

A Country is Not a Company

Richard A Epstein

NEW ZEALAND BUSINESS ROUNDTABLE



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He has been a member of the American Academy of Arts and Sciences since 1985 and a Senior Fellow of the Center for Clinical Medical Ethics at the University of Chicago Medical School. He served as editor of the *Journal of Legal Studies* from 1981 to 1991, and as editor of the *Journal of Law and Economics* from 1991 to 2001.

His books include *Free Markets Under Siege: Cartels, Politics and Social Welfare* (New Zealand Business Roundtable and Institute of Public Affairs, 2004), *Skepticism and Freedom: A Modern Case for Classical Liberalism* (University of Chicago, 2003), *Cases and Materials on Torts* (Aspen Law and Business, 8th edition 2000), *Torts* (Aspen Law and Business, 1999), *Principles for a Free Society: Reconciling Individual Liberty with the Common Good* (Perseus Books, 1998), *Mortal Peril: Our Inalienable Right to Health Care* (Addison Wesley, 1997), *Simple Rules for a Complex World* (Harvard, 1995), *Bargaining with the State* (Princeton, 1993), *Forbidden Grounds: The Case Against Employment Discrimination Laws* (Harvard, 1992), *Takings: Private Property and the Power of Eminent Domain* (Harvard, 1985) and *Modern Products Liability Law* (Greenwood Press, 1980).

Professor Epstein has written numerous articles on a wide range of legal and interdisciplinary subjects. He has taught courses in civil procedure,

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A Country is Not a Company

Features of a company

One of the most famous statements about the relationship between a company and a state is contained in a remark by Charles E Wilson ('Engine Charlie' of General Motors) when he was being questioned for his appointment as Secretary of Defence in 1953, the early days of the Eisenhower administration. He said that, "for years I thought what was good for our country was good for General Motors and vice versa". The clear intention of this statement was that the social policies that worked to preserve the long-term success of the nation were also those policies that worked on behalf of General Motors, at that time (but no longer) the dominant corporate firm in the United States. One obvious virtue of the proposition is that it began with the view that sound national policies started with the nation, and then reverberated to the benefit of the firm. The obvious criticism of the remark centred about the words "vice versa", which clearly overstated the case: corporate welfare could benefit the firm and hurt the nation, for example.

It is, however, on this occasion important to ask a question that the confluence or conflict between firm and nation also raises. The topic is 'A Country is not a Company'. Are the policies that are good for the organisation of the nation good for the organisation of the firm, and vice versa? I have no idea how Engine Charlie, himself no deep theoretician, would have attacked this question. But I will explore some of the differences between the two forms of organisation, and then turn my focus to the specific question of how companies should interact with stakeholders and governments. In approaching this problem, I will not follow Engine Charlie's lead, but will endeavour to try to place the key stylised facts within a broader intellectual framework

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before getting immersed in the detail. In this case, the starting point is the simple law of contracts.

In spot transactions that involve the exchange of goods or services between one party and another, the original owner has no residual claim on whatever is transferred. Here, the ideal is often the 'clean deal' of which the sole function is to replace A as owner with B as owner. Completing these transactions requires no further thought about the dynamics of cooperation between individuals or the nature of ongoing relationships. For some purposes, however, the coordination of resources within firms is more efficient than clean transfers executed in spot markets. That is why corporations and partnerships come together as voluntary associations. When these groups form, they try to satisfy an initial business constraint: when individuals invest their various forms of wealth – either capital or labour – in a firm, they expect to receive more, in the form of returns on investment or wages, than they surrendered. Everyone hopes to come out a winner, or they do not want to play at all.

This one simple constraint makes people very careful when they select investors or employees to take part in their collective ventures. Ideally, they choose people of similar tastes and preferences, because decisions that please one person will be more likely to please everyone: a high positive correlation of attitudes on means and ends reduces the magnitude of the conflicts in collective ventures. To be sure, diversity in expertise is helpful, but solidarity with respect to purpose and plan is a very important feature of a company. When most businesses form, the participants are very conscious of their mission and strategy. Agreement that is not there at the beginning will not come thereafter when hard decisions have to be made on incomplete information and under great time pressure.

In my experience, most successful corporate leaders have an almost single-minded focus. In this role, one cannot thrive with the intellectual temperament of a Jack-of-all-trades, trying to do everything at once and doing nothing particularly well. As an academic, I like to explore many different fields, even at the cost of mastering none. That would not work for a business manager.

Easy exit rights are also very important within a company. These can take one of two forms. First, people who are unhappy with the direction of the

business can sell their shares. Substituting new shareholders for old ensures the sentiments of the new are realigned with the business objectives of the company, thereby reducing the cost of doing business. Secondly, through the takeover mechanism, it is possible for shareholders to bring about change in the face of management underperformance.

In addition, internal governance processes are important. The basic trade-off is between the speed and economy of quick executive decisions and the need for reflection and collective deliberation with respect to major, infrequent decisions, which is the role of boards.

Safeguards on the government

When we look at a government, we discover that many of the safeguards that make corporations work are not relevant or feasible. Therefore, greater weight has to be placed on the safeguards that remain.

Citizens of a state are birthright shareholders, as it were, in its jurisdiction. They have very limited powers of selection of the officials of the state that governs them. Individuals with heterogeneous interests and preferences must be governed through collective authority, without the ability to resort to voluntary sale of interests. Although there seems to be a modern notion that a government should undertake as many activities as possible, I believe the right lesson is the opposite. If a population has diverse views, the state should try to limit the use of public coercion and public support to those critical social functions that a strong majority of citizens agrees are essential for their own freedom and the state's survival. We cannot insist that all citizens agree, for to do so is to give outliers, often at many ends of the political spectrum simultaneously, a stranglehold over collective decisions. But aiming as a matter of prudence for comfortable super-majorities is a useful objective no matter what the particular decision rule the state uses for the enactment of laws. It is never wise to push close to the tipping point in making collective decisions, because it leaves too little room for marginal errors in the long and often complex process of the implementation and modification of new programmes.

There is, moreover, another key difference between a country and a firm. Compared with the discipline it imposes on a company, the exit right is not

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nearly as powerful in respect of a state. Although citizens can migrate to another country, they must abandon their friends, family, homes and livelihood to do so. This complex set of consequences is the complete opposite of the clean deal that arises from selling shares in a corporation, which involves no collateral dislocation for the seller. I do not mean to suggest that the exit right is not important. Quite the opposite, it is often the critical last-ditch line of defence for individuals and businesses that find rule in a given state intolerable. Think only of how the entire history of totalitarian nations would change if they all respected the exit rights of their embattled minority groups. Think, too, how much more willing firms might be prepared to invest in foreign nations, or even different states within the same nation, if the exit right were guaranteed and secured, which all too often it is not. But even when it is firmly established and fully protected, the political exit right is weaker than that from the collective business.

How then do we compensate for the weaker safeguards through the exit right with a state? The answer lies in governance structures. States ought to move relatively slowly, with deliberation and care. The United States and New Zealand have different democratic systems but similar goals. The United States has entrenched constitutional provisions, whereas under New Zealand's system of parliamentary sovereignty certain statutes have a higher status than others. The 1990 New Zealand Bill of Rights Act is an example. Ironically, if we look at the way things work out in practice, the degree of discretion afforded to the government is similar in the two countries even though the institutional arrangements used to define the role of government power differ.

The multiple functions of a state distinguish it from a corporation. In addition, as profit-making entities, corporations are not generally engaged in redistribution of wealth among their shareholders. It would be very difficult to attract investors with a promise of systematically differential returns, and that initial win-win constraint carries through all the stages of the corporate venture. In contrast, redistribution and the challenges that go with it seem to be accepted roles of most democratically elected governments. The question of internal management thus poses a greater challenge. Just because some redistribution is regarded as necessary and proper, that does not define the

appropriate determinants of a redistribution policy, which can easily go awry as has happened with the American Social Security and Medicare programmes, where errors are so difficult to unwind in mid course.

The internal and external relationships of a company

Now that these preliminaries are completed, two key questions remain. How should a corporation relate to the individuals and institutions that it deals with? And how should corporations handle their relationships with governments?

A corporation is commonly referred to as a nexus of contracts among shareholders. However, if we look more closely, it becomes clear that a shareholder-owned company also works in many other dimensions. These include relationships with employees, suppliers, bondholders, creditors and customers. How should the company deal with these various groups?

One of the possibilities favoured by the corporate social responsibility (CSR) movement is to extend company officers' soft fiduciary duties of responsibility, loyalty and care that now run toward shareholders to include these other 'stakeholders'. I think that from all perspectives this notion is flawed, so much so that it undermines the very idea of fiduciary duty that it seeks to extol and expand. The basic principle of loyalty dictates that it is very difficult – if not impossible – to serve two masters simultaneously. Companies are organised in ways that reduce conflicts of interest between shareholders. When a company enters into transactions with outsiders, a deal that benefits one shareholder will benefit others. But other stakeholders have competing interests with each other and with shareholders. When company officers try to become fiduciaries for divergent interests, they lose their focus. By attempting to serve two masters at the same time, they fail in their principal task of maximising shareholder returns.

This does not mean a corporation should simply disregard the wider stakeholders. The right way to look at these relationships is stunningly simple but profoundly important: individuals and organisations who deal with a company as outsiders should, and will, protect themselves by contract. Corporate officers under a duty to devote their energies to getting the best

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possible deal for shareholders will meet resistance from these other parties. If there are alternatives and choices, sound contractual arrangements will serve the interests of all. That is why markets exist: they are sources of experimentation by which different arrangements can be tried and discarded if unsuccessful.

Take creditors as an example. They will demand interest and perhaps default provisions whereby the firm turns over control to a creditors' committee in the event of insolvency. It is far better to negotiate that transfer of control by agreement than to have a single set of fiduciary duties that stipulates that all creditors must be treated equally with each other and with shareholders, when the priorities of the different groups differ by their place in the capital structure. Only equity holders will be tempted by high-risk high-return ventures when the corporation teeters on bankruptcy. And, the best way to prevent that course of action, when it does harm to creditors, is for them to have contractual rights to take over the board or to veto the transaction, if they see fit. No single fiduciary duty can touch the problem.

When it comes to customers, fiduciary duties that prevent a firm from charging different prices in different markets would not make sense. Firms would be unable to engage in perfectly sensible price discrimination. If a customer wants protection against competitors getting a better deal they can seek a preferred customer deal (along the lines of a most favoured nation arrangement) with their supplier. The supplier in turn will be in a position to know whether that concession makes sense, or whether another device, such as more limited price adjustments tied to some other index, will be more acceptable. Again, the wide range of possibilities cannot be captured in a simple fiduciary arrangement.

The same arguments apply to employees. In many cases, at-will contracts will be perfectly adequate and, in fact, will dominate. However, for certain key staff they will be too simple. Employment contracts are likely to become more individuated the higher one goes in the corporate hierarchy. Once again, a series of arm's length arrangements will be superior to a vague notion of a fiduciary duty to employees. To get key workers to sign up in the first instance may require that they receive some compensation later on in the event of a dismissal or company takeover. Only a specific contract with the firm can spell

these contingencies out in sufficient fullness. A loose fiduciary duty breeds uncertainty that will only invite litigation down the road.

Pollution and other externalities

Consensual arrangements can be handled in a simple fashion through contracts. However, corporations do many things besides making deals; for example, they may pollute the environment. How should we think about such issues? If an individual were engaged in pollution or reckless behaviour, tort and criminal sanctions would be invoked. There is no reason why individuals should be immune from such actions simply because they are members of a company. An adequate set of sanctions should exist to deter harmful actions and to ensure sufficient compensation if they occur. This gives rise to a new arm's length relationship: between the company on the one hand, and common law courts or state regulators on the other. This could easily be complicated in smaller firms by the doctrine of limited liability.

Both courts and regulators ought to impose the right kind of sanctions so that companies have incentives not to become polluters. Company directors would be motivated to declare, "we're sitting on a tort case waiting to happen - we should stop this behaviour". Given the current high level of environmental vigilance, I doubt whether significant cases of this sort occur with any frequency. Balance is also needed because sanctions can be ratcheted up so high that they undermine wealth creation. Whether we deal with the corporate or individual context, not all environmental harms are worth preventing, therefore it is critical to structure the sanctions so that no firm finds it better to pollute more on the grounds that it will be made to pay less.

Charitable activities

To what extent should corporations be involved in charitable activities under the guise of some notion of corporate responsibility? I subscribe to an old maxim by Lord Justice Bowen who said, "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company." He meant that it is not appropriate for a profit-making institution to engage in gratuitous wealth redistribution at

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the whim of directors. This does not mean that companies cannot be 'good corporate citizens' in some other way. Certain activities may well provide benefits in the form of improved goodwill that allow the company to do better in the market place. I have no reason to oppose decisions by firms to support good causes on that basis. What is really of concern here is that pet projects of key management staff and their families not be confused with public ventures that assist the corporation.

But let us set aside these indirect benefits. The first argument against corporate redistribution is that most company charters are designed to preclude such behaviour. Of course, there is nothing to stop any innovative promoter from drafting another kind of charter. However, most people believe there is no efficiency gain from merging the redistributive activities of a charity with the wealth creation mission of a company. Nor is there any reason to allow for the deliberate confusion of roles. The same individuals who invest in corporations can also become members of charitable boards. They can raise money with explicit redistributive purposes. A corporation engaging in redistribution takes it upon itself to act on behalf of every investing shareholder. While these shareholders may have a powerful community of interest with respect to their investments, they are likely to have a broad divergence of views regarding the kind of charitable activities they want to support.

Faced with these diverse preferences, the appropriate approach for a company is to declare a dividend and let the shareholders invest it in charitable activities of their own choosing. The argument against corporate social responsibility expressed through redistribution is not that such activities do not count as a private sector responsibility. (To the contrary, the more charitable activity that is undertaken privately, the less need there will be for government welfare, and so much the better.) Rather, the argument is that redistribution is decided much more efficiently at the level of individuals than as a collective decision at the level of the firm.

Recently, Microsoft declared a US\$32 billion dividend. Bill Gates took his US\$3 billion share and turned it over to his charity, the Bill and Melinda Gates Foundation. Imagine if, instead, Microsoft had declared a US\$32 billion special dividend to the Gates Foundation. That would have been an act of

corporate malfeasance, and no corporate leader at Microsoft would have seriously considered it. Individuals should be free to decide which charities to support, and how much they wish to donate. Anything else, as Milton Friedman has noted, amounts to misappropriation.

Essentially, we should treat corporations as special-purpose vehicles. We should not try to load on to them all sorts of tasks that they are not particularly suited for. Let them do one thing, and do it well.

The relationship between corporations and government

The next issue is a very difficult one: how should corporations deal with governments? Interactions are complex because governments have assumed such multifarious roles. They engage in all sorts of activities, some of which benefit firms and society at large, such as the definition and enforcement of property rights, and some of which are oppressive. In the latter category, one might list certain exclusionary provisions, heavy taxes, onerous regulations, unreasonable permit conditions and forms of expropriation.

I have always liked one line from Gerald Ford to the effect that the government that is strong enough to give you everything that you want is also strong enough to take everything that you have. This raises the issue of government subsidies to individual corporations, whether by way of tax breaks, direct payments or various kinds of franchises. How do we handle this issue?

One possibility is systematic structural reform. In my view, the best approach would be to draw up either an informal fiscal constitution or a formal US-style constitution that would aim to get the government out of both the taxation-as-punishment and the tax-concession-as-privilege business. Ideally, the tax system should be kept neutral between rival business forms (for example, corporates and cooperatives) and rival business projects (for example, farming and forestry investments). I have no doubt that the US constitutional prohibitions against takings, together with mandated flat taxes, would take us a long way in that particular direction if they were correctly understood and consistently honoured.

However, we must focus on the world as it is, rather than as we might envisage it in our dreams. What responses are appropriate when the government

engages in oppressive activities that harm a company? This is not an easy question to address because the moment punitive measures are introduced, the parties that are affected will consider their lines of defence. If individuals or companies believe they are being unjustly attacked by a government agency they will be tempted to take liberties in the way they deal with the state. They may try to do things that in other circumstances would be regarded as sneaky and underhanded. If one side is not playing by the rules of the game, the other side will not feel obligated to stick to the rules either. I would never recommend such a strategy, even though many private lobbyists and consultants make a living by doing so. In the end, I believe such a strategy is self-defeating, because all that the corporation achieves is to add legitimacy to oppressive government actions.

There is another, more principled, approach that I believe is better. When confronted by an oppressive government regulation, a company should attempt to make a case to the public that the policy is not only bad because it harms a specific business or industry but is also unjust or inefficient with respect to the community as a whole. Admittedly, it is a daunting task for a corporation to show that it has an enlightened approach to public policy. It requires a high level of intellectual expertise and a change in the way corporate executives see themselves and their role. In day-to-day operations, playing and prospering within the rules is critical to company success. Corporate executives cannot simply ignore every ill-advised, silly regulation. That would be too costly. The short-range challenge is to optimise under a series of external constraints when there is no immediate prospect of changing them.

However, the nature of the game changes when it comes to major policy issues over the longer run. Now, the challenge for company leaders is to explain what is wrong with a measure that has a major impact on their businesses. They must make a case that changing it would benefit not just their firm but also the public in the long term. This means that people who have expertise in management must develop at least a feel for public policy. This is not easy, particularly if a company tries to meet the challenge alone. For company executives, operating through an organisation such as the New Zealand Business Roundtable is much more efficient because it can invest expertise in understanding the arguments and can help educate other

businesses, policy makers and the public. With excessive government and insecure property rights, businesses face the risk of punitive regulation. They must be able to make the economic, moral and fairness cases for improving a particular public policy or their operations may be put in jeopardy.

This is one of the biggest challenges I have seen in the United States and New Zealand in the past 30 years. There is no shortage of people who argue for a larger government, more public spending and higher taxation. Their arguments must be contested by people making principled and coherent arguments for limited government.

Subsidies

Business subsidies complicate matters further. Here, there is a serious problem because every firm in a competitive market faces a genuine prisoner's dilemma. If one company accepts a handout from the government it will be at a systematic advantage over every competitor that decides not to do so. How can firms exercise self-restraint when, by acting virtuously, it simply benefits rival firms that have fewer scruples?

This is enormously difficult. In the United States, local governments have offered companies large parcels of land and tax concessions paid for by local residents to induce companies to locate in their districts. There have been attempts to call together corporate leaders to get them to agree, at the very least, not to be the first mover in these situations. If every company were to comply, a loose alliance of this sort could solve the problem. These are not contracts in restraint of trade but contracts in support of trade. They should be legal under the Sherman Antitrust Act because the aim is to create an anti-subsidy cartel. However, the looming presence of the antitrust laws makes this approach more difficult than ought to be the case.

How else might the problem be handled? Because legal remedies do not exist, what is needed once again is public education and debate to increase pressure on governments to abandon subsidy policies. Ideally, even companies that take advantage of subsidies will join the campaign. This can sometimes succeed. In the United States, I have worked closely with the Institute for Justice. One of its major campaigns has been against the use of the eminent

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domain power to condemn private property and turn it over to a firm to build a factory. This had been regarded as a 'permissible public use' for a long time, and received its most explicit endorsement in 1981 in a decision of the Michigan Supreme Court in the *Poletown Neighborhood Council v City of Detroit* case. Recently, in *County of Wayne v Hathcock*, that decision was unanimously overturned by the Michigan State Supreme Court, which accepted that grandiose claims of "economic development" count as a misuse of the eminent domain power that does not satisfy the "public use" requirement of the state constitution. This was a case of public debate influencing judicial thinking. I would urge businesses to continue this struggle in the face of oppressive action by a government.

Working for the government

A final issue concerns another interaction between businesses and the government. The question is whether people in the private sector ought to take positions in government agencies so that, instead of constantly knocking on the door or trying to bar the gate, they become the people who help shape policy.

Some might argue that people in the private sector should never sully themselves in government. I beg to differ. There have been cases in the United States of smart and able people going from business into government service and doing a commendable job. On the other hand, there have been cases – such as the current chairman of the Securities and Exchange Commission – who enter government, lose their bearings and champion regulations of which the chief effect is to place unjustified burdens on business.

What does it take to make a successful shift from business to government? I think many businesspeople will often be ill-prepared for the Byzantine political environment of government agencies. University professors are more accustomed to such a world – it has much in common with non-profit-making organisations and the world of tenured employees. The issues are so numerous, daunting and emotionally charged that outsiders can easily be overwhelmed if they do not come to the task with a firm intellectual orientation already in place.

The first thing a newcomer to government must learn is the value of having a team of experienced hands. The next thing to understand is that there is no

opportunity on the job to develop a general economic framework. A company is a centrally planned institution, even though there can be markets within firms. A centrally planned economy does not work. Thus, businesspeople accustomed to hands-on direction of their enterprises have to master a quite different set of skills in government. Running a market economy is a matter of getting the road rules right, not directing all the economic traffic. This means the only people who should enter government are those who have applied themselves to the task of understanding the principles that should guide public policy in the national interest. Those who lack the necessary application and ability to learn are a liability not an asset in government, no matter how good they have been at running a business.

I am in the academic business. I have reached the conclusion that, normally, we academics have no immediate impact on public affairs. On the other hand, we may have some small and subtle influence on many public policies over the long run. If you can shift the world just one or two degrees in a direction that is more consistent with sound principles of government, the results will work themselves out in unknown ways and places and benefit society at large.

Anyone like myself, who has coherently defended the principles of autonomy, property, contract, and limited government, has no interest in defending privileged groups in society. Policies based on these principles have long-term benefits that improve the lives of citizens in general. As President John F Kennedy once said, "A rising tide lifts all boats." I believe talented and successful corporate leaders have a special duty to help promote economic policies that are in the interests of society at large and business as a whole in the long run.

Questions

Advocates of corporate social responsibility invoke the rights of 'stakeholders'. What is your view of this term?

It is a strange term, with an interesting political pedigree. Traditionally, it signified that a person had an ownership interest in something – a stake in an enterprise. In that sense it sounds like a property notion. However, in terms of modern political theory and modern administrative law, stakeholders are basically people with an economic interest, as opposed to a proprietary interest, in some larger venture with which they are associated.

When the term is used this way, there is a tendency to suggest that the company's relationship with stakeholders should be the same as its relationship with shareholders, and that stakeholders should have decision rights in the enterprise. But, the reason shares are freely tradeable is to eliminate conflicts of interest: transactions by the firm will benefit shareholders in even proportions. To treat stakeholders like shareholders is to be a trustee for people who have conflicting interests. It simply does not work. The stakeholder terminology is dangerous if it is taken to mean that the relationship with the firm is anything other than arm's length.

The corporate family – to use another loaded term – must have two kinds of relationships. It must have the soft fiduciary relationships appropriate for collective institutions. It also needs the harder-edged relationships associated with contracts that are made with persons who are not the residual claimants of the firm. There can be modifications of this model but they should be made through contracts. That is what typically happens when workers have

compensation arrangements that are more complicated than ordinary wages. For example, a commission system basically gives employees part of the residual value of a transaction in order to encourage them to make a greater effort to bring that transaction about. In one sense they become a stakeholder. However, the duties owed to them based upon sales are numerically calculable. They are not soft fiduciary duties. The old distinction still applies even though the nature of the particular contract has altered somewhat.

Whereas it is very important for a corporation to have a vision and a series of strategies to achieve that vision, do you believe it is possible or advisable to have a vision for an economy, or for a political party to have a vision – other than to be elected?

As far as the economy is concerned, amalgamation of objectives leads to confusion rather than a cohesive vision. Each corporation has a unique set of business objectives, and nothing is gained by striving for a common set of goals that cover all firms. If there were some gain, either there would be collusion in restraint of trade, or it would be a signal that the firms should consider merging or entering into a joint venture. But it would be wrong to impute purposes to loose amalgamations of individuals or firms as though there is some organic unity among them. The answer therefore is, no, it is neither advisable nor possible for an economy to have a vision.

What about politicians? I think it is important for a political party to have a vision that voters recognise, that it is prepared to defend against all comers, and that helps it to get elected. Obviously, parties want people to share their political visions.

The danger is that when people have a vision about how their party should view the delineation of rights among individuals, some will want to go further and dictate how everyone should lead their private lives. Politicians ought to address themselves to genuine collective issues – such as public goods, taxation and foreign relations – and not tell other people how they should rear or educate their children.

Will politicians say anything other than that which is strictly necessary to get them elected? There is a rather cynical public choice view that being elected is the only thing that politicians care about. I would amend this

axiom to say that it is one of the things that politicians certainly care a lot about. But consider why we have segmentation of political parties. One reason is that someone with strong classical liberal sentiments like me would not join a socialist party, even if it increased my chances of being elected. And socialists would be unlikely to join a party with policies that I subscribe to. People will end up supporting parties whose basic intellectual orientation is similar to their own. Re-election is very important for politicians, but it is not the whole story.

Structurally, it is important to think about a set of rules that preclude politicians from buying votes by promising subsidies to their friends at the expense of everybody else. That brings us back to the question of constitutional design. If we could limit what politicians could give away, we could limit many of the factional appeals that they make.

One of the reasons why the United States has such difficulty with campaign finance reform is that, at any level of government, a stroke of the pen can decide whether a permit is granted to build a factory that could be worth billions of dollars to a corporation. Politicians have something to sell that they ought not to have, so companies will line up to become political buyers. If governments were simply limited to ensuring the provision of orthodox public goods, there would be much less willingness to cut deals. Public officials would have less to offer, and the prices that would be paid to curry their favour would drop accordingly.

You mentioned the undesirability of companies distributing shareholders' funds at the whim of directors. What about donations to political parties? How, for example, would US elections be run without donations from major corporations?

The problem with political donations is not that they are illicit gifts to buy favours, but that sometimes they are strictly necessary. Without them, some corporations might find themselves without an ally in government. I would hope that corporate donors would only use donations and influence to help restore some kind of political equilibrium – not to tilt the playing field in their favour. The problem is that the political economy of our countries lacks a baseline as to what is right and wrong.

Because the public cannot differentiate between good and bad forms of political funding, the practice in the United States has been to impose fairly rigid limits on what can be given to political parties. Some people assume this ensures they will get good government. In fact, it ensures that corporations and others give money not directly to parties but to single-interest groups with extremely shrill views. I believe campaign funding restrictions will, in the long run, increase the level of polarisation on a variety of issues.

I think there is no principled way to handle the question of corporate donations until the prior question of what a government is supposed to do is dealt with. In a situation in which the discretionary powers of governments are enormous, the issue is not whether somebody will try to appropriate available rents, but simply who will do so, and by what technique. If you eliminate corporations from rent-seeking then it will be special-interest groups that fill the void. That is a worry. Organisations in the United States from the Sierra Club to the National Rifle Association thrive precisely because political contributions pay handsome dividends.

What do you think of the idea of citizenship as a tradeable commodity, so that citizens have an exit option?

With local government, residents have an exit option, which is a valuable constraint, at least on egregious political behaviour. With a national government, it is harder for citizens to vote with their feet – the binding constraints are immigration rules in other countries. Making citizenship tradeable would create more options, but the issue is who would be eligible for such a trade. If someone wanted to trade citizenship with a known criminal in another country, people would be upset, just as they would be if the deal was for the purpose of milking the social welfare system.

When we talk about the assignability of any kind of personal right, we are faced with the same problem that exists under elementary contract law. Whenever shares are sold in an active governance situation, the change in the composition of the shareholders could matter. This may not be the case with sales of small blocks of shares in large corporations but in smaller closed corporations it may matter greatly. That is a reason why they may not allow

the free alienability of shares by contract. A change in the composition of the shareholders may influence the way the company is run, and other shareholders may be materially affected.

I would not necessarily oppose the concept, but I would want to look carefully at the rules of a specific proposal. There is a case for selling or auctioning a quota of immigration rights, even though the idea raises political hackles. At least for the moment, these are not the battles that I want to fight. I would rather fight to try to limit the scope of government activities so that excessive taxes and excessive subsidies are both removed from the political landscape.

