A NOTE ON CORPORATE AMERICA

*Simon M. Lorne**

THE ATTACK ON CORPORATE AMERICA: THE CORPORATE ISSUES SOURCEBOOK. Edited by *M. Bruce Johnson.* New York: McGraw-Hill. 1978. Pp. xv, 348. $14.50.

The first copy of *The Attack on Corporate America* that I received was sent to me by a former teaching colleague who commented in his transmittal letter that "considering its source [The Law and Economics Center of the University of Miami School of Law] [it] is likely to be a hymn of praise to the free enterprise system." My colleague was right . . . and wrong. Considering its source it *was* likely to be a hymn of praise. And, indeed, its sixty-one essays are in large part, if not unanimously, in praise of the free enterprise system. However, when sixty-one essays occupy 299 pages of text (my pocket calculator advises that the average is 4.9 pages per essay), it is difficult fairly to characterize the result as a "hymn." When the four major headings are "Sociopolitical Analogies and the Corporation," "Control of the Corporation," "State Versus Federal Chartering of Corporations," and "Corporate Power and the Market," any such characterization becomes most implausible.

It appears, then, on its face (and the appearance is thoroughly substantiated by the contents) that the volume is too broad in scope, and the individual essays too abbreviated, for the book successfully to accomplish the mission that I would design for it. To say that, however, may not be to level any great criticism at the work. For its mission may not be that which I would design, and it does not advertise itself as anything more (although certainly nothing less) than "The Corporate Issues Sourcebook." And to some substantial extent, it may be that it does an adequate job of providing a source from which one can discern a variety of corporate issues. But it strains credulity to suggest that the sole *raison d'être* of this work is providing a shopping list of issues. And, indeed, Henry Manne, founder and director of The Law and Economics Center, suggests in his preface that more is intended: "Many persons studying this work will be surprised to learn that the weight of high-grade scholarship about the modern corporate system supports strongly the conclusion that unregu-

* Member, California Bar. A.B. 1967, Occidental College; J.D. 1970, University of Michigan.—Ed.

lated corporate capitalism functions far more desirably than various louder voices have led us to believe." That banner is carried throughout the work. Unfortunately, Professor Manne is guilty once again of overstatement. It is a shame that one who brings as much innovative and provocative thought as does Professor Manne to the field of corporate and securities regulation tends so often to reduce his arguments to political, if not actual, absurdity, and to continue to defend them.

"Many persons studying this work. . ." Unlikely. Some, no doubt, will study it. Many, I hope, will use it and consult it. But that many will study it is simply not to be expected. And if they did—without undertaking considerable additional effort to read much more broadly—they would no doubt be frustrated by the results of their efforts. How does one "study" a group of sixty-one five-page essays?

". . . will be surprised. . ." Even less likely. The level of commitment required to "study" this volume—if it can be done—is such that only those who are already dedicated to the conclusions may be capable of accomplishing it. It would be astonishing if those few individuals were to be surprised.

". . . to learn that the weight of high-grade scholarship about the modern corporate system. . ." Impossible. Some of the sixty-one essays are excellent. Some are not. But they are certainly not, as a group, capable of conveying to the reader any clear notion of what "the weight of high-grade scholarship" truly holds. I tend to believe the premise of Professor Manne's preface. I have a great deal of faith in the social efficiency of capitalism. I even think myself capable of "high-grade" scholarship. Yet even I could not fairly draw conclusions from this book as to what a large group—much less the weight—of high-grade scholars would conclude. Furthermore, the book does not purport to be a dialogue that would expose the thoughts of both sides. It is rather in the nature of rebuttal, and to draw firm conclusions from it would be both difficult and dangerous.

". . . supports strongly the conclusion. . ." See *supra,* but read it with even more emphasis.

". . . that unregulated corporate capitalism functions. . ." No such tenet is put forth in any of the essays, nor should it be. We have never seen unregulated corporate capitalism. Indeed, it may be that the essence of incorporation—made possible only by enabling legislation—implies regulation. Whether or not that is true, it is certainly true that we have never experienced unregulated corporations, for the world's attraction to economic regula-

tion predates the wide-spread use of the corporate format. And it is difficult to imagine the existence of unregulated corporate capitalism in the modern environment.

". . . far more desirably than various louder voices have led us to believe." Possible, assuming the editorial "us" is in use—certainly those louder voices have seldom led Professor Manne to believe very much. Even with that assumption, however, and even combining the last two quoted phrases for fairness's sake, one could not fairly conclude so much from this volume. The broadest legitimate conclusion is that the views of the louder voices are not likely to be true, and that some less, or different, regulation than we now have would be beneficial.

This book does fulfill a function. It does present a point of view that has too often been ignored. It does provide a forum for sensible views. But its reach exceeds its grasp by too much. To respond in such a relatively short book to an attack as widespread as that on the modern corporation is impossible. No matter how concisely written, it is difficult for five pages to respond to fifty, much less five hundred or five thousand. Time and again, the reader's response—even when the reader is already a true believer (as I am)—is more likely to be "Good point!" or "Interesting!" than "Q.E.D."

As one who has at times been rash enough to suggest that Adam Smith's "invisible hand" was indeed, and even is, a useful basis for analysis, rather than a silly historical eccentricity which economic history survived, perhaps I should not be heard to criticize any attempt to give greater credence to views with which I fundamentally agree. But even I—perhaps because I was reading the book rather than using it as a source book—found myself bored well short of its end. The various essays are each titled with a question. *(E.g.,* "Does advertising persuade consumers to buy things they do not need?" [no], "Is corporate executive compensation excessive?" [no], "Does antitrust activity increase economic welfare?" [no], etc.) The answers to the questions posed are overwhelmingly, if not universally, in the negative. And after not very long one becomes tired, no matter how strong one's initial allegiance, of five-page essays advising that government involvement is bad, and that present corporate activity is good, acceptable, beneficial, and quite possibly beyond reproach.

Indeed, the reaction of even this reader was to begin to focus upon the areas in which modern corporate behavior *is* at fault, if not to sympathize with the "louder voices" to which Professor Manne referred. It seems entirely plausible that within the confines of what I would call strict conservatism one might disagree with much of the underlying theme of the volume. For example, to the extent that the essays in the book deal with the environment, they tend to suggest that attempts by the government to force corporations to confine environmental pollution are wrong because they will increase prices, destroy jobs, and so on (although, again, some of the better essays do refrain from that sort of excess). However, it strikes me as fully within the dogma to suggest (as these better essays do) that if a particular method of production creates external costs such as pollution, the market mechanism of capitalism can operate efficiently *only* if those costs are internalized, and the government must in all likelihood be used to accomplish that end. For example, in a purely theoretical system (thanks to the wonders of theory) one would suggest that if a method of production by manufacturer *A* creates pollution causing X million dollars of damage annually, then the manufacturer should be taxed at X million dollars, with the proceeds used to compensate those who suffered from the pollution. Only in that way can manufacturer *B*, whose methods do not create such pollution, properly compete with manufacturer *A*, so that the marketplace can make the decision that self-interest properly requires (we embrace again Adam Smith). That is not, of course, to say that manufacturer *A* should be prohibited from polluting, for the citizenry may well prefer to suffer with the pollution and effectively (as a result of the tax redistribution) acquire the pollutant-causing products at a lower price. That remains a decision that is properly the citizens' to make and not the government's. Given the practical impossibility of measuring compensation, and of properly redistributing it, one might even argue reasonably about whether manufacturer *A* should be taxed in some estimated appropriate amount, or should rather be required to eliminate the pollution. However, the tendency of the essays in this book is simply to assert that there should be neither tax nor prohibition, with the implied result that manufacturers may properly obtain disproportionate benefits through being able to ignore social costs.

Similar analyses can be made with respect to many of the topics covered in the book. Some of the essays are excellent, some shallow. Those which are excellent lead the reader to believe that with more development, with more examination, with more analysis, they could be conclusive. Unfortunately, few of them are given that essential development. And as the hearing officer advised opposing counsel in the first administrative hearing I ever attended, "being *able* to prove it doesn't inspire me, Mr. Jones. If you can, please do so, forthwith."

But the real flaw of this work is not so much in its predictability as in its failure to examine in a constructive way the real and significant problems that do face modern American free enterprise. To my mind, the greatest of those is not unique to the private sector, but rather is one which besets all economic activity in this country at the present time, both private and public. It is simply this: While the theory of rational economic behavior depends in substantial part upon long-term rationality, our decisions seem more and more often to be made on a short-term basis. While John Maynard Keynes's analyses of political economics have been vastly distorted—so that he seems to be in popular disrepute today for unfounded reasons fully as much as he was the hero of yesterday for equally unfounded reasons—we have accepted completely his recognition that "in the long run we are all dead," and we seem generally to have chosen not to let that frame of reference affect our decisions.

That recognition is not, of course, novel: It may be traced directly from the pioneering work of Berle and Means,[1] and their recognition (even forty years ago) that modern corporations are typically controlled by managers rather than by owners. What is, perhaps, if not new, then at least rather more pressingly important than it has been, is the recognition that we are critically in need of long-run decision-making, yet incredibly unable to obtain it. In part, that is no doubt a result of the increasing impact of short-run government decisions on corporate behavior.

An aspect of the labor relations field provides an obvious example. It is not at all difficult to understand why a succession of mayors in New York, seeking reelection and needing to please the electorate immediately, compromised the future while quelling the immediate unrest by agreeing with labor unions to provide pension benefits that were clearly beyond the City's means (at least in combination with the City's other well-intentioned but perhaps excessive social programs). We all know what happened to New York,[2] and in the publicity that followed its near collapses in the 1974-1978 period, we became aware that New York was far from alone in its unfunded pension schemes. The City of Los Angeles is thought to be in reasonable fiscal health, as large mu-

1. A. Berle & G. Means, The Modern Corporation and Private Property (1933).
2. *See generally* SEC, Staff Report on Transactions in Securities of the City of New York (1977).

nicipalities go, but even it is reported to have unfunded pension liabilities in the billions of dollars.

With some, but considerably less, publicity, much the same thing has happened to our corporations. Some two years ago *Fortune* magazine ran a most significant article discussing the unfunded future pension obligations of major corporations in this country.[3] But while the SEC has since then become embroiled in substantial controversy with the accounting profession regarding questions such as the capitalization of lease obligations and accounting for inflation,[4] relatively little attention (at least of the publicized sort) has been given to unfunded pension obligations or the assumptions on which they may be viewed as being funded.[5] Yet surely such issues are worthy of our concern—unless they, like the prospect of nuclear war, are simply too great and fearsome to contemplate.

Why has this state of affairs come to exist? The answer is simply this: that by and large, managers are scrutinized on the basis of current results. The strike that is not solved today is likely to have a far more meaningful impact on the executives responsible, on the way in which corporations are perceived by the stock market and the public, and on similar interests, than are future pension obligations which cannot or can scarcely be met. They are a problem to be solved by tomorrow's managers, who will have to worry at that time.

While the short-run/long-run tradeoff may be most apparent in the context of labor strikes and pension benefits, the difficulties seen in that context recur in a number of areas. In the public sector, of course, many of those systemic failures have been chronicled over the years—thousands of "pork barrel" projects, the failure to establish an energy policy that would prevent what is probably the too cheap distribution of oil and gas, and the like. All are the result of concern with short-run appearances, and with

3. Ehrbar, *Those Pension Plans Are Even Weaker Than You Think*, FORTUNE, Nov. 1977, at 104.

4. *See, e.g., Unaudited Replacement Cost Information—Replacement Cost Information Required in Filings with the Securities and Exchange Commission*, SEC Statement on Auditing Standard No. 18 (May 1977); *Lease Accounting and Disclosure Rules*, SEC Accounting Series Release No. 225, (Aug. 31, 1977); SEC, Staff Accounting Bulletin No. 7 (May 23, 1976); SEC, Staff Accounting Bulletin No. 9; SEC, Staff Accounting Bulletin No. 10 (Aug. 1, 1976).

5. The text no doubt overstates my case. The Employee Retirement Income Security Act, and its legislative history, give substantial attention to pension funding problems. However, that statute, and the related history, give relatively scant attention to the *investor's* need for information in the area. *See* 18 U.S.C. §§ 1081-1086 (1976).

reelection, that understandably, if not acceptably, outweighs concern with long-term consequences.

In many instances the private sector is only slightly better. Private-sector managers—as opposed to owners—tend also to devote their primary attention to the problems of today, those that will affect this year's bonus and next year's promotion. The rush of the late 1960s toward conglomeration on the basis of the modern Adam Smith's "super money"[6]—paper stock certificates—is an example. How many senseless combinations were made in that era on a foundation of nothing but mutual greed—the greed of buyers to acquire, through the wonders of accounting,[7] "instant earnings," and the greed of sellers to dispose of their companies for paper certificates supposedly representing far more than the worth of the company? The rush of failures and disposals that followed gives clear witness to that greed. Certainly, some acquisitions of that period were, or became by chance, mutually profitable. But countless others were foolhardy rushes to obtain today's paper fortune, mindless of tomorrow's reality.

This is not a sensible state of affairs and is probably a far more meaningful and legitimate problem than many of those discussed in the book. Yet it would not be in keeping with the theory of the book to assess such problems, for they suggest that all is not right with free enterprise today and that there may be a proper role for someone, somehow to play.

I do not have, at least in these brief pages, a solution to the problem. Nor do I expect that my raising it in this context will cause the attention to be given to it that is required. However, the dimensions of the problem should trouble us all. Our whole society has become oriented toward this day's results, this day's profits—and the long term has become coincident with that required by the Internal Revenue Code for long-term capital gains. By and large (with some notable exceptions), decisions regarding environmental matters, hiring policies, accounting practices, and the like focus upon the short term.

There are, of course, some bright lights upon the horizon. The development of the employee stock-ownership plan, if used seriously as a means of retirement planning, may significantly tie the future compensation of today's managers to the future success of the enterprise. It is an attempt to make managers again into

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6. 'A. SMITH,' SUPERMONEY (1972). *See also* J. BROOKS, THE GO-GO YEARS (1973).

7. *See* A. BRILOFF, UNACCOUNTABLE ACCOUNTING (1972).

owners. However, while I am not aware of any statistical examination, I would hazard a guess that such plans are of importance only with respect to a minor part of the economic power of this country.

Increased attention to the role of the board of directors, with a shift toward independent directors,[8] is probably a more meaningful recent phenomenon. That body, to the extent that it actually controls the corporation, may serve to inject into decision-making processes the needed attention to long-run concerns. The importance of that relatively recent development—which was in large measure the result of government prodding—will be seen only in the future.

Perhaps it is inappropriate to criticize the particular work under scrutiny for failing to examine realistically some of the serious problems of free enterprise in this country. Perhaps this volume does perform a useful service in providing a background of readings sympathetic to free enterprise, and in opposing the "louder voices" to which its preface refers. But works of this type, no less than works of the Nader variety, tend toward a polarization that is neither helpful nor enlightening. At a conference in San Diego in January 1979, Professor (presently General Counsel to the Treasury Department) Robert H. Mundheim presented an important response to modern concerns with foreign payments "scandals" and many recent "corporate governance" issues. He warned that while there have been some serious abuses, and that they certainly need correction, it may be error to give too much attention to a "B-" on the "conduct and deportment" side of the report card and to ignore the "A's" that our corporations have achieved in arithmetic, english, and history. That sort of criticism—that search for balance and recognition of the value of the modern corporation—is needed and useful. Too often this volume tends to ignore balance and to react blindly to critics.

Henry Manne's Center undoubtedly fulfills an important function in educating those trained in the law to the world of economics and in presenting, typically, the view of the loyal minority. There is no doubt but that it, like this product of the Center, is a useful and important force. I, however, for one, hope that it will become more of a positive force toward seeking ra-

8. The *Wall Street Journal* recently reported that the ratio of "outside" to "inside" directors at industrial concerns is now 60-40. Wall Street Journal, April 17, 1979 at 1, col. 5 (Western ed.). *See generally* Solomon, *Restructuring the Corporate Board of Directors: Fond Hope—Faint Promise?*, 76 MICH. L. REV. 581 (1978).

tional solutions to the problems that free enterprise does face, and that it will candidly recognize those problems, rather than being merely the voice of opposition.