TRENDS

IN MANAGEMENT - STOCKHOLDER RELATIONS

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# The Case for 100% Dividend Payout

*In our* Trends *of September 1961, in which we reviewed "The New Capitalists," by Louis O. Kelso and Mortimer J. Adler, we commented ". . . there seems to be little question that the proposed changes are the most imaginative and provocative to appear on the economic scene in many years."*

*Among the recommended changes was a 100% dividend payout by corporations, forcing them to compete in the market for new capital, rather than retain corporate reserves for expansion. In response to the October, 1963 issue of* Trends *on the subject "Dividends and Common Stock Valuation," Mr. Kelso presented his reasoning on dividend payout, as follows:*

*In reviewing the fourth edition of *Security Analysis, Principles and Techniques,* by Graham and Dodd, in your October issue, you properly focus on the ultimate question in management-stockholder relations: dividend policy.

Only in an economy as confused as ours—an economy dedicated to securing Everyman's right to toil while super-stimulating technological advance and automation, the sole functions of which are to save (read "obsolete") labor—could the "savings theory" of dividend policy be credible.

Of course the notion that a corporation should avoid "sharing" its profits with its stockholders if it can earn more on the withheld sums than the stockholders could have earned on dividends had they happened to receive them is as credible as some other strange phenomena we have become inured to.

Take, for example, our practice of encouraging *gambling* (buying low, selling high) in corporate equities with a low capital gains tax, while discouraging *investment* (owning an equity in the non-human factor of production in order to receive the full net income produced by that factor) through such devices as: steeply graduated personal income taxes; corporate income taxes (falling solely on the wealth produced by capital after all labor costs have been paid); coercively-bargained wages which divert the wealth produced by capital to labor, and rejection of the concept of management trusteeship which in practice would either specifically limit or leave no discretion in management to pay or withhold from stockholders, as management's fancy and interests dictate, the full net earnings which are in legal theory, if not in fact, the *private property* of the stockholders.

But at this juncture, it is appropriate to point out that *any* theory seeking to justify or explain the failure of management to pay out 100% of the net earnings of the corporation, after setting aside reasonable operating reserves only, is inconsistent with *any possible* private property-free market theory of our economy as a *system.*

The word "system," combined with the adjective "economic," implies "logic." If an economy has no logic, it is not an *economic system.* It is *economically anarchistic,* i.e., it can be made to work only by an endless series of painful expedients.

It must be kept in mind here that there are *two* factors of production and only two. The first is the human factor. This comprises human labor in all of its forms, the manual worker, the executive, the technician and the professional. The second is the non-human factor. This includes everything ownable that is external to man which is used in the production of wealth—land, tools, factories, machines, tractors, railroads, airplanes, etc.

Wealth is produced by these two factors, singly or in combination. Each factor produces in exactly the same sense—economically, politically and morally.

Both factors are subject to being *privately owned,* although only in the case of the non-human factor can the ownership be concentrated. In a free society, each man owns his own labor power; this ownership is the basis for his *right* to receive wages. The non-human factor, which we call capital, can also be privately owned, as can a proportionate, or equity, interest therein. And if the phrase "private property" in capital has any meaning whatsoever, it means that the capital owner, whether a stockholder in a corporation or a direct owner, has a *right* to receive the full net income or *net wealth* produced by the thing owned.

This concept was well understood in the English common law with respect to land, where a grant of the "profits" of land in perpetuity by an owner was regarded as a conveyance of the fee itself.

We are now in a position to see why the "earnings theory," or any other theory attempting to justify less than full payout of corporate net earnings after operating reserves only, destroys the *logic* of a private property-free market economy which recognizes *two* factors of production.

The logical heart of an economic system is its principle of distribution. In a private property economy, this principle must be "from each according to what he produces, to each according to what he produces," whether he makes his productive contribution through his labor power, or through his privately owned capital, or through some combination of the two.

Say's law of free-market economies (an irrefutable truism since it is nothing but double-entry bookkeeping put to prose) holds that for any given time span, the aggregate market value of goods and services produced by a particular industry, or by the economy as a whole, is equal to the purchasing power received by the participants in production *as the direct result of the productive process.* In other words, the market value of economic goods is simply a cumulation of the costs and profits charged or received by the producers.

Thus if the owners of both factors of production receive in full that to which their ownership entitles them, they possess purchasing power (wages plus the return on capital) sufficient to take all the goods and services which the economy can produce off the market. True, they will do this in fact only if their individual participation in production, either through their labor, their capital ownership, or both, does not substantially exceed their consumer needs *plus* their legitimate investment opportunities.

Of course, for this system to function effectively to provide for all households in the economy, *each household must participate adequately in production* either through its labor or its productive capital or both. And as technological advance shifts the burden of production

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from labor to capital, capital ownership must be acquired by a constantly increasing proportion of households. This can be possible only if the social institutions for financing new capital formation make it so.

It follows from the foregoing that the policy of withholding corporate dividends involves a series of intolerable frustrations of the economy:

1) It tends to make purchasing power inadequate to fully remove goods and services off the market, and often results in diversion of the withheld income to building of excess corporate production capacity and surpluses of corporate working capital. The resulting deficiency of purchasing power must be counteracted by governmental redistribution of income, excessive and endless government debt, consumer and housing debt, coercive pressure by labor to raise wages in return for a diminishing work contribution, etc.

2) It promotes the concentration of capital ownership and prevents the broadening of the proprietary base. As noted above, in a private property economy, the concentration of *productive power* results in a concentration of *purchasing power.*

3) It destroys the institution of private property because private property in capital is the right to receive ALL the net income one's capital produces.

4) It promotes gambling and speculating in capital equities rather than honest investment for the income the invested capital produces.

5) It causes the absurd fluctuation in the value of capital equities. There is only one *logical* reason for owning securities, namely for the income they produce. When that income is drained off by others than the owners and when the right to receive it is uncertain, market values necessarily must be based upon *illogical* factors, e.g., speculation, emotion, and hysteria.

6) It often *causes* the lean years which boards of directors use as a justification for their failure to pay out the purchasing power due stockholders as the product of their capital ownership.

7) It is forcing the American economy away from the possible realization of the Capitalist Welfare State where the affluence of every household in the economy would be based on its enhanced economic productiveness arising from its private ownership of capital, and is compelling us into the Economic Communist Welfare State in which for most people affluence—if any—is provided through thinly disguised economic handouts based upon a bureaucratic appraisal of *need.*

The missing logic that prevents our economy from being an economic system in the rational fullness of the term is now obvious: *we do not build the economic power of households to consume as rationally as we build the industrial power to produce.*

The production of wealth or income is, from the standpoint of the producer, only a means to an end: *consumption.* A household which *consistently* produces wealth in excess of its reasonable desires for consumption violates this precept. It has no choice but to invest the excess purchasing power. But investment, whether effected directly by the capital owner or stockholder, or involuntarily for him by the "ploughing-in" of corporate net income, further increases the excess and contributes to the inadequacy of purchasing power to absorb all the goods and services produced. It further deprives non-capital-owning households, whose members may or may not be employed, of the opportunity to produce the wealth [income] that they reasonably desire.

So our present techniques of making vast increases in the productive power of existing stockholders through financing methods which concentrate ownership not only violate the logic of a private property system, but force the purchasing power resulting from production by capital to be diverted by government and government-supported private agencies to the capital-less masses.

We must not forget that if the private ownership of capital were widely diffused, the output of capital would remain as great as where its ownership is concentrated, but it would provide the purchasing power for the many to buy the goods and services so produced.

It is the height of folly to permit 40 to 50 billions of dollars—or even 100 dollars—of new capital formation to come into existence without at the same time systematically creating commensurate opportunities for households owning no, or insufficent, capital to become owners of newly formed capital.

In an advanced industrial economy where capital, not labor, already produces most of the wealth—and its relative productiveness is constantly increasing—there is only one possible way to build the economic power of households to consume commensurate with the industrial power to produce within the logic of a private property economy. This choice would require us to:

1) make the private ownership of capital accessible to an ever-growing proportion of American households as the relative productiveness of labor declines;

2) make certain that the purchasing power automatically produced in adequate quantity in a free market economy is not withheld from the producers of goods and services, i.e., the owners of labor power (who receive their purchasing power in the form of wages, salaries and fees), and the owners of capital (who receive their purchasing power in the form of dividends, interest, royalties, rentals, etc.);

3) gradually shrink, and soon abolish, the corporate income tax, which diverts only the purchasing power arising from production by the non-human factor (after labor costs are paid) and to make adjustments in the personal income tax so that it will not yield any greater revenue than the corporate and personal income taxes now do;

4) turn to new ways of financing economic growth out of *future savings* as well as through past savings as Mortimer Adler and I proposed in *The New Capitalists.* Not only would this provide a virtually unlimited source of financing, but it would make it possible for millions of households in due course to purchase and pay for productive capital, and to employ in their lives the purchasing power arising from it.

The two Great Aggregates, gross national product and the purchasing power arising out of production, are equal in a free market economy. At the same time, a private property welfare state is one in which *every* consumer unit produces, either through its labor or through its capital or both (as the state of technology dictates) wealth equivalent to the purchasing power each consumer reasonably desires.

A policy of short-circuiting or withholding the purchasing power due to the capital owners is one blade, and failure to extend significant private capital ownership to the millions is the other blade of the shears that are cutting away at the taproots of our free economy. As private property in capital goes, so go the political liberties of the citizens.