

Economics, Democracy, and the Distribution of Capital Ownership

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Abstract This article holds that widespread, practical access to capital acquisition is essential for sustainable widespread economic prosperity and democracy. The founders of the U.S.A. agreed that sustainable democracy required widespread ownership of land to provide a viable earning capacity sufficient to support robust participation in democratic government. The importance of widespread land ownership to individual prosperity and sustainable democracy was supported not only by the prevailing philosophical views of property, it was also apparent to the common man and woman. Compared to Europe, America offered widespread access to land ownership, higher wages, better work conditions, cheaper staples and greater individual freedom, equal opportunity, prosperity, and political participation. This conviction that widespread access to ownership is a necessary condition for widespread prosperity and sustainable democracy continued throughout most of the nineteenth century, but today public discourse reveals virtually no trace of this once universally held opinion. This article suggests that the disappearance of this conviction can be traced to an erroneous view shaped by neoclassical economics and Keynesian economics. According to this view, (1) the disappearance of the American frontier and industrialization made the goal of widespread capital ownership either impractical or of little or no economic significance and (2) by way of technological advance, sufficient earning capacity and consumer demand to promote growth and sustain democracy can be achieved, without widespread ownership, primarily through jobs and welfare. Although differing in many respects, both mainstream schools, along with Adam Smith's classical economics, share one common but unstated economic assumption: the broader distribution of capital acquisition (in itself) has no fundamental relationship to the fuller employment of people and capital, the broader distribution of greater individual earning capacity, and growth. Contemporary thinking, shaped by these economic schools, also tacitly assumes that widespread capital ownership is not essential for the sustainable individual earning capacity needed to

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support robust democracy. This erroneous “ownership-neutrality assumption” (1) contradicts both the views of America’s founders and the colonial experience, and (2) provides theoretical justification for structuring capital markets and capital acquisition transactions to unfairly and dysfunctionally favor existing owners at the expense of broader ownership distribution, more widely shared prosperity, greater efficiency, ecologically friendly growth, and a vital democracy. America’s conscientious founders would be shocked by the diminished importance of the distribution of ownership in the mainstream analysis of prices, efficiency, production, growth, and democracy. Rather than enhancing democracy, they would view the “ownership-neutrality assumption” of mainstream economics as contributing to its deterioration and corruption. They would openly search for economic analysis built on an alternate assumption more consistent with their understanding of the requisite conditions for sustainable democracy. This article advances an economic analysis that suspends the ownership-neutrality assumption, replaces it with a “broader-ownership-growth assumption,” and suggests a voluntary market strategy for substantially broadening capital ownership, enhancing individual earning capacity, and providing the widespread economic prosperity needed for robust democracy.

Keywords Adam Smith · Binary economics · Capital democratization · Capital ownership · Classical economics · Colonial economy · Corporate finance · Democracy · Economic justice · Economic systems · Employment · Growth · Industrial revolution · Labor economics · Louis Kelso · Keynesian economics · Macroeconomics · Microeconomics · Neoclassical economics · Property rights · Thomas Jefferson · Wealth concentration · Wealth distribution

“We can have democracy in this country or we can have great wealth concentrated in the hands of a few, but we cannot have both.” Louis D. Brandeis, October 1941¹

Part I: Introduction

This article holds that widespread, practical access to capital acquisition is essential for sustainable widespread economic prosperity and democracy. In this article, “capital” includes land, animals, structures, machines, tools, patents, trademarks, and other capital intangibles – anything capable of being owned and employed in production. Until freed, it also shamefully included people held as slaves.

In the campaign that led to the adoption of the U.S. Constitution, both the federalists and the anti-federalists agreed that a sustainable democracy requires widespread, practical means to acquire a viable earning capacity sufficient to support robust, individual participation in democratic government. They further agreed that such earning capacity could not be achieved by labor alone but rather requires the ownership of a sufficient amount of wealth-producing property to supplement labor income, which at that time generally meant land.

¹ Conlin (1984) p 48.

This original “American Dream” (the realistic opportunity for ordinary, hard-working people to acquire a viable earning capacity by way of labor and ownership) continued through the enactment of the Homestead Act of 1862, but rapidly declined as a goal thereafter. During that period, (1) the widespread availability of affordable land greatly diminished; (2) technological advance led to industrialization that yielded growing, per-capita production increasingly owned by corporations; (3) ownership of productive capital (increasingly represented by corporate shares) grew highly concentrated; and (4) economics emerged from a minor field of philosophy to the preeminent global paradigm used for formulating economic policy Korff (2008).

Today, public discourse reveals virtually no trace of the once universally held original American Dream. Rather, in contemporary discourse, earning capacity for the vast majority of people means *labor* earning capacity, and “income” is a combination of wages and welfare redistribution.

One explanation for the disappearance of the original American Dream is that the realistic prospect of widespread capital ownership became a practical impossibility because (1) the availability of widely affordable frontier land ceased to exist and (2) industrialization made the goal of widespread capital ownership seem impractical in a market economy. Another explanation, advanced in this article, is that the diminished understanding of the importance of widespread ownership as a necessary component of widespread earning capacity and democracy can be traced to the emergence of mainstream economics: (1) in the late nineteenth century, neoclassical economics (which focuses on exchange value and efficiency – the primary domain of contract rights rather than property rights) and (2) joined in the twentieth century by Keynesian economics (which reduces the economy to time, money and labor and focuses on the distribution and redistribution of income rather than the distribution of ownership). Mainstream economics erroneously (1) implicitly assumes that the distribution of capital acquisition has no fundamental, positive relationship to the profitable employment of labor and capital and growth, (2) suggests that by way of technological advance, sufficient earning capacity and consumer demand to sustain growth and democracy can be achieved primarily through jobs and welfare, and (3) thereby provides theoretical justification for structuring capital markets and capital acquisition transactions to unfairly and dysfunctionally favor existing owners at the expense of broader ownership distribution, more widely shared prosperity, greater efficiency, ecologically friendly growth, and a vital democracy.

Of course, the two mainstream economic approaches differ significantly and in some ways diametrically oppose each other. During recessions, some economists propose government austerity to reduce government spending and debt and others propose increased government spending and greater government debt to stimulate the economy, with both claiming the authority of economics. Nevertheless, both schools, along with Adam Smith’s classical economics, share a common but unstated assumption (herein referred to as the “ownership-neutrality assumption”): namely that the broader distribution of capital acquisition (in itself) has no fundamental, positive relationship to the fuller employment of people and capital, the broader distribution of greater individual earning capacity, and growth. Contemporary thinking, shaped by these economic schools, also tacitly assumes that widespread capital ownership is not essential for the sustainable individual earning capacity needed to support robust democracy. Consequently, mainstream political discourse is limited to a compromise of

policies promoting capital acquisition primarily with the earnings of capital for existing owners and jobs (but generally not the best jobs) and welfare for everyone else.

America's founders would be shocked by the diminished importance of the distribution of access to ownership in the mainstream analysis of prices, efficiency, production, growth, and democracy. Rather than enhancing democracy, they would view the "ownership-neutrality assumption" of mainstream economics as contributing to its deterioration and corruption. Respecting the scientific method, conscientious founders might do what scientists frequently do regarding theories that share a common assumption and do not seem capable of adequately solving problems: namely, suspend the commonly shared assumption and develop an analysis based on an alternative assumption. One alternative assumption (herein referred to as the "broader-ownership-growth assumption") is that a broader distribution of capital acquisition will yield more broadly distributed earning capacity in future years and therefore more profitable employment of labor and capital in earlier years. Moreover, the more broadly distributed earning capacity will enable more people to participate more robustly as citizens of a democracy.

Part II briefly compares some major differences between the American economy in the late eighteenth century with the then-existing economies of Great Britain and other western European nations. Part III considers explanations for the differences based on the ownership-neutrality assumption and the broader-ownership-growth assumption. Part IV considers the vanishing frontier, the industrial revolution, and the concentration of capital acquisition in light of those two conflicting assumptions. Part V offers a further analysis of classical, neoclassical, and Keynesian economics in light of those two assumptions. Part VI considers what conscientious founders of the U.S.A. might do based on the information provided in this article. In conclusion, Part VII urges that economists give greater attention to the broader-ownership-growth assumption and the reforms that it indicates are necessary to achieve enhanced and more broadly distributed earning capacity, sustainable growth, and a more robust democracy.

Part II: Widespread Access to Ownership, Individual Prosperity and Political Freedom – The Colonial Evidence

The conviction that widespread, practical opportunity to acquire land was essential for widespread individual prosperity and sustainable democracy was not only shared by colonial leaders; it was also apparent to the common people. Compared to Europe, America offered widespread land ownership, higher wages, better work conditions, cheaper staples and greater individual freedom, equal opportunity, prosperity, and political participation. All but the very poorest in America lived in better conditions and with more economic opportunity than all but the richest in Europe. With land plentiful and wages high, most people in a few years could acquire productive land to supplement their wages. Although voting rights (which then extended only to white, adult males) were conditioned on property ownership, the percentage estimates of white males qualified to vote in 1787 range from certainly more than half to above ninety percent.²

² Brown (1935,1955) pp. 1–20, 37, Perkins (1988).

Part III: Explaining the Connection Between (1) The Distribution of Access to Land Acquisition and (2) High Wages, Better Work Conditions and Low Cost Staples

There is substantial research regarding economic conditions in colonial America focusing on issues including growth rates and theories, life cycles, life styles, living standards, Native American culture, prices, slavery, and wealth distribution.³ However, there is little in the literature that explicitly suggests that the widespread access to land ownership was an important cause of the relative high wages, good working conditions and low-cost staples. Perhaps the reason is that there is a standard no-brainer, neoclassical explanation for high wages and good working conditions that goes without saying but that short-circuits a deeper understanding: namely, the scarcity of labor. Certainly, labor was scarce in America compared to the Old World. Certainly, substantial transaction costs restricted immigration. Upward pressure on wages resulting from labor shortage would have been reduced by slavery and indentured servitude, and affected by the fact that much work on family farms not provided by owners was done by other family members.

But an added factor uniquely contributing to the scarcity of labor is the fact that relatively low cost land enabled laborers to become owners. The promise of future land ownership also provided the sustained incentives for family members to work on the family farm rather than work for others. Conversely, if the barriers to land acquisition were greater, fewer workers would become owners and fewer family members would stay working on their family's farm, but would rather compete for jobs; and wage rates would decrease. Thus, rather than view the scarcity of labor merely as the *cause* of the high wages, it might be more helpful to also understand labor scarcity as an *effect* of the widespread, practical ability to acquire capital. The causal mediation of supply and demand determined in large part by the preferences of the market participants and reflected in prices is affected by the practical opportunity to acquire land: the wages required to voluntarily employ a person may increase as that person's opportunity to earn by owning increases. This relationship between wages and access to capital earnings is presented in Fig. 1. In essence, it suggests that the price of everything, not only in Colonial times but also presently throughout the world, is fundamentally affected by the distribution of access to capital ownership.

Further, what was the source of the productive capacity available in America to pay the higher wages of workers and soldiers, provide the superior work conditions, and provide the lower cost staples? Is the cause found in greater output per person (human productivity) as though American workers were substantially outperforming their Old World counterparts, or was it rather the broader distribution of acres per owner with a need and interest to employ it profitably that provided more income to spend? Nor does the labor-scarcity approach explain why staples were cheaper in America than in Great Britain and Europe. The higher wage rate would produce a higher cost of staples, unless of course any unit-labor-cost price increase in staples was countered by the greater supply resulting from the broader distribution of land ownership. Thus, at least in a predominantly agricultural economy (in which the

³ See e.g., Matson (2006) and McClusker and Menard (1985).

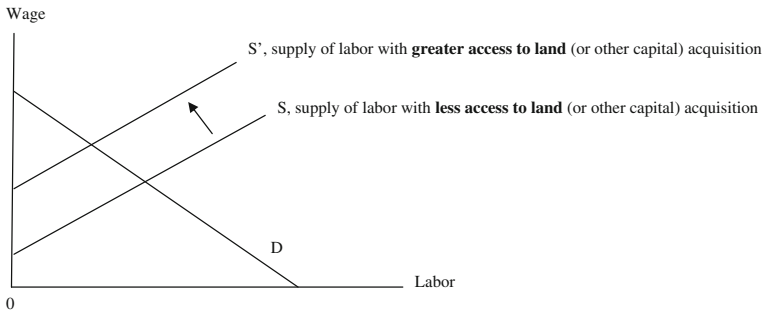


Fig. 1 Impact of broader land (or other capital) acquisition on labor supply and wages

most important capital ownership is agricultural capital), the earning capacity of laborers may be substantially enhanced by the broader distribution of agricultural capital ownership by way of earnings from ownership, higher wages, and lower prices. Accordingly, with broader access to capital acquisition, the societal goals of more widely spread economic prosperity and more robust participatory democracy can be better served. As explained in Part V below, the same is true in an industrial economy in which agriculture comprises only a minor part of gross domestic product.

Part IV: The Vanishing Frontier, the Industrial Revolution, and the Concentration of Capital Acquisition

As noted above, the widespread recognition that the realistic prospect of acquiring wealth producing property is a necessary feature of sustainable democracy continued through much of the nineteenth century, but its practical viability was challenged by two major developments: (1) the inevitable disappearance of widely affordable, frontier land; and (2) the massive increase of property in human-made (i.e., “fabricated”) capital resulting from technological advance characterized by the industrial revolution. With the former came the demise of hopes for the broad-ownership, agricultural, yeoman democracy idealized by Thomas Jefferson. With the latter came the massive increase in industrial productive capacity, the corporatization of major segments of that capacity, and a severe concentration of capital ownership.

Those who benefitted most from industrialization were the few, not the many. They acted through privately owned corporations that amassed a colossal ownership of productive capacity with the help of government-created benefits and preferences denied to natural persons to this day. Among the benefits, government’s visible hand endows corporations with unlimited life, limited liability, centralized management separated from share ownership, and legally protected transferability of shares. Endowed with these advantages, and limited by a flawed understanding of economic growth (i.e., the ownership-neutrality assumption), the wealth-concentrating dynamics of corporate enterprise in a market economy spring from the very purpose of corporate finance which is to enable corporations to acquire capital *before* they have earned the money to pay for it. Well-capitalized people are thereby able to acquire capital with the earnings of capital even as they sleep, but those without initial ownership are generally excluded from the process.

Fast-forwarding to the present, one sees the cumulative effect of the process of industrialization and corporatization of the economy. The financial capitalization of America's three thousand largest credit-worthy companies comprises over 90% of America's equity market.⁴ Most of these companies have unutilized capacity which is reflected in a suboptimal rate of return: at diminishing unit costs, most of these companies can profitably produce much more of the goods and services that people would purchase if they had the earning capacity to do so; and if they could do so, the market value of the shares of these companies would increase. Presently, almost all capital acquired by these corporations is acquired with the earnings of capital (not labor), and much of it is acquired with borrowed money (Brealey et al. 2004). Moreover, the ownership of this corporate wealth is highly concentrated: approximately 1% of the people own 40% - 50% of the wealth and 10% own 90% of the wealth, leaving 90% owning little or none.⁵ Thus, capital earns at a rate reflective of its long-run (suppressed) earning capacity as it earns primarily for a small minority the population. To acquire capital with the earnings of capital, well-capitalized people rely on corporations, trusts, lenders, private and public capital credit insurers and reinsurers, and the central bank to manage a stable monetary system. Once the ownership-neutrality assumption of mainstream economics is suspended in favor of the broader-ownership-growth assumption, then it becomes apparent that the same government-supported capital acquisition process that presently works for people primarily in proportion to their existing wealth can work even more profitably if it is allowed to also work democratically for all people (like the right to vote) irrespective of their existing wealth.

Part V: The “Ownership-Neutrality Assumption” of Classical, Neoclassical, and Keynesian Economics

Except for agricultural production, Smith grounded his theory of per-capita growth entirely on the specialization and productivity of labor and the exchange value of commodities and labor. According to Smith's analysis (consistent with the ownership-neutrality assumption), whether capital is widely or narrowly owned has no fundamental impact on growth. In explaining why in his view investment in agricultural production is by far the most advantageous to society, Smith notes that the work of the farmer is assisted at every turn by nature: sun, rain, and soil convert seed to edible fruits and vegetables; and farm animals convert vegetation to milk and meat, but “in manufactures...nature does nothing; man does it all.” Thus, Smith conceived such “natural” capital as doing work distinct from labor and therefore contributing to per capita growth in ways beyond the contribution supplied by the specialization and productivity of labor and voluntary exchange. But Smith denied the same effect for “manufactures ... [because] man does it all.”⁶

⁴ http://www.russell.com/Indexes/data/US_Equity/Russell_US_equity_indexes.asp

⁵ Wolff (1995, 2011). These statistics include all the holdings in pension, stock ownership and profit sharing plans.

⁶ Smith (1937) p. 344–345.

Contemporary ecological understanding reveals the homocentric flaw in this aspect of Smith's analysis. No more in manufacturing than in farming can it be accurately said that "man does it all." The energies of sun, wind, water, oil, coal, and many other natural resources contribute immensely to production not only in agriculture but in all economic activity. Likewise, advancing technology not only makes labor more productive, it continually makes capital assets much more productive than labor in task after task, thereby enabling the owners of capital to employ capital to both replace and vastly supplement the work of labor not only by doing much more, more quickly, and more cheaply the kind of work previously done by labor, but also by doing vastly more kinds of work than labor (working either alone or with less productive capital) can ever do.

Smith's approach obscures not only the productive power of capital to do more work and more kinds of work than labor but also the growth consequences of the distribution of its ownership. In his *General Theory*, Keynes builds on Smith's analysis that the distribution of capital acquisition has no fundamental relation to wages and growth by distilling the economy into three fundamental variables: time, money, and labor.⁷ Consistent with the ownership-neutrality assumption, in neither Smith's classical nor Keynesian economics is capital treated as a productive agent represented by an independent variable having the power both to do much more work and distribute much more income than labor

Economists sometimes insist that neoclassical analysis considers both labor and capital as competitive productive agents by reason of its focus on marginal productivity of capital and labor and its role in determining their competitive employment and the resultant factor shares of income. In assumed perfectly competitive markets, the demand for the work of (and income paid to) labor and capital is theoretically the (marginal) value of their contribution. However, that analysis includes no explicit recognition that the demand for the employment and production of labor and capital depends on the distribution of the income they each earn. According to the broader-ownership-growth assumption and contrary to the ownership-neutrality assumption, a broader distribution of capital acquisition will distribute a greater demand for products, capital and labor than a narrower distribution of capital acquisition. As with classical and Keynesian economics, the distribution of capital acquisition has no fundamental place in neoclassical analysis.

With advancing technology, there are always unutilized (including greener, safer, and more productive) technologies, in the minds of people, on the drawing boards, in the proto-types, and on the shelf waiting for the adequate distribution of demand to overcome the barriers of start-up costs and render their production profitable. The broader-ownership-growth assumption provides the missing analytical link (lacking in mainstream economics) that promises a broader distribution of future income to make more present investment in capital and labor profitable. With advancing technology, unutilized capacity is the rule, not the exception; and there is no vanishing frontier.

⁷ "It is preferable to regard labour, including of course, the personal services of the entrepreneur and his assistants, as the sole factor of production, operating in given environment of technique, natural resources, capital equipment and effective demand. This is why we have been able to take labour as the sole physical unit which we require in our economic system, apart from units of money and of time." Keynes (1936) pp. 213–214.

Part VI: What Might Conscientious Founders Do?

Seeing an economy frequently mired in recession, with massive unemployment and under-employment, with vast numbers of low wage earners buried in consumer debt, with growing public debt, with increasing wealth concentration, with only a small minority of people earning more than a trifling from ownership, and with few people earning enough for the independence needed for a robust democratic participation, what might conscientious founders do if, revived today, they learned that mainstream economic and political theories share a common implicit assumption that there is no fundamental connection between (1) effective widespread access to ownership and (2) widespread individual prosperity and robust democracy? Consistent with open-minded inquiry and the scientific method, they might likely suspend the commonly shared assumption and look for economic theories beyond mainstream economics that replace the ownership-neutrality assumption with the broader-ownership-growth assumption: a broader distribution of capital acquisition with the earnings of capital enhances widespread individual earning capacity and promotes growth.

Learning that a broader category of capital (that includes not only land, animals, crops, and simple tools but also the vast array of increasingly productive fabricated capital employed in modern production) had long ago surpassed the productive capacity of agricultural capital alone, the founders might conscientiously search for an economic approach capable of opening the nation's market institutions democratically to provide the widespread individual opportunity to acquire capital to supplement the diminished importance of the opportunity to acquire land.

They would likely fault the present wealth-concentrating system of corporate finance, which facilitates substantial capital acquisition with the earnings of capital primarily for well-capitalized people but little or no such acquisition for the vast majority of poor and working people. Noting that (1) the purpose of corporate finance is to enable corporations to acquire capital *before* they have earned the money to pay for it and (2) using this logic, existing shareholders are able to acquire capital with the earnings of capital even as they sleep, conscientious founders might reason that the same logic might be extended voluntarily and more profitably to all people using non-recourse corporate credit and paying for it with the *future* earnings of the capital acquired. Beginning with the alternate broader-ownership-growth assumption reveals how such an approach will provide market incentives to broaden capital acquisition: (1) the more broadly capital is acquired with the earnings of capital, (2) the greater the future distribution of consumer demand from the earnings of capital; and (3) the greater the present and future demand for more investment in labor and capital. At the urging of these founders, conscientious fiduciaries of major credit-worthy corporations having unutilized capacity might come to understand that corporate profitability and rate of return on shareholder investment would increase if acting cooperatively, corporations were to broaden their share ownership. A fuller explication of how such a voluntary ownership-broadening approach might be profitably implemented is beyond the space allowed for this article, but is published in an earlier volume of the *Forum for Social Economics*.⁸

⁸ Ashford (2010). The economic approach discussed in this reference is based on the work of Louis Kelso. See the Kelso Institute: <<<http://www.kelsoinstitute.org>>>.

Part VII: Conclusion

The founders of the U.S.A shared the firm conviction that widespread, effective means to acquire sufficient wealth producing property to provide people with substantial, sustainable earning capacity beyond labor alone is a necessary condition for a sustainable democracy. Mainstream economics has established a vast, profitable enterprise based on analysis that pays little or no heed to that conviction. Moreover, mainstream economics enjoys such prestige that no economic theory or policy will be seriously considered by government or any private entity capable of influencing government without validation by members of the mainstream economic profession. Hopefully this article will encourage economists to investigate carefully the distributional and growth consequences of broadening the distribution of the effective opportunity to acquire capital with the earnings of capital and its importance to widespread, sustainable individual prosperity, growth and democracy, and based on their investigation, to act in the public interest.

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