ON THE CORPORATE DEMOCRACY ACT

The Case for Corporate Democracy

Mark Green

WHEREAS THE American political agenda of the 1970s focused extensively on the size and abuses of *big government*, the agenda of the 1980s should focus on the size and abuses of *big business*. It is curious how partisans of the latter can ridicule the inefficiencies and unresponsiveness of federal bureaucracies yet somehow ignore similar problems with corporate bureaucracies. Who governs our giant corporations and how they in turn govern us—economically, politically, biologically—should be preeminent issues in a society whose democratic values require that major institutions be accountable to their various constituencies.

To be sure, there are laissez faire "theologians" who argue that the "free market" is a perfectly self-regulating mechanism, that corporations are merely pass-through devices that respond automatically to the "votes" of autonomous consumers in the marketplace. In fact, corporations are entities run by real people who make two kinds of judgments. First, they decide whether or not to obey the law—which apparently is a difficult choice for many of them. Second, because the law is society's statement of what constitutes *minimally* acceptable behavior, they make choices within a huge area of lawful discretion—where to locate a plant, whether to fight or cooperate with a unionizing effort, what to produce and how to price it, what legislation to support or oppose, whether to participate in the community or to pollute it. The key issue of corporate governance reform is *who* should make or shape these decisions—a handful of executives, or executives *and* a representative board that is open and responsive to the views of a company's many stakeholders?

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This fundamental issue of unaccountable corporate power warrants federal legislation for several interrelated reasons:

- *State chartering has failed.* It makes as much sense for states to print money or passports as to issue the legal birth certificates of corporations that market products interstate, if not internationally. The result of this historical anomaly, in the words of Harry First, is a kind of "law for sale" (*Pennsylvania Law Review*, 1969). States lure companies into their jurisdictions, and thus generate incorporation fees, by adopting corporation codes that are excessively pro-management. Because Delaware is the worst state in this regard, it gets the most business: about one-fifth of all Delaware state revenues comes from incorporation and annual fees; and about half of the Fortune 500 are incorporated in tiny Delaware, including Exxon Corporation, for example, which has 160 times the annual revenue of its legal parent. Because other states try generally to imitate Delaware's performance rather than act more responsibly, there is already a kind of federal chartering law—but one drafted in Wilmington, not Washington.

• *Corporate illegality is extensive.* As examples of antitrust violations, chemical dumping, product hazard cover-ups, consumer fraud, foreign payoffs, and other economic crimes proliferate, it becomes increasingly apparent that management-directed illegality is prevalent rather than aberrational. "The people who call the shots don't bear the risks," concludes law professor Christopher Stone in his book *Where the Law Ends.* The unblinkable documentation of illegal practices should inspire lawmakers to design a new system of internal governance backed up by workable sanctions in order to encourage lawful behavior. When, for example, there was extensive congressional and press attention on labor racketeering in the late 1950s, the result was a Landrum Griffin Act for labor unions. Today we need a kind of Landrum Griffin Act for our largest corporations—to deal with the problem of corporate "racketeering" in the 1980s.

• *Our largest corporations are private governments.* Edmund Burke's observation that the large companies of his time were states disguised as merchants is relevant today. One definition of government would be an entity that can tax, take life, and coerce citizens. But what is price-fixing but corporate taxation? What is the willful marketing of defective products but the needless taking of life? What is industrial air pollution or the poisoning of a waterway but coercing citizens to suffer the results of other peoples' transactions—that is, compulsory consumption? In other words, our largest firms exercise extraordinary influence over the citizens of our country and other countries.

Thus, the traditional distinction between the public and private sectors should give way to a new concept about the role of the large corporation—namely—there are two forms of government in the United States, the political government and the economic government. The political government is held roughly accountable to its citizens by means of the Constitution and elections. But the economic government is largely unaccountable to its multiplicity of constituencies—shareholders, workers, consumers, local communities, taxpayers, small businesses, future generations. Ironically, under the Fourteenth Amendment, corporations are accorded the rights of people but not the obligations of governments—although our giant companies are far more like huge governments than they are like real people.

The Content of the Corporate Democracy Act

Representative Benjamin Rosenthal (Democrat, New York) and seventeen colleagues introduced H.R. 7010, the Corporate Democracy Act, in April. Its provisions would establish

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minimum governance standards for the 800 largest U.S. nonfinancial corporations (those with $250 million or more in assets). The goal is not more regulation but more *self-regulation* so that these "private governments" give greater access and voice to their affected stakeholders.

Title I: Directors and Shareholders. By requiring such things as a majority of "independent" directors, cumulative voting, shareholder nominations, and specific committees to oversee law compliance and to receive complaints from interested constituencies, this title seeks to restore the influence and independence of the board of directors.

Almost all students of board activities—from William Douglas in the 1930s to Myles Mace in the 1970s—conclude that directors do not select the top officers, do not establish company objectives, strategies, or policies, do not possess the information necessary even to make such judgments, and rarely if ever dissent from managerial initiatives. Consider, for example, the Penn-Central board before that firm's derailment. "The board was definitely responsible for the trouble," recounted outside director E. Clayton Gengras. Its members "took their fees and . . . just sat there. That poor man from the University of Pennsylvania [University President Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out." Although Penn-Central was desperate for capital, for example, the directors paid out nearly $100 million in dividends just before the company filed for bankruptcy.

Shareholders, too, are relatively powerless. Because management controls the proxy machinery, because shareholders cannot nominate candidates for the board, because individual shareholders are overwhelmed by the bloc votes of institutional investors, the corporate structure typically permits only a ceremonial role for shareholders. The great theory of shareholder democracy, or "people's capitalism," comes down to a few shrill voices at a spring rite called an "annual meeting" which is often held in a distant, difficult-to-travel-to city. Ultimately, disgruntled shareholders sell their shares rather than attempt to throw out inept management. Corporate executives cannot have it both ways—they cannot point to shareholders as the legitimizing constituency of the corporation and also acknowledge privately, as many have in business sessions I have attended, that shareholders are merely interested in dividends, not governance.

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Corporate directors are almost invariably chosen by written proxies, with management so totally dominating the process that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot"—a ballot that lists only one slate of candidates. As is noted in the 1979 staff summary of the Security and Exchange Commission's corporate governance hearings, "According to Professor Seligman [of Northeastern Law School] shareholder democracy has collapsed. . . . Since 1967, incumbent managements have been re-elected 99.9 percent of the time. In the last five years, not one management slate in any of the 500 largest industrial firms was even challenged."

The institutional irrelevance of directors and shareholders is not ordained by economic imperatives. Managers can be required to share power more equitably and efficiently with directors and shareholders. Even a few conscientious, non-management-controlled directors or shareholders, asking the right questions and given adequate authority, can make it less likely that a Penn-Central, a Kepone, a Youngstown (Ohio), or a Chrysler situation will recur.

Title II: Corporate Disclosure. This part of the bill requires that affected companies disclose in simple fashion such information as worker injury data, employee hiring data by facility, profits abroad, and the effective federal tax rate.

John O'Leary, the former deputy secretary of energy, explained to a congressional committee in mid-1979 why the Department of Energy made an agreement with oil firms to keep certain information on supplies secret. "The companies simply don't like the public peering over their shoulders," he said. This

sentiment accurately reflects the traditional corporate view toward data disclosure—the less of it the better. But any effective strategy for bringing about greater corporate accountability to affected constituencies must be grounded in greater corporate dissemination of economic and social information. Such information enables shareholders and workers to know what demands to make, helps communities deal more knowledgeably with their business citizens, and informs press and public opinion—which are thereby better equipped to influence corporate policy. Enlightened executives have become well aware that unless they open their books more widely, the threat of increased and more sweeping regulation will grow. Besides, it seems a matter of simple justice, for example, that workers be allowed to know what detectable carcinogens are present in their work places and that community residents be informed of the distribution by race and sex of the work force in local establishments.

That some companies have disclosed full and precise data in these areas demonstrates that the information is neither confidential nor prohibitively costly to gather and report. That significant numbers of firms still refuse to disclose such information indicates that it will not be made consistently available unless required. The information requirements of the proposed act undermine neither customer privacy nor a firm's ability to protect proprietary secrets. Moreover, they are so simple that the information in question can be reduced to a few pages in company annual reports—as companies that already have adopted these standards have demonstrated. The result is a *corporate self-audit*, understandable to shareholders and lay people generally.

Title III: Community Impact Analysis. In an effort to help communities prepare for a plant closing or relocation by a major local employer, this title imposes prenotification requirements and allows the U.S. secretary of labor to conduct a local inquiry into why the change occurred and how best its local costs might be offset.

Bureau of Labor Statistics figures indicate that, overall, the New England, Mid-Atlantic, and Great Lakes regions lost 1.4 million manufacturing jobs between the mid-1960s and mid-1970s. Major cutbacks—both plant closings and partial transfers of work to other areas—have occurred in steel, clothing, textiles, rubber, auto parts, and electronics.

These basic corporate shifts take place for a variety of reasons—the search for nonunion regions, declining industries, outdated facilities, automation, access to new markets, energy costs, and availability of transportation. No sound economy can be wholly static, of course, and few would argue that the answer to economic dislocation lies in mechanisms that seek only to preserve the status quo. But a plant closing or relocation can be devastating to a community, in part because its effects ripple far beyond the employees directly involved. In the Youngstown case, for example, the *additional* loss from the steel shutdown, beyond the 5,000 jobs lost in steel itself, has been estimated at 11,200 jobs—including 1,413 in wholesaling and retailing, 372 in office supplies, and even 35 in auto repair.

These effects are exacerbated when the closings involve dominant local employers and occur unexpectedly. Without warning, the community's tax base shrinks, leaving schools and municipal services underfinanced and leading to layoffs of municipal employees, while demands on public services increase; unemployment skyrockets before anyone can plan to bring in new industry and jobs; and small businesses that had depended on the closed establishment as a customer are left without a market.

Critics of a "community impact analysis" say that it is up to private enterprise to decide where and when to locate or relocate, not government. This may be true, but it is not the issue. The proposal is not to require government approval for a move but rather to insist that employers give advance notice to the affected communities and employees in order to minimize the financial and emotional costs to those least able to bear them. Because some moves can lay waste a town's life-support system, it is entirely appropriate—regardless of whether the corporate decision makers consider themselves members of a purely private entity—that such private decisions be exposed to greater public scrutiny. As even the *Wall Street Journal* has acknowledged, "a company may have a responsibility not to leave its employees or its hometown in the lurch."

Title IV: "Constitutional" Rights of Employees. This title would protect employees from retaliation for the exercise of their constitutional rights of speech and assembly.

An airline pilot with over twenty-five years experience lost his job for blowing the whistle on a serious defect in the Lockheed 1011 aircraft. A worker in upstate New York who participated in a political demonstration was fired by his employer, who held the opposite view on the issue. What did these two workers have in common? Both were nonunion employees in the private sector who, under present law, had no meaningful legal recourse against dismissal.

This problem is neither conjectural nor infrequent. Cornelius Peck has projected from statistics on adjudged "unjust dismissals" in the unionized sector that thousands of such discharges occur annually in the nonunion sector, with no opportunity at all for redress (*Ohio State Law Journal*, 1979).

About one-third of the U.S. work force is protected against unjust dismissal or discipline for political beliefs or activities, either under collective bargaining agreements negotiated by unions or, in the case of government workers, under civil service laws and regulations. But better than two-thirds of the work force is not protected. These nonunion, nongovernment workers are subject to the archaic common-law rule of "servant at will." And under this rule, the employer is no more bound to the employee than the employee to the employer: either can break out of the employment relationship for "any or no reason." In short, the majority of American workers have the right to be fired—in the term of art used in court—"for good cause, for no cause, or even for morally wrong cause," without being the victim of a legal wrong.

The United States is one of the few industrialized nations that does not provide legal protection against unjust dismissals. France, West Germany, and Great Britain, for example, have developed not only extensive bodies of law to protect the worker's right to his or her job but also procedures to ensure that protection is provided as promptly, inexpensively, and fairly as possible. The Corporate Democracy Act would mandate that employees not be disciplined or discharged for exercising their political or other constitutional or civil rights, or for "corporate whistle-blowing." And it would protect employees against discrimination, discipline, or discharge for refusal to grant sexual "favors" to managerial employees.

Title V: Criminal and Civil Sanctions. This title provides for various penalties and sanctions designed to deter the existing level of corporate crime and to compensate its victims.

Business crime is as old as business. There were prohibitions against monopoly in common-law England. Lord Bryce's *The American Commonwealth* (1888) and Henry Demarest Lloyd's *Wealth against Commonwealth* (1899) examined that era's business corruption, with Lloyd noting that the Standard Oil Corporation "has done everything with the Pennsylvania legislature except to refine it." Widespread stock fraud led to the 1933 and 1934 securities acts. The 1960s saw the great electrical machinery bid-rigging case and the Richardson Merrell Company's marketing of MER 29 even though the firm had evidence of health risks. And today the apparent prevalence of "corporate crime"—a subcategory of "white collar crime" involving managerial direction of, or participation or acquiescence in, illegal business acts—has raised the issue of the adequacy of legal sanctions. Why has the law failed to deter "crime in the suites?" What new sanctions or governance structures can persuade companies to obey the law? The *New York Times,* in an editorial bristling with indignation, has concluded: "The only effective remedy is to change the incentives and penalties that now shape [illegal] decisions. . . . Otherwise irresponsible decisions will continue to poison not only the physical environment but public confidence as well" (May 1, 1979).

Setting Standards for Corporate Citizenship

The provisions of the proposed Corporate Democracy Act are both reformist *and* realistic, for with few exceptions they have been adopted already by some company or state or Western country. The act would apply only to the largest 800 or so nonfinancial corporations—only to those "private governments" that have little in common with small and medium-sized businesses. It is based on the procedural mechanism of *federal minimum standards,* so that

whatever the act does not require is left to existing state incorporation statutes and authorities. A standards rather than a regulatory approach has obvious and prestigious precedent: for example, the 1933 and 1934 securities acts, Title VII of the 1964 Civil Rights Act, the Food and Drug Administration rule that all drug companies establish quality control units. "We have largely federalized the law of antitrust, equal employment and securities," comments Professor Harvey Goldschmidt, of Columbia University's Law School; "the federalization of corporate law is long overdue."

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Ultimately, then, the issue is not big government versus freedom. The "freedom" to pollute or to market hazardous products or to retaliate against whistle-blowing workers is not quite the freedom our founding fathers had in mind—not, at least, if your perspective is that of the families around Love Canal who were not free *not* to ingest Hooker Chemical Company's toxic residues. Nor is it overregulation versus productivity. Chrysler and U.S. Steel are in trouble because of their own mismanagement, regardless of how much they may "scapegoat" regulation from Washington.

Nor, finally, is the issue capitalism versus socialism. Rather, it is autocracy versus democracy. For decades the abuses within the American economy have been addressed by remedial regulation affecting the *external* relationships of the corporation: don't pollute, don't fix prices, don't deceptively advertise. The Corporate Democracy Act of 1980 aspires to reform the *internal* governance structure of our largest corporations so that—consistent with a market economy—companies would exercise their power and discretion more democratically and accountably. It is a response to the demonstrated limitations of state corporation laws, of regulatory laws, and of criminal laws to deter corporate abuse.

If preliminary comment is any barometer, however, this approach will be the target of rhetorical overkill by the big business community. An overwrought *Business Week* characterized federal corporate chartering as a reminder of "Mussolini's Corporate State." Business partisans organized a "Growth Day," held on the same April 17 that "Big Business Day" undertook a variety of activities to spotlight the effects of corporate power and to promote the Corporate Democracy Act. "Growth Day" advocates said their target was "zero-growth zanies." Richard Whalen attacked "self-appointed vigilantes" who oppose corporate crime, as if it were somehow illegitimate to try to detect and deter the kind of illegal conduct that has been so massively documented. John Riehm of the U.S. Chamber of Commerce charged, apparently without reading the proposed legislation, that "the advocates of corporate chartering would turn over the control of our economy almost completely to Washington." A Chamber of Commerce "Special Report," calling the bill the "Corporate Destruction Act," warned that it "would end the private enterprise system as we know it in America today." Herbert Schmerz, the leading Mobil Co. publicist, said the bill was a "thinly veiled beginning of the socializing of American industry."

Such obvious distortions demean the importance of the issue of corporate governance. One would have thought that genuine conservatives concerned with human liberty, the entrepreneurial spirit, vigorous economic competition, and lawful conduct would care deeply about those big businesses that deny freedoms to others, that acquire rather than innovate, that seek to frustrate competition, and that violate the law. And one would have thought that the big business community would have learned to restrain its impulse for "Chicken Little" rebuttals—an impulse that has led it to oppose nearly every social advance of this century, from child labor laws to auto safety regulation. Instead of dogma, business critics might want to consider a dialogue. "It is not creative minds that produce revolutions," wrote H. G. Wells in *The Salvaging of Civilization*, "but the obstinate conservation of established authority. It is the blank refusal to accept the idea of an orderly evolution toward new things that gives a revolutionary quality to every constructive proposal." ■

ON THE CORPORATE DEMOCRACY ACT

What's Not in a Name

Ralph K. Winter

I ONCE HAD occasion to note that proponents of a new government agency to "represent" consumers had blundered in changing the name of the proposed tribunal from the "Consumer Protection Agency" to the "Agency for Consumer Advocacy." Not only was the latter title less catchy, but it was also more (although not completely) accurate. Any degree of accuracy, of course, was fatal to the proposal because it called attention to its merits.

The creators of the "Corporate Democracy Act" have not made the same mistake. The title they have chosen has nothing whatsoever to do with the merits of their proposal.

Briefly stated, H.R. 7010 would (1) mandate federal eligibility requirements for members of corporate boards, impose liability for certain acts upon those directors, and expand the mandatory prerogatives of shareholders; (2) require corporations to comply with stipulated disclosure requirements; (3) impose heavy penalties on corporations that desire to move corporate operations from one locale to another; (4) give tenure to all employees of corporations; and (5) create a variety of penalties to be imposed on corporations and their executives for violating federal and state law.

Obviously, the catalyst that binds together this amalgam of diverse regulatory measures is not democracy, but a generalized anticorporate animus. And the title, "Corporate Democracy Act," is intended not to describe the bill but to shut off debate.

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Accepting the bill's title at face value, however, a fundamental question may be asked. Why should business corporations, which claim only to be profit-making enterprises for private investors, be subjected to regulation in the name of democracy,* while organizations that boldly proclaim themselves to be "consumer advocates" or "public interest" groups would not be? It makes little sense to argue that Athlone Industries of Parsittany, New Jersey, must be "democratic," while the Nader conglomerate should be run autocratically and in secret. It can hardly be said that the source of funds for the Nader groups over the past decade is of no interest. This is not, I hasten to add, to argue that "public interest" groups ought to be subject to such regulation. They ought not—but because it is bad law rather than because the alleged principle of democratization does not apply.

While there is no space here to conduct a detailed technical analysis of the Corporate Democracy Act, its text is so technically deficient that at least that fact must be noted. Some of the bill's terminology is so general that the precise effect is in doubt. For example, is an airplane "a product . . . [which] may cause death or serious injury . . ."? Nor is its effect on exist-

*Indeed, one should also ask why some corporations are apparently excluded from coverage by the bill. As introduced in the House, it applies only to "manufacturing, mining, retailing and utility corporations." It would not seem, for example, to apply to the broadcast media, a rather odd exemption in light of the claim that this legislation is necessary to reduce the influence of large corporations on American social, political, and economic life.

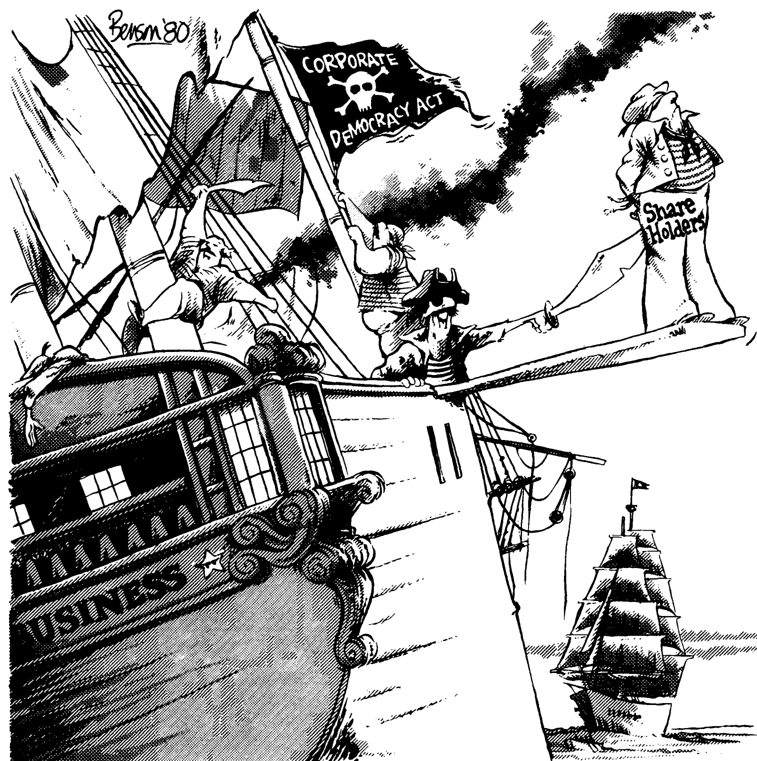
ing law in areas such as a director's duty of care clear. In fact, it seems to have been drafted by persons whose knowledge of existing law is sparse. For example, the bill seems to assume that corporate political contributions to candidates for federal office are legal.

Shareholder Power—A Shopworn Idea

Such relative refinements aside, however, the proposed legislation is fundamentally wrongheaded in what it seeks to achieve. So far as shareholder protection is concerned, the "problem" to which the bill is directed is an artificial creation of those who chronically favor contraction of the private sector. Proponents of the proposal want us to believe that Mark Green and the Building and Construction Trades Department, AFL-CIO, are the champions of private investors. The only senator to come to the rescue of shareholders is Howard Metzenbaum (Democrat, Ohio), while in the House of Representatives their protector is Benjamin Rosenthal (Democrat, New York), both of whom are among the most persistent critics of profit making in the private sector. That investor protection is a goal of the corporate democracy bill simply cannot be taken seriously.

Both the theoretical basis and the practical need for federal entry into this new field are illusory. The former consists of the antique notion that the chartering of corporations represents the conferral of some sovereign prerogative, which the states are bestowing improvidently. In fact, however, states "grant" nothing. A corporate charter is no more than a private contract recorded in a state office for the protection of third parties. The state plays exactly the same role as it does in the case of home mortgages, for which it provides a statutory code of general provisions and a place to record private contracts.

As for the asserted practical need for federal intervention: That consists of the discredited notion that Delaware and other states tilt their corporation codes in favor of management and against shareholders. Even on its face, such a proposition is implausible. Investors need not purchase common stock at all, much less stock in Delaware corporations. They can invest their funds in bonds, partnerships, individual proprietorships, short-term paper, real estate, stock in foreign corporations, or even indulge in present consumption. Nor do underwriters have to participate in stock issues by Delaware corporations or brokers have to recommend such stock. It is simply absurd to think Delaware can monopolize international capital and that Saudi sheiks are forced to sacrifice their petrodollars to greedy managements freed by Delaware law to bilk stockholders. If Delaware were in fact to tilt its laws toward management, the sole result would be to impair the access of corporations chartered there to the capital market. It is simply inconceivable to think that underwriters and investment counsellors would not impose heavy burdens on stock offerings made under a corporate code unfair to shareholders. States that offered bet-



"Trust me, mate."

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ter gains to shareholders would in fact get the most corporate charters. If anything, competition for charters leads to corporate codes that optimize the shareholder/management relation.

Limiting management discretion to act without formal shareholder approval is a shopworn idea that collides, each time it comes by, with the same harsh reality: shareholders do not want more "power." Shareholders generally have neither the time nor the desire to participate in management; when they are dissatisfied they prefer simply to sell their stock in the company. Indeed, state law frequently will not respect shareholder votes that ratify management conduct precisely because those votes are meaningless. Shareholders understandably view themselves as investors—like bondholders, but with a more volatile stake in the firm. In fact, one of the great contributions of the corporate form has been to permit the separation of equity investments from the responsibilities of control.

Existing voting rights in common stock play a critical function, because they blend the investment market with a market for control that permits takeovers. If management is inefficient, earnings will suffer and the price of stock will fall. This will create incentives for attempts (by way of merger, tender offer or, less frequently, proxy fight) to replace management through a shareholder vote and thereby reap a capital gain from the increased efficiency of the firm. The market for control thus gives management good reason to keep the corporation's stock price relatively high, a goal consistent with the well-being of shareholders. The provisions of the Corporate Democracy Act are irrelevant to this aspect of voting rights—the only aspect that significantly matters.

Of course, the recent flap over shareholder "power" has nothing to do with investor welfare. Rather, it is an attempt to construct legal procedures which allow small groups that have failed to achieve their goals through the democratic political process to continue to pursue those goals by embroiling management in time-consuming and highly publicized disputes. Although sizable numbers of shareholders are almost never involved, management's desire to avoid controversy often caps such movements with success in affecting corporate conduct.

The bill's attempt to strengthen shareholder "power" is not just meaningless. It would also be harmful. Shareholder votes are often cumbersome and require considerable legal advice given at the highest rates. Moreover, the bill seems to outlaw the use of different classes of stock; such a restriction, by reducing the flexibility of terms on which new investors can be admitted, would impair a corporation's access to capital markets. Finally, opening up the mechanisms of corporate governance to political zealots who have failed to win support for their causes would weaken the institutions and processes by which political majorities govern.

The attempt to strengthen the board of directors is an error in other ways. The bill would reduce the number of persons eligible for membership on boards by limiting the number on which one person may serve. The authors of the legislation no doubt regard financial experience and technical knowledge as of little importance, if not positively harmful, and foresee no problem in finding qualified people. In fact, the pool of people qualified to perform the functions of a strengthened board is necessarily limited so that, to limit it even further, might affect corporate performance adversely.

A strengthened, active board, moreover, is hardly more "democratic" or "independent." Deeper involvement in the ordinary affairs of corporations would require that directors spend more time and receive higher fees. The "independent" directors would thus become management in all but name.

More Burdens and Dangers

The Corporate Democracy Act also purports to give "affected communities" better information on the impact of corporate decisions. What this means, it turns out, is the imposition of financial penalties on firms that decide to shift the locale of certain corporate activities. Not only would such corporations have to continue to pay local taxes and wages to laid-off employees for a period of time but they would also have to give two years' notice of the move. Such notice would in most cases drastically impair the ability of the firm to operate efficiently during the intervening years. (See also Richard McKenzie's article, page 32, this issue.)

This aspect of the bill is, of course, outright protectionism—the functional equivalent of a tariff and just as detrimental to consumers.

The "affected community" to which the corporation was going to move and the potential employees living there are left out in the cold, and the cost reduction that would benefit consumers is prevented. Economic mobility is in the society's interest and, if individual hardship requiring remedial aid results, the proper remedy is not a protectionist law penalizing that mobility but transitional government aid.

So far as corporate disclosure is concerned, there is already an enormously burdensome tax imposed by the federal government in the form of paperwork. If anything, investors want less of this, not more. The bill's wholesale reporting requirements would produce only increased costs, a mountain of unread material, and socially useless litigation. Expansion of reporting requirements should occur only in connection with an articulated governmental policy administered by a relevant government agency. In that way, the overall burden of disclosure requirements could be more easily identified and taken into consideration. Calls for public reporting on every matter that happens to occur to corporate critics will inevitably increase costs without corresponding benefits.

The Corporate Democracy Act also prohibits the discharge of any employee except for "just cause." On a rhetorical level, that seems simple justice. As a legal proposition, it is disastrous. In effect, every employee would be given tenure and, to justify a discharge, serious misconduct or deficiency would have to be proven in legal hearings entailing vast amounts of time and expense. The fact that better workers might be available would be irrelevant. The model for this provision is the civil service—which, these days, is generally not thought of as a model for anything else. In some parts of the country, where tenure provisions like those contained in the bill protect public school teachers, private schools paying much lower salaries than their public counterparts have much better teaching staffs because they have the unlimited power to hire and fire.

The bill also provides a variety of expanded penalties for violation of vaguely defined state or federal laws. This wholesale approach has great danger, because its impact cannot possibly be assessed. Hundreds of laws might be affected—which ones cannot be identified in advance, given statutory language whose lack of precision is exemplified by "an offense resulting in . . . damage to the natural environment." In truth no one can assess the impact of such provisions until years of litigation have passed. Since there is an easy and sensible alternative—varying the penalties available under particular existing laws—this part of the legislation has absolutely nothing to recommend it.

The Love Canal of the New Class

The proponents of the Corporate Democracy Act have done a disservice to the nation. Instead of focusing on real problems and suggesting remedies tailored to those problems, they have adopted a wholesale, punitive approach accompanied by strident rhetoric ("crime in the suites") designed to appeal to base emotion. The very real problem of proliferating state anti-takeover statutes designed to insulate the managements of local firms from the market for corporate control is disregarded in favor of calls for more power to shareholders who do not want it and will not use it. The problem of reducing the destabilizing effects of economic mobility on individuals is ignored in favor of attempts to restrict the mobility itself. What may be a need for more corporate disclosure is lost in demands for the production of every piece of information that might interest the corporate critics, regardless of the cost society would ultimately have to bear.

If we have learned anything from the professional corporate critics in the past, it is that their animus against the private sector is so intense that they cannot be trusted to address real problems sensibly. At one time, a staple of their proregulation rhetoric was flammable children's sleepwear. When government solved that problem in a fashion that ultimately resulted in expensive carcinogenic pajamas, the critics continued to attack the manufacturers. Gas-guzzling antipollution and safety devices were heaped upon cars at the behest of corporate critics without regard to fuel consumption, but when the energy crisis hit, car manufacturers and oil companies were said to be at fault. The critics' present remedy for that crisis is to keep gas prices low to prevent corporate price "gouging"—the most effective device known to human kind for encouraging consumption. The Corporate Democracy Act comes from the same crowd, and goes in the same unthinking direction. It is the Love Canal of the New Class. ■

ON THE CORPORATE DEMOCRACY ACT

What Is True Corporate Responsibility?

Murray L. Weidenbaum

Big Business Day (April 17) proved to be the dud that its ill-assorted guard of sponsors invited—and richly deserved. Yet its ostensible concern about the role of the corporation in modern society remains to be dealt with, albeit in a more constructive way. In that spirit, let us consider the concept of "social responsibility" on the part of companies that supposedly—or so say the relatively responsible critics—concentrate too single-mindedly on maximizing profits.

How *should* the performance of business firms be evaluated? Brushing aside the theatrics of the Jane Fondas and Ralph Naders, we find striking similarities among the more serious scholars. That is, most academic writers on "social responsibility" view the corporation almost solely as an engine of income redistribution, as a community benefactor, as a mechanism for improving the "quality of life," both on and off the job—in short, in terms of its contributions to specific social or eleemosynary objectives.

But perhaps I am trying to state the point too subtly. My concern is not with the notion of paying some attention to the social dimensions of the business firm but with our growing habit of treating these noneconomic factors as paramount, sometimes I suspect unwittingly. Thus, traditional economic or business functions are so frequently viewed as secondary, or taken so much for granted, that the basic business of business is ignored by those outside the corporation who are evaluating its behavior. (Still in my unsubtle mood, let me note that "profit maximization" is itself shorthand for much, much more—for job creation and increases in productivity, for meeting payrolls, distributing dividends, and paying taxes.)

Surely the social impacts of business merit attention. We care about the air we breathe, the water we drink, and how the quality of both are affected by the actions of others. But, as citizens of the society, we have a wider array of concerns—economic as well as noneconomic.

To illustrate the point being developed here, let us conjure up two companies of similar size (measured by assets and sales) and in the same industry (say, pharmaceuticals): one is Social Responsibility Inc. (SR Inc.) and the other, Profit Maximization Inc. (PM Inc.). Let us further postulate that both SR Inc. and PM Inc. are law-abiding corporate citizens. Both operate at levels of honesty and integrity at least equal to those of government agencies, college professors, and social activists.

SR Inc. is the type of firm that meets all of the textbook criteria for social responsibility and even elicits admiration from Ralph, Jane, et al. It regularly fulfills its affirmative action "targets"; it goes beyond that and maintains special training programs to accelerate the career development of each minority and female member of its work force. SR Inc. is also a bulwark of its local community, supporting generously a variety of activist "citizen" groups as well as the opera, the art museum, the ballet, the symphony, and Scouts, Boy, Girl, and Sea. SR Inc. prides itself on the safety of its work places (it has never received so much

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as a *de minimus* citation from OSHA) and of its products (there has never been a product recall in its history). In fact, the Sierra Club and the Friends of the Earth regularly use the company's auditorium for their meetings, free of charge, of course (including the granola-nut cookies and all-natural apple cider).

Profit Maximization Inc., on the other hand, is a very different breed of cat. It refuses to take government contracts and so avoids any requirement for conducting an affirmative action program. Rather, it hires and promotes solely on what its personnel office describes as outstanding professional merit. PM Inc. rarely contributes to local charities. It also has been chided by OSHA for failing to post the required notices and for maintaining inadequate safety records. On occasion, some of its products have been recalled for adverse side effects, albeit of the nonfatal variety.

Ecologists consider PM Inc. to be unfriendly because it obeys EPA mandates only grudgingly and after exhausting all available administrative and judicial remedies. And, to complete the catalogue of venality, let us assume that, although the firms are of equal size, PM Inc.'s profits are double those of SR Inc.

Quite clearly, these two firms are at opposite ends of anybody's scale of social responsibility. SR Inc. is a ten and PM Inc. is a zero. Well, almost anybody's. Let us try to break new ground and go beyond the traditional notions of social responsibility. Let us, therefore, examine the economic functions of these two companies, remembering that both are producers of pharmaceutical products.

As it turns out, SR Inc. manufactures and markets an array of old-line, standard, tried-and-true prescription drugs used to treat routine ailments. This helps, of course, to account for its fine safety record, as well as its low profitability—and its slow growth in sales, employment, dividends, and taxes paid.

PM Inc., in contrast, concentrates on developing new medicines, especially those that can be used for curing major diseases not much responsive to traditional pharmaceuticals. PM Inc.'s work force of brilliant male WASP scientists constantly wins prizes for achieving a variety of scientific breakthroughs that result in lifesaving—*and* rapidly selling *and* highly profitable—new medicines. (The reader can readily think of similar contrasting examples in other industries, but the point need not be belabored.)

Now, until these two stereotypes are more fully fleshed out, some of us may be reluctant to state categorically that PM Inc. contributes more to the public welfare than SR Inc. But I, if pressed, surely would opt for PM Inc. By ignoring the merit of the "economic" functions of the business firm, most available analyses of corporate social responsibility are fundamentally flawed. At the least, they are inadequate to the extent that they implicitly assume that the act of producing and distributing food, clothing, shelter, and other necessities and amenities has little bearing on society's welfare. PM Inc. should not be a zero on anybody's scale of social responsibility.

To reduce the likelihood of being misunderstood, let me repeat the basic thesis of this article: the role and contribution of the business firm in modern society should not be viewed *primarily* in noneconomic terms. As an economic unit, if the business firm has any fundamental obligation to the society of which it is a part—aside from or even in contrast to its commitments to its shareholders—it is to produce those goods and services that consumers desire in order to enhance their welfare as they see it. Conventional notions of "social responsibility" should properly be viewed as constraints rather than basic goals to be aimed at.

The contributions of business to meeting other concerns of society are surely not trivial. But clearly they are ancillary. Perhaps we need to go a step further and point out that the business firm is not an all-purpose mechanism. It is an economic organization that was created for and is best suited to serve economic purposes —purposes, moreover, that are of vital importance to the health and welfare of the society.

The implications of all this may even be profound! To the extent that the basic role of the corporation is excluded from the analysis, the analyst will be led to question the "legitimacy" of the corporation and to conclude that society's will must be more directly imposed on these private mechanisms. And the analyst will be misled. A comprehensive and balanced analysis is more likely to conclude that the business firm, warts and all, is a major bastion of our free and productive society. Thus, the proper response to Big Business Day may well be— "Free the Fortune 500!" ■