, we have in this passage really two distinct definitions of the two components—"passive property" and "active property"—into which the authors have broken up the former unity of the "old atom of ownership." Under the first definition, "passive property"—specifically, shares of stock and bonds—is passive *because its owner is passive,* does not fulfill the function of "acting with respect to the enterprise." "Active property"—that which makes up the actual enterprise, "plant, good will, organization, and so forth"—is described as active *because individuals or a set of individuals other than the owner or owners act with respect to it.* Passivity and activity are not really predicated of property at all, but of two different classes of persons, passive and active, respectively. In the first definition, the thought is of the objective property: shares of stock and bonds as passive, the actual enterprise as active property. In the second definition, both "passive" and "active property" are defined as "a set of relationships," the difference between the respective sets of relationship, again, being entirely determined by the passivity or activity of the persons respectively involved in the relationship. We find here, again, the restriction of the honorific terms action and active to one type of activity only, that being the activity of management and control.

In the end, our authors remain puzzled by and helpless before the developments which they have so skillfully pictured. They deplore the divergence between the results obtained by two major social disciplines, economics and law. In reality, there is no occasion whatever for lament. The interests and the objectives of the two disciplines, economics and law, are so different that divergent results must be expected.

Why has the law, throughout its tradition, been so much concerned over the close association between "property" and "management?" It has been so concerned, because the experience of economic life, in a certain stage of its development, has shown such close association to be necessary to safeguard the interests and welfare of everyone concerned. The best management is subject to the making of mistakes of judgment and of practice. Obligations to creditors, for example, may be contracted which, when they fall due, cannot be met, perhaps because of the mistakes of management or because the enterprise has suffered losses through the spread and generalization of a business depression to the making of which its management may have contributed little or nothing. Claims for damages to property or injury to persons may result, for example, from the negligence or torts of employes for which the enterprise as employer is held legally responsible. The law has been concerned to provide recovery or compensation in such cases. But in order that there may be the *possibility* of recovery or compensation, the person or persons held legally responsible must possess property which is subject to legal judgment, assessment and seizure. Hence the close association between "management" and "property," which the law has quite properly supported.

The economist, on the other hand, has very different interests and objectives. As the authors properly say: "His interest is not primarily in the protection of man in his own, but in the production and distribution of what man desires." (Page 340.) Consequently the economist is not at all concerned over the association between property and management. He realizes and experience teaches that persons, by virtue of their property rights, may be put into a position which admits them to the management of an enterprise which they are quite incapable of managing efficiently and properly. In consequence of their mistakes in management, they may lose both the property and, thereby, the opportunity and right to manage it. Another person or persons, acquiring the property, will therewith acquire the opportunity and right to manage it. The appearance of the corporate system as a form of economic organization neither has made nor ever will make, so long as private property remains, any difference either in the process or in the result. The development of the corporate system has made possible, there is no denying it, the separation of ownership and management and control. It has made this possible by providing for the satisfaction of claims to recovery and damages out of the property of the owners (shareholders) of the corporate enterprise while attaching little or no liability to the person or persons who, by their mistakes in management, for example, may have given cause and occasion for such claims.

A revision of the fundamental concept of private property, fashioned from the economic point of view, will call for the recognition of the fact that the ownership of an enterprise is not necessarily the *only* nor, under all circumstances, the *best warrant* for the admission of a person to the performance of the functions of management and control of economic enterprises. This revision will also recognize the fact that the close association between ownership and management, in the past, has been warranted because it has been the best means for safeguarding the interests of a variety of persons, entering into various relations with an enterprise, against the incidence upon them of the consequences of mistakes and malfeasances in the management of the enterprise. Practical experience and the ingenuity of the men of the law may devise other means of safeguarding such interests; in a considerable measure that has already been accomplished in the corporate system.

Professors Berle and Means criticize severely and justly the abuses of the power, too frequently exercised as if it were an absolute power, which has fallen into the hands of management and the so-called "control." But neither the fact of such abuses nor the patent necessity for criticism and correction entails any revision of the fundamental concept of private property. If they, and the changed conditions and changed relationships in economic life which they have accompanied and out of which they have grown, do indeed suggest a re-examination of the content and implications of that concept, it may be found, as here suggested, that the revision will need to be even more thorough-going, but in a different direction, than the revision proposed by Professors Berle and Means. Conceivably such more thorough-going revision could have been made, and probably should have been made, even before the development of the corporate system made our minds ready to entertain any thought of revision. In any case, a thorough-going logical revision of fundamental economic (or other) concepts is much less affected with relativity and contingency upon historical institutional developments than is suggested or implied in the methodological presuppositions that underlie the revising procedure followed by our authors.

To put our critical objections to the authors' method and, per consequence, our exceptions to some of their results, in technical phraseology, perhaps, but tersely, we may say that these objections are chiefly two: (1) an objection to the "historism" of their method, which makes the logical revision of concepts contingent upon historical events and developments and therefore affects them with relativity and the necessity of constant and recurrent revision as "the picture of economic life" changes its aspects and requires to be re-painted. (2) An objection to the 'sociologism" of their method, which finds the motivation for the logical revision of concepts less in the (demonstrated or suspected) lack of clearness and self-consistency in the structure of the concept itself than in misapplication of the (possibly quite valid) concept as an instrument for the rationalization and justification of reprehensible action. Of our objection on the grounds of "historism"—which is merely a variant of realistic empiricism—we have already said enough. We shall have more to say of our objections on the ground of "sociologism"—and of the inconclusiveness for the logical enterprise undertaken by our authors of the pragmatic test which such "sociologism" implies—when we come to the authors' proposals toward the revision of the concepts of Profits.

IV. Wealth

The proposed revision of the fundamental economic concept of "Wealth" can be considered more briefly. Here, again, Professors Berle and Means compare the concept as it is found in the writings of

Adam Smith with the concept as it has been revised by them. The impulse to revision again arises from the changes in "the picture of economic life" which the development of "the corporate system" has brought about. Again, the outstanding characteristic of the change produced is taken to be the breaking up of wealth into "passive wealth" and "active wealth."

"To Adam Smith, wealth was composed of tangible things,—wheat and land and buildings, ships and merchandise * * * " On the other hand, "in connection with the modern corporation, two essentially different types of wealth exist." There is: (1) "Passive Property," which represents not "tangible goods" but "a bundle of expectations which have a market value and which, if held, may bring him (the stockholder) income and, if sold in the market, may give him power to obtain some form of other wealth;" and (2) "active wealth," which means to the possessor, the so-called "control," "a great enterprise which he dominates, an enterprise whose value is for the most part composed of the organized relationship of tangible properties, the existence of a functioning organization of workers and the existence of a functioning body of consumers." (Page 248.)

The critical objections already raised in the preceding section also apply to this revision and with the same force. There is, to be sure, a difference in character between "tangible goods" as wealth and a "bundle of expectations" which have a market value because (1) they represent claims to income and/or because (2) they are exchangeable for (a) tangible goods or (b) other but similar "bundles of expectation." The difference is similar to the difference between two distinct things designated by equally distinct (but frequently confused) uses of the word "capital." Readers of this article may be advised to consult the brief and lucid discussion of the differences in fact and in terminology contributed to the *Encyclopaedia of the Social Sciences* (Volume III, pp. 187-190, *sub verbo* "Capital") by Professor Frank A. Fetter. A few brief, particularly pertinent, passages may be quoted here, as follows:

"The manifold derivative meanings (derivative from capital defined as an interest-bearing sum of money) are all of two types, the one implying ownership of a valuable source of income, the other the stock of physical goods constituting the income source. The one idea was from the first characteristically individual, acquisitive and commercial, that of any financial fund having monetary expression; the other idea was characteristically impersonal and technological, that of the physical goods used to extract, transport, create or alter goods, ships, stores of merchandise, money, tools, machines, houses and, usually but not always, lands." * * *

"A business as a whole might be thought of either as the sum or fund of purchasing power invested, or as the mass of goods which, although not bought with borrowed funds, embodied the owner's business fund." * * *

"While recognizing divergent usage, we may define capital as the market value expression of individual claims to incomes, whether they have their sources in the technical uses of wealth or elsewhere. This is essentially an individual acquisitive, financial, investment, ownership concept. It is a 'fund' only in the financial sense, not a stock of wealth. It is the sum, in terms of dollars, of the present worths of various legal claims. It therefore includes the worth of all available and marketable intangibles, such as credits, promises, good will, franchises, patents, etc., as well as the worth of claims to the uses of physical forms of wealth. Their summation as a financial fund is the resultant of a capitalization process. Physical objects of value are not capital, being sufficiently designated as goods, wealth or agents."

Now, Professors Berle and Means propose the use of the term "passive property"—or "passive wealth"—to designate the economic entity for which alone Professor Fetter has reserved the term "capital." For wealth as "characteristically impersonal and technological" (Fetter), they propose the description "active property" (or "active wealth"). But in so far as goods (specifically "capital goods") are *active* as (factorial) agents of production in the production of other goods and/or services, they are *technologically* active. With technology, however, neither economics nor the science of law are directly concerned.

But the authors do not define such tangible property (goods, wealth) as "active" because of its technological activity; they describe it as "active" because a certain class of persons (collectively called "management" or "control") "act with respect to it," their action being, not technological but economic action. Be it noted again, however, that the adjective "active," according to the authors' notion, applies only if the function of "acting with respect to it" is fulfilled by a person or set of persons other than the owner or owners of the property, that is, under "the corporate system" with its separation of the "function" of "having an interest in an enterprise," upon the one hand, and the functions of "having power over it" and of "acting with respect to it," upon the other. In other words, we again find their analysis vitiated and invalidated by the "picture" of historically contingent conditions and relationships—a confusion which is the characteristic vice of "historism."

V. Private Enterprise

In the authors' revision of the concept of Private Enterprise, we find, besides the confusion characteristic of "historism," a further confusion in the use of terms which is so obvious that it is easily exposed. To Adam Smith, it is said, "private enterprise meant an individual or few partners actively engaged and relying in large part on their own labor or their immediate direction. Today we have tens and hundreds of thousands of owners, of workers and of consumers combined in single enterprises."

The distinction here made is one between "individual enterprise" and "corporate enterprise." It is not a distinction between "private enterprise" and enterprise which is other than private. The opposite of "private enterprise" is "public enterprise." Both "individual enterprise" and "corporate enterprise" are still "private enterprise," being merely variant forms of it. Now, because "private enterprise" appears in (at least) these two variant forms, our authors propose a revision of the concept of "private enterprise." The logical grounds brought forward for this revision are expressed in the plea that the prevailing (Smithian) concept of "private enterprise," like the other Smithian concepts, is "inapplicable to a dominant area in American economic organization," that is to say, to private enterprise in its corporate variant form. But that is an illegitimate procedure with concepts. Would an ornithologist think of defining the connotation of the concept "finch" and limit its extension in consideration merely of the fact that the common English sparrow is the "dominant" representative of the class "finches?" There appears here another vice of "historism," the vice of defining class-concepts in terms of the "dominant" sub-division of the class—the same vice which we find so flagrantly exemplified in the definition, by German racialists, of the "Nordic," the Aryan, or even the white race in terms of the "dominant" (?) blond German of northern Germany.

We find such methodological presuppositions clearly enunciated in the following sentence. "These great associations" (of corporate enterprise) "are so different from the small, privately owned enterprises of the past as to make the concept of private enterprise an ineffective instrument of analysis." (Page 349.) What does this statement imply? It implies a demand that concepts shall be descriptive—the more technical but also more precise term is "idiographic"—, a demand which involves a rejection of concepts as analytical, precisely because they are that. Our authors call for concepts as instruments of analysis and then propose to destroy this instrumental character demanded of them by declaring that they must be descriptive. The concept of "private enterprise" which they desire to apply to "corporate enterprise" as an instrument of analysis is quite ineffective for that purpose, just because they demand at the same time that it shall be a pat description of "corporate enterprise" as the dominant form of "private enterprise." These contradictory demands are merely a late American repetition—characteristic of Institutionalism in American economics—of the equally contradictory demands with which the Historical School of economists confronted the representatives of economic theory.

VI. Individual Initiative

The authors' brief discussion of "individual initiative" can scarcely be called a revision—or even a re-analysis—of the concept. It amounts to little more than the apodictic declaration that in modern industry, especially under its corporate form of organization, individual liberty and initiative are necessarily limited and curbed.

VII. The Profit Motive

The heading itself of this section (Book IV, Chapter III) suggests the "sociologism" of the approach. What is discussed is not the formation and distribution of "profits" but profit-taking as the motivation of individual economic activity. For better enlightenment on the function of profits in the economy of private enterprise, we must turn to the preceding chapter (Pages 340-344). The authors there point out that

"profits act as a return for the performance of two separate functions. First, they act as an inducement to the individual to risk his wealth in enterprise, and, second, they act as a spur, driving him to exercise his utmost skill in making his enterprise profitable. In the case of a private enterprise the distinction between these two functions does not assume importance. The owner of a private business receives any profits made and performs the functions not only of risk-taking but of ultimate management as well. It may be that in the past when industry was in the main carried on by a multitude of small private enterprises the community, through protecting property, has induced a large volume of risk-taking and a vigorous conduct of industry in exchange for the profits derived therefrom.

"In the modern corporation, with its separation of ownership and control, these two functions of risk and control are, in the main, performed by two different groups of people. Where such a separation is complete one group of individuals, the security holders and in particular the stockholders, performs the function of risk-takers and suppliers of capital, while a separate group exercises control and ultimate management. In such a case, if profits are to be received only by the security holders, as the traditional logic of property would require, how can they perform both of their traditional economic roles? Are no profits to go to those who exercise control and in whose hands the efficient operation of enterprise ultimately rests?" (Pages 341-342.)

Two alternatives between which the choice must be made in the distribution of the net income of a corporate enterprise are open. Professors Berle and Means have discussed these alternatives in the chapter (the Second of Book IV) on "The Traditional Logic of Profits," which is, in the opinion of this writer, the best in this concluding Book of their treatise. This discussion presents two aspects. It represents, upon the one hand, deductions from the two traditional logics, of property and of profits, respectively. It represents, on the other hand, a description of the changes in the conditions and relationships in economic life which have resulted from the emergence and development of the corporate system. So long as individual enterprise remained the dominant form of individual enterprise, the two traditional logics, it is contended, were mutually complementary components in an essentially unitary economic philosophy, of Adam Smith's for example, with harmony existing between its elements. With the development of the corporate system, however, diremption of its elements was introduced into the economy of private enterprise and contradiction—note, again, the pervasive "historism"—between the two traditional logics.

Under the system of individual private enterprise and according to the traditional logics which supplied its ideologies, the profits *in toto* belonged and accrued to the owners. The traditional logic of property, by the common law extended to the quasi-public corporation to meet a new factual situation, logically demanded the "award of the entire profit to the security holders, and in particular to the stockholders. According to this logic a corporation should be operated primarily in their interests." (Page 334.)

But is the traditional logic still applicable to the new situation without a distortion of its internal consistency?

"In the past, the ownership of business enterprise * * * has always, at least in theory, involved two attributes, first the risking of previously collected wealth in profit-seeking enterprises; and, second, the ultimate management of and responsibility for the enterprise. But in the modern corporation, these two attributes of ownership no longer attach to the same individual or group. The stockholder has surrendered control over his wealth. He has become a supplier of capital, a risk-taker pure and simple, while ultimate responsibility and authority are exercised by directors and 'control'. One traditional attribute of ownership is attached to stock ownership; the other attribute is attached to corporate control. Must we not, therefore, recognize that we are no longer dealing with property in the old sense? Does the traditional logic of property still apply? Because an owner who also exercises control over his wealth is protected in the full receipt of the advantages derived from it, must it *necessarily* follow that an owner who has surrendered control of his wealth should likewise be protected to the full? May not this surrender have so essentially changed his relation to his wealth as to have changed the logic applicable to his interest in that wealth? An answer to this question cannot be found in the law itself. It must be sought in the economic and social background of law." (Pages 338-339.)

It has already been contended, in this paper, that the ultimate management of and responsibility for an enterprise are not, in strict logic, *attributes* of ownership, they are, and have been for a long time, historically contingent *accidents* of ownership. It is because, with the traditional logic of property, they still regard management of and responsibility for an enterprise as attributes rather than as accidents of ownership, that the authors are driven into their undertaking, the revision of fundamental economic concepts. Had they recognized the commitment of the economy of individual private enterprise (and of its ideologies) to a close association between property ownership and management as one of the accidents of private enterprise in one of its historical stages of development—the individual, pre-corporate system for which it was a socially justified desideratum—their reasoning would have taken a different course.

The concept and the term "profits" have long been a stumbling block for economic analysis, particularly in Anglo-American economic (and other) literature. Both have been taken to cover, as a source of income, an entity which was falsely regarded as being unitary, while in reality there are two entities. These are (1) interest on capital and (2) the gains of enterprise (entrepreneurial gains). They were not recognized as distinct categories of income simply because, by the historically contingent relationships of the system of individual private enterprise, they accrued, as a rule, to a single individual who in his own person was both owner and manager.

Messrs. Berle and Means correctly observe, however, that "profits act as a return for the performance of two separate functions. First, they act as an inducement to the individual to risk his wealth in enterprise, and, second, they act as a spur, driving him to exercise his utmost skill in making his enterprise profitable." (Page 341.) It is unfortunate that the authors still cling to the term "profits" as a common name for these distinct types of income. The development of the corporate system, by its separation of ownership and ultimate management, has brought about a clearer and more general recognition of the distinction; it has not created that distinction itself.

A significant suggestion is made, pages 342-344, on the distribution of the net income of a corporate enterprise. If it were put into practice, it would have very far-reaching consequences.

"It is clear," it is said, "that the function of capital-supplying and risk-taking must be performed and that the security holder must be compensated if an enterprise is to raise new capital and expand its activity, just as the workers must be paid enough to insure the continuous supplying of labor and the taking of the risks involved in that labor and in the life based on it. But what if profits can be made, more than sufficient to induce new capital to come into the enterprise? Where is the social advantage in setting aside for the security holder, profits in an amount greater than is sufficient to insure the continued supplying of capital and taking of risk? The prospect of additional profits cannot act as a spur on the security holder to make him *operate* the enterprise with more vigor in a way to serve the wants of the community, since he is no longer in control. Such extra profits if given to the security holders, would seem to perform no useful economic function."

It is, therefore, suggested that instead of earmarking *all* profits for the security holder, as demanded by the traditional logic of property, "only a fair return to capital should be distributed to the 'owners'; while the remainder should go to the control as an inducement to the most efficient ultimate management." There is, in this suggestion, a recognition of the difference between the function of capital interest as a compensation for capital-supplying and risk-taking and the function of entrepreneurial gains as reward for efficient ultimate management.

According to the traditional logic of property, which holds ultimate management to be an "attribute" of property ownership, both capital interest and entrepreneurial gains should fall to the share of the owners of the enterprise. Where the owners no longer do and no longer can manage and where, consequently, others who may have little ownership interest in the enterprise take over its management, these latter persons must, according to the traditional logic of property, be regarded as exercising *powers delegated* to them by the owners, whose original prerogatives they are. This logic, however, disregards the fact, long since recognized by economists as such, that the entrepreneurial function is a function which cannot be delegated. If this fact has not always been accepted or understood in the consequences implied, this has been due to a failure to single out the function which is the characteristic function of entrepreneurs. The present writer is not at all sure that Messrs. Berle and Means have segregated it and made it sufficiently prominent in their analysis.

"In the development of the corporation," they write, p. 334, "constantly widening powers over the management of the enterprise have been delegated to groups within the corporation. At first these powers concerned mainly the technical (profit-making) activity of the enterprise. Later powers were delegated which had to do with the distribution of profits and interests among the security holders."

Of the powers here named as having been delegated, the first, concerned with the technical activity of the enterprise, is a managerial function (which can be delegated); it is not an entrepreneurial function (which cannot be delegated). The powers which have to do with the distribution of profits and interests among security holders and which are said to have been "delegated" *later* in the course of the development of the corporation, are neither managerial nor entrepreneurial in character. Moreover, there is abundant evidence to be found in the main body of the authors' treatise which can be read to show that they have never been delegated at all but have been usurped.

Usurpation, rather than delegation, of powers is, in fact, abundantly recognized by the authors. One form which such usurpation has taken is the exercise of legally delegated powers as if they were absolute. In either case, whether powers be delegated or usurped, the economic and legal status of the person or persons exercising them is involved. The recipient of delegated powers—primarily powers concerned with the technical activities—will stand in the relation of a servant to a master. Entrepreneurial powers, as already noted, cannot be delegated; they may, however, be surrendered, in which event the person to whom they are surrendered himself becomes the entrepreneur. If property-interest in the enterprise is retained, while entrepreneurial powers are surrendered, the person or persons assuming the latter will necessarily occupy a position of trustee toward *cestui que trust,* that is, toward the owners of the property-interest. Professors Berle and Means have sufficiently pointed out the difficulties, factual and legal, which stand in the way of a fully effective realization of such fiduciary relationship.

Officials of corporate enterprises who have assumed the burden of the entrepreneurial function may receive a salary, especially if they also perform managerial functions, technical functions, in the broad sense. Entrepreneurial functions, in the proper meaning of the term, on the other hand, *do not have a price which can be fixed by contract.* Entrepreneurial gains, being contingent upon the success or failure attendant upon entrepreneurial decisions of disposal, represent a residual and uncertain income. Therefore, if the entrepreneurial function—which consists essentially in the making of decisions of disposal—rests with a corporation official who receives a salary, such compensation must be understood to be of the order of "normal remuneration" for managerial functions. (*Cf.* John Meynard Keynes. Treatise on Money, *passim.*) Entrepreneurial gains, in the strict sense, represent what Mr. Keynes has aptly described as "windfalls." It is to such contingent income that the application of the word "profit" might well be restricted.

Professors Berle and Means have argued forcefully (pages 343-344) that participation in such "windfalls" of enterprise may be necessary as an "inducement for those in control to manage the enterprise efficiently," as an inducement to "exert themselves beyond the amount necessary to maintain a reasonably satisfied group of stockholders." As we have already seen, they even suggest that to give to the stockholders over enough to keep them satisfied and to make possible the raising of new capital, would involve "an economically wasteful disposal." (Page 344.) Surplus profits (in the sense defined) would be better applied "as an incentive to more efficient management by those in control," (P. 343), by the group of men "whose action is most important to the efficient conduct of the enterprise."

This application of the traditional logic of profits, which stresses the *profit motive* as the prime force in the motivation of economic activity, leads our authors to the conclusion that "the corporation would thus be operated financially in the interests of control, the stockholders becoming merely the recipients of the wages of capital." (P. 344.) This conclusion, however, is said to be "equally suspect" and as unacceptable as the conclusion of the traditional logic of property that the corporation should be run financially in the interests of stockholders.

In the main body of their treatise, the authors have called attention to the fact that shares of stock, preferred shares particularly, are progressively being reduced to the status of hired capital, like bonds and debentures being made subject to fixed returns and to retirement at the option of the company. It would seem to the writer that such and other tendencies point in the direction of placing upon the entrepreneurial control greater burdens of risk-bearing and of financial responsibility for the successful or unsuccessful issue of its entrepreneurial policies. It is all very well to assign "surplus profits"—as defined by the authors—to the entrepreneurial control and to the superior managerial officers as an inducement to, and bonus for, the most efficient ultimate management. But, as the authors have so abundantly shown, various devices, legal and extra-legal, can be and have been employed to divert more than a proper share of the corporate income stream into the pockets of "control" and "management." (*See also*: R. Weidenhammer, Causes and Repercussions of the Faulty Investment of Corporate Savings—American Economic Review, Vol. 33, pp. 35-41, March, 1933.)

There has, of late, been considerable criticism of the high salaries paid to executive officers of corporations. May it not be well to consider, in this connection, an enlargement of the burdens of risk-bearing and financial responsibility rather than a forced reduction of salaries? If the prevailing high corporate salaries represent, indeed, the proper "normal remuneration" of men of high caliber and competence and, if liberal bonuses represent a due reward for success in competitive management, should there not be offsetting burdens and deductions for failure and inefficiency? Should risks and reduction in dividend returns be borne wholly by stockholders whose risk-taking and capital-supplying function it is proposed to reward with comparatively fixed "wages of capital?" Would not competition thereby be re-introduced in circles which by dint of place and power are said to have blanketed the incidence of the selective force of competition upon themselves?

VII. The New Concept of the Corporation

In the concluding chapter, which bears as title the caption "the new concept of the corporation," the authors have undertaken to "consider and appraise certain of the more important lines of possible development." The possible lines of development considered are three:

First, operation of the bulk of American industry by trustees for the sole benefit of inactive and irresponsible security holders, "accompanied by possible diminution of enterprise."

Second, operation of a corporation by the men in control in their own interest, "with the corresponding danger of a corporate oligarchy coupled with the probability of an era of corporate plundering."

Third, the modern corporation serving, "not alone the owners or the control but all society."

How is this all-embracing service contemplated in the approved final alternative to be obtained? In the words of the authors:

> "It is conceivable—indeed it seems almost essential if the corporate system is to survive—that the 'control' of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity." (Page 356.)

That is a project and prospect which suggests to at least one reader a comparison with the rule of philosopher-statesmen suggested by Plato in his "Republic." "In still larger view"—a view which, by its stress on economic rulership, brings it closer to Auguste Comte's forecast of rule by industrialist-statesmen—the authors suggest that: "the modern corporation may be regarded not simply as one form of social organization but potentially (if not yet actually) as the dominant institution of the modern world." (Page 356.) In the light of recent developments in this country and in Italy, particularly, that pronouncement gains added significance as being indicative of the direction of winds of doctrine. It need not, however, for that reason, be taken as prophetic.

In their survey of possible lines of development, the authors have neglected to appraise a fourth possibility of development which they themselves have suggested but have rejected upon grounds which we shall presently consider. This possibility is represented by an operation of industry under the guidance of entrepreneurial control and technical management, working with hired capital which would be paid "wages of capital"—that is capital interest—according to the appraisal by the market of the hazards of the enterprise, including those of mistakes in entrepreneurial policy and of faulty management. Operation of a corporate enterprise under such conditions would obviate the necessity of appraisal, by courts of law in the last instance, of such defenses of entrepreneurial policy as "reasonable care," "honest judgment" and "exigencies of business," which at best is difficult.

Professors Berle and Means have described and analyzed, with great care and diligence, the structural transformation which the emergence and development of the modern corporation has brought about in economic organization. In that organization, as transformed, the bearer of the entrepreneurial function of making decisions of disposal more than ever occupies the key position. Are we permitted to observe, then, a corresponding transformation in the character of the entrepreneurial agent himself which parallels the structural transformation in economic organization? Professor Josef Schumpeter, of the University of Bonn, who has repeatedly lectured at American universities, has described the entrepreneur as an innovator, characterized, in the past, chiefly by distinctive qualities of will, as a man of daring in the choice of his course and of persistence in the pursuit of it once it has been chosen. Since writing this characterization of the entrepreneur, Professor Schumpeter has also expressed his expectation of the development of an entrepreneur of rather different type, a type more distinguished by qualities of intellect, relying for his guidance more upon research (market analysis, business forecasting, and the like), rather than upon instinct and intuition. (See the citation of Schumpeter's view in the article by Robert Weidenhammer named above, a citation which is based on Schumpeter's article on "The Instability of Capitalism," in the Economic Journal, September, 1928.)

The fourth possibility of development which we have mentioned above has been rejected by Professors Berle and Means. The grounds for their rejection of it are found in reflections upon "the profit *motive*" as the prime mover to economic activity. Such sociological reflections are not without interest; but they contribute little to the refinement of economic concepts, particularly if they are concerned with *what ought to be* rather than with *what is.*

VIII. In Conclusion

We have, in this paper, sought to answer critically the three questions stated in the Introduction. We may now briefly summarize our conclusions.

To the question, the first, whether the development of the corporate system necessitates a modification or revision of fundamental economic concepts, we have given a twofold answer. Our answer has been both positive and negative.

Our answer has been *positive* in so far as we have held that a revision of some economic concepts would be well-advised. This holds good especially for the concepts of private property and of "profits." The correction of the concept of "profits" as an ambiguous concept has already been made by economists in an analysis of economic realities. We have only contended that our authors have not observed this correction with sufficient strictness and fidelity. The revision of the concept of private property, which we also believe to be called for, still awaits formulation. We have found that the authors, while explicitly repudiating "the traditional logic of property," are still more consistently involved in this tradition than they seem to realize.

Our answer has been *negative* in so far as we have denied that the development of the corporate system, in and of itself alone, furnishes sufficient grounds for the revision of fundamental economic concepts.

With respect to the thoroughness of the authors' revision of economic concepts, the second of our questions, we have stated three conclusions: (1) that, as already indicated above, the authors' abandonment of the traditional logics of property and of "profits" has not been so thorough-going as their repudiation of them has been emphatic; (2) that they have not drawn to the full the conclusions which are implicit in the revision of the concept of "profits" which they have, not so much fashioned as accepted; (3) that, consequently, the authors find, as they are bound to find, a contradiction between the logic of "profits" (described as "traditional" but in reality a revised logic) and the traditional logic of property; and that they do find this contradiction because they have not really and thoroughly revised the latter concept.

The consideration and appraisal of possible lines of development also falls somewhat short of its promise because of these limitations of the preceding analysis. The two possible lines of development which are rejected flow, indeed, from the traditional logics of property and profits—and that is why they are rejected. The third possible line of development is accepted and welcomed, despite its obviously radical character, because it does not flow from either of these two logics—which indeed it does not. It flows rather from sociological reflections—and these are rather utopian. Another possible line of development, which would be a valid projection from the revised logic of property which we have suggested and from the already revised logic of "profits" accepted by the authors, has been rejected on the grounds of the sociological reflections already noted.

We have taken exception to the methodological presuppositions which we have found to underlie the revision of economic concepts proposed. The authors have deplored the fact that the application of the logic of two major disciplines, economics and law, leads to divergent results. We have held that the duality of the objectives of the respective disciplines calls for a corresponding dualism of methods. Economic analysis has too often and too long operated with some concepts which were too much weighted with legal reflections and presuppositions. On the other hand, the law has often put constructions upon economic concepts which properly they should not bear. A revision of economic concepts will be more thorough and more valid if it is predicated upon purely economic data and upon an economic analysis thereof.

The critical exceptions here recorded do not, and are not designed to, disparage in any way the value of the main body of the authors' very fine treatise (Books I, II and III). While we do not agree with many of the "deductions and speculations" in the concluding Book, we are duly grateful for the stimulation to thought which they certainly convey.