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Berle: The American Economic Republic

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THE AMERICAN ECONOMIC REPUBLIC. By *Adolf A. Berle.* New York: Harcourt, Brace & World. 1963. Pp. xv, 238. $4.50.

Few lawyers have been so provocative and so influential on economic and business subjects as Professor Adolf Berle. His important government service, distinguished academic career, experience in private law practice and politics, and past literary performance all combine to make the advent of a new book by Professor Berle a matter of some moment. The anticipation is heightened when it is realized that this time Professor Berle has made the entire American economic system his province. Indeed the very title, *The American Economic Republic,* sounds the grandeur and scope of the investigation.

The book, part of which comprised the 1963 W. W. Cook Lectures at the University of Michigan Law School, seeks to describe the American economy as it actually operates, to adumbrate a theoretical basis for our modern economic institutions and to offer an explanation for the phenomenal success of our economic machinery. Much of the material deals with notions more fully developed in *The Twentieth Century Capitalist Revolution*[1] and *Power Without Property.*[2] As the author states, the book is more an outline than a detailed economic treatise. Included are a discussion of Berle's familiar and somewhat vulnerable concept of private property, his argument that the power-property nexus has been severed, a somewhat elaborate discussion of capital markets and capital formation and a rather circumscribed evaluation of the free market and the profit motive.

An interesting new aspect of Berle's thinking is his defense of what he terms "passive property."[3] Regular readers of Berle will recall that "passive property" generally refers to accumulated wealth in the form of common stock. The very presence of arguments for a wealthy elite reflects an interesting new departure for Berle. But he does not sound strongly convinced of the necessity for this deviation from what he would consider an optimal distribution of wealth. The equality cat is perhaps let out of the inequality bag when one of the justifications offered is that a wealthy elite makes possible the application and collection of taxes which would otherwise be impossible. More interesting, however, are his arguments that wealth gives greater opportunity for individual self-realization and that it makes possible an "untrammeled leisure class" from which come university instructors, diplomats, politicians, and country newspaper editors (and presumably a wide assortment of other dilettantes). Finally, this class provides resources for activities not carried on commercially and which presumably should not

1 BERLE, THE TWENTIETH CENTURY CAPITALIST REVOLUTION (1954).

2 BERLE, POWER WITHOUT PROPERTY (1959).

3 Pp. 43-59.

be exclusively governmental, such as universities, hospitals and foundations.[4]

The most notable omission from the list of functions performed by a wealthy class is the accumulation of savings with its concomitant amount of capital investment. This omission is consistent with Berle's position that corporations and not individuals account for the major part of savings in the American economy. This is a vital part of Berle's argument that shareholders, the nominal owners of corporations, do not exercise any of the traditional functions of ownership, since shareholders' "investment" activities or stock market operations are irrelevant to corporate managers' investment decisions. This freedom from market constraint in turn allows managers to become a self-perpetuating oligarchy beholden only to their own conscience and the federal government.[5]

What then is the origin of investment capital? True to modern liberal economic philosophy, Berle finds it in the consumer. Since corporations accumulate earnings out of the profits made on the sale of goods, it is the consumers' dollar which expands industrial empires and builds factories and mills. Corporate investors, in the sense of those owning equity securities, get no credit for this function. Manifestly they could not in Berle's scheme, because they have no power to influence investment decisions.

It is not inaccurate to say that the particular dollar which an individual says he "invests" in the stock market is not invested in capital equipment by the corporation. Indeed, the corporation would ordinarily never see that particular dollar at all (except, as Berle points out, in the relatively few cases in which a company sells a new issue to the public). But even though individual savings (including those thrown into the stock market) are not identical with business investment at any particular moment, a tendency for savings to equal investment is necessarily present. The two are merely supply and demand functions in the special context of the capital market. This market certainly exists, and it cannot be made immune to the forces of supply and demand, complex though a complete market analysis might be.

The stock market is a distinctive but functional part of the total capital market. At any given moment the addition of new dollars to the stock market may have the effect only of raising stock prices. But this in turn affects the dynamic forces, including corporate investments, constantly tending to create a new equilibrium position in the capital market. And *ceteris paribus* a lowering of the price of capital will cause more to be used. The relationship between the stock market and corporate investment decisions may not be immediately evident, but it exists, substantially as delineated in classical theory.[6]

4 Readers desiring a more elegant brief for a wealthy elite should see DE JOUVENEL, THE ETHICS OF REDISTRIBUTION (1951).

5 See BERLE, THE TWENTIETH CENTURY CAPITALIST REVOLUTION (1954).

6 See Linter, *The Financing of Corporations*, in THE CORPORATION IN MODERN SOCIETY 166, 200 (Mason ed. 1960). For very recent additional evidence that the capital

A less technical answer to Berle is that corporate investment of its retained earnings is in reality new equity investment by the shareholders of the corporation. Basically this is the argument that a corporation is merely an administrative device for central management of the investments of a large number of people. Given the undisputed liquidity of the American stock market (certainly for shares of large corporations), a shareholder is free at any time his interests dictate to convert corporate earnings reflected in the market price into personally held cash. As long as the market is not capricious and arbitrary, as Berle is perforce obliged to maintain that it is,[7] the price the shareholder gets for his shares will reflect the accumulated earnings of the corporation. If a shareholder elects to retain or buy shares in a corporation whose managers are known to reinvest corporate-retained earnings, he has effectively made a decision to allow these funds to be so reinvested, albeit by someone acting for him in a representative capacity.

Part II of Berle's book, while purporting to be a brief description of the major institutions of the contemporary American economy, is in reality a brief description of the federal government's activities in the economic area. Discussed are the functions of the Council of Economic Advisors, the Joint Committee on the Economic Report, the Bureau of the Budget, the Federal Reserve Board, the Treasury Department, some regulatory agencies and the Justice Department. A survey is made of the activities owned or controlled by the federal government, including the defense establishment, the flow of credit, transportation, communications, public utilities and agriculture. There is also an imposing list of industries over whom the indirect controls are rather potent. Unfortunately, state and local governments, which in 1960 accounted for nearly thirty-nine percent of total direct government expenditures[8] and also undoubtedly accounted for a very considerable amount of regulation and control, find no place in Berle's economic republic.

Berle's emphasis on the federal government's economic role leads him to slight not only the local government sector, but makes him seriously distort and undervalue the entire, gigantic private sector of the economy. In Berle's world the free market is merely another of the many tools the federal government uses to direct the economy. In fact, it appears repeatedly that the market exists only at the sufferance of the federal government and would collapse, stagnate or become totally monopolized without the government's constant effort to maintain it as a healthy part of overall economic regulation.[9]

Since Berle does not see the markets as performing the functions traditionally attributed to them, it is not surprising that he renews his defense of

market functions in accord with classical theory, see STIGLER, CAPITAL AND RATES OF RETURN IN MANUFACTURING INDUSTRIES (1963).

7 P. 130.

8 U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACTS OF THE U.S. 416 (1962).

9 *E.g.*, p. 145.

cartel practices, whether of the real variety enforced by the federal or state governments, or the possibly imaginary variety alleged in the steel industry. In either case, while not specifically recommending the repeal of the Sherman Act, Berle suggests that the "administered" price arrangement is necessitated by the undesirable effects of uncontrolled competition. Without batting a critical or skeptical eye Berle traces developments in the petroleum industry from 1933 and the NRA through the Interstate Oil Compact and the "Hot Oil" Act. The result, in an industry riven by Department of Interior estimates of demand and Texas Railroad Commission proration orders, is, as no one would deny, an "administered price." The shocking part of this is Berle's conclusion that this result in the oil industry was "desired by all hands."[10] Apparently "all hands" refers only to those with sufficient political power to be influential, for no rational consumer would ever consciously choose this kind of gasoline price-fixing. Nor would he agree with Berle's assumption that everyone is really very happy with the price-boosting arrangements prevalent in the sugar industry, non-ferrous metals, or in controlled agriculture generally. Similarly, a part of Berle's justification (mild though it is) for our present farm program is that the results were satisfactory to most farmers.[11] Apparently political pressure and not rational analysis of economic factors should determine the desirability of programs in the American Economic Republic. But economics is not so bereft of logic, nor is politics so full of virtue that this should be accepted as the tolerable state affairs which Berle suggests.[12]

The very selection of matters dealt with by the author makes the work more an apologia for government regulation than a comprehensive survey of the American economy. But the real process of politics, certainly an integral part of federal economic activity, is, like the treatment of local government, strangely missing. Thus, we find no reference to the activities of the many lobbyists in Washington, recurrent stories of ineptitude or political bias among regulatory agencies or the effect of a government so vast that even the best informed citizens cannot know more than a small part of what is actually transpiring. Instead we find the surprising statement that "[A]n unwritten constitutional rule prohibits the use of political power in business administration, and vice versa. . . . Retribution is . . . swift where there is political interference with an American corporation, or where an American corporation incautiously induces a political officer to betray his trust in its favor."[13] Probably no humor was intended by the use of the word "incautiously" in the last sentence, but it does suggest

10 P. 157.

11 P. 143.

12 Consider, for instance, the following: "The economic republic has had to choose between an unnecessarily large but prosperous farming community with a concomitant oversupply and a tax burden or reverting to the old nineteenth-century market economy, where oversupply reduced the price enormously—and the producer to poverty." Pp. 143-44. Clearly there are other possibilities.

13 P. 12.

that the awful thing in such activity is to get caught. Berle is not naive and is well acquainted with President Kennedy's altercation with the steel companies in 1962; he is likewise fully familiar with the activities of very highly paid Washington lawyers. His statement then, like many others in this book, can only be taken as an ideal of the system as Berle sees it, not an objective description of how the American Economic Republic actually operates.

But Professor Berle despairs of offering a fully scientific analysis of the American economy. Having discarded self-interests, profit motivation, and the value theory growing out of neo-classical utility analysis, Berle is faced with the problem of discovering the fuel which makes his system operate, the force which allows men to reach such happy welfare solutions as we presently know. To meet this need Berle has elaborated his thesis of the "transcendental margin." Like many things transcendental, this one too eludes precise definition, although Berle invests it with some readily recognizable functions and characteristics. The "transcendental margin" is the American variant of the Protestant ethic, though it is not the same ethic as Weber and Tawney associated with a rather base profit motive. This American Protestant ethic emphasizes "the motivation of universal and selfless love—men were not justified merely by saving their own souls."[14]

Not only is the "transcendental margin" the embodiment of most American virtues, but, like virtue, it carries its own reward. For ethereal though this quality may be, it provides the needed fillip to make our economy successful. Berle recounts the happy material advantages we have serendipitously enjoyed because of such non-profit motivated activity as public education, foreign aid and welfare programs generally. But the latter two points are merely pump-priming arguments that such programs cause more money to be spent for consumption. And education, Berle explains, by increasing the desire for better things, induces more work to satisfy those desires.[15]

This last argument for the "transcendental margin" as exemplified by our policy toward education is remarkable for its similarity to the theory regularly advanced by spokesmen for the advertising industry. Substitute the word "advertising" for the word "education," and nothing else need be changed. While the argument has some dignity as applied to advertising, it seems a bit demeaning as applied to education. Transcendental margins leave room for strange bedfellows.[16]

The real difficulty with Berle's "transcendental margin" is not in the substance of what Berle suggests. No one should deny the spirit of altruism, neighborliness and brotherly love which is an important strain of the historical American character. But Berle fails to recognize that virtue,

14 P. 192.
15 P. 204.
16 Compare in this regard the discussion of education by a spokesman for "old style" capitalism in FRIEDMAN, CAPITALISM AND FREEDOM 85 (1962).

strong character and tolerance for hard work are rarely issued to the population by governments. Certainly, as Berle suggests, these traits are reflected in the political results of our democracy, but these traits are not accidental in America. They are closely related to the kind of freedom in economic matters which has characterized and, I respectfully suggest, still does largely characterize the American republic.

Berle's great faith in the political process and the ability of men to govern others intelligently must be viewed as an important part of modern idealism. His low regard for the unregulated private economic sphere, while also a modern attitude, should certainly be eschewed by anyone concerned with economic progress, political reality and, in no small measure, individual freedom.

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