JOURNAL OF LIBERTARIAN STUDIES
VOLUME 19, NO. 4 (FALL 2005): 37–57

THE CORPORATION AT ISSUE, PART II: A CRITIQUE OF ROBERT HESSEN'S *IN DEFENSE OF THE CORPORATION* AND PROPOSED CONDITIONS FOR PRIVATE INCORPORATION

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THIS IS PART II of a two-part paper in which a critique is offered of the private right to free incorporation from a classical liberal or libertarian point of view (for the present purpose we shall use the shorter "liberal" for "classical liberal or libertarian"). The topic of Part I, which appeared in the preceding issue of this journal, was how the private right to free incorporation violates liberal principles (van Eeghen 2005, pp. 49–70). It was pointed out in this connection that corporate status, that is being an impersonal legal entity, is native to the state only, which is why free private incorporation creates the imbalance of private agents being able to set up state-like institutions but without the accompanying restraints of democratic and legal control to which the state is subject; implicit in our argument is indeed that the state has a legitimate and important, albeit strictly limited role to play. Moreover, it was argued that the private corporation deviates from traditional common-law forms of private property and contract, as evidenced by the imbalance between the rights and responsibilities of ownership which it entails. Corporate shareholders obtain the right to receive the firm's profits and to appoint agent-managers but without the accompanying responsibility to pay for losses. Similarly, corporate managers receive control over assets by virtue of being the agent for the corporation but without having

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to pay for acquisition of these assets, having to absorb possible losses or being accountable to natural persons who do carry the full weight of these obligations, as shareholders don't do either. Not for nothing is it popularly said that "the corporation is not really owned by anyone" (Lodge 1987, p. 74).

Part I also contained a review of the various negative side effects of corporate domination of capitalist practice, including increased speculativeness of stock markets, increased market concentration and concentration of control, increased strength of the profit motive, and the loss of a sense of personal responsibility and thus of personal morality on the part of corporate managers and shareholders. The main thrust of our argument was that corporate domination has disturbed, once again, a sense of balance and proportion in capitalist practice, causing firm size, the pursuit of profit, productivity, growth, financial speculation, and inequality—things which are not wrong in themselves—to become excessive and, in their excessiveness, to undermine the health and sanity of a liberal free-market order.

All this leaves us with two important outstanding issues for Part II to develop in order to round off the argument of this paper.

First, the view taken in this paper is that the essence of incorporation lies in the fact that the incorporated firm acquires entity status: it obtains legal status as owner of the firm's assets separate from its shareholders. There is, however, an alternative school of thought, which denies that the corporation is a separate legal entity. This school of thought is probably best represented by Robert Hessen's *In Defense of the Corporation* (1979) which, in spite of being published almost thirty years ago, remains the most carefully argued exposition of its views, to which liberal defenders of the corporation still most commonly refer as having dealt definitively with those who regard the corporation as a state-like institution. Walter Block (2002, p. 28n), for example, refers to Hessen's book as "an antidote to this know-nothing-ism attack on the corporate form of business." The first section of Part II will be taken up with a fairly in-depth critique of Hessen's argument.

Second, while this paper argues against the right of private persons to freely incorporate their own business ventures, it does not wish to place a blanket ban on the incorporation of all private concerns. In line with historical (roughly pre-1860) practice, we propose that incorporation should once again be regarded as a state concession (state chartering). The most common objection to state chartering posed by liberals, however, is that it will leave too much discretionary power in the hands of the state. The second section of Part II will address this objection and argue for the existence of a limited,

fairly unambiguously defined public domain in which state interference, of which state chartering is an instance, is justifiable. What all this means in practice is that the state should confine the incorporation of private business ventures to firms involved in the development and management of infrastructure on land (roads, railways, canals, etc.), which is also significantly in line in historical practice. Hence, outside of the public domain of the infrastructural improvement of land, the corporate form should be withheld from private enterprise and only unincorporated proprietorships and partnerships should be allowed.

A CRITIQUE OF HESSEN'S *IN DEFENSE OF THE CORPORATION*

Basic to the view taken in this paper is that the corporation is an impersonal legal entity separate from shareholders. If so, it stands to reason that corporate status should be conferred on private institutions only by way of a state concession. First, if corporate status naturally belongs to the state, it is proper that the private creation of state-like entities should require state permission. Second, if the corporate form of business gives its members and agents a privileged position, it is befitting that it should be granted in special circumstances only. Third, if the corporate form, by the corporate veil it provides, cannot help but increase the temptation for its members or agents to evade their legitimate obligations toward third parties, it is appropriate that it should be subject to a degree of public oversight. All these issues will be developed further in the next section.

It has, in fact, always been foreign to common law principles to allow private persons the unrestricted freedom to assign their assets to the ownership of impersonal, and thus state-like, legal entities. As Roy (1997, p. 46) notes: "This feature [entity status] conflicts with a basic tenet of the common law of property: it clouds the distinction between personal rights (in personem) and rights in property (in rem)." In spite of his defense of the corporation, a liberal legal scholar like Richard Epstein (1995, p. 273) agrees that limited liability "deviates from the ordinary common law principles of partnership and agency."[1] Because it regards incorporation as a government

[1]The present author finds Epstein's defense of the corporation all the more disappointing since he is in substantial agreement with just about everything else Epstein has written. Epstein uses three basic arguments (1995, pp. 263–74). First, he maintains that other indispensable legal principles like vicarious liability also deviate from common law. But it is not obvious that

concession, Hessen labels the traditional view the *concession theory* of corporate identity and he contrasts it with his preferred theory of corporate identity, which he designates the *inherence theory*. According to this theory, the corporation has come into being as the product of contracting between private individuals for which no state involvement (active or passive) is needed beyond the enforcing of contracts in general. In consequence, the corporation is simply the product of the freedom of association, and any criticism of the corporate form is regarded as an attack on that freedom (Hesson 1979, p. xiii). Those who defend the corporation are thus the true liberals and those who attack it are in breach of liberal principles and a menace to free-enterprise capitalism.

The meat of Hessen's argument can be divided into three main parts. First, he asserts that the historical roots of the concession theory lie in the grubby soil of monarchic absolutism. Second, he opines that the typical features of the corporate form (entity status, limited liability, and perpetuity) can be acquired by mere private contracting without state involvement, which is the central claim of his inherence theory. And third, he contends that the difference between unincorporated partnerships and corporations is one of degree rather than kind anyway. In what follows we will attempt to show that Hessen is wrong on all three counts.

(a) Absolutist Roots of Concession Theory

Hessen regards the concession theory of corporate identity as a by-product of the Norman Conquest when William assumed title to all the land of England (Hessen 1979, p. 4). Since then private land

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vicarious liability is indispensable for a noncorporate private sector. Moreover, endorsing such deviations from common law does not aid Epstein's own quest for "simple rules for a complex world"; much unnecessary complexity and ambiguity can be removed from the law by applying the principle of personal responsibility more strictly and thus disallowing the use of the corporate form for the pursuit of purely private interests. Second, Epstein claims that the greater economic prosperity facilitated by the corporate firm will offset any negative side effect, which is debatable in the light of our discussion in Part I of this paper. Third, he contends that regarding incorporation as a state privilege would invite unwarranted government intervention in the private sector. However, the need for such intervention would, on balance, be greatly reduced if the private sector is once again dominated by unincorporated business forms and the state chartering of private firms is restricted to a domain where government intervention is justified in any case. And Epstein acknowledges that there is such a legitimate but limited domain for government intervention, about which more in the next section.

ownership could be obtained only through a special concession by the king to his vassals, maintained as long as the latter served the interest of the king. In the same vein, the incorporation of local government (cities and boroughs) had to be obtained by way of a special privilege from the monarch. In later years, under the Tudor and Stuart kings when mercantilist doctrine held sway, traders had to seek special permission to trade internationally, to which end a royal charter was given. This charter was granted only as long as the trader promised to serve the king's interest and promote the glory of his realm (Hessen 1979, pp. 26–27).

But all this proves nothing about the necessary association between state chartering and monarchic absolutism. It is indeed an instance of monarchic absolutism when the king seizes all the land, prohibits private citizens from trading internationally unless they have his express permission, or appropriates the right to grant incorporation to local government at his discretion. Private agents should already have the right to own land or trade internationally, for which they should, therefore, not be obliged to seek the king's favor. And local government should already have the right to corporate status, which is therefore not the king's business to grant or withhold. On the other hand, though, if we accept that private agents do not have a natural right to assign the ownership of their assets to impersonal, state-like entities, it is not at all evidence of arbitrary state absolutism when the state grants incorporation to private agents only as a privilege and only under certain conditions, provided the state is democratically elected and the relevant conditions for incorporation do not otherwise clash with liberal principles—to be discussed below. Hence to argue that the concession theory is rooted in state absolutism is to beg the question whether private parties have a natural right to free incorporation or not; state absolutism can be shown to exist only if private agents do have such a natural right, which is exactly the point at issue here.

Furthermore, in an apparent effort to deny the modern corporation's entity status, Hessen seeks to disprove that the medieval borough and guild, which undeniably did have entity status, are genuine precursors of the modern corporate business organization (pp. 3–11). Hessen admits that these medieval institutions had a minor attribute in common with the modern corporation, namely perpetuity, which is alleged to be considerably overshadowed by the differences, however, the main difference being that these medieval organizations were arms of government while the modern business corporation is a voluntary profit-seeking association. But Hessen ignores the fact that the shared feature of perpetuity is derived from the shared feature of entity status which, being the essence of incorporation, does

make these medieval institutions precursors of the modern corporation. Moreover, what Hessen identifies as the main difference between these medieval institutions and the modern corporation, namely that the former are arms of the state while the latter is a private business venture with purely private aims, is exactly the problem: voluntary associations formed to pursue purely private interests within the private domain should not be incorporated at all. Again Hessen begs the central question.

(b) Incorporation by Private Contracting

The second strand in Hessen's defense of the corporation is to show how corporate features such as entity status, perpetuity, and limited liability can be created by private contracting without any involvement of the state. Hessen's strategy is twofold. First, he seeks to deny that corporations have entity status in the normal sense of being a legal entity separate from shareholders. Second, he seeks to repudiate the idea that perpetuity and limited liability are derived from entity status, which frees them up to be seen as resulting from ordinary private contracting.

As far as entity status is concerned, Hessen starts out by giving it a subtly altered meaning. Entity status no longer refers to the fact that the corporation is a legal entity separate from shareholders, but merely to the fact that shareholders act as a unified collective in a court of law (pp. 16, 40–42).[2] The implicit suggestion is that the corporation is the undifferentiated collective of shareholders rather than a legal entity separate from shareholders. It is alleged that this view of entity status, which seems to confuse the joint-stock principle with corporate status, neither implies any fundamental difference from unincorporated business forms, nor does it amount to the privileged treatment of corporate shareholders *vis-à-vis* the outside world since the advantage of suing as a unity is neutralized by the disadvantage of being sued as a unity (pp. 16–17).[3]

Hessen's assertions in this regard seem contrived. First, the fact that shareholders have no legal title to the assets of the corporation, even when they seek to exercise such rights collectively (provided the corporation is not thereby broken up), clearly suggests that the

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[2]The etymology of the word corporation already indicates entity status in the traditional sense. Its Latin root word ("corpus" meaning "body") suggests that corporate status means "having a body" or "embodied," that is being a legal entity in its own right.

[3]For a discussion of the joint-stock principle, see van Eeghen (2005, p. 60, n. 13).

corporation is a legal entity separate from the collective of shareholders and that title to these assets rests with the former. Second, if entity status refers to the collective of shareholders and it is the product of private contracting, there should be private contracts between individual shareholders in existence which stipulate their collective ownership in respect of the firm's assets. But these contracts are simply not there. Hessen's argument that the right of corporate shareholders to sue as a unity is neutralized by the right of others to sue them in the same way is immaterial, given that these rights do not touch the core of what it means to have entity status, and thus what it means to be incorporated.

Hessen furthermore contends that

> [b]eing a legal entity . . . is clearly not a feature unique to corporations . . . [because] entity status is an optional feature available to all unincorporated businesses. . . . Owners can designate trustees to represent them in lawsuits and to accept or convey title to property on their behalf. (Hessen 1979, p. 17)[4]

Hessen now suddenly does accept that entity status refers to being a separate legal entity. It is true that unincorporated business firms can effectively acquire entity status when partners put assets in a trust (such was John D. Rockefeller's trick, giving rise to the label "antitrust movement"). But that is because trusts, at least in Anglo-Saxon law, can also be incorporated in the sense of acquiring a legal entity separate from its trustees and beneficiaries. Our argument is therefore as applicable to such trusts as it is to corporations: private people should also not have the right to create incorporated trusts at their own discretion and, where such incorporation is in fact granted, it should also be regulated by the state and allowed only under certain conditions—to be discussed below.

Elsewhere Hessen criticizes the idea that the corporation is a legal entity separate from shareholders on the grounds that it introduces metaphors or fictitious entities into the discussion:

> A definition must be literal, not metaphorical; it should not make a business organization sound like a judicial hallucination. . . . [I]s it really necessary to populate the universe with legal entities and fictitious legal persons in order to explain what a corporation is? (Hessen 1989, p. 7)

But a legal entity is most certainly not fictitious or metaphorical by virtue of not referring to a natural person or a group of natural

[4]See also pp. 29–30. The same point is argued in more detail in Hessen, "The Modern Corporation and Private Property: A Reappraisal" (1983, pp. 283–84).

persons. The state (e.g., the Republic of South Africa, the United States of America) is also not fictitious even though it most certainly constitutes a legal entity separate from its citizens as natural persons.

If it is agreed that the corporation is a legal entity separate from shareholders, then Hessen's claim that it can be the product of private contracting is obviously severely weakened if not dismissed. It is clear that private contracting can achieve only *joint ownership* of the contractors' assets (a partnership); it cannot establish a legal entity separate from the natural persons of the contractors themselves to which they assign their assets. Not surprisingly, Hessen does not offer any meaningful explanation of how this can happen, beyond the naïve suggestion that private people can create a corporation simply by writing their own incorporation contract and lodging it with the relevant state authorities (Hessen 1979, pp. 3–5, 25–26). It is not remarkable that state involvement seems absent here, because the legislation that authorizes free incorporation is already on the statute books. The point is that free private incorporation does require special legislation, as history in fact has shown, because to allow private people to freely create impersonal legal entities for the furtherance of their own personal interests is in clear violation of common law tradition, not to mention basic liberal principles.

We proceed with the corporate feature of perpetuity which, according to Hessen's inherence theory, can be created by normal private contracting. Hessen argues in this context that perpetuity is "not a special privilege conferred by government" because it "simply means that the articles of incorporation need not be renewed" (p. 17). He furthermore states that "perpetuity certainly does not guarantee that a corporation will continue in business forever; more than half of all corporate ventures fail and cease to exist within five years of their inception" (ibid.). Hessen contends that perpetuity is not even unique to corporations since unincorporated partnerships "can make their enterprise immortal by adopting a continuity agreement specifying that the firm will not be liquidated when one of the general partners dies or withdraws" (ibid.).

Hessen thus seeks to establish how perpetuity is not the logical outflow of possessing entity status, but the result of special private contracting. In order to succeed in this endeavor, he finds it necessary once more to subtly change the meaning of the relevant term. In the normal classical sense, corporate perpetuity does not mean that corporations literally exist for ever. It merely means that a corporation has a life separate from that of its shareholders, so that the death or departure of a shareholder does not require it to be reconstituted. And the corporation has a life separate from that of its shareholders because it is a legal entity separate from shareholders. Perpetuity is

therefore not the result of some implicit or explicit agreement by shareholders that the incorporation contract does not have to be renewed, but simply follows from the corporation's entity status. For sure, corporations do not live forever and often do go bankrupt, but literal immortality is not at issue here. And the very fact that unincorporated partnerships need additional contracting to acquire something which corporations have naturally and automatically, namely perpetuity, proves the point that corporations are indeed special and different from unincorporated business forms.

Lastly, we come to the corporate feature of limited liability. Again, Hessen's aim is to deny that limited liability follows from the corporation's entity status and to assert instead that it is the result of private contracting. Because private contracts that establish limited liability clearly do not exist, the suggestion is that limited liability is "the result of an implied contract between the corporate owners and their creditors" (pp. 19–20). It is alleged that this implied contract does not discriminate against creditors, because the latter have purportedly had a choice in the matter: after all, they can insist on full liability by entering into additional contracts with some shareholders or managers requiring them to act as personal guarantors of the loan.

This argument, frankly, borders on the absurd. The obvious and natural conclusion to be drawn from the nonexistence of private contracts that establish limited liability is not that the contracts must therefore be implied, but rather that they are not necessary to establish limited liability. And private contracting is not necessary to establish limited liability, because limited liability for shareholders is already obtained by virtue of the corporation's entity status. Of course, limited liability can be overturned by additional private contracting, but that only proves how the normal state of affairs for corporations is to have limited liability for their shareholders. Moreover, the supposed choice of creditors whether to accept or reject limited liability in this way is surely limited, because it can be achieved only when the relevant corporate firm is in a weak competitive position, which is evidently not always the case.

(c) To Be Incorporated or Not to Be Incorporated: A Question of Degree

We move to the third strand in Hessen's defense of the corporation: the idea that the difference between corporations and partnerships is one of degree rather than kind (pp. 37–46). A straight partnership can indeed be modified in various ways to allow for a greater number of capital-contributing partners as a means of enhancing its ability to bring together larger amounts of capital. The general pattern of such modifications is to create a separate kind of partner who merely contributes capital (often referred to as "silent"

or "nonmanaging" partners), which is achieved by transferring some of the rights and responsibilities inherent in co-ownership (like full liability, control over assets, consultation in ownership transfers, etc.) to the remaining partners (often referred to as "managing" partners), usually in return for a lower profit share. In this way, the responsibilities and risks of the managing partners in such partnerships become correspondingly greater. Since there are limits to any natural person's capacity to accept risk, the size of such partnerships also remains limited, which is why the corporation will always be far superior when it comes to bringing together large amounts of capital.

The legal status of nonmanaging partners is obviously similar to that of corporate shareholders, in that they can also obtain limited liability, have given up their control over assets and no longer have the right to consultation in ownership transfers. For Hessen this is evidence to suggest that there is a seamless continuum that starts with the straight, unqualified partnership and ends with the corporation, while the modified partnership is positioned somewhere between the two. But there does seem to be a fundamental difference between partnerships and corporations. Whereas in the case of modified partnerships the rights and responsibilities of ownership are rearranged between nonmanaging and managing partners, these rights and responsibilities are partially cancelled for *all* corporate shareholders. There are no longer any managing shareholders in a corporation; instead *all* corporate shareholders are silent partners. From a liberal point of view, such modified partnerships are perfectly in order (e.g., the limited partnership or the Italian *commenda*), provided that *some* partners carry the full rights and responsibilities of ownership and that accountability towards third parties is thus not compromised.

Finally, Hessen seeks to lend credence to the inherence theory by noting that the concession theory "has been rejected by most of the leading scholars of corporate law" (Hessen 1976, p. 32). Interestingly, Hessen cites scholars mainly from the first half of the previous century, including the very Adolf Berle of Berle and Means fame. However, Berle and Means's *The Modern Corporation and Private Property* should be seen as firmly in the camp of the concession theory in the sense that it acknowledges the corporation's entity status and the attendant separation between ownership and control. Stigler and Friedland note that in the 1930s the legal profession was in almost unanimous agreement with Berle and Means on this point, which would seem to contradict Hessen's claim (Stigler and Friedland 1983, pp. 241–43). As for current legal opinion, all the contemporary textbooks on corporate law which the present author

could lay his hands on acknowledge the entity status of the corporate firm, the only noted exception being Easterbrook and Fischel's *The Economic Structure of Corporate Law*.[5] Hessen may have taken his cue, however, from the fact that prevailing legal opinion is admittedly ambiguous. Although current legal scholarship generally agrees that the corporation is a legal entity separate from shareholders, it also accepts that the corporation should be seen as a form of private property, thereby granting corporations the same constitutional rights as private natural persons. When corporate entities are treated as having the same rights as private natural persons, the policy implications are the same as when corporations are treated as the product of private contracting by natural persons. That is how Hessen's inherence theory has for all practical purposes won the ideological battle in spite of having lost the logical argument.

That logical argument can once again be summarized as follows. The essence of the corporate firm is that it is a legal entity separate from its shareholders and managers—an entity which must thus be impersonal. Given that the common law tradition does not acknowledge the right of private individuals to create their own impersonal legal entities, that it does not accept the automatic duty of the state to recognize such entities, that the corporate form is germane to the state itself only, and that the corporate form creates opportunities for its members and agents to evade their legitimate obligations by hiding behind the corporate veil, the incorporation of private organizations should require special state permission and their functioning should be subject to a degree of public oversight. If the corporate firm indeed owes its existence to the state, not only is the inherence theory of corporate identity thereby invalidated, but the inclination of current corporate-law scholarship to give corporations the same constitutional rights as natural persons is also impugned.

The important outstanding issue is now: under which conditions should the state grant or withhold corporate status to private concerns?, which will be the topic of discussion in the next section.

CONDITIONS FOR GRANTING CORPORATE STATUS TO PRIVATE CONCERNS

The typical conservative Burkean and Disraelian notion is that historically developed institutions should not be cast off lightly because they often (by no means always, of course) carry within themselves

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[5]"The 'personhood' of the corporation is a matter of convenience rather than reality" (Easterbrook and Fischel 1991, p. 12).

the accumulated practical wisdom of ages. Partly for that reason and partly because it accords with abstract liberal principles, our proposal would be to revert back to the historical, pre-1860 practice concerning the granting of corporate status to private concerns. Without taking too many liberties, that practice can roughly be summed up by way of the following principles:[6]

1. Corporate status is natural to the state. Hence, any government institution, whether central, regional, or local, should automatically be incorporated from inception.
2. State permission is required for the incorporation of private institutions.
3. The incorporation of private nonprofit organizations is awarded when parliament (we assume a democracy) judges their goals to be serving some area of public interest.
4. The incorporation of private business firms is awarded when parliament judges them to be pursuing the public interest within a certain limited public domain.
5. The charter explicitly states the area of public interest for which incorporation is approved, from which private corporations deviate on penalty of having their corporate status revoked.
6. Incorporated institutions are obliged to have an *open door* and *open book* policy so that the public (in particular, private journalists and state officials) can check whether their activities conform with the public interest to which their charter restricts them. Thus, some degree of privacy needs to be given up in order to acquire the public characteristic of incorporation, which is again just a matter of not granting rights without accompanying obligations. The fact that modern business corporations are also obliged to issue publicly accessible financial statements is partly a legacy of this principle.
7. Incorporation is conceded for a limited period only and the merits of each case are to be reviewed periodically.

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[6]For insightful discussions of the historical practice see John P. Davis (1961); Joseph S. Davis (1965); Dodd (1934); Cooke (1950); Hartz (1968); du Bois (1971); and Creighton (1990).

The requirements for the incorporation of private organizations on account of principles 3 and 4 requires further elaboration.

As for principle 3, the fact that nonprofit organizations do not pursue the material gain of their members already makes them strong candidates for incorporation. The further requirement is that the majority of parliament judges their aims to be in the public interest. In connection with this requirement, the historical practice was that parliaments tended to grant corporate status to private institutions like schools, hospitals, universities, charities, and churches. The granting of corporate status to such institutions is important because it strengthens civil society, which plays an important role as informal training ground for formal public service.[7]

The greatest problem with this principle for granting incorporation is, of course, that the public interest is a partly subjective, malleable concept (though, on that score, not necessarily entirely arbitrary), which may give the state unduly arbitrary powers. This subjectivity does not undermine the principle, however, which concerns the proper procedure of deciding on the public interest rather than the legitimacy of the alleged public interest itself. In a democratic state, parliament is allowed a measure of freedom in deciding what constitutes the public interest, as long as the decision is supported by a majority and basic liberal values remain otherwise intact. Let us illustrate.

The majority of parliament in some countries may judge the practice of the Christian faith to be in the public interest and would, therefore, be inclined to grant incorporation to Christian church organizations, while a parliamentary majority in other countries would judge the public interest better served by the furtherance of gnostic humanism or Islam. All should enjoy the liberal right to practice the religion

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[7]The conservative Catholic scholar Michael Novak similarly defends the private business corporation on the grounds that it strengthens civil society. He argues that civil society, in which he includes the corporate sector, functions as an intermediating institution between the state and the private sector, a first line of defense against the state wishing to overextend its powers. See Novak, *Towards a Theology of the Corporation* (1981). But it is not obvious that corporate big business presents a bulwark against state tyranny and that it defends the rights of the private individual against the state. Rather, corporate size and power tend to corrupt the state by seeking to coax it into alliances. And alliances between big corporate business and big government are surely the single most perilous threat to the freedom of the private individual. Moreover, the potential size and power of the corporate firm tends to give it an undue bargaining advantage in its dealings with unincorporated private individuals, particularly in the labor market.

they want (within the normal limits of the law), but that does not mean that all should have the right to incorporate their religious organizations; incorporation remains a privilege. Note too that incorporation is not an unqualified advantage in all cases. While it has the advantage of facilitating more effective management of larger organizations, it has the disadvantage of being subject to public scrutiny of the organization's goings on by virtue of its mandatory open-door and open-book policy. In contrast, while nonincorporation has the advantage of greater privacy (closed door and closed book), it has the disadvantage of more cumbersome management when the organization overtakes a certain size. For some organizations the trade-off may come out on the side of remaining unincorporated and accepting the limitations thereof. Of course, the liberal right to protection of the private domain of natural persons and unincorporated institutions should be upheld in any case.

As for principle 4, it is not sufficient for profit-seeking private firms to further the public interest of greater general prosperity by being able to pursue their private profit interest more effectively. Rather, in order to qualify for incorporation, they must pursue the public interest within what can be called the *public domain*, which is the domain over which the state can be said to have decision making power anyway; and this paper takes it for granted, in classical liberal tradition, that such a domain does exist. Otherwise, the incorporation of private business would be an instance of illiberal state interference in private affairs and no incorporation of private business ventures should be allowed at all; in fact, the private right to free incorporation is illiberal precisely because it allows the corporate form, which is a state-like institution, to exist outside the public domain.

Such public domain can be defined as the domain where private interests are involuntarily interwoven and where personal liberties clash. As a result, the management of that domain requires communal decision making so that third parties are not exposed to involuntary spill-over effects. It should be emphasized that the communality inherent in this public domain does not result from deliberate cooperation but is already present by virtue of shared citizenship of the same body politic, irrespective of whether people wish to cooperate or not. There is an area of decision making which can more or less objectively be classed as belonging to the public domain thus defined, namely concerning the ownership and use of a nation's land (its natural resources in general). Given that a nation's land is in fixed supply (assuming respect for borders by peaceful nations), that its defense against foreign invasion counts among the basic duties of the classical liberal state, that land is a gift of nature rather than the

product of human effort, that the location of sites is often unique, and that liberty unmistakably also has a spatial dimension (people live and move on land), private interests in the ownership and use of land can become involuntarily intertwined, which may merit eminent domain, public land holding and communal decision making by representative bodies on how to use public land.[8] Because this kind of public domain can be defined and delineated fairly unambiguously, the scope for government intervention which it allows can effectively be restricted as well. Hence the common radical liberal anxiety that the floodgates of government intervention will be opened up by recognizing such a public domain, need not be justified.

In the same way, liberals commonly fear that state chartering will give the state too much discretionary power over the affairs of private citizens. But, given that corporate status is the natural preserve of the state, such fears should lead them to argue for a complete ban on all incorporation of private business rather than allow private persons to freely incorporate their business concerns. Moreover, the reasonably well-defined limits set to the public domain within which state chartering is allowed automatically limits the discretionary power which is thus given to the state. And this limitation accords well with historical practice. Before free incorporation, the only private nonfinancial firms to be incorporated were indeed those engaged in the development and management of infrastructure on land, such as roads, railways, canals, bridges, harbors, mining infrastructure and the like, which unavoidably require larger amounts of capital than unincorporated private business can generally bring together.[9]

The discretionary powers of the state can be further checked when the administrative process of state chartering is guided by law which sets out proper procedures and states the general requirements which private companies must meet in order to qualify for

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[8]For a liberal defense of this kind of public domain in which government intervention may be justified, see Epstein (1985 and 1998). The idea that natural-resource use has an unavoidable public dimension finds its most radical expression in Henry George's policy proposals: tax and redistribute the site value of land (as a possible Friedmanian basic income grant for all). For a recent discussion of a possible harmony between Georgean and liberal thought, see Harold Kyriazi (2001).

[9]Adam Smith similarly wished to limit corporate status to firms involved in infrastructural works, although he found reason to allow incorporation of banks and insurance companies as well. See Smith (1976, pp. 756–58).

incorporation. Such law should reduce the chances of corrupt practices and enable private parties to seek recourse in the courts when feeling aggrieved. Moreover, decisions on how infrastructure is best developed in the interest of the wider public will naturally be decided in most cases by local or regional government and thus by local or regional representative bodies. Because such representative bodies are naturally closer to the people, their discretionary power will to a greater extent be curbed by public opinion. In fact, the best exemplar of democracy at work (albeit, of course, always partial and imperfect) is probably evident in the process whereby local and regional representative bodies have to decide, after allowing for vigorous public debate both inside and outside their formal assembly, on the need for some piece of infrastructure, the ways in which it can be financed and the institutional mould in which its construction and management company can be cast, so as to optimally enhance the interest of the community concerned—of which many historical precedents exist, especially in nineteenth-century America (see the sources mentioned in note 6 above).[10]

Our proposal is therefore that the historical practice be restored of allowing the incorporation of private companies involved in the development and management of infrastructure, even if incorporation is not necessarily justified for companies involved in the exploitation of that infrastructure. In other words, corporate status can be given, for example, to firms that construct and own the railway infrastructure, but it can be withheld from firms running the trains. The latter will then have to rent the lines from the incorporated railway owners, also as a way of stimulating competition among rail operators.

It should be noted that the incorporation of private firms active in the construction and management of infrastructure should *not* entail a conferral of the power to exercise eminent domain for the state. State chartering acquired a bad name in the nineteenth century,

[10]There may be many creative ways of raising the involvement of the local citizenry in the ownership and management of public infrastructure, such as by guaranteeing a single share to each citizen in the relevant corporate firm. Incidentally, given that infrastructural works nearly always have a local or regional dimension and that incorporation was largely confined to firms involved in infrastructural development, it is not surprising that the granting of charters was originally done by local or regional government as well. Central-government (federal) chartering is a more recent phenomena, which only became prominent once generalized incorporation laws were instituted and the corporate form could be extended to any and every economic activity.

partly because the right to exercise eminent domain was regularly written into the charter of the relevant corporate firms (especially railway companies), which then legitimized a good deal of bullying of private land owners so as to force them to give up their land. Only the state should exercise eminent domain, its decisions being supported by a majority in the relevant local or regional representative bodies. Eminent domain is a state prerogative *par excellence*, never to be ceded to private parties at all.

If the state has the right to grant corporate status to private companies it should also accept the responsibility as guarantor of the debt incurred by such companies, which is not an uncommon feature of the historical practice either; the state too should have no rights without accepting the accompanying responsibilities. Otherwise, the limited liability of shareholder-participants leads to limited obligations towards third parties, which would be in breach of liberal principles.[11] And when the state acts as guarantor of a corporate firm's debts and its shareholders enjoy limited liability, then the state should also have the right to interfere in the corporate firm's affairs. It should be able to regulate and control such firms to ensure that they are well managed, do not run unnecessary risks, do not abuse possible market power, and indeed serve the public interest in the public domain, the oversight over which is the concern of the state in any case. Private operators who wish to enjoy the privilege of the state-like attribute of corporate status should not complain about having to operate within the confines of the public interest as determined by the state (representative public bodies).[12]

As with the aims of nonprofit organizations, what constitutes the public interest in the infrastructural improvement and management of public land and waterways can be open to debate and will be influenced to some degree by subjective and uncertain factors. Where exactly should the railway line be built? Should it go around some nature reserve or right through it? Again, this arbitrariness

[11]This again, raises the issue of bankruptcy law and how a liberal/libertarian order based on the principle of personal responsibility should treat it. Again, this issue falls outside the scope of our present effort.

[12]On grounds of the public nature of corporations, Ralph Nader similarly proposes that the state has the right to interfere in the affairs of private corporations, through regulation and public directorships (Nader, Green, and Seligman 1976). However, the logical consequence of the public nature of corporations is not only that the state has the right to interfere with corporate firms, but also that the granting of corporate status, and thus the right to interfere with private firms, should be confined to activities within a limited public domain (as defined above).

need not indicate any unsoundness of principle if the content of the public interest is decided by a majority in the relevant democratic body (or even by a census) and liberal values are not otherwise compromised. The quality of the decision, which can ordinarily be judged with hindsight only, will simply depend on the character and expertise of the public representatives concerned. No democratic arrangement can ensure that the public interest is optimally served, which simply points to the electorate's responsibility to elect people of vision and calibre.

In conclusion, the incorporation of private business firms driven by the profit motive should be allowed only in case the public interest is served within the public domain, which is largely confined to the management and infrastructural improvement of public land (natural resources in general). The incorporation of purely private business concerns in pursuit of profit should otherwise be disallowed; only proprietorships and partnerships should be available for private firms acting outside the public domain. While incorporated businesses operating in the public domain may in principle be subjected to a degree of state control and intervention, nonincorporated firms operating outside that domain should be free from state control and intervention—as long as there are no involuntary spill-over effects. A capitalism dominated by unincorporated business forms will thus become smaller, simpler, freer, gentler, less technologically advanced, less wasteful, less taxing on the natural environment in general, less concentrated, and less conducive to a starkly unequal distribution of income and wealth.

Not everyone will find the prospect of such a capitalism, particularly its lower average standard of living, very attractive. But the significance of the unavoidable decline in living standards can also be overstated. It will most certainly not amount to a reversal of the Industrial Revolution and a return to Amish lifestyles, as is sometimes suggested. After all, the Industrial Revolution was primarily carried, not by corporations but by proprietorships and partnerships financed by the capital contributions of but a few partners. During most of the nineteenth century the dominance of the corporate firm was largely confined to banking, insurance, railways and other infrastructural development, while its role in manufacturing was vestigial; the corporate firm only became dominant in manufacturing around the late nineteenth, early twentieth century.[13] Moreover, private incorporation of infrastructural development should be effective in maintaining relatively high levels of technological sophistication

[13]For a more detailed historical analysis, see Roy (1997).

and efficiency in transport and communication, which should go a long way towards facilitating a degree of division of labor commensurate with a satisfactory and suitable average standard of living.[14] Even so, that standard of living will be significantly less than it is at present, although, as we venture to suggest, the overall quality of life may just be better.

While tempering productivity and growth, a capitalism dominated by unincorporated business forms is not likely to compromise job creation. On the contrary, it will probably conduce to fuller employment, mainly because its smaller average firm size will mean that people need less capital and fewer entrepreneurial skills to compete successfully in the market place. In addition, more people will thus be enabled to become their own employers rather than be dependant on corporate Big Brothers for their livelihood, which should empower private individuals, and thus strengthen liberty and democracy.

Nonetheless, the changes will be nothing short of revolutionary.[15] How that revolution can be effected with the least possible disruption needs to be kept for later discussion. One thing should be clear, however: there is nothing inevitable about the dominance of the corporate firm over modern capitalism. Just as it required legal measures to make the corporate form available to private agents and to allow it to thrive, so also does it require the mere reversal of these legal measures to discontinue corporate dominance over private enterprise. The real issue is whether we find that dominance ominous and threatening enough in the long run to accept the short-run disruption required to get rid of it again. If people would develop a better understanding of how their liberty is threatened by the excesses of corporate capitalism, it is not unthinkable that popular opinion may once again rise up against the domination of big corporations over their lives, as it did during the second half of the nineteenth century

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[14]The continued use of the corporate form in transport and communication infrastructure and the relatively high levels of sophistication which can thus be maintained in these sectors, should also help to keep markets competitive by allowing any market to be reached by relatively large numbers of suppliers. At the same time, because the corporate form is confined to infrastructural development and no longer generally available to all firms in all sectors, competition is no longer undermined by the ease with which corporate firms can gain market share through mergers and acquisitions—as discussed in Part I.

[15]For more on these revolutionary changes and possible objections to them, see van Eeghen (1997, pp. 106–10).

when an anticorporation movement spontaneously sprang up among the common folk of the U.S.[16]

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[16]For a sympathetic, though not uncritical, review of the nineteenth-century populist movement against the dominance of the corporation over the American economy, see Derber (1998, pp.189–95). According to Derber, the populist movement of the 1890s, which was especially strong in the agricultural states, eventually fizzled out mainly due to a lack of campaign funding, and a lack of nuance and sophistication in some of its policy proposals, as well as a lack of integrity on the part of its leadership, some of whom hijacked the movement and distorted its aims for their own purposes.

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