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THE CORPORATION AT ISSUE, PART I: THE CLASH WITH CLASSICAL LIBERAL VALUES AND THE NEGATIVE CONSEQUENCES FOR CAPITALIST PRACTICE

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IN AN ARTICLE PUBLISHED in this journal, Walter Block (2002, pp. 3–36) is rather scathing about Henry Simons's credentials as a champion of free enterprise.[1] But it seems possible to be considerably more generous to Simons than Block is, and to regard him as significantly less unlibertarian than Block does, which is not to deny that many of Simons's policy proposals cannot be squared with classical liberal or libertarian principles, or that much of Block's critique is justified. Key to a more charitable consideration of Simons is to keep his overriding concern in mind: that an inconvertible fiat money system and the corporate form of the private business organization are inconsistent with classical liberal or libertarian premises. According to Simons, it is the combination of these two institutions which is mainly responsible for some of the more significant negative side effects of modern capitalist practice, like undue cyclical instability and excessive inequality of income and wealth. Unfortunately, while Simons does propose to prohibit fractional reserve banking, he does not advocate a repeal of the private right to free incorporation, but regularly seeks refuge in state intervention to address the negative side-effects thereof. That is how he strays into illiberal and unlibertarian territory, from which Block takes his cue.

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[1]Henry Simons was not a prolific writer. Most of his ideas are contained in a single volume, *Economic Policy for a Free Society* (1948). For an exhaustive bibliography of Simons's work see Bowler (1974, pp. 7–11).

Even so, one can still credit Simons for pointing out the inherently illiberal and unlibertarian nature of inconvertible fiat money and free incorporation for private business concerns. These insights are significant because they enable classical liberals and libertarians to reject the common socialist view that undue cyclical instability and excessive inequality are intrinsic to a free enterprise system, and they make it possible for us to attribute these ailments to the agency of institutions that are foreign to a classical liberal or libertarian order. While opposition to inconvertible fiat money is an almost standard element of the current libertarian credo (Block, of course, has contributed significantly to the relevant literature), it is far from standard for libertarians or classical liberals to oppose free incorporation of private business concerns, although there are some noted exceptions. Van Dun (2001, p. 31), for example, recently remarked in an article published in this journal:

> [M]ost liberal writers exhibit rather mechanical "free-market reflexes." . . . With respect to large, publicly traded corporations, the common liberal opinion seems to be the one propagated by Robert Hessen, *In Defense of the Corporation*, . . . and Armen Alchian [et al.] *Business Ethics*: large corporations are merely the outcome of efficiency-seeking behavior in a regime of freedom of contract, and are, in any case, effectively disciplined by "the market," especially "the market for corporate control"—hence, presumably, corporate power is nothing liberals should worry about. . . . [I]t is far from clear that large corporations can be seen as conforming to the requirements of natural law.[2]

Block attacks Simons's opposition to the corporation and defends that institution exactly along the lines indicated by Van Dun as quoted above. Block's treatment of Simons is unduly harsh, precisely because he fails to appreciate the illiberal and unlibertarian nature of allowing free incorporation of private business interests, which thus presents itself as the main topic of this article.

Throughout the remainder of this article, the shorter "liberal" will be used for "classical liberal or libertarian," partly because this

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[2]In addition to Simons, other noted anti-corporation liberals from the previous century include Wilhelm Röpke (1963) and Walter Eucken (1951, 1952). More recent critiques of the corporation from an Austrian point of view include Piet-Hein van Eeghen (1997, pp. 85–113) and Jeff Barr and Lee Iglody (2001). Interestingly, the FAQ of the Libertarian Party also proposes to "abolish the limited-liability shield laws to make corporate officers and stockholders fully responsible for a corporation's actions," but seemingly without advocating an all-out repeal of the private right to free incorporation (www.cath.org/~esr/faqs/libertarianism/html).

article is, perhaps, more classical liberal than modern libertarian in flavor, in that it insists on a legitimate and important, be it strictly limited, role for government—a position which is obviously not shared by all modern libertarians.

However, modern libertarianism seems not only characterized by its views on the role or nonrole of government, but also by a certain methodology, which this article fully shares and which has two main elements. First, modern libertarians are inclined to argue rigorously from abstract first principles, such as the right to self-ownership, the principle of nonaggression or the principle of personal responsibility, which are considered to be grounded in natural law (there may, of course, be disagreement about the exact formulation and foundation of these first principles, which is not unproblematic nor uncontroversial). Second, they are committed to showing that their deductions from such first principles produce universally beneficial and workable policy prescriptions. Hence, the rightness of such prescriptions is both deontological (based on the validity of the natural law from which they are derived) and consequentialist (based on the demonstrable beneficiality of their practical outworking). Put more simply, libertarians seek to be both principled and practical. While some noted libertarians (like David Friedman) seem to have given up on the principledness of libertarianism and other prominent libertarians (like Walter Block) do not always appear to face up to the negative practical consequences of some of what are currently considered standard libertarian policy proposals (more later in this article), the need for both a deontological-principled and a consequentialist-practical grounding of libertarian policy proposals remains imperative, even if far from all logical and practical problems attached to such a dual grounding have been solved as yet.

This article, which is divided into two parts, is organized as follows. Part I is in front of the reader, while Part II will appear in the next issue of this journal. Part I starts with a discussion of the distinguishing features of the corporate form, because disagreement over the legitimacy of the corporation often stems from disagreement over its fundamental nature. It subsequently advocates the idea that free incorporation of private business concerns violates basic liberal principles. After having discussed in some detail the various negative consequences of corporate dominance over capitalist practice, Part I ends with a brief reaction to Block's critique of Simons.

Part II has two main objectives, the first to present a challenge to Robert Hessen's *In Defense of the Corporation* (1974), which remains (perhaps together with Easterbrook and Fischel's [1991; 1985, pp. 89–117] various writings on the topic) the most detailed and careful defense of the corporation from a liberal point of view to date. Given

that we do not wish to advocate an outright ban on the incorporation of all private concerns, the second objective of Part II is to investigate the criteria according to which government may still grant corporate status to private institutions. Roughly, our proposal is to go back to the historical (roughly pre-1860) practice of allowing incorporation only on the grounds that the private concern performs some state-like function or pursues a public interest within a limited public domain; in line with the classical liberal tradition, we assume that such a domain exists in which state intervention is justified. What all this boils down to is that the corporate form should be restricted to private firms involved in the construction and ownership of infrastructural works (like roads, railways, canals, and mining infrastructure), which is also in material agreement with historical practice.

THE NATURE OF THE CORPORATION

Before the corporation can be criticized, its precise nature must first be established. While it is common to list various typical corporate features, such as entity status, limited liability and perpetuity, there is really only one defining feature: entity status. Entity status means that certain legal rights and duties are held by the corporation as a separate, impersonal legal entity. In the case of the private business corporation, entity status implies that title to the firm's assets is held by the corporation in its own right, separate from its shareholders.

Illustrative of the fact that the corporate form of private enterprise deviates from traditional forms of private property, entity status renders the legal position of both corporate shareholders and managers (directors) awkward and ambiguous. As for corporate shareholders, they are commonly regarded as the owners of the corporation, but they are owners only in a limited sense. Shareholders do not have title to the assets of the corporate firm, but merely possess the right to appoint management and to receive dividends as and when these are declared; title to the firm's assets reverts back to shareholders only when its corporate status is terminated. The lack of ownership rights over assets is illustrated by the fact that, in contrast to partners in an unincorporated partnership, corporate shareholders cannot lay claim to their share of the assets of the corporate firm nor do they have the right to force their co-partners to buy them out. Corporate shareholders can liquidate their investment only by selling their shares to third parties. In short, the ambiguity in the legal position of shareholders lies in the fact that, while certain traditional ownership rights rest with them (profit accrual and power to appoint agents to manage the firm for them), other traditional ownership rights are exercised by the corporation as a legal entity separate from them (title to the firm's assets).

As for corporate management, their legal position is equally ambiguous. Managers are appointed by directors who are the representatives of shareholders. Ultimately, management is thus the agent for shareholders, managing the corporation as their representative. This, however, is only part of the picture. While management is the agent for shareholders in the sense of being ultimately appointed by and accountable to them, it is also the agent for the corporation itself. After all, in order to manage the corporation's assets, management must legally represent the corporation as the titleholder to these assets. And because the corporation is an impersonal legal entity, agency for the corporation lends a significant degree of autonomy to the position of management, which is precisely why it has proved so difficult to make shareholder control over management more effective, despite the many legislative measures aimed at enhancing management accountability to shareholders. The significant degree of autonomy inherent in the legal position of corporate management was, of course, the main theme of Berle and Means's (1932) seminal work on the corporation. To sum up, the position of management is ambiguous because management acts as agent for two principals, the shareholders and the corporation.[3]

Other typical features of the corporation like limited liability and perpetuity are not independent, original attributes, but are derived from its entity status.

Shareholders possess limited liability because they do not own the corporation's assets and are, consequently, also not liable for claims against these assets. Responsibility for corporate debt rests with the corporation in its own right rather than with them. Corporate creditors cannot, therefore, lay claim to the personal possessions of corporate shareholders, as they can to the personal possessions of partners in an unincorporated partnership. The most shareholders can lose is their initial investment when buying the shares, which happens only when the corporation goes bankrupt and the shares lose their value. Such is the origin of limited liability for shareholders.

The corporate feature of perpetuity can also be traced back to the corporation's entity status. It is because assets are owned by the corporation in its own right rather than by shareholders that the death or departure of shareholders does not affect its continued existence. While unincorporated partnerships need to be legally reconstituted

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[3]The fact that principal-agent models of corporate behavior treat management as merely the agent for shareholders, ignoring its agency for the corporation, seems to an important degree responsible for the low descriptive value of such models. On that topic, see Mueller (1992, pp. 157–59).

each time partners leave, die, or are added, corporations continue irrespective of who holds their shares. The corporation's entity status thus gives it a life independent of the life of its shareholders, which is the sense in which it is commonly said to possess perpetuity or immortality. This kind of immortality should, of course, not be understood as if corporations literally go on forever, since they can most certainly cease to exist, for example when they go bankrupt or lose their corporate status.

THE CORPORATION: ITS CLASH WITH LIBERAL PRINCIPLES

Originally only state institutions (central, regional, and local government) possessed corporate status, which seems entirely natural and appropriate. If we wish to escape Louis XIV's infamous dictum "l'état c'est moi" ("I am the state"), which is the starkest, most chilling expression of state absolutism from which even ardent monarchists at the time recoiled, the state should indeed be given a legal entity separate from its officials. Only if such a separation exists can state power be vested in the office rather than the person; and only when state power is vested in the office can it be circumscribed by law. All this is the ABC of liberty and the rule of law. But if it is essential to the preservation of liberty and the rule of law that the state has a natural right to corporate status (entity status), it should equally be essential to the preservation of liberty and the rule of law that private individuals, when pursuing their own interests, are denied such a right and act in their personal capacity, which obviously does not exclude the possibility of private individuals acting as agents for each other.[4]

[4]There is no space here to elaborate on the origin and rationale for the corporate nature of the state, about which the political theory literature, both classical and contemporary, is surprisingly mute in spite of it being universally taken for granted in actual constitutional practice. Suffice it to say that the state has to be supra-personal, precisely because its task is to defend personal rights. Its powers to effect such protection cannot rest with the sovereign as a person, as that would give him or her absolute powers over the very private citizens he or she is to protect (the weakness in Hobbes's argument). Neither does it seem logical to suggest that state powers can be derived from the sovereign rights of individual citizens themselves, because these rights are then presumed already protected prior to the state being instituted, which undermines the very rationale for setting up a state by social contract and begs the question as to how citizens can effectively assert unprotected rights to establish such a contract (the weakness in Locke's argument as well as that of the anarcho-capitalists). If state powers are thus not derivable from the sovereign rights of either citizens or state officials in their personal capacity, they have to be understood as belonging to the state

Given that entity status naturally belongs to the state, it should come as no surprise that "at its origin . . . the [private business] corporation was conceived as an agency of the government, endowed with public attributes, exclusive privileges, and political power, and designed to serve a social function for the state" (Handlin 1945, p. 22).[5] Thus the historical practice developed that the state (Crown and, later, parliament) conferred corporate status on certain private institutions on the grounds that these institutions served some area of common interest or performed some function closely related to those classically belonging to the state, for the execution of which certain privileges (like legally protected monopoly rights) were frequently granted as well. Noted early examples of private business firms thus chartered include the medieval guilds, the Dutch and English colonial trading companies of the seventeenth century, as well as the Dutch and English forerunners of modern central banks (the Bank of Amsterdam and the Bank of England) of roughly the same era.[6]

Indeed, the corporate form was abused from the outset for the pursuit of purely private business interests. In some instances this abuse resulted from the fact that the presumed common interest on the basis of which incorporation was granted, turned out to be a sectional private interest, which was particularly pernicious when certain monopoly privileges were included in the charter too.[7] In other

as a legal entity separate from citizens and office bearers. The implication is that natural law should regard state powers and individual rights as codependent as well as equally original and foundational. The one should not be treated as prior to the other. What this means, among other things, is that fundamental liberal principles like the principle of nonaggression or the principle of personal responsibility should simultaneously define the rights and powers of both citizens and the state.

[5]For further insightful discussions of the historical origins and development of the corporation, see, John P. Davis (1961); Joseph S. Davis (1965); Dodd (1934); Cooke (1950); Hartz (1968); du Bois (1971); Creighton (1990).

[6]Not insignificantly, these latter institutions are precisely where the rot in the monetary system set in, as many liberals would undoubtedly agree.

[7]The case of the colonial trading companies is more complicated. Their incorporation seems to have been warranted on the grounds that they had to perform state-like functions (like defense and law enforcement) in their colonial territories. But it was also unwarranted as their prime aim was clearly the monetary interest of their shareholders. Some formula should have been found according to which an incorporated state body performed the governmental functions in the colonies (funded by the mother country or the colonials themselves), while trading activities themselves remained unincorporated. As the relevant colonies developed and prospered, they started to resemble such a situation more closely anyway.

instances the abuse stemmed from the fact that, in the course of the seventeenth and eighteenth centuries, the state increasingly condoned the practice of corporations getting involved in activities outside of the common interest to which their charter originally restricted them. In still other instances, unincorporated firms simply assumed corporate status without any state permission at all. Generally speaking, in the course of the seventeenth and eighteenth centuries governments became increasingly lax in controlling private corporations to ensure that their privileged status was confined to the public domain (to be discussed in Part II) and used to further the public interest.

To restore order in this chaotic situation Western governments had only two policy options. Either they could go back to the original policy of allowing private incorporation only when the incorporated institution performed state-like functions and was deemed to serve some area of common interest within the public domain—and more strictly enforce such a policy. Or they could allow private people to freely incorporate themselves at their own discretion without any restrictions but also without any (monopoly) privileges. After some decades of indecision, most Western governments opted for complete freedom of private incorporation (they passed so-called generalized incorporation laws), which happened around the second half of the nineteenth century. From then on, the corporation became the preferred legal form of the private business firm and soon came to dominate the capitalist landscape—as it has done ever since.

Free incorporation for private business is objectionable from a liberal point of view because it grants a distinctive feature of the public sector, namely entity status, to private concerns without the accompanying restraints of democratic and legal control. As such, the private corporation constitutes an illegitimate mixing of the legitimate domains of the private and public sectors. If it is agreed that entity status is indeed a typical attribute of the state, then anarcho-capitalists who advocate a stateless society have even more reason to oppose private firms taking on state-like attributes such as happens when they acquire corporate status.

Two further, closely related ways in which free incorporation for private business violates basic liberal values can be mentioned, about which we can be more brief.

First, the private right to free incorporation conflicts with the individualism inherent in liberalism, because private ownership rights are given to impersonal entities. The Harvard legal historian Morton Horwitz (1987, p. 21) notes in this connection:

> The corporation . . . was the most powerful and prominent example of the emergence of non-individualistic or, if you will, collectivist

> legal institutions. . . . In all Western countries . . . theories of corporate personality were associated with a crisis of legitimacy in liberal individualism.

Have modern liberals ever squarely faced up to this "crisis of legitimacy"?

Second, free private incorporation contravenes the basic liberal (and common law) principle of personal responsibility. According to this principle, people should not only be granted the freedom to make their own decisions, but they should also carry the full positive and negative consequences of these decisions. Otherwise, rights get given without the accompanying responsibilities, which inevitably has the effect of stimulating irresponsible behavior. As the moralists of old used to say: "liberty without responsibility is licence." The British historian Arthur Bryant (1940, p. 247) similarly notes:

> The historic justification of private property has been that it fostered responsibility and acted as a bulwark against tyranny. It was now [i.e., after the British parliament passed generalized incorporation laws in 1862] being used by the individual to purchase freedom from responsibility.

Andrew Fraser (1998, p. 129) more recently remarks in this vein: "Corporate law has been designed to facilitate a legalized flight from responsibility by those who nominally own the corporate system."

Corporate shareholdership is a licentious and irresponsible form of ownership because it is granted privileges of ownership (accrual of profits and the appointment of agent-managers) without carrying the obligations of ownership (payment for losses). If shareholders receive the full benefit of enterprise when things go well, why should they not also carry the full cost of enterprise when things turn awry?[8] Similarly, corporate management is licentious because it enjoys the privileges of ownership (control over assets by virtue of being the agent for the corporation) without having to face the burdens of ownership (payment for acquisition or loss bearing) and without being accountable to natural persons who do carry the full extent of these burdens, as shareholders don't do either. As already mentioned, insofar as management is accountable to shareholders, such accountability is difficult to make effective especially when shareholdership has become highly diluted.

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[8]The objection can be raised that bankruptcy law already limits the liability of ownership in this way. Unfortunately, the issue of how a liberal order based on the principle of personal responsibility should treat bankruptcy law is too involved to be treated here, with the result that an answer to this objection has to remain outstanding.

When Berle and Means broached this subject they were not saying anything new, but were merely rehashing an old theme in fresh ways. The inherent lack of responsibility on the part of corporate management was lamented by all the pillars of classical and neoclassical economics. Smith, Ricardo, Mill, McCullough, and Marshall were all wary of the corporation being liable to mismanagement because of the inherent difficulty of making management's accountability to shareholders effective and who, as a result, found the private corporation an aberration of private property and potentially dangerous to the liberal order they stood for.[9]

Classical writers, especially Smith (1976, pp. 723–58), thought that this mismanagement would primarily take the form of inefficiency and unproductivity, about which he was glaringly wrong—corporations have proven to be extraordinarily efficient and productive. But management's proneness to irresponsibility may take many different forms, on which we will elaborate in the next section.

The above should obviously not be taken to mean that the moral character of corporate managers is somehow on average more deficient. The point is not that managers as persons are necessarily irresponsible but only that their legal position is inherently lacking in responsibility and as such prone to abuse. The fact that the relevant temptations are often resisted and that many corporate firms are indeed decent and law abiding institutions with a sincere sense of moral obligation to both shareholders and the wider public bears witness to the decency of many corporate managers. As Alfred Marshall (1920, p. 253) already had to admit:

> It is a strong proof of the marvelous growth in recent times of a spirit of honesty and uprightness in commercial matters, that the leading officers of great public companies yield as little as they do to the vast temptations to fraud which lie in their way.

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[9]For a brief overview of classical thought on the corporation, see Mueller (1992). It could be argued that the classicals' negative attitude toward the corporation is not necessarily applicable to the modern corporation, because the corporation of their time was something different from its modern counterpart being indeed a creation of the state whereas the modern corporation is not. But a corporation is a corporation because it has certain legal attributes (entity status in particular), not because it has acquired these attributes in a certain way, as a state concession or by private contracting. And because these corporate attributes are the same then as they are today, we are allowed to apply the classicals' negative comments on the corporation (which they ascribed to these attributes) to the modern corporation as well. Even so, as will be argued in Part II, private agents should not have the right to freely create their own corporate entities without express state permission.

From a current perspective, however, Marshall's observations need to be qualified in two important ways. First, the "spirit of honesty and uprightness" among corporate management is probably less prevalent now than it used to be during the nineteenth century when the remains of a gentler and more chivalrous age were perhaps still more in evidence; the market seems in the meantime to have become a considerably harsher place where gain is more uncompromisingly pursued. Second, without necessarily yielding to dishonesty or fraud, corporate managers will unavoidably display behavioral tendencies which have undesirable long-run effects for society, as will be investigated more closely in the next section.

THE CORPORATION: ITS NEGATIVE CONSEQUENCES

Nobody denies the tremendous productivity advantages of the corporate form of the private business firm, for which there are two closely interrelated reasons.

First, the capital base of the corporate firm is potentially much larger than that of the unincorporated partnership. Because a partner in a partnership carries personal responsibility for the assets and debts of the firm, there will be a stronger incentive for such a person to be intimately involved in its management so as to ensure that risks remain within proper limits; absentee ownership of unincorporated partnerships is just too hazardous. Given that a firm can only be effectively managed by a limited number of fully liable owner-managers, the capital base of partnerships will thus be limited to what that limited number of partners can contribute. The corporation is free from such limitations to the number of capital-contributing shareholders, because shareholders enjoy limited liability and need not be involved in the running of the firm at all. Moreover, given that partners in an unincorporated partnership have a shared legal right to its assets, they also have the right to force their co-partners to buy them out. As a result, the larger the capital contribution of each partner, the greater the potential strain on co-partners to find the necessary capital to buy each other out, should one or more of them die or wish to leave, which is a further way in which the capital base of unincorporated partnerships is naturally limited.[10] By contrast, because title to its assets rests with the corporation in its own right (the corporation enjoys entity status), corporate shareholders have

[10]The threat posed to the continued existence of a partnership by the right of each partner to dissolve it and force co-partners to buy him or her out partly explains why partnerships tended to survive best in a family context where family loyalty reinforces loyalty toward the partnership.

no legal right to force their fellow-shareholders to buy them out, with the result that such limits to its capital base do not apply to the corporation. For these reasons the corporation hardly knows any capital restriction on size whatsoever and is thus able to reap all the economies of scale, and the technological innovations that normally go with them, which were previously out of reach of proprietorships and partnerships.[11]

Second, limited liability provides a measure of systematic risk protection for shareholders which will enable corporations to take on more risk. This increased ability to carry risk stimulates technological innovation as well as economic activity in general.

Against the productivity advantages of the corporate form stand a number of disadvantages, some of which are more fully elaborated elsewhere (van Eeghen 1997, pp. 96–106).[12] Four of the main ones can be summarized as follows.

(a) Increased Speculative Instability

Because incorporation separates ownership from control, shares in a modern corporation can be traded without necessarily affecting the management nor the capital position of the firm. As a result, an active market in such shares develops more easily. By contrast, the shares in an unincorporated partnership are less marketable because they are more strongly linked to the risks and responsibilities of managing the firm, which old owners are more reluctant give up and new owners accept. Moreover, partners normally have the right to consultation in ownership transfers, which also reduces the marketability of ownership stakes in unincorporated businesses.[13]

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[11]As will be argued in Part II, the corporate form can be maintained for the ownership and development of infrastructural public works, which normally require much more capital than private unincorporated business forms can generally bring together. The advantage of the corporate form's greater capacity to combine large amounts of capital is thus not totally lost to mankind and can still be put to good use.

[12]It is no wonder that modern capitalist practice is so excessively growth oriented, given that the growth-enhancing greater potential for size and risk acceptance of the corporate form are further reinforced by the growth-enhancing greater flexibility of the money stock under a fiat money regime.

[13]Sometimes partners in unincorporated partnerships are denied (or deny themselves) the right to consultation in ownership transfers, which is what underlies the so-called "joint stock principle." The joint stock principle thus facilitates enhanced marketability of shares without necessarily requiring incorporation (incorporation implies joint stock, but not necessarily the other way around). It was mostly the enhanced marketability of shares in

Unfortunately, marketability and the potential for speculative trading are intimately linked. Since incorporation significantly increases the marketability of ownership stakes, it thereby also enhances the opportunities for speculative activity in share markets. In addition, many of the participants in speculative markets are corporations themselves and thus enjoy a degree of risk protection in the form of limited liability. Because the balance between risk and reward is tampered with, speculative activity is artificially stimulated—which is not to say that there is anything inherently wrong with such activity. As Ricardo's disciple, J.R. McCullough, remarked about the passing of generalized incorporation laws by the British Parliament in 1862: "Were Parliament to set about devising means for the encouragement of speculation, over-trading and swindling, what better could it do?" (quoted in Diamond 1982, p. 42). In addition to the instability attributable to a central-bank protected fiat money regime, the excessively speculative nature of modern stock markets adds a further source of unnecessary instability to modern capitalist practice, which has the potential of seriously disrupting the real economy. And the ease and speed with which inordinate amounts of wealth are created and destroyed on the stock exchange is surely not one of the more attractive features of modern capitalist practice.

(b) Increased Market Concentration and Concentration of Control

Because the corporate form increases the average firm size, it will also *ceteris paribus* increase the degree of concentration in any given market. Furthermore, because incorporation enhances the marketability of shares as well as the ease with which capital can be raised, it also creates better opportunities to gain market share by mergers and take-overs. While gaining market share through the stock market by mergers and take-overs is a matter of persuading investors that the combination is more profitable, gaining market share through the goods market is solely a matter of persuading buyers that the quality/price of the product is better than that of competitors. Although the one does not exclude the other and superior profit may be realized through superior price/quality with the interest of investors and goods buyers overlapping, the general buying

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unincorporated joint stock companies which was responsible for the excessive speculative nature of seventeenth and early eighteenth-century stock markets, which gave rise to the Bubble Act in England. It is debatable whether the joint stock principle is not also in conflict with liberal principles. The present author is inclined to think that it is. Inherent in co-ownership of and coresponsibility for the firm seems to be the right to consultation in partnership transfers.

public is ordinarily better protected against market power abuse by sellers when the stock market route to increased market share is virtually blocked, as would be the case when unincorporated business forms are dominant once again.[14] But it should always be remembered that the corporate firm, through its potentially larger capital base, is in a better position to realize scale economies where they exist, which may, on balance, benefit buyers in spite of reduced competition in the relevant goods markets and the greater potential for exploitation by sellers which it entails. Put differently, corporate capitalism does generally make the broad population more prosperous, but it makes shareholders and managers disproportionately more prosperous as well as more powerful, which brings us to a further consideration.[15]

The problem with corporate capitalism is not only one of increased market concentration (at least on the supply side) but also of increased concentration of control. Control has become more concentrated under corporate capitalism for two reasons. First, because of the greater potential for increased firm size already discussed and, second, because of the conglomeration potential. The conglomerate firm, through pyramidal ownership structures, facilitates extensive control with relatively little ownership for the parent firm. Such ownership structures can be ascribed to the ability of firms to own other firms, which is directly attributable to the corporate form. Without incorporation only people can own firms. And because the law, since the abolition of slavery, does not allow people to own people, pyramidal ownership structures become an impossibility. Unincorporated business automatically forbids any form of conglomeration through holding companies. It is significant that prominent liberals like Hayek (1967a) and Hutt (1943), though not necessarily opposed to

[14]The argument that mergers and take-overs are necessary for firms to remain globally competitive is circular, because globalization itself is, to an important degree, the result of the increased potential for size of the corporate form of business.

[15]There is a critical tradition of the corporation, which also originated with Berle and Means, which claims that the corporate form allows management to victimize shareholders. This paper is not concerned with that type of criticism at all. While the corporate form allows management to gain a degree of independence from shareholders which may cause it to further its own interest at the expense of shareholders and thus betray its agency mandate, the corporate form still broadly benefits shareholders as well. Our criticism of the corporate form (corporate dominance over private enterprise due to the private right to free incorporation) is rather concerned with its negative consequences for society at large.

the private right to incorporation, nonetheless wished to control conglomerization by forbidding private corporations to own shares in other corporations, or by denying them voting rights in daughter companies; apparently, they too were concerned about the inherent potential for concentration of control of the corporate form.

The problem with increased concentration of control is that, for a given size of the total economy, fewer people make the relevant decisions: whether and where to invest, what to buy from whom, et cetera. As a result, fewer people are likely to benefit from these decisions, which are also likely to involve larger amounts of money. After all, increased size and concentration of control reduce competition not only on the supply side but on the demand side as well, through the increased buying power of the relevant firm, which particularly affects local labor markets and markets for investment location (of which government is the supplier). Because of the relative mobility of capital, the relative immobility of labor and the scarcity of jobs and tax income in any given locality (especially in Third World settings), the potentially excessive size of corporate firms causes them to obtain a potentially large bargaining advantage over local labor and government, which is why the latter often bend over backward to accommodate corporate investors through tax concessions and low wage policies and why large corporations are often in a position to exercise considerable leverage in their dealings with government.

Generally speaking, corporate capitalist practice has strayed far from the free-enterprise ideal of market decisions being taken at a decentralized level by countless relatively small suppliers and demanders so that market outcomes are broadly impersonal. The very invisibility and beneficence of the invisible hand is thus under threat. No wonder Adam Smith was skeptical about the corporate form of business! A liberal order can never rule out the possibility of market power abuse, but the system should nonetheless provide for circumstances which enable the private sector to rectify its own failures with reasonable likelihood so as to restore sufficient competition. Corporate capitalism seems no longer to provide such circumstances.[16]

[16]There is a sense in which the corporate firm can be said to aid competition. Its potentially larger size creates an increased potential for developing and applying new technologies. In the area of transport and communication, these new technologies stimulate competition by allowing any given market to be reached by an increased number of suppliers, which is precisely how the world has almost become a single market in which everybody competes with just about everybody else (globalization). But in spite of this competition aiding trend, markets have become more rather than less concentrated, mainly

(c) Increased Strength of the Profit Motive

Since corporate shareholders are normally so diversified that they become an amorphous mass, only the lowest common denominator of their wishes can be attended to, which is to maximize return on investment—the wish which the greatest number of shareholders have in common. Put differently, the profit motive is given additional impetus, because it has to perform the additional function of bridging the gap between management and an estranged ownership. The divorce of ownership from control also stimulates the development of a large, impersonal market in corporate control, which makes it even more difficult for management to moderate the pursuit of profit, as they live under the constant threat of losing their position through take-overs—and recall how take-overs are already made easier by the corporate form. That is why corporate behavior tends to be more strongly profit-driven than people tend to be when acting in their private capacity. An exaggerated materialist bias is thus introduced into the liberal capitalist ethos.[17]

(d) Loss of Personal Morality

The simple rule which underlies liberal moral thinking is that the possession of personal responsibility enhances personal morality, because the necessity of having to face the (positive and negative) consequences of one's freely chosen actions and commitments stimulates responsible and thus moral behavior. That is why Hayek (1967b, p. 229) could argue that liberty is a moral education in itself:

> It is . . . an old discovery that morals and moral values will grow only in an environment of freedom, and that, in general, moral standards of people and classes are high only where they have long enjoyed freedom—and proportional to the amount of freedom they have possessed.

And that is why the Christian Right and other conservative free-market groupings in the United States have made a return to an ethic of

due to an even stronger trend toward consolidation by mergers and take-overs. Most world markets, from beer to banking, are now dominated by just a few very large corporate players. As indicated above, the relative ease with which mergers and take-overs can be effected is also a corporate phenomenon. On balance, therefore, the corporate form is detrimental to the competitiveness of markets.

[17]While the corporate social responsibility movement is not insignificant and has substantially contributed toward important social causes, its scope will always be restricted by the institutional constraints on the ability of corporate management to compromise profit optimization in favor of a shareholdership which is difficult to mobilize *en masse* in support of such compromises.

personal responsibility, by which they mean a sense of personal obligation toward meeting the needs of oneself, one's family and one's broader community, the cornerstone of their political agenda through which they wish to roll back big government and stem the tide of the steady decline in personal moral standards.

But a consistent institutional application of an ethic of personal responsibility surely has to go beyond rolling back state welfare and state regulation (however valid and important that may be) and address the institutionalized irresponsibility of the corporate form of business as well. Due to the impersonal nature of the corporate firm which they represent (the corporate veil), managers have a reduced sense of personal moral agency which inclines them to stray more easily from agreed standards of decency or even break the law. And, as indicated above, the corporate system (the impersonality of the market for corporate ownership stakes) already causes corporate managers to be more narrowly profit-oriented than they would be when acting in their personal capacity, which is bound to diminish corporate concern for moral considerations extending beyond the maximization of profit.[18] Recent corporate scandals add a poignant immediacy to these observations.

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[18]In recent years, concern over the power and moral nihilism of corporations has spread beyond the leftist circles in which it has always been common. Of all recent publications in this mold, the most compelling is David C. Korten's (1995, pp. 9, 13). Korten writes:

> Although this book takes a harshly critical look at the institution of the corporation and the system within which business functions, I have never been, and am not now, antibusiness. . . . The problem is not business or market per se but a badly corrupted global economic system that is gyrating far beyond human control.

Even so, Korten does recommend some measures to counter the power of corporations which could be interpreted as antimarket and antiliberal (pp. 307–24), although, most interestingly, he does recommend a ban on fractional reserve banking for which he credits our very Henry Simons (pp. 185–93, 313).

Another instance of a nonleftist critique of the corporation is Andrew Fraser. Fraser proposes to reform corporate governance by giving a single vote to all shareholders whose investment exceeds a certain minimum but irrespective of how large their investment otherwise is. In that way, he hopes to make space for a new, more civic minded aristocrat-shareholder able to infuse more morality and old-world *noblesse oblige* into corporate practice and prevent it from further "erod[ing] the spiritual foundations of Western civilization" (Fraser 1998, p. 129). Less compelling but also in the pro-capitalist/anticorporation mold is William J. Cook (2000).

If the Christian Right and other conservative free-market groupings were indeed to question the legitimacy of the corporation in the light of their personal responsibility ethic, they might have to pay the price of losing some lavish corporate funding; but it might just make their cause a great deal more consistent and credible, and thus ultimately more powerful.[19]

The core of our critique can now be stated as follows: capitalist practice dominated by the corporate firm has lost a sense of proportion and balance. The corporate form boosts bigness, growth, productivity, financial speculation, inequality, and the pursuit of profit beyond the proper limits set by the liberal principle of personal freedom counterbalanced by personal accountability (that is, being forced, partially by state power, to face the consequences of one's freely chosen actions and commitments). The pursuit of profit is fine but we seem to have become motivated by profit just a bit too much; material prosperity is great but it tends to become just a bit too important for us; harnessing nature's powers and using its resources for our benefit is legitimate but we tend to go a bit overboard with our exploitation of nature; bigness creates marvelous opportunities for productivity gains but corporate firms tend to become somewhat oversized; inequality in income and wealth is the necessary accompaniment of personal freedom and the difference in talent and effort (and luck) which individuals bring to bear on their activities, but the inequalities seem to have become somewhat excessive; speculative activity is proper and may, in fact, be socially beneficial, but the speculative nature of modern financial markets has clearly become excessive, et cetera. If we still have the eyes to see, the threat which these imbalances pose to the long-term survival of free enterprise, if not of democracy and the natural environment, should not be difficult to appreciate.

Consequentialist utilitarianism which pervades modern normative economics will always be able to justify the corporate form by the welfare gains of the considerably greater material productivity of corporate firms as compared to unincorporated proprietorships and partnerships. But liberal policy prescriptions should not only be

[19]Pat Buchanan is the only exponent of the conservative Christian Right who was prepared to address corporate excesses (during his 1996 presidential campaign) and who did come close to arguing that the corporate form is in breach of an ethic of personal responsibility. This commendable stance was, however, marred by Buchanan's somewhat crude populism (bordering on jingoism) and his general political unsophistication (see Derber 1977, pp. 172–74). While Derber (1977) criticizes the corporation from a more leftist (pro-government, anti-free-market) vantage point than the present author is comfortable with, his book still contains valuable insights.

judged by their estimated effect on social welfare insofar as measurable (consequentiality), but also by the inherent rightness of individual liberty and responsibility (deontology). As stated in the previous paragraph, the pursuit of profit and material advancement is fine within the limits of what personal liberty and responsibility allow, but not beyond that. And if social welfare is permitted to record more than just the gains from the greater abundance of goods and the negative side effects of that greater abundance are honestly considered as well, then the impact of free incorporation on social welfare may just be negative on balance, although the inevitable difficulties in measuring the relevant welfare gains and losses, even roughly, will always make it hard to prove this objectively.

A CRITIQUE OF BLOCK'S CRITIQUE OF SIMONS

The negative consequences of free incorporation discussed in the previous section overlap to an important degree with Henry Simons's (1948) concerns about corporate capitalism's unduly skewed income and wealth distribution and its proneness to monopoly abuse, which he regularly sought to counteract through state regulation or the legal strengthening of labor unions.[20] Without having to go into much detail, the essence of Block's (2002) critique of Simons can be summarized as follows. First, Block points out that government intervention and the legal bolstering of union power are illiberal measures with seriously destructive side effects. Second, he emphasizes that there is nothing necessarily and inherently wrong with market concentration (which can be gained by offering a superior price/quality combination), inequalities of income and wealth (which can be due to difference in skill, effort and good fortune), financial speculation (which is the corollary of free exchange) or the profit motive (which merely expresses free agents' primary responsibility to provide for their own needs). Because these arguments are fairly standard in liberal circles, most liberals would find it easy to agree with Block on this score.

[20]Stigler (1983, p. 1) notes in a warm-hearted biographical sketch of Simons, how "[t]his strong egalitarian element separated Simons from most conservatives." While a strict egalitarianism is most certainly incompatible with liberalism, a liberal may still legitimately inquire whether current inequalities are not excessive and even unjustified, namely insofar as the result of a systematic, institutional bias in favor of certain categories in society. Because the corporate form raises the power and profitability of business ownership, it creates an institutional bias in favor of those with a major stake in the corporate business sector (shareholders and managers) at the expense of those who do not.

But the fact that there is nothing necessarily and inherently wrong with monopoly, inequality, speculation, and the pursuit of profit does not justify them being artificially boosted by the corporate form. Not recognizing this possibility is where Block misses the mark and becomes unfair to Simons. Surely, if it is improper, as Block is at pains to point out, to use the law to elevate the power of unions beyond what they can naturally obtain by the freedom of (dis)association, then it should also be improper to elevate the power of private business firms in the same way. And the fact that Bill Gates most certainly deserves to earn incomparably more than almost all of us, does not negate the possibility that the relevant income differences are somewhat excessive. A return to a situation where private business concerns are once again mostly organized by way of proprietorships or partnerships, while not designed to eradicate income differences in any way, should at least be able to bring back some semblance of proportionality to free-market earnings.[21]

In conclusion, the main problem with Block's critique of Simons is that it shuts the door on the liberating realization that capitalism and corporate capitalism need not be synonymous. That realization is liberating for a number of related reasons. First, it relieves liberals from a strained sense of obligation to defend some clearly objectionable aspects of corporate capitalist practice out of loyalty to liberal principles. Second, it enables them to be more openminded about leftist critiques of that practice without feeling obliged to endorse leftist alternatives. Third, it strengthens the conviction that a more consistent application of liberal principles is far better able to address the ills of modern capitalist practice than any socialist, liberty-destroying alternative could ever do. Last, it helps liberalism to transcend the conventional political divide between a rightist/pro-business/pro-free-market orientation and a leftist/pro-interventionist ("liberal" in the American sense of the term) orientation, which keeps public opinion in the grip of an insoluble policy dilemma. Conservative rightists are legitimately concerned about personal freedom and private property, which they, however, wrongly express by providing legal protection for the private corporate firm. In turn, leftists are legitimately concerned about the negative side-effects of a

[21]The liberal case for diminishing the power of unions by removing their preferential legal treatment would be much enhanced if the power of business were simultaneously diminished by removing their preferential legal treatment in the form of free incorporation. If the power of big business were curtailed, there would be no need for countervailing powers in the form of either big labor or big government.

marketplace dominated by big corporations, which they, however, wrongly express by seeking refuge in state intervention. If liberalism were to combine its pro-free-market stance with a rejection of the private right to free incorporation, it could show respect for the legitimate concerns of both sides, thus opening up a much larger audience for its ideas.

All this will probably not impress Block, because he is not convinced that the corporation is indeed a state-like institution and that free incorporation is indeed the product of undue state intervention and, as such, in violation of liberal principles. But an in-depth discussion of these issues needs to await Part II of this article.

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