

CHAPTER 8

ECONOMIC INSTITUTIONS: A DARWINIAN VIEW OF CORPORATIONS

Overview of Economic Institutions

Having cast the light of the renewed Darwinian theory on the institutions of government in the previous chapter, I will now turn that light upon an institution, which rivals government in its influence over people's lives around the world—the corporation. But to put the corporation in perspective, I will first briefly sketch the leading economic institutional forms that preceded it during the historic period.

In late Stone Age tribes, the primary economic organizations were the gathering parties and the hunting parties. When it came to hunting large mammals, such parties probably had to be fairly large. When certain animals became domesticated, the nomadic pastoral life became dominant and these domesticated animals became the primary forms of wealth. Then, of course, agriculture took over as the dominant way of “making a living” and the individual ownership of arable land became the chief basis of wealth.

Not much is known about the patterns of land ownership during the transition to the earliest empires of the Middle East. However, since hunting and foraging land seems to have been “owned” by the tribe as a collective and since, during the transition to individual ownership, arable land would probably have changed hands primarily by armed conquest, it is likely that conquered land would have been treated as the property of the tribal warlord or, later, the king or emperor. He, of course, would then have the right to award large parcels of conquered land to others, such as his successful generals. The people who were living on the land at the time of the conquest were probably treated as landless serfs with some rights but not many. Clearly this was the established system during the Dark Ages and on into the feudal period in Europe. It was by this process that arable land, the primary means of production at the time, became subject to individual ownership and was usually held in large parcels. Various arrangements would have been made to secure the labor needed to work these large parcels, such as slavery, serfdom, indentured servitude, day labor, and tenantry. The renewed Darwinian

theory predicts that, wherever free-riders managed to secure the ownership of large parcels of land; they would seek the least costly form of labor available, which was at times slavery.

These traditional land-ownership arrangements were brought to the English colonies in America, with the King of England granting large parcels to favored members of the aristocracy. In the Southern tidewater region, these parcels were of a large “plantation” size; and, while individual families could certainly own them, a significant number of landless laborers were needed to work them. The fact that, in time, most of these landless laborers were secured by a slavery system suggests that some of the landowners were free-riders. The English landowners were learning about slavery from the Spanish and Portuguese colonists in other parts of the Americas and English law at the time was silent about slavery. In the New England and mid-Atlantic colonies, however, the pattern of land ownership took a different turn. For various complex reasons, the large parcels of land originally distributed came to be broken up into smaller parcels that could, by and large, be worked by a single land-owning family. To cite just one example, William Penn, who secured a large land grant as an eligible aristocrat, persuaded a group of his fellow citizens in England to join him in the New World based on the promise of land of their own. The ownership of land in these family-sized parcels also became the norm in the northern colonies.

Meanwhile in Europe, workshops with skilled artisans had been steadily growing in number since the start of the Renaissance. These small shops were manufacturing a wide variety of artifacts and were staffed by the master/journeyman/apprentice system. Over time, these shops clustered into guilds, which established and enforced the terms of trade and of employment for each craft. Trade expanded from the local market to a national market and even to an international market. But the workshop form of economic institution, despite its rapid growth, never employed as many people as agriculture did. Only when manufacturing scaled up into the industrial-factory form in Europe, and then shortly afterwards in the newly established United States, did it replace agriculture as the dominant form of employment—the setting in which most people fulfilled their dA drive.

The concept of private ownership of the physical means of production of goods and services was carried forward from the ownership of arable land to the ownership of workshops and finally to the ownership of factories and corporations. And the laws which legitimated private ownership of land more or less “went along for the ride,” legitimating the private

ownership of workshops, then of factories, and then of larger and larger corporations, without explicit regard to the fact that the private owners in question were an ever-smaller minority of the vast number of people involved in these production processes. In this way, large corporations that were owned by relatively few people became, in industrial societies, the setting in which a large percentage of the population were fated to attempt to fulfill their basic drive to acquire. But we are getting ahead of our story: Corporations, much less large corporations, were essentially unknown to the Framers of the Constitution. In fact, for Locke, and for the Framers of the U.S. Constitution, the very essence of liberty was the private system of ownership, and the ownership they had in mind was that of the family farm.

The U.S. Constitution was one of the legal documents in which private property rights to the physical means of production were explicitly established. Amendment V of the Bill of Rights states, “No person shall... be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.” At the time they drafted these words, the Framers were implicitly thinking that the ownership of the means of production would be widely dispersed, as was true when farmers owned their own land. This, as we all know, is not how it has turned out.

Overview of the Corporation

Today’s corporations are legally established collectives that have been empowered primarily to fulfill the human drive to acquire. The positive results of this particular means of organizing the fulfillment of the drive to acquire are conspicuous and impressive. Compared to other ways of organizing economic activity, corporations are, by and large, vastly more cost-efficient and innovative. The reasons for this success are complex, but scholars of the process generally agree on the two most important reasons. First, the corporate form, in contrast to individual ownership, enabled a rapid collection of the significant capital required to quickly achieve the economies possible in large-scale production. Second, by opening up the possibility of multiple start-up firms in all types of industries, the corporate system created the competitive striving (dA) between firms that led each firm to constantly seek efficiency improvements and useful innovations.ⁱ

As a result, the corporate form has been able to marshal economic resources on an unprecedented scale and to put those resources to work in singularly patient, long-term

enterprises capable of economic undertakings , which no individual or small group of individuals could hope to accomplish. Corporate institutions have been so successful in increasing the ability of people to produce useful goods and services that they have become the dominant means for doing so all over the world.

Unfortunately, the historical record shows that the harm that corporations at times do has also been impressive. The abuses can take any of six general forms: 1) exploiting and harming employees, 2) promoting the sale of wasteful or even harmful products, 3) defrauding small investors and creditors, 4) competing unfairly with competitors and dealing unfairly with suppliers and distributors, 5) damaging the physical and biological environment, and 6) corrupting the government. When corporations are successful in corrupting the government, they can control policies and laws to the point of evading responsibility for any harm they do to others, of evading taxes, and of securing unfair subsidies. Such abuses, if practiced with impunity, can, of course, help the corporation's large investors and top executives acquire enormous personal wealth.

How can the same institutions be so beneficent and also, at times, so abusive? How can they be both Mr. Hyde and Dr. Jekyll? This is a mystery that will take some effort to untangle. What does the renewed Darwinian theory suggest about this puzzle?

In today's world, corporations are the primary institutional means most people in industrial countries have to fulfill the human drive to acquire, but dA is not the only human drive. Today's corporation is a highly complex collective, typically drawing together the participation of hundreds, thousands, or even millions of employees, customers, suppliers, and shareholders. To various degrees, these people are drawn into bonds of mutual caring or there would be no team effort, no brand loyalty, no creative spark, no corporate esprit, and no management motivational tools other than financial rewards and threats. In other words, although corporations are organized primarily to fulfill the drive to acquire, they could not accomplish this without relying heavily on the human drive to bond, the human drive to comprehend, and even the drive to defend.

With our grounding in the RD theory, we should already hear some alarms going off in our minds:

- A corporation, given the way it has been chartered and legally defined, is essentially unbalanced in terms of our four innate drives. In some corporations, the drive to bond is treated strictly as a means of fulfilling dA. These corporations treat employees well, play fair with competitors, and give customers and suppliers an honest deal because that's good for the dA bottom line—and only to the extent that it is good for the dA bottom line—not because it is what humans are innately designed to do in relation to one another. (And we must remember that, in the end, the “corporation” is not a conscious being and can do nothing; only its individual members can make decisions and take actions.) Seen in terms of what we learned in Part I about the functioning of the human brain, every corporation has to address the stubborn fact that all four human drives are in the heads of each and every normal person involved. But legally, the four drives do not have equal voices. In some corporations the dA drives of individuals are deliberately and expertly stimulated and magnified, but the dB drives of individuals are largely ignored. In these corporations there is one all-powerful faction—the coalition of large shareholders (represented by the directors) and their top management with their laser-like focus on maximizing profits—with little in the way of checks and balances.
- A corporation is legally defined as an “individual” with all the rights and responsibilities that entails. But what kind of individual are we talking about? The courts seem often to be supporting the view of the neo-classical economists that corporate “individuals” have only dA wired into their brains and have no mandated responsibilities to address drives other than dA or segments of society other than owners. At times, the courts have even insisted that corporate leaders put maximum profitability above every other concern or else face financial penalties from suits brought by stockholders. In fact, the World Trade Organization seems to be concluding that any national government's effort to enact and enforce laws to constrain multinational corporations from abusive behavior within their own national boundaries is to be judged a “restraint of trade” and hence illegal under emerging international trade law. Far from encouraging a healthy balance of dA with dB and the other drives, that balance

is discouraged and may even be penalized—by the marketplace, if not by the authorities. From this legal perspective, then, the corporation is *expected* to behave like a free-rider—in fact, like a superhuman free-rider, with the combined power of hundreds, thousands, or even tens of thousands of ordinary people. And so it sometimes does. The abuses of such corporations are precisely the abuses we expect of a free-rider—doing anything they can get away with to acquire wealth and to acquire the power needed to acquire wealth.

- The very conspicuous success and power of corporations acts as a powerful magnet attracting the free-riders in our midst who maintain a single-minded focus on gaining power and thereby wealth. Corporations seem fairly vulnerable to being taken over by a small clever group drawn from the tiny minority of free-riders in the population. It is important to remember that a free-rider at the helm of a collective is dangerous not only because he or she is a free-rider, but because practically everyone else is not a free-rider. A free-rider CEO with ten thousand free-rider employees would not pose that much of a threat; they wouldn't begin to have the coherence and effectiveness of a normal company. But any real company, even with a free-rider group at the top, is mainly composed of four-drive humans who feel friendly toward fellow workers, grateful for favors done, sympathetic toward a coworker struggling with an obstacle, concerned for the welfare of their families, and loyal to their employing firm. A reasonably well-organized collection of such people is capable of performing remarkable feats but, with a free-rider at the top, these might be feats of manufacturing and selling defective products or driving someone else out of business by underhanded means.

A free-rider who gets control of a major corporation can change the business culture of an entire industry. Employees at lower levels have no choice but to go along with their leader's tactics or quit their jobs. Normal, four-drive leaders of competitive firms are put on the defensive by free-rider tactics and are pressured into imitating them or selling out on unfavorable terms. Top-level free-riders can exercise power on a scale that is far beyond face-to-face social controls. They can command the help of sophisticated lawyers, accountants, and public relations experts in abusing the rights of others involved and the public interest. They command vast financial

resources that can go far toward corrupting the governmental process itself. They can make a finely tuned analysis of whether dollars spent on lobbying or on campaign contributions return the most value in special favors, greatly complicating the already difficult job of regulating corporations. They can, at times, even gain control over the drafting of laws designed to regulate their own behavior.

We saw in the previous chapter that when the rise of civilization brought about larger and highly stratified collectives, such as cities, the free-rider genie was let out of the bottle in which it had been largely confined since the transformation to *Homo sapiens*. Seen from the point of view of the RD theory of human behavior, the rise of corporations—of collectives legally sanctioned and socially encouraged to fulfill dA without having to balance it with an equally powerful dB—was a serious mistake. What more perfect vehicle for acquiring personal wealth can a free-rider imagine, especially in the United States where the government has been designed to keep free-rider politicians under control, and where there was no experience with regulating corporations?

How did this situation come to pass?

James Madison could not have predicted the rise of corporations, but he did foresee that political factions would organize around the narrow economic interests of an elite few: “Those who hold and those who are without property have ever formed distinct interests in society.”ⁱⁱ Madison believed that the acquisitive drive was deeply human, a powerful drive that no political structure would be able to ignore. Any government trying to wrestle it under control by brute force would cease to be a republic. The only solution, the only “republican remedy,” Madison could see was to turn the acquisitive drive against itself, not only by checking the acquisitive passion (dA) with the passion for the common good (dB), but also by checking the raw, irrepressible dA energy of one individual with that of another. This later was Madison’s solution for any free-riders—those without a dB—who could be counted on to try to work their way into top governmental power positions.

The Framers created a remarkable set of institutions with a powerfully adaptive capacity for balance and growth in the political sphere that has been able to reasonable well constrain the free-riders, but in the business sphere, they took only the first steps of what has proven to be a painful, protracted, and limited search for effective check and balance mechanisms. In effect, the corporation as we know it flew in under the radar of the Founders and the Constitution. The

corporate structure was never given the kind of impulse/check/balance embodiment that the government itself received. Corporations never had its constitutional convention. It was never provided with the structural mechanisms to constrain the damage that free-riders could do from top corporate power positions. Despite the Founders' concern to control factions, this particular corporate type of faction has even had the chance to become powerful enough to overwhelm, at times, the government's regulatory powers themselves, first at the state level and then at the federal level. Quite simply, over the course of the 19th century, the power of corporations expanded more quickly than the regulatory reach of government.

The Rise of American Corporations and the Struggle to Regulate Them

Early European corporations were chartered one-at-a-time as joint stock firms by the executive, the crown and constrained to undertake a single tightly defined job such as the building roads and bridges. But post-Revolution Americans so distrusted the idea of broad executive powers that this power was instead given to the state legislatures, as elected guardians of "the people." An 1804 Supreme Court decision confirmed that corporations were "mere creature[s]" of the state legislatures, holding only those powers of operation expressly granted by their charters.ⁱⁱⁱ This made it possible to reshape the concept of the corporation from a privileged grant of power over a very specific economic opportunity to a vehicle of unbounded economic opportunity. State legislatures granted charters increasingly freely as the pace of economic activity quickened.

By the middle of the 19th century, the largest American corporations were already operating across state boundaries, while the federal government was only belatedly and tentatively assuming comparable proportions and powers and facing intense resistance, particularly to federal control of slavery. Concerns about corporations' growing abuse of their growing power coalesced at the time into the concept that governments should police (rather than directly initiate, sponsor, or run) corporations, but only when their actions conflicted with the property rights of others.

The First Big Corporations with National Scope: The Railroads

The railroads were the first American businesses to reach massive scale and thus the first to outgrow state regulatory structures. The first American railroad charter was granted by New

Jersey in 1815 to support the construction of a railroad from Trenton to New Brunswick. The railroad idea slowly gathered inexorable momentum. By the 1840s and 50s, states were granting numerous charters to railroad corporations and railroads began to spread across the country. Meanwhile, consistent with Madison's warning about the "bribes of the rich," the emergence of these new enterprises led to systematic efforts to corrupt the political process. The railroads were acquiring preponderant influence within state legislatures and the state courts. The railroads depended on favorable policies and rulings in order to increase their profits and they exerted as much pressure as they could bring to bear when critical decisions had to be made. Shaping and bending policy via "factions" were ancient arts, but it was the railroads that made them into quintessential American scandals. The nation's earliest professional lobbyists were spawned from this industry; graft and corruption took hold in a significant way.^{iv}

Jay Gould—to judge by his behavior pattern—was the first and most clear-cut candidate for the free-rider label to appear on the national railroad scene as a major player. Gould began speculating in railroad securities during the Civil War, buying up run-down roads, cobbling them together, and selling them off at huge profits. Whenever he achieved a local monopoly he raised the rates. He used predatory pricing to force competitive roads to sell out to him at rock-bottom prices. In 1867, he tilted with Cornelius Vanderbilt, another candidate for the title of an early free-rider, and acquired control over the Erie Railroad. In 1875, he acquired control over the Union Pacific. By 1881, at the peak of his power, he ran a vast railroad empire, spread across the continent. Along the way, he issued millions of dollars in fraudulent securities and dispensed thousands of dollars in bribes to judges and legislators. He was utterly unscrupulous as a highly skilled financier, although he proved less adept at actually operating railroads. His record closely matches Hare's list of the defining characteristics of free-riders.

Meanwhile, Vanderbilt was establishing his own record as a candidate free-rider. A set of reports issued by Rufus Hatch in 1871 exposed Vanderbilt's business methods. They concluded that, "through stock waterings, fictitious construction costs, and profits on land grants, the four roads, controlled by Commodore Vanderbilt, realized profits of \$135 million in excess of the actual cost of these roads."^v A book by Henry and Charles Francis Adams, published in 1886, reported on the competition between Vanderbilt and Gould to corrupt the government. As summarized by Perrow, "It was a stunning condemnation of wildly extravagant corruption centered on the New York railroads and their masters. [It] discussed the open bidding for votes.

In one example, Commodore Vanderbilt is dismissed by legislators for this ‘paltry’ offer of only \$1000 (and only half in cash), while Jay Gould was paying between \$2,000 and \$3,000 for a vote.”^{vi} Quite literally, this was a free-rider race to the bottom.

By the 1870s, the abuses of the railroads had become a serious national political problem. Early efforts at regulation were sporadic and unevenly effective. But as railroads became increasingly indispensable economic lifelines to surrounding communities, popular agitation over the very high rates that railroads were charging for freight whenever they secured a local monopoly grew intense. A number of states (mainly in the agricultural Midwest) passed Granger laws in the 1870s, attempting to regulate railroad rates. However, these efforts were checked in the Granger cases of 1877, in which the U.S. Supreme Court, while upholding the principle of government regulation over railroads and other industries “affected with a public interest,” nonetheless insisted that state regulatory authority ended at state lines—which, of course, most railroads crossed and left behind. Then, in 1886, the Supreme Court issued the *Wabash, St. Louis and Pacific Railroad Company v. Illinois* decision, which held that commerce originating or ending outside the boundaries of a given state could not be regulated by that state.

The Federal Response

The *Wabash* decision made the need for federal regulation clear. As progressive reformer Henry Demarest Lloyd observed, “Our laws and commissions to regulate the railroads are but toddling steps in a path in which we need to walk like men.”^{vii} Accordingly, in 1887, Congress created the Interstate Commerce Commission. The statute authorizing the ICC outlawed rebating, pooling, and most forms of rate discrimination between long- and short-haul traffic. Congress also held that rates had to be “just and reasonable,” a determination the ICC was empowered to adjudicate.

But the Supreme Court whittled away at ICC authority in a series of decisions in subsequent years, in turn forcing Congress to expand it incrementally. In the Elkins Act (1903), Congress reaffirmed and reinforced federal restrictions against rebating; in the Hepburn Act (1906), Congress authorized the Interstate Commerce Commission to fix railroad rates; the Mann-Elkins Act (1910) broadened these powers. It took the federal government several decades, in other words, to assert the authority of full regulation over the railroads.

Meanwhile, other businesses were reaching comparable scale. As national infrastructure (particularly railroads and telegraph networks) welded together a national market, and as technologies of mass production emerged in a series of industries over the 1870s, 1880s, and 1890s, manufacturing businesses grew bigger in scale and in scope of operation until they were doing business on a national, and indeed international, scale. Like the railroads, moreover, they assumed corporate form as they grew.

For these new large-scale manufacturers, meanwhile, the regulatory context was even more tentative. Because they were chartered by the states, the states held jurisdiction over their behavior—at least theoretically. But as these manufacturers expanded their operations to a national scale, state governments handled the situation gingerly—if they handled it at all. Although, by the 1880s, most states had set up advisory commissions to oversee the activities of corporations engaged in transportation, banking and insurance, it wasn't until 1903 that any state except Massachusetts had set up a commission to oversee its manufacturing firms.^{viii} And while state laws were beginning to affirm the right of regulation in theory, there were virtually no effective policing mechanisms.

By the end of the 1880s, big business seemed to be running amok and, in 1890, Congress responded with the Sherman Act, which outlawed “every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce” and criminalized “every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations.” Yet the act set up no new machinery of execution and its limits became clear in 1895 when the Supreme Court ruled that the American Sugar Refining Company, although it controlled 98% of its market, was not in violation of the law because it manufactured sugar rather than selling it, and so was not engaged in interstate commerce.

By the end of the 19th century, then, a tightly cohesive and politically powerful cluster of corporate leaders had formed a faction which had outgrown the reach of republican governance. In terms of this book's theory, this small set of men, several of whom were probably dA-driven free-riders, were in power over wonderful new vehicles for the acquisition of power and money and were operating without restraining dB mechanisms, either personal nor institutional. (There were no income or estate taxes to constrain their accumulation of wealth.)

Meanwhile, social tensions were rising. Confrontations between organized labor and big business were escalating; Homestead was only one of numerous bloody battles fought during this period. In 1886, a man attending a rally of striking workers in Haymarket Square in Chicago hurled a bomb, provoking the police to open fire on the gathering. In 1894, armed conflict again enveloped Chicago when a strike at the Pullman plant spurred President Cleveland to send federal troops to the city. The ensuing melee left 13 dead and dozens more wounded. Over 1,300 strikes erupted that year, many of them violent, as the United States plunged deeper into a national depression that made fears of “insurrection” all the sharper. By the mid-1890s, many Americans feared that the nation was coming apart.

One figure confronting the specter of insurrection and republican collapse was Theodore Roosevelt. “The time of the great social revolutions has come,” he declared as a rising political figure in 1894. And indeed, it was insurrectionary violence that thrust Roosevelt onto center stage. On September 6, 1901, less than a year after being reelected president, William McKinley was assassinated while attending the Pan-American Exposition in 1901, ushering Roosevelt into the presidency.^{ix}

McKinley’s assassin, Leon Czolgosz, explained his act bluntly: “McKinley was going around the country shouting about prosperity when there was no prosperity for the poor man.”^x Here was class warfare embodied. Indeed, Czolgosz was a professed anarchist. Anarchism, at the time, was an inchoate creed. Emma Goldman, in the journal *Mother Earth*, came as close to codifying the movement as anyone when she defined anarchism as “the theory that [because] all forms of government rest on violence,” government itself is illegitimate.

The anarchists were few, disorganized, and scattered. Still, they were genuine in their belief and fully determined to act. Listen to the description of anarchists provided by historian Eric Rauchway in his book, *Murdering McKinley: The Making of Theodore Roosevelt’s America*.

During the two decades since the anarchist movement first announced its enthusiasm for terrorism, its practical and philosophical teachings had borne bloody fruit. Within the previous ten years, the Spanish Prime Minister Canova del Castillo, the French President Sadi Carnot, the Hapsburg Empress Elizabeth, and the Italian King Umberto I had all been assassinated by anarchists. Anarchist bombers Fracois-Claudius Ravachol and Emile Henry killed dozens of Parisians in terror bombings throughout the 1890s, and in

the United States the deaths of seven policemen in the 1886 bombing at Haymarket Square in Chicago had been laid at the door of the anarchist movement... There was no coordinating committee, no chain of command. There was only a network of allies, contacts, and publications; a shared, and increasing, body of knowledge about the modern weapons of mass destruction; and a commitment to war on modern civilization, whatever the cost. Alienated by a society that reduced men to faceless drones—to nobodies—the terrorist anarchists determined to dismember, piece by piece, the system that they believed oppressed them.^{xi}

The social strain these terrorists signified—the sense that republican government itself was breaking down if not broken—was also very real. McKinley’s assassination was the violent action of one man, but it was also a symptom of a widening crisis.

Roosevelt sensed this crisis and he feared it acutely. In his first message to Congress as president, he called for legislation banning anarchists from immigrating into the United States. He also called for aggressive police action to track down the American anarchists behind acts of violence and to bring them to trial. But he also recognized that American government, indeed American society, faced a deeper, graver task. Pressing social issues had to be addressed. Mechanisms of governance and government had to be revitalized. A social system had to be restored. And these challenges meant, in turn, imposing meaningful regulatory structures on society’s engines of acquisition—the corporations. Their abuses had to be curbed. Industrialization was creating massive business organizations and a class of workers that was becoming increasingly exploited and alienated. What Roosevelt feared, as events like the Homestead strike erupted, was the very real prospect of class warfare. This fear dominated his thinking about the issue of business regulation.

This situation was quite different from that which confronted the Founding Fathers. Still, the issues vexing Roosevelt’s generation were familiar. To put the situation in Madisonian terms: What Roosevelt feared—what the prospect of class warfare threatened—was the division of Americans into two inimically opposed “factions.” If Americans were to resist this calamitous development, TR passionately argued, it was vital that they remain capable of “self-government.” And self-government, he believed, required the national government to rise above any particular class interest. “In the history of mankind,” he said in a speech, “many republics have risen, have flourished for a less or greater time, and then have fallen because their citizens

lost the power of governing themselves and thereby of governing their state; and in no way has this loss of power been so often and so clearly shown as in the tendency to turn the government into a government primarily for the benefit of one class instead of a government for the benefit of the people as a whole... The outcome was equally fatal, whether the country fell into the hands of a wealthy oligarchy which exploited the poor or whether it fell under the domination of a turbulent mob which plundered the rich.”^{xii} In opposition to both the “turbulent mob” and “a wealthy oligarchy,” with each class bent only on protecting its own, narrow economic interest, Roosevelt urged awareness of a “community of interest,” an awareness he considered vital to American civic functionality. “It is all-essential to the continuance of our healthy national life that we should recognize this community of interest among our people. The welfare of each of us is dependent fundamentally upon the welfare of all of us, and therefore in public life that man is the best representative of each of us who seeks to do good to each by doing good to all; in other words, whose endeavor it is not to represent any special class and promote merely that class's selfish interests, but to represent all true and honest men of all sections and all classes and to work for their interests by working for our common country.”^{xiii}

Roosevelt instinctively resisted the notion that the U.S. was becoming a nation of distinct classes. He espoused politics and policy that transcended particular class interests. He warned eloquently against danger of a particular class taking unchecked control of national politics. The prospect of an aristocracy of Robber Barons was deeply unnerving. Equally unnerving was the prospect of a proletarian class of embittered and alienated wage-earners.

Roosevelt made the specific point about corporate regulation to Congress: “Experience has shown conclusively that it is useless to try to get any adequate regulation and supervision of these great corporations by state action. Such regulation and supervision can only be effectually exercised by a sovereign whose jurisdiction is coextensive with the work of the corporations—that is, by national government.”^{xiv}

Standard Oil

Under Theodore Roosevelt, the government intensified enforcement of the Sherman Antitrust Act, trying to make it the basis of methodical federal corporate regulation. The administration launched 44 Sherman cases.^{xv} Symbolically, the most important was the case against Standard Oil, founded and led by John D. Rockefeller. The federal government filed suit

against Standard in 1906, at which time Standard refined 87% of all kerosene in the United States and marketed 89% of it. According to a 1907 ICC report, the company was pressuring the railroads into giving it significant secret rebates (in violation of the Elkins and Hepburn acts), spying on competitors, and engaging in predatory pricing to drive competitors into selling out to Standard at fire-sale prices. Twenty-one states eventually joined in the proceedings against the corporation. Roosevelt stepped up his attack rhetorically in a special message to Congress in January 1908, decrying “the speculative folly and flagrant dishonesty of a few great men of wealth.”

The federal circuit court ruled against Standard in 1909, ordering the breakup of the company. The U.S. Supreme Court upheld the breakup in 1911, forcing the corporation to dismantle itself. In Ron Chernow’s apt assessment, “Thus ended the longest running morality play in American business history.”^{xvi}

Yet the larger “morality play” was far from over. Regulation through judicial action was highly unwieldy and useful only after the fact. It was a reactive response to the problem, rather than a proactive one. Roosevelt came back to the issue and firmed up his ideas after leaving the White House. He argued for the institution of regular, ongoing regulation through new agencies or commissions, comparable to the ICC, with broad powers to regulate the major industries and even to set prices on the commodities produced by monopolies. This program became the basis for TR’s third candidacy for the presidency, as an independent, in 1912. In *An Autobiography*,^{xvii} which amounted to an extended justification for his proposed presidential policies, he gave his version of recent history: “There has been in our country a riot of individualistic materialism. The power of the mighty industrial overlords of the country had increased with giant strides, while the methods of controlling them, or checking abuses by them, on the part of the people, through the Government, remained archaic and therefore practically impotent.”^{xviii}

Throughout the 20th century, policy makers fretted over the extent to which the federal government should “intervene” in the business sphere. The corporate abuses that reappeared in the boom of the 1920s were primarily created on Wall Street. The manipulation of stock prices to the benefit of a few—and to the catastrophic detriment of ordinary small investors—was the abuse of choice. A sustainable consensus regarding regulation was not attained until the mid-1930s, when severe economic depression gave reformers the momentum to implement regulatory

institutions and polices. Congress established the Securities and Exchange Commission, which, for a time at least, severely curbed stock manipulation. Most notably, the National Labor Relations Act (or Wagner Act) of 1935 asserted the positive right of labor to organize into unions and bargain collectively with corporations—and in the process legitimated the ongoing federal oversight of labor relations. Finally, after considerable experimentation, policy makers were beginning to evolve a set of regulatory tools to check abuses on an industry-by-industry basis. Such institutions had the potential to tailor their regulations to the unique features of each industry, to curb its major abuses and bring its affairs into balance. The Interstate Commerce Commission (governing the railroads) and the Securities and Exchange Commission (regulating the financial markets) were followed by agencies such as the Federal Trade Commission and the Federal Communications Commission. Perhaps the way was being found to establish regulatory institutions whose rules were appropriate, proactive, cost-effective and enforceable.^{xix}

But progress has not been uniform or linear. Some industries have proven less amenable to regulation. Coal mining, for example, probably had the most flagrant and persistent employee abuses until nearly mid-century. Miners were inadequately protected from cave-ins, methane explosions, carbon monoxide poisoning, and the pervasive coal dust that led to black lung disease. Mining companies pushed wages below a sustainable living level, engaged in violent union-busting, and even subjected children to deadly working conditions. There was nothing inevitable about these manifold abuses; they now have all been corrected. But that only happened by means of governmental regulation and in spite of the persistent resistance of the mine owners who argued that governmental regulations were violating their property rights. It was if in a land of plenty, a hard-working miner had no rights to wages and working conditions that enabled him to survive and support the life of his family.

Episodes of serious backsliding have also punctuated our story. The irrational fad for deregulation in the 1980s and 1990s was a significant retreat from the responsibilities of federal corporate regulation, with such disastrous consequences as the savings and loan collapse of the late 1980s. More recently, the outbreak of massive scandals such as Enron, WorldCom, and Tyco in the first few years of the 21st century points to the dangers of lapsed vigilance. Enron, a case we will return to later, seems to have managed to carry out all six forms of abuse that were cited earlier. Large multinationals are now overreaching the capacity of even national governments to regulate them, and their behavior frequently reflects the knowledge of their top managements

that nobody can police them. Just as the railroads earlier overran the capacity of states to regulate them, so Tyco can evade U.S. taxes by deciding it is based in Bermuda. Our Congress as yet has not been able to produce legislation that stops this kind of abuse. Nor are there any adequate international institutions in place to address the problem. As will be discussed more in Chapter 12, exploitive sweatshop conditions are still prevalent in Latin America and Asia.

What does the renewed Darwinian theory suggest to us about corporations and the ongoing problem of adequate regulation? Corporations are not inherently destructive or dysfunctional. They are able to produce a wealth of valuable goods and services that can enhance the life of all. They arise in response to, and they channel, the basic drives that shape us all. However, balance among the drives is difficult to maintain in a corporate context. One point is obvious, but easily overlooked. Corporations are not just engines of acquisition. To be sure, they are profit-driven, which is to say, they are manifestations of our drive to acquire. But, because they depend on the cooperation of large numbers of people to perform the necessary work, they are totally dependent on the human drive to bond. The etymology is instructive: *corporation* derives from the Latin word *corpus*, or “body,” signifying a collective enterprise.

To sum up: Because corporations did not become important until after the framing of the Constitution, a chance was missed to give them the impulse/check/balance form that would have balanced their power to marshal the acquisitive drives of large groups of investors with the obligation to honor the implicit, conscience-driven dB ground rules of mutual caring. Instead, the second half of that equation is no more than a peripheral part of the makeup of many corporations, entirely outweighed by the drive to acquire. This has left corporations vulnerable to free-rider domination and each society in which such a corporation operates (often the entire world)—is vulnerable to the resulting corporate abuses. This is my answer to the Jekyll and Hyde mystery.

The Contagious Effects of Free-rider Control: Andrew Carnegie

This is a good point at which to remind ourselves that free-riders are a very small minority and do not cause all the trouble in the world. (Just a disproportionate amount of it.) The rest of us are all possessed of the drive to acquire; it is probably just as strong in us as it is in free-riders. We are all trying to balance it with the other drives but we by no means always succeed in the best fashion. Andrew Carnegie provides a fascinating case in point.

Born into near poverty in Scotland in 1835, Carnegie became the epitome of either the American “Captain of Industry” or the “Robber Baron,” depending on your point of view. By the time he retired in 1901, he had built an empire of steel companies and various ancillary ventures and was known as “the richest man in the world.” Here, on the surface of things, was dA personified.

Yet Carnegie was as intensely conflicted by all four drives as any person. In 1872, when he was 37 years old and already a highly successful businessman and investor, he sensed he was reaching a turning point in his life and wrote a memo to himself, taking stock of his assets and his goals for the future. Clearly he was rich and needed no more, and he believed that there was more to life than money. “The amassing of wealth is one of the worst species of idolatry,” he wrote. “No idol more debasing than the worship of money. Whatever I engage in, I should be careful to choose that life which will be most elevating in its character. To continue much longer overwhelmed by business cares, and with most of my thoughts wholly upon the way to make more money in the shortest time, must degrade me beyond hope of permanent recovery.”^{xx} Carnegie vowed in his memo that, after two more years of business, he would “settle in Oxford & get a thorough education making the acquaintance of literary men.” Then he would buy a newspaper or journal, “taking a part in public matters especially those connected with education & improvement of the poorer classes.” In our terms, he planned to balance his focus on dA with dC and dB goals.^{xxi}

However, he did not do this. Carnegie spent the next 27 years amassing more wealth. When he sold out to an investing syndicate headed by J.P. Morgan in 1901, he set a price of \$480 million on his steel enterprise and Morgan paid it readily. And yet, he was always more than a walking drive to acquire. He pioneered many of the best practices of modern corporations. He was very customer-oriented. He was technically innovative and progressive in terms of cost-cutting and product improvement. He improved working conditions and worker benefits. He had an almost uncanny ability to spot capable workers and move them up through the ranks to top jobs. He publicly supported the workers’ right to unionize; his mills led the nation in moving from the deadly two twelve-hour shifts to three eight-hour shifts. Carnegie freely used incentive plans and the prospect of partnerships to motivate his managers and increase their involvement in the company.^{xxii} When the Brotherhood of Locomotive Engineers made him an honorary member, Carnegie was deeply touched: “I feel honored by your adopting my name. It is another

strong bond, keeping me to performance of the duties of life worthily, so that I may never do anything of which your Society may be ashamed.”

However, a crucial lifetime test of his priorities came in 1892 with a long and bitter labor struggle at Homestead, a plant with twelve steel mills and thousands of workers. Carnegie put his partner, Henry Frick, in charge at the steel mills and retreated to Europe. Frick hired Pinkerton armed guards, notoriously violent strike-breakers, and dozens of workers, as well as some women and children, were killed in the resulting confrontation. The union was broken, but so was Carnegie’s heart. It was only a few years later that he sold out to Morgan.

What had happened to the four-drive Carnegie we have seen up to this point? He was not a free-rider, but in this case he acted like one. Many factors may have been at work:

- One of Carnegie’s most important competitors, National Steel, was run by a man whose record suggests he may have been the free-rider of the steel industry who was triggering a race to the bottom.
- Herbert Spencer visited Carnegie at the Homestead Works and had long talks with him about his theory of Social Darwinism. Carnegie may have bought into Spencer’s ideology that, like it or not, only the toughest would survive.
- The union was opposing Carnegie’s changeover to more automatic, lower-skilled technology. He may have felt that they had to be defeated at any cost or his company would be left behind competitively.
- Frick, judging by other evidence a likely free-rider himself, was available to do the dirty work Carnegie wouldn’t want to do himself.

In other words, Carnegie may well have been converted, at least temporarily, into a “cognitive” free-rider; a person who does have a normal balance of drives but for complex reasons, including the ideological rationalization Spencer offered, is able to act, for a time, as if he didn’t,

Carnegie’s story gives us some indication of the poisonous effects free-riders can have even beyond the immediate effect of their own self-serving and pitiless actions:

- A free-rider CEO, willing to do anything to defeat a competitor, can overstate his profits, artificially boost his stock price, and use this inflated stock to force his competitor to sell out, tipping their industry even more toward overall free-rider control.

- Free-rider behavior makes it harder and harder for more balanced leaders of competitive firms to fulfill their own dA. In plain terms, once there's a bastard in the game, everybody else is under extreme pressure to become a bit of a bastard, too, or else be content to lose. Or, as the saying goes, one bad apple can spoil the whole barrel.
- Some free-riders will succeed spectacularly, at least for a while, so they naturally serve as role models for others.
- A subordinate free-rider executive can even convince a non-free-rider CEO, such as Carnegie, to look the other way while the free-rider, without qualms of conscience, takes unbalanced actions.

Looking at Carnegie's overall record, it seems clear that he had not turned into a free-rider. (For one thing, that would be impossible, as it is a genetically-based condition.) By the end of his life, he had given all of his fortune to philanthropic causes with the exception of relatively modest bequests for each of his children. But his lapse shows us how difficult it can be to keep corporations on a constructive track, steering them clear of exploitive and abusive practices. When a man of Carnegie's wisdom and character can be drawn into abusing the power of his position, there is reason for grave concern. The current record gives us little reason to think that we have yet found adequate ways to keep corporations on-track.

In competitive sports, we need to remind ourselves, a carefully thought-out rulebook is the *sine qua non* of each and every one. We cannot conceive of professional baseball without umpires, nor even sandlot baseball without rules. Why is that not also true of competition between corporations? Competition brings out enormous effort and wonderful skills in people, which is terrific as long as they are channeled constructively and fairly. Of course, regulation can be overdone and some rules are stupid, but the historical record demonstrates that, without sensible rules, the great positive potential of corporations can be largely lost and the result can even be a free-for-all disaster. Might it not be possible for the many normal, four-drive CEOs in any given industry to sit down with public officials and, with input from all the stakeholder groups, draft truly sensible regulations along with an appropriate enforcement process on an industry-by-industry basis? One of the necessary rules would call for ways of identifying genetic free-riders and for finding humane ways to constrain them from attaining powerful positions in industry. (I will discuss this more explicitly in Chapter 11.) If such positions were reserved for

normal, responsible, people such as Carnegie, balancing the acts of corporations for the well-being of all stakeholders would still be a challenge, but a much more attainable one. And, as we will see in Chapter 11, when fair pay-offs in dA terms are provided for all stakeholders, there is evidence that every stakeholder will be better off, even the stockholders.

ⁱ See especially, Chandler, A., 1977, *The Visible Hand*, Cambridge, Belknap Press.

ⁱⁱ J. Madison, *The Federalist Papers*, 1982, No. 10, p.44.

ⁱⁱⁱ *Head v. Providence Insurance Co.*, quoted in Charles W. McCurdy, “*The Knight Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869-1903*”.

^{iv} See especially on the subject of government corruption, Perrow, C., 2002, *Organizing America: Wealth, Power, and the Origins of Corporate Capitalism*, Princeton, NJ, Princeton University Press.

^v Perrow, 2002, p. 145.

^{vi} Perrow, 2002, p. 145.

^{vii} *North American Review*, 1884

^{viii} McCurdy, “*The Knight Sugar Decision*”.

^{ix} Rauchway, E., 2003, *Murdering McKinley: The Making of Theodore Roosevelt’s America*, New York, Hill and Wang. Roosevelt quoted from Rauchway, p. 93.

^x Rauchway, 2003, p. 42.

^{xi} Rauchway, 2003, p. 17-18.

^{xii} Roosevelt, T. speech to NY State Agricultural Association, September 7, 1903

^{xiii} Roosevelt, speech, 1903.

^{xiv} McCurdy, p. 331

^{xv} Taft, who of course succeeded Roosevelt as president, initiated 65 anti-trust suits.

^{xvi} Chernow, R., *Titan: The Life of John D. Rockefeller, Sr.*, New York, Random House. p. 554,

^{xvii} Roosevelt, T., 1916, *An Autobiography*. New York, Macmillan.

^{xviii} Roosevelt, 1916, *An Autobiography*, Chapter 12.

^{xix} See especially McCraw, T. 1984, *Prophets of Regulation*, Cambridge, MA, Harvard University Press.

^{xx} Livesay, H. C., 1975, *Andrew Carnegie and the Rise of Big Business*, Boston: Little, Brown and Company, p. 72.

^{xxi} Liveay, 1975.

^{xxii} This paragraph has drawn heavily on Lawrence, P. and D. Dyer, 1983, *Renewing American Industry*, New York, Free Press, p. 59-61.
