# A Humanist Economics
## Louis Kelso and the Hope of Broadened Ownership

by **Luis Granados** • 17 February 2015
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**THOMAS PIKETTY** grabbed the world's attention last year with his magnum opus, *Capital in the Twenty-first Century*. In hundreds of pages of dense prose and statistics, Piketty delivers a mountain of proof for what most of us already feel instinctively: that the rich are *really* rich, and getting steadily richer. Incidentally, outrage over growing wealth inequality is what fueled the "Occupy" movement that dominated headlines in recent years. We now find ourselves on a course that, barring some major upheaval, will reproduce and then exceed the record levels of ownership concentration experienced by Europe prior to the outbreak of World War I. Piketty demonstrates at great length how that cataclysm, followed by thirty more years of chaos, annihilated the old fortunes and produced the relatively level growth surge of the 1950s and '60s. But the inexorable tendency of capital to grow by itself, like mold in the refrigerator, began marching us back toward wealth concentration. With a swift kick from government in the Reagan-Thatcher years, the trend accelerated.

Piketty's achievement is especially impressive because governments do not produce handy, accurate statistics on wealth concentration. They did so even less in the earlier parts of the three hundred years he studied. The research he's done to produce plausible results is astounding. Which is all the more reason for a reader to be disappointed by everything that follows his "therefore… ." After all that brilliance, Piketty's solution is simplistic: let's tax the hell out of them, without any clear plan for what the government will do with all the money it confiscates. And the tax, he sagely notes, must be global in character, or notoriously fluid capital will simply escape to a lower-tax territory.

This will all happen sometime after we figure out how to make it stop raining on weekends and how to make two-year-olds quiet and polite. But humanists need solutions that will actually work. Piketty tantalizes us with a reference to "innovative financing techniques," but is too drained by the effort of measuring wealth concentration over time to tell us what they are.

John Maynard Keynes once quipped that we are all the intellectual slaves of "some defunct economist." The political economist Louis Kelso has been dead for twenty years now. Perhaps that's "defunct" enough for him to start to be taken more seriously, at the highest levels, than he was during his lifetime. For Kelso actually offers a solution to the evil that Piketty so exhaustively describes—a solution that's been proven to work, not just on paper, but for hundreds of thousands of flesh and blood humans. And this solution isn't just a financing gimmick but a plan grounded in thoughtful principles of economic justice that humanists ought to like.

Kelso grew up in Colorado during the Great Depression. He used to watch freight trains roll by loaded down with people; then a passenger train would roll by, empty. During the war, Kelso was stationed in the Panama Canal, which (fortunately) gave him a lot of down time. He spent that time thinking and writing, ultimately producing a manuscript that was so radical he was afraid to do anything with it.

In the early 1950s, Kelso attended a lecture by the philosopher Mortimer Adler, who assured his audience that no general theory of capitalism had ever been written. When Kelso contradicted him, Adler became indignant; he had read everything there was on the subject, and he knew that no such theory existed. "But you haven't read the manuscript in my closet," Kelso replied.

Adler read it, and was so impressed by what this seeming nobody had come up with that he asked to become a co-author. Kelso and Adler's *The Capitalist Manifesto* was published in 1958, and three years later they came out with *The New Capitalists*. Kelso and his wife Patricia Hetter later published *Two-Factor Theory* (1967) and *Democracy and Economic Power* (1986).

It doesn't really take four somewhat repetitive books to communicate Kelso's fundamental insight. First, an important definition: "capital," in Kelso's scheme, is not "money." Capital is any "thing" used in the production of goods and services. For example, hand tools, factories, land, computers, and power plants are all capital. Capital and labor, when combined, produce all the output of our economy. They are independent factors in production—the two factors of his *Two-Factor Theory*. It is not useful, in Kelso's view, to think of capital as "enhancing" labor, any more than it's useful to think about your left foot as "enhancing" your right foot as you walk down the street. It is an independent factor of production.

As an independent factor, capital contributes to production in exactly the same physical, legal, and moral sense as human effort does. Which factor is more important? Capital is—by a mile. People don't work any harder today than they did two hundred years ago. Most of us don't work nearly as hard. Yet output per person is vastly higher than it ever was, and growing fast. Just in my own legal profession, normally considered labor intensive, the ubiquity of copy machines, faxes, word processing, emails, and computer research tools has tremendously increased legal service output (which is not necessarily a good thing, but that's another article). How many complex business transactions could an attorney do in a year using a quill pen and a candle?

Kelso estimated that capital contributes as much as 90 percent of the value of production, especially when you consider the effects of things like minimum wage laws, immigration restrictions, collective bargaining, and so on, that artificially inflate the payments labor receives over what it would otherwise receive in a totally unfettered market. That was sixty years ago, in a book that did not even mention the word "computer."

It's not possible (or useful) to pin down capital's relative importance vis-à-vis labor; the point is that it's extremely high, and growing. The entire thrust of the Industrial Revolution is to make our tools more and more powerful, producing an ever-larger percentage of total output.

Aristotle actually anticipated this 2,300 years ago: "If the shuttle could weave and the plectrum touch the lyre without a hand to guide them, chief workmen would not want servants, nor masters slaves." Amazon drone deliveries, anyone? How many jobs will that eliminate? Only a fraction of the retail jobs Amazon has already destroyed using capital, all the while providing a vastly superior means of getting products to consumers. Kelso's question is, who will own the drones?

Capital pays for itself. Unless and until smart people are quite certain that a given item will pay for itself, usually in just a few years, capital (like Amazon's drones) will not come into existence. People who finance capital creation are not always right, but they usually are, and their rare losses are easily covered by all their wins.

Capital pays for itself, and then keeps on paying. Once it's allowed to concentrate in the hands of a few, it spirals out of control. When owners can't think of more things they want to consume with capital's output, they just buy more capital, creating the phenomena that Piketty documents in such excruciating detail. In*Two-Factor Theory* Kelso describes a lavish 1960 party put on by John Paul Getty for a thousand of his dearest friends, which the *London Express* called "easily the most fabulous evening since the war." But while the party was occurring, Getty's net worth went up, not down, because of what his capital was quietly earning in the background.

So here's Kelso's insight in a nutshell: since capital pays for itself, why can't it do so for average people as well as for the rich? We have an extraordinarily effective credit system for loaning people money to purchase houses, boats, cars, clothing, even lunch—all things that do not pay for themselves. How hard can it be to design a practical financing scheme to loan money to ordinary people to acquire capital, that magical stuff that actually *does* pay for itself?

Turns out it's not hard at all. Kelso, who became a successful investment banker, developed the first Employee Stock Ownership Plans, or ESOPs. An ESOP is a trust, similar to a 401(k) trust, for the benefit of employees of a corporation. The trust borrows money and uses it to purchase capital, represented by shares of stock of the corporation where the employees work. The capital earns money, as always, some of which is then paid to the trust, which uses it to repay the loan. The employees then own the capital outright, and everything it produces thereafter goes to them.

If you followed the last paragraph closely, you'll note that the employees never spent or risked a cent. The capital paid for itself, for ordinary people, rather than for the "one percent."

Does this actually work? It does. There are thousands of U.S. companies (some worth billions of dollars) that combine to employ hundreds of thousands of people and that are substantially (often 100 percent) owned by the rank and file people who work there. There are a number of foreign employee-owned companies as well. Lawyers and bankers have created rich diversity in adapting the concept to varying circumstances, but the underlying idea remains the same: employees are provided credit to purchase capital in a well-structured system, the capital pays for itself, and the employees then get the benefit of what the capital produces ever after.

When workers become owners, are there any positive effects on their productivity? This question has been studied by academics *ad nauseam*. The answer is yes, there are important positive effects, especially where management is sharp enough to implement more participative procedures for employees to enhance the profits that are now going into their own pockets. That's just the gravy, though; the meat is Kelso's little finance engine that, if adopted on a wider scale, could break the ownership concentration patterns Piketty finds so inexorable.

**IN THE** United States, by historical accident, the lawmaker who first became sold on Kelso's ideas was the chairman of the taxation committee in the Senate. As a result, American ESOPs became largely a tax-driven phenomenon, and for companies in the ESOP sweet spot, the tax savings truly are impressive. That's unfortunate in some ways, because what really should be powering the idea is government regulation of credit, not taxation. The rules of the credit game are rigged to favor continued ownership of newly financed capital by the already wealthy. They don't have to be. Even moderately creative financial minds could devise incentives for lenders to favor loans to ESOPs—or to cooperatives, or various other types of ownership-broadening vehicles—over other types of loans. Even a tiny advantage of one financing form over another can shift trillions of dollars in today's data-driven environment.

Unlike Piketty's plan to tax capital, and the Occupy movement's even more drastic dreams, Kelso never proposes confiscating anything from anyone. He focuses primarily on growth—on capital that no one today has any legal or moral right to. That makes his ideas vastly easier to implement than any socialist or populist scheme. In the United States, Kelso's pro-business but egalitarian approach has actually been better received by Republican politicians than by Democrats. "If a little capitalism is good," Ronald Reagan used to say, "what's wrong with a lot?" Former Republican Senator Bob Dole joked that he liked ESOPs because they make more stockholders, and stockholders vote Republican.

Kelso didn't stop with a clever financing scheme, though. He proposed a theory of economic justice that not only hangs together well but fits the humanist philosophy. The theory has three premises, which work together like a three-legged stool: remove one, and you tip over.

#1: The principle of participation—everyone has the right to produce. This is easy for most people to accept at first. When you consider, though, that nearly all production actually happens through capital rather than through labor, you begin to suspect that this may be more radical than it sounds.

#2: The principle of distribution—from each according to what he or she produces, to each according to what he or she produces. This is the direct opposite of Marx, who advocated distribution based on "need," hence Kelso's first book title, *The Capitalist Manifesto*. The experience of the twentieth century, though, is that Marx's formula of "to each according to what he needs" simply doesn't work. People's "needs" tend to be large, especially when strangers are fulfilling them. Conversely, the incentive to produce, either through labor or well-managed capital, is diminished when the fruits of that production immediately disappear. No amount of bureaucratic jawboning or threats seems able to reverse that. Billionaire apologists would be happy if Kelso stopped there, but he does not.

#3: The principle of limitation—it is wrong to produce more than you can consume. The purpose of producing goods and services is to consume them. It's not a game for the purpose of scoring points, though many rich people treat it that way.

During the 2008 presidential campaign, John McCain (who married a beer heiress) was asked the simple question of how many houses he owned. He didn't know. (The answer appears to have been seven, although I've also seen other estimates.) He later started answering the question with the evasion typical of politicians: "I define rich in other ways besides income. Some people are wealthy and rich in their lives and their children and their ability to educate them. Others are poor if they're billionaires."

Kelso would say if you want to own multiple houses, even multiple mansions, that's fine, so long as you use them. But when it gets to the point where you don't even know how many you have you can't possibly be using them. That, says Kelso, is morally wrong. When a person owns capital that produces income that he or she has no intention or capacity to consume, and that income by the principle of distribution must go to the owner, it necessarily results in a violation of the principle of participation—someone, somewhere, is being denied the right to participate in production because people who aren't desirous or capable of consuming more are hogging it all. That is, quite literally, *immoral* under Kelso's scheme of justice. John Stuart Mill, in *On Liberty,* said that the only restriction on a person's use of his property should be that it may not be used to injure others. Kelso argues that owning capital that produces more than you can consume does exactly that, and is therefore illicit.

The story is told, perhaps apocryphally, of a meeting that one of Kelso's investment banking partners arranged between Kelso and Barron Hilton, the hotel magnate (Paris Hilton's grandfather). The purpose of the meeting was to try to sell Hilton on the tax benefits of ESOPs. The conversation was proceeding smoothly until at one point Kelso blurted out "Barron, don't you already have enough?" Hilton nearly swallowed his cigar, Kelso's partner nearly fell off his chair, and the employees of Hilton Hotels never got their ESOP.

**KELSO AND ADLER** explained their thinking through the time-honored example of the Robinson Crusoe economy. When Crusoe is alone on his island, he certainly has the right to produce, and he is certainly entitled to all the results of his production. If he develops some capital in the form of tools (a plow or a rabbit trap, for example) to help him produce more, he is entitled to the greater production that results from combining the two factors. No one anywhere else on the planet has the moral right to take away any of Crusoe's accumulated capital or any further output that Crusoe and his capital produce.

One day a second castaway turns up. Let's call him Smith. He's one of the seven billion people who we just decided have no right to confiscate or claim any of Crusoe's property. But he does have a right to himself produce, and to claim the results of anything he produces. If he weeds Crusoe's fields and thereby adds 10 percent to the resulting harvest, he is morally entitled to 10 percent of the output.

Is it morally right to let him starve, if 10 percent doesn't happen to be enough to keep him going? Especially if Crusoe's capital, his cultivated fields and animal traps, produce far more food than Crusoe can possibly eat? Kelso says no. In a just society, a way needs to be worked out for Smith to acquire his own tools, perhaps by initially sharing with Crusoe some of what they produce until their value has been paid for. It's not necessary that Crusoe and Smith ever be equal, but it's morally wrong for Crusoe to produce *more* than he can consume while Smith is deprived of the ability to produce *as much as* he wants to consume.

The *Humanist Manifesto III* states: "Knowledge of the world is derived by observation, experimentation, and rational analysis." Kelso began by observing anomalies in rail transport, rationally analyzed what caused them, and launched experiments in broadened ownership that have been, on balance, a roaring success. The well-intentioned alternative proposed by Marx has also been tried, and found wanting. Piketty demonstrates exhaustively that the "mixed economy" model in place since the end of the thirty-year cataclysm that began in 1914 is falling apart. It's hard for a humanist to ponder Piketty's projections and not say, "That's really bad—we can't let that happen!" What exactly is the good reason *not*to try Kelso's ideas on a broader scale?

Of course, nothing is entirely new under the sun. Thomas Jefferson and his followers believed that men could only be truly free if they owned income-producing property. The cheap land policies of the early nineteenth century and the Homestead Act of 1862 were conscious government efforts to broaden the ownership of land, which at the time was the principal non-human factor of production. These efforts worked—Piketty's figures show America as being far more egalitarian than the Old World before the storm broke in 1914. Kelso shows us how to reproduce that in an industrial or post-industrial age.

On a deeper level, the *Humanist Manifesto* also stresses that humanists "are committed to treating each person as having inherent worth and dignity, and to making informed choices in a context of freedom consonant with responsibility." There is nothing remotely dignified, free, or responsible in living off of government handouts, either in a pure socialist economy or in a "mixed economy" that is increasingly (and necessarily) heading in a more socialist direction (as demonstrated by recent healthcare reforms). But if the rich just keep getting richer, and own all of Amazon's new drones, more of us will become ever more dependent on confiscation and charity to survive. There's no dignity or "informed choices in a context of freedom" in that.

Dignity is Robinson Crusoe turning his island prison into a paradise with his sweat and ingenuity. When Smith turns up, he needs not stolen or donated pineapples, but the realistic opportunity to acquire his own non-human means of production, which pay for themselves, allowing him the leisure to spend his days conversing with his fellow capitalist Crusoe about art, philosophy, and the joys of island life.

Humanists have been on the cutting edge of so many world-changing trends over the past seventy years, from reproductive rights to equality for minorities to keeping superstition out of science. It's time for us to add broadened ownership of capital to our agenda.

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**Luis Granados** is the director of Humanist Press, the publishing house of the American Humanist Association, and the author of *Damned Good Company: Twenty Rebels Who Bucked the God Experts*. He writes the *Rules Are for Schmucks* column for TheHumanist.com.