

4 CONSEQUENCES OF THE TRADITIONAL FINANCING METHODS

A. CONCENTRATION OF OWNERSHIP OF CAPITAL

The most obvious, and certainly the most distressing, consequence of a system which rigidly links the formation and ownership of new capital to the ownership of existing capital is the progressive concentration of the ownership of capital. Once we state the proposition that the ownership of savings (capital) is a condition precedent to becoming the owner of newly formed capital and that the magnitude of one is directly proportionate to that of the other, then it follows that increasing industrialization is synonymous with growing concentration of the ownership of capital. It is this relationship between the ownership of existing capital and the ownership of newly formed capital which explains why, in spite of the ownership of some capital by perhaps 15 percent of the households of the economy, the great bulk of capital is owned by 3 or 4 percent of the households.

Since the ownership of capital can be concentrated to any degree, while the ownership of labor cannot be concentrated at all except in a slave society, the problem of the concentration of the ownership of capital would exist under our conventional financing techniques *without regard to any change in the productiveness of capital*. We can only speculate as to how much more severe is this tendency toward concentration where relentless progressive technological change increases the productivity of capital in relation to the declining productivity of labor. The present ownership of productive capital becomes the basis for the future ownership of even more productive capital, and the process is repeated over and over again.

The tendency is quite the same whether the savings of individuals are used to acquire the ownership of newly formed capital, or whether the assets of a corporation are used in financing expansion in such manner that the existing pattern of stock ownership is unchanged and existing stockholders become the ultimate owners of the newly formed capital.

Nor does it seem likely that the spiraling concentration of ownership of capital can be seriously impeded by the meager efforts on the part of the household of modest means to withhold some funds from consumption and accumulate savings. The small saver has open to him in today's economy investment opportunities that are more apt to concentrate the ownership of capital by others than to make him an owner of capital. He may deposit his savings in a savings bank, or he may buy one of the widely advertised types of insurance policy that contains savings or accumulative features, or his employer may invest a portion of his income for him in a pension fund that in turn may be used to purchase interests in capital of one sort or another. In the case of the savings account or the insurance policy, the funds will find their way into new capital formation, but the small saver will receive only a small fixed return that will rarely be more than the erosion resulting from the inflation that is inherent in our full-employment policy. The

funds will probably be invested by the bank or the insurance company at market rates of interest in loans to a corporation that derives two or three times that return, or more, on its invested capital.

Every such attempt at saving by the household that is not already the owner of a substantial capital holding contracts consumption. Attempts at saving by the masses drive business and government to devise further consumer credit schemes to raise present spending to support our mass-production industries. Any attempt to make the average household a more effective accumulator of savings in order to enable it to become an owner of productive capital would bring on a recession that would end only when such saving ceased and when large doses of compensatory purchasing power had been artificially injected into the economy.

If one must be an owner of capital to become the owner of newly formed capital, and if the more capital one owns today, the more newly formed capital one can and probably will own tomorrow, then conventional finance is designed to accomplish precisely the opposite of the capitalist dream—a constantly growing number and proportion of households owning viable capital estates. As the burden of production is shifted through technological change from labor to capital, the amount of wealth produced by an almost stationary class of capital owners will continuously increase. In consequence, the maintenance of prosperity and a widely diffused standard of economic well-being will depend upon ever more intensive efforts by government and government-supported power blocs to divert the wealth produced by capital to those who do not own capital. This is the essence of the policy of full employment, and it is the essence of the relentless socialization of the ownership of capital through the *normal* workings of our corporate-financing and business-financing practices.

In *The Capitalist Manifesto*, we called attention to the distinction between the technical efficiency of large-scale production and mere

financial efficiency, or market dominance, which on the one hand suppresses competition and may even restrain technological advance, while on the other hand it intensifies the concentration of ownership of capital.⁹ Here, in analyzing the relationship between the present ownership of capital and the acquisition of newly formed capital, we are face to face with the mechanics of competition-destroying financial efficiency on the part of corporations.

Consider the following news items selected from among hundreds of similar ones that appear each year:

Capital spending will be stepped up by various companies. Union Carbide said it expects 1960 construction expenditures to “increase appreciably” over the \$136 million spent last year. E. J. Thomas, chairman, reported Goodyear Tire & Rubber Co. has authorized capital outlays of \$90 million for 1960, compared with expenditures of \$55 million out of \$78 million authorized for 1959.

Wall Street Journal, February 23, 1960

General Dynamics Corp. and Philadelphia & Reading Corp. agreed “in principle” to set up a jointly-owned company that would produce hydrogen, ammonia, acetylene and other industrial gases and chemicals from Philadelphia & Reading’s stocks of anthracite coal waste.

The new company . . . will spend \$100 million in plant construction and other capital expenditures . . . “details of the financing of the proposed organization are not yet worked out” but . . . the venture will not require any new financing for Philadelphia & Reading itself . . . each of the parent companies will contribute equity capital to Dynamics Reading, and the joint venture thereafter will do its own financing “through sale of debt and possibly other senior securities.”

. . .

Wall Street Journal, May 12, 1959

WANTED: \$30 MILLION COMPANY

Houston, Texas, April 14. (AP) Reed Roller Bit Co. is shopping around to buy a company with assets up to \$30 million.

⁹ See *The Capitalist Manifesto*, pp. 225-226.

John Maher, president, said today Reed is hunting an industrial concern and it doesn't necessarily have to be allied with the petroleum industry.

Maher said Reed, an oil tool manufacturing concern, is ready for further diversification.

San Francisco Chronicle, April 15, 1960

William W. Prince, president, disclosed Armour & Co. will undertake large scale expansion, which "will definitely" involve the company's chemical business. He said "We have some \$30 million invested in commercial paper and it is not the intention of Armour & Co. to become a bank."

Wall Street Journal, February 23, 1960

The following news item is extracted from an article in *Time* about a very enlightened philanthropist named Charles Dana. Buried in the story is evidence of what our foregoing analysis would lead us to assume.

Why Wait to Die? Dana gets as much fun out of giving as he did out of getting. He was to both manners born, in New York City's fashionable Gramercy Park area of the 1880s. His wealthy banker father financed Pacific whaling fleets, invested in coal mines; his cousin was the *New York Sun's* famed editor-owner . . . At 36 he reorganized New Jersey's Spicer Manufacturing Co., maker of the first successful universal joint for autos. By the time Spicer was renamed Dana Corp. in 1946, it was a Toledo-based complex of five thriving auto-parts companies. Net sales last year: \$168.5 million.

"I found myself with all this money," recalls Board Chairman Dana. "If you wait until you're dead, it often doesn't get used the way you want it to. . . . Why should I let Washington waste it?"

Time, December 21, 1959

The following appeared in an article entitled "Khrushchev's Favorite Capitalist." It is about a visit by Russia's Deputy Premier Anastas Mikoyan to Mr. Cyrus Stephen Eaton.

Now in his twilight years, Cyrus Eaton is the archetype of the fading dog-eat-dog capitalist . . . His personal wealth is estimated at

something like \$100 million, and his hard-knuckled grip on U.S. industry extends over a \$2 billion empire of iron and steel, railroads, shipping, coal and paint.

Time, January 19, 1959

The following item was contained in an obituary notice on John D. Rockefeller, Jr., who, as the son of a man who gave away 531 million dollars during his life, himself is reported to have given away 478 million dollars to numerous institutions, projects and charities during his lifetime. At his death, taking advantage of the Federal Estate Tax marital deduction, he divided the bulk of his 150-million-dollar estate equally between his widow and the Rockefeller Brothers Fund, Inc., a charitable foundation:

Early in life he decided that his mission was to give his vast fortune back to the world, wisely and where it would do the most good. His motivation was not so much simple charity as a religious awareness that wealth is only a trust, and in redistributing the family's gain, he was in a sense carrying out the will of God. At 36, he resigned from half a dozen directorships, and for the next half-century he dedicated his life to philanthropy.

Time, May 23, 1960

The next one is extracted from *Fortune*:

MONOPOLKAPITALISMUS?

At the war's end, Allied officials set out to fragment German industry so completely that all the king's horses and all the king's men, let alone Farben and Krupp, couldn't put it back together again. But in October, at a meeting in Cologne of some 800 bankers, businessmen, and government officials, Chancellor Konrad Adenauer stated: "There is great future danger, say in ten or twenty years, of a handful of economic structures controlling the German economy to such a degree that [the government] will be forced to take drastic steps against them."

The Adenauer threat was prompted by a government investigation which indicated that Germany now has only a few big companies that are not dominated by a few big stockholders. Among companies surveyed—1,636 of the country's 2,580 stock firms—34 per

cent of their stock was controlled by another company, 45 percent held by “large” stockholders, banks, or the government—leaving but 20 per cent for small investors.

Fortune, December 1958

Each of the foregoing news items, and hundreds of others like them, are mute testimony to a system of financing new capital formation which systematically unifies the present ownership of capital with the ownership of newly formed capital. The particular capital owners who were involved and their advisers can no more be credited with the wisdom of the Almighty in financial matters than they can be charged with a deliberate attempt to destroy the private property base of the economy under which they live. Yet every major increase in new capital formation that is not accompanied by an increase in the number of *new* capitalists is a leap in the direction of socialism!

The great corporations of America think nothing of adding 50 or 100 million dollars to their productive capital in a manner that will not create a single new capital-owning household. The men who accumulate, through this financing system that almost makes it impossible for them not to accumulate, may with some urging from confiscatory gift and estate tax laws, see it as their mission to give their great fortunes back to the world where they think it will do the most good. But it would seem that where the whole progress of technology is to make capital the predominantly productive factor in our economy, and to make ever greater quantities of labor economically worthless, either it is not important that all men continue to be economically productive, or the wisdom of the Western world’s system of corporation finance is open to question. For clearly it is concentrating the ownership of the most productive factor of production in a very few hands, and ever larger segments of the population must live through redistribution and charity, however much these are disguised.

No one is surprised today when the owners of a hotel suddenly become the owners of a chain of hotels, nor when the owners of a

restaurant become the owners of a chain of restaurants, nor when the owners of a warehouse become the owners of a system of warehouses, nor when the owners of a supermarket become the owners of a nation-wide chain of supermarkets, nor when an automobile company grows to such titanic size that it produces 50 percent of the motor vehicles consumed by the nation, etc. This is the natural working of a method of financing new capital formation which gives newly formed capital almost exclusively to those who already own substantial quantities of it.

Capital is a factor of production in an industrial society. We have estimated that it accounts in America today for the production of not less than 90 percent of the total of all wealth produced.¹⁰ Its productiveness is constantly increasing. By comparison, the productiveness of labor is constantly decreasing, although we use ingenious means through our “full employment” policy to conceal these facts. Capital can serve its function of helping all households to participate in production to a reasonable degree if it is privately owned, if its ownership is widely diffused, and if the number and proportion of households owning viable capital estates grows apace with technological advance. Clearly, our conventional methods of financing new capital formation are ill designed to serve these ends.

B. DENIAL OF ACCESS TO CAPITAL

A free society does not owe every man a living. It may, and undoubtedly should, as a matter of charity, make modest provision for those who cannot produce the wealth they reasonably need to consume. *But its first economic duty to its citizens is to enable them to be or to become productive.* One does not make men productive by locking

¹⁰ See *The Capitalist Manifesto*, pp. 52-54, 268-277.

them, through coercive bargaining, into featherbedding positions in industry. They are indeed given the power to become consumers by this means, but to say that workers are productive when their labor, in a freely competitive market, would be worthless, or worth less than enough to support them, is simply a demoralizing fraud. Nor are men made productive while they are engaged in any kind of contrived work, whether it is work creating politically embarrassing surpluses or work creating war material that better serves the ends of full employment than the ends of necessary defense. In fact, one makes men productive not by granting them wages or a salary, but only by enabling them to exercise the power to produce in such manner as to produce goods for which there is an economic demand. In an industrial society, in which the burden of production is progressively passing from labor to capital, all men cannot possess the power to produce the wealth they need to consume unless a constantly growing number and proportion of men have *access* to the ownership of capital.

Such access to the ownership of capital cannot be brought about by taking from some who have too much and giving to others who have too little or none, for this would be an attempt to maintain the integrity of private property in capital by means which would destroy it. But it would seem worth considering whether a system of financing new capital formation can be devised which would simultaneously promote the growth of new capital formation and increase the number of households owning viable capital estates.

The alternative, of course, is the alternative which the United States and other countries of the Western world are using: the welfare state's policy of full employment. This is a policy of contriving toil for the sake of making men appear to be productive. It is not questioned by the worker, for he has learned by bitter experience and from history that under the conventional financing system, the ownership of capital is not for him. Nor is it questioned by those

who, by accident or inheritance or in some other way, own capital and therefore have access to increasing quantities of newly formed capital. They are not prone to reflect upon the system of conventional finance which frequently gives them access to newly formed capital without regard to their qualifications in other respects.

We have elsewhere stated the underlying principle which we think is applicable here:

Every man has a natural right to life, in consequence whereof he has the right to maintain and preserve his life by all rightful means, including the right to obtain his subsistence by producing wealth or by participating in the production of it.¹¹

When the great bulk of the wealth is produced by capital instruments, the principle of participation [set forth in the paragraph just quoted] requires that a large number of households participate in production through the ownership of such instruments.¹²

There would seem to be little doubt that conventional business-financing methods fall far short of satisfying this basic principle of economic justice in the United States and in other countries of the Western world today. Nor is the shortcoming through which the non-owner of capital is denied access to capital compensated for by redistributing the wealth produced by capital through artificially contrived toil or artificially priced toil.

C. INFLATION

Inflation is a natural and necessary process in an economy that is capitalistic in its mode of production and laboristic in its form of distribution. Over 70 percent of the wealth produced is distributed to labor, but over 90 percent of that wealth is produced, not by labor,

¹¹ *The Capitalist Manifesto*, p. 80-81. See also pp. 90-95.

¹² *Ibid.*, p. 94.

but by capital instruments. Quite apart from the manifest injustice of this imbalance, it is in this ulcerous gap that the spiral of inflation breeds.¹³

If this analysis is correct, and we think that it is, then conventional corporate finance, which brings on this maldistribution of participation in production through its tendency to concentrate the ownership of capital, is itself the main and necessary cause of continuous inflation.

At first glance, it might appear that in any event inflation would tend to counteract the effects of the growing concentration in the ownership of capital. Property-less (*i.e.*, capital-less) workers who borrow money to finance consumption can in any event pay back their loans in inflation-debauched dollars, thus offsetting the effects of concentration of ownership of capital. However, the reverse is true.

Consumer credit, which is generally the only form of credit that is resorted to outside the field of business finance, bears rates of interest that are well in excess of any inflation we have suffered so far. Instead, it is the small savers, the owners of savings accounts, savings-type insurance policies, or government bonds, who collectively are the *creditors*, that mainly suffer from inflation. A corporation that borrows 50 million dollars from one or more insurance companies on a 25-year loan during a period when the annual rate of decline in the purchasing power of the dollar is 2 percent will ultimately have almost half of its loan repaid through inflation. Stated in another way, the small savers whose insurance policies are about as close to capital ownership as they can come—and this is anything but close—will lose about half the purchasing power of their savings to the borrowing corporation over the term of the loan.

¹³ *Ibid.*, p. 142. See also pp. 143 ff.

Other examples could be given, but the point is clear. Not only does conventional finance make inflation inevitable, but its worst consequence—the intolerable concentration of the ownership of capital—is further intensified by inflation itself.

D. LOSS OF INCENTIVE

In economic matters, an incentive is a reward for production. Our traditional system of corporation finance, however, forces us to penalize rather than reward production.

The owners of capital, who constitute not more than 5 percent of the households of the economy, through the employment of the capital they own, produce the bulk of the wealth. The government is compelled to invade their ownership to redistribute their wealth over the remainder of the population in order to maintain mass consumption. Ownership in the more productive factor of production is rifled to provide adequate incomes for the great number of those who own only the less productive factor.

The disincentive effect of this penalty would undoubtedly be more severe if the owners of capital understood the whole process. Nevertheless, it seems reasonable to assume that an incalculable price is currently being paid in terms of lost production as the result of this inherently disincentive system.

Conversely, it is slowly becoming clear to labor, both organized and unorganized, that the highest wages are not currently being paid for production, but rather for being present at the scene of production as a member of a well-organized power bloc. Indeed, an industrial psychologist of the University of California, in addressing himself to the question “Why are wages paid?” concluded that

in most cases, what we pay for is attendance, and a minimum of production. Little difference appears in practice in the pay for high pro-

duction and low production. If a man comes to work on time and stays out of trouble and produces the minimum, he is pretty well assured of his continued pay. If he produces more, in all likelihood he is still assured of his continued pay. In general practice, we do not pay for production, we pay for attendance.¹⁴

Conventional finance, through its built-in tendency to foster the massive concentration of the ownership of capital, is thus both disincentive to the owners of capital and morally corrosive to labor. The owners of capital, who produce a constantly increasing proportion of the total output of wealth, are rewarded by being unceremoniously relieved of much of the wealth their capital currently produces. The owners of labor, on the other hand, are being taught, by the most powerful and well-publicized examples, that the highest rewards are not for production, but for the employment of organized power to take over a share of what others produce.

For those who think that we should run an economic race with Russia, where a far lower degree of industrialization leaves that nation still in a position of labor shortages which are easily combatted with wage incentives, perhaps this doubly disincentive impediment of our economy is worth contemplating.

E. PRICE DISADVANTAGE IN INTERNATIONAL TRADE

It is unfortunate that the United States, although employing a system of business finance that is widely imitated by the industrial nations of the free world, has gone much further than these other industrial nations in its system of producing wealth primarily through capital and distributing it principally through labor. This

¹⁴ Mason Haire, *Psychology in Management* (1956), p. 126.

results in labor rates in the United States which are anywhere from two to fifteen times higher than those in competing foreign industrial nations. What this has done, and is going to do, to the foreign trade of the United States—and to its foreign relations if it adopts high tariffs in retaliation—is too well known and understood to require emphasis here.

A happy alternative would be an economy in which the private ownership of capital is so widely diffused that the wealth produced by capital can be distributed to the owners of capital while the economy still maintains a high general standard of living and universal participation in production by all households. In such an economy, prices could fall far below those of the world market, to the great advantage of all concerned. It is dear, however, that no such alternative can come about through our conventional system of financing new capital formation.

F. POLITICAL DISADVANTAGE IN WORLD AFFAIRS

A much longer book would be required fully to catalogue the disadvantages and inadequacies of a system of business finance which ties the ownership of existing capital to the ownership of newly formed capital. We can only call attention to one further serious defect.

There is much evidence that the leaders of many of the underdeveloped economies of the world would like to see their nations industrialized in a manner that would bring about the wide diffusion of privately owned capital. They have no difficulty in seeing that this is a means—very probably the only means—of achieving power diffusion in an industrial society.

The evidence is extensive that the growth of socialism in the underdeveloped countries is encouraged by the inadequacy of the

Western system of corporation finance. We will quote one recent commentary:

In the socialist countries a rapid rate of economic development is made possible by reducing consumption and increasing investment in capital goods. If the underdeveloped nations cannot obtain large amounts of capital by borrowing or by aid they may finally conclude that, to achieve the necessary growth, they must establish a socialist economic system capable of controlling economic resources and diverting them from the production of consumer goods to the production of capital goods . . .

The attitude of the underdeveloped nations toward the competitive struggle for economic power between East and West will not be primarily based on ideology. If they choose a regimented socialist system, they will do so because they are convinced that it is the only way to achieve rapid economic growth . . .

The outcome of the economic struggle for world power will depend not only on the competition between the western and communist powers, but also on the course of development of the underdeveloped nations.

These nations constitute more than two thirds of the world's population. They have vast natural resources and supply a great part of the world's raw materials and food products. Their development will provide expanding markets for manufactured goods. Their share of world trade will grow and their position in the world economy will steadily increase in importance.

Their prospects for success under a system of economic freedom are not very bright. Already many of them are forced to resort to extensive economic controls and restrictions. These may lead to some forms of mixed economy, midway between free enterprise and socialism. The movement of the developing nations away from free enterprise will in itself weaken the economic position of the West.¹⁵

¹⁵ "Make Mass Poverty Obsolete," by George Hakim, in *Nation's Business*, May 1960.

The conventional method of corporation finance in the free world depends upon the prior accumulation of savings—indeed, great prior accumulations of savings—before it can achieve significant industrial success. The underdeveloped economies neither have accumulations of savings (which would be accumulations of capital) nor do they have the time to wait for such accumulations to come about naturally. They have, one by one, rejected our example for the quicker method of industrialization through socialism. Nor is that all. If they look closely, they can see that constantly to increase the concentration of the ownership of capital is to achieve socialism in the end, but through a slow and painful process. Some of them may even have read the conclusion of one of our foremost economists, that

... divorce between men and industrial things is becoming complete. A Communist revolution could not accomplish that more completely. Certainly it could not do so with the same finesse.¹⁶

It is clearly in our interest to achieve a private property, power-diffused economy in the United States. It is equally in our interest to begin spreading capitalism to other nations of the world not only in order that we may realize its ideological power, but also that we may acquire political friends in the world.

It becomes urgent, then, for us to consider whether it is necessary—or indeed in *any* sense desirable—to employ a system of corporation finance, however conventional, that inevitably concentrates the ownership of capital.

G. RESTRICTION OF ECONOMIC GROWTH

If we employ methods of financing new capital formation that use existing capital (*i.e.*, savings) to insure against entrepreneurial

¹⁶ Adolf A. Berle, *Power Without Property* (1959), p. 76.

error, new capital formation is not merely limited by the amount of existing capital that is not already actively committed to this insurance function, but it is also limited by the extent to which the owners of existing capital or savings will permit their capital or savings to be used for this purpose. In America today, the amount of capital or savings available to support new capital formation—particularly the capital held in corporations themselves—is so vast that it does not tend seriously to impede economic growth. The intolerable disadvantage of such a system of finance lies rather in the resulting concentration of the ownership of capital.

This artificial dependence of new capital formation upon the use of existing capital as an insurance fund gets apparent support from a theory still widely held by economists. This is the theory that industrialization is an alternative to high consumption. It is said, for example, that “the richness of America and its ability to set aside without serious inconvenience part of its current production each year for capital accumulation” explains our high rate of capital formation. On the other hand, it is said that “a very poor nation must consume all it produces in order to avoid starvation and to provide the barest minimum of clothing and shelter for its people. Such a nation cannot afford to save; it cannot afford to devote a significant part of its resources to producing capital goods that will raise the productive power and living standard of future generations.”¹⁷

This theory is nonsense when applied—as it generally is—to an economy as a whole. In a study by Harold G. Moulton of The Brookings Institution, made a quarter of a century ago when the funds for capital formation came mostly from market sources, it was clearly demonstrated that new capital formation took place only in response to increases in demand for consumer wealth. Mr.

¹⁷ This is taken from a college economics textbook in wide use: *Economics, an Introduction to Analysis and Policy*, by George Leland Bach, Prentice-Hall, 1957, pp. 43-46.

Moulton's analysis left no doubt that high levels of capital formation are reached during periods of high-level consumption.¹⁸ To this we might add the evidence of the second world war, when unprecedented capital formation, unprecedentedly high consumption, and a world's record in *production for destruction* (i.e., non-economic use) were all accomplished simultaneously. *This is something that would be quite impossible if it were physically necessary to have savings precede new capital formation.*

Let us press the examination a step further. Imagine an underdeveloped economy today that is substantially without capital instruments—a pre-industrial economy. Suppose it to possess the natural resources necessary to support industrialization and high-level production. It may have no unemployment, in the sense that every able-bodied individual is engaged in scratching a bare subsistence from the earth, but it has vast amounts of badly used or underemployed manpower. It has and will have, for the foreseeable future, almost limitless needs, but those who are in need do not have the purchasing power to satisfy their needs. The power to produce wealth is low because the most productive factor of production is missing from the economy. Let us say, further, that while technical know-how is lacking in such a country, it is available for purchase in almost unlimited quantities in other parts of the world—something that was not true when America was in the process of industrializing.

In such an economy, the wealth-producing potential of plants, tools, equipment, railroads, airlines, etc., cannot be questioned from the standpoint of competitive survival. There is no competition. To the extent that the industrialization is carried out through the use of capital instruments whose efficiency has been long demonstrated in other parts of the world, the risk of entrepreneurial

¹⁸ Harold G. Moulton, *op. cit.*, pp. 157-158.

error is minimal. All of the necessary physical equipment can be bought in already industrialized nations that are anxious to export it. The period required to build modern industrial plants, or modern railroads, or modern powerhouses, is relatively brief. There are few plants that take more than a year to erect, few hydroelectric installations that cannot be completed in three or four years.

In such an economy, all those who must take part in the development of industry would inevitably be compensated from the wealth produced by newly formed capital. Some instances of entrepreneurial error would arise. But it would seem that the risk of loss must here be insured by means other than existing savings or capital, for there is none. And it would further seem that traditional finance, looking to already created capital as a fund for the insurance of loss against managerial miscalculation in new capital formation, would greatly impede the rate of new capital formation.

If foreign capital is used here to promote new capital formation in the traditional manner employed by Western economies, the new industries will come into existence under the foreign ownership of those whose capital is used. This, obviously, does not make private enterprise more attractive than socialism to an under-industrialized nation.

Any agency, in short, whether private or governmental, which had the confidence of those whose services and materials are necessary to bring new capital instruments into existence and which obligated itself to channel a portion of the wealth to be produced by the new capital into the reimbursement of those who have participated in its formation, can start the process of industrialization *without resort to past savings*. The agency must be of such stature that its credit is acceptable in trade, or it must have access to bank credit. Nor does it strain the imagination to assume that a method of mutual insurance of the risk of entrepreneurial error can be devised by such an agency, again without resort to past savings.

In a socialist economy, the state is indeed such an agency. This is precisely the reason why the underdeveloped economies of the world are increasingly turning to socialism; for the political pressure on their leaders to bring about industrialization does not leave them time to use the halting methods of traditional finance to induce new capital formation. But in the socialist state, political power is united with economic power through the state's ownership of the most productive factor of production. The inadequacies of Western corporation finance are eliminated, but so is the pattern of power diffusion which is the basis of democratic freedom. Industrialization is achieved at the cost of totalitarianism.