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A Radical Idea As Old As Lincoln

By W. Hiram Coe
HE 1,342 has come, perhaps to ask the question modern liberalism has always ducked. What is the wealth of the nation? Why is it not distributed more equitably? Why must capital and its attendant political power be concentrated in the hands of the few while the masses have only a mortgage and, if they are lucky, a student pension?

The question themselves sound vaguely Marxist, which is one reason why welfare state liberals have always ducked. Liberalism is defined and disciplined by its right-wing adversaries, whose red-baiting effectively scares off or silences, even new questions. I could make an argument that the long march of liberal solutions to social injustice — tinkering with wage floors, morning cash from one group to another, juggling up the law and the weak, governing the rich and the jobless from establishments — all these are erasions of the more fundamental questions about wealth and its gross maldistribution.

If liberal government could not do anything about the distribution of wealth, then it must concentrate on wages and particular benefits, property. But the welfare state device and deeper into private economic channels. Essentially, the federal government hands out coupons, little tickets that entitle qualified citizens to buy food at a supermarket, to occupy an apartment in a subsidized building, to buy medicine at the ghetto pharmacy, to pick up a little cash on the first of the month, to bill the Treasury for catastrophic illness.

No one who has talked to the recipients of these benefits or examined their actual conditions can find very satisfied with the results. Real pain and suffering, even hunger, truly are alleviated, but these people, still poor, have become prisoners of the government coupons.

The liberal imagination, knowing that real improvements in ordinary lives have flowed from the security programs, will tinker on renewed dedication to the concept. If desperate people, if some people still live in deplorable conditions while the rest of us live in royal luxury, then we must tinker with the coupons, increase their cash value. Or invent new coupons for other items that these people cannot afford. Can't All conditions be treated equally?

Obviously speaking, this is the road American politics traveled to its present frustration. The liberal mind set, honorable and well intentioned, cannot confront the natural limits that always will stand in its way. One cr-



cial boundary in the politics of redistributing cash in the private wage system. Nobody really believes Washington should give a nonwage coupon that are more generous than the wages earned by his neighbor, the worker.

The other limitation is how obvious but more basic. As the welfare state created safety nets for the poor and the weak, other, stronger groups in society invented their own versions of coupons, serving their own needs, and sold them to the government. Price support systems for farmers, tax breaks and housing subsidies for the middle class, guaranteed markets for industrial sectors, guaranteed jobs for unions strong enough to demand them.

I could argue that, in the final but

the group called the Ownership Campaign which it has forced as ideological ideology on this eclectic collection of individuals, probably would be called right-of-center.

The Ownership Campaign is an assortment of businessmen, government technocrats, old labor types, young idealists and blue-collar political neophytes. All of them came from different starting points to a shared conclusion: The welfare state fails ultimately to achieve justice; the government must intervene instead to create a broad distribution of capital wealth, stock ownership in the new productivity capacity of the future.

Those inspired amateurs think this is the main point in that virtually everyone, every economic sector, saw participation in the government transfer of cash from one pocket to another. Measurably, the fundamental injustice of concentrated wealth is not altered in the slightest.

WHY OWNERS AMERICA? I am pleased to report that this question will be raised next winter when all conventional politicians are campaigning in the New Hampshire presidential primary. Not by a bunch of party bosses. Not by desperate liberals begging for party new recruits. The question will be raised by a strange lit-

ing the original lunatics of the American experience and trying to graft them onto modern corporate capitalism. At the edges, there is a barbarous yelp of protest borrowed from Ayn Rand. The heart of the idea, including the approach to banking and credit, is as old as Jefferson and Jackson, more radical than any reform entertained by the New Deal.

To grasp the full historical flavor, forget about all of the modern subsidy programs created in the last 40 years. Think just 10 of the really radical coupons handed out by government in the 18th century — Lincoln's Homestead Act. Through the national government, vast wealth was distributed free to ordinary Americans, including new immigrants, regardless of birth or education or economic status. The wealth was land and it was given freely, with one crucial condition: The people had to make it productive.

The ownership guerrillas believe stock in new industrial capacity can be distributed similarly, writing interest rates for ventures that represent real growth — not the paper gains of borrowing and buying. Unlike the Marxist systems of shared wealth, nothing would be taken from the rich. Not would the new factory become a state-owned industry, as in Britain or France. Anyone who has ever tried to use a telephone in France knows the limits of state socialism.

WORK WHO? Don't find single lower productivity the wilderness and disrupts

may be especially aggravated by the Ownership Campaign. It is raising money to enter not one, but two candidates in the 1980 New Hampshire primary — a Republican and a Democrat who will campaign jointly, share advertising costs and generally try to make the other conventional candidates take them seriously.

Neither major party has the intellectual vitality to take the plunge on this idea, though either could claim it as consistent with its past. The Ownership Campaign may end up looking silly, but can count itself successful if the horde of presidential candidates begins stealing their material.

Hold the smug laughter, for now. Some folks out there already understand this ownership pitch. When the farmers took their tractors to the Federal Reserve Board, demanding 3 percent interest rates, they were responding to the credit arguments of Norman Kurland, chairman of the Ownership Campaign. Kurland knows little about politics but he is one of those brilliantly obsessed figures one encounters in Washington, a person who cares more about ideas than making a living. Kurland has been pushing stock-ownership plans for more than a decade, undaunted by his limited success. He is the rarest combination — a creature who understands the banking laws yet continues to believe in the possibility of economic justice.

His political director is 25-year-old Luis Granados, a newly graduated law-

yer from Takoma Park, who knows the operations of a political campaign from serving local candidates but who lacks the jaded amorality of experienced operatives. Granados learned economics from ordinary experience:

"I grew up middle class," he said. "I got a scholarship to a fancy prep school and I saw that end. Then I saw the other end, campaigning in poor neighborhoods. I just think the distribution of wealth is wrong. There's not sufficient difference in people to justify the differences in wealth."

This observation matches my own experiences as a reporter. Over the years, I have had many encounters with people on the bottom rung of our society — white mountaineers, black youths in the cities, migrant workers, poor people urban and rural. I always come away with a chilly feeling, a fresh recognition that most poor people could perform just as well as the rest of us, if they had gotten a few lucky rolls of the dice.

Others in the Ownership Campaign are not exactly bleeding hearts. They include Tim Maloney, a young new state legislator from Prince George's County; Anthony M. Carey, partner in a high-toned Baltimore law firm; Joe Rourke, a retired Massachusetts labor leader, and Wally Johnson, a former Republican mayor of Berkeley, Calif., who runs an aluminum scaffolding company called Up Right Inc.

Johnson is the only one with experience in a presidential primary. He received 35,000 votes in New Hampshire

in 1978, running for vice president in the GOP primary on a single issue opposing congressional pay raises. This was 12,000 votes more than Jimmy Carter got in New Hampshire, but the press ignored Wally Johnson because he was not deemed to be serious.



SERIOUS political people will be hostile to this idea. They will endorse the rhetoric of broadened ownership because it sounds like Mom and apple pie, but the major power centers of American politics feel threatened by the idea of actually distributing capital ownership to everyone.

Organized labor sees it as compromising the hard and clean lines of worker-management bargaining. Corporate management distrusts it as an ultimate threat to its own control of corporate behavior. Technocrats devoted to managing the welfare state do not wish for its demise. No-growth environmentalists do want a new industrial boom for this country. Status-conscious conservatives are offended by the egalitarian premise.

Listen carefully to their objections. These people have impressive arguments on why this scheme will not work or why it should not be tried. Listen, then ask yourself what these experts would have told Lincoln about his crazy plan for homesteading.

Ownership History

...That the inhabitants of the English colonies in North America, by the immutable laws of nature, the principles of the English constitution, and the several charters or compacts, have the following RIGHTS:

Resolved ... That they are entitled to life, liberty and property: and they have never ceded to any foreign power whatever, a right to dispose of either without their consent.

-Declaration and Resolves of the
First Continental Congress-,
October 14, 1774

"The control over a man's subsistence amounts to a control over his will."

-Alexander Hamilton-

...That all Men are by Nature equally free and independent, and have certain inherent Rights, of which, when they enter into a State of Society, they cannot by an Compact, deprive or divest their Posterity; namely, the Enjoyment of Life and Liberty, and the Means of acquiring and possessing Property, and pursuing and obtaining Happiness and Safety.

-Virginia Declaration of Rights-
June 12, 1776

...We hold these truths to be self-evident; that all men are created equal; that they are endowed by their Creator, with certain inalienable rights; that among these are life, liberty, and the pursuit of happiness. That to secure these rights, governments are instituted among men, deriving their just powers from the consent of the governed;...

-Declaration of Independence-
July 4th, 1776

All men are born free and equal, and have certain natural, essential, and unalienable rights; among which may be reckoned the right of enjoying and defending their lives and liberties; that of acquiring, possessing and protecting property; in fine, that of seeking and obtaining their safety and happiness.

- Massachusetts Declaration of
Rights -
October 25, 1780

Article V. No person shall ... be deprived of life, liberty, or property, without due process of law; nor shall property be taken for public use, without just compensation.

-Bill of Rights-
December 15, 1791

Private property is a creature of society, and is subject to the calls of that society, whenever its necessities shall require it...

-Benjamin Franklin, 1783-

Law is a very good thing for men with property and a very bad thing for men without property.

-Rousseau, Social Contract-

The nations of our time cannot prevent the conditions of men from becoming equal; but it depends upon themselves whether the principle of equality is to lead them to servitude or freedom.

-de Tocqueville-

final comment in Democracy in America

Tenantry is unfavorable to freedom. It lays the foundation for separate orders in society, annihilates the love of country, and weakens the spirit of independence. The tenant has in fact no country, no hearth, no domestic altar, no household god. The freeholder, on the contrary, is the natural supporter of a free government, and it should be the policy of republics to multiply their freeholders, as it is the policy of nonarchies to multiply tenants.

-Thomas Hart Benton-

Jefferson, though the secret vote was still unknown at the time had at least a foreboding of how dangerous it might be to allow the people to share a public power without providing them at the same time with more public space than the ballot box and with more opportunity to make their voices heard in public than on election day. What he perceived to be the mortal danger to the republic was that the Constitution had given all power to the citizens, without giving them the opportunity of being citizens and of acting as citizens.

-Hannah Arendt-

in On Revolution

...if you believe in democracy...distribute property as widely as possible.

-Aldous Huxley-

...In Harlem, for instance, all of the stores are owned by white people, all of the buildings are owned by white people. The black people are just there paying rent, buying the groceries; but they don't own the stores, clothing stores, food stores, any kind of stores; don't even own the homes they live in. They are all owned by outsiders, ...

"When the thing is finally sparked, the white man is not there-he's gone. The merchant is not there, the landlord is not there, the one they consider to be the enemy isn't there. So, they knock at his property. This is what makes them knock down the store windows and set fire to things, and things of that sort.

-Malcom X-

Government has the responsibility to provide the climate in which Americans, all Americans, have an opportunity for good jobs; and not only for good jobs, but an opportunity if they have the ability and the desire, to be owners and managers, to have a piece of the action, because if they have a piece of the action, then they believe in the system rather than fighting against it.

-Richard Nixon-

Property performs the function of maintaining independence, dignity and pluralism in society by creating zones within which the majority has to yield to the owner. Whim, caprice, irrationality and 'antisocial' activities are given the protection of law; the owner may do what all or most of his neighbors decry. The Bill of Rights also serves this function, but while the Bill of Rights comes into play only at extraordinary moments of conflict or crisis, property affords day-to-day protection in the ordinary affairs of life. Indeed, in the final analysis the Bill of Rights depends upon the existence of private property.

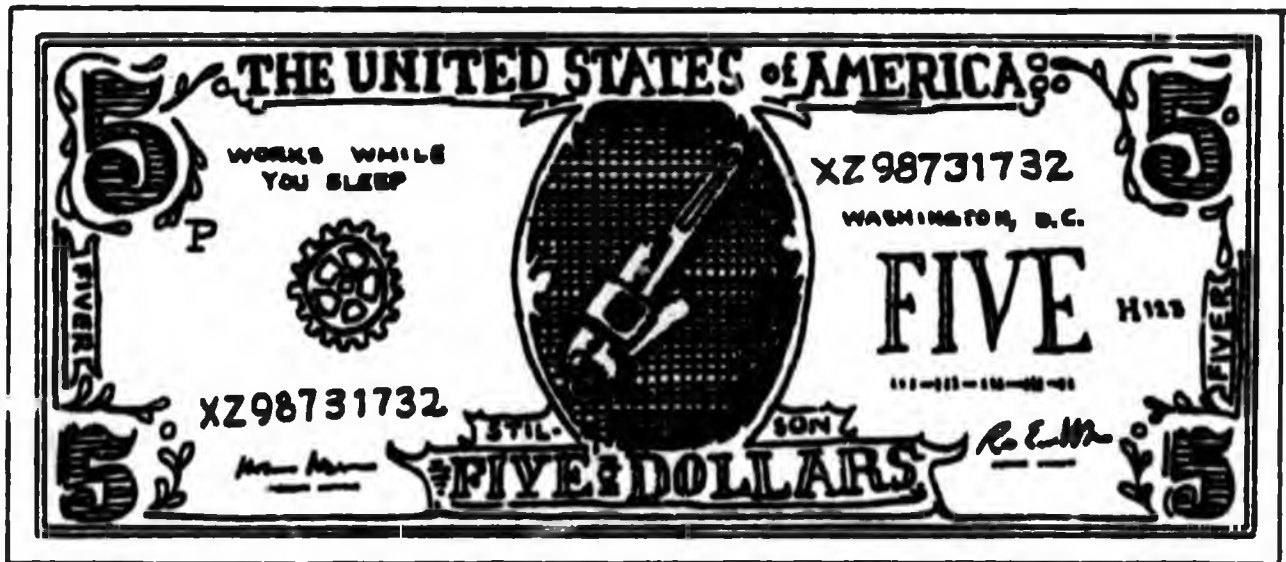
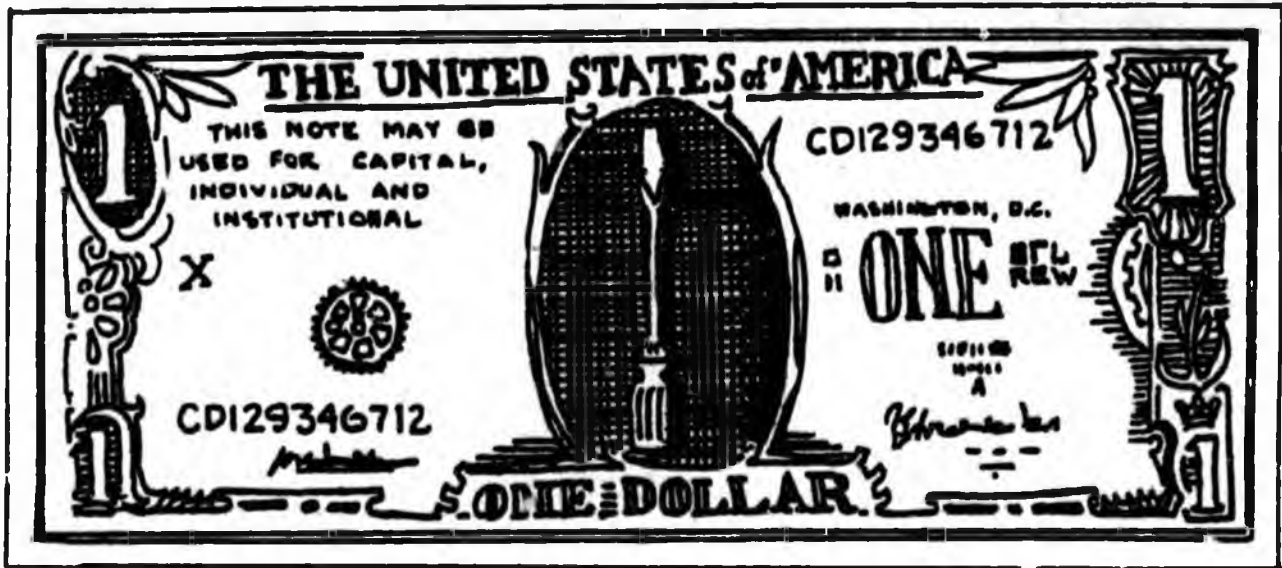
-Charles A. Reich-

Profit sharing in the form of stock distributions to workers would help to democratize the ownership of America's vast corporate wealth which is today appallingly undemocratic and unhealthy.

-Walter P. Reuther-
President, United Auto Workers

"...democracy is a method of finding proximate solutions for insoluble problems."

-Reinhold Niebuhr-



Share the Wealth

During three years in power, a socialist government succeeded in nationalizing or buying into a number of British Columbia's natural-resource companies. But in 1975, exasperated voters of Canada's third-largest province threw the socialist premier out and elected William R. Bennett, the millionaire son of a previous B.C. premier. A champion of free enterprise, Bennett, 46, has found a way to undo part of the socialists' work. Every one of the province's 2.4 million residents will be offered five shares of British Columbia Resources Investment Corp., a holding company set up by the government.

B.C. Resources owns 81 percent of Canadian Cellulose, a \$153-million forest-products firm, and 10 percent of Westcoast Transmission Co. (1977 sales: \$735 million), which operates a natural-gas pipeline. B.C. Resources also has two wholly owned forest-products companies, and valuable oil- and gas-exploration rights on some 2.3 million acres.

Under Bennett's plan, 80 percent of the stock—some 12 million shares—will be distributed to every man, woman, and child who has lived in the province in the last year and is a Canadian citizen. They will also be eligible to buy more stock—up to 5,000 shares—at a discount. Each share of B.C. Resources has a book value of \$10, and the company will be listed on the Vancouver Stock Exchange. "We live in a rich province," says the premier. "Now my government wants to give the people the opportunity to share these riches."

The Washington Post

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SUNDAY, OCTOBER 22, 1978

Alaska Inc.: An Economic Experiment

Senator's Plan Would Distribute State's New Wealth to Citizens

By William Greider

Washington Post Staff Writer

Alaska, a state where pioneering is still a daily reality, wants to launch a grand experiment in economic democracy—distributing new wealth to all its citizens, giving each an owner's share in Alaska's bountiful energy development.

If the scheme works, every Alaskan—men, women, children—will hold stock shares in huge capital investments such as the Trans-Alaskan oil pipeline or the proposed natural gas pipeline or a future petrochemical complex. Every year, citizens would each receive dividend checks of several hundred dollars or more and, every year, their share of equity interest would grow.

In addition to spreading cash among the citizens, the idea might produce political benefits for the oil companies. If people have a personal stake in the profits, the public may be more sympathetic when private enterprise complains about government regulation and taxation.

Is the capitalist revolution upon us?

The "general stock ownership plan" (GSOP) is the brainchild of Sen. Mike Gravel (D-Alaska), who derived the idea from the economic philosophy of Louis Kelso, a prophet of broadened capital ownership for workers. Last week, without any fanfare, the federal tax-law changes necessary for the venture were enacted by Congress in its omnibus tax bill, now awaiting the president's signature.

"This idea has floated around for years and nobody has taken it seriously," Gravel said. "But wait until the day when the first dividend checks go out to every citizen of Alaska. When the long green touches their hands, you will see a revolution begin."

Gravel, his enthusiasm getting somewhat ahead of events, predicts the Alaskan venture will alter American politics and economics in profound ways, as other states rush to copy the model. The senator sells it as the alternative to welfare-state liberalism, as the way "to build a constituency for capitalism."

The potential political effects are almost as intriguing as the presumed economic benefits. Gravel's plan would make all citizens into minority partners with the major oil companies, a fact that could greatly alter public opinion on issues such as state taxation of energy ventures. If a citizen holds a personal stake in energy profits, albeit a small one, he or she may not like the idea of the state government increasing its taxes on those profits in order to finance public programs.

In the meantime, the state government of Alaska has not yet committed itself to do anything beyond studying the idea.

The legislature has placed Louis Kelso's San Francisco investment firm under a \$180,000 contract to draw up the blueprint for this economic creature—a state-chartered corporation owned by everyone, empowered to borrow money, perhaps with a credit guarantee from the state, and to invest the money in private business ventures. Earnings from the venture would pay off the loan and the leftover profits would be distributed every year as dividends to each of the 405,000 citizen stockholders.

For starters, Gravel thinks the GSOP corporation might buy out British Petroleum's 16 percent share in the oil pipeline. Owned jointly by eight oil companies, the pipeline is already carrying North Slope crude oil south for distribution. BP has expressed an interest in selling its investment, valued at \$1.5 billion, and the senator's staff calculates that, when the pipeline is at full capacity, BP's share of the revenue would run about \$406 million a year.

This would be enough for the GSOP corporation, according to Gravel, to cover the operating costs plus the annual debt payments and still leave about \$158 million a year for distribution in dividends.

That means about \$390 per person. Nobody will get rich on \$390, but a family of four would have four dividend checks coming every year, or \$1,560. This could make a real difference to a poor family, Gravel reasons, offsetting some of the government obligations to provide welfare and subsidized services.

Since the value of an oil pipeline depreciates as it ages, the citizen stock would presumably be worth considerably less than \$1.5 billion when the debt is finally paid off in 15 or 20 years. After five years, however, a citizen could sell his or her share for the going price.

To avoid concentrated ownership, nobody could hold more than 10 shares.

Each share of stock would have a single vote to elect the officers of the GSOP corporation, who in turn would have 16 percent worth of influence over the pipeline company itself.

Among other things, the Alaska legislature has to decide who qualifies as a "citizen." One idea is to set a cutoff date of Jan. 1 this year, so the state would not be flooded with new immigrants seeking a share of stock.

Down the road a way, Gravel envisions several layers of citizen investment on a grander scale—another stock issue to help finance the multi-billion-dollar gas pipeline expected to be built in the 1980s, another to share in a vast petrochemical complex envisioned for the Kenai Peninsula. If Gravel's wish list were to become reality over the next decade, Alaskans would be drawing modest second incomes in addition to their wages—a collection of dividend checks.

At this point, the reader of normal intelligence is probably rolling his eyes and wondering if Sen. Gravel and the Alaska legislature have gone bonkers, not to mention the U.S. Congress, which has authorized the experiment. It all sounds too good to be true. Where is the hidden catch? And who pays the bill for this redistribution of wealth?

That is approximately the reaction that Gravel encountered last March when he first proposed the scheme to the state legislature and, again, this summer when he tried it out on the Senate Finance Committee. With a little persuasion from Sen. Russell B. Long (D-La.), the committee chairman and an advocate himself of broadened ownership, the Congress decided to let Gravel try out his mini-revolution.

Long has said privately that, if Gravel's idea works, and it may or may not, it would become the most significant item in the 1978 tax legislation.

The heart of the scheme is credit, the power to borrow money. As Gravel and Kelso see the world, ordinary people, even poor people, could accumulate wealth in the same way that well-to-do people make their assets grow, if the government will intervene. A person who has sufficient assets or earnings to guarantee his or her credit can borrow money to make investments, pledging to pay back the loan with the new income expected from the investments.

If the venture is a success, the person winds up with new capital that paid for itself, but nobody calls this process a "giveaway." It's called "risk-taking" in the free enterprise system.

Gravel's notion is that government, which in effect aggregates the assets of all citizens, can provide a mechanism for extending a share of credit to everyone—a chance to buy something based on its anticipated future earnings.

That concept is the essential novelty of Gravel's scheme. Beyond that point, the proposition works more or less like ordinary business transactions, with the same tax benefits, the same risks. The citizen-owned corporation would enjoy the same tax treatment as a partnership or a certain corporation with a limited number of stockholders (known as "Subchapter S" Corporations). The GSOP would be exempt from paying corporate income tax on its own earnings, but it would have to distribute at least 90 percent of its profits every year to shareholders who would each pay individual income tax on the money. The GSOP could not, however, pass through losses, so its shareholders could not use it as a tax shelter.

The Treasury Department objected to Gravel's original version because he had tucked in additional, more exotic "tax benefits." When the tax experts studied his final proposal, however, they concluded that the U.S. Treasury would lose little or nothing.

Gravel contends the federal government will actually collect more revenue under his plan because the profits now collected by British Petroleum, for instance, are "sheltered" from taxation by various provisions of the tax code. If some of that profit goes directly to individuals, it could yield as much as \$40 million in income taxes, Gravel claims.

If the GSOP decided to buy BP's share, it would have to go to a friendly banker somewhere, presumably on Wall Street, and ask to borrow the \$1.5 billion needed. The banker would make a calculation on whether it is a good risk. If not, the banker would look as if it wouldn't "pay out" as handsomely as he or she says projections, then the GSOP would have to be turned down or be forced to pay high-risk interest rates that might kill the whole idea.

But, if the Plans Alaskan pipeline

is such a good deal, how come British Petroleum wants to get out of it? That question leads into arcane subjects where only experts tread with confidence—pipeline economics, corporate debt structure and optimum rates of return for oil companies.

British Petroleum, which has expressed no more than an informal interest in selling, has complained about its low earnings from the pipeline so far, which suffered from an explosion and shutdown last year. It is the only major partner that doesn't also own a share of the North Slope oil field. The state of Alaska, like Exxon and Arco and the others, does own production shares in the oil field.

"If you own a share of the oil field," said John Gore, BP's Washington representative, "it's economic to own a share of the pipeline. If you don't hold a share of the oil field, it doesn't look so good."

BP has one of the highest debt-equity ratios among petroleum majors and some think the company would like to extract its investment from the Alaskan pipeline so it can spend the money closer to home—drilling more oil wells in Britain's North Sea fields.

In any case, one reason the pipeline looks less attractive to the British company today is that the state government of Alaska has been fighting the oil companies over how much the pipeline can charge to move the crude oil. The state collects a severance tax on all oil pumped in Alaska, but transportation costs are deducted from the tax—so a higher pipeline fee means less tax revenue for the state government and vice versa.

This is a political hook that could have important implications for the future development of energy projects.

Right now, the oil companies are asking federal regulators for a pipeline tariff of \$635 per barrel, while state tax officials insist that a fee of \$168 is all that can be justified. For the state treasury, the difference represents about \$1 million a year in severance tax revenue. But, if Alaskan citizens owned BP's share, the higher tariff would deliver an additional \$106 million to their citizen-owned corporation.

Question: Would Alaskans prefer a lower tariff that sends more tax money to the state capital or a higher tariff that adds more money to their own dividend checks? The political message from the citizens could very well be: Get off the backs of the oil companies.

Sen. Gravel claims this possibility is one of the major benefits of his proposal. "You set in motion a conflict between the citizens and the government," he said, "and you give the citizen a handle for seeing what the government is doing."

Alaska Revenue Commissioner Sterling Gallagher, originally skeptical about Gravel's proposal because of its tax implications, is now a supporter. He agrees this political tension is likely, but he sees that as healthy. In any case, Gallagher doesn't think the GSOP would go forward with the

pipeline purchase until the tariff issue is settled conclusively by the Federal Energy Regulatory Commission.

"It's hard for people to tell what government is doing for them," Gallagher said. "If there is wealth in the state — public wealth — I think we should distribute it to the people and let them decide how to use it."

Citizen ownership, in Gravel's argument, is an alternative to state socialism—a way to distribute the benefits of corporate capitalism without nationalizing private enterprises and turning over their management to politicians and bureaucrats. For several years, Alaska has been contemplating whether the state government should acquire shares of the new energy venture, so Gravel sees the GSOP approach as an alternative to state ownership.

Construction of the huge natural gas pipeline, for instance, still depends upon raising the capital, and some industry officials believe it can't be done without government participation of some kind, either direct investment or by loan guarantees.

If government is going to share in the risk-taking, Gravel thinks it makes more sense to pass on the benefits to individual citizens, rather than the public treasury.

In many ways, Alaska is a unique laboratory for this idea. It has a very small population and a promising, undeveloped future. But Gravel and Gallagher, among others, think the GSOP model can be widely copied in other states—as provided by the tax legislation — and applied to certain types of ventures seeking new capital, such as natural resource projects or public utilities.

Gravel likes to suggest that Potomac Electric Power Co., which sells electricity to metropolitan Washington, could be forced to obtain its new capital from a corporation owned by all of Pepeco's customers, from the very poor to the very rich. Nobody would make a fortune, but it would take a little of the pain out of rate increases.

Despite Gravel's probusiness rhetoric, some conservatives are still offended by the idea of "giving" equity to people who haven't paid anything for it. In the Senate Finance Committee, Sen. John Danforth (R-Mo.) asked how he could explain this to his constituents, and Gravel responded rather tartly, considering that Danforth is an heir to the Halston-Purina fortune.

"Here is how you explain it to the people of Missouri," Gravel replied.

"You say, if you are a citizen of Missouri and you inherited \$10 million, you are well off and you got it for nothing and that is okay in our capitalist society . . . so we are going to fix it so that you can do like the wealthy people—go borrow money on your net worth and take that money and put it into something and let that simply pay the cost of the loan and then pay you wealth thereafter. I told the people of Missouri would jump up in the air and say, 'Hosanna! Somebody finally is letting us have a piece of the action.'"

THE FOLLOWING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

Alaska State Legislature

Libertarian
Representative
RICHARD (DICK) L. RANDOLPH
1105 Cushman St.
Fairbanks, Alaska, 99701



While in Juneau
POUCH V
Juneau, Alaska
99801

House of Representatives

Dear concerned Alaskans,

Senator Gravel is energetically promoting his AGSOC proposal. In typical Gravel fashion he is employing every technique of professional "con-ism" available. Please do not swallow his big lie. AGSOC is not free enterprise! It is not capitalism of any kind! It is complete and total collectivism and it must be stopped!! I can appreciate the appeal of something-for-nothing "professta-tions," but it's full of holes, it won't work, and it will commit at least one and maybe many generations of Alaskans to its cruel hoax.

Gravel's altar-ego, Louis O. Kelso, has been promoting this "economic idiocy" for over 20 years and in Gravel he has finally found a politician who is politically oriented enough to promote it. It is a scheme completely void of any redeeming values to a free society.

I appreciate that this is a harsh indictment, but one which is completely defensible. I will, between now and however long it takes to expose and defeat this sham, provide information and leadership to those who agree with this indictment.

To begin with, it is important that we understand Kelso's so-called "economic theories" from which AGSOC is derived. Toward that understanding I have enclosed two critiques of his book, The New Capitalists.

The first critique was recently produced by Robert Shelley, a life-long Alaskan, attorney, and presently my administrative aide in Juneau. Bob does an excellent job of tying Kelso, Gravel and AGSOC together and pointing out their fallacies.

Percy L. Greaves, a free-market economist, in his critical analysis of this work comments: "This small book contains more economic fallacies than it does pages. The basic assumptions upon which it is built cannot withstand the light of careful scrutiny. Furthermore, the alleged facts are not documented and the logic employed is extremely loose. Its strong effect on the casual reader rests largely upon the repeated assertion of seemingly plausible statements

AGSOC
Page 2

which, upon close analysis turn out to mean almost the exact opposite of what they first seemed to say.

Any attempt to put the book's proposals into effect would immediately reduce the incentive to produce and result in a rapid paring down of the American standard of living. At the same time, it would set up an economic dictatorship which would select the management of the nation's industries and determine all production goals. In short, it is an unwitting blueprint for the establishment of a Socialist America."

Please carefully read both, and then compare the AGSOC proposal in detail against this background. I am convinced that anyone who understands and believes in true free enterprise and capitalism will agree that this sham does not qualify in any aspect!

I would not dignify this proposal with a response if it were not apparent that many fine and normally right-thinking Alaskans are being drawn in by the insidious lure of this bankrupt proposal.'

It is my commitment to provide a well studied, articulate defense of the free market as opposed to this vicious, fraudulent misrepresentation of the facts! I am absolutely convinced that the adoption of the AGSOC proposal would have the most negative economic and social impact on the traditional Alaskan lifestyle conceivable.

I sincerely and emphatically request that you study the enclosed material and the other information which I will provide you from time to time. If you agree and want to help, let me know. Together we can expose and defeat this fraud and save 450,000 Alaskans from inadvertently creating a socialist Alaska!!

Freedom is the issue,



Dick Randolph
Alaska's Libertarian Legislator

AGSOC -- A FOOL'S PARADISE

prepared for

Representative Dick Randolph (L)

by

Robert Reed Shelley

AGSOC - A FOOL'S PARADISE
by
Robert Reed Shelley

In order to understand the meaning of the Alaska General Stock Ownership proposal presently before the legislature and the people of Alaska, it is necessary to become more familiar with the philosophy of its creator and to test some of the premises upon which its foundation is built.

Certainly any discriminating thinker who has encountered the AGSOC concept has realized that there must be more to the proposal than meets the eye. This is primarily because rarely in human experience does one get something for nothing. Try to picture Senator Gravel performing his political song and dance version of Jiminy Cricket's "Oh the World Owes Me a Living" on the Gong Show. Then compare The Sound of Music in which Julie Andrews sings, "Nothing comes from nothing, nothing ever could." Which one would you believe?

The creator of this attractive sounding 'horn of plenty' is a man named Louis O. Kelso who, along with myself, has combined the two professions of which the discriminating thinker is most skeptical, Economist and Lawyer, to form his background. From that point on, however, Mr. Kelso and I seem to diverge in our approach to human nature and the application of human nature to the economics of man.

Among Mr. Kelso's publications are two books with rather deceiving titles. The first in order is one entitled The Capitalist Manifesto, and its sequel is one called The New Capitalists. This paper is primarily con-

cerned with The New Capitalists, with references made therein to The Capitalist Manifesto. It's the inclusion of the term 'capitalist' which makes these titles so deceiving. Upon close scrutiny it is clear that Mr. Kelso is to capitalism what Benedict Arnold was to the American revolution.

Webster's Dictionary (1979 Ed) defines 'capitalism' as: "the form of economic, industrial, and social organization of society involving ownership, control, and direction of production by privately owned business organizations" (as opposed to the government) In other words, capitalism means free enterprise without government interference in the economy. Mr. Kelso, on the other hand, has the audacity to try to pawn off his plan for governmental direction of the economy to unsuspecting readers as 'capitalism.' If he and Senator Gravel (Kelso's political promoter) are successful, they should be named the flim-flam men of the century.

Basically, Mr. Kelso sees only two factors in production: 1) Physical labor and 2) Capital goods (those goods which produce other goods). It is his contention that capital produces 90 percent of the gross national product in our economy, and that all but a small fraction of the capital instruments are owned by 5 percent of the households of the economy. In addition, he claims that despite this "concentration of ownership of capital, "70 percent of income produced is distributed through labor.

It is important to critically examine these contentions because they are the basic assumptions upon which his entire theory rests.

Any reasonably astute person knows that the initial factor in any kind of production is an 'idea.' While ideas are not exactly physical labor, they are essential to production. When physical labor and capital are added

to ideas, we may have production. Mr. Kelso seems to practically ignore ideas as the factor of production which is uniquely human. Instead, he classifies the factors of production into physical labor (his "human" factor) and capital (his "nonhuman" factor). One might wonder how capital can be termed "nonhuman" since it is only by human conception, creation, and operation that capital exists.

At any rate, contrary to Kelso's views, each factor of production is not mutually exclusive. Neither ideas, physical labor, nor capital can produce anything by itself. It is ludicrous to attempt to determine what percentage of any finished product was the result of the idea, the physical labor, or the capital goods used to produce it. We could argue forever as to how much of the production of the Wright Brothers' first plane at Kitty Hawk was the result of their idea, their physical labor, or their capital. For each item of capital produced, it takes ideas and labor to put it together, to operate it and to maintain it. Then, once the capital produces something, it takes ideas and labor to distribute and market the product. Mr. Kelso has conveniently determined, in an effort to support his theories, that 'capital' is responsible for 90% of all production. So much for the first of Mr. Kelso's premises.

Next, Mr. Kelso claims that this 'capital' is almost totally owned by only 5% of the households in America. While it is undoubtedly true that some Americans own more capital than others, Mr. Kelso's estimate is obviously misleading. The number of stockholders of publicly held corporations listed on the New York Stock Exchange now exceeds 20 million, or one out of every six adults in the United States. In addition, Kelso seems to ignore the multitude of privately owned closed corporations, partnerships, sole proprietorships, house ownership, real

estate holdings, life insurance and other forms of capital. The most important point to make is that a large extent of what capital concentration does exist in the United States is the result of government control of the economy, which results in political rather than economic allocation of available resources. In other words, through subsidies, regulation, and huge government spending, government, through politics, helps some wealthy people to unjustly remain wealthy and even become wealthier. In any case, it is the divergence in wealth between people in a free society that has given the world its highest standard of living and which makes life interesting. It is the opportunity to better one's well-being that stimulates all production. The extent of that opportunity should not be limited. Variance in wealth should not be disdained in itself as Mr. Kelso seems to do.

The third 'statistic' which Mr. Kelso uses to further his plans is that 70% of all income produced is distributed through labor. While one might be able to come up with such an estimate, careful thinking would certainly question the accuracy of such a figure. For instance, is the board member of a large corporation really earning \$500,000 worth of labor in his salary, or is this a payment in lieu of dividends which could be taxed as high as 70%, whereas earned income has a 50% maximum tax rate? Even assuming Kelso's 70% of all income being distributed through labor, one could argue that this refutes his previous assumption

that capital produces 90% of all production, since one would assume that each factor would be rewarded in relation to its worth. Kelso, however, argues that this disparity between 10% of production being caused by labor and 70% of income being distributed to it proves that American labor is composed of primarily lazy people who just take up space and time but don't really produce anything. Kelso says that unemployment in a capitalist system is both desirable and inevitable. He supposes that soon machinery will do everything and humans will do nothing. This concept is so naive that it barely rates refuting. While it is true that capital equipment may eventually produce more products which were produced previously by labor, so far no machine can replace man's unique ability to reason and create new ideas. In addition, it will always take human physical labor to get the resources, to build the new capital equipment, to operate it, to maintain it and to distribute the product which it produces. In addition, it will be a long time before machines totally replace humans in the service industries. Perhaps technology has allowed mankind to concentrate on mental labor rather than physical labor, but even physical labor will never be totally eliminated. Kelso says his plan would cast out the irrational doctrine of full employment, indicating the people wouldn't have to work. As he says, "unemployment is natural and desirable in a technically advanced economy." Until human needs are totally satisfied, there will always be a demand for new and better products at a lower price, and this will keep most of us employed (if we so choose) through the next major evolution of man.

From these "statistics" as to production and the distribution of income, Mr. Kelso comes up with some incredible conclusions and recommendations.

One such conclusion is that the rich get richer and the poor get poorer. Mr. Kelso reasons that since "labor is being replaced by capital as the total factor of production," soon those who currently own capital will be the only ones who will survive economically. He further argues that it's nearly impossible to accumulate capital unless you already have capital. This, he says, is causing an increasing concentration of wealth in the country. Then Kelso wonders what these wealthy capitalists do with all of their extra capital. He comes to the conclusion that they just make themselves wealthier by re-investing it, with no benefit to anyone else. This is a distorted conclusion indeed. Because when that 'extra' capital is reinvested, many people become employed, and we can assume that somebody's need will be fulfilled if the product sells. On top of that, it is true capitalist economic theory to believe that because of the increased supply of products on the market, the added competition by the new business venture, and the added growth to the wealth of the economy, both the particular price of that product and the general price level of the economy would fall to some extent. In turn, this lowering of prices and increased availability of goods on the market make almost everyone else in the economy better off (wealthier). It is clear, then, that Mr. Kelso's conclusion should have been that the rich get richer (assuming they make productive investments) and so do the poor. Everyone is made better off by the reinvestment of the capital which the wealthy man did not consume himself.

What's wrong with some rich people getting richer in relation to some poor people? In my view, nothing. In Mr. Kelso's view, however, it is somehow unfair, and he claims it will soon lead to socialism since the relatively less rich will use government to control the economy, and redistribute the wealth. The incredible inconsistency

in Mr. Kelso's thinking occurs when in the next breath he suggests the creation of a new governmental agency that would virtually take over the banking system and control the entire economy. This he calls the Capital Diffusion Insurance Corporation (CDIC).

Although Kelso doesn't like his plan to be associated with the redistribution of wealth, he believes that the government needs to take an active role in redistributing wealth so that there are many little "capitalists" rather than just a few. It shows his lack of understanding of capitalism that he should use the concepts of redistribution of wealth and capitalism in the same breath. In addition, Kelso defines a capitalist as "a member of a household which derives not less than half the amount the household spends on consumption from the ownership of capital." Under this definition, Leonid Breznev would be one of the biggest capitalists in the world (although he steals it) and an average American with a business, a house, a retirement system, and a small portfolio of common stock probably would not qualify (although he probably earned it honestly). Of course, when this average American retires and lives off the return on his investment rather than labor related income, he can suddenly call himself a capitalist even though he might be virtually nothing.

Kelso says government's objective should be to make sure that technological unemployment falls on those who can afford it (the wealthy). Does he actually advocate government retirement of successful people so that others can take their place?

The Capital Diffusion Insurance Corporation (CDIC) is the governmental mechanism by which Kelso plans to "create" lots of little "capitalists" out of nothing. In Kelso's view, the only thing that is preventing more

little "capitalists" from popping up is the present free market system of capital formation financing. Under the current system, someone who doesn't own capital can only get it in one of two ways: 1) forego consumption and accumulate savings (capital), or 2) find someone who will lend you money (capital) so that you can reinvest it and make a higher return. Kelso argues that most people can't afford to forego consumption so as to accumulate capital, and that this wouldn't be good anyway because it would cause a decrease in the demand for consumer goods and the economy would collapse. Again, Kelso fails to see that as the economy expands because of capital investment, the entire populace benefits due to more and better products at lower prices. If the average American of today was compared to the average American of 100 years ago, there is little doubt that today's subject is much better off economically than yesterday's. As the man of today rises higher and higher above a subsistence living, he ends up having more wealth to spend on both consumption and capital investment, thereby both keeping up the demand in the economy and giving himself more opportunity to own capital. Again, Kelso leaves out the Human idea factor of production. He almost assumes that an investment is just an investment. The truth is that a man with a big idea and little capital can make more wealth than a man with a small idea and lots of capital. Therefore, Kelso's view that there is no upward mobility in our society and that one can only acquire capital if he already has capital, is not entirely correct.

Kelso astutely observes that those lending capital to others want some insurance that they will be repaid. Under the current system of financing, this means that the lender will want collateral in the form of a claim upon the currently held assets of the borrower. Kelso claims those without currently held capital will then not

be able to get a loan to acquire their own capital. He fails to see that at some point all of us must forego some consumption (save) in order to borrow to accumulate capital. (Unless it's given to us, of course.)

In order to provide those who lack collateral with capital-producing potential, Kelso's CDIC would guarantee, in the name of the government, loans by commercial banks to borrowers who would otherwise be poor credit risks. These loans would not even provide for the personal liability of the borrower. Responsibility is totally removed for the borrower. Kelso compares his plan to the federal FHA program, which is noted for its bankrupt failings.

By the government becoming involved in capital financing, all of us, including those who make successful investments, would be paying for the mistakes of those who didn't deserve a guarantee in the first place and who would go belly up in their investment. There are only two ways the government could pay off such guarantees. 1) raise taxes on everyone else; or 2) start up the printing presses and pay the claims off in phony dollars thereby feeding fuel to inflation. Neither method is fair or honest.

But the fact that such a government program is not fair because it would force innocent people to pay for others' mistakes is only a small part of the real evils that such a scheme would create. In describing CDIC still further, Kelso discusses what 'policy' factors should go into the manner in which CDIC decides who should get the guarantee and in what business ventures these borrowers should be able to invest.

Included in these proposed policies are the following:

1. Anti-Monopoly Policy: This would be left to the political whim of bureaucrats who would likely insure through government power that the rich and powerful were well protected. Still Kelso calls

his plan capitalism.

2. Promotion of technological improvement policy: There could be no more detrimental effect on technological change than to misallocate resources for such change by political (government) means rather than by the free market. Leave it to competition! Still Kelso writes of capitalism?
3. Increase the number of capital owning households policy: This basically means redistribution of wealth by transferring opportunity and risk from those who deserve it to those who don't. The New Capitalists?
4. Investment preferences for new capital estates policy: Another form of the redistribution of wealth. Capitalist?
5. Prevention of speculation in stocks policy: Let's say goodbye to the New York Stock Exchange. Kelso fails to see that stock speculation is the incentive for persons to first put money into a proposed development. He still refers to his plan as capitalist!
6. Coordination of consumer demand and new capital formation policy: This is plain and simply a planned economy proposal. Kelso the capitalist?
7. Inflation control and reduction of consumer credit policy: There are several reasons why Kelso's plan would in fact be inflationary. First, the misallocation of resources from the free market to borrowers with a poor credit risk will adversely affect economic expansion while the money supply either remains constant or expands. Second, it is likely that the government would honor guarantees made by CDIC by printing dollars (a hidden tax) rather than by raising actual taxes.

Additionally, once the government, through CDIC has guaranteed a major portion of outstanding loans

in the economy, it will have even a more vested interest in promoting inflation as a way to make the loans easier to repay.

8. Personal aptitudes and education requirements policy:

This is perhaps the most appalling of the powers Kelso wants to place in government hands. Under this policy, a bureaucrat would direct the economy by giving preferences on loans to only those with a particular level of education or background. This would be a very hard part of Kelso's planned economy to swallow. I can just see a father telling his son that he must become an artist in order to get started in the world because that's what the CDIC decided he should be.

It is inconceivable to me that any reasonable person after reading Kelso's proposed policies could not see his plan as pure socialism -- governmental control of the means of production. This is definitely not capitalism.

A good rule of thumb is that any government policy means government control -- unless that government policy is freedom. Kelso's "new capitalism" is in fact a blueprint for a totally socialist society. The most incredible thing is that he claims to propose his plan to avoid socialism.

The CDIC would have to make countless arbitrary rules about who was eligible for the program and who wasn't. By Kelso's own description, bankers would basically become government agents interpreting regulations and helping to operate a government program. Their decisions would be based on political governmental edict rather than good solid business factors.

Only a fool would believe that CDIC guaranteed loans would not soon permeate the capital market, drying up available capital to non-government approved enterprise. Eventually, anyone not qualifying for the CDIC program would be at a tremendous competitive disadvantage to those using

the program. Why should anyone strive for financial well being if government programs will eventually discriminate against them?

Creating the CDIC would substitute a political economy for a free market economy. It would open the whole system up to graft and corruption both in terms of bureaucrats wielding undeserved power and in terms of crafty entrepreneurs ripping off a shoddily run government program.

Eventually, the government, through CDIC, will literally be controlling the economy by deciding who's going to get loans, and for what purpose. No better plan could be conceived to destroy free enterprise and substitute socialism in the name of "capitalism."

Even beyond Kelso's CDIC blueprint for socialism, he advocates several changes in free market corporate operations. For instance, Kelso wants some kind of legal requirement that all earnings of corporations be paid out in dividends rather than allow investment for future expansion. This goes right along with his plans to eliminate speculation on resale of stock certificates. He wants an end to consumer credit so that people will be forced to become capitalists by foregoing consumption. (This is despite his fear that less consumption will hurt the economy.) Even if all corporate earnings were paid out in dividends, there is no assurance that people would spend the money on capital investment rather than consumption. The fact is that the government would get a larger part of it since dividends are taxed as non-earned income, and the sale of speculated stock is taxed at capital gains rates.

As an additional tool for the redistribution of wealth (which Kelso claims he does not advocate) he suggests major increases in inheritance tax rates. This proposal would give even less incentive for a man to build up his capital estate.

So as to not let Mr. Kelso off the hook too easily, let's look at some additional inconsistent remarks made by him which indicate a lack of understanding about capitalism and the free market.

At one point Kelso remarks that in Russia, industrialization is achieved at the cost of totalitarianism. Actually, industrialization isn't achieved very well in Russia, and even then only by almost completely foregoing consumption. In addition, Kelso is promoting totalitarianism here by creating an economy based on politics rather than the free market.

Kelso also claims that "conventional business financing falls far short of satisfying the basic principles of economic justice." The truth is that the free market finance system is the only one which does create economic justice. Justice means no more nor less than one deserves. Kelso's plan would, through government intervention, give some more than they deserve at the expense of others. At another point, Kelso says wealth should be distributed to those who produce, yet he comes up with plans like CDIC, and increased inheritance taxes.

Consistent with Kelso's something for nothing theory, he attempts to create capital wealth for those who he thinks don't have it by bookkeeping entries brought about by government guarantees without any abstaining from consumption. This is economically ridiculous and amounts to government increasing the money supply without additional wealth, thereby fueling inflation.

Placing his personal value judgment on everyone else, Kelso states that "society's first economic duty to its citizens is to enable them to be or become productive." True capitalism, meaning economic freedom, is the only way that individuals will have the opportunity to be or become productive. "Society" is a group of individuals, and individuals should have no duty to anyone other than

those they choose to contract with. It is individual freedom that sparks economic growth even for less productive people. Kelso's meddling in the economy is nothing but anti-productive.

Elsewhere, Kelso states that we "need even more intensive efforts by government and government supported power blocs to divert the wealth produced by capital to those who do not own capital." If this isn't a proposal for the redistribution of wealth and socialism, then neither was the Communist Manifesto.

Later Kelso states "every major increase in new capital formation that is not accompanied by an increase in the number of new 'capitalists' is a leap in the direction of socialism." Not only is this an untrue statement in itself, but if there is any leap to socialism, it would be to adopt Kelso's proposals.

While Kelso indicates that it's impossible for those without capital to become capitalists, he complains that "today owners of a hotel suddenly become owners of a chain of hotels" and says the same about restaurants and warehouses. This only points out the fallacy of his theory. If someone has a good idea, and foregoes a little consumption, then there's no reason why he couldn't become a wealthy capitalist. If someone doesn't do that, it's primarily because they don't have the qualities necessary to be capitalists. One of the most dangerous aspects of Kelso's theory is that he wants to make the government the insurer for people who probably don't have the qualities to be capitalists, are poor credit risks, and don't deserve loans.

At another point, while speaking woefully about inevitable socialism if we don't adopt his plan, Kelso states "socialist methods of new capital formation are more efficient and quicker than traditional methods of business finance now employed by the free world." This

is called talking out of both sides of your mouth.

Kelso virtually ignores that there is a skill involved in choosing good capital investment which should be rewarded. Instead, he figures that by putting capital into anyone's hands, benefit will result.

In short, Kelso's theory closely follows that of another economist who advocated, 'from each according to his ability, to each according to his need.' Kelso further admits the failure of his theory by stating that, with it in effect, "the government would wield considerable power."

It is unfortunate indeed that so many pages of words need to be produced describing Kelso's illogical economic theory, but when the legislature and the people of Alaska are asked to swallow the demagogic AGSOC proposal of Senator Gravel, they should know what the ultimate theory is behind the AGSOC plan. After examining Kelso's inconsistent and illogical reasoning, it would be incredible that any legislator could lend their support to AGSOC. Let's look at how the AGSOC proposal fits into Kelso's overall plan, and why certain parts of Kelso's plan are conveniently being left out at the initial stages of AGSOC.

In brief, AGSOC would hand out shares of stock "free" to most every Alaskan. The corporation would be formed by the initial appropriation of millions of your tax dollars by the government, with no guarantee or liability by the state or the stockholders (at least for the time being). One indicator of the deception built into AGSOC is that while its initiative literature only mentions initial government aid to the project, the Alaska House State Affairs Committee and Senate Finance Committee plans call for the likely guaranteeing of loans to AGSOC by the state. Ownership of the "free" shares would have all kinds of restrictions: including the number of shares, how and when they could be sold, and who could own them. Then, this paper corporation would supposedly be able to

to borrow all kinds of capital to invest in money-making projects that would make us all wealthy since it would be required to pay all hoped-for earnings out in dividends without investing in itself. Even though there is talk of AGSOC buying various companies, one might wonder at the viability of such companies if they're willing to sell to AGSOC.

Comparing such a plan to Kelso's theory, it's easy to see what essential feature of Kelso's plan is missing from AGSOC. That missing piece is CDIC and the government guarantee of any part of the operation.

The question might be asked how could such a plan work when even Kelso admitted that some kind of a guarantee or collateral is absolutely essential to the formation and acquisition of capital? The answer is that it won't.

For AGSOC to go begging to a lender for money would be ridiculous. Can you imagine yourself, or any other intelligent person, readily lending huge amounts of capital to some immature youngster with no experience, no well-formed ideas, no collateral, no guarantee, and no strong sense of direction? Of course not. And this is exactly what AGSOC will be when it attempts to get a loan.

The only reason anyone would lend money to such a scheme would be if there were some hidden factors involved. I can immediately see at least one possibility of such a hidden factor.

The most dangerous of such hidden factors would be the unwritten assumption that based on political experience, the government, (State of Alaska) would eventually step in and guarantee, loan, or subsidize to AGSOC if it should ever find itself in bad finances (which it is doomed to from the outset). Any astute political observer (such as Senator Gravel) knows very well that if the state had already invested millions into AGSOC's start-up costs, had

perhaps lent money to AGSOC, if powerful legislative political figures had supported the AGSOC concept, and if politically appointed 'leading citizens' had been appointed to its directorship -- then the State of Alaska would politically be forced into saving the sinking ship of AGSOC before it went totally under. Such a bail-out of AGSOC by the state would be inevitable, and would complete Kelso's blueprint for socialism. There is no way that those demagogic promoters of AGSOC would allow AGSOC to go under, and if there's one attribute which politicians like to maintain, it's the characteristic of infallibility. Senator Gravel's primary concern is getting re-elected in 1980. The AGSOC 'something for nothing' appeal might get him over that hurdle and set him up for another six years, by which time he would find another distraction with which to attempt to fool the voters.

It would be this unwritten, but politically sound assumption of bail-out by the wealthy state of Alaska that might actually find someone willing to 'risk' a loan to AGSOC. An analogous situation would be a child's (AGSOC's) first loan, with the father (politicians) winking in the background that he will actually guarantee the loan even though it's not on paper. Such a risky loan would particularly be possible by the application of political pressure or offer of political gain by a powerful promoter of AGSOC to some government protected holder of extra capital which could be loaned to AGSOC (political payoff).

The next question to ask is, why wouldn't the AGSOC proposal include government subsidy, loans, and guarantees right from the beginning? The answer is simple. It would be easier for Kelso and Gravel to hold AGSOC up as "capitalistic" and not socialistic if they can minimize the aspect of government involvement. They may also be clever enough to realize that it wouldn't be necessary to include government guarantees at the outset. If they just feed

AGSOC to the people a little at a time, they'll be hooked by the time it's too late to do anything about it. Promoters of AGSOC would know that once the corporation was created on paper, and stock was issued to all Alaskans, it will be easy to get the missing government guarantees and subsidies worked into the picture later on. When those subsidies and bail-outs occur later on, individual owners of AGSOC shares may not be personally liable as stockholders, but they would certainly be liable as taxpayers.

In addition to the possible devious scheme behind AGSOC, there are many other aspects of it which make it undesirable. For instance, promoters claim that the fact that AGSOC would not be subject to taxes on its earnings (even though shareholders would be on their dividends) will make it attractive enough for investors to lend to it. That not only points out the ridiculous level to which taxation has risen in this country, but it should be obvious to the observer that by exempting AGSOC from taxation, the government is actually subsidizing it, since all of us will probably have to make up the revenue lost by tax exemption.

Another aspect of AGSOC is its political control from the outset. Politicians would be appointed to its board of directors at the beginning, and because of its diversified ownership, those directors would be nearly impossible to dislodge. These political directors would have AGSOC competing with other businesses in the Alaskan economy with the competitive edge of no taxation and no capital requirements. Through a slow process, this politician's boondoggle would begin to control and affect more and more of the Alaskan economy, with government's help.

Since AGSOC would be prohibited from retaining earnings for reinvestment, it couldn't help itself grow even when reinvestment might be economically feasible.

Even if the claimed purpose of AGSOC is to somehow return wealth to the people, there is no question that there are many better ways to do so. The people of Alaska are already in a dangerous situation with a state government holding billions of dollars of surplus funds while individual Alaskans go without. The simplest, most reasonable, and most consistently capitalistic way to solve the problem is to take that dangerous surplus away from the government and give it to each individual to choose for himself whether to consume or invest with it. This can be achieved through the elimination of taxes, among other means. We must assume that each person knows his own happiness better than the government does.

I have laid out my observations about the theories promoted by Mr. Kelso and Senator Gravel. If you have been concerned enough to stay with me to this point, you may ask yourself, "What can I do?"

The thing that must be done is for all of us as individuals or in groups to oppose AGSOC now, before it's too late.

The most effective group to begin this effort is the hard-working, self-sufficient businessmen and businesswomen of Alaska. They are the ones who keep this economy limping along despite government interference, and they are among those who would be affected most adversely by the adoption of the AGSOC foolishness.

If Kelso's scheme is allowed to happen, capital accumulation, the source of our high American standard of living, would soon begin to dry up. Men do not save and invest when they know it will be confiscated from them.

Schemes like AGSOC would set up an economic dictatorship which, through the political application of capital, would select and manage the economy's industries and determine production goals. There is no more devious a plan for a socialist economy.

THE NEW CAPITALISTS

by

Louis O. Kelso and
Mortimer J. Adler

A CRITICAL ANALYSIS

by

Percy L. Greaves, Jr.

This small book contains more economic fallacies than it does pages. The basic assumptions upon which it is built cannot withstand the light of careful scrutiny. Furthermore, the alleged facts are not documented and the logic employed is extremely loose. Its strong effect on the casual reader rests largely upon the repeated assertion of seemingly plausible statements which, upon close analysis, turn out to mean almost the exact opposite of what they first seemed to say.

Any attempt to put the book's proposals into effect would immediately reduce the incentive to produce and result in a rapid paring down of the American standard of living. At the same time, it would set up an economic dictatorship which, through the political allocation of capital, would select the management of the nation's industries and determine all production goals. In short, it is an unwitting blueprint for the establishment of a Soviet America.

A complete analysis of all the book's fallacies would necessitate a theoretical treatise of several large volumes. However, the following brief analysis of seven of the book's basic fallacies should be helpful in indicating why the book is unworthy of serious consideration. These seven basic fallacies are:

- I. Capital produces at least 90 percent of the gross national product. (pp. 5, 6, 38-40, et al.)
- II. A progressive concentration of the ownership of capital exists; the great bulk of capital is owned by 3 or 4 percent of the households (pp. 14-15, 28-37, et al.)
- III. Savings are not required for capital accumulation. (pp. 53, 55, 59, et al.)
- IV. No real shortages of labor and resources exist in Western nations. (pp. 4, 41, 46, 86, 101, 104 et al.)
- V. Government redistribution of income is now necessary. (pp. 6, 31, 32, 41, 45, et al, ad infinitum.)
- VI. Bank credit expansion can create wealth. (pp. 17-18, 55-56, 58-59, 60-63, 100-102, et al.)
- VII. Proposals provide for a free society. (Implicit throughout and stated in conclusion, pp 108-10.)

I. Capital produces at least 90 percent of the gross national product.

The early classical economists and Karl Marx believed that human labor produced all economic values. Today, most labor union leaders, as well as those who write our laws, believe that human labor is responsible for producing almost all economic values and that employees, as employees, are entitled to all increases in production.

The authors of this book believe that capital is responsible for the production of almost all economic values and that the share attributable to capital is ever increasing with each addition to available capital. They assume that this is an apparent fact and make no attempt to document it or defend it logically. They apparently assume that because the increasing use of capital results in higher physical volume of goods, all the increased human satisfaction resulting from such increased quantities must be attributed to capital.

This neo-capital theory of value is just as indefensible as the labor or neo-labor theory of value. They both ignore the essential factors of time and abstinence as well as the factor of profit and loss which results from the uncertainty of future demand at the time businessmen commit their capital to the time-consuming process of producing particular goods. Attributing 90 percent or more of all production to any one essential factor and belittling the contributions of the other factors as insignificant and no longer needed is a little like attributing all football victories to the backs who score the touchdowns and thus implying that the linesmen are no longer necessary. Attention is concentrated on the sensational at the expense of other very essential contributions. No football game can be won without linesmen. Similarly, no economic production can take place without human foresight and the combination of capital and labor over a period of time. Each of the four factors is both important and essential.

Capital is always the result of human action. To obtain capital, men must first save, i.e., consume less than they produce. Only such savings can give them the time and ability needed to produce capital goods. Human ideas and foresight of future needs must also precede the introduction of every new capitalistic method. Then men must not only produce the capital goods but also direct and manage their use in production of other goods. Without the human factor, there would be no production, capitalistic or otherwise. Capital alone is incapable of producing anything.

Men do not value all labor or all capital. Men only value the specific units of labor or capital which they are considering in connection with a specific situation. Men think in terms of the value to them of one more, or one less, unit, that is the marginal unit. If they are buying, they compare the value to them of one more unit of labor or capital of a specific type and the price they must pay for it. They then buy until one more unit is no longer worth its market price to them. When they consider selling, they compare the value to them of one less specific unit with the value to them of the sum of money they receive in return for it. The market values of all types and units of both labor and capital are traceable to the values consumers are expected to place on their final products.

In the market place all identical units sold at the same time and place are sold at the same price. The market process thus tends to allocate every available unit of capital and labor to the production of those products which are expected to bring the highest prices from consumers. This means that each additional unit of capital tends to be used to produce something considered less valuable than what was produced with previously available capital. Otherwise, the previously available units of capital would have been used to make those products.

So, with any given population, each additional unit of capital is not only worth less than the units of the previously existing supply of capital units, but it also reduces the value of every other existing capital unit with which it competes. Thus, with any given population, every increase in the amount of available capital reduces the importance of every existing unit of capital. Man can then have more of the things he wants but the additional things are not as important to him as the things he desired when less capital was available. So more capital makes capital less important (valuable), rather than more important (valuable) to man.

Let us attack them in another way. As man is constituted, his desires are insatiable. As soon as some desires are satisfied, other unsatisfied desires arise to take their place. If they did not, man would stop eating and all his other activities. He would, in fact, lie down and die.

As long as man lives, he has unsatisfied desires. This means there is always a demand for more of what labor can produce with available resources. There are always ores that are not mined, land that is not planted, waters that are not fished, and goods that are not made because there is an insufficiency of labor. Labor, a necessary factor of all economic production, is the limiting factor in almost all areas of production. Every new person born on this earth brings his own unsatisfied demands for more things than can be produced with available supplies of labor. There is no such thing as a sufficiency of all kinds of labor.

Some types of labor are always in short supply. The economic problem is how to use available supplies of labor so as to produce the highest valued possible products, that is, how to prevent the waste of available supplies in idleness or producing less valuable products than such types of labor are capable of producing. All men have a point at which they prefer rest or leisure to the results of more labor, but up to that point men desire more of the goods and services that they can obtain only by more of their own labor or by spending money they are paid for contributing more of their labor.

Millions are unemployed today because political conditions either make them unemployable or create a situation in which they prefer to be unemployed, even though there is a great unsatisfied demand for the things they could help to produce. These political conditions are the laws and customs which hinder or prohibit the employment of persons where they could be most productive in terms of what consumers want more of most. These laws and customs include those that permit unions

to raise wages above free market rates, thus reducing the number employable in unionized industries; minimum wage laws, which prohibit the employment of those for whose products consumers will not pay the equivalent of the minimum wage; unemployment benefits, which encourage men to remain unemployed; and employment taxes, including social security taxes, progressive income tax rates and higher rates for overtime, all of which increase the costs of labor to employers and thus to the ultimate consumers.

It must be remembered that businessmen are merely middlemen between the workers and consumers. They will always hire every possible person they can afford to pay, up to wage rates that raise costs above what they can expect to recover from consumers. If they can make a penny by hiring one man more and selling his product, they will do so. Businessmen constantly strive to hire all who are willing to work at the free market wages which are set at the point which it is expected can be recouped from the ultimate consumer. Laws and customs which interfere with such free market wages also interfere with employment. They either cause unemployment or shift men into poorer paid jobs where they compete with less skilled persons who are driven further down the economic ladder, some of them being pushed below the minimum wage and thus into compulsory unemployment. These interventions have produced mass unemployment but in a free market society there can be no surplus of labor as long as men have unsatisfied desires which the employment of labor could satisfy. As mentioned above, such unsatisfied desires are a fact of human life.

One of the values of owning capital is that it saves men time. If we have the capital, we do not have to take the time and trouble to produce it. The payment for capital is thus a payment for time saved as well as for the labor needed to produce it. The payment for time is called interest. The rate of interest is determined by man's time preference, that is, by how much he prefers to have some things now rather than a year from now. Businessmen devote time and labor to the production of specific types of capital goods when they foresee that the cost of producing such capital goods will be less than their expected market value at the time of their completion. Not even the best businessman can always foresee future market conditions perfectly. This imperfection of human foresight is responsible for the factor of profit and loss. A period of time must elapse between the time businessmen decide what to produce and its later availability for sale. Those who turn out to have been relatively the most proficient in foreseeing correctly future demands make a profit. Those who do not suffer a loss.

In this connection, it should be remembered that profits are the amounts they receive over and above their labor costs, expenses for supplies and raw materials, and interest charges on necessary capital for the necessary period of time. When businessmen recover only their expenses for labor, supplies and raw materials and do not recover sufficient funds to pay the interest rate they could have obtained by lending their capital funds, they have suffered a loss. No one goes into business without the hope of earning more than he could by lending his money out or putting it in a savings account. On the other hand, profit or loss is merely the relative difference in expected market values between the time production is started and when it is completed, that is the time when the producer can transfer its ownership to another who then assumes the responsibility for future changes in its value.

For the fallacy of this book, all this means that the contributions of capital to production must be traced back to the contributions of the four essential factors that are necessary for the creation of capital. These four factors are human foresight, scarce goods consumed (savings) human labor and time. The scarce goods consumed in producing capital are the tools, supplies, and raw materials which, in turn, represent savings produced by human labor over a preceding time period.

The more capital savings there are available, the more apt we are to undertake projects which take a long time to produce to the point of operation and which will last a long time before their value is fully consumed. This means that interest payments are likely to be a larger factor in the costs of such enterprises. Any profits above the basic interest rate will attract competition which will pare down and finally eliminate the profit item. However, with the passage of time and changes in consumer preferences, new opportunities constantly arise for the re-emergence of new profits and losses.

As men are constituted, human foresight in deciding what to produce is imperfect and always will be. Likewise, our time, labor and capital are in short supply and always will be. The competition of a free market will allocate available supplies so that in the long run they will be combined to produce the highest possible values known to mankind. Should any investment temporarily obtain profits over and above labor, material and interest charges, competition, if not politically prevented, will soon tend to eliminate the profits. All profits are at best only fleeting in character and must be re-earned if they are to reappear.

In this connection, it should be pointed out that every increase in capital permits the production of goods and services not previously produced. Each new addition to capital goes to work by bidding up wages and the prices of raw materials before it can obtain the factors needed to go into production. Then, the newly produced goods must compete with existing goods and services and offer consumers a better buy before the contributor of the capital can receive a cent back on his investment. Further, the capital goods and the products they make must continue to compete for their originally estimated life if the capitalist is to get back his full investment with interest and possibly a net profit.

Another popular fallacy, inherent in the logic of the book's authors, is that it is thought that if corporate income taxes are reduced or repealed, the present profits before taxes would continue to be about what they are now and that this would be a windfall for the owners of capital. This is a gross error.

As long as a market economy exists, competition will determine the allocation of the reduced taxes among the various market participants as each specific condition dictates. This means that the repeal of 50 percent corporate income taxes would not double available corporate income as the authors seem to think when they estimate the share of production they attribute to capital. Actually, market competition would rapidly force the sharing of the tax savings in lower prices, increased production and higher wages. No doubt such an event would affect interest rates (time preferences). It would also change the

pattern of goods and services produced and thus those on which the highest profits of the future would be made. However, these changes in the allocation of produced income would be determined by the existing market forces and not by corporations trying to maintain the same wages, prices and production pattern as prevailed before the reduction in corporate income taxes.

Corporate income taxes are indirect taxes levied on market operation. Such taxes tend to hide the real burden of government spending from the general public which in the long run must bear the full burden. Unfortunately, many high and low income people, as well as the authors of this book, tend to think that it is the capital stock holders who now bear the full burden of corporate income taxes. This is just not so. Investors still earn the market rate of interest plus profits or less losses, depending on the foresight of each company's management, under existing conditions, in supplying what consumers want most as shown by how they spend their money.

In the long run, those who accumulate capital by consuming less than they produce must receive interest on their savings. If they did not, they would not invest their savings in capitalistic production. No law short of a complete dictatorship can force a man to save and invest without payment of interest. Nor can any law eliminate the uncertainties of the future. Any attempt to reduce or eliminate profits from business enterprise would only result in reducing the efforts of business to provide more efficiently for the uncertain human wants of an unknowable future.

While laws can and do reduce the return on capital, they cannot do so without at the same time reducing real wages and increasing the costs of the goods and services people want. Every government tax, rule or regulation which is not for the purpose of protecting or defending life, health, property or the activities of the market place must be a burden on all market participants. What is more, it is the market and not the government that allocates that burden and it does not spare those with low incomes. Except for their proposal to remove all corporate income taxes, the proposals of this book would increase the present burdens of every American. Its authors have no real concept of how a capitalistic society functions and how the benefits from the increased use of capital are shared by all market participants.

II. A progressive concentration of the ownership of capital exists; the great bulk of capital is owned by 3 or 4 percent of the households.

There is a slight plausibility to this argument. However, such plausibility is entirely due to political interferences rather than free market operations. One little known result of the political interventions before, during and since the New Deal is that they have tended to protect the positions of those already at the top of the business heap by making it considerably more difficult for new and struggling new competitors to replace them.

This is particularly true of the tax laws. Under present tax laws, it would be impossible for any man or family to duplicate the contributions to society of Henry Ford. He raised wages and benefited millions by making autos available for a few hundred dollars because he was able to

plow back his profits into expansion of his original small plant. This process could not be duplicated on a similar scale today. In this connection, it should be further stressed that the benefits of his increased capital investment did not all go to him or his family. The market compelled him to share his gains with his workers, his suppliers and his customers.

Other laws also help to protect those who have arrived from the competition of newcomers. This is most apparent in the labor area where union members can keep the unemployed from competing for the highest paid jobs. This unfortunately is the underlying cause of the economic distress and unrest among American negroes. However, all interventionary laws have this effect. It is quite evident where permits or licenses are required for the sole purpose of limiting competition. Laws which prevent the use of new materials or more economic methods or protect featherbedding are other instances. So also are the farm laws which curb the most efficient use of land. So also are oil import quotas, export licenses, interstate commerce regulations, certain food and drug regulations and many many more types of government owned and operated activities.

However, it is not such intrenchment of established business that the authors of this book have in mind. Nonetheless, it is the results of such interventions that opened the door to their approach. They build heavily on the results of government directed expansion of bank credit and the progressive income tax. They constantly stress the point that much present day capital accumulation is amassed by corporations plowing back their earnings rather than paying them out in dividends. They even admit that personal income taxes at higher rates than those on capital gains are a major factor.

However, they neglect to mention another contributing factor---that interest payments on corporate bonds entirely escape corporate income taxes. This fact, plus the effects of inflation, encourages the accumulation of capital in the form of corporate debts and capital gains upon the retirement of the bonds. They do not seem to realize that many of the conditions they deplore could be eliminated by simply removing the double taxation now levied on corporate dividends and levying the same tax rate on all personal and corporate income.

Unfortunately, the error in their reasoning is still greater. They assume that because a great part of capital accumulation takes place within existing corporations that almost all of it does and then as they proceed they not only assume that all capital accumulation happens in this manner but also that the owners of capital stock always remain the same persons. Actually, where corporations accumulate capital in order to provide their owners with capital gains rather than dividends, the stockholders must sell some of their holdings in order to realize their capital gains. The authors ought to visit the stock market some day, or at least read the figures on the turnover of stock ownership every business day. It runs into millions of shares.

While the authors with ever increasing emphasis proclaim the ever narrowing number of the nation's stockholders, the actual figures belie them. On June 24, 1965, the New York Times and Wall Street Journal

published figures of the New York Stock Exchange reporting that the number of stockholders of publicly held corporations has increased with every count made since 1952. The total figure now exceeds 20 millions and includes one out of every six adults in the United States. This is a far cry from the claim of the authors and this is only for the publicly owned corporations.

Many of our wealthiest men are owners of closely held privately owned corporations. So are many of our middle class citizens, including millions who place their savings in their own businesses with which they are more familiar than with the affairs and management of publicly owned corporations. The facts indicate that over the years the ownership of capital has become ever wider as has the resulting benefits to workers and consumers who use the many products made possible by the increase in capital. Many more than the Ford family are now benefiting from the existence of the Ford Motor Car Company. And so it is with every large corporation that earns profits.

The authors completely overlook the huge savings of the masses in many areas, including home ownership and other real estate. Take life insurance for example. There are now more than 120 million individual policy-holders insured with legal reserve life insurance companies holding more than \$141 billions in assets. In 1960, 89 percent of all family heads were insured, including 71 percent of those with annual incomes under \$3000. In 1963, American families received from life insurance companies payments amounting to 10 billion dollars. Such payments as well as the assets held by life insurance companies for their policy-holders are increasing with every passing year.

By the end of 1964, insured deposits in mutual savings banks had risen to more than 42 billion dollars, compared with only 10 billions at the end of 1945. This quadrupling was not done by any 3 or 4 percent of the nation's households. In the same period the savings capital of the savings and loan associations had increased from less than 8 billion dollars to almost 102 billion dollars. This is not where a few enormously wealthy capitalists are concentrating their savings. Individuals also now hold more than 49 billion dollars worth of the national government's baby bonds. This figure is up by more than 6 billion dollars since the end of World War II.

There is absolutely no evidence that there is a progressive concentration of capital in the United States. In fact, all the available evidence points in the opposite direction. Unfortunately, too much of the increasing savings have gone into forms that are hard hit by the inflationary policies of our national government.

There are two lesser points that should also be mentioned. First, the authors consider depreciation, amortization and depletion, along with withheld earnings, as "internally generated funds" which contribute "today almost three-fourths of new capital formation." Such funds are merely a replacement of capital consumed in production. While they may represent a demand for new capital goods, they are not an increase in capital, but merely a maintenance of prior capital accumulations.

Second, the book makes no mention of the effects of inflation on corporate earnings as figured by tax authorities, in general, a part of what is considered "taxable profits" is in fact only illusory profits. Under the tax laws, taxpayers are allowed to amortize or depreciate only the original costs and not the eventual replacement costs. Thus, when inflation increases the dollar costs for replacements, the government is actually taxing as a profit what is in fact a loss, or technically a consumption or depletion of previously accumulated capital assets. So the authors actually consider the mere replacement of such consumed capital as further evidence of their imagined concentration of the ownership of capital.

III. Savings are not required for capital accumulation.

This is one of the most idiotic ideas on which the entire book is based. The authors bluntly assume that capital can be created from scratch and without any abstinence by the application of the future earnings from capital created by the mere bookkeeping addition of sums to bank deposits. The only basis furnished for such illogical reasoning is a study that Harold G. Moulton made some thirty years ago. That study indicated that historically capital accumulations have on certain occasions increased most rapidly during periods of "high-level consumption."

Dr. Moulton made this study for Brookings Institution early in the New Deal. It was part of a four volume series in which each succeeding volume pyramided its own fallacies on top of those of the preceding volumes. However, Dr. Moulton and his Brookings associates, including Dr. Irwin G. Nourse, later, 1946-49, Chairman of President Truman's Council of Economic Advisors, are not to blame for the extreme interpretation placed on their findings by the authors of the book under review. In boom times, particularly those induced by expansion of bank credit, there are more dollars for both consumption and investment.

The fact remains: all capital accumulation must be the result of savings on the part of someone. Capital can only be amassed by abstaining from consuming all that is produced and available. Before goods can exist, they must be produced. Those who consume all that they produce have no savings or capital. Those who consume less than they produce have some savings. These savings are their capital. It is as simple as that.

Unfortunately, the authors of this book have been fooled, as have many others, by the illusion that the granting of bank loans by bookkeeping processes is a wealth creating process. This illusion will be dealt with under VI. Here, it is sufficient to state that physical capital goods, the only kind that can be used in production, can not be created by accounting manipulations. Capital accumulation requires abstinence on the part of the owners of wealth. They must first live on less wealth than they, their ancestors or other benefactors have produced.

In the market economy, people are paid in money for their contributions to the market. When they do not spend all their money income for consumption of goods and services, there must remain in the economy a portion of their contribution to society which is available as capital. They can use that capital themselves or transfer title to it by lending or investing that part of their money income. When one lends his savings, he merely transfers title temporarily to existing wealth.

This, of course, assumes no theft or manipulation of the money supply such as the authors of this book endorse when they propose making their proposed capital-creating bank loans redeemable in newly created Federal Reserve Notes. When one borrows or spends artificially created bank credit, one merely exercises a claim on previously existing wealth---wealth which in a free and moral society would be allocated to someone spending funds that were received in return for a contribution to society.

Capital cannot be created out of thin air or by the bookkeeping opening of a bank credit. The authors believe that capital can be so created. All that they ask is that the bank borrower pay an insurance premium to a government agency which will insure the bank against any entrepreneurial error by the user of such accounting-created-capital. They expect that such accounting created capital will earn sufficient profits and interest to pay off the original loan with interest. This is pure nonsense. Yet the entire plan of the book is based on it.

IV. No real shortage of labor and resources exist in Western nations.

If this were so, there would be no economic problem. A prime factor of life here on earth is that the things men want and can produce are in short supply. Where they are not in short supply they are free goods and there is no economic problem.

The top shortage is labor. As mentioned under number I, many resources are not fully developed to the extent of present technological knowledge because there is a shortage of labor. The usual expression is that labor costs would be too high, or that it would be uneconomic or simply that it would not pay. All of which means that there are better uses available for the labor on hand. Unfortunately, governments are not always guided by such economic logic. The present development of atomic power for peaceful uses is still uneconomic. The labor and capital so consumed could produce higher values if there were no government interference with market processes. This is true of almost every government activity except those of defense and the peaceful settlement of disputes. If this were not so, men would find it profitable to undertake such activities in a free market.

Nothing can have value in the market place unless the supply is less than the demand for it as a means for satisfying some human need or want.

It goes without saying that there are many resources around the world that men could and would exploit if governments did not hinder or prohibit such exploitation. However, there is a real shortage of labor and resources in the form that men find them useful and there always will be.

V. Government redistribution of income is now necessary.

The only justification for such a belief is that of Marx and Engels in the Communist Manifesto, where they state that every government intervention makes matters worse and creates a demand for further intervention until the point is reached where the whole capitalistic system is overthrown and replaced by a dictatorship of the proletariat.

A good argument might be made that because government spending, taxing and inflation policies have destroyed considerable private savings and potential private savings the government now has an obligation to those it has impoverished. However, that is not the argument of the book. The authors imply that all present deplorable conditions are the natural result of a free and unhampered capitalistic system which must be reformed by governmental action. They thus offer their plan for the political creation of capital with the promise that Congress will vote to give every person his fair share of the capital created by bank loans. The owners of such capital will then somehow be entitled to receive 90 percent or more of all production.

It is true, of course, that there are people in this country who are in need of financial help. That this number is now large is due primarily to political interferences with the operations of a free market as well as uneconomic fiscal and monetary policies. However, it is still likely that private charity could and would take care of all cases of real need, particularly if political restraints on employment were lifted.

Present day political programs only serve to encourage and sustain poverty and unemployment by dampening the spirit and ability of people to find self supporting jobs where they could contribute to society as they improve their own lot in life. Present programs lead people to believe that they are entitled to a living without any contribution on their part. In fact, they are even encouraged to think they are contributing when they are living on and distributing largesse obtained through taxes collected from the more successful citizens. The illusion that the burden of such taxes fall entirely on the well-to-do is encouraged at every opportunity. It is popularly considered a form of economic justice. Actually, as explained previously, the market allocates the tax burden on every citizen of the land, even those with the least to spend.

This book encourages the popular fallacy that only a few own capital and if the government did not intervene, these few would receive 90 percent of the nation's production. This is pure nonsense. Market processes, if left free from government interferences, allocate all production to those responsible for its production. Everyone is then free to choose the most attractive opportunity open to him. Every worker is assured of the market value of his wages before those advancing his wages can get back a cent. The market processes thus see to it that the capitalists are the last to receive any of the gains from their contribution. This book encourages its readers to think otherwise. They declare that every person is entitled to become owners of capital without any contribution or sacrifice on their part, except for the

payment of a small insurance fee to a government agency. Their plan is a plan for the redistribution of 90 percent of total production. It would rapidly reduce total wealth to the point where many would starve. They simply do not understand that every honest and moral person would attain his maximum possible income in a free and unhampered market economy.

VI. Bank credit can create wealth.

It would take a volume to present fully the monetary explanation of the trade cycle as expounded by Ludwig von Mises. However, Mises has clearly demonstrated that modern recession and depression problems are basically the result of political attempts to stimulate economic activity by the expansion of the money supply through the creation of circulating bank credit. Should the holders of such bank credit desire to convert their artificially created bank accounts into cash, the central banks, in our case the Federal Reserve Banks, are empowered to print legal tender paper money against evidences of debt owed to banks. In the United States, such printed money is in the form of Federal Reserve Notes.

The authors of this book would extend this disastrous principle still further. They propose the printing and issuance of Federal Reserve Notes against bank loans with no security except government insurance and the hope that the sum created will be put to work as capital in such a way that it will before too long repay the loan with interest. They blithely assume that such government insurance can be sold for a mere trifle just as the National Government now insures mortgages on real property.

Actually, banks perform a useful social function when they operate as middlemen between savers who want to lend money and borrowers who need and want funds they expect to be able to repay with interest at the maturity of the loan. Such loans are merely temporary transfers of monetary savings (purchasing power) from one person to another. They do not increase the available amount of spendable money in the economy. What the borrower can now spend, the lender can no longer spend. Such voluntary loans help all parties concerned, whether made through a bank or not.

However, when a bank makes a loan merely by adding the sum to the checking account of the borrower, it is not transferring to the borrower the title to someone's actual monetary savings (purchasing power). The bank is merely adding this sum to the available amount of spendable money in the economy. This addition to the money supply empowers the borrower to go out and buy something, leaving less available for all previous owners of money. Thus, those who have obtained their money in payment for their contributions to society find that they cannot buy as much as they could have bought if the bank had not issued an artificially created claim to its borrower. Such bank loans merely transfer a part of the existing wealth from those who helped create it to the borrower from the bank. Such bank loans add no wealth to that previously existing. They merely transfer titles to existing wealth at the expense of all those who have earned or saved their dollars which will now buy less.

Needless to say, such expansions of bank credit cannot create any useful capital goods. All that such bank credit, as these authors propose and endorse, can do is to transfer ownership of existing capital goods from their rightful owners to those receiving the proceeds of the bank loan. It is done by a process that probably not one in a million can detect, for each loan reduces each person's purchasing power only infinitesimally. However, over a period of time such loans have a tremendous effect. Any expansion on the scale proposed by these authors would quickly depreciate the already shaky value of the dollar.

The authors propose that their plan will make everyone a capitalist merely by the creation of such bank credits. They believe that future earnings from the capital so created will pay off the loans with interest and that thereafter the borrowers will be entitled to all further earnings for evermore. Such income is then supposed to make it possible to sustain millions without any further effort on their part.

Such a program is absolute nonsense. It could not work once people realized what it meant. It would certainly not encourage an increase in real savings, the only kind businessmen can use. The greatest incentive for the increase of capital is for people to believe that their savings are safe from either direct or indirect confiscation. The scheme proposed is an indirect confiscation of the wealth of others. It could not and would not increase wealth in any useful form. It would merely dilute titles to existing wealth until the point was reached when people no longer found it profitable to invest their savings in capitalistic production. They would then put their savings in gems, jewelry and precious metals that they could hide and quickly move should the authorities become too nosy.

VII. Proposals provide for a free society.

The first fifty or more pages of the book make no mention of the government controls involved. However, starting on about page 55, such controls are mentioned on almost every succeeding page. In short, the scheme provides that a governmental agency would insure all lending banks against all future human errors of their borrowers in investing their loans so they can be repaid by earnings without any further claim on the sum lent or what was bought with the sum so lent. A government agency would thus be forced to determine all future investments as well as the amounts banks might lend for the purpose of creating capitalists out of bank borrowers. By such a fantastic scheme of government controls of the very life-blood of business we would "start the process of industrialization without resort to past savings." (Pg. 55)

To get the plan started, they would force present corporations to pay out all earnings in dividends. To keep it going and put an end to uncontrolled investments, they would enact inheritance taxes which equalize the dividend income of the entire population, or so they think. They would prohibit those owning a certain amount of income from capital from working and thus competing for jobs. The government could control all monopolies by shutting off capital and creating competitors. The government would, of course, prevent all malinvestment.

"Each loan would be made in accordance with policies established by Congress and administered by the Federal Reserve System" or some other agency "as Congress might determine." (Pg. 61) If the politicians would decide which industries and which managements could have capital, pray tell where would any free enterprise exist??

On page 75 we learn that the government would impose "high standards for demonstrating feasibility of new enterprises or new expansions before their securities could qualify for CDIC-insured loans." Shades of Thomas A. Edison !!! Could he have gotten the capital for his inventions?

On page 69 we learn that American political history has been characterized by changes "required to increase its efficiency in the face of its large-scale tasks by eliminating much of its original decentralization." Shades of Adolf Hitler!!!

They do admit, "there is no doubt that government would exercise considerable power." However, they do not admit that it would exercise totalitarian power over the access to capital, without which no business could even exist. If men were not free in the economic realm, they would soon find that they had lost all that freedom had ever meant. Who could print books and papers? Those the politicians selected and allocated the needed capital. Who could build churches and schools? Those the politicians selected and allocated the needed capital. Who could work? Those the politicians decided were eligible.

One could go on and on but the reader who has read this far should easily see that it is merely another scheme for milking those who have produced, saved and invested wealth for the benefit of those who will keep the politicians in office. The book's authors would make everybody a capitalist by giving them a share of the wealth already produced by others.

If such a scheme were ever attempted, capital accumulation, the source of the ever higher American standard of living, would soon dry up. Men do not save and invest when they know their savings will be despoiled or confiscated. Workers and consumers alike are heavily indebted to those who have saved in the past. Without such additions to capital by every succeeding generation, our standard of living would have stood still. If the capital so carefully accumulated over the decades should be dissipated by any such illogical wild scheme as this proposal, Americans would be compelled to return to the living standard of the Indians. Our population would also have to shrink to that of a century or more ago.

THE PRECEDING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

**A Discussion of the Financial Foundation
for General Stock Ownership Plans***

by

Stephen A. Buser
(April 1979)**

• This paper was prepared in part from material gathered under a research project for the Ford Foundation and was submitted in support of oral testimony before the Alaska State Legislature in Juneau on March 20, 1979.

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I. Preface and Summary

A General Stock Ownership Corporation (GSOC) is not a magical money machine. In the absence of external support in some form, a GSOC cannot be expected to earn a net cash flow simply by borrowing from one group of capital owners in order to finance asset acquisitions from other capital owners. Inappropriate analogies are sometimes drawn between financed asset acquisitions that a GSOC might undertake and those that wealthy individuals and solvent firms undertake as a matter of routine. By definition, wealthy individuals and solvent firms have equity bases to cushion temporary or chronic operating deficits. In contrast, the financial condition of an unsubsidized GSOC, is similar to that of any other firm whose liabilities exceed its assets; it is insolvent. Like any other insolvent firm, a GSOC can be made to show an operating profit if given sufficient subsidies in the form of donated cash or assets, tax benefits, and/or credit assistance. However, since these subsidies would have earned a normal return if put to alternative uses, it is erroneous to attribute a GSOC "profit" to its leverage-acquisitions. Any such "profit" is simply a residual of the normal return on the subsidies invested in a GSOC, after the GSOC's own expenses have been deducted.

Therefore, despite optimistic claims by a few exuberant supporters, a GSOC is more accurately described as an elaborate financial device for capturing and redistributing the federal taxes currently paid on privately owned assets. Since these tax payments can be sizable, the implicit federal subsidy represents a potentially valuable source of State revenue. However, under the federal "enabling" legislation a GSOC's tax liability is not forgiven but instead is passed through to (and borne fully by) the citizen shareholders of the GSOC. Technically, the federal tax "break" is limited distributions in excess of the

GSOC (pass through) tax liability. This provision carries important implications both for the financial viability of the GSOC and for the form of the distribution of the federal subsidy.

In terms of financial viability, the pass-through restriction, reduces the portion of the federal subsidy that a GSOC can use to cover its own overhead and debt-service expenses. Projected GSOC operating deficits (which any pure leverage investment company would run) must be funded from some other source. Most likely, State assistance will be required on a continuing basis and in an amount that is significant when measured against the after-tax benefits received by the citizens of the State.

In an attempt to lessen its own subsidy burden, a State might direct its GSOC to acquire assets that would generate a low (or even a zero) pass through tax liability. However, to the extent that such assets also generate low tax liabilities for existing owners, the federal subsidy is reduced as well. The "solution" that seems implicit in the federal legislation is for the GSOC to acquire assets that are eligible for tax credits and/or accelerated depreciation charges from owners who have already exhausted such benefits for themselves. Since nonsubsidized firms have a similar tax incentive for acquiring such assets, a GSOC must expect to pay prices above those that would otherwise prevail in the secondary market for depreciated assets. Sales at inflated prices would allow the selling firms to capitalize a greater portion of their scheduled tax payments to the federal government, reducing the portion of the subsidy captured by the GSOC.

GSOC advocates have suggested that careful investment analysis might eliminate such overpricing. However, the GSOC's investment team, will be virtually totally dependent on projections provided by the selling firms. Experi-

enced negotiators for selling firms also have been known to cite pressing cash needs or other smokescreens in an effort to convince buyers that the assets are actually offered below the prevailing market prices. Experienced buyers recognize, of course, that if such were in fact the case, a rational seller would always sell at the higher market price unless the sale at the lower price constituted an implicit payment for some past or future consideration. Such might be the case in a "pilot" program where a selling firm has a clear incentive to "prove" that the GSOC is viable in order to establish a future flow of subsidy benefits. In other cases, selling firms may simply rely on the observation that even at inflated prices, the GSOC will show a "profit" as long as the federal subsidy is less than fully capitalized by the seller.

Despite the apparent inevitability of the diversion of GSOC subsidies to selling firms, even GSOC directors with impeccable standards may be hard pressed to determine the true extent of these diversions. Efforts at extensive investment analysis might succeed in limiting the subsidies to selling firms but ^{by} only-creating another type of subsidy diversion in its place since the required analysis is apt to be quite expensive, and these costs must be subsidized as well. Regrettably, it is unlikely that even an outside "watch dog" agent (perhaps established by the State legislature) could successfully monitor GSOC activities. On the contrary, the risk appears far greater that outside pressure will be exerted on the GSOC directors to use their considerable subsidy powers in support of particular firms or banks that might be deemed "essential" to the State or local economy. In fact, it might be argued by some that the GSOC has a "moral obligation" to provide such support as long as it can do so and still show an operating "profit." For example, subsidy diversions to the shareholders of particular firms might be regarded as necessary to continue employment for

workers who might otherwise face a loss of jobs. Unfortunately, the firms destined for subsidy diversions are capital intensive rather than labor intensive so that GSOC subsidy diversions are apt to be extremely inefficient (in terms of cost per worker) as a means of providing job security.

When the inherent disadvantages of the GSOC concept are measured against the ambiguous federal support for the program, a State may decide that the "price" it must pay for a GSOC is too high in relation to the potential benefits. Even if a State determines that GSOC benefits are "offered" at a bargain under the federal legislation, the State should be aware that the citizen-shareholders in a GSOC will share the federal and State subsidies with the GSOC bureaucracy and with the firms that sell assets or lend funds to the GSOC. While subsidy diversions in small amounts might be regarded as "normal" operating costs, the potential for large-scale subsidy diversions cannot be ignored. Such diversions are not necessarily "bad," but they defeat the expressed purpose of the GSOC concept by funnelling benefits to existing capital owners rather than to new capital owners. At present the "unintended beneficiaries" of a GSOC program appear to be the shareholders of capital intensive firms, as well as banks and other lending institutions that might win the favor of a particular board of GSOC directors. The federal immunity from personal income taxes on distribution in excess of the GSOC pass-through tax liability obviously benefits citizens in the highest tax brackets the most. Those who pay little or nothing in the way of taxes obviously receive little or no benefits from this tax "break." Those suffering the most from the proposed GSOC program would be firms that would have to compete with the GSOC, either in the market for credit or in the market for depreciated assets. In addition, despite the fact that the costs of the federal and State subsidies would be dispersed, every dollar of benefits distributed

by the GSOC will have to be made up, either in the form of additional tax revenues to replace those diverted or in the form of greater inflation if the lost tax revenues are not made up.

Economists note that asset transfers do not create new cash flows. In fact, transfer programs, no matter how socially desirable they might be, absorb rather than generate market value as new costs are merely grafted onto the existing economy. Thus economists place a heavy burden of proof on the proponents of particular plans to show that their plans are adequately funded (or subsidized) and that the benefits actually accrue to the targeted groups. Unfortunately, despite the force of a highly emotional call for action, the GSOC backers have not satisfied these basic requirements. "Faith" and "vision" are all that have been offered in support of the contention that a GSOC can achieve its intended goals and avoid becoming simply one more program that promises broad-based benefits but instead imposes broad-based costs and funnels the benefits to familiar recipients, the banks, the capital intensive industries, and of course, bureaucracy itself.

II. Financial Viability of a GSOC

Case I: Viability without external support

To appreciate the limitations of the federal GSOC legislation, it is important to understand precisely how and why a GSOC is not financially viable without external support. To do so, let us reexamine a hypothetical example of financed capitalism found on p. 71 of the report submitted by Kelso & Co. to the Alaska State Legislature, "Design of an Alaskan General Stock Ownership Plan, Volume I" (February 15, 1979). In that example, a Mr. Adams borrows \$200,000 and builds a fourplex which he rents out for a total of \$24,000 per year. For simplicity, the drafters of the Kelso & Co. report abstract from vacancy risk, from taxes, from overhead expenses, and even from interest on the loan. Such simplifications might have served the narrow purposes of the commission issued by the State to Kelso & Co. They do little, however, to reassure a potential lender who is concerned with the financial viability of a GSOC. For example, with an interest rate of 10% (generous by today's standards), the annual debt service on a ten-year fully amortized loan is \$32,500 rather than the \$20,000 figure used in the interest-free example. Thus even if the \$24,000 earnings figure is reinterpreted as net taxes and net of all expenses, the financed acquisition plan would fall considerably short of the goal of self-liquidation. Instead of an excess annual cash flow of \$4,000 found in the zero-interest example, Mr. Adams would have to cover a short-fall of \$8,500 per year over the life of the loan. The loan could be amortized over a longer period, thus reducing the annual debt service. However the interest alone amounts to \$20,000 per year so that a self-liquidating the mortgage would have to be written with exceptionally long maturity. At an interest rate of 12% or better, the mortgage could never be paid off out of the projected rents alone.

Advocates for the concept of financed capitalism might observe that the rental rates chosen by the drafters of the Kelso & Co. report were arbitrary and just happened to be too low in order to make sense when representative charges are introduced. Therefore, it is important to recognize that even if the example were restructured so that Mr. Adams would have been able to arrange self-liquidating financing for his investment, that does not mean he would sell his fourplex to the GSOC at a price that (in the absence of external support) would allow the GSOC to finance the acquisition with a self-liquidating loan. On the contrary, rather than sell at such a price, Mr. Adams would simply refinance any outstanding mortgage against his fourplex, in order to raise the same amount of additional cash that the sale would have produced (after repaying the loan). Thus even though the financed capitalism concept might work for original investments, the model breaks down when it is applied to asset transfers. As long as asset sellers require full compensation for the stream of earnings they relinquish, the debt service on loans to provide such compensation must exhaust the full value of the asset's earning potential. Otherwise, the alternative of financed asset retention dominates the decision to sell the asset.

In reaching this general conclusion, it must be remembered that external factors, such as tax considerations, have not yet been introduced. Similarly, differences in borrowing capacities have not yet been considered. Thus the general conclusion is not contradicted by examples of asset acquisitions that are entirely financed via self-liquidating loans to individuals or firms who can secure the loan pledging more than just the asset's own earnings. Implicit in such arrangements is the very important premise that, if needed, the borrower can draw on other funds or resources. In contrast, a GSOC has no equity base to use

as supplemental collateral for loans. Thus in the absence of external support, a GSOC would be unable to acquire assets via self liquidating loans even though equity firms and some individuals might be able to do so. GSOC's are by no means unique in this regard. Extensive analysis of investment companies (including mutual funds) confirms that these equity institutions would not be viable as pure-debt firms. I.e., they do not earn a rate of return equal to their risk-adjusted cost of capital.

Case 2: Viability under the federal legislation

The federal "enabling" legislation is not a legal requirement for the operation of a GSOC. It is merely an open admission that a GSOC is not financially viable without external support of some form. On its own a GSOC would not earn leverage arbitrage profits, it would make leverage arbitrage losses as would any other pure-debt investment company. Without an equity base or an external subsidy to offset these losses no lender would extend funds to a GSOC. This observation, more than any other single factor, explains why pure-leverage investment companies have failed to materialize on their own despite promises of sure profits offered by advocates of financed capitalism.

Recent federal legislation grants qualifying GSOC's immunity from the federal corporate income tax. Had immunity been granted in an unrestricted form, a GSOC would have been able to use a greater portion of the pretax earnings on assets to cover GSOC overhead and to service the debt raised to finance asset acquisitions. Any excess subsidy would then have been available for distribution to citizen-shareholders or for accumulation as equity in the GSOC. To illustrate this point, let us return to the previous example, and assume that the pretax earnings on Mr. Adams' fourplex had been \$40,000, of which he was required to pay \$10,000 in federal taxes and another \$6,000 in state

taxes, leaving \$24,000 for expenses and debt service. Under federal (but not state) immunity, the GSOC would have the use of \$34,000 per year, and thus, over some price range, could afford to offer Mr. Adams more for the asset than he would be able to raise via his own self-liquidating loan. At such a price, Mr. Adams would capitalize all of the after-tax earnings plus a portion of the earnings stream otherwise lost to the federal government. In such a case, both Mr. Adams and the GSOC would benefit at the expense of the U. S. Treasury.

Apparently the U.S. Congress did not intend that the federal legislation reduce to merely a tax dodge (at least not so simply). Therefore, in granting GSOC's immunity, the "enabling" legislation also mandates that the equivalent tax liability be passed through to the citizen-shareholders without regard for the special tax status of the recipients. Had the GSOC been a viable-self-supporting firm, the pass-through restriction would not have been especially significant. A GSOC would simply pass through its own tax savings in order to cover the tax liability that it must also pass through. However, the GSOC requires these (or some other) funds to cover the amount by which its overhead and interest costs will exceed its (after-tax) earnings. Thus, as presently structured, the federal legislation does nothing to improve the financial condition of a GSOC. To qualify for the tax subsidy, the GSOC must accept an offsetting financial commitment.

Despite this negative assessment, a GSOC would have the same opportunities for tax-arbitrage exchanges as any other firm would, and it might be able to make use of such opportunities to strengthen its financial base. Tax savings arise if the tax payments that would have been made by an existing owner (by Mr. Adams in the hypothetical example), are less than those that a GSOC would incur and this difference is less than fully capitalized in the sale of the asset to

the GSOC. The corresponding portion of the pre-tax earnings flow is, in effect, donated by the federal government rather than purchased from the previous asset owner. Such opportunities arise as a matter of routine because of federal tax laws that provide acquisition tax credits and/or accelerated depreciation charges which are renewable only if the qualified assets are transferred to new owners. Thus a GSOC might earn a tax-arbitrage profit by acquiring depreciable assets from owners that have already exhausted the liberal tax benefits for themselves. Unfortunately, these assets offer similar tax advantages for acquiring firms other than GSOC's. Thus GSOC's must bid against other firms for these assets, and this competition will allow the selling firms to capitalize even greater portions of their projected tax payments.

Since a GSOC cannot earn tax-arbitrage profits by acquiring assets from firms in lower tax brackets than the GSOC (based on the pass-through computation), the only way that a GSOC might be able to strengthen its own financial base is to divert a portion of the federal tax subsidy to the shareholders of large capital-intensive corporations seeking to unload some of their depreciable assets after the initial tax benefits have been gutted.

This description of the federal legislation is vastly different from the expressed intentions of the backers of the GSOC concept. So much so in fact, that it is difficult to imagine that the U.S. Congress had a similar goal in mind in settling on the form of this particular "enabling" legislation. It would be far easier to explain the federal "enabling" legislation as an attempt to provide large capital-intensive firms with additional relief from federal taxation.

Case 3: Viability under alternative forms of State assistance

At present the extent of federal support for a GSOC appears anything but overwhelming. Kelso & Co. or some other source may be able to furnish a

description of the type of asset acquisitions that would recover enough of the federal subsidy to render a GSOC financial viability. As yet, however, no such encouragement has been provided. Nor is there any evidence for a legitimate reference to required State assistance as "start-up" costs. Surprisingly few of the proposed budget items are truly nonrecurring. On the contrary, virtually all of the GSOC's expenses contribute to the annual deficits that a GSOC must run in the absence of continuing financial assistance. These annual deficits are projected as substantial and must be supported from some external source. Moreover even after these deficits have been absorbed (by the State), the State must directly or indirectly provide for every dollar of benefits distributed by the GSOC (in excess of the GSOC tax liability). Recall the federal "contribution" is limited to forgiving the personal taxes that citizen-shareholders would otherwise owe on these excess distributions.

Although there are many forms that State assistance might take, any such assistance reduces to two basic dimensions, perpetual year-by-year maintenance, and/or an initial endowment. As a substitute for equity capital in a normal firm, an initial endowment of cash or earning assets would provide an income flow needed for an initial operating margin. To the extent that such an initial subsidy is insufficient, supplemental annual subsidies will be required as well. One obvious possibility for an annual maintenance subsidy is immunity from the State corporate income tax. In essence, the State could donate its own tax flow in support of the federal subsidy. Assuming that this benefit is less than fully capitalized in the sale prices of assets, the GSOC would then capture at least a part of the State subsidy (with the balance accruing to the seller of the asset as with the federal tax subsidy).

Credit assistance provides an alternative form of a maintenance subsidy. Instead of furnishing additional revenue, a credit subsidy is designed to reduce

borrowing costs and hence lower debt service claims against GSOC income. Agency status would provide the GSOC with direct access to the tax exempt borrowing market. Equivalently, the State could borrow (or divert funds from other uses) and lend to the GSOC at rates less than those charged in the fully taxable market. In either case, however, the State could have earned the higher (market) rate, on its funds and thus the State, should regard the difference in revenue as a subsidy to the GSOC.

Loan guarantees have been proposed as a low cost form of subsidy. Unfortunately, it is only the visibility of the cost that is low. In any insurance situation, such as a loan guarantee, it is not the visible or out-of-pocket expense that determines the true cost to the insurer. Far more important is the associated risk that must be borne. Without a highly diversified asset base to support precise actuarial assessments, the invisible costs of insurance are usually regarded as prohibitive rather than as negligible. If lenders (who are apt to be more highly diversified than the State) believed that these costs were negligible, they would not offer a substantial reduction in rates in exchange for a loan guarantee. The fact that lenders are willing to accept less interest in exchange for a loan guarantee indicates that they presume that the implicit risks are high. In effect, lenders are betting the difference in interest charges that even with massive federal and State subsidies, the GSOC may be overextended in relation to its financial commitments. It is important to note that financial overextension can arise even if the asset portfolio of a firm is of the highest possible quality.

A normal firm that is overextended but otherwise sound is referred to as undercapitalized. In order to raise debt capital, such a firm may first have to raise additional equity capital. In the case of a GSOC, there is no initial equity capital, only a subsidy base. If this base is insufficient to assure an adequate

operating profit margin, the condition of the GSOC is analogous to that of the undercapitalized firm. Loan guarantees provide an additional subsidy, and eliminate the lender's risks. But, since there is no reason to presume that the State has any advantage over lenders in terms of bearing such risks, any apparent "profit" from selling loan guarantees (in exchange for lower borrowing costs) is purely illusory.

In terms of pure cost effectiveness, direct cash payments provide by far the most efficient form for subsidies since they are the least costly to administer. However, these payments are also the most visible and therefore they are often the least attractive from a political standpoint. Opting for less visible but also less efficient forms of subsidy makes it difficult, if not impossible, for the State to assess the extent of its own subsidy. (Just as it is already difficult to assess the extent of the subsidy implicit in the federal GSOC legislation.) For a State that is truly concerned about the extent of its own subsidy to the GSOC program, it is especially important to consider only the most cost-effective and visible subsidy program. It is difficult to imagine what is to be gained, other than short-run political expediency, by burying the unavoidable costs of a GSOC through a series of complex financial arrangements.

III. Distribution of the federal and State subsidies

A GSOC may be useful as a device for capturing and redirecting federal tax revenues on earning assets. However, the GSOC's own budget, no matter how spartan, can only draw from the subsidy pool. Moreover, even before the subsidies get to the GSOC, a portion will be diverted to asset sellers in the form of inflated market prices. An additional portion of the subsidies will be absorbed by banks and other lenders who earn more money from engaging in leverage-arbitrage of their own than they do by creating those opportunities for others.

This observation explains why the powerful bank lobby did not oppose the "enabling" federal legislation. That lobby would almost certainly have opposed any serious attempt at diffusing stock ownership since it is precisely this issue--disintermediation--that the banks have lobbied against for so many years. However, the GSOC legislation promises to cut banks in on the subsidy (at least those banks who win the favor of the GSOC directors).

Under scrupulous and cold-blooded financial management, it might be possible to hold the subsidy diversions to a minimum. But to do so, the GSOC's directors must turn a deaf ear to the pleas of special interest groups. It is to be expected, however, that the GSOC directors will be besieged with requests for help from particular firms or industries that might be deemed essential to the State or local economy. Moreover, the subsidy diversion would be largely hidden in the sense that the GSOC still would be able to show a "profit" as long as it retains enough of the subsidy. Thus it may be difficult for GSOC directors to defend a decision to "support" some firms and some banks but not others. Such dilemmas always raise the possibility that political or other nonfinancial factors may influence the operating decisions of a GSOC.

In sum, while supporters may yet be able to show that GSOC benefits outweigh the additional costs that a State must bear under the federal "enabling"

legislation, thus far, little evidence has been offered in support of that contention. Instead, the case that has been presented is long on moral posturing, and long on railing against the sorry state of affairs that now exists, but painfully short in terms of sound economic reasoning that would lead one to believe that a GSOC offers any reasonable hope of achieving the expressed objectives. If left unattended, the existing biases in the federal legislation would funnel benefits to existing capitalists, as stockholders in banks and capital intensive firms, and to new GSOC bureaucrats, leaving an as yet undetermined fraction for (excess) distribution to citizen-shareholders. Even this distribution is regressive in the sense that the federal tax savings is greater for those in higher tax brackets. Since the same citizens must pay for the State subsidies (as well as their portion of the federal subsidy) either in the form of increased taxes or in the form of increased inflation (assuming that taxes are not raised), it is far from clear that the benefits outweigh the costs for any group of citizens. It should be clear, however, that the society as a whole loses since new costs are created but no new revenues are created to pay for those costs.

In the absence of "clarifying" analysis, the decision before the Alaska State Legislature appears to be one of whether or not to assist capital intensive firms in recovering part of the taxes they currently pay to the federal and State government. If so, a GSOC might be an appropriate vehicle, one that would also benefit selective banks and would create supporting jobs through its own bureaucracy. If sufficiently subsidized through tax benefits, loan guarantees, etc., a GSOC might even produce a modest excess cash flow to citizen-shareholders. However, if this is the ultimate goal, the State would be far better off to scrap the proposal for a costly administrative structure (the GSOC) and eliminate the subsidy diversions by simply distributing to its citizens the equivalent of the

proposed State subsidies to the GSOC. If it is deemed essential that checks be considered as "dividend" disbursements rather than as transfer payment (which they will be in either case), then the State might adopt a more ennobling title such as "the return on a citizen's share in State Wealth." It is doubtful that many citizens will feel all that different once they have cashed their checks. Only the banks and the capital intensive firms appear to have a strong financial incentive for favoring the more cumbersome and costly GSOC alternative.

Two-Factor Theory And ESOP Financing

Why, In An Advanced Industrial Economy,
Substantial Income-Producing Capital
Must Be Owned By Corporate Employees

And

How--With Very Slight Changes In Basic
Business Strategy--This Can Be
Effectively Accomplished Through Employee
Stock Ownership Plan (ESOP) Financing:

- °The Most Potent Instrument For The Purpose
- °The Most Advantageous To The Corporation
- °The Most Beneficial To Employees

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Although two-factor economics is a new and fundamental concept, it is simple and straightforward. The reasoning runs as follows:

1. While it is true that people, participating in the economy through the performance of their various tasks, are a basic source of productive input, they are not the only source of productive input.
2. Non-human things, such as land, structures and machines, also make productive input into the economy.
3. The division of the input sources into two types is both necessary and adequate, because the ownership of labor power cannot be concentrated, while the ownership of non-human things can easily be concentrated. It is, after all, an individual's property in an input factor that entitles him to receive what it produces.
4. Under the logic and morality of a market economy, productive input into the economy is the basis for the individual's right to receive income from it. Economic outtake is conditioned on economic input. To accountants and businessmen, this relationship is simply double-entry bookkeeping. To economists, it is "Say's Law" or "Say's Identity". To moralists, it is the Puritan Ethic, or simply the principle of economic justice defined by Aristotle. To lawyers, it is the principle of private property, under which the owners of capital and the individual owners of labor power are accorded the income equivalent of what each privately-owned input factor contributed to production.

Figure 1: **SAYS LAW THE BASIC LAW OF TWO-FACTOR ECONOMICS**

For every dollar spent, somebody gets a dollar in economic value. Say's Law is simply a prose statement of the principle of double-entry bookkeeping, which is the logic of a private property, market economy.

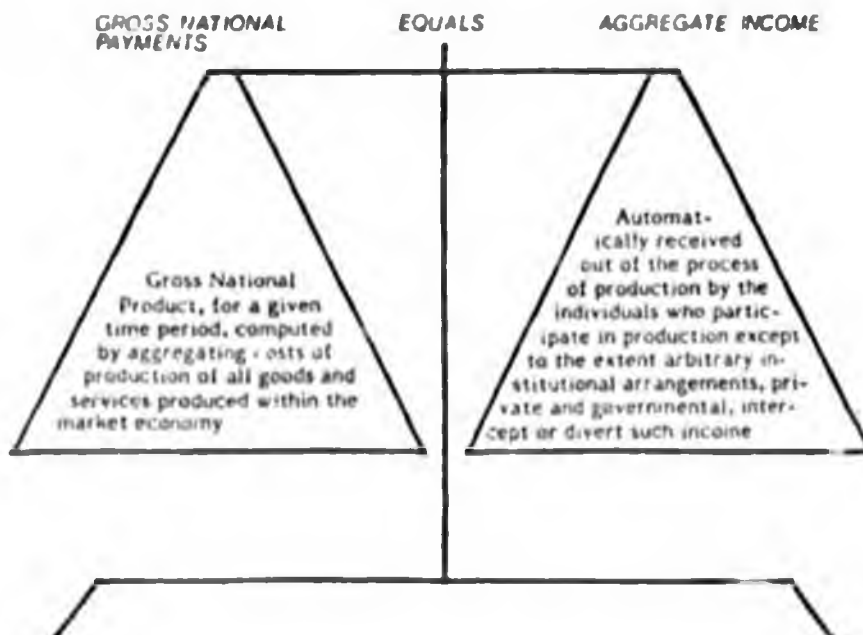


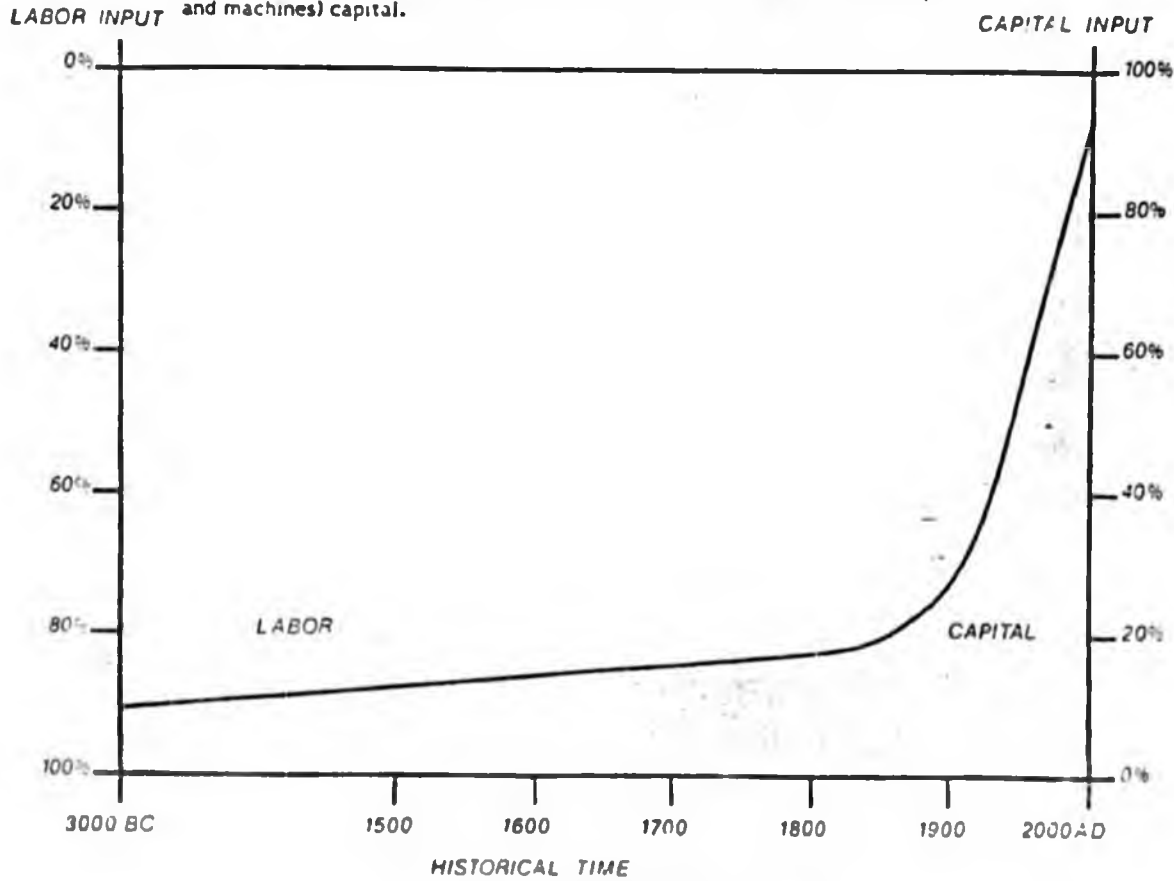
Figure 2: SAY'S LAW ILLUSTRATED ON THE BASIS OF 1973 STATISTICS (IN BILLIONS)

<u>Gross National Product</u>	<u>Pre-tax Income</u>
Less adjustments for capital consumption allowances, indirect business tax and non-tax liability, business transfer payments and other minor adjustments.	Pre-tax Income Automatically Arising out of Production and Received by the Participants in Production
CONSUMER COSTS OF:	INCOME OF PARTICIPANTS IN:
Agriculture, forestry, and fisheries \$ 37.8	Agriculture, forest.y, and fisheries \$ 37.8
Mining 9.7	Mining 9.7
Contract construction 57.5	Contract construction 57.5
Manufacturing 291.9	Manufacturing 291.9
Transportation 39.3	Transportation 39.3
Communications 21.7	Communications 21.7
Electric, gas, and sanitary services 19.8	Electric, gas, and sanitary services 19.8
Wholesale and retail trade 151.5	Wholesale and retail trade 151.5
Finance, insurance, and real estate 118.9	Finance, insurance, and real estate 118.9
Services 133.6	Services 133.6
Government and government enterprises 162.9	Government and government enterprises 162.9
Foreign trade and transactions 9.6	Foreign trade and transactions 9.6
\$1,054.3	\$1,054.3

5. Technological advance, which is the phenomenon responsible for the Industrial Revolution, as well as our own automation revolution, and all of the intermediate revolutions brought about by science and technology, changes, and is intended to change, the input mix. It shifts the burden of production off labor (the human factor) and onto capital (the non-human factor). Technological change does not operate directly on labor. It cannot increase the productiveness of an individual worker. It increases the productiveness of machines, tools, structures, land and processes. The economic productiveness of human workers--what they can accomplish with their unaided muscles or minds has not changed during the course of history, if the value of that productiveness is determined objectively and competitively by the free operation of the law of supply and demand.

Figure 3: THE FUNCTION OF TECHNOLOGICAL CHANGE

The function of technological change is to shift the burden of production off the human factor, labor, and onto the non-human factor, (land, structures, and machines) capital.



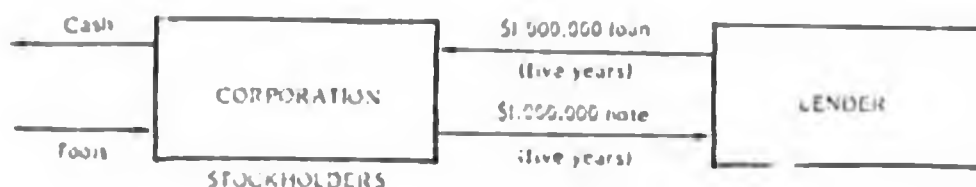
6. In the United States economy, the world's most advanced, the process of technological change has gone so far that most of the goods and services today are produced by capital instruments; only a minor portion of the productive input is made by people. With rare exceptions, it is capital that produces affluence. Labor, in a free labor market, can normally produce only subsistence. The relative distribution of aggregate personal income between workers (roughly 3/4ths) and the owners of capital (1/4th) does not reflect the relatively higher productive input by capital because our governmental economic policy (the Employment Act of 1946), and implementing legislation, attempts to repeal the law of supply and demand as it applies to the value of labor. This is the purpose of minimum wage laws, coercive fixing of wages, vast governmental make-work programs, government subsidies to industry and other government entities to "create" jobs, etc.

The costs of all such efforts enter into the costs of production, directly or indirectly, and thus are inflationary precisely because they are not reflected in the increased production of goods and services by labor. Such costs, neither representing increased labor input nor labor shortages, are, in fact, disguised welfare. They are injected into the costs of the same quantities of goods and services that, prior to the coerces increases, would have been produced at lower costs. These attempts to overvalue labor constitute the monetization of welfare.

7. The shifting of the input mix from labor to capital would cause no economic problem, even under competitive labor markets, if the declining productiveness of labor were offset by increasing capital ownership, i.e., if, as technology diminished the productive role of the human factor, workers simultaneously acquired ownership of enough productive capital to compensate for their loss, or even better, enough capital to provide what few labor-dependent persons have ever achieved, a truly affluent standard of living.
8. Unfortunately, traditional techniques of finance do exactly the reverse of what the situation logically requires. They insure that all newly-formed capital will be automatically owned by those who own all existing capital. Under these techniques, the \$100 billion-plus of new capital formation that comes into existence each year in the U.S. economy becomes owned by a tiny proprietary class--5% of consumer units at most. If averaged over the past 15 years, about 98% of new capital formation in the corporate sector (which produces more than 85% of total private sector goods and services) is financed out of direct cash flow or borrowings repaid out of cash flow.

Figure 4: CONVENTIONAL CORPORATE FINANCE

Including internal cash flow, borrowings repaid from after-tax cash flow, accelerated depreciation, depletion, and investment tax credit, but excluding sale of new stock to the public for cash

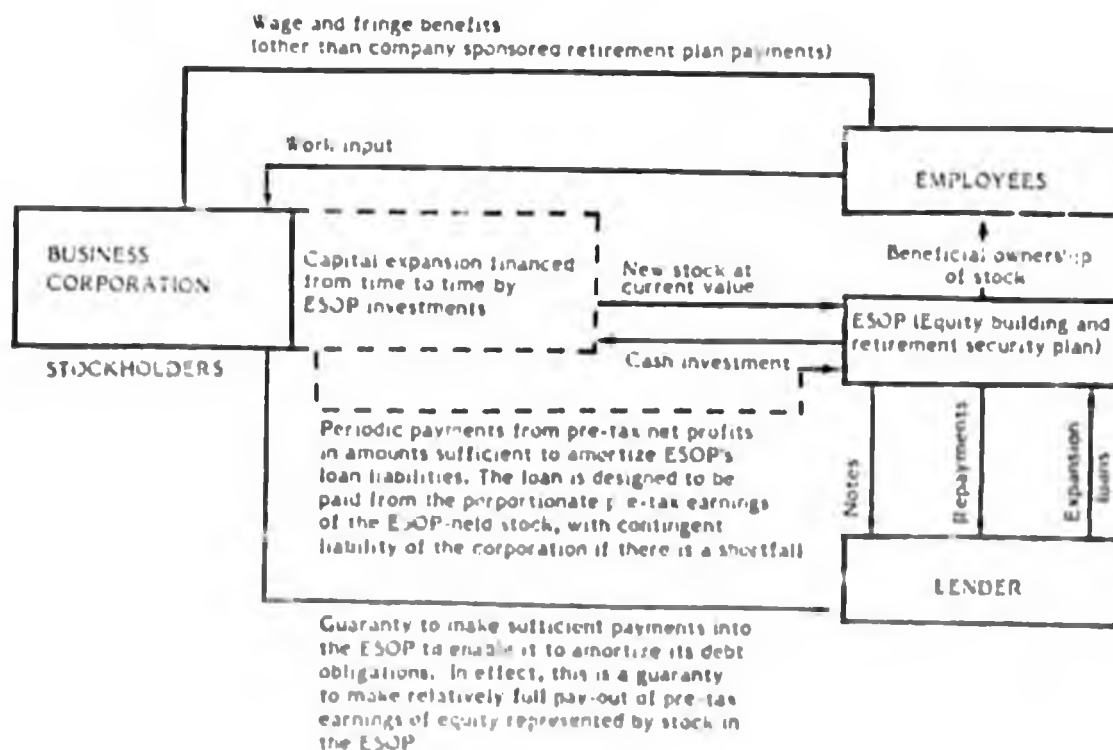


These methods of financing new capital formation have one common characteristic: they do not create a single new stockholder. The portion of new capital formation (about 2%) financed by sale of equity stock to the public does not alter this propensity. Every qualitative study of stock ownership to date shows that ownership of virtually all individually-owned productive capital is lodged in the top 5% of consumer units. These are the families who have excess funds to buy newly-issued stock. Conventional finance has created this monopoly.

9. The logic of business finance is to invest in productive capital that will pay for itself within a reasonably short space of time, normally three to five years, and then go on throwing off wealth indefinitely, its productive power being replenished through depreciation funds set aside out of gross income before net income is computed. Two-factor financing techniques, of which the most widely used today is the Employee Stock Ownership Plan or ESOP, makes this logic available to employees.

Figure 5: BUSINESS CORPORATION FINANCED BY A PROPERLY DESIGNED ESOP

Intended to simultaneously (1) finance growth of the corporation, and provide second incomes for the employees (if the stock is dividend paying and, if the shares are paid for, the dividends pass through the ESOP currently to the employees) and (2) to build retirement security in the form of equity capital ownership.

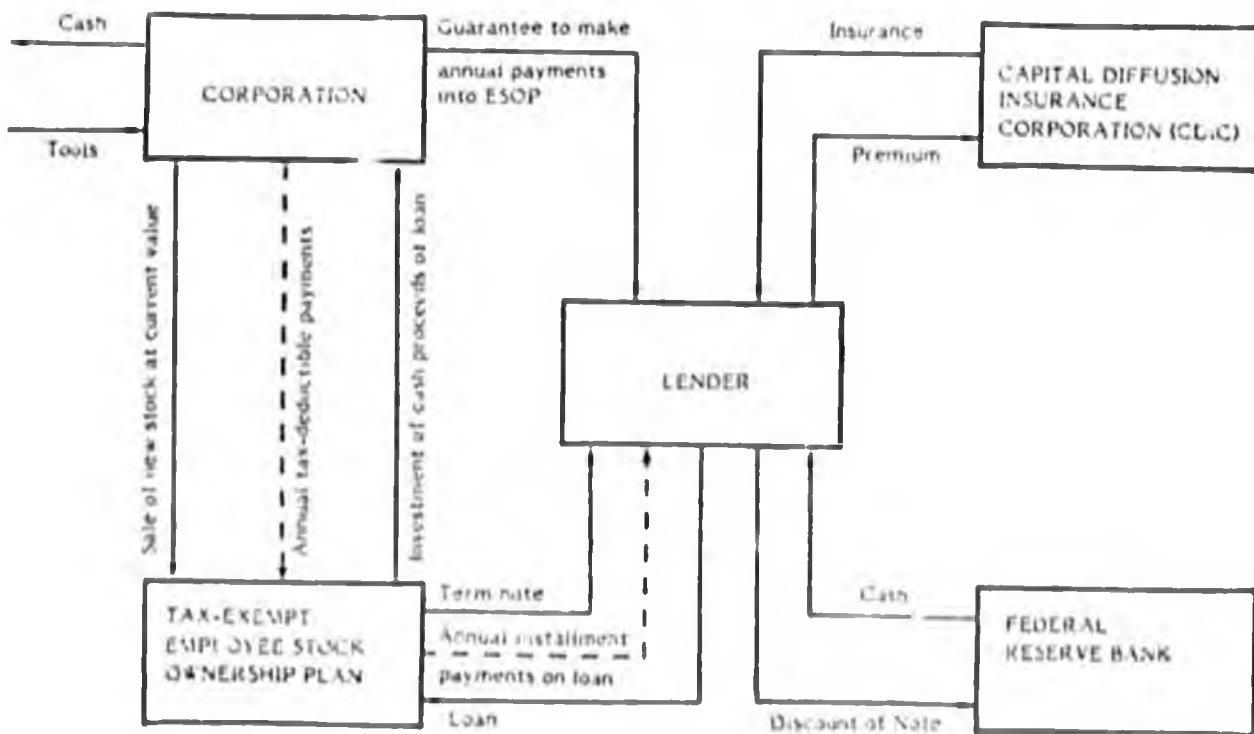


10. ESOP financing, on the one hand, provides low cost capital, through the use of pre-corporate-tax funds, to finance corporate growth, and on the other hand, builds ownership into workers without diminishing their take-home pay or calling upon their small or nonexistent savings.
11. With minor legislative changes to provide capital diffusion insurance (modeled after FHA insurance) for lenders that make sound ownership broadening loans and to make the financing paper held by lenders discountable at a rate not in excess of the administrative costs of the Federal Reserve Bank, two factor techniques provide means for financing unlimited growth, while building market power, economic security, and growing current second incomes from capital* into the masses of workers; thus the market power of potential consumers rises in step with the productive output of the economy.

*Where the stock in the ESOP pays a dividend, the plan often provides that, after each particular share of stock is paid for, the dividends on it shall currently pass through the trust into the workers' pockets.

Figure 6: FINANCING ECONOMIC GROWTH

Financing economic growth by monetizing productive capital while building market power into consumers through ESOP financing

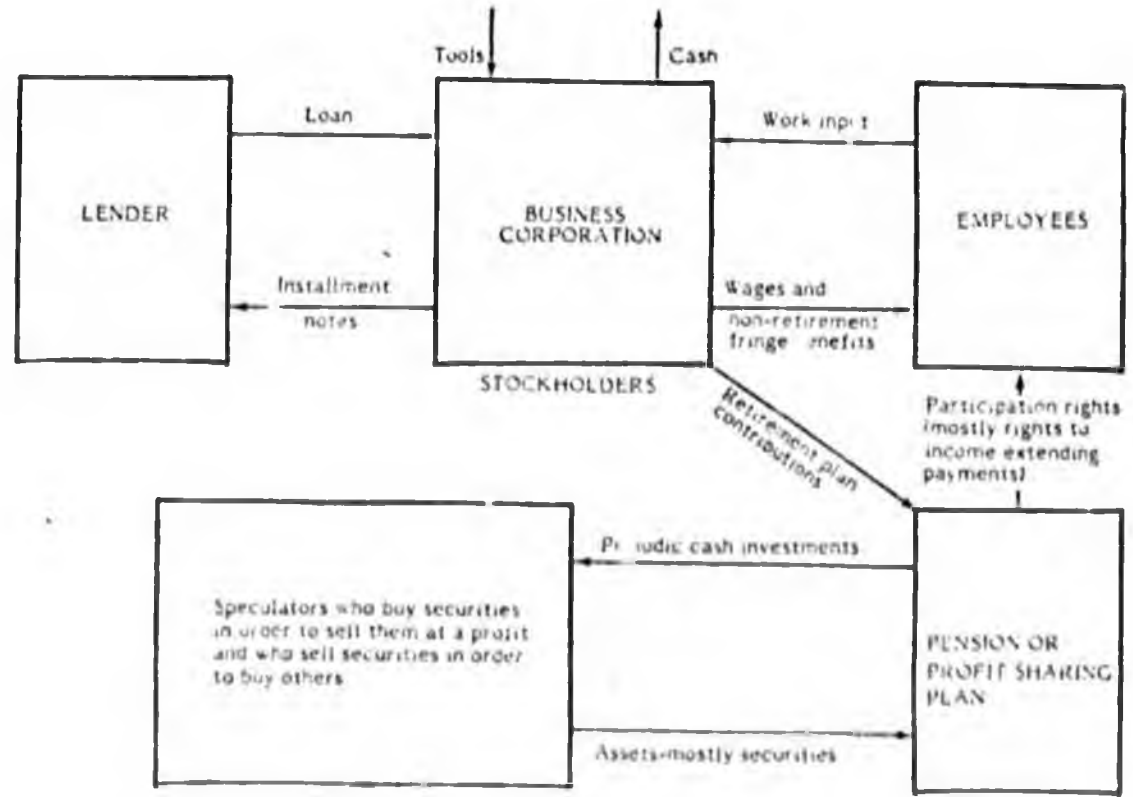


12. Inflation is eliminated. Institutional barriers, such as lack of "money" to finance solid, self-liquidating economic growth are eliminated; legitimate leisure, built upon the ownership of a holding of productive capital that will enable a man or woman to produce a viable income, becomes possible over a reasonable working lifetime; and the burden of public taxes imposed upon producers to support the non-productive and under-productive can ultimately be virtually eliminated. Fully productive households and individuals do not need to be subsidized.

13. The ESOP is an enormous cost-saver for the corporation which--sooner or later--can substitute it for a fixed-benefit pension plan, or any other pension plan or conventional profit-sharing plan. All payments by the corporation into these conventional plans are pure cost.

Figure 7: CONVENTIONAL FINANCING OF A BUSINESS CORPORATION

Conventional financing of a business corporation, other than by sale of new stock to the public for cash, with conventional pension or profit sharing plans invested wholly in assets purchased from sources other than the employer-corporation.

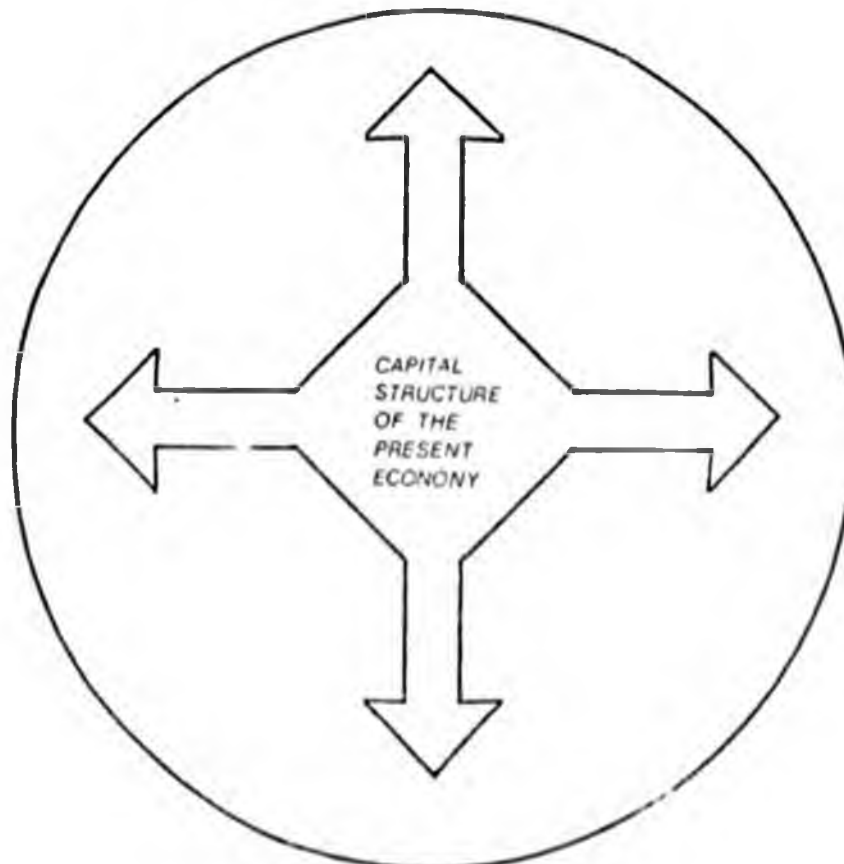


Compared with the ESOP (see Figure 5), not only does the identical dollar paid by the corporation to build stock ownership into employees also finance corporate growth, but corporate growth can be accomplished on pre-tax dollars. By comparing the ESOP (Figure 5) with conventional economic security-building plans (Figure 7), you will see that the ESOP enables the corporation to gain \$3 of advantage for each dollar spent. And it conforms to the sound economic goal of enabling employees, who work hard and well over a reasonable working lifetime, to retire singularly well off.

14. Finally, because the economic goal implicit in Two-Factor Theory is to expand the U.S. economy (and any other economy that adopts it) sufficiently to enable all consumers to live well--general affluence--while also producing the technology to protect the environment, a change to a two-factor policy by business and government could give us twenty-five years or more of legitimate full employment. This would be time enough for society to adjust to a world in which each person will spend less time in economic work and more time in the work of civilization.

Figure 8: OBJECTIVE OF TWO-FACTOR ECONOMICS

Capital structure of the present economy, owned by 5% of consumers, expands ten-fold to create the SECOND ECONOMY, owned primarily by the 95% of consumers who now own no capital



SUGGESTED READING ON TWO-FACTOR ECONOMICS

Books

THE CAPITALIST MANIFESTO by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1958. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

THE NEW CAPITALISTS by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1961. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

TWO-FACTOR THEORY: THE ECONOMICS OF REALITY by Louis O. Kelso and Patricia Hetter (Random House, New York, 1967; Paperback Edition, Vintage Press, 1968)

Testimony

Testimony by Louis O. Kelso before the Joint Economic Committee, U.S. Congress, December 11-12, 1975, on "Employee Stock Ownership Plan Financing and Other Financing Concepts Based on Two-Factor Economics"

Testimony by Louis O. Kelso, Norman G. Kurland and Patricia Hetter before the Senate Finance Committee, U.S. Congress, March 31, 1976, on "Major Tax Revisions and Extension of Expiring Tax Cut Provisions"

Reports and Publications

"ESOPs: An Analytical Report" prepared for the Profit Sharing Council of America, Chicago, Illinois, by Hewitt Associates, Deerfield, Illinois

"Employee Stock Ownership Plans" prepared by The Committee of Publicly Owned Companies, New York, New York

"A Symposium on Employee Stock Ownership Plans", The American University Law Review, Spring 1977, Volume 26, No. 3, prepared by The Washington College of Law, American University, Washington, D.C.

"Making New Capitalists -- A Creative Response to Income Inequities" prepared by the 1977-78 Twentieth Session, Executive Seminar in National and International Affairs, Department of State

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SCHOOL OF LAW

DAVIS, CALIFORNIA 95616

April 4, 1979

The Honorable Mike Miller
Chairman
State Affairs Committee
Alaska State House of Representatives
Pouch "V" State Capitol Building
Juneau, Alaska 99811

Dear Chairman Miller:

I am enclosing the promised specific, suggested amendments to SSHB 240 which are addressed to the questions of accountability of the Board, the rights of shareholders, and procedures for Board and Board Committee meetings. In each instance I have attempted to describe the content of the proposed amendment and to offer an explanation of why I hold the view that such an amendment would be desirable. I have then attempted to break the amendment down into its component ideas and to give the Committee an opportunity to vote them up or down. My further function in this regard is then to draft statutory language which carries into effect the decisions of your Committee.

A number of critical questions concerning SSHB 240 are not addressed in this transmission. We have yet to discuss the regulation of proxies, their content and the vexing issue of how they will be financed. If the legislature desires to influence these thorny problems, now is the only opportunity. Another unfinished item is the future political activities of the GSOC. We can anticipate substantial first amendment problems if we embark on a project to muzzle the directors in their individual capacities. If the directors can speak to the public, the limitation on the "corporation's political activities" is, at best, theoretical. Working on this problem should present quite a challenge!

Finally, there are the proposals I advanced on the first evening of my testimony regarding criminal liability of directors in certain instances. I will work on these in the course of the next week.

If I may offer a suggestion: As I spend more and more time with SSHB 240 and the Alaska Business Corporations Act the more I become convinced that the better course is not to amend the existing corporations code to make room for the GSOC, but to begin anew and design a fully developed Code to regulate the GSOC, a set of laws designed with the special attributes of a general stock ownership corporation in mind and not as an afterthought. This project sounds bigger than it will turn out to be. I sincerely believe that working with your staff people it could be accomplished in a matter of weeks although I would prefer to have the summer months to fine-tune the statute but, in the final analysis, having come this far with you, I am the servant of the Committee.

I hope that this material proves of use to the Committee. When you have reached your decisions simply mail them back to me and I will sit down and draft the content of suggested legislation.

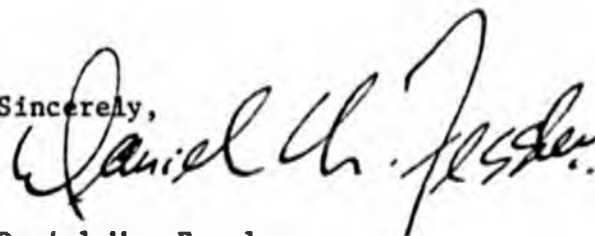
The Honorable Mike Miller
Chairman
State Affairs Committee

April 4, 1979

May I take this opportunity to thank you, the other members of the Committee, the various nonmembers who sat in on our discussions and the staff people for a splendid experience. People here have remarked that they have never seen me so energetic. One student commented that I seem to be following the "North Star." In any event, it has been an experience beyond the imagination of the scriptwriters for the "Paper Chase." I thank you all.

Best personal regards,

Sincerely,

A handwritten signature in cursive script that reads "Daniel Wm. Fessler". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Daniel Wm. Fessler
Professor of Law

DWF:hf

Enclosures

1 TO: THE STATE AFFAIRS COMMITTEE OF THE ALASKA HOUSE OF
2 REPRESENTATIVES
3 FROM: Professor Daniel Wm. Fessler, King Hall, the Law School of the
4 University of California at Davis
5 SUBJECT: Suggested Amendments to Sponsor Substitute for House Bill 240:
6 "An Act Creating the Alaska General Stock Ownership Corporation;
7 and providing for an effective date."
8 DATE: April 4, 1979

8 Preliminary statement: At the conclusion of my appearance before the
9 Committee last week I agreed with the members to prepare a series of written
10 proposals for your consideration. Depending upon the sentiment of this body I
11 will be directed in the drawing of amendments to the Sponsor's Substitute for
12 House Bill No. 240. As will quickly become evident, it is time for the
13 Committee to make some basic choices concerning the nature of the General Stock
14 Ownership Corporation which it may wish to pass to the floor for consideration
15 in the whole House. The suggestions which follow represent nothing beyond the
16 scope of our discussion last week unless specifically indicated as "NEW." In
17 each instance I will set forth the proposal and a brief statement illustrating
18 specifically what it is that I am suggesting be accomplished if you elect to
19 follow my recommendation.

20
21 I. SUGGESTIONS DESIGNED TO MAKE THE BOARD OF DIRECTORS MORE RESPONSIVE TO THE
22 DESIRES OF SHAREHOLDERS OF THE GENERAL STOCK OWNERSHIP CORPORATION:
23

24 My perception of the need for revision: The pending proposal is that the
25 legislature create the AGSOC as a "private" corporation essentially regulated
26 under the terms of Chapter 05 of the Alaska Statutes (The Alaska Business
27 Corporation Act). As I indicated in my testimony, this general statute is a
28 bare bones version of the "Model Act" which is, in turn, fashioned after the

1 Illinois Business Corporation Act. Its essential feature is to give a corpora-
2 tion a license to create a very strong board of directors, a board which is
3 effectively insulated from shareholder pressure during its tenure in office.

4 This is a crucial assertion. Once this corporation is created and
5 deemed "private" the legislature will part with its major chance to have an
6 effective voice in the behavior of such an instrumentality. If the GSOC is a
7 successful economic venture the power of that unchecked body will rise
8 dramatically and its ability to pursue conduct which subsequent legislatures
9 may deplore is a real danger which ought to concern this present body.

10 Why is the board of directors of a corporation organized under a
11 statutory framework such as the Model Act virtually unchecked in these circum-
12 stances? To begin our assessment we should think in terms of the content of
13 three documents: the statutory framework, the articles of incorporation, and
14 the bylaws. It is no accident that the Kelso Report presents this legislature
15 with a package containing a recommended content for each of these essential
16 documents. Here is a point the Kelso Report does not stress: the legislature
17 has control only over the statutory framework (the enabling legislation now
18 before the Committee). Once the GSOP is formed by this legislation, the
19 incorporators (See, Sec. 10.50.010(a), p. 1 SSHB 240) will adopt the articles
20 of incorporation and it will then be beyond the powers of this or subsequent
21 legislatures to interfere with the content of that fundamental document. Once
22 the incorporators have elected themselves as the initial board of directors
23 (See, Sec. 10.50.030(b), p. 3 SSHB 240), they will act in that capacity to
24 adopt the content of the bylaws. Again, it will be too late for the legisla-
25 ture to exert its will. Thus unless changes are made you will have surrendered
26 to these nine appointed individuals sole determination over the content of the
27 documents which will become the framework in which the corporation will
28 actually be structured and function. Your only chance for effective influence