

# The Problematique Resolved

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## Introduction

I propose that a relatively simple and effective solution is at hand to the *problematique* identified by the founders of the Club of Rome thirty-some years ago. It relies on techniques which fall into the domains of politics and finance, but I believe it is fairly easy to infer positive impacts on elements of the *problematique* other than material needs and political freedoms (thinking, e.g., of urban congestion, pollution, health, resources depletion).

It is my hope that members of this group and others will join me in an exploration of what I perceive to be a major evolutionary step in political economy, to critically evaluate its core and to infer the likely consequences for issues that concern us collectively and as individuals. Essential

details of the financial wing of the solution have been explained several times by several persons whose expertise in the subject matter cannot be tossed aside lightly. Since I can improve on neither their authority nor their expository efforts, I simply provided copies of two excellent one-page essays for participants at the CACOR luncheon. To avoid potential problems with copyright, the editor has suggested that I provide my own summary, plus references. The articles reproduced for the luncheon were by Winnett Boyd, president of Arthur D. Little of Canada, Ltd., and Frank Capon, Vice-President, Dupont of Canada Limited and president of the Canadian Institute of Chartered Accountants. They may be found in *Canadian Business*, July 1972, and *Financial Times of Canada*, January 1972.) Other articles from Canadian sources are listed at the end of this text. Useful contemporary introductions to the debate I am hoping to initiate include an op-ed piece by James Laxer in the *Globe and Mail* of September 10 (p.A25) on "Third Ways," whose aspiration is "to embrace the market and a new social bargain", and the column "Bagehot" in *The*

*The most brilliant economic solution to the problems of material sufficiency and equity is not very helpful if there is no prospect of having it put into effect by a system of government which seems increasingly to serve us badly*

*Economist* of September 18, "The third way revealed".

These critical comments on the transformation of formerly socialist parties into mushy proponents of market solutions decry the "third way" as little more than a plea that neither capitalism nor communism/socialism seems to be a workable solution, so we must find a new and "holistic" one. About the only one that is offered so far, however, is more and better education so that more young people can have higher-paying jobs. This comes

in the wake of recent reports of research which demonstrates the rapid disappearance of good jobs, and the deceit of "full employment" in the U.S. where two or more jobs per family does not suffice to keep poverty away. Closely related to the jobs and employment income issue is the mounting concern for medical care

and old age income security. A special review of this subject appears in *The Economist* of October 24, 1998.

The articles by Boyd and Capon focus on the folly of trying to solve the incomes distribution problem by either full employment policies or redistributive social programs. Instead, they advocate a plan for making every member of society a significant property owner—with sufficient wealth that a life-sustaining income might be had from dividends alone. In other words, complete democracy in the modern sense means that every citizen should also be a capitalist. This is the message of *The Capitalist Manifesto* issued by Maurice Kelso and Mortimer Adler forty years ago. To accomplish it, some legislative initiatives are required, varying slightly from one country to another. This is not a minor detail, as we all know who have been trying for years to influence public policy. One of the subjects to be addressed in this forum, therefore, is the political process itself, the issue of governance. That is why I call your attention to the attached broadsheet about "mendicant democracy" by Don Kemner of Philadelphia II. Mike Gravel, a former

United States Senator and a critic of representative democracy founded the latter organization. Gravel is also an innovative and aggressive proponent of the Kelso-Adler prescription of universal capitalism

## Thesis

The thesis I propose for evaluation is that a combination of Kelso's brand of universal capitalism with direct democracy as defined by Gravel implies an evolutionary leap in the political economic tradition called liberal democracy.

## Considerations

Conversations with Gravel and Kemner brought to my memory a conference of the International Political Science Association held in Ottawa in 1986, titled "The Crisis in Political Thought". Organizers called attention to the point that virtually the entire world is living on political ideas invented in Europe and North America, and that both the left and the right wings of that tradition have exhausted their capacity to resolve social problems. In the years since 1986, this thesis has been underscored, first by the collapse of the Soviet Empire and more recently by the ongoing financial meltdown of the capitalistic "victor". The most radical innovations I heard at that conference were keynote papers by Lester Milbrath of SUNY Buffalo, for making ecological consciousness a foundational postulate in any further work in political theory, and one by Carole Pateman on a similar claim for feminism. While both of these themes are unexceptionable, I find them less breathtaking in scope and implications for achieving real results right away than the Kelso-Gravel formula. The combination reminds me of another initiative, which came to my attention at about the same time as Boyd, and Capon were touting Kelso for Canadians. It is a book titled *In Search of a Third Way*, written by University of Guelph philosopher T.W. Settle and sponsored in part, if I remember correctly, by the Science Council of Canada. In other words, the inadequacy of both the left and the right wings of liberal democracy has been evident to thoughtful observers for some time; it is now becoming painfully obvious to a larger audience. The Bagehot column in *The Economist* which is mentioned above was actually a review article about a book by the director of the London School of Economics, Anthony Giddens, titled *The Third Way*. "Bagehot" describes the third way as the politics of Tony Blair and of other refurbished leftist parties in Europe. On the other side of the political

spectrum, George Soros has expressed his misgivings about the "success" of capitalism following the demise of the Soviet empire (in an article in *Atlantic Monthly* earlier this year), and has discussed his views in an interview with Anthony Giddens published in the LSE alumni newsletter. In other words, our subject is the presumed failure of both extremes of the European-American tradition and the exhaustion of its fundamental political-economic postulates.

The importance of the political element in ideas of material wellbeing is demonstrated in what I have seen and experienced of efforts to explain or understand why the Kelso economic innovation has not been more popular with legislators. The most plausible answer always centres on the sharing of social power and the insistence of those who have it to maintain their sense of superiority over the less "fitted" masses. This is the answer that Kelso himself is reputed to have evoked on several occasions from the more frank of his own peers. Another potential explanation, which has been the subject of substantial efforts by persons who were close to Kelso, is that economists are to blame. This explanation is couched in terms of Kuhnian "paradigm shift" and avers that economists do not understand the real sources of productivity and well being. These critics follow a cue from Kelso himself, whose most complete exposition of principles for achieving the goal of making everyman a capitalist seems to have been *Two Factor Theory: The Economics of Reality* (with Patricia Hetter). The essential core of this argument is that economists fail to acknowledge that capital has productive power independent of the human actors who interact with it. In the words of Robert Ashford, they fail to grasp the principle that "capital has a potent distributive relationship to growth."

## How To Make Capitalists From Householders—Two Paragraphs

The explanation of how it can be done involves concepts in the realms of money, capital, investment, effective demand and economic growth and is familiar to economists who have studied the developments in economic theory that led to the Keynesian Revolution. (See chapter 9 in *The Ownership Solution*, described below.) It involves a pattern of causation that is counter-intuitive for many people, perhaps most. That is, investment can and very frequently does precede saving. If an entrepreneur and his banker agree that a significant

opportunity is available, the banker can create the money necessary for the businessman to pull together the people and other resources necessary to get the enterprise underway. Once it is generating revenues sufficient to cover costs, repayment of the loan is the only act of saving involved. That is, it is neither necessary nor completely accurate to conceive of the loan to the businessman solely as the transfer of surplus currency accumulating in householders' savings accounts. When a banker believes in a grandiose scheme, he can create the money necessary to get it going. (If the project doesn't pay off, however, the banker can be in serious trouble when it comes to making good on promises to his creditors—including householders with savings deposits.)

These are old and well-known principles. What Kelso contributed is a way to make this process available to "householders" who are not themselves entrepreneurs, necessarily. He believed that they should be able to participate in the process by which already wealthy people are able to buy ownership in new wealth-creating opportunities without actually putting any of their own money on the line. Instead, they are able to take a substantial "position" in a new venture by taking a large loan from their banker which he grants on the basis of the collateral value of their pre-existing assets. In this way, new economic growth benefits mainly those who are already wealthy. Kelso believed this process could and should be democratized in a way that is conceptually quite simple. He devised schemes of insurance and re-financing that make it possible for people without collateral to buy into new but relatively risk-free investment projects (such as the expansion or privatization of a public utility like Ontario Hydro, for example) and to thereby acquire a share position sufficient to assure a minimum income without the necessity of having a paying job.

### **Issue Number One**

Although the explanation above asserts conventionality for the most critical concept in Kelso's innovation, the idea has apparently met resistance in professional circles.

The first issue is therefore theoretical, turning on the point of whether standard economic rationale either misses or distorts a principle that Kelso discovered and built into a proposal for resolving an old riddle in social relations. (It involves the relationships among money, savings and investment in addressing the macroeconomic

problem of insufficient demand.) If this is the case, then the failure to adopt Kelso's solution can be attributed to a failure of communication between Kelsonians and economists. If, on the other hand, it can be shown that Kelso's innovations are compatible with much of orthodox economic reasoning, resistance may have something to do with economists' own sense that their best ideas do not get much attention from the real power brokers.

### **Issue Number Two**

If it is accepted as a normative premise that social justice requires greater equity in the distribution of income and wealth, then the debate over Kelsoism engages a question of how best to achieve it. The Kelsonians propose that it is possible to give everyone an endowment of wealth sufficient to underwrite a modestly adequate income—an order that is equivalent to proposals for guaranteed annual income or negative income tax. Furthermore, they insist that this can be done through new growth, without re-distributing existing wealth or incomes. If the first issue is resolved in favour of the feasibility of Kelso's vision, therefore, issue number two concerns its desirability. Right-wingers who favour the idea will do so because it involves greater freedom from heavy-handed and inept government regulations and redistributive taxation. And although it promises to achieve the goals for which left-wingers have long struggled, sceptics on the left are prone to worrying that some people can't be trusted to take care of themselves even when given a substantial "inheritance." There will always be the prodigal sons. Persons of this persuasion typically prefer the idea of some kind of minimum income guaranteed by the state.

### **Issue Number Three**

Even those who favour the left-wing, womb-to-tomb security approach to social justice and equity usually sweeten its appeal by invoking economic growth as the source of expanded benefits for all. The third issue is raised therefore by persons who are alarmed by the burgeoning human population, its appetite for the finite supply of energy fuels, pollution, destruction of species and ecosystems, all augmented by the frenetic pursuit of technological power. In other words, can civilization, humanity, the biosphere, afford more economic growth? If not, by what means should we be aiming to avoid it? War? Pestilence? Famine? Mass sterilization? Further

concentration of wealth and power? Withdrawal of services to the poor? Cessation of economic development programs? These are questions of a kind that I characterize as *allocative* in distinguishing them from the *distributive* problems of issue two and the *theoretical* ones of issue one. I might add that these are the questions that have greatest appeal to me, and for which I hope for the largest contribution by participants in the anticipated electronic forum.

### **Background Information and Resources for Independent Study**

It will probably be helpful if I declare my own connections and interest in the subject: I first read Kelso and Hetter, *Two Factor Theory* sometime in the early seventies, on the recommendation of a colleague (economist) who knew of my interest in the concentration of economic power and its implications for social justice. Pressure of other work (in the federal department of agriculture), and concerns leading from it, drove the subject from my mind until 1997 when I chanced to be at a conference of the Society for Advancement of Socio-Economics (SASE, Montreal) and found Kelso's ideas on the program. I attended the session, in the company of two colleagues from the University of Waterloo, who I had also encountered unintentionally. (I expect that they will be participants in the anticipated forum.) The presentations tweaked my interest and I noted that the chief orchestrator of the event was located close by, at Syracuse University College of Law. Later that year I paid an unannounced call on him (Robert Ashford) as I was passing through Syracuse. He was generous with his time and with his writings on the subject of what he and other of Kelso's disciples call "binary economics" (for a reason that will be important to our discussions). A few months later I had occasion to refer Ashford's writings, without recommending them, to the director of the government unit in which I work, who was also Chief Actuary of the Canada Pension Plan. His general interest lay in the adequacy of employment incomes for Canadians in the long term future, and he passed the materials back to me with an affirmation that he considered the subject to be worthy of further consideration. Given this signal of support, I began reading Ashford's materials more carefully and spent a day with him the next time I passed through Syracuse. That led to my participation in the "binary economics" symposium organized by Ashford at the 1998 conference

of SASE, representing the Social Policy Unit in the Chief Actuary's Office. (Bernard Dussault therefore has an important link of sponsorship to the exchange of ideas, which this paper is intended to launch.) The opportunity of spending a week with a small group who worked closely with Kelso provided most of what I know about the subject, as reflected in references and anecdotes which follow.

Robert Ashford and Mike Gravel have already been identified. Others with whom I spent substantial time in discussion of these ideas include:

Jerry Gauche, a former member of Gravel's Senate staff and now an executive with an oil-well supply company in Texas;

John Jones, a banker from California whose exposition on practical details of applying the Kelso principles you will want to read;

Patricia Hetter, Kelso's co-author and widow, principal of the Kelso Institute in San Francisco.

Other presenters at the conference, with whom I have been in correspondence since, include:

Richard Coughlin, chair of sociology at the University of New Mexico;

Richard Hattwick, economist at the University of Illinois and editor of the *Journal of Socio-Economics*;

Charles Whalen, political economist at Cornell University, Buffalo.

Papers presented by Gauche and Coughlin are available electronically, by arrangement with the authors.

Patricia Kelso quotes the following from a letter to me:

*Louis' and my efforts in Canada go way back. There were two wings—one in Toronto, led by Winnett Boyd, former president of Arthur D. Little of Canada, and Frank Capon, financial vice president of DuPont, and the second a Kelso faction of the Social Credit Party in western Canada—its leader died. In our archives we have quite a lot of material on binary economics and Canada, going back to Ernest Manning. Unfortunately, Winn, while brilliant and committed, was what might be considered an extreme conservative in a liberal environment. Frank retired from DuPont and, having done his bit for our cause, retired from that as well. The Social Credit people did not have enough influence or credibility to carry the day there. We are sending*

you the most important writings by the most expeditious method possible, considering the vagaries of both our postal systems. The article you will find most useful is "General Affluence for Canadians via the Second Income Plan," written by Louis and me (although my name did not appear). This article applies the basic Kelsonian principles to the Canadian economy.

The articles described above are listed at the end of this text.

Two longer expositions by Robert Ashford have been published recently in journals. They provide extensive references as well as substantial detail on the financial techniques developed by Kelso to democratize capital ownership:

\_\_\_\_\_ "A New Market Paradigm for Sustainable Growth", *PRAXIS: The Fletcher Journal of Development Studies*, Volume XIV, 1998, pp. 25-59.

\_\_\_\_\_ "Louis Kelso's Binary Economy", *The Journal of Socio-Economics*, Volume 25, Number 1, 1996.

An important new American book that addresses the search for a third way builds on Kelso's innovation and was published earlier this year by Addison-Wesley (later this year by Penguin in Britain). The author is Jeffrey R. Gates and the title is *The Ownership Solution*. It was mentioned in Vienna; John Jones later read me several quotations from it by telephone, and Michael Marien abstracted it in *Future Survey*, highlighting it as a "very important book endorsed by a wide range of forward-looking leaders." You can peruse the stunning array of endorsements by getting in touch with the author at [jeffgate@mindspring.com](mailto:jeffgate@mindspring.com), or by visiting his Web site, [www.ownershipsolution.com](http://www.ownershipsolution.com). Gates was formerly an assistant to Russell Long, who championed Kelso's ideas in the United States Senate and was instrumental in the passage of legislation which permitted the flowering of Employee Stock Ownership Plans. I acquired a copy of the book recently, and while I have not had time to digest all of it thoroughly, it is quite clear that the author has focused much of his attention on applying the ownership approach to the issues of sustainability that concern members of CACOR and, presumably, Gaia PC.

Two important sources of further information recently came to my attention, via Internet: A search for references to ESOP led to The National Center for Employee Ownership. The NCEO conducts research,

and publishes books, articles and a quarterly journal on employee ownership law and finance, as well as conducting courses and providing answers to specific questions. It may be contacted via e-mail at [nceo@nceo.org](mailto:nceo@nceo.org) or at [www.nceo.org](http://www.nceo.org). A review of the information package they provided by mail makes no reference to the theoretical groundwork provided by Kelso, or to the legislative background which made ESOPs possible in the United States. In other words, it is very focused on how to make ESOPs work, to the advantage of management, owners and workers. A more satisfying site, from the theoretical and philosophic perspectives, which I expect to be our principal focus, is the home page of the Center for Economic and Social Justice ([www.cesj.org](http://www.cesj.org)). I found it by searching under "CSOP".

### **Complementary Activities to the Anticipated Electronic Forum:**

Two developments since the CACOR luncheon presentation are germane: An investment counsellor in a large brokerage firm has initiated a fortnightly brown-bag lunch at his office to evaluate Gates' book and the Kelso approach generally. The table now includes three economists, and another has announced his intention of joining. The other event was a small weekend gathering in the Adirondack Park, hosted by Michael Marien. Most of the discussion focused on Kelso themes, for Robert Ashford was present as well as others who are interested in the relationship of income and wealth distribution as they relate to population and environment issues.

The fruit of these exchanges so far includes the observation that there are at least four species of ideas for resolving the current global problem of insufficient demand combined with extreme concentrations of wealth and income in fewer and fewer hands. In addition to the Kelso prescription there are the "basic or minimum income" schemes which are straightforwardly redistributive and may involve innovative ideas for generating tax revenue while deterring some kinds of undesirable activities (taxes on currency transfer or on all electronic information exchange). It has also been observed that there are elements of similarity between Kelso's focus on the two factors of labour and capital, and that of Henry George much earlier on the two factors of labour and *land*. It was also pointed out, in the latter connection, that whereas there is a small school of single-

taxers (Georgeists) which includes some otherwise "standard" economists, they have not succeeded in having much impact on taxation policy. I found it personally useful to refer to George's arguments as a reinforcement of Kelso's. They may also suffer from similar species of misunderstanding or disagreement.

The brown-bag lunches address issues of this kind. The discussions will put flesh on the bare bones of a paper already outlined, on the question of why Kelso's ideas have not been discussed more broadly and deeply in the specialist literature of economics, finance, political science and law. It seems reasonable to expect that there will be a significant degree of sharing between the luncheon group and the electronic forum.

### **References from The Kelso Institute, San Francisco**

*Executive Magazine, January 1967, Special Feature on "General Affluence for Canadians via the Second Income Plan" Introduction by Winnett Boyd; feature article by Louis O. Kelso.*

*Canada Month, May 1967. Articles by Anthony J. Patterson (biographical), and by Winnett Boyd and Jon W. Kieran.*

*Financial Executive, October 1973. W. Boyd, "Business across the Border".*

*Canadian Business, November 1972. W. Boyd, "Get Wealthy on Credit".*

*Canadian Business, March 1973. W. Boyd, "Freedom or Serfdom—A Choice for Canadians".*

*Financial Times of Canada, October 8, 1973. Anthony J. Patterson, "More for the Workers" (re MacMillan Bloedel).*

Cliff Downey, M.P. *Hansard* (House of Commons), March 16, 1971.

Frank S. Capon, "The Distribution of Income". Speech in Halifax, October 1971, as President of the Canadian Institute of Chartered Accountants. (Mimeographed, but possibly available from the CICA)

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