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THE "OWNERSHIP OF THE FIRM" IS A MYTH

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Who is to be the firm?

Consider any enterprise which carries out a production process. The productive activity uses some inputs such as the services of land, labor, and capital, and it produces some outputs. The payments for the inputs are the costs or expenses, and the receipts from selling the outputs are the revenues. The revenues minus the costs are the profits or net income of the production process. One legal party (which may include many individuals as members) owns the outputs and is liable for the used-up inputs, i.e., one party pays the costs and receives the revenues, and thus receives the profits of the production process. That same party holds the management rights over the production process. We will call that party—which owns the outputs, is liable for the inputs, and holds the management rights—the firm. The basic question under consideration here is: "Who is to be the firm?" How is it determined that one party rather than another will have those rights and thus be the firm?

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Consider, for example, a simplified corn farming production process which, in a year's time, requires the use of 100 acres of land, one tractor, and one corn farmer, and which yields 2,000 bushels of corn. Thus the inputs would be 100 acre-years of land, one tractor-year, and one man-year, and the outputs are 2,000 bushels of corn. If the annual land rent is $8 an acre (i.e., the price of an acre-year is $8), the rental rate of a tractor is $600 a year, and a corn farmer can be rented (or, as it is usually said, hired) for $3,000 a year, then the costs are $800 (i.e., 100 times $8) plus $600 plus $3,000, or $4,400 in total (all prices are what would be paid at year's end if the inputs had been purchased on credit at the year's beginning). If corn sells for $2.40 a bushel at the year's end, then the revenues are $4,800 (2,000 times $2.40). The production profits equals revenues minus costs are then $4,800 minus $4,400 = $400 (these figures and prices are only illustrative). Moreover, suppose we have a corn farmer, Mr. L, and a property owner, Mr. C, who owns 100 acres of suitable land and a tractor.

Is it now legally determined as to which party will be the firm, i.e., will receive the production profits ($400) and will hold the management rights over the production process? The answer is "no," even though we do know who owns the requisite labor and who owns the requisite capital (tractor and land). The party that will be the firm must acquire the ownership of *all* the inputs to be used in the production process, and that may be accomplished in at least two ways. That is, Mr. L (who already owns a man-year of corn farming services) could buy the 100 acre-years and the tractor-year from Mr. C (i.e., rent the land and tractor for the year)—or Mr. C (who already owns the acre-years and the tractor-year) could buy the man-year from Mr. L (i.e., rent or hire Mr. L for the year). If Mr. L hired the capital, then Mr. L would be the firm, and if Mr. C hired Mr. L., then Mr. C would be the firm. In fact, if any third party, Mr. T, hired both the capital and the labor, then Mr. T would be the firm (but, for our purposes, it suffices to concentrate on the capital and labor owners).

The point of the example is that the question of who is to be the firm is answered solely by the way in which the hiring contracts are made. If the workers in any productive enterprise hire the capital, then the workers are the firm. If the capital owners hire the workers, then the capitalists are the firm. In general, it is the *hiring party* (i.e., the party which hires the productive factors that it does not already own) that is the firm. It is particularly important to apply this simple legal logic to the case where the capital-owning party, instead of being an individual like Mr. C, is a corporation. A corporation is not automatically the firm, i.e., is not automatically the party undertaking the production process that involves the corporate capital. A corporation is the firm only if it additionally is the hiring party, i.e., only if it also hires in the labor instead of hiring out its capital.

THE FIRM OWNERSHIP MYTH

The orthodox answer to the question "Who is to be the firm?" is, of course, "the owners of the firm." But we have just seen the simple logic which shows that the whole concept of "ownership of the firm" is a myth. The productive factors, such as capital and labor, are indeed owned (e.g., by corporations and by workers), but that ownership does not legally determine which party will be the firm, i.e., which party will legally undertake a certain production process. The latter is determined solely by the hiring contracts. The hiring party is the last buyer and owner of all the inputs (man-hours, machine-hours, and so forth) to be used in the productive activity, so that party bears the costs of production and thus has the legally defensible ownership claim on the produced outputs. Thus the hiring party is the firm.

There is no such property right as the "ownership of the firm" which would legally necessitate that the party holding

that right be the firm. The hiring party is the firm and there is no legal necessity that one party (e.g., a corporation) rather than another be the hiring party. Let us refer to the associated owners of the capital used in the given production process as *Capital* (e.g., the collectivity of the shareholders in a corporation), and let us refer to the working community of people who work in the production process as *Labor* (regardless of the color of their shirt collar). If Capital hires the workers, then Capital is the hiring party and thus the firm. Alternatively, if Labor hires the capital, then Labor is the hiring party and thus the firm.

The above reasoning is summarized in the following two theorems.

(1) Nonownership Theorem
There is no ownership of a firm.

(2) Hiring Party Theorem
The hiring party is the firm (so the identity of the firm is determined solely by who hires what or whom, and not by who claims some alleged ownership of the firm).

One source of the ownership of the firm myth is clear. Capital owners are usually associated together as shareholders in a corporation. The expression "the shareholders own the corporation" is used to summarize the legal facts that the shareholders collectively own the corporate capital and are the voting members of the corporation. A corporation is typically also the hiring party and thus the firm, i.e., it typically hires in labor instead of hiring out its capital. Thus the stockholders own the corporation and, by virtue of being the hiring party, the corporation is also the firm (i.e., the party undertaking the production process that utilizes the stockholders' capital). This situation leads to the inspired 'misinterpretation' of the shareholders' ownership of the corporation as a mythical property right which legally necessitates that the corporation be the firm, i.e., as a mythical ownership of the firm. But a different party can

become the firm (i.e., the party undertaking the production process previously carried out under the auspices of the corporation) without any change in the ownership of the corporation. For example, hire out the corporate capital to Labor. Then Labor would be the hiring party and thus the firm, but the very same stockholders would still own the corporation. There would have been no sale of the corporation—only a reversal of the 'customary' hiring contract between Capital (equals corporation) and Labor. What has happened to the shareholders' ownership of the firm? With this simple reversal of the contractual roles of Capital and Labor (i.e., Labor hiring capital instead of vice versa), Capital's ownership of the firm vanishes into thin air. It was only a myth in the first place.

THE FUTURE PROFITS MYTH

The myth of Capital's (e.g., the corporate shareholders') ownership of the firm is at the foundation of capitalist ideology. It supports several subsidiary myths which can now be considered. For the sake of simplicity, we will divide the productive inputs into the services of capital (land services included) and the services of labor. The production costs can then be divided into the capital costs (i.e., the capital rentals or interest) and the labor costs (i.e., the wages and salaries). Hence costs equals capital costs plus labor costs, and production profits equals revenues minus costs equals revenues minus capital costs minus labor costs. If Capital hires labor, then Labor is paid the labor costs while Capital receives the revenues and pays the labor costs. Thus Capital would receive in net terms; revenues minus labor costs equals capital costs plus profits. If Labor hires capital, then Capital is paid the capital costs while Labor receives the revenues and pays the capital costs. Thus Labor would receive in net terms; revenues minus capital costs equals labor costs plus profits. Thus regardless of which party is the firm, Capital and Labor will each receive the costs of their respective inputs (i.e., the

capital costs and the labor costs, respectively). But the party which is the firm (i.e., the hiring party) will also receive the production profits above and beyond the costs of its already-owned inputs. Hence the pecuniary aspect of the question of who is to be the firm can be expressed as: "Who is to receive the profits from the production process?"

The belief that some party "owns the firm" therefore leads logically to the belief that the same party has an ownership right (in the present) to the stream of future profits which will be generated by the production process. But the ownership of the firm is a myth, and the "present right to the future production profits" is only a subsidiary myth built on the basic firm ownership myth. And it is a myth for the same reason. The identity of the present firm, and thus the ownership of the present production profits, is only determined by the present set of hiring contracts. When those existing hiring contracts expire (say) a few years hence, then a new set of hiring contracts must be made. The old hiring contracts could be renewed (with adjusted terms perhaps) or they could be completely reversed (e.g., by Labor hiring capital instead of vice versa). And if the hiring contracts are reversed, then the new hiring party will be the firm as well as the owner of the profits of the production process for the lifetime of those new hiring contracts. Thus the belief that a certain party has a present property right to all the future profits of a production process vanishes into thin air. The ownership of the future production profits is determined solely by who hires what or whom (i.e., by who is the hiring party) in each future contractual time period. And there is no legal necessity that the future hiring contracts be made one way rather than another. This reasoning is summarized in the following theorem.

(3) Future Profits Theorem
There is no present ownership right to the stream of all the future profits generated by a production process.

Here again, a prime source of the myth—in this case, the future profits myth—is an inspired misinterpretation of corporate law. Naturally, the shareholders have the (ultimate) legal right to the future net income or profits of the corporation (i.e., of the party Capital). But, similarly, Labor has the legal right to the future net income of Labor. In fact, any legal party whatsoever has the legal right to the future net income of that party. That is only a legal truism, because otherwise it would not be the net income of that party. While each party has the right to its net income, the nontrivial question is that of which party is to have the net income or profits *of the production process* as that party's net income. The stockholders' ultimate legal right to the net income of their corporation no more answers that question than does the equivalent right of the members of any legal party (i.e., their right to the net income of their party). If the corporation is not the hiring party then the net income from the production process (which nevertheless involves the shareholders' capital) will not accrue to the corporation at all. If the capital is hired out (instead of the labor being hired in), then the corporate income will be only the interest or capital rentals (i.e., the capital costs) while the production profits will accrue to the hiring party.

This reasoning can be illustrated by the analogy with any two-sided game or contest where each side receives a certain remuneration just to play the game (win or lose) and where the winner additionally receives a certain prize. Then it is quite clear that neither side has any present (i.e., pregame) ownership right to the winner's prize, even though one of the sides will own the prize in the future (i.e., postgame). But each side does have the pregame ownership right to its win-or-lose remuneration plus its winnings (whatever the latter may turn out to be). Suppose that one of the sides—call it "side C"—is owned by means of transferable ownership shares. Then a shareholder would have the legal right to a certain share of the income of side C, where that income consists of side C's remuneration plus side C's winnings. Side

C's winnings would be the winner's prize or nothing depending solely on whether side C won or lost. Thus it is legally necessary that a shareholder get a share of side C's winnings, but it is not legally necessary that side C win, so it is *not* legally necessary for the shareholder to get a share of the winner's prize.

How would these shares be valued on the market? If, for some reason, it was impossible for side C to win (so C's winnings were always zero), then a share would sell for each share's fraction of the guaranteed remuneration if the game was played only once (and for each share's fraction of the discounted sum of the remunerations per game if the game was played repeatedly). Let us call this value of a share its *book value.* If, however, it was quite possible for side C to win, then the shares would have a market value higher than book value, and that higher market value would be based on the expectations that side C would win. By paying a market price higher than book value, a shareholder has made a gamble. If the shareholder loses the gamble (i.e., side C loses), then he might protest that he thought he was buying a share in the winner's prize (by paying the higher price for his shares). But the protest would be groundless because he had purchased not a share in the winner's prize (there being no such pregame property right in the first place), but only a share in side C's remunerations and winnings—where the winnings turned out to be zero.

The shareholders' inspired misinterpretation of their rights would be quite understandable in the following set of circumstances. Suppose that the game was played repeatedly, once every few years, and that side C had always won in the past (so side C's winnings had always equaled the winner's prize). Moreover, suppose that the members of the other side (call it side L) had been indoctrinated into believing that their purpose was not to win, but only to receive the highest possible remuneration for playing (and losing) the game. Under those circumstances, it would be quite understandable if the shareholders propagated the myth that they owned all the future winner's prizes.

The abstract logic of the argument behind the future profits theorem has been illustrated in terms of a two-sided game or contest—but the "game" has an economic interpretation. Consider any productive activity. The people owning the capital used in the activity are associated together as the party Capital (which we assume to be a corporation), i.e., side C, and the working community of people who work in the activity are associated together as the party Labor, i.e., side L. The game or contest between Capital and Labor is the *hiring conflict*—the conflict over who hires what or whom. Does Capital hire labor or Labor hire capital? The winning party is the hiring party, and the winner's prize is the net income or profits of the production process. The guaranteed win-or-lose remunerations accruing to Capital and Labor are, respectively, the capital costs and the labor costs. The fact that neither side has any pregame ownership of the winner's prize means, in the economic interpretation, that no party has any precontractual ownership of the production profits, and moreover, no party has any present ownership of all the future production profits (i.e., the future profits theorem).

The remarks above about the value of side C's shares all pertain to a corporation's shares. A corporation's assets have a certain book value which can be thought of as the cost of replacing the assets (i.e., the land, buildings, machines, and so on). Subtracting the corporation's liabilities yields the net worth or net book value, and then dividing by the number of outstanding shares gives the (net) book value of a share. The market value of a share is usually much more than, and often several times, its book value. The excess of market value over book value is primarily due to the expectation that the shareholders will receive a return, i.e., the future production profits, above and beyond the capital rentals or interest on book value. But if the corporate capital was hired out, then the returns would be only those capital costs (i.e., the capital rents or interest on book value)—not the production profits.

There is no legal right to the future production profits attached to corporate shares (there being no such present property right at all)—even though that is the customary (mis-)understanding. A shareholder has only a legal right to a share of the corporate income which, however, might only be the capital costs. The alleged shareholders' right to the future production profits—generated by the production process which will utilize their capital—is only a myth.

THE MANAGERIAL PREROGATIVES MYTH

The last myth to be examined is the myth that the capital owners have the inherent managerial control rights over a production process using their capital. This is essentially an updated version of the ancient myth that a landowner had the inherent 'sovereignty' over any people living on or using his land, i.e., that the landlord was the "Lord of the land." By "managerial control rights," we mean the right of discretionary decision-making and control over production—not simply the veto control right which allows a property owner to not consent to the use of his property. All property owners (including landlords) have the veto control rights over the use of their property.

The hiring party purchases (or already owns) the property to be used in productions (i.e., the inputs). Since any party has the legal right to manage its use of its own property, it is the hiring party which holds the managerial control rights over the production process. And Capital is not necessarily the hiring party. The capital can be hired out just as the labor can be hired in. Thus Capital has no inherent precontractual managerial control rights over a production process using its capital. Before a hiring contract is made, one way or the other, Capital—like Labor—has only veto control rights over the anticipated production process. And, in the absence of any contracts, a landlord has the right to make a person using his land a trespasser—but not a servant or 'subject'.

The logic can be illustrated using an example where Mr. C is a car owner and Mr. L is a car driver. Who is to hold the

management rights over the activity of Mr. L driving Mr. C's car? Either party can veto the activity—but neither party has any precontractual management rights over the activity. The holder of the management rights is determined solely by the hiring contract itself. If Mr. L rents the car from Mr. C, then Mr. L holds the management rights over the activity. If Mr. C hires Mr. L, then Mr. C is the management. In fact, if any third party, Mr. T, hires both the car and Mr. L, then Mr. T has the right to manage the activity of Mr. L driving Mr. C's car. Thus the 'management' is determined solely by the hiring contract, and no party has any precontractual managerial prerogatives—no matter what bargaining bluffs Mr. C may make. Mr. C, of course, stands for Capital, Mr. L stands for Labor, and the driving activity symbolizes the production process wherein Labor uses the property of Capital. The logic and the conclusions are exactly the same.

The reasoning is summarized in the following theorem.

> (4) Managerial Prerogatives Theorem
> There are no inherent or precontractual managerial control rights over a production process (since the production management is determined solely by who hires what or whom).

As one might expect, the myth—in this case, the myth of Capital's inherent managerial prerogatives—is based largely on an inspired misinterpretation of corporate law. Of course, the shareholders have the (ultimate) legal rights to manage the activities of the corporation (which are delegated to the corporate managers). But, similarly, Labor has the legal right to manage the activities of Labor. Indeed, any legal party whatsoever has the legal right to manage the activities of that party. That is another legal truism. But which party has the production process as its activity (from the legal viewpoint)? That is the question, and the answer to that question is solely determined by the outcome of the hiring conflict—by who hires what or whom. It is legally necessary (given corporate law) that the shareholders and their agents (the corporate

managers) have the legal right to manage the activities of the corporation. But it is not legally necessary that the production process, which utilizes the corporate capital, be an activity of the corporation (i.e., be an activity legally undertaken by the corporation). Thus there is no legal necessity that the corporate management be the 'management', i.e., the management of the work process which utilizes the shareholders' capital. In particular, if Labor rents the shareholders' capital, then Labor will hold the production management rights. When Capital is not the hiring party, then the capital owners' representatives would still manage the activities of their 'capital union' (which, however, would not include the work process)—just as when Labor is not the hiring party, the workers' representatives still manage the activities of their labor union.

ON CAPITAL DOES NOT EQUAL FIRM

The above arguments and theorems all stem from the logical distinction and separation of the legal party undertaking production (herein called the "firm") from the capital-owning party (herein called "Capital" and assumed to be a corporation). We have found that the corporate shareholder's ownership rights, net income rights, and managerial rights all pertain to the corporation—not to the firm. By systematically confusing and identifying the capital-owning party (i.e., the corporation) with the party undertaking the capital-using production process (i.e., the firm), capitalist ideology has indoctrinated the general public into believing that corporate law specifies that the shareholders own the firm, own the production profits, and hold the production management rights. For example, the word firm is commonly used to refer ambiguously to both the party undertaking a capital-using production process (whichever party that might be) and the specific corporation owning the capital. This is reminiscent of the recent attempt to use the phrase "The President" to refer ambiguously to both the person holding the office of the presidency (whoever that might be) and the specific person, for example, Richard M. Nixon (e.g., the use of the phrase in the notorious title "The Committee to Reelect The President"). The misinterpretations of corporate law examined above are analogous to the following sort of argument. It is legally necessary that Mr. Nixon be the person with the right to make Richard M. Nixon's decisions. Given that Richard M. Nixon equals The President (i.e., that RMN = P), does it then logically follow that it is legally *necessary* that Mr. Nixon be the person with the right to make the President's decisions? No! The fallacy in the 'argument' is that there is no legal necessity in the identification RMN = P. While Mr. Nixon does indeed have the right to make RMN's decisions, the equation RMN = P is contingent on additionally being the winning candidate in a presidential election (and thereafter avoiding impeachment or resignation under threat of the same).

Similarly, the corporate shareholders do indeed have the ultimate legal rights to the net income and managerial control (via their representatives) of the corporation (i.e., of the party Capital). But there is no legal necessity in the equation corporation equals firm (i.e., Capital equals firm). The equation Capital equals firm is contingent on Capital additionally being the winning party in the hiring conflict (i.e., being the hiring party). Capital enters the hiring conflict as simply one 'candidate' for being the firm—pitted against the other principal candidate, Labor. If Capital wins by hiring labor, then Capital equals firm. If Labor wins by hiring capital, then Labor equals firm. And there is no legal necessity that one candidate, rather than the other, win the contest.

Today, the outcome of the hiring conflict between Capital and Labor is hardly in doubt. But it is important to realize why Capital consistently wins. At first, one might think that it is because of Capital's bargaining power in the market for productive inputs. But that is not the whole reason, or even the most important reason. Capital's greatest weapon is its

power in the marketplace of ideas, i.e., capitalist ideology. The basic capitalist myths–that Capital (e.g., the collectivity of stockholders in a corporation) owns the firm, owns the future production profits, and holds the production management rights–are all accepted by the public in general and by organized labor in particular. Labor believes not only that Capital will always win the hiring conflict, but that Capital must always win by law. Labor leaders thus believe that "the purpose" of organized labor is not to hire in capital and to engage in production, but only to hire out labor on the best possible terms. Labor leaders tend to be like generals who, for some reason, believe the other side's propaganda that the other side must (by law!) win the conflict. Hence they sincerely believe that "the purpose" of leading the troops into battle is only to try to obtain the best possible terms of surrender. Since Labor accepts the capitalist myth that the capitalists, must, by law, be the firm (because they "own the firm"), the only 'battle' actually 'fought out' between Capital and Labor is the customary conflict over the terms of the labor hiring contract. It is this ideological hegemony of capitalist mythology, and the resultant pacification of the labor movement, that is Capital's most valuable asset.

ON LABOR EQUALS FIRM

Our purpose here has been the theoretical one of exposing the roots of capitalist ideology by driving a logical wedge between the capital-owning party (i.e., Capital) and the party legally undertaking production (i.e., the firm). We will conclude by mentioning one way of separating Capital and the firm in practice, i.e., one way of Labor hiring capital. It would be rather impractical and unworkable for the shareholders and their agents to maintain the depreciating physical capital (buildings, machines, and the like) of the corporation and yet lease the same to Labor (so that Capital equals corporation does not equal firm equals Labor). It would be more practical for Labor to hire capital in the form of financial capital, i.e., capital funds.

One way of Labor hiring financial capital is strongly suggested by the separation of ownership and control in modern widely held corporations. The legal theory of the (stock) corporation is that it is the collectivity of the stockholders (i.e., Capital) that controls the corporation (by means of the stockholders' voting rights). Thus the theory is that Capital equals corporation, and if the corporation hires in labor, then Capital equals corporation equals firm does not equal Labor. But it is now generally agreed that the legal equation Capital equals corporation is only theory and not practice. While the corporate directors and managers are nominally the representatives of the shareholders (i.e., of the party Capital), the corporate management in fact wields its power in an autonomous and unaccountable fashion. In factual terms, the shareholders function only as moneylenders, i.e., as holders of debt capital like bondholders. Hence the present legal theory says that Capital equals corporation, but the facts say that Capital does not equal corporation, and the latter inequation is what is referred to as the separation of ownership and control of the modern corporation.

This situation suggests that the equation firm equals Labor could be established by the legal conversion of a stock corporation into a democratic corporation, i.e., by changing the voting membership of the corporation from the stockholders to the constituency consisting of all the people working in the enterprise (herein called "Labor").[1] The stocks could be legally changed into a form of debt capital (e.g., bonds) since the stockholders in general function only as moneylenders anyway. Then the corporation, with its new membership after the democratic 'takeover', would have hired (i.e., borrowed) the capital of the old stockholders. For the democratic corporation, we would thus have Capital does not equal corporation equals firm equals Labor (instead of the usual Capital equals corporation equals firm does not equal Labor).

When a production process is legally undertaken by the community of people working in it, i.e., when the firm equals Labor, then that is usually referred to as *industrial democracy* or *workers' self-management.* It is ordinarily believed that the private property system gives Capital (e.g., the corporate shareholders) the ownership of the firm (as well as the production profit and management rights). Hence it is usually concluded that the equation Capital equals firm can only be replaced by the equation Labor equals firm if Labor "buys the firm" (or if the private property system is altogether abolished). But we have seen that these "Divine Rights of Capital" are only the myths of capitalist ideology. The private property system contains no such rights in the first place (the naivete of many socialists notwithstanding). There is no ownership of the firm, and no party has any legal right to the production profits or to the management of the work process before a labor hiring—or a capital hiring—contract is made. Capital and Labor have symmetrical precontractual legal rights. Before a hiring contract is made (one way or the other), Labor has just as much legal right to be the firm as Capital. And in order for Labor to be the firm, and thereby establish democracy in 'what people do all day long', it is sufficient for Labor to 'turn the bargaining tables around' and to hire the capital.

NOTE

1. The case where the stockholders do effectively exercise their corporate franchise is sometimes called "corporate democracy" or "shareholders' democracy." But that is an apologetically inspired misnomer. The shareholders would then effectively elect and control the corporate managers, but the point is that the latter are to manage not the shareholders, but the corporate personnel. How can a system be called democracy where one group of people (the shareholders) elect the managers who are to manage *another* group of people (the corporate personnel)? If the people of Russia elected the governors of Czechoslovakia, would that be democracy? Democracy is *self*-government or, in the workplace, *self*-management. A corporation can only be an industrial democracy when the corporate franchise is in the hands of the people being managed by the elected corporate management—and not in the hands of the absentee owners of capital.

Part II.
THE DYNAMIC OF WORKER PARTICIPATION
An Interpretive Essay on the Chilean and Other Experiences

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This article will outline some of the major findings and will briefly discuss some of the analytical implications of our survey on worker participation in management in Chilean socialized industry during the Allende period. The survey was cross-sectional and it included 35 manufacturing enterprises ranging in size from between 90 and 1,800 employees. The analysis of the survey is based on the construction of a relative index of participation and, through multiple regression analysis with linear functional form, attempts to examine the structure, the antecedents, and the performance results of worker participation in Chilean industry.[1]

In August 1973 the socialized sector of Chile's economy comprised approximately 370 enterprises. According to the *Normas Básicas* of participation, promulgated in June 1971, these enterprises were managed by an administrative council which, in theory, was to be composed of five worker

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