LIVING WITH THE CORPORATION

No American institution provokes a wider range of reactions than the corporation. It is a source of jobs and wealth, an object of loyalty, and an engine of economic and technological creativity. It is also a disruptive social force and a powerful influence in American culture and politics. Our authors explore a long and complicated relationship.

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The Making of the Modern Corporation

by Morton Keller

The large business corporation has a firm place in the American imagination as the dark repository of private power. There are no more reliable villains on TV or in movieland than these shadowy, soulless, omnipresent institutions and the faceless, greedy men and women who serve them. And yet today as much as ever before, corporations are accepted as the driving engines of our economy, as the places where most of us work. It sometimes seems that corporations in America are what lying was to the English schoolgirl: an abomination unto the Lord, but an ever-reliable friend in time of trouble.

The corporate charter was invented in medieval Europe. For centuries, incorporation legitimated a variety of public institutions and semiprivate enterprises, rather than private businesses. It found receptive soil in the American colonies, and during the early years of the Republic became a widely accessible instrument of economic growth. Yet from early on there was a tension between the public character and private purposes of corporations.

As the term *corporation* became a synonym for big business after the late 19th century, corporations increasingly became the subject of political debate and the target of legislation and regulation. But to an extent that is not generally appreciated, many of the challenges posed by the corporate form have been handled in the nation's courtrooms rather than in the political arena. In part, this is simply because corporations are creatures of the law. But turning the corporation to public purposes without impinging on its proven ability to create wealth (which is, in fact, another public purpose) has proved also to be a very delicate task—one of many such tasks that Americans have relied heavily upon the courts to carry out.

To understand what corporations are, it is necessary first to have some idea of where they came from. The idea that certain kinds of institutions—towns, guilds, schools, hospitals—should have a charter from some higher authority that grants them defined privileges dates from at least the Middle Ages. Early charters were vari-

In 1721, William Hogarth memorably satirized England's South Sea Bubble, one of the world's first bouts of speculative fever in corporate shares.

ants of the basic feudal contract that linked lords and vassals in medieval society; if for individuals, then why not for institutions?

Out of this experience came the idea of chartering commercial ventures as well. During the 16th and 17th centuries, English entrepreneurs sought royal charters for all sorts of ventures, including trading outposts in the Baltic, Russia, and Ireland, and then "plantations" in the New World.

Most of these early chartered ventures were joint-stock companies, composed of investors who pooled their assets for a single enterprise. The Dutch East India Company of 1602 is often accounted the first true stock corporation, with a permanent fund of capital. The great advantage here was that in the (not unlikely) event of failure, the participants' liability was limited to the amount they had invested. This made it easier to amass the large capital pools these early overseas ventures required.

So the early modern corporation emerged to meet the financial and organizational needs of the Age of Discovery. But charters also served the power-aggrandizing monarchs of 17th century England, such as James I. By establishing the principle that corporations were legal entities created by the Crown, the king not only asserted his authority over them but was in a position to grant monopolies and other perquisites to his favorites.

But the royal stamp of approval, too freely given, encouraged rampant speculation, much as U.S. government deposit insurance in the 1980s encouraged American savings and loan societies to overextend themselves. The inevitable end came in 1720 with the ruinous collapse of

the South Sea and Mississippi "bubbles," rampages of speculation in the shares of two companies established to launch commercial ventures in the New World. Parliament's Bubble Act of that year put an end to almost all corporate chartering for commercial purposes in England for the rest of the 18th century.

That long hiatus, coming as it did during the seedtime of the Industrial Revolution, strengthened what was already a strong inclination in England to rely on partnerships rather than corporations as the preferred form of business enterprise. Partnerships made sense in a tightly knit, hierarchical society, where extensive and complicated bonds of personal relationship defined the social structure and controlled the major sources of investment capital.

The Bubble Act applied also to the American colonies, which faced the added difficulty of trying to launch commercial ventures in the face of a British imperial policy that reserved the profits of more sophisticated forms of enterprise to the mother country. The Philadelphia Contributionship for Insuring Houses from Loss by Fire (1768) was the only chartered business corporation in colonial America, acceptable because of the socially useful nature of its business.

Nevertheless, incorporation turned out to be as American as apple pie. Every colony had a royal charter by the eve of the Revolution. Colleges, charities, New England towns and villages, churches, and quasi-public enterprises such as wharves and mills eagerly sought charters of incorporation from colonial assemblies.

Independence opened the floodgates to innovation in many realms of American society, not least the launching of commercial ventures. No longer did a hostile king or parliament threaten their legitimacy. And a new structure of state and national government now existed that could create, define, and limit incorporation.

An important early statement on the place of the charter in the American system of government was John Marshall's decision in the *Dartmouth College* case (1819). Could New Hampshire unilaterally alter the terms of Dartmouth's pre-Revolution royal charter? Marshall (and a dutifully unanimous Supreme Court) said no: Dartmouth's charter was a contract, and hence came under the protective wing of the Constitution's clause barring the impairment of contract.

This ruling seemed to suggest that incorporated bodies would enjoy a high level of immunity from state interference. New York judge James Kent said soon after the *Dartmouth College* decision that it "did more than any other single act . . . to throw an impregnable barrier around all rights and franchises derived from the grant of government; and to give solidity and inviolability to the literary, charitable, religious and commercial institutions of our country."

But to say that a charter was the same as a contract challenged the

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assumption in English common law that a corporation was free to do everything that it was not explicitly forbidden to do. Instead, American courts took the view that a corporation could do only what its charter—granted by the state legislature, that republican tribune of the people—explicitly said it could do. In other words, a charter was not an open-ended grant of authority but a specific and limited authorization to take on a particular task: an approach well suited to a republic dedicated to the principles of limited and representative government.

There was more. By saying that corporate charters were contracts, not grants, the Supreme Court stripped away any implication that corporations enjoyed the special favor of the chartering authority. It thus enabled the charter of incorporation to become a widely accessible instrument in the contract-dominated market economy of the 19th century.

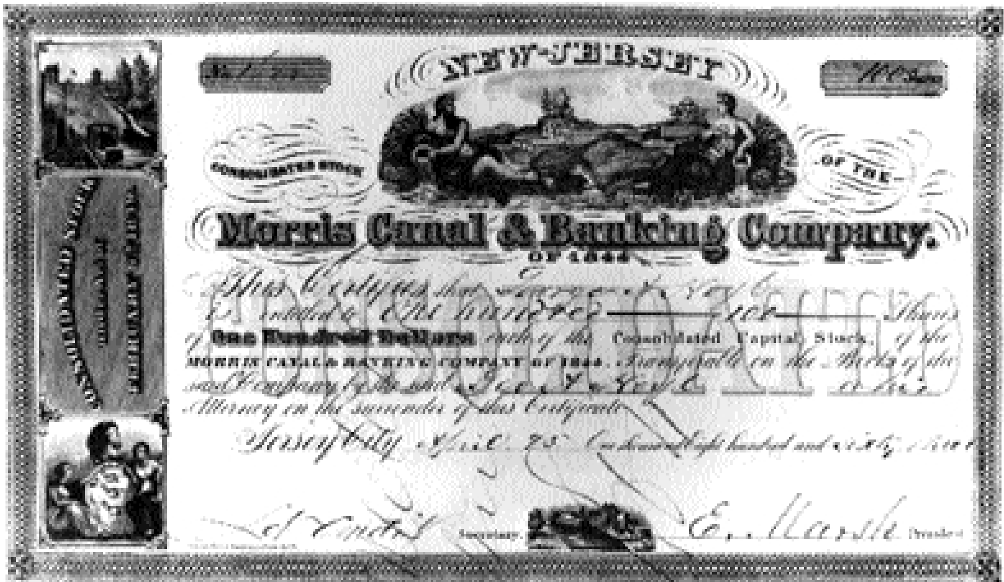
The benefits of the corporate device quickly became evident. Incorporation's limited liability reduced investor risk, thus making it easier to attract the relatively large and unaffiliated American investing public. And a corporate structure made it easier to bring in professional management. These were important advantages in a scattered, diverse society, so unlike the tightly interconnected world of business and capital in England.

The spread of corporations also democratized—or, more accurately, republicanized—commercial enterprise by bringing it within the framework of American government. Charters came not from an unaccountable sovereign but from popularly elected state legislatures. At the same time, the semiofficial status of corporate charters eased the access of companies—and their competitors—to the new nation's legislatures and courts.

In the heady days of the early and mid-19th century, American corporate chartering expanded as never before. Schools and colleges, medical and agricultural and charitable societies, churches, towns, and cities barraged state legislatures with charter requests. The number of business corporations soared. By 1817 some 2,000 had been chartered, and this was just the beginning. Turnpikes, canals, bridges, banks, ferries, steamboat and insurance companies, and railroads were the most conspicuous recipients. New York alone granted about 500 turnpike charters between 1797 and 1847.

The prevailing view was that there was no important difference between purely commercial and quasi-public enterprises. Each in its own way benefited the young republic. It was not difficult to believe that banks, bridges, canals, turnpikes, railroads, and insurance companies played a public role, and to accept the fact that they often got special privileges, such as monopoly rights for a period of years, when they were chartered.

But as the economy grew, these privileges came under fire. Some critics were rising entrepreneurs who sought to compete with existing enterprises, while others voiced a more general resentment that these "artificial creatures" should be so favored by the state. "Corporations have neither bodies to be kicked, nor souls to be damned," went a common complaint of the time.



Widespread sales of corporate shares like those above to the general public was a uniquely American practice, speeding the rise of corporations.

The depression of the late 1830s and early ’40s, which led to massive failures of canal and railroad companies, cleared the way for new ideas about the scope and meaning of incorporation. One result was easier access. By the mid-19th century, legislatures were passing general laws designed to make incorporation as cheap and easy as possible. No longer was it necessary to secure a legislative act. Now one filled out a simple form and paid a small fee. Incorporation became almost a perquisite of American citizenship, like voting or going to school. This democratization of what had once been an instrument of privilege made the corporation a form of economic organization more widely used in the United States than anywhere else in the Western world. In New York, for instance, more than 4,700 manufacturing firms were chartered between 1848 and 1866.

At the same time, the ability of the state (if it so chose) to regulate corporations was reinforced. The Supreme Court’s *Charles River Bridge* decision (1837) set the tone. Writing for the majority, Chief Justice Roger B. Taney refused to let the privileges granted to an 18th-century Massachusetts bridge company block the construction of a second bridge nearby, even if the effect of the new enterprise was to destroy the economic advantage of the old one. The promise of economic growth lay not in the guarantee of old privileges (as Marshall had suggested in the *Dartmouth College* case) but in a process of “creative destruction” in which existing charter rights were narrowly interpreted in their duration and impact, and legislatures were empowered to foster economic change at the expense of vested corporate interests.

States that freely granted the gift of incorporation were ready to regulate or limit what they created. A number of them (including New York in its 1846 constitution) forbade subsidies or favors of any form to railroads and other corporations. While the courts remained sensitive to

the sanctity of property and contract, they tended to interpret corporate charters narrowly; in effect, to say to a company that wanted to go beyond its prescribed powers, "Have you got it in writing?" It was common for corporate charters to include a reserve clause allowing the legislature to amend them at any time. And by the 1850s, the "police power" to regulate the safety, health, morals, and welfare of the people had come to be accepted in American law as a broad justification for economic regulation.

This, then, was the ambiguous status of the business corporation in the mid-19th century, on the eve of the rise of big business. The corporate charter had evolved into a readily accessible instrument for a vibrant entrepreneurial society. Simply and cheaply attained, stripped of its traditional exclusionary or monopoly character, it was an essential handmaiden of economic growth. But at the same time, the corporation had an aura of threatening economic power to which government was expected to respond.

The first corporate body to evoke such fears was the Second Bank of the United States. But it died in 1832, when President Andrew Jackson vetoed the bill rechartering it. Next came the railroads. By the mid-19th century they had become the nation's first big business, a new and frightening source of unchecked power. In the early 1870s E. L. Godkin of the *Nation* observed, in his usual portentous way: "The locomotive is coming in contact with the framework of our institutions. In this country of simple government, the most powerful centralizing force which civilization has yet produced must, within the next score years, assume its relations to that political machinery which is to control and regulate it."

Popular anxiety over corporate power peaked at the turn of the century with the movement against "the trusts." In the late 1870s, John D. Rockefeller's attorney Samuel C. T. Dodd figured out a way for Standard Oil to absorb competitors without running afoul of its Ohio charter, which forbade it from holding the stock of other companies. The stock of Standard Oil and the companies it absorbed was turned over to a Rockefeller-dominated board of trustees, which issued trust certificates in return. A trust was not a corporation, and thus no state laws were broken.

Only about 10 trusts were launched during the 1880s. But the potential for more such mergers, and the fearsome business practices of the Standard Oil combine, made the trust a lightning rod for public concern over corporations and big business. The author of an 1883 law journal article wondered, "The Standard Oil has grown to be a more powerful—corporation, shall we call it? or what? for this is one of our questions—than any other below the national government itself." A number of states passed antitrust laws, and in 1890 the Sherman Antitrust Act, which outlawed "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce," swept through Congress.

But this legislation hardly eased the growing national concern over big business. In its early years, the Sherman Act proved to be difficult to administer. The Supreme Court, in the *Sugar Trust* case (1893), severely limited the impact of the law by ruling that although the American

Sugar Refining Company controlled more than 90 percent of the nation's output, it could not be attacked under the Sherman Act. Why? Because sugar refining was part of the manufacturing process, a concern of the chartering state; the federal government's authority applied only after the company's product began moving in interstate commerce.

At the same time James B. Dill, another creative corporation lawyer—it was soon after this that Finley Peter Dunne's Mr. Dooley observed that what looked like a stone wall to the ordinary man was a triumphal arch to the lawyer—came up with a new legal device that nicely removed the remaining constraints on corporate consolidation. Dill's invention was the holding company: a corporation whose sole reason for being was to possess the stock of other corporations.

What to do about state laws that forbade corporations from doing this? That was easy: get a state or two to ease that restriction, and then interstate competititiveness would do the rest. Delaware and New Jersey soon obliged in response to intensive corporate lobbying and became the legal homes of many of America's largest corporations. The result, said one observer, was that "the conduct and condition of [a corporation's] business are treated as private and not public affairs."

This legal-legislative transformation went hand in hand with a new judicial perception of the corporation. In its *Santa Clara* decision of 1886 the Supreme Court held, en passant, that a corporation was a person under the Fourteenth Amendment and thus was entitled to the guarantees of due process and equal protection that the amendment afforded to the nation's citizens. This quiet change sculpted a constitutional safeguard of the rights of newly freed slaves into a potent instrument for use against state taxation and regulation.

It is not surprising that large American corporations felt free to go on a consolidation binge around the turn of the century. From 1898 to 1902 there were 2,653 mergers, with a combined capitalization of $6.3 billion. Within a few years an economy dominated by large, consolidated railroad, coal, steel, tobacco, oil, and dozens of other giant firms—the world of the 20th century American economy—had come into being.

Europe was creating its own economic megaliths at the same time: Great Britain saw 198 mergers during 1898–1900. But very different political, economic, and strategic realities prevailed there. Partnerships continued to be the rule in Britain (though they enjoyed limited liability and other corporate goodies). And English courts saw nothing wrong with—indeed, encouraged—firms entering into cartel agreements on prices and production. As an observer of the time put it, "Combination has been accepted without regulation in England because the entire English social system is a series of closed groups." Nothing of this sort was legal in the United States.

The popular American response to the rise of big business was colored by very different social realities. American historical memory did not include sentimentalized feudal-aristocratic traditions of patriarchal oversight, or guilds that were part of a traditional social order, or a tradition of class conflict. Rather, the most powerful economic creeds were

A century ago, the growing economic and political power of big business alarmed many Americans. An 1886 cartoon targets corporate influence in Congress.

individualism and self-reliance; enterprise was not to be cosseted but was to be left alone by the state. The growing diversity of early-20th-century American life—with manufacturers, merchants, farmers, railroads, shippers, retailers, consumers, unions, lawyers, judges, economists, journalists, and politicians pushing their interests and jockeying for position—served only to strengthen this fluid social environment.

In theory, Americans could draw on several different policy responses to the rise of big business. One was public ownership of public utilities. Another was federal incorporation (and therefore oversight)—sometimes sought by industry leaders themselves, who saw in it protection from burdensome state supervision. Yet a third was general federal regulation of

industrial prices and services: the creation of an interstate trade commission to parallel the railroads' Interstate Commerce Commission.

But these alternatives failed to suit the national temperament—or to fit the prevailing realities in American politics and government. Public ownership of utilities was tried in a few places, but the opposition of private interests and public suspicion of politician-run enterprises kept it marginal. Presidents Theodore Roosevelt and William Howard Taft proposed federal chartering, without success. And while the Federal Trade Commission was created in 1914, it did little more than try to block false and deceptive advertising.

What developed instead was a heavily judicial and highly nonideological system of mixed state and federal oversight, dominated by the federal courts. The number of antitrust suits varied from presidential administration to administration. But in the last analysis, antitrust policy was not set by elected officials or the government bureaucracy. It was set by the Supreme Court.

What was the character of that judicial policy? At first, reluctance to use the Sherman Act to strike down large combinations. Then, influenced in part by political and public opinion, a growing readiness to order the dissolution of combines that clearly violated the letter and spirit of the Sherman Act, culminating in the *Standard Oil* and *American Tobacco* decisions of 1911. In these cases, the Court set down a "rule of reason" for judging when combinations and bigness passed over the invisible line from efficiency to monopoly—and it ruled that both companies had done so. But the decisions made it plain that it would be the *Court*, and not an administrative or political agency, that would decide when that line had been crossed.

There were other forms of corporate regulation besides court-driven antitrust policy, but none were very satisfactory. Insurance companies, banks, and securities markets were subject to state regulatory systems—all notable for their inadequacy. Railroads, regulated by the Interstate Commerce Commission since 1887, were involved for decades in an intricate, politically charged, and terribly costly regulatory drama.

The newer public utilities—gas and electric, bus and streetcar and telephone companies—operated in yet another distinct regulatory environment. They were expected to provide a constant flow of a necessary service, and by their very nature they were monopolies, or nearly so. To deal with them, the states resurrected the old regulatory device of licensing. Public service or utility commissions issued "certificates of public convenience and necessity" to the companies under their supervision: a new form of corporate oversight. But often these commissions were "captured" by the utilities they regulated.

None of these problems reduced the ubiquity of the corporate form of business organization. Big business was only the tip of the American corporate iceberg. The vast majority of corporations were small enterprises, remote from the regulatory world of antitrust or utilities regula-

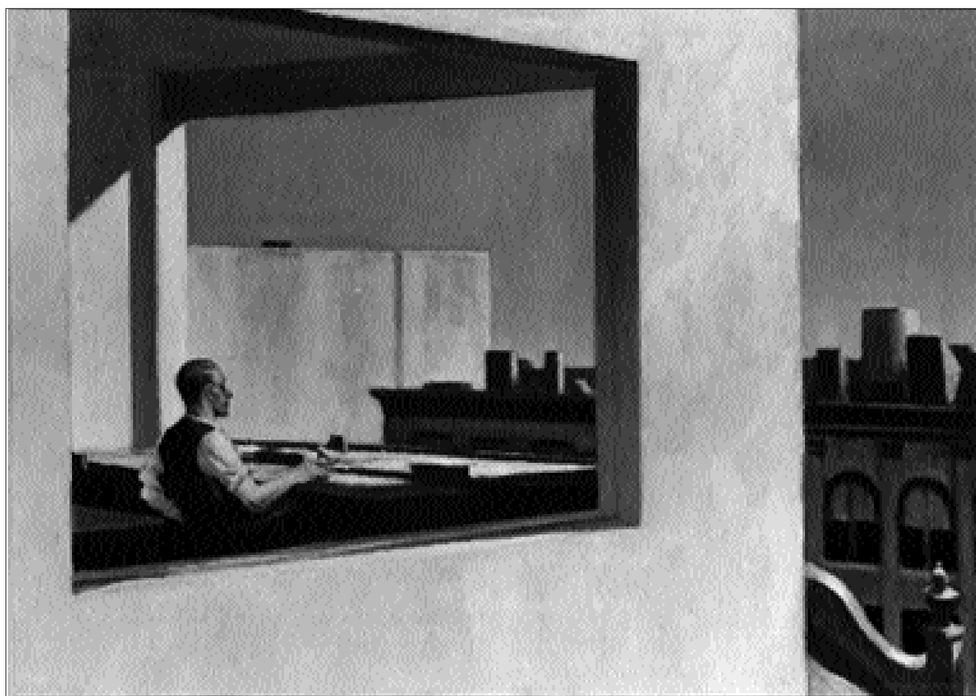
tion. Easy access to the corporate form was now a century old, and taken for granted. There were more than 340,000 corporations in 1916 and 516,000 in 1931, when they controlled some 30 percent of the nation's wealth and accounted for four-fifths of business income. No one worried that hundreds of thousands of farmers, shopkeepers, and small manufacturers availed themselves of the liability and, increasingly in the 20th century, the tax advantages of incorporation.

What did continue to concern courts, legislatures, and (intermittently) the public was how to restrict the corporation's potential for economic and political power while not crippling its potential for economic growth. This involved, first of all, an assault on the late-19th-century legal doctrine that a corporation was the equivalent of a person. That doctrine was the source of some of the more controversial judicial decisions of the early 20th century. It allowed corporations to claim Fourteenth Amendment immunity from much state taxation, and to beat back some attempts to regulate wages and working conditions. Companies argued with some success that the states had no right to interfere with the contracts that they as "persons" entered into with their workers.

Not until the 1930s did the Supreme Court finally come to accept that both the federal government and the states should have considerable regulatory authority over corporations. Congress then passed laws severely limiting the ability of employers to secure court injunctions against strikers and guaranteeing collective bargaining. Corporate taxation increased significantly during the New Deal and World War II. Big business came once again, as in the Progressive era, to be treated as what in fact it was: not a collection of legal "persons" more or less free to do what they would, but a potent American institution.

The decades since the 1930s have not fundamentally altered the place of the corporation in American life. Antitrust now, as throughout the 20th century, ebbs and flows with the forces of politics and the economy. Comparing the breakup of Standard Oil in 1911 and of AT&T a decade ago gives one an overpowering sense of *déjà vu*. The anticorporate strictures of Ralph Nader and other latter-day critics stand in a tradition that has its roots in the early 19th century. True, there is far more regulation of corporations today, including rules on environmental and occupational safety and health. And modern liability law makes companies much more subject to consumer and bystander damage suits than in the past. Yet big business today has as secure a place in American society as at any time during the past century.

One feature of large corporations has been a continuing source of trouble: the separation of ownership and control. Until the 20th century, ownership rested in relatively few hands—though rarely in the hands of only one proprietor, such as Henry Ford—and owners were able for the most part to exercise effective control. But as companies grew bigger, and stockholders more numerous (4.4 million in 1900, an estimated 18 million in 1928), the separation of control from ownership loomed ever larger. In 1927 and 1929 leading New York corporation lawyers revised Delaware's statutes, already hospitable enough to make that state the home of 70,000 firms, further



The move from farm and factory to white-collar work in corporate offices brought a major cultural shift, suggested by Edward Hopper's midcentury painting.

strengthening the hand of management against stockholders.

The Modern Corporation and Private Property (1932), by lawyer (and later New Deal brain truster) Adolf Berle and economist Gardiner Means, addressed the ownership-control problem in much the same way as, a generation before, Louis D. Brandeis's *Other People's Money* (1914) focused on corporate consolidation and size. Could stockholder-owners who were not actually responsible for the operation of a firm justly claim all of its profits? And given the impossibility of oversight by masses of stockholders, how could non-owner managers be counted on to maximize profits and secure the health of the company, rather than seek perquisites and power for themselves?

Berle and Means's larger point was that corporations were social as well as economic institutions and thus subject to public accountability. It took the Great Depression and the New Deal to bring about significant reform, though nowhere near as comprehensive as many corporate critics wanted. The Securities Act of 1933 and the Securities Exchange Act of 1934 imposed strict new rules on stock issues and securities trading, and required full disclosure of executive compensation. State securities laws were also tightened.

But the gap between stockholders and management persisted. Stockholders continued to be regarded more as investors than as owners—and, indeed, it is hard to see how any other assumption could work. "Faith in publicity," the sovereign Progressive remedy (along with antitrust) for corporate ills, has remained the guiding spirit of corporation law reform. In times of corporate profitability (that is, pretty much since the Great Depression), criticism of the management-stockholder

relationship—like criticism of corporate size—tends to be muted. Even today's excessive stock options, golden parachutes, and other arrangements that avaricious managers secure with the help of complaisant directors elicit more indignation than action. Of course, an economic catastrophe could very well change that.

Two very different impressions emerge from the long history of the corporation in the United States. One is that the corporate form has been extraordinarily useful as a way of giving legal (and public) standing to economic or social ventures. Whether in regard to a covenanted New England town in the 17th century, a colonial college in the 18th century, a bank or a railroad company in the 19th century, or the biggest of big businesses in the 20th century, some form of incorporation has been a sine qua non. It guarantees public standing or limited liability, helps attract capital, or gives managers relatively free scope to operate.

No less striking is the halting and uncertain, slow and limited record of the state and of public opinion when it comes to subjecting corporations to significant government control. The usual explanation is that big business wields enormous political power. No one would deny the existence of that power, but it seems an insufficient explanation. Corporations seldom form a united political front, and big business is often vulnerable to adverse public opinion. The antitrust movement of the early 20th century, the New Deal, and the continuing strain of populist hostility to big business are all evidence of that. In American politics, an aroused public that knows what it wants usually can get its way.

It is revealing that the area in which modern corporations have been most vulnerable to public control is liability law. Customers or bystanders who suffer harm from a company's products, even if the harm was impossible to anticipate, now routinely win multimillion-dollar judgments against corporate giants. It is no accident that this is an area, like antitrust, that is the particular responsibility of the courts. Corporations to a considerable degree are legal creatures, and it is the law, more than politics or government, that seems best able to trace the bounds between their private rights and public responsibilities.

Much of the corporation's relative immunity from broad political assault exists because it has been able to lay claim to the status—and the legitimacy—that comes from being an old, massive, generally successful American institution. The corporate device is used by middling farmers and entrepreneurs as well as gargantuan businesses. And despite highly publicized episodes of downsizing, many big companies still command the loyalty of their managers and workers. Corporations, as has so often been observed, are social as well as economic institutions, and the attractive power of the corporate culture should not be underestimated. Most of all, corporations, especially large ones, have been able to deliver the economic goods. For all their very evident faults and inadequacies, as long as they continue to do that, their place in American society seems assured.

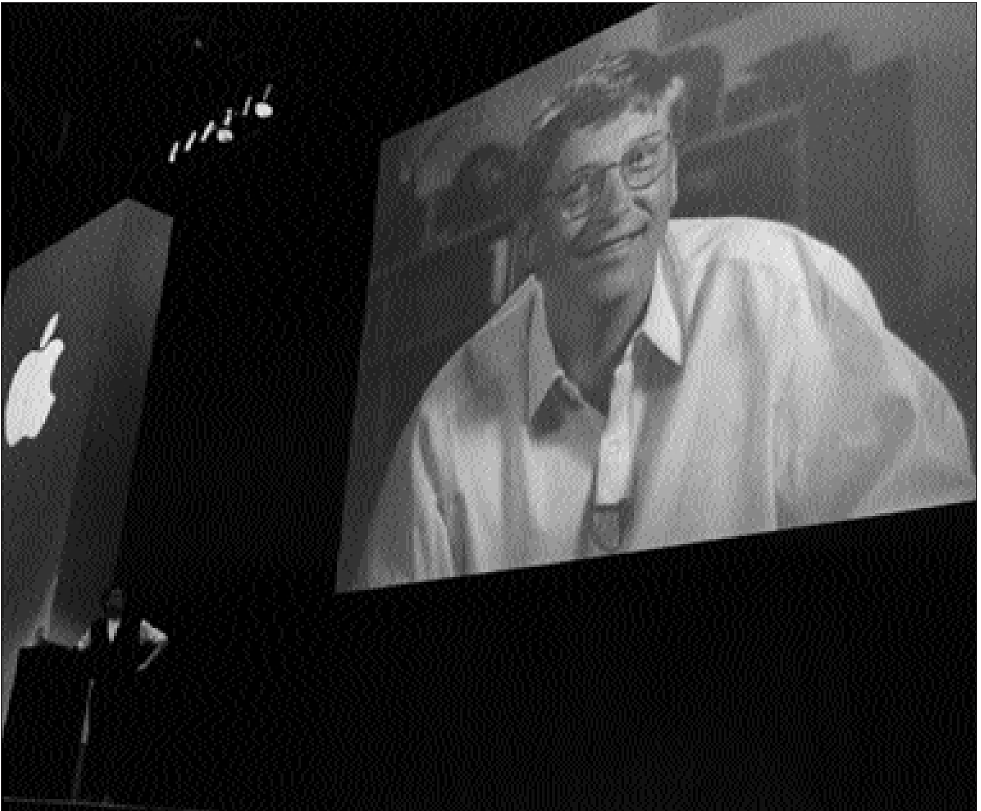
From Beast To Beauty

by J. Bradford De Long

Early in 1996, Secretary of Labor Robert Reich was full of frustration, an activist in an administration recently convinced that the age of bold new government initiatives was over. The growing cost of Social Security and Medicaid, combined with the need to service a bloated national debt, ensured that there would be no money available for the ambitious programs Reich favored in worker training and other fields. In his memoir, *Locked in the Cabinet* (1997), he says he concluded that if the government had to do less, then private corporations should have to do more. "Corporate social responsibility," an idea that had been kicking around for decades, would be harnessed to policy. Corporations, Reich believed, ought to be given incentives—and obligations—to invest in their employees' skills, to share fat profits with their workers, to invest in their communities, and to hire and train poor people. "Why not reduce the corporate income tax on companies that met some specified minimum responsibility to their employees and communities, while raising it on those that didn't?" Reich asked himself.

As Reich tells the story, President Bill Clinton's influential secretary of the treasury, Robert Rubin, hated the idea. So did others inside and outside the Clinton administration. Reich's plan to enforce corporate social responsibility was branded "inflammatory" or worse. Reich was quickly squelched: his exclusion from the inner economic policymaking loop was whispered around Washington, he says. His themes were not picked up in presidential speeches. And White House aides quietly told their reporter contacts that Reich had "gone off the reservation," and would soon be muzzled.

Reich's opponents had strong arguments on their side. When the Clinton administration took office, investment in the U.S. economy—both private investment by corporations and public investment by the government—was anemic. Low investment means low productivity growth, higher unemployment, and stagnant real income and wage levels. Congress had already rejected Clinton's proposal to increase public investment in infrastructure and technology. So the administration had taken a different tack, betting that deficit reduc-



What a difference a few decades make: corporate leaders like Microsoft's Bill Gates (on screen) and Apple's Steven Jobs have become national heroes.

tion would induce the Federal Reserve and financial markets to lower interest rates, triggering a surge of private investment.

In fact this economic strategy did, through some skill and considerable luck, generate a strong recovery. Net private investment was a relatively paltry $160 billion in the year before Clinton took office—an amount that would boost the gross domestic product by only $200 per worker per year. Today net private investment approaches $400 billion (in 1992 dollars), generating two-and-a-half times as much growth. But "business confidence" is fickle. Whatever the particular virtues or vices of Reich's scheme, talk of sweeping new mandates on corporations could well have provoked a disastrous collapse in private investment, doing vastly more harm than any good the measures might have accomplished.

Nevertheless, it is striking that Reich's ideas attracted so little support. Nearly everyone in the first Democratic administration since Jimmy Carter's lined up on Robert Rubin's side. In fact, Reich's call for an emphasis on corporate social responsibility, and especially his demand for an end to "corporate welfare," seemed to have more resonance inside the Republican Party, with people such as commentator and onetime presidential hopeful Pat Buchanan, who had roundly denounced "big corporations in New

York," and Representative John Kasich (R.-Ohio), chairman of the House Budget Committee and an ardent foe of various federal subsidies for business.

By the spring of 1996, as Reich's failure illustrated, the governing center of the Democratic Party had committed itself to the position that America's corporations were fragile entities that needed to be supported and nurtured, not controlled. They were too fragile to bear the burden of being required to provide additional benefits to employees. This marked a sea change in American politics.

At least since the turn of the century, the center of the Democratic Party had emphasized the need to control the growth and power of the modern corporation. In the 1910s, Woodrow Wilson and Louis Brandeis roundly denounced monopolists and financiers. At times Franklin D. Roosevelt sounded similar notes, as in his famous inaugural address of 1933, in which he denounced "the money changers" who had "fled from their high seats in the temple of our civilization." In the immediate aftermath of World War II, the Keynesian wing of the economics profession argued that corporate monopoly had become the major source of unemployment and needed to be fought with greater government spending to boost demand and more aggressive antitrust policies. In the 1970s, Jimmy Carter came close to declaring U.S. oil companies public enemies when they swelled with profits created by the Organization of Petroleum Exporting Countries (OPEC) oil embargo of 1973. And even Bill Clinton, before sliding into his 1992 "campaign mode," had lambasted corporations that brutally "downsized" lower-level employees while letting the rare displaced executive drift gently to earth in a golden parachute.

What happened? Why do today's New Democrats and other reformers sound so much like Eisenhower Republicans? Robert Reich's dilemma in 1996 suggests one answer. A government without the ability to bankroll large new initiatives is a weak government. President Clinton put it bluntly in his 1996 State of the Union speech: "The era of big government is over." A strong interventionist state, such as the one that shaped the post-World War II "mixed economy," has a sure sense of the economic rights of its citizens and of the benefits and investments in people that it wishes to provide. It does not beg corporations for charity, exhort them to take care of the communities and suppliers that depend on them, or provide marginal incentives for the private provision of social welfare. The fact that Robert Reich was forced to resort to such strategies, not to mention that they fell completely flat, is a reminder that the American interventionist state has passed the peak of its strength. The federal government's spending may increase in the future—the rising cost of Social Security and Medicare practically guarantees that—but it is highly unlikely that it will undertake any important new missions,

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even if, like Reich's scheme, they require only modest sums of money. A weak government has to be tentative in everything it does.

An even more important constraint on reformers is the new (and somewhat belated) recognition that the American corporation and, by extension, the entire U.S. economy are not as invulnerable as they once seemed. During the 1960s American corporations bestrode the world, challenging their rivals in Europe to modernize or disappear. They could still scoff at Asia as a continent of gimcrack industries.

This easy economic success had cultural consequences. Socialists such as Michael Harrington, in *Toward a Democratic Left* (1968), could see a steady reduction in the number of college students seeking corporate careers as a hopeful sign. It never crossed his mind that the profitability of America's corporations and the liberal spending initiatives he sought to promote were Siamese twins: continued political support for liberal initiatives would last only so long as corporate America continued to deliver rising living standards. Nor did the cultural critics who excoriated the corporation as a deadening, conformity-inducing weight on society appreciate how much they owed to affluence, which helped create the receptive audiences that greeted their indictments. During the 1960s and '70s, widespread disdain for all things corporate encouraged politicians not to worry much about the health of American business.

In any event, the idyll did not last. For reasons that nobody fully understands, corporate productivity growth slowed dramatically after the 1973 OPEC oil embargo, and American living standards began to stagnate. According to official statistics (and there is a controversy here: official statistics may understate economic growth by about one percent per year), the median wage of male workers grew by 2.3 percent annually in the two decades before 1973, and by only 0.2 percent per year in the two decades after 1973.

That unpleasant development was accompanied by a number of shocks that slowly changed Americans' attitudes toward the corporation. Beginning in the 1970s, they were continually reminded that corporations that once seemed as solid and eternal as mountains could in fact go bankrupt. In the late 1970s, Chrysler, one of the Big Three and a pillar of the U.S. economy, did go bankrupt in all but the legal sense: no one would loan the corporation the money to pay the interest on its existing debt. Only a government bailout saved the company. In the early 1980s, General Motors as we know it survived only because the Reagan administration wandered far enough from its free-trade ideological roots to negotiate stringent "voluntary" restrictions on imports of Japanese cars. Since then, the list of big name-brand American corporations that have foundered or drifted to the edge of bankruptcy (and sometimes beyond) has lengthened, including even IBM, the very embodiment of the solid paternalistic corporation of yore, and, more recently, Kmart, AT&T, and Apple Computer.

Globalization contributed to the new awareness of corporate fragility. Global markets are neither as far advanced nor as destructive as

many politicians and pundits seem to believe—the dollars that American consumers send overseas eventually return to the United States, either to purchase U.S. goods or to finance construction or some other investment. But the fear of globalization probably has deeper roots, in the nation's shocked post-1973 recognition that its days as the world's unchallengeable number-one economic power were over.

The 1980s also reminded Americans of another threat to corporate stability: Wall Street. In their classic book *The Modern Corporation and Private Property* (1932), Adolf Berle and Gardiner Means planted the seed of the image of corporation managers as arrogant crews of self-perpetuating oligarchs with no regard for the preferences of the formal "owners" of the corporation, the shareholders: shareholder insurrections at corporation annual meetings almost inevitably failed. By the mid-1980s, executives faced a new challenge to their power. The market in high-yield "junk" bonds created by financier Michael Milken suddenly gave people who had previously been shut out of the capital market because of the riskiness of their enterprises the ability to raise large sums of money. Some of these people used the money to "grow" existing businesses. But the high-yield market also spawned a new breed of Wall Street shark capable of buying up, taking over, and often dismantling corporations that were badly managed. Profitable lines of production were sold off to competitors, while others were closed or slimmed down.

The takeovers were sometimes little more than financial jujitsu by sharp operators, and they were almost always painful. Economists Andrei Shleifer and Lawrence Summers argued that the takeovers were motivated in large part by a desire to break promises both explicit and implicit that corporations had made to workers, customers, suppliers, and other "stakeholders" in the corporation's ongoing businesses. Yet as economists Steven Kaplan and Jeremy Stein showed in a major study in *Quarterly Journal of Economics* (May 1993), at least the first half-decade of the merger and acquisition boom (1981–86) probably was a needed corrective to corporations grown lazy and unresponsive to markets and stockholders. Subsequent mergers and acquisitions, they concluded, appeared to have less of an efficiency-increasing economic rationale.

Somewhat paradoxically, the growth of what economists call "the market for corporate control" through mergers and acquisitions made the paychecks of top managers much bigger even as it reduced their job security. Their jobs were increasingly at risk because Wall Street applied new pressure for rapid improvements in corporate bottom-line results. Their pay ballooned in part because no one is in a better position to aid or thwart a corporate takeover—or lead an effort to take the corporation private—than a firm's top managers. Takeover suitors and antitakeover boards alike are willing to pay dearly to secure these executives' loyalty.

A Corporate Balance Sheet

(All numbers for 1996 unless otherwise noted)

Number of U.S. corporations (1994): 3.1 million
Percentage of workforce employed (1994) by corporations: 62
Percentage of workforce employed by Fortune 500 corporations in 1996: 15
in 1980: 20
Number of employees of Fortune 500 corporations: 20.4 million
Total revenues of Fortune 500 corporations: $5 trillion
Gross domestic product (1995) of Italy: $1.1 trillion
New corporations formed: 790,569
Business failures: 71,811
Average total compensation of 500 top corporate CEOs: $5.8 million
Percentage increase, 1995–96: 54
U.S. median family income (1995): $34,076
Percentage increase, 1994–95: 2.7
Number of employed workers lacking health insurance: 23 million
Percentage of those employed by firms with fewer than 100 employees: 49
Percentage of Americans aged 45–54 in same job for 10 or more years: 47
Percentage of Americans "somewhat" or "completely" satisfied with their job: 86
Percentage of Americans who think workers have not received a fair share of economic recovery's benefits: 65
Profits of U.S. corporations in 1996: $736 billion
in 1991: $411 billion
Federal income taxes paid by corporations: $171 billion
by individuals: $656 billion
Estimated annual federal subsidies for corporations: $28–65 billion
Estimated annual cost to corporations of federal regulations: $667 billion
Total corporate PAC contributions in 1995–96 federal cycle: $78.2 million
Contributions by all other PACs: $139.6 million
Philanthropic contributions by corporations: $7.4 billion
Number of shareholder resolutions on corporate governance and social policy voted on by shareholders: 399
Number approved: 0
Percentage of outside directors on Fortune 500 boards of directors in 1997: 82
in 1979: 69
Amount corporations spend (1994) on management consultants: $15 billion
Amount Americans spend on self-help books: $462 million

Sources: 1,2 U.S. Department of Commerce; 3,4,5,6 Time-Warner, Inc., Fortune 500 Group; 7 *World Development Report, 1997*; 8 U.S. Department of Commerce; 9 Dun & Bradstreet Corp.; 10,11 "Executive Pay Report," *Business Week* (April 21, 1997); 12, 13 U.S. Census Bureau; 14, 15 Employee Benefit Research Institute; 16 U.S. Bureau of Labor Statistics; 17, 18 CNN/*USA Today*/Gallup poll, Aug. 22–25, 1997; 19, 20 U.S. Department of Commerce; 21,22 U.S. Internal Revenue Service; 23 U.S. Congressional Budget Office, Cato Institute; 24 Center for the Study of American Business; 25, 26 U.S. Federal Election Commission; 27 *Giving USA 1996*; 28, 29 Investor Responsibility Research Center; 30, 31 Korn Ferry International; 32 *The Witch Doctors: Making Sense of the Management Gurus* (1996), by John Micklethwait and Adrian Woolridge; 33 industry estimate

Anticorporate sentiment grew during the 1960s. In 1969, picketers at Dow Chemical's annual meeting protested the corporation's production of napalm.

All of these forces—bankruptcy, globalization, Wall Street—served as constant reminders during the 1980s and afterward that the market system has real teeth. The modern corporation, once seen chiefly as a great, lumbering beast, was now exposed as highly vulnerable to internal disorders, eager competitors, and hungry predators.

We can see this shift in mental attitude toward the American corporation by looking at the transformed image of General Motors on the American left. In the 1960s, General Motors was seen as bad: it exploited workers and consumers, collected obscenely large profits, made cars that were "unsafe at any speed," and even hired private detectives to snoop into the private life of a lone critic, Ralph Nader. By the end of the 1980s the leading critic of General Motors was no longer Ralph Nader but Michael Moore, the director of the film *Roger and Me*. General Motors is still bad: its principal crime, however, is not that it makes billions of dollars a year in profits but that it *loses* billions, and so shuts down all its plants in Flint, Michigan, throwing thousands of employees out of work.

Even in its somewhat diminished state today, General Motors remains the largest industrial corporation in the United States, with 700,000 employees, sales of some $169 billion annually, and profits

in a relatively good year (such as this one) of more than $7 billion. Does this seem a fragile creature? Critics of Nader's era would have scoffed. "GM can take care of itself," they would have said. Critiques such as Moore's raise another kind of issue entirely: shouldn't the government make sure that corporations do not suffer ruinous losses?

This brings us to another change, in addition to the decline of government and the end of the myth of corporate omnipotence, that the 1980s wrought. At the beginning of the decade, utopia for many people on America's political left was located somewhere near Sweden. But when Sweden suffered the same enervating combination of inflation, unemployment, and sluggish economic growth as the rest of Europe during the 1970s and '80s, the location of utopia shifted to the Pacific.

The swift rise in the prestige of the Japanese model cannot be understood without recognizing that it occurred while the governments of Ronald Reagan and Margaret Thatcher were both claiming that the cause of the economic malaise in their countries was meddling big government. Only a return to a form of capitalism red in tooth and claw would deliver faster economic growth. Searching for a rebuttal, some social thinkers looked to East Asia, where Japan and other countries had achieved phenomenal growth rates. In those nations, government and business worked very closely together. Americans described the Japanese "partnership" of business and government simply as "Japan, Inc." Dozens of books—including *Minding America's Business* (1982), by Reich and Ira Magaziner, Chalmers Johnson's *MITI and the Japanese Miracle* (1982), Ronald Dore's (excellent) *Flexible Rigidities* (1986), and James Fallows's *Looking at the Sun* (1994)—argued that the East Asian economic model showed that the Reagan-Thatcher embrace of laissez faire was misguided: the fastest growth occurred where governments did play a powerful role in the economy.

Hence the temptation to say that the old adversarial relationship between government and corporations in the United States was harmful, that the two needed to work more closely together. The economy would grow faster, it was argued, if government adopted industrial policies similar to Japan's. That particular prescription, with its threat of a suffocating government embrace, horrified much of the corporate world, but if one had to sum up the intent of Japanese industrial policy in a phrase, it would be "Have the government do nice things for large industrial corporations."

In a peculiar reversal, then, an intellectual quest that began as a left-wing critique of Reagan's "miracle of the marketplace" culminated in a reformist romance with the corporation. The Left's new notions, combined with the public's growing awareness of the fragility of even the largest enterprises, have helped to make the corporation in the public imagination less a beast and more a beauty than at any other time in recent history.

That is not to say that the corporation has somehow been completely unfettered and freed of criticism. Regulations still pour out in *The Federal Register*. The old-style "economic" regulation by agencies such as the Interstate Commerce Commission and the Civil Aeronautics Board has been greatly reduced. But health, safety, and environmental regulations by agencies such as the Food and Drug Administration and the Environmental Protection Agency continue to increase, and continue to have overwhelming political support.

Legislators still impose new obligations on corporations. The 1990 Americans with Disabilities Act, for example, required employers to provide, sometimes at considerable expense, "reasonable accommodation" to employees with disabilities. And Bill Clinton's first legislative initiative was the Family and Medical Leave Act of 1993, which requires corporations to give employees time off to care for sick relatives.

Moreover, while Robert Reich's ambitious scheme to shape corporate behavior came to naught, more narrowly targeted efforts at control have made more of an impact. In product liability lawsuits, American juries severely punish corporations when there is any hint that they cut corners on product safety, whether it is Ford's failure to spend more money to keep the Pinto's gasoline tank from exploding or McDonalds' routinely keeping its coffee at flesh-scalding temperatures. Large jury awards in product liability cases may not do much to alter the distribution of wealth (and many awards, such as the one in the McDonald's case, are reduced or thrown out on appeal after the initial headline-grabbing judgment), but they loom large in the consciousness of insurance companies and corporation managers. Overall, U.S. corporations spend about $1.4 billion every year defending themselves against product liability lawsuits, and far larger sums in judgments and settlements.

The "shareholder rights" movement, meanwhile, has been attempting to make corporations openly confront issues such as environmental protection, worker safety standards, and executive pay, albeit with little success. The corporate world itself has pursued some modest reforms. There has been an effort to put more outside representatives on corporate boards of directors, and many large investors are taking a more active role in the oversight of corporate management.

It may be a measure of Americans' overall willingness to leave corporations to their own devices that the issue that most agitates the public appears to be executive pay. By the end of the 1980s, the average chief executive officer of a large American company received 20 times the salary of the average manufacturing worker—more than twice the relative pay of top managers in Canada, France, or Germany. The widening gap between the pay of CEOs and others is important, but mostly as a symbol: highly paid CEOs are only a tiny fraction of the population, and so drastic reductions in CEO compensation would have little impact on income inequality

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The revolt of the cubicles: the grim humor of the enormously popular Dilbert cartoon strip captures the mood of resentment in the era of downsizing.

in the United States. And indeed, the public's concern is selective. It is outraged when CEOs are paid millions even as they preside over the "downsizing" of thousands of employees. But the heads of growing, entrepreneurial companies—such as Netscape and Microsoft—are immune from such criticism: they are culture heros.

Public opinion prompted Congress to act in 1993, barring corporations from deducting salaries of more than $1 million from corporate income taxes. It was a symbolic gesture. Assessing the measure recently in the *New York Times*, Yale University law professor Michael Graetz concluded that it "was really designed to not have any real effect and . . . just as intended, it had no effect."

What distinguishes all of these attacks against and proposed limitations on the power and role of the American corporation is that they are narrowly focused. While Ralph Nader and the *Nation* can still be relied upon to deliver the old-time anticorporate religion, we lack a critique of the role of the contemporary corporation with anything like the comprehensive reach of the Progressive-New Deal tradition.

One effort in recent times is the argument exemplified by William Hutton's *The State We're In* (1996). Hutton, editor of Britain's *Observer*, calls for a corporation governed in the interest not of shareholders alone but of all "stakeholders." The "stakeholder society" has become a prominent part of the political language of British prime minister Tony Blair's New Labor Party (though it is not yet clear what difference it will make for policies).

In its essence, the idea is a very old one, a concept at the heart of the New Deal. Corporations have certain responsibilities to the communities in which they operate. Employees have an obvious stake in the corporation. Suppliers who have invested in capacity, or customers who have assumed that a corporation would continue to supply them with a valued component, all have something to gain by the success and good-faith behavior of corporations, and all have something to lose by corporate failure or the breaking of implicit contracts and commitments.

Conservatives argue that market competition will ensure the protection of stakeholders' interests. Corporations that do not treat their workers (or suppliers, or customers) fairly, in this view, will soon find that these stakeholders have voted with their feet for some other cor-

poration. To impose more formal obligations on shareholders, moreover, would be to reduce the corporation's ability to compete and, in the long run, to hurt the stakeholders as well. Reformers have had less confidence in the market's power to safeguard stakeholder interests. New Dealers, for example, created the National Labor Relations Board and imposed on corporations the vaguely stated but powerful legal mandate that they "bargain in good faith" with recognized unions. Abroad, New Dealers experimented further: the post–World War II "co-determination" system that gave West German union representatives full seats on the country's corporate boards of directors was strongly encouraged by the American Occupation.

Conservatives complain that such attempts to give nonowner stakeholders formal voices in corporate affairs are illicit: they confiscate and redistribute the private property of shareholders. Yet the government gives shareholders the extremely important privilege of limited liability—they gain the profits of the corporation if it does well, but are not liable for the losses if it goes bankrupt. Shouldn't some shareholder obligation or responsibility be required in return?

The only reasonable answer must be "perhaps": we don't know enough to strike the right balance between the voice of shareholders interested in efficiency, innovation, and profits, and the voices of other stakeholders. During the 1980s, shareholders made two major gains in different fields at the expense of stakeholders: the private-sector union movement virtually collapsed, and the growing "market for corporate control" amplified shareholder power. If—as advocates of laissez faire believe—the economy suffers large losses in efficiency from corporations' taking nonshareholder stakeholder interests into account, then the reduction in nonshareholder stakeholder voice in the 1980s should have been accompanied by a burst of rapid economic growth. But economic statistics show no sign that these reductions led to a more efficient and more productive economy. And the rapid increases in income inequality in the 1980s suggest that they may have had substantial social costs.

The case is not conclusive. Aggregates mask important details. Many other factors affected the pace of economic growth in the 1980s, complicating assessments of the impact of changes in corporate governance. There is reason to think that the assertion of stakeholder rights can be economically disastrous. For example, no one disputes that the economic performance of the British industries nationalized in the late 1940s (and then denationalized under Margaret Thatcher in the 1980s) was abysmal.

The stakeholder point of view provides a language in which to talk about corporate governance, not a comprehensive program or set of settled conclusions. This is just as well. A Clinton administration that arrived in office aiming to pile on new mandates, attack global oligopoly, and launch a campaign of rhetorical warfare against the man-

agerial class would not have presided over an economic expansion like the one of the past few years. There is a sense in which the policies pursued since 1993 by the administration are the very skillful playing-out of a weak deal.

Yet the near-universal obeisance paid today to the importance of a "good business climate" is not necessarily healthy. A polity has its own ecology. Intellectual and ideological variation is the source of adaptability. And adaptation is necessary when conditions change, as they always do.

Perhaps change will arrive in the form of crisis. Perhaps it will come in the form of economic success: as large government budget deficits shrink and real interest rates fall, economic growth may well accelerate. More certain prosperity could shift the focus of political concern away from making the economy grow faster to figuring out how to better distribute the economic pie. Some obvious problems present themselves. We know that America's corporations give their workers less training than corporations in other industrial countries. The gap between managerial and worker pay is far wider in the United States than elsewhere—and far wider than it used to be here. We know that U.S. corporations are not shouldering as large a share of the nation's social-insurance missions—such as employer-sponsored health insurance and defined-benefit pension plans—as they once did. When Richard Nixon was president, seven out of 10 Americans received health insurance through their employer. By 2000, that proportion will likely fall to five out of 10.

In the 1930s, the United States was able to respond quickly to the Great Depression in large part because the Progressive critique of the economic order had developed as part of the nation's political ecology since the Gilded Age. The ideas had been discussed, refined, and even experimented with at the state level for decades. So at least some of the flaws in such policies had been worked out.

The fact that our national political ecology now lacks such a living, breathing body of ideas should be a matter of concern to all friends of democratic capitalism.