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Notes for talk by Irwin M. Stelzer* on
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Before lapsing into silence for several years on issues related to “The Modern Corporation”, my assigned topic, and then turning that topic over to me for the simple reason that my telephone number was easily accessible on the Adam Wolfson/Irving Kristol speed dial, *The Public Interest* made its pages available to academics on both sides of the debate started in 1932 when Berle and Means published “The Modern Corporation and Private Property.” Those of you of a certain age will remember that the authors raised serious questions about the role of the corporation in American economic life since, in their

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view, widely scattered shareholders had lost control of their property to managers who might have an agenda that did not include maximizing shareholder value.

Anyone with a taste for the literary delight that is the work of John Kenneth Galbraith, set against the analytical skills of Bob Solow, can dip into the 1967-1968 debate between these titans, and have a double treat. First, and this a forerunner of later disputes between other distinguished disputants, you have a high-quality intellectual joust over an issue that continues to rage some forty years later. Do large corporations control the economy? Are their managers free of shareholder control, and able to enrich themselves at the expense of the owners of the business? Do managers seek to maximize growth, rather than profitability? Are consumer wants in fact created by those who profit from their satisfaction?

A second treat is the style of the debates. *The Public Interest* succeeded in making itself accessible by allowing its contributors to practice the delicious art of personal vituperation. We have Solow attacking Galbraith: "He mingles with the Beautiful People; for all I know, he may be a Beautiful Person himself." We have Galbraith responding: "Professor Solow is one of the most distinguished and prestigious economists of our

time,...conscious of his scientific prestige. [He is] compulsively negligent of the scientific mood...”

I mention this for two reasons. First, the willingness of the editors of *The Public Interest* to sheath their red pencils in the interest of allowing good knock-about is, alas, no longer practiced by editors of journals of this type, editors who confuse monochromatic dullness with scholarship.

Second, this is but one example of the many ways in which the editors made the journal accessible to a wider audience, one until then beyond the reach of most conservative economists, who had ceded the field of popular debate to such brilliant writers as John Maynard Keynes and John Kenneth Galbraith. Another rule in the drive for a nontechnical audience was a rule against equations and, in my view less wisely, one that deprived readers of footnotes.

Variants of this debate about the role of the corporation cropped up several times, in articles about the role of antitrust policy (get rid of the Sherman Act; Lino A. Graglia), the power of big business (not a worry; M. A. Adelman); corporate social responsibility (“the consumer-oriented free-enterprise society no longer satisfies the citizenry..., so it will have to change”; Daniel Bell); and the ability of interest groups “to use the powers of government for their own ends” (Richard A. Posner).

The Public Interest's willingness to devote precious pages to the role of the large corporation in a liberal, capitalist economy can be attributed largely, although not entirely, to Irving Kristol's concern that if such relatively new business enterprises did not establish their legitimacy, they would find themselves increasingly under government control. Kristol noticed, as many capitalist triumphalists did not, that "the modern corporation [is] in the critical condition that we find it in today." After all, he wrote, "No other institution in American history – not even slavery – has ever been so consistently unpopular as has the large corporation with the American public. It was controversial from the outset, and it has remained controversial to this day."

"This day" in which the American corporation is "in the critical condition", it should be noted, was 1975, a quarter of a century before anyone heard of Enron or Sarbanes-Oxley. Unfortunately, the critically ill patient thought itself to be in rude good health, and made no effort to change its daily routine of board meetings among chums, executive compensation unrelated to performance and, it now seems, abusing the options systems that were designed to align management interest with those of shareholders. All the while, America's corporate leaders failed to heed Kristol's warning that the emergence of the large corporation as a "quasi-public institution, ... which liberal democracy never

envisaged, whose birth and existence have been exceedingly troublesome to it, and whose legitimacy it has always found dubious” requires them to decide “what kinds of reforms are necessary to a vigorous defense”. Kristol is probably not surprised at this unwillingness of the corporate community to leap to its own defense, since he saw what others less nuanced defenders of capitalism did not, that few chief executives “have an inclination to take a long and larger view of the corporation and its institutional problems.”

Which brings me to the present, or almost. I won't bore you with a summary of my later articles on corporate governance that the editors were kind enough, or foolish enough to publish. Suffice it to say that among my ideas to preserve healthy capital markets and win what I called “the battle of ideas over the acceptability of capitalism” were, first, stock options to align shareholders' and managers' interests – how was I to know about backdating – and then reliance on some sense of shame to limit CEO compensation – how was I to know that shame is in short supply in many boardrooms.

So we have come full circle since *The Public Interest* provided a forum for debate about the virtues and sins of modern-day corporate capitalism. The critics of America's corporations are having a field day in what is called the popular press raising

governance issues that go to the legitimacy of the corporation, and are paving the way for more intensive governance regulation of day-to-day business operations. The defenders take time from back-dating options and voting themselves compensation packages that combine a maximum of inscrutability with a minimum of relationship to performance, to whine rather than take Kristol's advice and "confront...the reality of its [the corporations'] predicament."

Meanwhile, economists trade equations in journals largely unread by policymakers (like other parts of this brief talk, this is a generalization to which there are notable exceptions), leaving the field to populist critics and obtuse corprocrats. Where is *The Public Interest*, now that we so desperately need it?

How, finally, did *The Public Interest* shape our understanding of the role of the corporation? In my view it staked out territory that was previously unoccupied. First, it raised the still unanswered question: "Just what sort of institution is the modern corporation?" Legally, the corporation is a "person", entitled to all the constitutional protections that the Founding Fathers had in mind for "real people". In structure, it is a democracy, with its actions dictated by the votes of its owners. In its relation to government, the modern corporation is supposed to be a creature of, and therefore subordinate to, government.

But the large corporation is not a person as we ordinary persons think of that term. And it is not a democracy, which may be a good thing since it is difficult to imagine how a large corporation could survive the politicking characteristic of democracies. And it at times is able to bend government to its will, rather than submit to the will of government.

Second, the *Public Interest*, a journal that was friendly to American capitalism, provided a forum for its constructive critics. Neither those who see the large corporation as an unmitigated evil, nor those who see that institution as an unambiguously benign contributor to the fabulous performance of the American macroeconomy could take solace from its balanced approach: a recognition of the contribution of large aggregations of capital to economic growth, but an understanding that the governance systems in place are inadequate to permit the complete legitimization of what Kristol dubbed an “accidental institution” with the “power to make economic decisions affecting the lives of tens of thousands of citizens”. Would that more of America’s CEOs had been among *The Public Interest’s* subscribers.

But let’s end on a high note. Or two.

First, markets have done much to correct some of the unwanted consequences of the governance structure of the American corporation. Think Mike Milken, who used a new

approach to corporate finance to make hostile takeovers easier to accomplish, thereby subjecting the worst practitioners of managerial sloth and greed to the risk of unemployment.

Second, contrary to the views of many no-government conservatives, regulation has helped to solve some of the problems raised by Berle and Means. Thanks to new legislation passed in response to various corporate scandals, audit and compensation committees are more independent of the managers they supervise. Given new powers, and the threat of jail for ignoring their fiduciary responsibilities, directors are groping towards improved methods of linking executive compensation to performance, and representing shareholder-owners with greater vigor.

This combination of markets and intelligent government intervention is just the sort of combination that *The Public Interest* would smile upon were it still with us.

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