

BY GLENN YAGO

The promise of the democratization of capital is at the heart of the American republic. The nation’s founders considered widespread property ownership indispensable to the success of democracy, and it remains a primary means of empowering the citizenry. Indeed, I believe that the key to sustainable prosperity in coming decades lies in expanding capital ownership, thereby aligning the interests of investors, workers and the broader public.

The two main issues of capital – access and distribution – provide my two major themes. Distribution addresses capital as both a factor of production and a measure of wealth. Access and control over credit is played out through the history of banking and money creation. This latter theme is marked by historical conflicts over centralized versus democratic control from Jefferson’s and Hamilton’s competing visions, to the establishment of a formal central bank, to the current period of rapid innovation in capital markets.

IN THE BEGINNING

American financial history embodies many of the struggles to broaden ownership – of homes and farms, and small businesses, as well as fractional ownership of great enterprises. What distinguishes American capitalism from the more statist forms that evolved in Japan and Europe is that feudal traditions never had much influence in this country. Jeffersonian democracy dominated the inclination of John Adams and others to create leadership from a new aristocracy.

With ideas passed from Jefferson to Jack-

son to Lincoln, Americans bought into the belief that economic mobility would lead citizens to the values, habits and discipline needed to make democracy viable. Politicians and economic policymakers in this tradition promoted the view that the best way to combine a democracy with a market economy was to make sure that everyone had a stake – that assets were widely distributed.

By the end of the 18th century, European demand for grains created an extraordinary opportunity for ordinary men to produce for trade. Increased commerce propelled westward expansion for 30 years after the American Revolution. And Jefferson’s vision was neatly tuned to this reality: access to land for small farms was not meant to shelter a traditional way of life, but rather to apply scientific advances in cultivation, processing, marketing and finance to enhance agricultural profitability. As the historian Joyce Appleby explains, “it was exactly the promise of progressive agricultural development that fueled hopes that ordinary men might escape the tyranny of their social superiors both as employers and magistrates.” Easy access to land for

family farms, open global markets, government-financed infrastructure and little regulation were all part of Jefferson's approach to raising living standards, protecting individual liberties and buttressing democracy.

These notions were the very definition of "Americanism" – a term coined by Jefferson as an antonym for "aristocracy." He argued against allowing a new economic elite to emerge, and to that end gave high priority to laws that would prevent the concentration of landed wealth. Jefferson's genius, one can argue, rested in integrating a program of economic development and a policy for nation building into a radical moral theory. A national market, the rise of public credit, uniform currency and the protection of contracts all became means to ensure economic participation and capital access to overcome poverty, create wealth and build the nation.

Following Malthus, Jefferson feared that population growth would outrun productive employment. Access to markets and land, he reasoned, would enable the population to be self-sustaining by generating its own capital. Government existed to protect property rights, but also to promote access to property and the opportunities it afforded. His focus was not on forcible redistribution of existing wealth, but on creating institutions that would lead to broader distribution of new wealth.

DEMOCRATIZATION AND INDUSTRIALIZATION

As the American industrial base grew, so did tensions with democratic principles. One concern was that Jeffersonian and Jacksonian ideas of individual economic independence could not be realized, given the requirements of large scale industrial production. As Christopher Lasch recounts in his history of political thought:

Even when Americans finally came to accept the wage systems as an indispensable feature of capitalism, they continued to comfort themselves with the thought that no one had to occupy the condition of a wage earner indefinitely – that each successive wave of immigrants, starting at the bottom, would eventually climb the ladder of success into the proprietary class.... Permanent status as wage workers ... simply could not be reconciled with the American Dream as it was conventionally understood.

The homestead movement, promoting farm ownership, embodied the Jeffersonian view. Ever since the passage of the Land Ordinance of 1785 and the Land Act of 1796, the government had provided assistance to settlers in the form of low-priced land. Other laws, like the Pre-emption Act of 1841, which

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permitted settlers to stake claims on most surveyed lands and to purchase up to 160 acres for a minimum price of \$1.25 per acre, served the same function.

In 1862, Lincoln signed the Homestead Act, which promised all families 160 acres of land – provided they worked and lived on it. That same year, Lincoln signed the Morrill Act, granting each state that had not seceded sufficient land to endow at least one agricultural college. Hence, land was formally linked to the creation of the human capital needed

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to enhance its value. Lincoln, the historian Eric Foner points out, spoke of

... the prudent, penniless beginning in the world, who labors for wages for a while, saves a surplus with which to buy tools or land for himself ... and at length hired another new beginning to help him. This, the just and generous and prosperous system, which opens the way to all.

One of Lincoln's favorite economists, Henry C. Carey, held a "transcendental" view of economics inspired by Ralph Waldo Emerson. He thought that industrial capitalism with its potential to create enormous wealth could raise the standard of living for all, and thus ease the social tensions that led to the Civil War. As this tension diminished, Carey believed, so would the need for heavy-handed government. In effect, prosperity would lead to a more moral society. Economics would transcend the realm of the physical to buttress democratic values.

This optimistic vision required broad access to capital. Carey believed that rapid industrialization would help to accomplish this. As labor productivity rose, so would wages, and laborers would eventually be able to save enough to start their own enterprises. Carey also supported the circulation of greenbacks – paper money originally issued by the Union to pay for the Civil War – because they provided an alternative form of exchange for people who lived far from financial centers. Greenbacks would aid the growth of smaller markets otherwise dependent on Eastern banks.

The post-Civil War "Gilded Age" proved more turbulent than Carey had anticipated.

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The growth of the railroad, coal and steel industries, and their eventual consolidation, helped spawn a new social order that exacerbated class distinctions. New technologies and wealth did indeed grow, but inequality grew, too, because government failed to mitigate market outcomes. There was no counterpart to what the Homestead Act did for the distribution of land. Indeed, tight credit, fed in this pre-central-bank time by reliance on the convertibility of paper money into gold, served to limit access to capital.

U.S. Treasury Secretary Hugh McCulloch allowed the money supply to contract after the Civil War, depriving small producers of working capital. Carey and his colleagues argued that this bestowed power to Eastern bankers and disrupted relationships between consumers and producers, discouraging production and undermining the economic autonomy of local communities.

The old economic debate re-emerged, this time between anti-monopolists and what might now be called libertarians. The former charged that by manipulating financial institutions and a corrupt government, corporations were able to hoard capital and to suffocate competing sources of production. The result was a growing class of impoverished laborers who could never save enough to create individual businesses.

The anti-monopolists accused corporations and the classical liberal economists who supported them of blaming scarcity on natural laws. Centralized control over economic resources, they argued, threatened to succor precisely the sort of despotism the Revolution had been fought to eliminate. Corporate liberals retorted that there was so much competition that profit rates were declining even as wages rose. In any case, they said, the concentration of wealth was beneficial to society because it allowed corporate managers to

allocate capital more efficiently.

It was in this context that expansion of capital ownership was again raised – this time by the nascent labor movement. William Sylvis, the leader of the National Labor Union, supported employee ownership as “an alternative to the wages system,” adding, “So long as we continue to work for wages, so long will we be subjected to small pay, poverty and all the evils of which we complain.” By the 1880s, the railroad tycoon Leland J. Stanford adopted the idea of employee ownership, which became part of his legislative agenda as governor of California and the founder of a new university.

POPULISM, PROGRESSIVISM AND LIBERAL REFORM

Agriculture suffered, at least by comparison with manufacturing, in the late 19th century, as food prices fell and high interest rates distributed income away from farm debtors. Farmers responded with political activism. In 1889, Charles W. Macune of the Southern Farmers’ Alliance proposed that the government implement a system of “democratic money,” with warehouses to store surplus crops that could be used as collateral. In effect, he proposed to use the concept of commodity backing for currency to securitize and monetize future production. These ideas on capital access informed the establishment of the New Deal farm programs four decades later.

With the rise of the Progressives during the first decade of the 20th century, the role

of government to balance economic power (rather than to democratize it) emerged. Progressive reforms and the eventual emergence of the welfare state supplanted capital ownership as the means of popular participation. The pluralist corporate welfare society enabled liberal reformers to claim to be the inheritors of the notion of democratiz-

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ing capitalism. They argued that modern technology, the closing of the frontier, and the centralizing and concentrating characteristics of rational modern industrial organization precluded ownership as a means to popular democracy. Democratizing capital, for the most part, was removed from political discourse and the debate over the American vision. The 19th century quest

to create economically independent citizens was abandoned as government redistribution led to dependency. Income support replaced wealth creation as the focus moved from the individual citizen to the centralized state. Problems of poverty and income inequality continued unabated.

DEMOCRATIZING BANKING, HOME OWNERSHIP AND SECURITIES MARKETS.

The drive to democratize capital then shifted to business policy. American banking was

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dominated by banks in New York, and to a lesser extent, Chicago and Philadelphia, whose clients were institutions, corporations and the very wealthy. These banks made loans to none but the most creditworthy customers – certainly not to modest, immigrant-run enterprises. The same methods were used by major California banks, like Wells Fargo and Crocker National.

Enter A.P. Giannini, founder of the Bank of America. Giannini focused on small depositors and borrowers, intending to open banking to the masses. He advertised for depositors and made local businesses aware that his bank was prepared to offer its services for personal and business loans, as well as for home mortgages.

Giannini made no secret of an ambition to become national in scope, and in time, international as well. These ambitions generated political opposition from Wall Street (and thus Washington) and led to regulations that balkanized credit access.

The development of the modern mortgage industry, mortgage guarantee insurance and the expansion of home ownership were extensions of the logic of the homestead movement. Before Giannini and the New Deal guarantee system for home ownership, mortgages were not all that common and were of short duration – usually under 10 years. The principal was returned with a single payment at maturity. In the 1930s, the Federal Home Loan Bank Board and the Home Owners' Loan Corporation emerged along with the government mortgage insurance program to correct glaring inefficiencies in the housing market.

Other innovations that served to stimulate savings and reduce transactions costs to investors arose during this period as well. John Elliott Tappan was among the hand-

ful of financial pioneers who sought higher yields for small savers. He devised a method of mobilizing funds before capital markets were available to non-elite investors, selling certificates of deposit that could be purchased in monthly installments. The business evolved into IDS (which, decades later, was acquired by American Express). His financial instruments were backed by mortgages and became a liquid alternative to real estate or land for urban investors. His financial innovations were also linked to the development of the life insurance industry and the opening of the capital markets to small investors through mutual funds.

Mortgages, diversified stock ownership through mutual funds, and consumer loans all served to underwrite an emerging American middle class. These financial innovations came about without the benefit of a modern institutional framework. Partly as a result, the period 1930-33 produced some of the most chaotic and difficult conditions in U.S. history. Waves of failures led to the virtual shutdown of the banking system, other financial intermediaries and capital markets. The effectiveness of the financial sector to intermediate between borrowers and lenders was badly impaired. And as the costs of financial intermediation increased, households, farmers and smaller businesses found credit almost impossible to obtain.

The effects of this credit crunch on aggregate demand helped to transform the severe, but not unprecedented, downturn of 1929-30 into a protracted depression. Banks switched out of loans into more liquid investments, further shrinking credit access and quickening the rhythm of business failure. The contraction of bank credit for households, farmers, and smaller businesses occurred precisely among those firms that relied most on bank credit. As credit flows constricted, borrowers

were unable to undertake expansion activities or investments and savers devoted their funds to less productive uses, further limiting productive output.

Widening credit access followed by its retraction devastated the economy, as ordinary people now faced huge debts and lacked options to extend them. The credit crunch thus exacerbated the country's downward spiral into depression.

ideas with Mortimer Kaplan in *The Capitalist Manifesto* and later in *Two-Factor Theory* and other publications. He believed that corporations could be taken private in leveraged transactions financed through employee stock ownership plans and expanded access to credit markets.

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Kelso argued that as long as wages were the only source of labor income, polarization and poverty would be inevitable, and economic growth would suffer too.

The welfare state would thus be forced to take on an ever-growing burden of displaced workers and would be unsustainable in the long run.

Kelso suggested that the new post-industrial economy was a "closed private property system." He thus drafted the blueprint for a "binary economy" designed to distribute new wealth more fairly. In this binary economy, a basic private property right would provide that all people could acquire capital on credit and pay back the debt with pretax profits that the capital produces. Wider distribution of capital would lead to more competition and economic growth. In the long run, an increasing percentage of ordinary people's income would be from capital earnings and less from their own labor.

Between 1973 and 1988, Senator Russell Long sponsored a series of legislative initiatives



WHY CAPITAL STRUCTURE MATTERS

Changes in corporate finance, financial and information technology, industrial organization and market structure converged to create a renewed interest in expanded capital access and ownership in the post-World War II period. Louis Kelso initially developed these

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providing tax benefits for firms and banks sponsoring employee stock ownership plans (ESOPs). The effort enabled employees not simply to “rent” their jobs through wages, but to “own” those jobs through capital.

A whole panoply of forms of employee capital participation have emerged. As of 2003, employee stock ownership plans, stock bonus plans and profit-sharing plans primarily invested in employer stock cover some

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8.8 million participants. Another 11 million employees belong to 401(k) plans that are primarily invested in employer stock. ESOPs now control over \$400 billion in corporate stock (about 8 percent of the total) while 401(k) plans and broad stock options each control or have the right to control another \$160 billion.

Despite these gains, employee ownership and the application of Kelso’s other binary models are not flourishing. The leveraged buyout business has shifted buyout structures away from the original Kelsonian models. And ironically, Department of Labor regulations designed to protect retirement funds have actually created preferences in accounting treatment that favor non-ESOP leveraged buyouts.

Households remain the largest owners of corporate equities, exceeding those of pension and mutual funds combined. And the concentration of holdings by the wealthiest households continues to grow. Access to credit to acquire property and accumulate wealth

is still a promising, but unfulfilled, aspect of citizenship.

In the 20th century, the struggle to fulfill the promises of American democracy focused largely on political rather than proprietary dimensions. As I have suggested, though, this was not always the case. Jefferson, Jackson, Lincoln and the populists all focused on property ownership as the rock on which an egalitarian society could be built.

Contemporary survey research suggests that aspirations have not changed all that much; most people still want a piece of the rock. In America, the percentage of the population that own businesses at some point during their working lives exceeds that of most other countries.

The struggle between entrepreneurial capitalism, characterized by diffuse ownership, and corporate capitalism, characterized by concentrated ownership, is one of the leitmotifs of American business and social history. Expanding business participation and linking capital ownership and control are logical and necessary extension of our democratic challenge. Political representation without economic participation through business ownership and the capital access to finance it could prove democracy’s dead end – one characterized by widening inequality and social conflict.

We live in a time in which information technology and financial technology intersect. The rapid deployment of financial innovations to overcome informational barriers to expanded capital ownership and economic participation are required if we are to fulfill Jefferson’s dream of an enduring republic “built much on the enlargement of the resources of life ... and the belief that men are disposed to live honestly, if the means of doing so are open to them.” **M**