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THE DISTRIBUTION OF CONTROL AND RESPONSIBILITY

IN A MODERN ECONOMY

By Gardiner C. Means

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Friends of the Political Science Association, I, an economist, come to you for aid. Economic and political developments have forced upon us a great problem of analysis in the field of politico-economic organization. The center of this problem lies in the midground between the science of politics and the science of economics and its scope is coterminous with the scope of both. It demands the best minds of both science to forge a new pattern of thinking which will weld the elements of politics and economics into an integrated whole having validity in the present day.

I need not tell you that this pattern-making problem grows out of present economic conditions. It has been focused by the activities of the administration in Washington. In that maelstrom which goes under the name of the New Deal, the lines--political and economic--are crossing and recrossing in bewildering fashion. Where does a code authority fit into our preconceived notions? What can be meant by a partnership in enterprise between government and business? We have no clear-cut philosophical pattern to which this present activity conforms.

It was originally suggested that this meeting, in trying to throw light on current happenings, should discuss the traditional subject: government ownership vs. private ownership. I can imagine no discussion more irrelevant to the New Deal except perhaps it be a discussion of

the subject: socialism vs. capitalism or government enterprise vs. private enterprise. The developments in Washington are not moving within the bounds of traditional categories. Does a code authority represent government ownership or private ownership? Does a company subject to a measure of code authority control represent private or government enterprise? Such questions have no answer in terms of our inherited concepts.

It is our present need, then, first, to formulate the problem of building a philosophical pattern in terms which are applicable to the actual conditions and, second, with the problem well-formulated, to take initial and perhaps faltering steps in the direction of creating a new pattern. In this paper I intend to present the problem as I see it and in terms which will facilitate its analysis. The actual formulation of a pattern must be the work of economic and political scientists.

Before plunging directly into the central problem, let us first consider the respective fields which our two sciences have chosen to till. I will first discuss the realm of economics, as I can speak with some measure of experience in that subject. Traditional economics is essentially a science of economic organization through the market place and abstracts from all problems of administrative organization. In the most rigorous of traditional economic pattern-making the individual is reduced on the one hand to a buyer and seller and on the other hand to a simple combiner of economic ingredients. The worker sells labor and buys other commodities to combine them in an economic pattern of living; the business man and the business enterprise buy labor and other commodities to combine them in economic proportions for sale. The whole economic process is reduced in the traditional economic thinking to a process of buying, recombining, and selling--to the science based on the market place. It is the function of this science to depict the organization of economic activity as it is brought about through the market.

Such organization of economic activity as it is brought about by administration is simply disregarded by the traditional economist. He recognizes administered activity but treats it as lying outside of his chosen realm.

What then is the realm of political science? Here I must walk as a raw recruit--carefully, instead of marching and counter-marching over the well-drilled field of my own discipline. I must therefore ask your indulgence if I make a misstep here or there. Take the objective of my thought and do not trip me on the precise use of terms.

As I see it, the realm of political science is or lies within the realm of social associations or administrative organizations. It makes little difference for this discussion whether political science has only to do with the state--a great social association--or whether it deals with all types of social associations of which the state is the most important. What is significant here is that political science deals with a phase of activity which is wholly outside of traditional economics--namely, administrative organization. That politics deals only or primarily with administrative organization as typified in the state does not minimize the contrast between the two sciences, the one dealing with administrative organization and the other organization through the market place.

But what has all this talk of the sciences to do with the basic problem of our discussion? Come back a century with me and notice how appropriate was the sharp distinction between politics--the science of administrative organization in the state, and economics--the science of the market place. In this country, a hundred years ago, the political sphere was the only one in which administrative organization was of primary social significance. In the sphere of economic activity the existence of administrative organization was of secondary, if not negligible importance. The main forces of economic life appear to have operated much as though

associated activity of factory and business enterprise did not involve administrative organization. Quite properly the economist could abstract from this fact of administration as being of the second or third degree of importance.

But economic developments during the past hundred years have played an outrageous trick on the economic fraternity. Gradually but steadily great segments in the organization of economic activity have been shifted from the market place to administration. The traditional economist, constantly abstracting from this growing area of administered coordination must find himself dealing with a smaller and smaller segment rather than the whole of economic activity. This tendency to abstract and the resulting loss of a major part of economic activity from the field of economic study is clearly brought out by the criticism leveled by a leading statistician in one of the most prominent of our eastern universities at certain of the figures I have published. He maintained that by including public utilities, railroads, and those other industries in which conditions are especially favorable to concentration I have given a false picture of the degree of economic concentration existing today. He treats these industries of high concentration as “special cases.” Yet the areas he insists should be excluded comprise from 70 percent to 80 percent of all industrial wealth! Clearly, if economics is to deal only with market induced coordination it will lose much of its subject matter.

The extent of administrative coordination of economic activity is difficult to realize. Today hundreds of thousands of workers are often organized in a single great enterprise. Their activity is coordinated, not through the shifting of prices and of supply and demand in the market, but through positive administrative action. In 1929 the American Telephone and Telegraph Company was coordinating the activity of over 450,000 people within its system. Think of the difference between this situation and the 450,000 separate and independent

enterprises such as we would have if all economic organization were accomplished through the market place. Clearly the economist who abstracts from administrative organization as of the second or third degree of importance, is belying the facts.

What are the facts as to organization? Elsewhere I have published figures which indicate that in 1929, approximately 49 percent of all corporate wealth--excluding the duplication of financial corporation--was controlled by 200 corporations. The control of something approaching half of industrial activity had become an administrative matter for 200 great administrative units. In the decade following the War the growth in the relative importance of these large units was phenomenal. During the depression the relative position of large corporations has increased still further in importance as large companies have increased their assets or held them constant while the assets of smaller companies have melted away. At the beginning of 1932, 200 companies controlled something like 55 percent of the wealth of all non-financial corporations.

This shift from organization through the market place to organization by administrative action has gone so far that the market place though still of major significance, appears to have become rather a disorganizing than an organizing influence. Instead of having prices set in the market place by the interaction of large numbers of buyers and sellers, prices are set by the administrative action of our great organized units. The increased rigidity of prices, a rigidity which seems inevitably tied up with the administrative organization of economic activity, reduces the flexibility of the market place and destroys its efficacy as an overall coordinator. The great globules of administrative enterprise fail to mulsify into a homogeneous and balanced economy. A Ford Company can throw a whole countryside into depression by its single decision to alter radically the character of its output. Since the market place must operate on the principal

of large numbers if it is to be an effective over-all coordinator, the very transfer of coordination from market place to administration reduces or destroys the capacity of the market to act as coordinator.

Concentration into great economic units has thus brought us to a highly unstable position so long as we rely on the market place as coordinator. This is an intolerable situation. We must take positive action along one or the other of two courses. Either we must make the market place a satisfactory coordinator or supplement the market place by other coordinating devices. To make the market effective, it would presumably be necessary to reverse the trend of a century and break the large units into a multitude of smaller enterprises. I can see little activity under the New Deal that works in this direction. Rather, the whole thrust of the New Deal points in the direction of increasing the element of administrative coordination of economic activity rather than its elimination.

It is in the development of further administrative coordination that we must come to political scientists for aid. We ask that you apply to the field of economic administration the technique of analysis and principles of organization which you have developed in the study of administrative organization in the form of the state. It may well be that the economic and political scientists together can work out a blend of market coordination in some areas and administrative coordination in other areas of economic activity which will both insure the smooth and efficient workings of our economy and at the same time preserve the maximum of individual freedom.

Without pausing for a full analysis of the various possible agencies of administrative control, we can fairly assume for the purpose of our discussion that since the New Deal is developing under the aegis of the state, the ultimate coordinating of economic activity will rest in

its hands. I will analyze the problem on that assumption though it must be recognized that economic administration could quite conceivably head up in an organization independent of the state or one to which the existing political state would become subservient.

Assuming then that the overall elements of administration introduced by the New Deal will head up in the state, our problem becomes one of creating a pattern or organization which is neither capitalism in the complete laissez faire sense nor socialism in the sense of complete state ownership of the instruments of production. There are undoubtedly many among you who despair of any such intermediate. You say that it is necessary to choose between private property and government property. Here again we are harking back to language and concepts which might have been suitable a century ago when a particular object was mine or thine--subject, of course, to the police powers of the state. But the past century, in bringing into existence great administrative economic units, has brought a change which has broken up or dissolved private property in the instruments of production and opened the way to a new approach. If we are fairly to analyze the possibilities inherent in our present situation we must exercise the concept of private property as a "ding an sich." Only then can we properly approach consideration of the possible patterns of economic organization.

What do I mean when I say that private property as such has dissolved? Our law schools are to an increasing extent teaching that property involves a bundle of rights and powers, a bundle of relationships between persons. They mean by this not only that an individual may lay claim to a bundle of rights and powers over other persons in respect to a house or enterprise, but also that since these rights and powers which constitute property are a bundle of separate threads, they may be distributed by appropriate action in almost any desired combination. For instance, it is possible that the rights and powers with respect to a particular house could be so split up that

A and his heirs or assignees would have the full rights and powers of occupancy, that B would have the sole rights and powers with respect to rebuilding or altering the house, that C should have the sole responsibility of paying taxes, that D should receive annual money payments from the occupant of the house, and that E should own the land on which the house is built. Who owns the house? Actually the rights and powers are so grouped into smaller bundles that it is no longer relevant to say that so-and-so owns the house. In much this fashion modern corporate development has redistributed the rights and powers in business enterprise.

But even more than the simple breakup of the customary bundle of property rights and powers into smaller bundles, the modern corporation has tended to separate rights from powers. By a slow process of development which I have elsewhere described, the property rights have been separated from property powers. It is this regrouping that has the greatest importance for our analysis. Instead of making smaller bundles of property rights and powers which are qualitatively the same as the larger bundles out of which they are made, the separation of rights and powers brings a qualitative change in the bundles derived.

This difference in quality can be most clearly seen if we transfer our analysis from the legal to the economic field. Where the lawyer deals with property the economist deals with wealth and just as legal students have in the analysis of property problems adopted the concept of a bundle of relationships, so corporate development is forcing the economist to treat wealth in terms of a bundle of interests and powers. Things as such cease to be the center of problems of wealth. Rather, we must deal with the social relationships between individuals, sometimes relationships which have no attachment to tangible things--stocks and bonds and human organizations--sometimes relationship between individuals but also relating to tangible things--houses or factories.

When we deal with wealth in relational terms, the two types of relation already indicated in the law have their economic analogues. For legal rights we have the corresponding economic interests; for legal powers we have economic powers. To distinguish economic powers from the legal, we can adopt the term "controls" for economic powers. In relational terms then, wealth involves a bundle of interests and controls. These are the basic elements--the basic concepts out of which our new pattern must be built.

Consider the modern corporation in the light of these concepts. The dispersion of stock ownership in our great corporations has sub-divided the interests in a single enterprise, into the hands of hundreds of thousands of persons. At the same time, the major threads of control over great segments of economic activity have been concentrated into the hands of a few central administrators, or, all too often, into the hands of irresponsible manipulators. In most of our large corporations, the dispersion of security holdings has involved a separation between the interests and the controls which have traditionally been associated with ownership. The ordinary stockholder can do as he pleases with his share of stock--sell it, hold it, or burn it up--he has the full interests and controls over his share of stock which constitute traditional ownership. But over the corporate enterprise as such he has practically no control, though he still retains the full interests of an owner. In essence, he is reduced to receiving or not receiving dividends. The threads of interest and the threads of control run to different hands,--the interests scattered; the controls concentrated.

But the separation of interests and controls has gone very much further than this in modern enterprise. In the old days of individual enterprise, a single person would constitute an enterprise--being not only owner but also worker, as in many of our farms and retail stores today. The interests of the individual as a worker were in the same hands as the controls over his

activity. With the widespread adoption of the factory system, a process was set in motion whereby the worker has become increasingly separated from direct control over his own activity. The very act of hiring out constitutes a partial surrender of control on the part of the worker. During working hours the worker agrees within limits to operate under the direction of a boss. It is this very surrender of control on the part of the worker that makes factory enterprise so much more efficient than individual enterprise. The activity of a large number of workers can thus be directly coordinated.

Though workers surrendered important elements of control in hiring out to a business enterprise, so long as the enterprise was small and one of a large number competing for the services of workers, an important measure of control over enterprise lay with workers. An individual could always transfer to some other enterprise. But as the administrative units became ever larger, the direct control of the worker over the conditions under which he operated became less and less. It was this separation of worker from control which was the basis of Marx's thesis of the class war. Though the interests of workers in economic activity remained as great as ever, their share in the direct control over enterprise diminished. To some extent this loss in direct control was counterbalanced by a measure of control through labor organization--consider how a powerful union can reduce the elements of control over an enterprise which are traditionally associated with ownership. But for the most part, workers have not been in a position to exercise an important element of control over industrial activity. So far as workers are concerned interests and controls have to a significant extent been separated.

In a third sphere, interest and control have been separated by the development of great administrative units. In the old days of small enterprise, the consumer could bargain on a fairly equal footing with the seller and could in this way exercise a very direct control over industrial

activity,--over the price and production policy of enterprise. The individual buyer had sufficient control over enterprise to protect his interests as a consumer. He dealt directly with a seller could bargain, and could find many alternative sellers if his interest dictated.

Today, the consumer has lost much of his old direct control in industry. He deals with a sub-subordinate in a great enterprise. He is faced with fixed prices and a 'take it or leave it' formula. For any one article he has few alternative sellers to choose from. He no longer has the means to test quality at all comparable to that of the seller; and finally, he is bludgeoned by all the arts of advertising to conform to the pattern laid down by one or another of the great units of economic organization. The element of consumer control over industrial activity is truly at low ebb. No longer does the market place give the consumer an effective share in the control of economic enterprise.

What is our picture, then? The shift of large segments of economic activity from coordination through the market place to coordination through administered activity has gradually sucked controls over economic activity away from the three parties mainly at interest--the security holders, the workers, and the consumers. It has placed this control in the hands of administrators, nominally responsible to the security holders but factually responsible in all too many cases to no one. Such a concentration of controls leaves the security holders, the workers, and the consumers,--the forgotten men--with great and basic interests in industrial activity but with minimum controls over it. Controls without interests lead to irresponsible actions. Interests without controls lead to social frustration.

What then is our next move? Stay as we are, we cannot. Shall we break up the administrative units to the point where real control is returned to the various parties primarily at interest in industry and where the market place can act as an effective coordinator? The New

Deal points in the other direction, towards supplementing and reinforcing coordination through the market place by introducing administrative coordination in the areas where the market place fails to function. What pattern of coordination can we develop which will not be at once top heavy and too little responsible? What areas of activity and what functions had best be left to coordination and control through the market place and what areas and functions require administrative coordination? How shall the threads of control be reattached to the parties at interest in industry? Such is the problem we face and such are the terms we must use in seeking a solution.

In developing a pattern we can probably agree on certain principles. First, we want the maximum decentralization of control that is compatible with a smoothly functioning economy. Few of us want centralization for its own sake. As great enterprises have learned to decentralize control and responsibility within the confines of the single enterprise while certain significant threads of control are carried through to the central coordinating administration, so on a national and perhaps international scale, while the bulk of the threads of control should be left in the hands of individuals or enterprises certain threads should be carried clear through to the central body--let us say, the government--while other threads should be carried through only to intermediate bodies, such as code authorities. It may well be that with greater centralization of certain threads of control we can develop a vastly greater decentralization of most of the threads of control than now exists. Gradually, the rigid lines which demark single enterprises will become softened and blurred, just as the holding company-subsidary set-up and the affiliated company set-up have already blurred the lines of enterprise, or much as that great confederation of grocery stores, the Independent Grocers' Alliance, has located certain threads of control beyond the border of the single independent unit.

But the redistribution of threads of administrative control is not sufficient. It is necessary that those exercising controls should be responsible to the parties at interest in industry. Does this mean that each of the interests should have a direct share in the ultimate controls? How can this be arranged? The extensive demand that workers and consumers each have representation on code authorities is a definite step in this direction. Should we not apply the principle of decentralization here also and have local code authorities composed of representatives of the various interests?--local controls for local problems and national controls of those of broader import.

Here, then, is our basic problem of pattern-making. First we must drop the confusing concepts of private property and private enterprise. The modern corporation has destroyed their usefulness as tools of analysis. Second, we must cast our analysis in terms of interests and controls. Third, we must distribute controls, centralizing only those which are essential to the smooth and adequate functioning of our economy. And fourth, through some form of representation, we must bring back to the parties at interest industry controls over those exercising administrating control in order that ultimate interest and ultimate control may go hand in hand. It is to forge such a pattern that I, an economist, come to the masters of the science of organization for aid. Only as the two related disciplines combine on this problem can the basic pattern of a new and distinctly American political-economy be developed.

1. Project No. - Trends of Recent Corporate Development.

Director - Adolph A. Berle, Jr., Professor of
School of Law, Columbia University. Begun January 1928;
completed October 1931. Council funds allotted \$25,000;
expended \$18,933.83.

2. Nature of Research. An analysis of the property relationships implicit in the modern large business corporation. The analysis covers the role of large corporations in the American economy, their ownership, their control, and the legal and factual relationships between ownership and control with respect to assets, income, and activity of corporate enterprise. The proposal to make the study arose out of the growing realization of the social, legal, and economic implications of institutionalized corporate enterprise as distinguished from private enterprise. The study centered around the separation of ownership and control implicit in the modern corporation and the legal and economic implication of this separation. The study was concerned with a borderline area overlapping both law and economics and required not only the use of the tools of analysis developed in both these disciplines but the fashioning of a final report which was consistent with and interrelated the two points of view involved.

3. List of Publications
 - a) Monographs

The Modern Corporation and Private Property,
Adolph A. Berle, Jr., and Gardiner C. Means
Commerce Clearing House, Chicago, 1932.
Subsequently reissued by the MacMillan Company
New York, 1933.

Cases and Materials in the Law of Corporation Finance
Adolph A. Berle, Jr. editor, West Publishing Company
St. Paul, 1930.

 - b) Articles

The Diffusion of Stock Ownership in the United States,
Quarterly Journal of Economics, Vol. XXIV,
August, 1930.

The Large Corporation in American Economic Life,
American Economic Review, Vol. XXI, March, 1931.

The Separation of Ownership and Control.

Cases on purchase of own stock by a corporation
Irving J. Levy, (1930) 15 Minn. Law Review 1.

Liability for Stock Market Manipulation, Adolph A.
Berle, Jr., 1931, 31 Columbia Law Review 264.

Stock Purchase Warrants and "Rights", Russell G.
Garner and Alfred R. Forsythe, Southern California
Law Review, April and June 1931, Vol. IV, No. 5
and Vol. IV, No. 5.

Investors and the Revised Delaware Corporation Act,
Adolph A. Berle, Jr., 1929, 29 Columbia Law
Review, 563, 565.

Elements of the Law of Business Accounting, Adolph
A. Berle, Jr. and F.S. Fisher, Jr., 1932, 32
Columbia Law Review 573.

4. Conclusions and significance of the study.

The main conclusions of the study are 1) that ownership and control have become widely separated in the modern business corporation; 2) that persons in control are in a position to and often do use their power over corporate assets and income to benefit themselves at the expense of ownership; 3) that the traditional logic of property calls for the operation of a corporation in the interests of ownership with persons in control acting as trustees; 4) that by the traditional logic of profits any profits over and above enough to insure the supplying of risk-taking capital should go to persons in control of a corporation to induce their active zeal in its management; that neither the traditional theory of property or profits is adequate to deal with the new situation presented by the modern corporation; that a new concept of the corporation must be developed which analyzes the modern corporation not in terms of business enterprise but in terms of social organization; that if the choice is solely between adopting the logic of property and adopting the logic of profits, the former is the less objectionable alternative and should be adopted at least until a new concept of the role of the corporation has developed; and finally, that it is conceivable, - it seems almost essential, if the corporate system is to survive, - that the "control" of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.

The influence of the published studies appears to have been very considerable. The articles published in the technical journals are frequently quoted or cited and the case book on corporation finance is used extensively (????can you have this checked with the Law School or else cross it out. Perhaps it could be made more specific) The main report on "The Modern Corporation and Private Property" has come to be recognized as a

standard work and is extensively used as required collateral reading in both economic and law courses dealing with corporation problems. It has also received attention in public discussion, having been extensively cited or quoted (in Congress, in presidential speeches, in Supreme Court decisions). Criticism has come from Rufus Tucker published in the New York Times Annalist (?) to the effect that the estimates of corporate concentration were gross over-estimates. Careful compilations made directly from income tax returns but not yet published indicate that the estimates made of corporate concentration in 1929 were substantially correct for that year.

Crum has objected to the inclusion of large railroads and other public utility corporations among the large corporations in estimating the degree of corporate concentration in the American economy. Except for these two criticisms involving specific though crucial figures, the main report has received little adverse criticism.