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On the Origins of *The Modern Corporation and Private Property*

Bernard C. Beaudreau

ABSTRACT

The *Modern Corporation and Private Property* (*MCPP*) by Adolf A. Berle Jr. and Gardiner Means, published in 1932, is undisputedly the most influential work ever written in the field of corporate governance. In a nutshell, Berle and Means argued that corporate control had been usurped by a new class of managers, the result of which included (1) shareholder loss of control (a basic property right), (2) questionable corporate objectives and behavior, and (3) the potential breakdown of the market mechanism. In this paper, I examine the origins of *MCPP*, paying particular attention to the authors' underlying motives. I argue that shareholder primacy was not the principal motive. Rather, the principal underlying motive was the well-documented growing gap between potential gross domestic product (GDP) and actual GDP in the 1920s, a problem they, like myriad other period writers, attributed to managerial behavior—in short, a breakdown of governance. In this regard, *MCPP* should be seen as analogous in scope to the period writings of Thorstein Veblen, Paul Douglas, Henry Ford, Edward Filene, Rexford Tugwell, and many others in the 1920s.

INTRODUCTION

The *Modern Corporation and Private Property* (*MCPP*), published in 1932 and authored by Adolf A. Berle Jr. and Gardiner Means, left in its wake an intellectual legacy that has only grown over the decades. Today, it is seen as the preeminent work on the question of corporate governance as well as a perspicacious account of developments in the U.S. economy in the early twentieth century. As a result, *MCPP* is regularly cited as the defining work in the fields of governance, of managerial remuneration, and of management behavior in general. Adding to its legendary status was its timing, namely at the height of the Great Depression (i.e., 1932). To many, *MCPP* merely confirmed what scholars like John Maynard

Keynes and others would refer to as the breakdown of the self-regulating market mechanism.[1] The alleged culprit: managerial usurpation/piracy. In short, managers of the nation's leading corporations had usurped control from shareholders leading to the breakdown of the self-regulating market mechanism. Unfortunately, a closer examination of the facts reveals serious problems with this view of *MCPP*. First, there is the question of timing. *MCPP* was published in 1932, but it was written in the mid-to-late 1920s, a period characterized by a buoyant stock market. From 1925 to 1930, shareholder value had more than tripled[2]: notwithstanding the crash and the ensuing depression, the 1920s were good—even great—to shareholders. Second, there is the phenomenal economic growth that characterized the 1920s, referred to in the popular literature as the Roaring Twenties. Clearly, whatever the managers of the *MCPP*'s two-hundred leading corporations were doing, shirking or engaging in self-serving behavior was not one of them. Third, among the authors' conclusions was the observation that the new managerial elite had redefined the rules of the game, usurping the market mechanism. In short, they observed that the new managerial elite had successfully insulated and isolated themselves from the discipline of the market. Yet, the evidence seemed to show just the contrary. For example, the flagship piece of New Deal legislation, the National Industrial Recovery Act—which Berle had helped draft—was premised on the view that the large, dominant firms, like those in *MCPP*, had engaged or were engaging in price-cutting from 1929 to 1933, to the point of undermining smaller, less competitive firms. The resulting Codes of Fair Competition explicitly condemned aggressive price cutting by large corporations.[3]

Another incongruity lies in the thought experiment that underlies the book, namely in a comparison of the classical governance structure of yore with that of the early twentieth century.[4] Specifically, Berle and Means begin by assuming that throughout the nineteenth century the owners of capital (investment associates, partners, etc.) exercised complete control over the companies in question. Ideally, evidence to this effect would have been presented. Instead, we are presented with what is a strawman of sorts.

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1. *See* JOHN M. KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY (1936).

2. Specifically, the Dow Jones Industrial Average went from 105 in January 1920 to 362 in September 1929. Daniel Feenberg & Jeff Miron, *NBER Macrohistory Database*, NAT'L BUREAU OF ECON. RES., http://www.nber.org/databases/macrohistory/contents/ [https://perma.cc/5CM3-K4V3] (see Chapter 11 m11009b, titled *U.S. Industrial Stock Price Index, Dow-Jones 12/1914–12/1968*).

3. *See* National Industrial Recovery Act of 1933, Pub. L. No. 73-67, § 3, 48 Stat. 195, 196–97, *invalidated by* Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

4. *See generally* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977).

Another important issue is the question of managerial/corporate officer information, knowledge, and skills. Berle and Means implicitly assume that shareholders have as much, if not more information, knowledge, and skills than the corresponding managers, and as such are as well, if not better positioned, to provide direction to the firm. In fact, the impression one gets from *MCPP* is that the representative manager's task consists simply of choosing a point on a well-defined profit function. I maintain that this was an important oversight on their part.

There is also the question of proof. *MCPP* leaves the reader with the impression that the separation of ownership and control prejudices market outcomes—in short, the separation of ownership and control is welfare reducing. The problem, however, is that this fails to square with the facts. In fact, if anything, notwithstanding the 1930s, economic growth in both Berle and Means's lifetime was stellar, to say the least. The post-WWI period (1918–1929) as well as the post-WWII period (1945–1975) were characterized by record-level growth rates (output, wages, profits, share prices), the latter being referred to as the "Thirty Glorious Years."[5] Yet, despite evidence to the contrary, Berle and Means never reconsidered their highly critical view of management and social welfare—if anything, the post-WWII period should have sufficed to spark a change of heart. Taken together, these incongruities serve to raise questions regarding the authors' original objectives. In short, the new managerial elite referred to in *MCPP* (the two-hundred largest corporations) had contributed to the second industrial revolution, modernity, and the rise of America as "the" dominant world power. How then are we to understand *MCPP*? In this paper, I argue that *MCPP* was less about corporate governance than it was about a problem that had commanded the attention of a large part of the intellectual community in the 1920s, namely the apparent failure of the U.S. economy in the 1920s to perform at its new, technological change-induced higher productive capacity—something I refer to as the failed transition (FT).[6] In short, in the 1920s, the U.S. economy was systematically underperforming relative to its potential.[7] I argue that *MCPP* was, in many regards, analogous in both scope and objective to the

5. *See Maddison Project Database 2018*, GRONINGEN GROWTH & DEV. CTR., https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2018 [https://perma.cc/G8K6-MZ4H] (statistics on world population, GDP, and per-capita).

6. In his 1983 rebuttal of Robert Hessen's reappraisal of *MCPP*, Gardiner Means argued emphatically that "the main thrust of our book . . . concerns the effect of the modern corporation on the working of the economy as a whole." Gardiner C. Means, *Hessen's "Reappraisal*,*"* 26 J.L. & ECON. 297, 297 (1983).

7. *See generally* BERNARD C. BEAUDREAU, MASS PRODUCTION, THE STOCK MARKET CRASH, AND THE GREAT DEPRESSION: THE MACROECONOMICS OF ELECTRIFICATION (1996) [hereinafter BEAUDREAU (1996)]; THORSTEIN VEBLEN, THE ENGINEERS AND THE PRICE SYSTEM (1921).

writing of University of Chicago economics professor Thorstein Veblen, who alleged in *The Engineers and the Price System*, published in 1921, that the nation's managers had "sabotaged" the transition to the new, higher growth path defined by the new power technology that was electric unit drive. Essentially, he maintained that instead of raising wages (cutting prices) and thus ensuring an orderly transition to the new, higher growth path, managers responded by cutting employment in order to increase profits. The upshot was simple, namely that the profit motive was incongruent with an orderly transition in periods of technological change. In this regard, *MCPP* was analogous in scope and purpose to the work of such notables as University of Chicago economics professor Paul Douglas, Columbia University economics professor Rexford G. Tugwell, and the Technocracy movement.[8] I maintain that *MCPP* was Adolf A. Berle Jr.'s attempt (with the assistance of Gardiner Means) at understanding and rationalizing the failed transition: this failure. First, this Article begins with a summary of the FT literature of the 1920s that describes the U.S. economy's failure to transition to its new, higher capacity, along with the various corrective measures that were put forth at the time. Second, this Article proposes that *MCPP* should be viewed as Berle and Means's contribution to this literature. Third, this Article compares Berle with Karl Marx, who attributed a nineteenth century FT to opportunistic behavior on the part of the owners of capital. To this end, Marx invoked the labor theory of value, according to which all wealth/value is produced by labor alone, the implication being that profits were not only not earned but instead constituted a form of theft. I argue that Berle's managerial usurpation hypothesis and Marx's theory of surplus value were strategems—both being unsubstantiated—intended as a justification for third-party involvement in resolving the FT. Fourth, the Article looks at the unintended consequences of *MCPP*, based on my findings regarding the authors' original intentions. Specifically, it is argued that the stock market crash and the ensuing depression transformed what was an indictment of the managerial elite for their role in the failed transition to a general critique of corporate governance.

I. THE PROBLEM OF THE FAILED TRANSITION

I proposed the notion of a failed transition,[9] referring to the inability of a market economy to make the transition to a new, higher equilibrium

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8. *See* HOWARD SCOTT ET AL., INTRODUCTION TO TECHNOCRACY (1933); REXFORD G. TUGWELL, INDUSTRY'S COMING OF AGE (1927); Paul H. Douglas, *The Modern Technique of Mass Production and Its Relation to Wages*, 12 PROC. ACAD. POL. SCI. N.Y. 663 (1927).

9. *See generally* BERNARD C. BEAUDREAU, UNDERINCOME: WHEN MARKETS FAIL TO MONETIZE OUTPUT (2007); BEAUDREAU (1996), *supra* note 7.

growth path in response to a new process technology—in this case, electric unit drive powered by abundant, inexpensive public utility-generated electricity (EUD-PUE).[10] In essence, the failure is attributed to two factors: the lack of incentives on the part of firms to increase wages (and purchasing power) in response to higher productivity, and the residual nature of profits.[11] That is, profits are not paid up-front but rather after product markets clear. This makes for a situation in which a technology shock does not, per se, increase profits except via the reduced demand for labor per unit output.[12] A variant of the FT hypothesis maintains that the root cause lies with the functional distribution of income. That is, overall income increases in step with potential output, but that profit income increases by more than wage income, resulting in under-consumption. In this case, profit income increases by more than the increase in potential output given that wages remain relatively constant. The result, however, is similar as firms reduce output and the demand for labor given the presence of unsold goods. In the former case, output does not actually increase as income fails to increase. Spurgeon Bell of the Brookings Institution described the FT of the 1920s in the following terms:

> In recent times, however, the process by which new technological developments are transmitted into higher standards of living is obviously not working smoothly. Even before the coming of the great depression, there appeared to be some doubt as to whether the system of wealth production and distribution was operating with maximum effectiveness. At a time when cumulative scientific knowledge might be expected to give us an accelerating tempo of industrial growth, the rate of advancement for some reason, or combination of reasons did not seem to be an increasing one. In any case, the issue in recent years has been sharply raised: can the economic system be counted upon to produce the beneficent economic results which were supposed to be the automatic accompaniment of scientific knowledge, and the increasing efficiency of production? Under modern conditions, do not technological improvement simply throw men out of work, destroy purchasing power, and retard economic advancement?[13]

Adherents to the under-income version of the FT hypothesis included Henry Ford, Edward A. Filene, and Thorstein Veblen, to name a few, while adherents to the excess-profit-over-savings version included Senator

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10. *See* BEAUDREAU, *supra* note 7; Warren D. Devine, Jr., *Electrified Mechanical Drive: The Historical Power Distribution Revolution*, *in* ELECTRICITY IN THE AMERICAN ECONOMY: AGENT OF TECHNOLOGICAL PROGRESS (Sam H. Schurr, Calvin C. Burwell, Warren D. Devine, Jr. & Sidney Sonenblum eds., 1990).

11. *See generally* BEAUDREAU (1996), *supra* note 7.

12. *See id.*

13. SPURGEON BELL, PRODUCTIVITY, WAGES AND NATIONAL INCOME 165 (1940).

Robert Wagner, Rexford G. Tugwell, Paul Douglas, and Raymond Morley. Tugwell and Morley, like Berle, were members of President Franklin D. Roosevelt's Brains Trust, a group of intellectuals that were responsible for drafting the New Deal (National Industrial Recovery Act).

Table 1: The Brookings Institution Estimates of Excess Productive Capacity 1922–1929[14]

Year	Potential GDP (%)	Actual Capacity	Gap Productive
1922	75.5	63.4	16
1923	83.2	69.9	17
1924	85.1	71.5	17
1925	89.6	75.3	16
1926	91.9	77.2	16
1927	93.2	78.3	17
1928	94.9	79.7	16
1929	97.5	81.9	17

Evidence of a growing output gap was amassed by the Brookings Institution, whose founder, Robert Brookings, adhered to the excess-capacity account of the 1920s and 1930s.[15] In an exhaustive study of U.S. productive capacity in the 1920s, they provided estimates in the order of 16 to 17 percent (Table 1).[16]

Without exception, the period writings on FTs went beyond simply describing and/or quantifying the problem. They also provided a number of corrective measures/policies (Table 2).[17] Perhaps the most notable were Henry Ford's five- and seven-dollar day, President Herbert Hoover's Associative State, Paul Douglas' three-quarters/one-quarter rule, and the Technocracy movement with its radical reform of production and distribution, not to mention exchange technology based on energy certificates and a guaranteed income. With missionary zeal, Henry Ford set out to change the managerial ethos, stressing the need to increase wages

14. EDWIN GRISWOLD NOURSE & ASSOCIATES, AMERICA'S CAPACITY TO PRODUCE 176 (1934).

15. ROBERT S. BROOKINGS, THE WAY FORWARD (1932).

16. Comparable estimates are also provided in HAROLD LOEB ET AL., THE CHART OF PLENTY: A STUDY OF AMERICA'S PRODUCT CAPACITY BASED ON THE FINDINGS OF THE NATIONAL SURVEY OF POTENTIAL PRODUCT CAPACITY (1935).

17. What distinguishes this literature from the corporate law literature (i.e., the Berle–Dodd Debate) is its focus on a real, identifiable problem. The corporate law literature, on the other hand, was couched in rather general and oftentimes vague notions such as the collective good, workers' rights, stakeholders' rights, etc. Here, the problem was not only well defined but also a source of agreement among writers. Where they differed, however, is in terms of their policy prescriptions.

and lower prices.[18] While at the Department of Commerce, Hoover stressed corporate planning and the need to raise purchasing power.[19] Paul Douglas went even further, arguing that the functional distribution followed a scientific law (3/4-1/4), thus justifying wage increases in the face of greater productivity.[20] Perhaps the most known of these measures was President Franklin D. Roosevelt's National Industrial Recovery Act, which called for across-the-board wage increases.[21] Other non-income based measures include tariff policy (Smoot-Hawley Tariff Act of 1930), fiscal policy (President Franklin D. Roosevelt's 1936 undistributed profits, corporate income tax), labor legislation (the National Labor Relations Act of 1935), and government expenditure (New Deal I and II). Each of these was intended to correct the FT.[22]

Table 2: FT Literature and the Corresponding Policies/Measures

Author	Policies
Thorstein Veblen[23]	Engineer-governed economy
Henry Ford[24]	Five- and seven-dollar day, New management ethos
Rexford Tugwell[25]	Higher wages, taxes on profits
Paul Douglas[26]	Higher wages
Howard Scott[27]	Technocracy
Robert Brookings[28]	Higher wages
Senator Reed Smoot[29]	Smoot-Hawley Tariff Act of 1930
Franklin Roosevelt[30]	National Industrial Recovery Act of 1933
Senator Robert Wagner[31]	National Labor Relations Act of 1935, Unionization

18. *See* HENRY FORD, MY LIFE AND WORK (1922) [hereinafter FORD (1922)]; HENRY FORD, TODAY AND TOMORROW (1926) [hereinafter FORD (1926)].

19. Ellis W. Hawley, *Herbert Hoover the Commerce Secretariat, and the Vision of the "Associative State," 1921–1928*, 61 J. AM. HIST. 16 (1974).

20. *See* Douglas, *supra* note 8.

21. This included the wage increases found in the 597 Codes of Fair Competition as well as the President's Reemployment Act of 1933.

22. *See* BEAUDREAU (1996), *supra* note 7.

23. *See* VEBLEN, *supra* note 7.

24. *See* FORD (1922), *supra* note 18; FORD (1926), *supra* note 18.

25. *See* TUGWELL, *supra* note 8; REXFORD G. TUGWELL, THE INDUSTRIAL DISCIPLINE AND THE GOVERNMENTAL ARTS (1933).

26. *See* Douglas, *supra* note 8.

27. *See* HOWARD SCOTT ET AL., INTRODUCTION TO TECHNOCRACY (1933).

28. *See* BROOKINGS, *supra* note 15.

29. *See* BERNARD C. BEAUDREAU, MAKING SENSE OF SMOOT-HAWLEY, TECHNOLOGY AND TARIFFS (2005).

30. *See* Bernard C. Beaudreau & Jason E. Taylor, *Why Did the Roosevelt Administration Think Cartels, Higher Wages, and Shorter Workweeks Would Promote Recovery from the Great Depression*, 23 INDEP. REV. 91 (2018).

31 *See* Theodore J. St. Antoine, *How the Wagner Act Came to Be: A Prospectus*, 96 MICH. L. REV. 2201 (1998).

The key point here is the overwhelming emphasis on management and management practices. Most adherents to the FT view pointed an accusing finger at management, stressing the need for a new ethos of sorts, one that would allow the economy to take full advantage of the new technology that was electric unit drive.[32] *MCPP*, I submit, was Berle and Means's contribution to this literature in that it proposed a rationale for what was seen as destructive, transition-aborting managerial behavior.

II. FT AND *MCPP*: THE EVIDENCE

Evidence that the FT was at the heart of the *MCPP* comes in a number of forms. For example, there is 1932 Democrat presidential candidate Franklin D. Roosevelt's California Commonwealth Club Address (September 23, 1932), penned by Adolf A. Berle Jr., in which government intervention is introduced as an optimal response to the problem of insufficient demand, itself the result of the absence of what had been up until then a key part of the second industrial revolution, namely the Western frontier. In short, growth in the post-Civil War era had been fueled by the ever-expanding frontier, creating the necessary demand conditions for the industrial revolution underway.[33] However, by the early twentieth century, the frontier had disappeared, and with it, the demand conditions that had sustained growth, making government expenditure and intervention necessary.

> A glance at the situation today only too clearly indicates that equality of opportunity as we have known it no longer exists. Our industrial plant is built; the problem just now is whether under existing conditions it is not overbuilt. Our last frontier has long since been reached, and there is practically no more free land. More than half of our people do not live on the farms or on lands and cannot derive a living by cultivating their own property. There is no safety valve in the form of a Western prairie to which those thrown out of work by the Eastern economic machines can go for a new start. We are not able to invite the immigration from Europe to share our endless plenty. We are now providing a drab living for our own people.

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32. Perhaps the most high-profile of these were Henry Ford and Edward A. Filene, two businessmen who, with missionary zeal, attempted to change the managerial ethos, stressing mass production, higher wages, and lower prices. *See* EDWARD A. FILENE, SUCCESSFUL LIVING IN THIS MACHINE AGE 1 (1931); EDWARD A. FILENE, THE WAY OUT: A FORECAST OF COMING CHANGES IN AMERICAN BUSINESS AND INDUSTRY 93–104, 234–57 (1924); FORD (1926), *supra* note 18, at 38–50. A similar argument can be found in WILLIAM TRUFANT FOSTER & WADDILL CATCHINGS, BUSINESS WITHOUT A BUYER 172 (1928).

33. *See* CHANDLER, *supra* note 4, at 213–15.

. . . .

As I see it, the task of Government in its relation to business is to assist the development of an economic declaration of rights, an economic constitutional order. This is the common task of statesman and business man. It is the minimum requirement of a more permanently safe order of things.

Happily, the times indicate that to create such an order not only is the proper policy of Government, but it is the only line of safety for our economic structures as well. We know, now, that these economic units cannot exist unless prosperity is uniform, that is, unless purchasing power is well distributed throughout every group in the Nation.[34]

However, perhaps the most convincing piece of evidence comes from *MCPP* itself, where, in Chapter 1, the concern over large conglomerates involves the question of saving; more specifically, of free cash flow (retained earnings), where a substantial portion of profits are withheld by the two-hundred corporations, hence not paid out as dividends. As it turns out, this is a direct off-shoot of the excess-savings hypothesis that had gained traction in the late 1920s, being found in the writings of Rexford Tugwell, Paul Douglas, and numerous others. Berle and Means tendered another cause, namely increasing firm size, increasing concentration and managerial usurpation. Put differently, the savings glut referred to earlier, in whole or in part, could be attributed to the managerial elite, which had usurped not only control but also resources, thus hindering the transition.

More proof comes by way of Berle and Means's focus on the role of firm size and industry concentration on pricing behavior. Again, given the lack of competition, firms wielding market power were less inclined to cut prices in the face of excess capacity.[35] In his 1935 brief to Congress, Gardiner Means proposed a dichotomization of U.S. markets into (1) those in which prices are administered (i.e., administered prices), and (2) those which are market-based (i.e., market-based prices). Administered prices (the purview of the two-hundred large conglomerates in *MCPP*) were set

34. Franklin D. Roosevelt, Governor of N.Y., Address at the Commonwealth Club in San Francisco, California (Sept. 23, 1932).

35. As it turns out, these notions would be formalized in the monopolistic competition literature with contributions by Edward Chamberlin, Joan Robinson, and Paul Sweezy. The underlying idea was that firms had acquired a form of market power that de facto insulated them from competition. *See* Edward H. Chamberlin, *The Origin and Early Development of Monopolistic Competition Theory*, 75 Q.J. ECON. 515, 515–16 (1961).

by large conglomerates and were, as such, less responsive to market forces.[36]

The last piece of evidence is an article published in 1921 entitled *How Labor Could Control* by Adolf A. Berle—the same year Thorstein Veblen published *The Engineers and the Price System*—in which he outlined his view of how the corporation could be used as a tool for the redistribution of wealth and power to the "staff of the plant."[37] The "staff" in this case included the managers and the board members as well as the workers.

Distant Cousins?: Veblen's Managerial Sabotage and BM's Notion of Shareholder Usurpation

It is my view that Berle and Means's notion of managerial usurpation has much in common with Thorstein Veblen's notion of "managerial sabotage."[38] Veblen argued that by not raising wages and/or cutting prices in response to greater production/cost efficiency, for-profit managers sabotaged the transition, thus denying society the gains from the new technique. Berle and Means made a similar argument, pointing out that managers were no longer behaving in what could be referred to as the appropriate manner. In Berle and Means's case, they were engaging in excess saving behavior and resisting price decreases (owing to greater concentration). According to Veblen:

> Without some salutary restraint in the way of sabotage on the productive use of the available industrial plant and workmen, it is altogether unlikely that prices could be maintained at a reasonably profitable figure for any appreciable time. A businesslike control of the rate and volume of output is indispensable for keeping up a profitable market, and a profitable market is the first and unremitting condition of prosperity in any community whose industry is owned and managed by business men. And the ways and means of this necessary control of the output of industry are always and necessarily something in the nature of sabotage—something in the way of retardation, restriction, withdrawal, unemployment of plant and workmen—whereby production is kept short of productive capacity.
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> The mechanical industry of the new order is inordinately productive. So the rate and volume of output have to be regulated

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36. *See* GARDINER C. MEANS, INDUSTRIAL PRICES AND THEIR RELATIVE INFLEXIBILITY, S. DOC. NO. 13-E-7, at 24–25 (1935).

37. *See* Adolf A. Berle, Jr., *How Labor Could Control*, 28 NEW REPUBLIC 37, 38 (1921).

38. Charles O'Kelley made a similar argument, pointing out that "[i]t is clear that Berle shared Veblen's belief that control was responsible for the periodic underutilization of factories and manpower." *See* Charles R.T. O'Kelley, *Berle and Veblen: An Intellectual Connection*, 34 SEATTLE U. L. REV. 1317, 1348 (2011).

> with a view to what the traffic will bear—that is to say, what will yield the largest net return in terms of price to the business men who manage the country's industrial system.[39]

Berle and Means, however, focused on the legalities—or illegalities—of this new form of industrial organization and management, emphasizing the question of power and property. One could argue that such was Adolf A. Berle Jr.'s intellectual comparative advantage, being the legal scholar that he was. In short, the managers of the two hundred corporations in question had shirked their fiduciary duties and thus were guilty. Veblen, on the other hand, put the onus on financial capital that had commandeered the principal sectors of the U.S. economy.

As it turned out, this was the basis for Veblen's proposed solution, namely a plan for a "soviet of technicians," or technocrats, that would manage the economy in lieu of profit-seeking managers. In short, managers would give way to "several thousand technically trained men scattered over the face of the country, in one industry and another; must carry out a passably complete cadastration of the country's industrial forces; must set up practicable organization tables covering the country's industry in some detail—energy-resources, materials, and man power."[40]

This would eventually be realized in the form of the Technocracy movement with its emphasis on the role of energy in material processes and its advocation of a new class of managers, the *Technate*, composed largely of engineers whose goal would be to optimize/maximize output, thus eliminating the problem of excess capacity.[41]

III. MARX AND BERLE, TWO PEAS IN A POD?

In this section, I argue that while the similarities with Veblen were important, they were even more pronounced in the case of nineteenth century political economist Karl Marx. Specifically, both Marx and Berle had much in common, including invoking a theoretical/conceptual stratagem as a basis for advocating profound change in the workings of the economy: the labor theory of value (in the case of Marx) and the shareholder usurpation theory (in the case of Berle).[42] The labor theory of

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39. VEBLEN, *supra* note 7, at 7–8.

40. *Id.* at 139.

41. *See* SCOTT, *supra* note 27, at 39–49.

42. It is interesting to note that Berle saw himself as a twentieth-century version of Marx, defending the rights of workers and investors (stakeholders) vis-a-vis managers. According to Fenner Stewart, Jr.,

> [Berle] envisioned the distribution of corporate ownership through the middle and working classes as a mechanism to place the power of economic concentration under a form of democratic control through shareholder power. In fact, Berle had the bold ambition of

value provided Marx with the theoretical basis for his concept of surplus value or, more formally, the rate of surplus value.[43] According to Marx, given that labor was the only physically productive factor input, payments to the owners of capital amounted to a form of theft. Moreover, the greater the rate of surplus value, the greater profits and the less purchasing power in the hands of workers. The only way to correct this anomaly, and thus ensure an orderly transition, according to Marx, was via state/third party control—in short, socialism or communism. In the case of Berle and Means, the solution was to be found—at least in part—in what they referred to as the "law of corporations," which they saw as "a potential constitutional law for the new economic state":

> The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state—economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation. . . . The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization. The law of corporations, accordingly, might well be considered as a potential constitutional law for the new economic state, while business practice is increasingly assuming the aspect of economic statesmanship.[44]

There are, however, problems with both arguments. In the case of Marx, it lies with the technical underpinnings of the labor theory of value, specifically the fact that by the mid-nineteenth century labor was no longer physically productive but rather had been reduced to a supervisory input. In other words, not only was capital not physically productive (according to classical mechanics), but labor in the factory system was also no longer physically productive.[45] In short, the labor theory of value was a strategem of sorts whose purpose was to legitimize/justify his proposed solution to the problem of the nineteenth century FT.

> becoming the prophet of the shareholding class, or as he so modestly put it, "the American Karl Marx."

Fenner Stewart, Jr., *Berle's Conception of Shareholder Primacy: A Forgotten Perspective for Reconsideration During the Rise of Finance*, 34 SEATTLE U. L. REV. 1457, 1465 (2011) (citing JORDAN A. SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN 62 (1987)).

43. The level of surplus value (s) is defined as the excess of value of product over value of inputs. The value of inputs is defined as the sum of constant capital (c) and variable capital (v). As such, the total value of product is defined as $C = (c + v) + s$. The rate of surplus value is simply s/c.

44. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 357 (Macmillan 1933).

45. The only physically-productive factor input was the steam engine, which provided the energy that powered all material processes.

The same was true of Berle and Means. As a number of writers have since shown, shareholders (as distinct from owner-managed firms) in the nineteenth and early twentieth centuries never de facto controlled firms beyond threatening to withdraw their investment or sell their share. This owed, in most cases, to the lack of either knowledge or skills (understanding of the products/processes/markets) and/or the increased capital requirements that resulted in diffused ownership. However, Berle and Means hoped to use the legal argument as a lever towards what many describe as a stakeholder view of the firm. This, however, would be achieved via the issuance of worker-held shares/equity.[46] Moreover, it is my view that Berle's position in the celebrated Berle–Dodd debate was motivated by strategic concerns. In other words, his espousal of the shareholder primacy view was a necessary condition for making a case for a new arrangement in which workers would become shareholders. The Dodd stakeholder view, while not dissimilar, would have invalidated the very basis of Berle's approach. In other words, it would have legitimized the role of managers as arbitrators in the distribution of income. The point here is that while both positions shared a common objective, the means to such an end were fundamentally different.

Furthermore, it could be argued that the shareholder dilution theory was also a stratagem of sorts. The shareholder dilution theory alleged that the number of shareholders in the early twentieth century had increased such that no one shareholder held a controlling interest. While holdings were in fact diluted in the early twentieth century, this was not new, having characterized the U.K. and U.S. economy throughout the nineteenth century.[47] In fact, in *Das Kapital*, Marx had referred to the separation of ownership from control.[48] Further, Eric Hilt has shown that throughout the eighteenth and nineteenth century, ownership in U.S. corporations was highly diluted.[49] It is my view that shareholder dilution theory was an instrument intended to strengthen the case for third-party intervention. In other words, the shareholder dilution theory was a call-to-arms of sorts, intended to spur on and motivate a policy response.

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46. This view originated in Berle's early writings. For example, in Berle, *supra* note 37, at 31–39, Berle argued in favor of shareholder primacy as a necessary prerequisite to a new, radical form of income distribution based on both investor-held and worker-held shares. In other words, shareholder primacy should not be seen as a defense of the status quo (i.e., skewed distribution of income), but rather as a stepping-stone to a more egalitarian distribution of income. *Id.* at 37–39.

47. *See, e.g.*, LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY—AND HOW THE BANKERS USE IT 214–16 (1914); RICHARD T. ELY, MONOPOLY AND TRUSTS 269 (1900); LEWIS H. HANEY, BUSINESS ORGANIZATION AND COMBINATION 63–80 (1914); WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 144 (1927).

48. 3 KARL MARX, DAS KAPITAL ch. 27 (1894).

49. *See* Eric Hilt, *The 'Berle and Means Corporation' in Historical Perspective*, 42 SEATTLE U. L. REV. 417 (2019).

In the late nineteenth century, the labor theory of value was replaced by neoclassical production theory according to which both labor and capital were physically productive. However, while this solved the Marxian conundrum (i.e., justifying profits), it only muddied the waters more as capital (tools and structures) was not, according to basic physics, productive because it is not a source of energy.[50]

Table 3: Marx and BM's Stratagems: Fact and Fiction

Author	Stratagem	Fact
Karl Marx (1867)	Labor Theory of Value Rate of Surplus Value	− Labor is a supervisory input. − Labor is not physically productive.
Berle and Means (1932)	Managerial Usurpation	− The owners of capital never controlled the firm. − Capital (tools and structures) is not physically productive. − Presence of organization capital.

This leads us to conclude that, despite the commonly held view, *MCPP* was not ultimately about shareholder primacy per se. Rather, shareholder primacy should be understood as a means to an end and one intended to legitimize Berle and Means's proposed solution to the overriding problem in the 1920s, namely the failure of the U.S. economy to perform at its potential.[51] Fate would have it that the stock market crashed in 1929, and the economy fell into a severe depression, which changed both the context and nature of the ensuing debate over the issue of governance. As such, I maintain that *MCPP* should be understood not as an ode to shareholder primacy, nor as a critique of managerial behavior in the midst of the downturn/Great Depression, but rather the authors' attempt at analyzing and providing a solution to the problem of the FT in the 1920s.

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50. *See, e.g.*, BERNARD C. BEAUDREAU, ENERGY AND ORGANIZATION: GROWTH AND DISTRIBUTION REEXAMINED 109 (1998); Bernard C. Beaudreau, *The Problem with Production Theory*, 77 REAL-WORLD ECON. REV. 85, 88 (2017).

51. Fenner Stewart Jr. made a similar argument, asserting that

> Berle's theory of the Corporate Liberal Revolution is significant to understand because it makes clear that his motivation for endorsing shareholder primacy was to shape the corporation to be a tool to democratize the American economy. Understanding this motivation helps one appreciate Berle's later shift away from shareholder primacy toward other strategies to bring economic power under democratic controls. Shareholder primacy was not an end for Berle, it was merely a means to an end.

Stewart, *supra* note 42, at 1463.

IV. WHY *MCPP* HINDERED PROGRESS IN THE FIELD OF CORPORATE GOVERNANCE

It is my view that contrary to the accepted wisdom that *MCPP* brought the problem of governance to the fore (although the authors were neither the first nor the only ones to raise the problem), it actually hindered progress in the field of corporate governance. This is based, in large measure, on two factors: (1) Berle and Means's original intent/interests and (2) the unscientific nature of *MCPP*. *MCPP* was not an attempt on the part of two scholars, one legal and the other economic, to understand the question of control within both the pre- and post-second industrial revolution firms. That would have entailed a detailed examination (technology, information, bargaining) of entrepreneurial and owner–manager forms of organization, complete with an analysis of the choice space (multidimensional) of each. Instead, *MCPP* was based largely on popular sentiment and a set of preconceived notions, notably that ownership had become highly disparate, thus providing the basis for managerial largesse and failings—especially regarding the transition. Greater productivity had not led to higher purchasing power and a successful transition, but rather had led to greater savings on the part of corporations and rigid prices—two of the key findings of *MCPP*.

MCPP resulted in the polarization of the debate; those on the right refuted *MCPP*'s conclusions, and those on the left used *MCPP* to further their agenda. The debate soon degenerated into a shouting match, which explains, in large measure, the little real progress that has been achieved in the field. The political right continues to see governance in terms of agency theory, while the left sees it in *MCPP* terms, namely that managers have usurped and continue to usurp control. Unfortunately, neither school has presented a convincing theory complete with corroborating evidence. Agency relationship has been systematically refuted,[52] and the *MCPP* has failed to gain traction as a theory of managerial behavior, except when there is a scandal (e.g., the Financial Crisis of 2008).

This leaves many questions unanswered, including what do managers actually do? What is the role of organization capital in the firm?[53] How do scarcity and managerial skills influence the question of corporate control? I, for example, have proposed a bargaining approach to

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52. *See* Michael Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, *in* THE MODERN THEORY OF CORPORATE FINANCE 82 (Michael C. Jensen & Clifford H. Smith Jr. eds., 1984).

53. *See* Bernard C. Beaudreau, *Corporate Control: Towards a Realistic Theory*, 4 CAN. INV. REV. 47 (1991); Edward Prescott & Michael Visscher, *Organization Capital*, 88 J. POL. ECON. 446, 446–48 (1980); David Teece, *A Dynamic Capabilities-Based Entrepreneurial Theory of the Multinational Enterprise*, 45 J. INT. BUS. STUD. 8 (2014).

control in which the owners of organization capital and the owners of physical capital bargain over a state space that includes the return on capital and uncertainty/risk. The resulting equilibria include cases in which, given the underlying uncertainty, shareholders earn an above-average rate of return on their investment in return for having assumed risk/uncertainty.

Ironically, while the problem *MCPP* set out to address (i.e., the failed transition) had been resolved by the end of WWII—largely as the result of government expenditure—its basic underlying argument went on to live a long and illustrious life as the cornerstone of corporate law. This was unfortunate as it hindered real progress in the field of corporate governance. Today, the owners of tools and structures are still seen as the de facto and de jure corporation, despite being a passive and physically unproductive factor input. The important role of organizational capital in the rise of the modern corporation continues to be ignored.[54]

SUMMARY AND CONCLUSIONS

In this Article, I have argued that the *MCPP*, the work that single-handedly launched the field of corporate governance, was less about the question of shareholder primacy and more about the 1920s problem of the failed transition from a lower to a higher equilibrium growth path. As such, it should be seen as belonging to a period of literature that included the writings of Thorstein Veblen, Paul Douglas, Rexford Tugwell, Henry Ford, Edward Filene, and numerous others, each pointing an accusing finger at the managerial class for the purported failure.

This explains—or at least goes a long way to explain—the incongruities found in both *MCPP* and the many writings of Adolf A. Berle Jr. *MCPP* should, as such, be understood not as an attempt to understand corporate governance per se, but as Berle and Means's attempt to understand the FT in the 1920s, attributing it to greater savings on the part of the two hundred large corporations studied as well as their alleged failure to behave according to basic, fundamental economic principles (i.e., cutting price in the face of excess supply).

I am also of the view that Berle and Means's inability to distinguish between what was an episodic problem (i.e., the FT) and the steady-state or the long-term tainted the bulk of their work, resulting in glaring incongruities and contradictions. For example, despite their dire warnings, the post-WWII period witnessed record growth in wages and profits, experiencing the most prosperous period in its history. Yet, Berle and Means persevered with their critique of managers.

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54. *See, e.g.*, CHANDLER, *supra* note 4, at 498–500.

Lastly, I argued that while the *MCPP* was largely about the failed transition, the events of 1929 to 1932, specifically the stock market crash and the Great Depression, transformed it into something different—a broad critique of the capitalist system and of its new managerial class. For example, the delayed recovery was attributed, by many, to the managerial class whose behavior no longer responded to market incentives—in this case, no longer adjusted prices downwards in response to excess supply. Unfortunately, this only served to further muddy the waters and made understanding the origins of *MCPP* all the more difficult.

Largely ignored in the post-WWII period, *MCPP* became the battle cry for jaded shareholders but failed to gain early traction as the dominant view of governance and of the purported ill-effects of the new managerial elite. This changed with the productivity slowdown in the late 1970s and early 1980s when it was felt that a new breed of managers was needed to rekindle growth; specifically, managers who responded to incentives. Thus was born the era of MBA-trained, incentivized, and stock-optioned upper management whose ultimate goal was to restore growth to previous levels. It turns out, however, that they did little more than cut costs, which did increase profits but failed to restore growth rates to their post-WWII levels.

It is my view that failure to understand the very nature and behavior of the very managerial elite that ushered in the second industrial revolution was largely to blame. They were, among other things, great visionaries more bent on changing the world than their stock option plans. The control they exerted on firms was owed to their genius, vision, and sense of purpose. Shareholders came on board and provided the tools, buildings, and other material inputs needed to realize their visions.