

The curse of the corporate state:

Saving capitalism from itself

Bob Monks



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The curse of the corporate state: Saving capitalism from itself.

By Bob Monks

Preface

Bob Monks is no shrinking violet; his own website (Ragm.com) makes that clear. Indeed, he relishes the sobriquet of “traitor to his class” – the title of his biography, by Hilary Rosenberg. He is a rich man, from an old family, who rowed for Cambridge, graduated from Harvard Law School and whose varied (some might say eccentric) career has taken him from partnership in a Boston law firm to Washington (where he was administrator for the ERISA legislation and sat as a director of the Synfuels Corporation), and then to the fund management industry – only to emerge as the doyen of American corporate activism. His LENS fund and its transatlantic joint venture, Hermes LENS Asset Management, are in the vanguard of the fight to make asset managers more responsible fiduciaries for the investors whose money they manage – and for the companies of which, as institutional investors, they are owners.

He is a guy who has been called “brilliant but complex” by Dennis Kozlowski (who knows complexity when he sees it), “a truly bizarre creature . . . an activist in and on behalf of business” by Nelson Aldrich (author of “Old Money: the making of America’s upper class”), and “a formidable personal opponent” by Wall St.’s favourite lawyer, Marty Lipton.

These are not empty words. Bob Monks is someone who has used his physical presence and his law school smarts to shift the US shareholder activism movement from the woolly fringe to mainstream Wall St. – not least through his creation of Institutional Shareholder Services (now chaired by his son), which handles voting for hundreds of corporate and government pension funds. But (and I hope he doesn’t mind me writing this), Bob is not quite as young as he was.

That doesn’t mean he has mellowed. Indeed, this paper would suggest quite the contrary: he is angry – angry that the progress he believes was being made in creating a more responsible (and responsive) business model in the US, a model in which individual investors can place their trust, has been stopped in its tracks.

Part of the problem (the most visible part, for most lay people) is the endemic corporate greed and corruption revealed by Enron, WorldCom, and their ilk. But Bob’s paper goes beyond these scandals to highlight:

- the way that the US political process has (in his opinion) been penetrated, subverted and suborned by the (apolitical, amoral and profit-oriented) corporate model, such that the US is now effectively a “corporate state” in which the President rules as CEO;
- the connivance in this of press and TV, which have entered into a Faustian pact with US politicians – the media being increasingly dependent on political ad revenues and politicians being afraid to say boo to all-powerful media giants; and

- the end result – which is that “the perspective of the flesh-and-blood individual has all but disappeared in favour of the corporatist world-view”.

What is the solution? To those who know Bob’s work, it is no surprise that he advocates mandatory shareholder activism – or that he endorses term limits for all government agencies (including his *bête noire* the SEC). But what is new is his belief that an even more fundamental change has to be made. The US (and, equally, the UK) has to redefine the appropriate role of the corporation in social and political life. Bob points out that, for many years, it was taken for granted that the rights of corporate establishment were privileges, granted by the authorities in the furtherance of some limited, public interest goal. They were heavily circumscribed, and it was well understood that corporations were economic entities, not individuals with political and social rights. Unfortunately, in recent years, the US legal system has moved, apparently inexorably, to blur the distinction between individual rights and corporate rights – facilitating the shift from participatory democracy to “corporacy”. It is time, Bob argues, to put the genie back in the bottle – to make corporations serve society, not *vice versa*. And to give back to the US political system the integrity that it has lost as a result of its disastrous affair with corporate mores and corporate money. It is powerful stuff.

Andrew Hilton
Director, CSFI

“If you put a frog in cold water, and very slowly turn up the heat, it will happily sit there until it boils to death; whereas if you throw a frog into boiling water, or turn up the heat too fast, it will jump out.”

“Nobody rings a bell to tell you when it will start.”

Introduction: The corporate state¹

The history of our time will record that more than two centuries of government “of the people, by the people and for the people” in the United States came to an end at the beginning of the twenty-first century. Instead, what we have today is a new phenomenon, one that I deplore: the corporate state.

A change in kind . . .

The key ingredients of the corporate state have been evident for years. But we are now talking about a change not just in degree, but in kind. Only today does the American public, mutely and uncomplainingly, accept corporate hegemony. What previously was considered unacceptable is now commonplace. Corporate interest and the national interest are now congruent; corporate personnel guide the nation. It is as if political controversies of the past century – which pitched Big Business against Washington – have been settled. There has been a transformation from democracy to corporatism.² Corporatism has won, and this President now governs as a CEO, rather than as the representative of those who voted both for and against him.

Is this new? And does it matter?

I think that it *is* new – and that it *does* matter. I accept that increasing corporate power and presence have been evident on many fronts in recent years, and interest group influence is nothing new in American politics. What *is* new is the scale of this influence today; what is new is its blatancy; what is new is the unchallenged interchangeability of highest officials weaving between corporate directorships and chief executive jobs and high appointed (and elected) office.

In this paper, we will review the current relationship of corporation and state in the US. We will look first at the pernicious phenomenon of “corporate welfare”, at examples of growing corporate power over the democratic process and at the impact of corporate money on US elections – with specific attention to the role of corporate media. Second, we will review the history of the modern corporation in an effort to explain the key question – how did we get here? This ends with my own suggestion as to how we can continue to enjoy the real benefits of corporate wealth creation (and there are plenty) without the pervasive erosion of personal liberty.

¹ There is no settled terminology. Corporatism inevitably evokes Mussolini; corporacy, perhaps better, is not a recognised word; so I will make do with ‘corporate state’.

² Bill Emmott, *The Economist*, A survey of Capitalism and Democracy, June 28, 2003, p16.

The third part of this paper is an effort to understand what “corporate language” really means. It concludes by imploring the United States Supreme Court to reverse its decision that a corporation is a “person” entitled to participation in the American political process. We argue that the judicial and executive branches should enforce existing laws requiring trustees and shareholders to act as “owners” of portfolio companies and that they should be willing to prescribe appropriate guidelines for management.

But first a word about me. Why am I so concerned about what I see as the erosion of democracy in the US, and about the conflation of business and politics into a new kind of engine for American society?

I write from personal experience. Over many decades and several careers – law, business, politics, government administration, and history – I have worked in virtually all the situations which I describe in this paper. I have even made mistakes: I was close to spectacular disaster as a director of Tyco until 1995. I worked to enable shareholder activism as the Federal official responsible for the private pension system embodied in ERISA legislation - and, since then, I have endured the non-enforcement of this important law. This perspective enables an overview that – at the very least – permits understanding of the differences between what parties say they are doing and the actual import of their acts. I can sense the water heating and I can hear the bell!

The state of US corporatism in 2003

What has driven me into print is what I see as the increasingly egregious behaviour of those who don’t seem to understand the need to maintain a seemingly distance between US business and the political process. Let me give you just a couple of examples:

- John Snow’s role in the Bush Administration: Through the nomination of John Snow to be Secretary of the Treasury, the Bush Administration went out of its way to associate itself with the “stealth compensation” that has enriched American CEOs during the past decade. Mr Snow, in an earlier incarnation, was chairman of the Business Roundtable, which – on his watch – bamboozled the accounting profession (and the US Senate) into permitting in the money share options to be issued to senior managements without having any impact on a firm’s profit and loss statement. This single act was, in my opinion, significantly responsible for the subsequent corporate defalcations that cost so many Americans so much. It is public knowledge that Mr. Snow himself took over US\$70 million out of CSX railroad, which he ran before, during and after he left the Roundtable. Unfortunately, Senator Grassley, as chairman of the Finance Committee, which had jurisdiction over Mr. Snow’s confirmation, declined to criticise his compensation – saying simply (albeit accurately) that it conformed with the tenor of the times.

Conflict of interest is endemic

- The Halliburton affair: Quite rightly, there has been some attention paid to the non-competitive selection of Halliburton (of which Vice-President Cheney used to be CEO) to oversee reconstruction of post-war Iraq – but not enough. The *Los Angeles Times* is fairly typical in appearing to give the Administration the benefit of the doubt:

“Corps (of Engineers) officials defended the manner in which the contract was awarded, saying secrecy and speed were essential because the then Iraqi President Saddam Hussein was expected to torch hundreds of oil wells. As it turned out, only a few wells were set on fire, and Halliburton’s mission was quickly transformed into evaluating the wreckage caused by the war and looters.”³

Cheney is, no doubt, a fine man, but shouldn’t he be concerned with how this appears? Isn’t the American public entitled to some kind of explanation for what seems to be a blatant sweetheart deal?

- Boeing: But it is not just Halliburton – and it is not just the Administration. More recently, Boeing (which has fallen on hard times, as global markets have shrunk and as it has lost civilian orders to Airbus) has leaned on its friends in the Defense Department and Congress to give it a sole-source (i.e. non-competitive) contract to supply tanker aircraft to the military on apparently uneconomic lease terms. Despite serious questions being raised, this deal still seems quite likely to go through.

This is just part of a broader phenomenon. As Paul Krugman (admittedly, no friend to the Bush Administration) has written:

“...[T]he people now running the country seem determined to have private services provided by public corporations, no matter what the circumstances ... The logistical mess in Iraq isn’t an isolated case of poor planning and mismanagement, it’s telling us what’s wrong with our current philosophy of government.”⁴

This clearly isn’t new – but it has got worse as a particular brand of corporatism has tightened its hold on the reins of government. For instance, a couple of years ago, the Senate Government Affairs Sub-committee on Investigations, under the Chairmanship of Carl Levin (Dem, Michigan), provided the most perceptive insights into the volcano of value destruction that was Enron. Under its current Republican leadership, however, there are no follow-up hearings by that same sub-committee into either corporate misconduct or the loss of value by employees and pensioners,⁵ even though the press is replete with egregious examples. Instead, despite difficult economic circumstances and (until recently, at least) a weak stock market, the pay of US chief

³ David Streitfield, New Iraq Contracts Offer Just Scraps, *Los Angeles Times*, August 14, 2003, Business page 1, 11.

⁴ Paul Krugman, Thanks for the M.R.E.’s, *New York Times*, August 12, 2003, p A21.

⁵ Republicans are, however, interested in comparable abuses by union leaders in Uillico.

Corporations outmuscle individuals

executives has continued to increase – both absolutely and as a multiple of median rank-and-file earnings. There is no public outrage; there are no public hearings; there is no action.

This dereliction of responsibility by Congress and others is not cheap, by any measure. The level of “corporate welfare” – defined as direct appropriations and tax breaks to benefit corporate America – exceeds US\$170 billion a year, even before taking into account the effect of President Bush’s 2003 stimulus bill. From 1996 through 2000, it is said that ten large (and profitable) US companies enjoyed a total of US\$50 billion in largely unnecessary corporate tax breaks.⁶ One of the most pernicious aspects of the current system is the suspicion that only those with no choice actually pay taxes (as Leona Helmsley is reputed to have said, only “the little people” pay taxes).

A good indicator of this is the ratio of corporate income taxes paid to the total amount withheld from employees’ salary checks.

Employees have little or no choice about deductions; corporations can use all the lobbying and legal skills in the world to reduce their payments. The result is devastating. In 1995, corporate income tax payments were 12.35% of the total collected, while withholding taxes were 36.59%. As of 2002, withholding taxes comprised 39.48% of the total – while corporate taxes had fallen to 8.35%. Over seven years, a three-to-one ratio became a five-to-one ratio. The lesson is clear: Pay taxes or hire an accountant.

Of course, it would be wrong simply to blame the Republicans or President Bush for this. Indeed, corporate welfare has now become a bipartisan matter; it would actually appear to be a core plank in the “New Democrats” program.

That said, it is also true that the Bush Administration settled the Microsoft anti-trust litigation on very favourable terms for the firm, despite earlier judgements during the Clinton Administration. Even the *Wall Street Journal* was indignant about this settlement, which seemed to legitimise Wall Street greed: “Perhaps the regulators were engaging in a genteel cover-up for their own lack of oversight. And perhaps the list of Enron’s enablers ought to be made richer still by adding the US Securities and Exchange Commission, the Federal Reserve, the Manhattan District Attorney and New York State Banking Department and the Comptroller of the Currency.”⁷

This isn’t just a Wall Street issue. For instance, a long-anticipated report on global warming was prepared by the Environmental Protection Agency (on a mandate awarded under the previous Administration) – but was substantially altered ahead of publication by Bush Administration officials. As the *New York Times* put it:

“The editing eliminated references to many studies concluding that warming is at least partly caused by rising concentrations of smokestack and tail-

⁶ Microsoft, General Electric, Ford, Worldcom, IBM, General Motors, Enron, El Paso Energy, Colgate-Palmolive and Navistar.

⁷ Susan Lee, The Enron Report *Wall Street Journal*, August 15, 2003.

pipe emissions and could threaten health and ecosystems...In its place, Administration officials added a reference to a new study, partly financed by the American Petroleum Institute, questioning that conclusion.”⁸

The truth is that, from its earliest days, this Administration has plainly and unashamedly based its energy policy on industry priorities. If this is not the case, why does Vice President Cheney – plainly an honest man – still decline to reveal those with whom he consulted when conducting his own study of US energy priorities?

There is another example of this phenomenon which is even closer to my heart.

The decline of ERISA

The Comptroller-General is currently investigating the continuing failure of the US Department of Labor to enforce the provisions of ERISA⁹ respecting fiduciaries’ obligation to monitor portfolio companies with the aim of optimising long term value for pension plan participants.

In theory, corporate directors in the US are elected by and are accountable to shareholders. In practice, they are appointed by the chief executive and are accountable to no one. The reason CEOs can get away with this is that institutions own the vast majority of the voting equity in America’s publicly-held companies. These trust institutions represent a hundred million American mutual fund holders and pensioners; they are the true owners of corporate America – but they are largely ignored by those who look after their money. With the exception of a small number of public employee pension plans, none of these institutions have properly discharged their fiduciary ownership responsibilities. Since the passage of ERISA in 1974, *there has never been a single instance of shareholder activism by a private pension plan subject to ERISA.*

It gets worse. In 2002, the most celebrated merger of the year, Hewlett Packard and Compaq, was successfully concluded through the good offices of Deutsche Bank, which rode a coach and horses through ERISA – there was no enforcement of the Act, and there was no protest. Through this failure to enforce the law, the US government has acquiesced in – and, therefore, has been co-opted into – a corporate system in which management is effectively accountable to nobody.

Spitzer vs the SEC . . .

Eliot Spitzer, Attorney General of the State of New York, has recently cast light on the multiple failures of the Securities and Exchange Commission. He, virtually single-handed, has shown the strength of a Federal system in which a determined prosecutor, even with small resources, can bring to light a whole generation of financial crimes while the SEC does nothing. After ferreting out some of the conflict of interests on Wall Street, Spitzer is now moving to protect the close to 90 million Americans who participate in mutual funds.

For many years, the SEC has been a wholly-owned subsidiary of the Investment Company Institute. The mutual fund industry has been effectively unregulated, and it has accepted virtually

⁸ Andrew Revkin and Katherine Seelye, Report by the E.P.A. Leaves Out Data on Climate Change *New York Times*, June 19, 2003.

⁹ Employees’ Retirement Income Security Act of 1974

no ownership responsibility for portfolio companies. There should be a law that limits the life of any government agency. None should last more than thirty years; many substantially less.

Is there any sign that this can be turned around?

I am not optimistic. Take the celebrated campaign reform bill of 2002, for example. It is subject to continued challenge in the courts, so that no one today has any confidence in its ultimate impact. Conspicuously, political candidates are raising more money than ever before for campaigns at every level – taking their lead from the fund-raising practices of the President, who aims at building a money mountain to protect his re-election in 2004. It is unimaginable that US\$150 million (or more) can be raised without the involvement of corporate staffs from donor companies to co-ordinate contributions from officers and employees; there simply isn't enough time or energy to raise money one individual at a time. The result has been to make contributions from flesh-and-blood persons virtually irrelevant to the US political process – though Howard Dean's successful use of Internet technology to raise money for a presidential run is a source of modest optimism.

This point has been made by many other people, though I don't apologise for repeating their arguments, since our political process has been stretched close to breaking point by this kind of abuse. But there is another point which barely gets a mention, though it is equally important. That is the hypocritical role played by television.

It is sad but significant that, despite the glow of populist heroism in which he continues to bask, Senator John McCain had to delete the provisions for donated TV time from his campaign reform bill right at the beginning of the debate in 2001. Otherwise, he would never have got any kind of consideration for the rest of the bill from Congress.

One of the dirty little secrets of US political finance is the importance to their bottom lines of the oligopolistic charges that TV stations extract from political candidates.¹⁰ It is estimated that political ad revenues comprised as much as 8% of the total advertising revenue of NBC, CBS and ABC-affiliated stations in 2000.¹¹ But this figure is extremely misleading, because political ad revenues have no off-setting expenses. The entire cost of production is born by the political organisations who are buying the time. So, that 8% is a direct contribution to the bottom line. Imagine what that means in terms of wealth for the station owners when multiplied by the industry's average p/e ratio.

As a result, one simple (and, I believe, potentially effective) solution to the complex problem of ensuring a healthy financial framework for elections – providing free TV time in exchange for the candidates' agreement to limit election spending – will not occur because local TV

¹⁰ The "Lowest Unit Charge" ("LUC") provision was adopted in 1971 as Section 315(b) of the Communications Acts, but is observed in the breach. See Taylor, *infra*.

¹¹ Paul Taylor, Gouging Democracy: How the Television Industry Profiteered on Campaign 2000, Appendix 1; Oregon Follow the Money: Money in Politics Research Action Project; BIA Financial Network, Inc.

**In hock to
TV . . .**

stations (and their managements) are a Congressman's best friend. No elected official will take a chance of offending networks and station owners who are so well positioned to affect his or her career.

The consolidation of corporate control over television and newspaper media in huge conglomerates further debases the language of political discourse in the US. Deciding what information to publish or broadcast is important; editing it so as to emphasise particular elements provides the framework for corporate influence. Plus, there is another important issue: *in the US the media is constitutionally protected in whatever activity it takes with respect to elections*. This means that, while there are some restrictions on expenditures by and on behalf of individual candidates and parties, the press and media can devote limitless space or time to particular campaigns – regardless of who owns a newspaper or television station, and regardless of what corporate axes or interests are involved.

This is an enormously important factor for elected officials to consider – and there is plenty of evidence that it inhibits them. They realize that it is very difficult for them to overcome a hostile press.

And it is not going to get any easier. One does not have to be unduly cynical to wonder whether the political muscle of the media barons had anything to do with the recent decision by the Federal Communications Commission to eliminate restrictions on the ownership of newspapers, radio, and television within a community – or with Congress's earlier (1996) "gift" of the ether to incumbent institutions.

These are the crucial components of corporatist America – press, corporation and party politics. They constitute a mutually nourishing system of power. The press can affect elections; parties, as the authorised recipients of unregulated corporate contributions, allocate those resources to candidates who will protect the interest of donor corporations. And the corporations themselves increasingly control the press. The result is that corporations are winning. CEOs can determine elections – and, in return elected officials can then produce a legal framework within which the power of CEOs is virtually immune from serious challenge. At present, it is virtually impossible for any force external to the corporation – government, union, even public opinion – to force change; meaningful change can only come from within the governance of the corporation itself.¹² This cycle undermines democracy and brings the political process into disrepute.

¹² Boards of Directors in the US have neither the legal power nor a tradition of monitoring effectively the exercise of power by a CEO. Only institutional investors, acting collectively, can change corporate policy.

How did we get here?

A brief history of corporations . . .

Although it is widely assumed to be a quintessentially capitalist tool, the modern corporation was in fact created by government in order to accomplish specific, defined public purposes.

**It started
out very
different . . .**

The intention was to encourage entrepreneurs by limited liability, perpetual existence and transferable holdings, to channel their energies through the corporate form in aid of a wide range of public goals – from trade with the East Indies, India and the American colonies to building bridges and ferry systems in the New World.

These roots in the public interest persisted well into the nineteenth century. Indeed, for many years, corporations could only be created by specific act of the sovereign, though over time, incorporation became a right available to all.¹³ As that happened, the public purpose component was diluted, although corporations were still limited as to size, term and purpose. No one has ever described the rationale for these limitations as well as Justice Louis Brandeis:

“The prevalence of the corporation in America has led men of this generation to act, at times, as if the privilege of doing business in corporate form were inherent in the citizen, and has led them to accept the evils attendant upon the free and unrestricted use of the corporate mechanism as if these evils were the inescapable price of civilized life, and, hence, to be borne with resignation. Throughout the greater part of our history, a different view prevailed. Although the value of this instrumentality in commerce and industry was fully recognised, incorporation for business was commonly denied long after it had been freely granted for religious, educational, and charitable purposes. It was denied because of fear: Fear of encroachments upon the liberties and opportunities of the individual. Fear of the subjugation of labour to capital. Fear of monopoly. Fear that the absorption of capital by corporations and their perpetual life might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations.”¹⁴

¹³ In 1980, President Carter and Congress made a rare Federal incursion into the private sector by authorising US\$82 billion for the United States Synthetic Fuels Corporation. Congress had been persuaded that the marketplace could not be relied on to develop alternatives to oil and natural gas soon enough to liberate the country from its dependence on Middle Eastern sources. Although it was widely criticized, by creating a special purpose corporation to meet a specific public need, the government was actually returning to the origins of Anglo-Saxon corporate history.

¹⁴ Brandeis, dissenting in *Liggett v. Lee*, 288 U.S. 514, 458 (U.S. Sup. Ct. 1933).

Unfortunately, Brandeis's concerns fell on (largely) deaf ears. Indeed, the power of the corporate form has continued to increase steadily. In particular, large publicly-held corporations passed from the control of *owners* to control by *managers* in the early 1930s.

Since then, the debate about corporate responsibility has focused on a rather theoretical question – whether management is responsible in a narrow way simply to owners, or whether managers are trustees for society as a whole. Note that both alternatives presuppose an all-powerful management that may be *responsible* to someone else, but that is not meaningfully *accountable* (a more relevant day-to-day concept) to anyone. As Allen Sykes put it: “Mega companies are clearly their own masters. As even large governments sometimes seem powerless in the face of mega-companies, the lack of management accountability to shareholders or anyone else is a matter of major concern.”¹⁵

Sykes and I have recently written at some length about the current situation:

“More serious doubts have been raised over the last 12 months about the acceptability of the current practices of Anglo-American shareholder capitalism than in any period since the aftermath of the 1929 ‘great crash’. . . The problems to be addressed are rather more complicated and often of a fundamentally different nature from what is commonly perceived. Unlike many quite recent and often reluctant converts to governance reform, we believe in and hope to demonstrate the existence of a significant ‘*systematic fault*’. . . The key example of the systematic fault is what is now widely recognised to be the excessive powers which have been relinquished to CEOs in both Britain and America, powers which a minority have abused. This gradual, unintended and unconscious transfer of power explains why the interests of a relatively small number of CEOs have prevailed against those of millions of individual and underlying shareholders.”¹⁶

The AGM farce

Let me give you a fairly gruesome example from close to home. I recently participated in the annual meeting of a major US corporation, ExxonMobil – and experienced, in full colour, that transfer of power away from the shareholders to an increasingly autocratic management. What happened has lessons for us all.

First, however, it is worth noting that a company's annual meeting is the only occasion when the law in the United States *requires* management to meet its owners.¹⁷ Against that requirement, ExxonMobil's 2003 annual meeting was a milestone which we should not pass without examination. I believe it shows the power of contemporary corporate management to nullify even the slender rights of shareholder/owners to monitor that which is theirs: the needless restrictions on shareholder communication, the minatory security apparatus, the anal fixation on the clock, the enlistment of apparently “bought” testimony on particular resolutions, the deliberate sleighting of those who exercise their right to appear – all of them undermine the rights of owners to

¹⁵ Sykes, Allen, *Capitalism for Tomorrow – Reuniting Ownership and Control*, (Capstone, 2000) p.55.

¹⁶ Monks, Robert and Sykes, Allen, *Capitalism without Owners will Fail*, (Centre for the Study of Financial Innovation, November 2002), Introduction

¹⁷ See <http://www.ragm.com>.

participate in corporate decision-making. As I walked out of Myerson (the fine hall in which the AGM was held) into the noonday Dallas spring, chapters out of Russian history flashed through my mind. Maybe it was the talk of Emperors (during my allotted four minutes, I had called Exxon's CEO an emperor); after all, a hundred years ago, the masses had petitioned the Tsar for reform. But the enduring image is not so much Tsarist Russia as the Stalinist show trials of the 1930s. I felt diminished for having participated in this charade.

Business learns the language of politics . . .

For a long time in America, the separation between corporation and state was so complete that the private sector didn't even understand that it could or should learn the language of Washington. Instead, it felt its best interests were served by keeping itself to itself. True, President Franklin Roosevelt inveighed against excessive executive salaries; President Truman briefly 'seized' the steel industry; President Kennedy was also inclined to repeat his father's characterisation of big business leaders as "SOBs". But these were Democrats after all – so the occasional anti-business rant could be dismissed as playing to the cheap seats. The result was that, over time, big business lost the ability to understand the US political process – and paid the price for doing so.

A case in point: when General Motors was caught using private detectives to shadow the consumer activist, Ralph Nader, it demonstrated the utter inability of big business to speak the language or feel the sensitivities of government. As a result, business continued to "lose" frequently - to labor, to Democrat-dominated Congressional Committees, to Federal agencies – until that former Democrat, John Connolly, in the waning days of the Nixon Presidency, began the work that led to the creation of the Business Roundtable (BRT).

Hats off to the BRT . . .

The BRT was an inspiration. Only chief executive officers can be members: only CEOs in person can attend meetings. There was no DC office. There was a minimal staff; all operations had to be approved by an Executive Committee. And responsibility for implementation was assumed by a committee chairman or other designated CEO, who undertook all of the staff expenses necessary for the project – thus ensuring top quality private sector professionals and a small BRT bureaucracy. The result was a much more effective voice for business than ever before in the corridors of US political power.

Thanks to the BRT, US business leaders eventually started to understand that Democrats were real people too – people (often lawyers) who looked forward to a post-Congressional future of golf and consulting fees for lobbying services. The result was that business co-optation in the US has become bi-partisan. In fact, by the time of Bill Clinton, the United States had a Democratic President who was convinced that his ideal reincarnation would be as a bond trader.

Under the second President Bush, this has gone even further. He has deliberately staffed his Administration from the BRT. Moreover, today, former Administration officials of the highest rank fight to associate themselves with the Carlyle Group – which has been conspicuously involved in government-dependent businesses.

Where do we stand today?

Business domination of government has occurred before in American history – notably at the end of the nineteenth century. But there has never before been a time like today, when virtually all senior elected and appointed Federal officials have been personally enriched from their big business connections. There has never before been a time when Federal programs that are focused on business have reached such a level as to deserve the Cato Institute’s sobriquet – Corporate Welfare. And there has never before been a time of such brazen disregard for propriety on the part of government officials favouring their former corporate connections. Yes, there have been campaigns to clean up corporate abuse; and, yes, there have been prosecutions. But, by and large, the government’s prosecutorial zeal has concentrated on subordinates – guilty to be sure – while the fate of the “top people” who were ultimately responsible, and who made the most money, remains uncertain. “Why did the regulators wimp out?”, asks the passionately pro-business *Wall Street Journal*.¹⁸ The reason is that corporate priorities are now accepted as national priorities.

The problem with this is that there is no attempt to understand or explain where corporations fit into the broader American polity. Instead, there is a morass of misunderstanding. In my view, there can be no “philosophy” of corporations. There can be no “ethic” of corporations. Efforts to anthropomorphise corporations must fail.¹⁹ They are simply legal assemblages with a profit-maximising dynamic. Unfortunately, no one really understands the consequences of unleashing this amoral, impersonal profit-maximising dynamic on a pluralistic society – although we would be naive not to recognise that maximising profit implies a constant increase in the scale of corporate operations and a global struggle for the entitlement to resources.

I feel strongly (as did Brandeis in his *Liggett* dissent) that this is a bad thing. I also feel that it is not inevitable; there are better ways to organise economic activity – particularly in a world of finite resources.

I am a radical, not a revolutionary. As a capitalist of some standing, I am not interested in overthrowing the system. Rather, I want to make it work better; I want to make it fairer, so that it can command the political allegiance it needs on grounds of efficiency and equity, not because that support has been bought.

That means unpicking the knotty problems that we face today in the corporate sphere.

¹⁸ *Wall Street Journal*, op.cit.supra.

¹⁹ This conclusion adds to our impatience with the legal classification of corporations as “persons”.

Towards a solution . . .

Courts can make a mistake

In my view, the key to understanding what has gone wrong in American corporatism is a surprisingly little known Supreme Court decision that dates back to 1878, through which the artificial construct of a corporation was given the legal (and effectively, the political) rights of an individual.

How did this come about? In my opinion, the problem began when the Court characterised corporations as “persons” entitled to participate in American politics. By doing this, it made the invasion of political language by corporate concepts inevitable, and produced the nexus of corporate and political interests that pollutes American life today.

This wasn’t the only time the nineteenth century Supreme Court got human and property rights mixed up. In 1857, for instance, in a majority verdict, the Court interpreted the Constitution as providing that black persons were property (the Dred Scott decision) – and equivalent to three-fifths of a white person for purposes of political rights. After the Civil War and the passage of the Fourteenth Amendment (1868), the Constitution purported to right this wrong (although it took another “four score and six” years till Brown completed the job) – only, eighteen years later, to commit almost as heinous a wrong in concocting a new combination of personhood and property. Since then, it has gone even further – extending corporate personhood into the financing of Federal elections. That prompted an attack by the noted author/lawyer, Scott Turow, on a particular Court decision which I believe to be extremely perceptive – and to have much wider implications:

“...my view is that Buckley may well come to be regarded as a sort of twentieth-century stepchild to Dred Scott . . . To our eyes, Buckley appears far less iniquitous. But as in Dred Scott, the court used formalist reasoning to find constitutional protection for economic interests at the cost of fundamental notions of equality. We can only hope that the long-run damage to the Republic is not as severe.”²⁰

It is worth emphasising that there has never been a convincing rationale for the Court’s extension of bill of rights protection to corporations. As Ted Nace put it:

“[T]he process has been a perfect illustration of the Orwellian ability of large unaccountable institutions to bend even ordinary language into a tool to serve their own needs – the gravitational force exerted by power. Far

²⁰ Scott Turow, “The High Court’s 20-Year-Old Mistake” *New York Times*, October 12, 1997. Buckley relates to restrictions on expenditures in Federal elections; Bellotti, discussed below, relates to corporate expenditures in referendum campaigns. There are several other decisions extending other First Amendment rights to corporations. This paper considers them as a totality and urges reversal of the underlying “logic” of all such decisions, namely that a corporation is a “person” under the Fourteenth Amendment to the Constitution.

from laying ordinary tracks, that force of power seemed to operate between the cracks of reason, leaving in its wake only muddled, blurry traces.”²¹

As I argue below, this decision needs to be reversed – and as soon as possible.

The language of ‘corporatism’

Corporate power (and its impact on society) is a much-discussed subject. Post-Enron, almost everyone has a view on it. Nevertheless, we need to inquire further in order to understand the increasing domination by corporate interests of the US civil agenda.

Corporations are about making a profit. As noted, when the corporate form was first introduced, there were deliberate limitations placed on corporate scope and activity depending on whatever public objective had occasioned creation of the particular corporation. Since then, however, those limits have evolved with the process of free incorporation into a much more loosely defined boundary on what constitutes the legitimate pursuit of profit. Moreover, within the law, the boundary of what a corporation may or may not do seems constantly to be expanding. This is clearly contentious. For instance, Hayek argued (persuasively, in my view) that corporations must be kept on a very short leash, at the risk of chaos for the political and social state. As we will discuss below, Milton Friedman’s formulation of corporate purpose as a maximisation of profit *within the rules* also assumed that corporations will not significantly influence – to say nothing of dominating – the process or administration of those rules.

I have elsewhere²² compared the design of a modern corporation with that of a shark; each perfectly fitted to accomplish its mission. For the corporation, that means maximising profit – which, at its most basic, means selling something for more than you pay for it. But that is obviously far too simple. The critical questions are – what costs do you count? And who pays for them?

Take the case of a bituminous coal mine, which involves exposing workers to all manner of physical and psychological injuries, as well as implying an adverse impact on ground, water and air. The question as to how many of these costs should be born by the mine operator at any one time is the subject of many laws and even more lawsuits, which are all part of a legal bargaining process. Ultimately, however, there will always be costs that are not born by the operator – and corporations will inevitably push to expand this category. Who pays for these? Sometimes, it is the employees; sometimes, their families; sometimes, society at large. This means that by encouraging the growth of corporations and the corporate form, we are essentially accepting that society should be saddled with unallocated costs, the nature and amount of which are largely unknowable. The unstated assumption seems to be that these costs (enormous though they might be, and, in the case of underground mining, indefensible) are more than offset by the wealth-generating properties of corporations.

²¹ Ted Nace, *Gangs of America*, (Berrett-Koehler 2003), p.170.

²² Monks and Minow, *Power & Accountability*, (Harper Business, 1991)

The “language” of corporations (their frame of reference, what drives them, what success means in a corporate context) is different from the normal language of politics – but, over time, it can dominate the political environment to create a corporate society in which the goal is to minimise trade barriers (except our own barriers), to maximise profits, if necessary by externalising new costs, and to sanctify property rights over the rights of individuals:

“Hidden in these principles...are a number of questionable assumptions. First, there is the assumption that humans are motivated by self-interest, which is expressed primarily through the quest for financial gain...Second, there is the assumption that the action that yields the greatest financial return to the individual or firm is the one that is more beneficial to society...Third, is the assumption that competitive behaviour is more rational for the individual and the firm than co-operative behaviour. Finally, there is the assumption that human progress is best measured by increases in the value of what the members of society consume, and that ever-higher levels of consumer spending advance the well-being of society by stimulating greater economic output.”²³

As corporate influence increases through its political domination of a society, these assumptions become the premises on which education, employment and the commitment of human energy is based. For several decades now, the aspirations of a free people have been channelled primarily through a vocabulary that recognises but a single element of their nature – greed. This perversion of America’s political vocabulary by corporate imperatives is a wrong that must be addressed before our traditional citizen-based government can be restored.

The problem for me is profound. I believe that looking at questions of public policy with a corporatist vocabulary changes the way we look at difficult issues – and that it dangerously undermines our democracy.

Let me give you an extremely relevant example. The legal use of violence is (and must be) uniquely the domain of government. How and when citizens are asked to risk their lives for the purposes defined as within the national interest is the most precious piece of the electoral franchise. By “professionalising” the military, the United States has created a more efficient fighting force – but it has also significantly reduced the quality of political dialogue about war since the only people risking their lives are now “volunteers”. They are essentially “salarymen”, just like the employees of any giant corporation. Like so much to do with the corporate realm, the benefits of this are clear – while the costs are much harder to calculate. Indeed we can only speculate on the longer term cost of diminished restraint on the unleashing of destructive power.²⁴ That said, we already have a pretty good idea of the direction we are moving in:

“Consider the decision to go to war with Iraq. In its public statements justifying the attack, the Bush Administration cited heightened national security concerns since September 11, 2001. Yet ideas such as ‘regime

²³ Richard H. Robbins, Global problems and the culture of capitalism. (2d, Ed., 2002) p.90 quoting noted author David Korten.

²⁴ *Financial Times*, August 14, 2003

change’ and ‘pre-emptive war’ had actually been developed by corporate-supported policy development groups even before the 2000 elections. The founders of one such think-tank, the Project for a New American Century, included a number of men who later became top members of the Bush Administration: Donald Rumsfeld, Dick Cheney, Paul Wolfowitz ... One investigator of the relationship between the Bush Administration and the defence industry described it as a ‘seamless web’. Yet aside from a few allegations of conflict of interest, that web does not appear to depend on any actual illegalities. In that regard, the defence industry followed a pattern that can be seen in any number of other areas where corporate influence has an overriding effect on public policy: energy, finance, pharmaceuticals, telecommunications, media, agriculture, tobacco, high tech, criminal justice ...²⁵

As I have said, the influence of business is not new. What is new is the *blatancy* of business power – and the lack of shame. As the *New York Times* put it following the 2002 Congressional elections:

“Having spent more than \$30 million to help elect their allies to Congress, the major drug companies are devising ways to capitalise on their electoral success by securing favourable new legislation and countering the pressure that lawmakers in both parties feel to lower the cost of prescription drugs . . .²⁶

This is outrageous; it is utterly insensitive to democratic legitimacy. Political contributions are now viewed as relevant only in empowering industry; the public interest is not worthy of serious consideration. And this statement is typical of many that appear daily in the American press, virtually without comment.

I know this is a contentious area – one in which I often find I clash with people whom I consider my intellectual allies. “Buy America” legislation, for instance, is frequently criticised by liberals and free-traders as neanderthal. But, for me, it can be defended. Indeed, too often, I see attacks on “Buy America” provisions as motivated by corporate America’s corporatist world view: I find it bizarre that corporatist imperatives can be used, not only to defeat those politicians who want to promote the traditional interests of their constituents in preserving local jobs, but also to subvert national interest considerations.

Let me give you an example. According to the *New York Times*, an internal Pentagon inquiry concluded that the “Buy America” provisions that House Armed Services Committee Chairman Hunter inserted into the FY 2003-04 Pentagon budget could have “catastrophic effects” – pushing up the bill for machine tools by US\$7-10 billion.²⁷ Catastrophic? Maybe; but the arguments put forward sound like the language of business, not of national security. In my view,

²⁵ Nace op cit p185

²⁶ Robert Pear and Richard A. Opper, Jr., Election Gives Drug Industry New Influence, *New York Times*, November 21, 2002.

²⁷ Leslie Wayne, Butting Heads with the Pentagon – Old Friend in House for Military Wants to Force it to ‘Buy America’, *New York Times*, July 23, 2003, at p. C1.

the issue of whether to outsource vital defence components is a legitimately *political* one – not simply a business question.

There is another crucial policy area that embodies the same sort of dilemma – pensions.

Today, the United States does not have a coherent retirement policy. In the past, the pressure on employers to provide “real” pensions – that is to say post-employment payments bearing a relationship to final income – required both companies and government to share the risk that assets might not yield returns commensurate with the actuarial liabilities. Ultimately, this risk became too high – so a corporatist solution was adopted. Shift the risk away from the corporation (and the government) ... to the employee. The (not entirely coincidental) corollary is that corporate profits have advanced accordingly. Again, it is worth reflecting on our own societal values, where we, unquestioningly, transfer responsibility for retirement to those least able to bear it – the seniors themselves.

There has been much talk in recent years about correcting this problem by investing a proportion of the Social Security fund in common stocks.

Financially, there is something to recommend this, since investment returns over the longer term (with which the Social Security program is concerned) have always been greater from equities than from realistic alternatives. Nevertheless, the question must be raised – who should bear the risk that this happy cycle will persist? Corporate America? Society at large? Or just the beneficiaries?

The reliability and predictability of Social Security payments is most important – indeed, it is literally life-saving – for precisely the poorest people in society. What kind of government is it that countenances their being put at the ultimate risk of stock market movements?

One could go on to point out that the noisy national debate in the US about the increasing cost (and decreasing quality) of education and medical services often seems focused on which corporate entity will profit the most from a proposed solution. The critical question – what is the best alternative for the consumer – has dropped from the political vocabulary. The perspective of the flesh and blood individual has all but disappeared in favour of the corporatist world-view. The language of the day in the US is the language of corporate power – and power ultimately means the capacity to allocate resources in society.

This is relevant since there has been much attention given over the last few years to the increasing gap between rich and poor – and to the growing separation of the very richest people from all the rest. CEOs, who were satisfied with salary levels of thirty to forty times that of entry-level employees twenty years ago, now think nothing of a one thousand times multiplier. These absolute levels of remuneration, and the distinctions that they imply, were not part of the message that God gave to Abraham. They were not divinely ordained; they are simply the result of the exercise of power – and a reflection of the corporatist ethic.

The corporate media rules

That we don't rebel against this more overtly may well, in my opinion, reflect the success such corporations have had in capturing the organs of mass communication. After all Disney, Viacom, NewsCorp and GE, the controllers of the press, are aggregations unimaginable in more populist times. But it is not just that: \$150 million spent by the incumbent on an uncontested primary campaign for President compels the question – just what is being bought? Corporatism creates its own vocabulary of scale; the individual becomes increasingly barely measurable

George Draffan has put this well:

“The mass media, think-tanks, public relations firms, and the education system deliver the corporate message into mainstream thinking. Lobbyists influence politicians. Think-tanks and foundations influence teachers and students. Advertising influences consumers. The corporate construction of reality ridicules economic and political alternatives (public ownership, proportional representation) while promoting views and choices (corporate financing of political campaigns, dependency on international trade) which come to seem inevitable. As people cease to notice that some issues aren't discussed, their desires and beliefs are manipulated in an “engineering of consent” and eventually the entire society (including the powerless who would gain from political change) internalises a truncated agenda which favours existing power relations.”²⁸

There is a seeming inevitability about this value change, largely because of the absence of an effective countervailing force.

Resolution – a slender suggestion

Where to begin the road back?

Look to the law . . .

In my opinion, we must start with Court-made law. Twenty-five years ago, the United States Supreme Court significantly changed the nature of corporate personhood in the bitterly divided decision in First National Bank of Boston v. Bellotti, 435 US 765 [1977]. In holding that business corporations have a constitutionally protected liberty to engage in political activities, the Court did not base its judgment on the rights of business enterprises, but posited a new rationale: “The Constitution often protects interests broader than those of the party seeking their vindication.”

This formulation completed the transformation of corporations from parties entitled to some of the liberties conferred on “persons” to entities having “organisational prerogatives”. As a

²⁸ George Draffan, *The Corporate Consensus: A Guide to the Institutions of Global Power*, (November 2000) at <http://endgame.org/corpcn1.html>

consequence, corporate “speech” has been ruled a right to which the corporation must be entitled, and of which the public cannot be deprived. Bellotti, by its terms, validates the expenditure of corporate funds for political campaigns that management – in its business judgment – considers relevant.

I think that this decision was a disaster, and that it must be reversed.

This is not inconceivable. Indeed, American history has been embellished by the Supreme Court famously reversing itself – Dred Scott, Plessey v. Ferguson, and Lawrence are conspicuous examples.

We can take some comfort that there are scenarios – indeed philosophical frameworks – in which corporate energies and wealth-making capacities can be made available to a free society at an affordable social and political cost. In recent times, as noted, Milton Friedman has sharpened this discussion with his insistence that the purpose of corporations is the maximisation of profit for owners, within the rules, period. David Engel²⁹ has painstakingly pointed out that managers have no legitimate authority to redefine their own responsibility beyond profit optimisation. But, of course, the question must arise – who makes the rules? And are the rules that are made a legitimate expression of the public interest by fully informed, democratically elected representatives?

. . . and enforce better corporate behaviour

Engel proposes a useful corporate “Bill of Rights” to ensure consistency between corporate behaviour and the public good. This consists of three main elements:

- full disclosure, at least to government, of all information that the corporation possesses respecting the impact of its functioning on society;
- restraint in dealings with the electoral, political and administrative processes; and
- obedience to the law

This last point is (sadly) necessary since obedience to the law today is usually just the result of another cost effectiveness calculation by corporate management. In Engel’s world, law is (as it should be) the legitimate expression of an informed and un-coerced democratic process.

Friedman and Engel provide a theoretical structure within which corporations can co-exist harmoniously in a democratic society.³⁰ Friedman³¹ insists on rigorous discipline to an economic agenda within politically formulated rules; Engel prescribes the permissible modes of corporate involvement within these rules – full disclosure, moderation, and obedience to the law. Following from this, the owners of America’s publicly held corporations need to take on responsibility for implementing the Friedman/Engel paradigm. Fortuitously, fiduciary shareholders already own a majority of the equity in America’s public companies. Enforcement of the existing law that

²⁹ 32 Stanford Law Review 1 (1979)

³⁰ Hopefully, this may answer the implicit question with which Charles E. Lindbloom concludes *Politics and Markets*; “The large private corporation fits oddly into democratic theory and vision. Indeed, it does not fit.”

³¹ And, perhaps, more importantly, Friedrich Hayek.

requires these trustees to act exclusively in their beneficiaries' interests will provide a practical – and legitimate – basis for a new and valid form of shareholder capitalism.

Conclusion

“Things are in the saddle, and ride mankind”

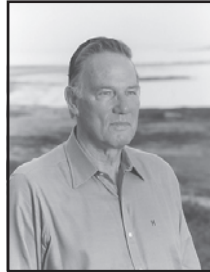
RW Emerson

The United States today is a corporatist state. This means that individuals are largely excluded from meaningful participation, both in the political and corporate spheres. We must work to change this. Unfortunately, their power is now such that corporations cannot be compelled to change from without; only internal pressure will create pressures to change.

The genius of the “American” system has always been a balance of power among informed and motivated participants. Today, this balance is askew. As a result, the question is: What immediate steps can be taken to set the balance right? In this paper, I have emphasised three areas where progress can be made that will put America back on track. Progress won't be easy, but it is crucial:

- First, government. I believe that government – particularly the Federal government – must explicitly recognise that closer involvement by informed owners in the governance of publicly-held corporations is a national priority. No new laws are necessary; but a clarifying statement by the Securities and Exchange Commission, the Department of Labor and the Federal Reserve – which collectively have the authority to prescribe standards for fiduciaries holding more than a majority of outstanding shares – coupled with a visible and effective enforcement policy, would eliminate present ambiguities. It is only the acquiescence by half the population (those with interests in publicly-traded companies) that legitimises the power of the large corporation in a democratic state.
- Second, shareholders themselves. Majority shareholders can and must persuade management that only a corporate system involving effective accountability can be sustained. To be sure, there are shortcomings in a solution which (in effect) proposes shareholders as a proxy for the polity as a whole, but, in my opinion, this approach is preferable to any plausible alternative.
- Thirdly, the Courts. The United States Supreme Court must recognise its century and a quarter-old mistake in styling corporations as “persons” entitled to protections under the Constitutions that were originally intended only for flesh-and-blood individuals.

Will that do the trick? Maybe, or maybe not. But I have no doubt that these steps are crucial to save American capitalism. They would, at the least, indicate a decisive turning of the tide against a pernicious corporatism that has grossly undermined the capitalist model.



Robert A G Monks

Robert Monks is one of America's most prominent corporate governance activists. He is also a prominent lawyer, businessman and a former US Department of Labor pensions fund regulator. He founded LENS, the institutional activist investment fund, in 1992, and has since developed a partnership with Hermes in the UK. Bob was the first to identify corporate directors, particularly non-executives, as the pivotal balance between the interests of managements and their shareholders. He is the author of four best selling books on investment and corporate accountability. His latest book, *The new global investors – how shareholders can unlock sustainable prosperity worldwide* was published in Britain and America in 2002.

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