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# Eliminating the Underlying Cause of Poverty as a Means to Global Economic Recovery

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Eliminating the Underlying Cause of Poverty  
As a Means to Global Economic Recovery  
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ABSTRACT

The public analysis of the causes of the current recession and the ways to achieve economic recovery generally proceed on the widely-shared, tacit assumption that there is that there is no substantial, first-order connection between the recession and the failure to address the problem of systemic poverty. Otherwise, the need to alleviate systemic poverty and needed solutions to promote economic recovery would be commonly addressed in the same discussions; and they are not. This widely-shared, tacit assumption is false. The failure to reverse systemic poverty *is* the fundamental cause of current economic crisis.

Recessions (and sub-optimal growth) occur when a critical mass of market participants come to believe that the distribution of future earning capacity is not sufficient to purchase what can be produced despite the physical and technological capacity to employ available labor and capital to produce more over the same period at lower unit cost. The essence of systemic poverty likewise is inadequate earning capacity. In periods of rising unemployment, the problem of inadequate earning capacity (which perennially plagues poor people even in good economic times) rises up through the middle class like rising flood waters. Thus rather than view Wall Street as too big to fail, it is more accurate to recognize that the earning capacity of poor and middle class people is too important to fail.

The mainstream political/economic strategy for promoting economic recovery is (1) capital acquisition with the earnings of capital primarily for big corporations and for well-capitalized persons (generally in proportion to their existing wealth) along with considerable government redistribution, and (2) primarily jobs (but by no means the best or highest paying jobs) and various forms of welfare redistribution for poor and middle class people.

Such policies fail to fully employ existing productive capacity because they do not distribute sufficient earning capacity to purchase what can be produced even at decreasing unit costs. The mainstream political/economic approach fails to recognize that a broader distribution of capital acquisition with the earnings of capital will provide greater incentives to profitably employ unutilized productive capacity (both labor and capital) than a narrower distribution of capital acquisition.

The missing element in mainstream strategy (which could easily be added to government and private corporate policy, without extra cost to anyone) is to open to poor and middle class people the same government supported institutions of corporate finance, banking, private insurance, government loans, guaranties, and reinsurance and favorable tax and monetary policy (presently relied upon by the Federal Government to stimulate the economy and to facilitate capital acquisition with the earnings of capital for people primarily in proportion to their existing wealth). In this way, poor and middle class people will also be able enhance their earning capacity by acquiring capital with the earnings of capital. A fairer and more competitive market foundation for the systemic market-based enhancement of the earning capacity of poor and middle class people will thereby be established; and greatly enhanced prospects for greater and more broadly distributed economic opportunity, earning capacity, and sustainable growth can be reasonably expected and realized by all.

## **I. Introduction**

The current global economic crisis has the attention of almost everyone in the circles of power and influence around the world. The problem of poverty has the attention of relatively few people, except the poor and their advocates.

In most circles of power and influence, expressing concern about the future of capitalism and advancing ways to promote its economic recovery puts one in the “in.” In most circles of power and influence expressing concern about poor people and advancing ways to enhance their economic recovery puts one in the “outs.”

Analyses that seek to identify the most important causes of the current global financial meltdown command the ongoing attention of print and on-line publications, blogs, radio and television. Analyses that seek to identify the causes of poverty receive scant media attention.

To date, the government has appropriated over seven hundred billion dollars to help Wall Street, the banks and insurance companies, and even some folks on main street; but relatively little of the recovery efforts is directed to help the poor.

For those who believe most assuredly in the lassie faire, free-market approach to macro-economic issues, many of the proposed ways of helping to address poverty are viewed as having a drag on the engines of economic recovery and growth. For those who adhere to the recently revived interest in the left-of-center Keynesian approach of increased government spending and involvement in the economy, these same approaches are not seen as a drag on economic recovery and growth, but nor are they front-and-center among the priorities for government involvement and spending. In effect, even among those in the circles of power and influence who are (when judged by their rhetoric) most politically sensitive to the interests of the poor, the poor are largely told to wait until more pressing matters of economic recovery are addressed. A rising tide raises all boats, they are told.

Thus, for this reason, and for others discussed below, the Keynesian approach (while friendlier to the interests of the poor than other mainstream approaches) may not by itself be the best way (1) to serve and promote their interests and (2) to help the economy to move beyond its present crisis to achieve a sustainable recovery.

The analysis directed toward determining the causes of the current economic crisis and formulating ways to achieve economic recovery generally proceed on the widely-shared, tacit assumption that there is no substantial, first-order connection between the current economic crisis and the failure to substantially reduce poverty. Otherwise, addressing the problem of systemic poverty and the solving the current economic crisis would be commonly be addressed in the same discussion; and it is not

This widely-shared, tacit assumption is false. Quite the opposite is true. The failure to

identify and reverse the underlying cause of poverty *is* the fundamental cause of the current economic crisis. This is not to say that a number of the other causes identified below did not contribute to, hasten, precipitate and exacerbate the economic crisis. But only the a deeper, more potent economic cause of the economic crisis that continues to erode the earning capacity of poor and middle class people has yet to be recognized by government, business, civic leaders, the media, economists, and advocates for the poor. The purpose of this article is to shed light on that deeper cause and how it can be addressed to hasten an economic recovery in a way that proves structurally stable and sustainable in the long run.

Based on the premise that among the highest duties of the lawyer are (1) to help clients identify and secure their essential rights and responsibilities in society, and (2) to help clients not only with immediate, pressing problems that clients have brought to their attorneys' attention, but also with fundamental, systemic causes of and solutions to client problems that clients may not even recognize or understand, this article invites poverty lawyers, law teachers, and law scholars who profess to be advocates for the poor (1) to achieve an understanding of an important connection between (a) the failure to remedy the systemic persistence of poverty and (b) the current economic crisis, and (2) then to act on that understanding in a lawyerly way.

In the sections of this article that follow, I will develop and further explicate an analysis that runs as follows:

1. Although there are a number of precipitating factor (that can be viewed as “causes”) that have resulted in or contributed to an eruption of the current economic crisis on such a scale and in such a decisive way that no informed person can ignore or deny the existence of the crisis, the underlying cause of the crisis (though not widely recognized) has been brewing for many years.
2. The recession/depression that brought the crisis into undeniably plain view can best be characterized as a substantial decrease in profitable economic production for an extended period of time, despite the physical and technological capacity (with existing and available labor and capital<sup>1</sup>) to produce more and more over the same period.
3. The lay-offs, down-sizings, mergers, business failures, collapse in real estate values, stock-market plunge, credit freeze, and government bail-outs, loans, guarantees, tax cuts, and increases in the monetary supply that have occurred and that are anticipated as necessary to return the economy to a modest level of sustainable growth can all be seen to be a forward looking response to the prospect of inadequate earning capacity of both consumers and private produces to purchase what can physically be produced and to repay existent and anticipated debt obligations – or in short the

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<sup>1</sup> As used in binary theory, capital includes land, animals, structures, and machines – anything capable of being owned and employed in production. It does not include financial capital, which is a claim on (or ownership interest in) real capital.

sustained prospect of inadequate earning capacity in the context of unutilized productive capacity..

4. The mainstream strategy for addressing the problem of inadequate earning capacity (which is a composite compromise of strains of Adam Smith's classical economics, neoclassical economics and Keynesian economics) is a mix of government policies that promote (a) capital acquisition with the earnings of capital primarily (and also considerable redistribution) for well-capitalized persons, and (b) jobs (but by no means the best or highest paying jobs) and various forms of welfare distribution for poor and middle class people.
5. The missing element in the mainstream strategy (an element that could easily be added without extra cost to anyone) is to provide for poor and middle class people the same government assistance (presently primarily provided to well-capitalized people) so that poor and middle class people can also enhance their earning capacity by acquiring capital with the earnings or capital.
6. In the context of the present economic crisis, the combined actions of the Congress, the President, the Treasury, and the Federal reserve (already undertaken and presently likely to be undertaken) for the purposes returning the economy to a modest level of sustainable growth include:
  - a. government investment in banks;
  - b. government loans and/or loan guarantees to private industry;
  - c. government insurance and/or reinsurance programs;
  - d. government purchase of toxic mortgages;
  - e. a lowering of interest rates and taxes; and
  - f. or increase of the money supply through monetization);  
plus continued reliance on the private business sector (supported and facilitated by laws, regulations and administrative and judicial enforcement mechanisms) by way of
    - g. the corporate form in doing major business  
(which provides limited liability and non-recourse credit for owners);
    - h. fiduciaries, trustees, and agents to act for the benefit of owners;
    - i. capital credit via private bank lending;
    - j. private insurance and reinsurance;
    - k. tax advantages for owner (but not for non-owners) in the form of deductions for depreciation, research and development for capital acquisition;
    - l. favorable income tax treatment for capital gains; and
    - m. government subsidies for various forms of business.
7. By openings to all people the institutions of corporate finance, banking, insurance, government loans and guaranties, and favorable tax and monetary policy (the very institutions presently relied upon by the Federal Government to stimulate the economy and to facilitate the ability to acquire capital with the earnings of capital

(primarily for people in proportion to their existing wealth) can be more broadly extended more equally and democratically to all people. In this way a fairer and more competitive economic playing field can be established, with the result that greatly enhanced prospects for greater and more broadly distributed economic opportunity, earning capacity and growth can be reasonably expected and realized by all.

## **II. The Advocates Duty to Separate Immediate, Precipitating Causes from Major Underlying Causes:**

In representing clients, competence requires lawyers to distinguish between the more important and the less important. Lawyers who address only factors that from a short term perspective may seem to be major causes, but that from a longer term perspective may more clearly be perceived as mere symptoms or precipitating causes of more serious, fundamental causes do not serve their clients as well as lawyers who address the fundamental causes as well. Clearly, when addressing causes it is better to address fundamental causes as well as secondary causes.

If the current economic crisis is seen as a problem that materialized with the burst of the real-estate bubble, as a result of sub-prime lending practices, the emergence of mortgage backed securities, deregulation, or a climate of lax enforcement then certain “causes” may be seen to tell the whole story, and the remedies will be forged accordingly to address those causes. On the other hand, if the crisis is understood to have roots that extend back in time for many years, even decades, then different and perhaps deeper causes may be discovered and different remedies may be required.

In fact many people, including some economists, have for years been predicting a major economic meltdown of the sort that was precipitated in mid September (September 17, seems to stand out as a critical day in time). But the economists making such predictions are generally not among the “mainstream” of credentialed, celebrated economist-elites that receive prominent posts and recognition in government, business, foundations the media. After the crisis, the economist-elites such as Alan Greenspan then testify to Congress that the market failures were far beyond what *anyone* could have imagined, but this is not so – the events were merely beyond what economists could predict if they wanted to continue to be regarded in the mainstream.

Now that the current economic crisis has materialized on such a scale and in such a decisive way that no informed person can ignore or deny its existence, a search for the important causes abounds in the mainstream discussion. A number of developments that might be called “causes” have been noted. These include:

1. the swelling and burst of the high-tech bubble;
2. the swelling and burst of the real-estate bubble;
3. the excesses of sub-prime lending;
4. deregulation and insufficient enforcement of the securities, insurance, and banking industries and of corporate governance;
5. increased securitization of financial assets in context of deregulation and non-

- enforcement;
- 6. growing consumer debt;
- 7. continuing down-sizings;
- 8. growing income and wealth disparity;
- 9. erosion in the power of organized labor;
- 10. continuing globalization on an unlevel playing field; and
- 11. increasing concentration and disparity in the distribution of income and wealth;

Some of these go back a few years; others go back decades. It would be difficult to fault lawyers and other professionals vested with fiduciary responsibilities from focusing on ways to curb the speculation in bubbles, the excesses in sub-prime lending, fraud in the sale of mortgage-backed securities, and lapses in due diligence by financial rating agencies and fiduciaries. Likewise, it would be laudable for such professionals to shore of regulation and enforcement in the securities, insurance, securities banking industries, and in general corporate governance. But such professionals and advocates for the poor should also look deeper to determine whether more potent underlying causes need to be identified and addressed.

### **III Identifying the Deeper, Common Transcendent Cause of the Economic Crisis and Poverty: Inadequate Earning Capacity.**

Sometimes, deeper causes can be revealed by considering various problematic conditions and determining what the problem in them is *not*. For example:

1. The Real Estate problem is not that builders cannot build houses that people would love to buy.
2. Although American auto makers may have not acted as prudently as their foreign counterparts, the American auto industry problem is not that those auto companies and their workers cannot build cars that people would love to purchase and maintain.
3. The unemployment problem is not that too few people would like to work at a secure job at a living wage.
4. The problem with the medical system is not that providers lack the ability to provide much more medical care that people dearly need than is now being provided.
5. The problem with the banks is not that they do not want to make loans to borrowers who can properly secure and repay them.
6. The problem with excessive consumer debt is not that people prefer to borrow rather than to pay for consumer needs and desire from sufficient earnings.
7. More generally, the problem with the economy is not that producers lack sufficient

productive capacity to produce much more than they are presently producing at lower unit costs that they could profitably sell if only consumers had the earnings to purchase the increased production.

In all of these areas, and many more, the problem is a lack of present earning capacity and a lack of confidence in future earning capacity, of people and institutions to repay their debt obligations and support a level of consumption that produces sustainable growth rather than recession.

The federal government's failure to solve the present credit freeze can be explained in the same way: Having provided a great infusion of cash into the banking system, having shorn up confidence of depositors by increasing deposit insurance, and having lowered interest rates to historic lows, a major immediate concern is what else can be done to induce banks to begin lending again? Even with substantial government financial assistance to enhance their lending capacity, banks face two problems in extending credit,

1. Interbank problems - banks don't trust the solvency of other banks
2. Non-bank borrower problems - banks do not trust that borrowers can properly secure and repay loans

Once again, the deeper problem is inadequate present and anticipated future earning capacity of borrowers,

Likewise the long term success of much the governmental attempts to revive the economy may be understood to raise the same concern: whether the debt obligations presently undertaken by the government to promote economic recovery in the immediate future and for the present generation can be satisfied in the near and long-term future by the earning capacity of present and future generations.

The importance of distinguishing between fundamental and secondary causes also applies to the causes of poverty. In search of the causes of poverty, a number of problems of have been identified including the lack of job and skills training, education, family structure, jobs, higher wages medical (including mental health) services, child-care services, and generally needed government support. Social factors contributing to, or exacerbating, poverty include unequal opportunity and discrimination by way of race, gender, and age. Likewise the problems faced by the poor are frequently made worse by unjust legislation, administrative practices, and judicial decisions. But one transcendent way of characterizing the condition commonly known as poverty is the lack of sufficient earning capacity.

The characterization of poverty as a problem of inadequate earning capacity is economically and politically important because it has the potential of uniting the economic and political interests of poor people (both the working and non-working poor) with the interests of middle class (including of course upper middle class people, like many law teachers and lawyers), most of whom are presently (and for a considerable time have been) suffering from an systemic erosion in earning capacity. In fact, the descriptive essence of poverty (earning capacity insufficient to sustain a middle-class life style has been spreading up through economic strata. This common problem of a deteriorating earning capacity is evident from a host of economic data that indicates that in terms of income, only the top portion of the top 10% of the population is advancing.

The symptoms of the deteriorating earning capacity abound. Two earner families become increasingly necessary to support a middle class life style. An increasing number of individuals holding two and even three jobs to make ends meet. Increasing consumer debt. Increasing borrowing on home equity (facilitated by the real estate bubble) to supplement consumption in light of eroding earning capacity.

The current economic crisis is a relatively recent experience for the upper and middle classes, but not for the poor. The poor have been experiencing an economic crisis – an ongoing depression – for centuries. The suffering of the poor becomes more widely recognized, and more a matter of public concern during recessions and depressions, when this description of poverty – inadequate earning capacity – spreads upward from the unemployed poor, to the working poor, to the middle classes.

Despite growing production (GNP in the growing US economy that prevailed before the economic bursting bubbles and downturn of the last decade, incomes and wealth accumulation were rising for only the top ten percent, and primarily for the top one percent of the population. Thus, despite rising GNP, the earning capacity of those most domestic consumers to purchase what is produced was not rising, but rather was funded by increasing consumer debt, borrowing on home equity (fueled by the false belief that home prices would continue to rise) and transfer payments. This deficit in demand has been and continues to be partially remedied by increased exports paid for in part by more wages paid to employees overseas to whom US producers have exported what were formerly American jobs; but an economy that can increasingly produce necessities and simple comforts that its people can increasingly not afford is not an economy in sustainable balance.

Once the seamless connection between the inadequate earning capacity of the poor and the deteriorating earning capacity of the middle class in times of economic downturn is recognized as a unitary problem, the foundation for a more systemic way of addressing both the problem of economic recovery and poverty can begin to be forged.

#### **IV. Recognizing That in a Private Property System There Are Two Ways to Earn a Living: by Working *and* by Owning.**

Many years ago, Professor Lon Fuller, writing in praise of the adversary system, noted that one of its great virtues is that it helps to protect against the errors in judgment that arise from erroneous initial preconceptions. Research in human psychology reveals that by a mental process called cognitive dissonance, once an initial theory is formulated, people who accept that formulation tend to gather and analyze “evidence” in a prejudicial way. They quickly recognize and give weight the evidence that confirms the initial conception and frequently fail to recognize and discount evidence that tends to support a conflicting conception.<sup>2</sup> The same is true of preconceptions that comprise what John Maynard Keynes called “the received wisdom.” One of the virtues of the

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<sup>2</sup> Lon L. Fuller, *The Adversary System*, in *Talks on American Law* 34 (H. Berman ed., 1971); Joint Conference on Professional Responsibility, 44 ABA JOUR 1159 (1958).

adversary system is its premise that to do justice, the law must always be open to yet another way of looking at or reframing an issue. The lessons to be drawn from these observations are of extreme importance to advocates for the poor and their clients.

When most people in our society think of the plight of poor people and the growing problems of middle class people and are presented with the descriptive condition of “inadequate and deteriorating earning capacity,” they think of jobs, skills training, human disabilities, unequal employment opportunity, law-offs and other such words and phrases all relating to earning capacity by way of labor. The preconceptions of conventional wisdom assume that to acquire capital with the earnings of capital requires access to credit that can only be secured by the ownership of collateral in the form of some existing capital assets, when in fact market-priced capital credit insurance (also paid for with the earnings of capital) is a perfectly viable substitute.

However, sadly lacking in the mainstream conversation is a deeper and more potent understanding of the lack of sufficient earning capacity that is descriptive of (1) poverty, (2) the deteriorating economic condition of middle and upper middle class people, and (3) the current economic crisis. The deeper and more important understanding requires first a recognition of the obvious: in a private property system there are two ways of earning an income: (1) by way of labor and (2) by way of the private ownership of capital.

Of course, the idea that there are two ways of earning (through working and through owning) is by no means foreign to economic analysis (witness the concern for such phenomena as “corporate earnings,” “return on investment” and “profit incentives”); it is simply not usually associated with a practical, market opportunity for poor and working people. This is yet another debilitating preconception for the advocates of poor and working people and their clients.

The traditional prescription for becoming an owner of a viable capital estate (work hard, save, and invest wisely) is demonstrably ineffective for the vast majority of people. Although there are rags-to-riches success stories that inspire imagination and hope, and an increasing number of millionaires and billionaires, their number is statistically insignificant. If one defines a capitalist as a person who earns at least fifty percent of his or her current consumption from capital, then traditional capitalist economies have produced many workers and welfare recipients, but relatively few capitalists.

Moreover, the traditional savings prescription for capital acquisition is not the way most capital is presently acquired in modern industrial economies. In the USA, for example, of the billions of dollars of capital acquired each year, virtually all of it is paid for with the earnings of capital, and much of it is acquired with borrowed money. Relatively little capital is acquired with the earnings of labor.

Consider the capital ownership of America’s three thousand or so largest companies, whose common stock is roughly represented by an index known as the Russell 3000 Index. These companies represent the ownership of over 90% of the investable, non-residential productive capital in the USA. The continuing profitability of these companies is a major concern to those vested with

the responsibility to promote economic recovery from the present crisis. These are the companies that are experiencing the credit freeze and the prospects of a substantial decrease in demand for their products and services, massive lay-offs in their work force, declines in their earnings, and business failure. Yet virtually every one of these companies could employ more workers and capital to produce more of what it is producing for people who would gladly purchase their products, if only people had the sustainable earning capacity to purchase the production.

Presently through these corporations, almost all new capital is acquired with the earnings of capital, and much of it is acquired with borrowed money.<sup>3</sup> At the same time, the ownership of this corporate wealth is highly concentrated so that approximately 1% of the people own 50% of the wealth and 10% own 90% of the wealth, leaving 90% people owning little or none.<sup>4</sup> Thus, when the U.S. government undertakes to help business by various means to promote economic recovery, it is promoting of capital acquisition with the earnings of capital primarily for well-capitalized people (and generally in direct proportion to existing wealth) and jobs (and by no means the best and highest paying jobs) and welfare for everyone else.

The preferred means among the rich to acquire new capital is to buy it with non-recourse corporate credit and to repay the acquisition debt obligation with the income earned by the assets acquired. To acquire capital with the earnings of capital, well capitalized people use (1) the pre-tax earnings of capital, (2) collateral, (3) credit, (4) insurance and capital markets mechanisms to diversify and reduce risk, and (5) a monetary policy intended to protect private property. No less competitive a means is needed by middle class and poor people, who have little or no assets to place at risk.

As explained in Section VIII, below, the same institutions and practices that work profitably for well-capitalized people can also work profitably for all people. Moreover, in an economy operating at less than full capacity (as in the present recession), if capital can competitively pay for its acquisition costs out of its future earnings primarily for existing owners, it can do so even more profitably if all people are included in the capital acquisition process.

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<sup>3</sup> For example, during the fifteen year period from 1989 through 2003, in the case of major prime credit-worthy companies in the U.S.A., the sources of funds for capital acquisition, in approximate terms, reveal that annually retained earnings accounted for at least 70% and more usually 80% of the capital acquisition. Borrowing accounted for almost all of the rest. Sale of stock as a source of funds capital acquisition never exceeded 5% during the period and was negative in most years (meaning that loans and retained earnings were used to retire equity stock.) See Richard A. Brealey & Stewart C. Myers, Franklin Allen *Principles of Corporate Finance* Chapter 14, pp 561-563 3rd edition, 2004). *Stock Market Pricing and Securities Regulation*, (87 Mich. L. Rev., 613 at 648, 1988).

<sup>4</sup> Edward N. Wolff, *Top Heavy: A Study of Increasing Inequality in America* (New York, Twentieth Century Fund, 1995) and Edward N. Wolff, "How the Pie is Sliced: America's Growing Concentration of Wealth," *The American Prospect*, No. 22, (Summer 1995), pp. 58-64.

## V. Earning Capacity and the Right to Acquire Capital with the Earnings of Capital.

The foregoing discussion leads to a focus on a specific property right that is central to capitalism but that is rarely identified in so many terms: namely, *the right to acquire capital with the earnings of capital*. Although first advanced in a law review as a solution an alternate means of addressing poverty,<sup>5</sup> it has rarely been noted in law reviews since then. Although poor people have suffered, and continue to suffer, greatly over the last fifty years since its publication, there is little, if any, discussion of this right by their advocates course materials on poverty.

And yet, once articulated, it is a right that can be appreciated as a right of monumental importance. With the exception the Nazi period in Germany and the Second World War, from an Anglo-American perspective, much of the global power history of the Twentieth Century (from the early revolts in Czarist Russia starting in 1903, to the Bolshevik Revolution of 1917, continuing with the Cold War, and ending with the collapse of the Soviet Union and state-sponsored communism in Russia) might be viewed as a struggle over whether the right to acquire capital with the earnings of capital was to be outlawed by the state (economically, the essence of communism) or remain a private right (economically the theoretical essence of private-property-capitalism). It singularly defines a major economic difference between communism and capitalism. It is a property right that is presently enjoyed by people generally in proportion to their existing wealth and therefore is certainly valued by wealthy people. It forms a major part of the strategy in corporate finance, private business, and economic recovery.

Although in theory, everyone has the right to acquire capital with the earnings of capital in practice, most people do not. And they do not, not because they would not like to, but rather because institutional advantages available to well-capitalized people are not, as a practical matter made open to them. By reason of institutional advantages routinely accorded to existing owners (advantages related to tax law, corporate finance, lending and insurance regulation and practices, and monetary policy), the right to acquire capital with the earnings of capital is a plutocratic right enjoyed abundantly by well-capitalized people, but much less abundantly by middle class people, and almost not at all by poor and working people. However, by making the same institutional advantages that presently facilitate capital acquisition with the earnings of capital primarily for the benefit of existing owners, it is also a right that could be competitively extended to everyone without taking from anything from existing owners. Yet, as noted before, it is a right that has rarely been articulated in widely publicized media, or in popular or scholarly writing in economics and political economy, political science, history, and law.

Before going further, it is well for advocates for the poor to consider, why has this right received almost no attention. One way of providing a partial answer (which is a bit conspiratorial in nature) is to draw from a characteristic of the adversary system well-understood by most experienced lawyers. Lawyers do not expect their adversaries to draw attention to weakness in their arguments, or to unarticulated perspectives that will deprive them of cherished systemic advantages,

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<sup>5</sup> L.O. Kelso "Poverty's Other Exit," 41 *North Dakota Law Review* 147 (1965)

or to announce where the major potential profit in the case has been hidden. To the contrary, except where ethically required, adversaries are expected to do what they can to keep their opponents in the dark regarding such matters. A less conspiratorial answer, perhaps easier to accept, is one based on ignorance. This is discussed in the section that follows: But even if such crucial matters are not revealed by reason of ignorance rather than intentional concealment, it is no less the responsibility of counsel to discover them.

## VI. Economic Theories of Production, Distribution and Growth

An explanation more innocent than the adversarial theory set forth above for why the right to acquire capital is rarely mentioned and why opening to all people the institutions that facilitate its enjoyment primarily for wealthy people is not widely viewed as a practical means of substantially enhancing the earning capacity of poor and middle class people (and also as a means of presently laying the foundation of an economic recovery characterized by modest, if not robust, sustainable future growth) is that the basic paradigm for understanding production, distribution, and growth laid down in 1776 by Adam Smith in his *Wealth of Nations*,<sup>6</sup> and relied on upon by all mainstream economists and political economists since, fails to consider the distribution of capital acquisition to be important to the profitable employment of existing capacity or the promotion of economic growth.

To understand the limitations of his approach it is important to bear in mind that Smith formulated his approach in 1776, *before* the great impact of the industrial revolution was widely understood. Smith never saw a factory and never witnessed any form of automation.. The first rudimentary steam engines were just then being invented. Most human-made capital instruments employed in production were hand-powered extensions of the human body. For Smith, (1) the primary role of capital was to make labor more productive, and (2) per capita economic growth was the result in increases in human productivity. Although they took issue with other aspects of Smith's analysis, the founders of subsequent economics schools (Karl Marx with communism,<sup>7</sup> William Stanley Jevons, Carl Menger and Alfred Marshall with neoclassical economics,<sup>8</sup> and John Maynard

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<sup>6</sup> ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (photo. reprint 1981) (Oxford Univ. Press 1976) (1776).

<sup>7</sup> KARL MARX, CAPITAL 188 (Friedrich Engels ed., Encyclopedia Britannica, Inc. 1952) (1887).

<sup>8</sup> WILLIAM STANLEY JEVONS, THEORY OF POLITICAL ECONOMY (1871); Carl Menger, Principles of Economics (1871). See also Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*, 31 HASTINGS INT'L & COMP. L. REV. 295, 319-21, 336 (2008).

Keynes with Keynesian economics)<sup>9</sup> did not disagree with Smith's fundamental theory of production and growth. This approach dominates virtually all economics (both mainstream and heterodox), all the social sciences, and all government economic policy to this day.

Based on this fundamental premise that the primary role of capital is to increase labor productivity, Smith formulated his basic theory of economic growth as follows: he reasoned that higher productivity allowed for the profitable employment of more people, the payment of higher wages, and the investment in more capital which in turn would promote yet more profitable employment, higher wages, and more capital investment. . Moreover, the increased production would distribute increased demand through the employment of more people and the payment so that ever more production would become profitable.

As if guided by “an individual hand” following a natural law of supply and demand, prices and thereby the employment of people and resources could privately determined by the individual choices in the decisions to invest, work, and consume. All government had to do was to protect private property, prevent monopoly and protectionism, and promote individual opportunity.

Within this system, things are worth the work people are willing to do to acquire them, and the profitability of capital investment is dependent on the wages needed to employ workers and its scarcity, but not a function of the distribution of its ownership. In his *General Theory*, Keynes continued this logic by reducing the economy to three fundamental variable: time, money and labor.<sup>10</sup> Capital in the thinking of Smith, Marx, and Keynes is a dependent variable – fundamentally dependent on the earning capacity of labor.

In this labor-centric approach to production and growth, the distribution of capital acquisition with the earnings of capital is not fundamentally important in and of itself, to the promotion of growth, and is consequential with respect to growth only if it positively affects human productivity. According to this labor-based paradigm, whether capital is broadly or narrowly acquired simply does not matter, and so the right to acquire capital with the earning of capital is not important as means of promoting economic recovery.

In the history economic thought, I have discovered no fundamental challenge to this labor-centric approach to growth until 1958 when a corporate finance attorney named Louis Kelso teamed up work the internationally renowned philosopher, Mortimer J. Adler, to publish a book entitled *The*

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<sup>9</sup> JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 213–17 (Harcourt Brace Jovanovich 1964) (1936);

<sup>10</sup> “It is preferable to regard labour, including of course, the personal services of the entrepreneur and his assistants, as the sole factor of production, operating in given environment of technique, natural resources, capital equipment and effective demand. This is why we have been able to take labour as the sole physical unit which we require in our economic system, apart from units of money and of time.” Keynes, *General Theory of Employment, Interest and Money*, Harcourt, Brace & World, Inc. (1936) pp. 213-214.

*Capitalist Manifesto*.<sup>11</sup> In this book and a long series of other authored or co-authored publications, Louis Kelso went on to formulate a theory which in later works he called “binary economics.”<sup>12</sup> According to this theory, universalizing the right to acquire capital with the earnings of capital is the key to not only to eliminating poverty, but also the profitable employment of unutilized capacity, robust economic recovery, widespread affluence, and sustainable, ecologically friendly, economic growth.<sup>13</sup>

## VII. Brief Overview of Binary Economics

**Basic Premises:** Binary economics accepts the classical economics of Adam Smith as set forth in *The Wealth of Nations*, but modifies Smith's analysis uniquely to account for the increasing role of capital in production and distribution. Binary economics can be distinguished from Adam Smith's classical economics and other economic schools by the following related propositions:

- (1) Labor and capital are “equally fundamental” or “**binary**” factors of (or “inputs to”) production;
- (2) Technology makes capital much more productive than labor; and
- (3) Capital has a strong, positive, **distributive** relationship to growth, such that the more broadly capital is acquired, the more it can be profitably employed to increase production. (The principle of binary growth.)

**Productivity and Productiveness:** To understand the binary approach, it is important to distinguish between “productivity” (which is the ratio of the output of all factors of production, divided by the input of one factor, usually labor) and “productiveness” (a special focus of binary economics, which retrospectively means “work done” and prospectively means “productive capacity”). According to the binary view of production, although labor and capital may cooperate (just as people may cooperate) to do work, each factor (the human and the non-human) does its own work and provides its own “productiveness.”

The “binary productiveness” of labor and capital can be illustrated by considering any sort of work. Consider, for example, the work of sawing boards and hauling sacks. A person can saw ten boards per hour with a hand saw, and one hundred boards per hour with a machine saw. According to conventional economic analysis, compared to working with the hand saw, with the

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<sup>11</sup> L.O. Kelso and M.J. Adler, *The Capitalist Manifesto* (1958).

<sup>12</sup> L.O. Kelso and M.J. Adler, *The New Capitalists*; (1961) L.O. Kelso and P. Hetter, *Two-Factor Theory: The Economics of Reality* (1967); L.O. Kelso and P.H. Kelso, *Democracy and Economic Power: Extending the ESOP Revolution through Binary Economics* (1986, 1991). The authoritative and most complete source of writings by Louis Kelso (the originator of binary economics) can be found on the web site of The Kelso Institute: << <http://www.kelsoinstitute.org> >>.

<sup>13</sup> Although neither Louis Kelso nor his two major co-authors, Mortimer J. Adler and Patricia Hetter Kelso were formally educated economists with Ph.D.s in economics; nor were Adam Smith and John Maynard Keynes.

machine saw the worker can saw ten times as many boards in the same time: so working with the machine saw, the worker is said to have become ten times as productive. In other words, working with the machine saw, the worker is said to have ten times the productivity as compared to working with the hand saw. But when sawing each board with the help of the machine saw, the worker is doing much less work. Per unit of production, the labor contribution to the production of sawed boards has decreased. From a binary perspective, the worker is contributing no more than ten percent of the productiveness that was required to work with the hand saw, and the machine saw is doing essentially all of the extra work.

The binary productiveness of capital and labor is more clearly revealed in the work hauling sacks: a person can haul one sack one mile in one hour and is exhausted; (1) with a horse, ten sacks can be hauled four times as far (yielding a forty-fold increase in production) and (2) with a truck, five hundred sacks can be hauled forty times as far (yielding a twenty thousand-fold increase in production). According to the binary perspective, the horse and truck are doing essentially all of the extra work.<sup>14</sup>

**The Six Powers Capital:** Based on its “binary productiveness,” capital has six powers important to production, distribution, and growth. Capital can

- (1) replace labor (by doing what was formerly done by labor);
- (2) vastly supplement the work of labor by doing much more of the kind of work that humans can do;
- (3) do work that labor alone can never do (e.g., people cannot a single board without a saw; elevators lift tons hundreds of feet in seconds; airplanes fly; scientific instruments unleash forces that create computer chips that cannot be made by hand; fruit trees make fruit while all farmers can do is assist in the process);
- (4) work without labor (as in the case of washing machines, automatic bank tellers, gasoline dispensers, vending machines, automated factories, and fruit-

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<sup>14</sup> In this context, it should be noted that the “independent” in “independent productiveness” has a particular meaning. It requires treating labor and capital as *independent variables*. Compared to the conventional economic approach of Adam Smith and J.M. Keynes (that treats capital as a dependent variable and labor as the only independent) productive variable, the binary approach treats capital and labor as independent (i.e., binary) variables. Thus, with the binary approach, the concept of independent productiveness does *not* negate the fact that in many instances both capital and labor are generally needed to complete specific kinds of work, or the fact that labor is needed to conceive of, design, create, operate, maintain, store, and repair capital. But the work of conceiving, designing, creating, operating, maintaining, storing, and repairing capital is not the work of the capital conceived, designed, created, operated, maintained, stored, and repaired. Thus, although it takes a person to lead the horse, the work of leading is not the work of hauling. If instead of leading a horse, the leader led ten people each carrying one sack, who would deny the independent work (productiveness) of each of the ten human haulers merely because someone is leading them? Likewise, although it takes a person to operate the hand saw and machine saw, and no boards would be sawed without the worker, it is also true that no boards could be sawed without a saw, and there is now automated machinery that can saw a great number of boards in a comparatively short period of time with virtually no human input.

- bearing trees);
- (5) pay for itself out of its future earnings (the basic rule of business investment); and
- (6) distribute the income necessary to purchase its output

The first four powers concern what might be considered the “real economy” powers of capital; the latter two are powers that are most clearly revealed in a private property, market economy with a stable credit system protected by a reliable legal system. Each of these powers, when actually reflected in production, contributes to growth (including mere labor replacement, which produces the same physical output, plus leisure), but only the first power directly involves the mere substitution of capital for labor.<sup>15</sup>

Thus according to the binary economic approach, although technology may be seen as making labor more productive and creating more jobs for labor, the far greater impact of technology

- (1) is to make capital much more productive than labor in virtually every task it is employed to perform and
- (2) to create far more and more productive jobs for capital than for labor.

**Productiveness, Distribution, and Growth:** When analyzing how production and productive capacity have grown since the first publication of Smith’s *Wealth of Nations* in 1776, conventional market economics interprets the role of capital as merely facilitative: capital increases human productivity, thereby allowing for a rise in output per unit of labor, higher wages, and the employment of more labor. According to binary economics, however, in contributing to economic growth, capital does much more than increase the productivity of the people who work with it: increasingly capital is doing ever more of the work. ***The economic imperative is generally to produce more with more productive capital and less labor.*** Although capital may be seen to concentrate higher productivity into fewer workers, as the general rule, per unit of output and in the aggregate, the primary effect of technological advance is to make capital more productive than labor and thereby to replace and vastly supplement the productiveness of labor with ever greater capital productiveness.

As a consequence, per unit of production and in the aggregate, capital is doing proportionately ever more of the work. In task after task, and in the aggregate capital’s claim on production is increasing while labor’s claim is decreasing.

Moreover, capital works on both sides of the production-consumption economic equation

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<sup>15</sup> Thus, although some economists and policy advocates use the marginal efficiency theory of neoclassical economics as the foundation for (or the primary component of) a general theory of growth, the capital/labor substitution process is only one component of growth (operating *after* the creation of greatly increased productive capacity); and from the binary perspective, the wealth enhancing contribution of market pricing and resource allocation is severely limited so long as the distribution of capital acquisition remains narrow. (See “Productiveness, Prices, Values, and Efficiency,” below.)

by providing vastly increased

- (1) productive capacity and production, and
- (2) capacity to distribute income and leisure.

According to binary economists, in a private property, market economy, it is the capacity of capital both to do much more work and to distribute much more income and leisure that explains how broadening capital ownership promotes greater employment of existing capacity, capital accumulation, and growth. Thus, from a binary perspective, ***growth is primarily the result of increasing capital productiveness and the distribution of its ownership rather than increasing labor productivity.***

**Binary Growth:** Noting that present demand for capital goods is dependent on demand for consumer goods in a future period, binary economists reason that a voluntary pattern of steadily broadening ownership promises more production-based consumer demand in future years and therefore more demand for a fuller employment of existing labor and capital and more capital investment in earlier years. Thus, a broader distribution of capital acquisition, ownership, and income strengthens the promise of capital to pay for itself out of its future earnings, and makes profitable the employment of more (and increasingly more productive) capital. Therefore, binary economists consider the return on capital is not only related to its scarcity, the wage rate (as Smith maintained), and the interest rate (as Keynes added), but also significantly related to the increasing productiveness of capital and the distribution of its ownership. Thus, growth is positively related not only to increased labor productiveness, increased capital investment, and accelerated technological advance, but is also positively related to the distribution of capital acquisition.

The potent *distributive* relationship between capital acquisition and growth is called the principle of binary growth. As a fundamental economic principle, it is unique to binary economics. If valid, the principle binary growth will greatly enhance mainstream understanding of how to economically empower poor and working people and thereby promote greater growth. This principle therefore requires special attention. The question of binary growth will be explored more fully in Part IX below.

It is important, however, to emphasize that the asserted positive relationship between the distribution of capital ownership and growth (i.e., the principle of binary growth) is ***not*** based on the behavioral premise that people will work more productively if they own more or have an ownership stake in their employer. Although most binary economists accept this behavioral premise as true, this behavioral premise (that broader ownership will increase labor productiveness, and therefore cause growth) is neither unique to binary economics nor inconsistent with mainstream economics. Rather, the unique binary premise is that the promise of broader ownership, ***in and of itself***, will cause the fuller employment of existing capacity and greater growth.

Moreover, if valid, the principle of binary growth does not involve the involuntary redistribution of any existing assets in which people have existing property rights. It is the growth-enhancing promise of broader ownership that gives rise to the voluntary transactions that produce the broader ownership and growth.

The principle of binary growth is unique to binary economics. This distribution-based relationship to the rate of return on capital and growth is not revealed by conventional classical and neoclassical analysis that assume that the return on capital is a function of only its scarcity and labor productivity, but not its independent productiveness and the distribution of its ownership. Likewise, Keynesian analysis (which reduces the operation of the economy to time, money and labor) cannot yield a conclusion that growth and the return on capital is an independent function of the productiveness of capital and the distribution of its ownership.

**Productiveness, Prices, Values and Efficiency:** The binary approach to understanding production also offers a new perspective on the impact of the broader distribution on price and value. So long as most people own little or no capital, most consumer goods and services will be worth the work people are willing to do by their labor to acquire them. This is (1) how Adam Smith and John Maynard Keynes saw it, (2) the foundation of price theory and (3) in an economy in which capital ownership is highly concentrated, “empirically” the “value of labor” and the foundation of prices. However, in an economy in which ownership is much more broadly distributed, the value of goods and services is not limited to the work people are willing and able to do by way of their labor, *but also includes the work they are willing and able to let their capital do*. Without a horse, few sacks are “worth hauling” before the hauler becomes exhausted. With a horse, many more sacks are worth hauling; and the economy of sack-hauling will grow as horse (and truck) ownership becomes more broadly distributed. Thus people express value not only by the work they do but also by the work they let their capital do.

Thus, from a binary perspective, (1) the technical relationship used in the theory of marginal productivity that governs conventional understanding of the relative employment of capital and labor in production and (2) the factor income shares derived from production are significantly dependent on the distribution of access to capital acquisition with the earnings of capital. In other words, the willingness of a laborer to work at given wage depends on his competitive opportunity to acquire capital with its earnings and then receive its full net return. (But without access to the same government-supported infrastructure available to well-capitalized people, the opportunity to acquire capital with the earnings of capital and thereby through ownership to produce goods and express value is not open to most people as a practical matter.) From a conventional economic perspective, in terms of its impact on pricing, capital/labor substitution and employment, and factor income shares, the distribution of access to capital ownership is either irrelevant or of only minor consequence.

Competitive market pricing requires (1) no barriers to entry, (2) voluntary (rather than coerced) exchange, and (3) no monopolization of the means of production. Once it is recognized that labor and capital are independent factors of production and that capital is increasingly the more productive factor, then it becomes clear that broad, essentially universal, individual access to capital acquisition is necessary before the presumed theoretical, allocational benefits of efficient pricing can be fully realized.

## **VIII. The Binary Private Property System**

Although binary economics is premised on a unique theory of production, distribution, and growth, it also rests on ancient principles of private property that find expression in the Anglo-American common law and in the writings of John Locke.

**Three Foundational Principles:** The legitimacy of private property is premised on three foundational principles:

- (1) Universal participation,
- (2) Distribution according to production and voluntary exchange, and
- (3) Limitation when required to insure universal participation and distribution according to production and voluntary exchange.

It should be noted that these three principles also express three essential conditions of an efficient market.

**The competitive right to acquire capital with the earnings of capital:** As a matter of property law, a binary economy extends to all people “the binary property right” (i.e., the competitive market right to acquire capital with the earnings of capital). More particularly, the binary property right is the right to acquire capital with non-recourse credit and to repay the cost of acquiring the capital with the pre-tax yield of the capital acquired.

**The Binary Property Right Is a Market Right, Not a Welfare Right:** Strictly speaking, this competitive capital acquisition right is a market right, not a welfare right. It is the right to participate in a voluntary transaction with one or more willing parties.

**Using Institutional Precedents That Work:** Combining the salient principles of (1) the Homestead Acts (intended to broaden land ownership), (2) the employee stock ownership plan (ESOP) technique of corporate finance (intended to broaden capital ownership by employees by using tax exempt, limited liability trusts, as fiduciary agents for employees, to acquire shares of employer stock with non-recourse credit), (3) a market for capital credit insurance (such as that profitably provided for years – until the present economic crisis – by the Federal Housing Administration to broaden home ownership), and (4) a return of the Federal Reserve to its original Congressional mandate under Section 13 of the Federal Reserve Act (intended to broaden access to capital credit) to allow for the discounting of eligible productive private credit, binary economic analysis offers an entirely voluntary means that would enable prime-credit-worthy companies to meet any portion of their capital requirements while simultaneously enabling their employees, customers, neighbors and others to acquire (with non-recourse credit) full-dividend shares of the participating companies which would pay their full return (net of reserves for depreciation, research, and development to maintain the competitive productive capacity of the capital) first to repay the capital acquisition loan obligation and then to provide a capital source of income to supplement wages and welfare benefits.

**A Proposal for Instructional Purposes:** There are many variations of “binary financing” that can be applied to broaden the right acquire capital with the earnings of capital in different contexts. The approach set forth in Figure 1 below is offered for instructional purposes. It

involves the fewest number of changes in the present system of corporate finance to model the prospect of binary growth., Figure 1 sets forth a structural representation of a single binary financing transaction. It also represents the aggregate of all binary transactions within an economy. Figure 1 shows (1) a corporation, (2) an ownership-broadening, constituency trust, (3) a lender, (4) a private capital credit insurer, (5) a government reinsurer, and (6) the central bank. Corporations eligible to participate in binary financing would be prime-credit-worthy companies. In the USA, these eligible companies would generally (though not necessarily) number among the three-thousand or so largest companies. The implementation of this proposed structural alternative for private capital acquisition requires no transactions; but it provides the property rights basis enable market participants voluntarily to price the value of broader ownership distribution.

On the strength of the pledged, anticipated profits of the capital acquired, and market-priced, capital credit loan insurance as a substitute for collateral, the lender loans funds to the trust in return for a promissory note. The trust invests in “full-dividend” common stock of the corporation at fair market value. With the cash received for the issuance of its stock, the company makes the investment and (if all goes according to plan) distribute the income earned on the capital investment to the ownership-broadening trust which uses the funds to repay the loan obligations and then distributes all net earnings to the beneficiaries. Consistent with necessary monetary discipline, the central bank is authorized to discount the trust’s outstanding promissory note at its administrative cost. Based on experience with present bank loan-service charges, insurance charges of the Federal Housing Administration, and the administrative costs Federal Reserve, the cost of borrowing to the constituency trust has been estimated at approximately at less than 5% per year, consisting of (1) 2% bank service charge, (2) 2% for the capital credit insurance and (3) 1/4% for the central banks administrative costs.<sup>16</sup>

Thus, in a binary economy, the logic of corporate finance (which enables corporations to acquire capital before they have earned the money to pay for it, and which enables existing owners to become richer on future corporate earnings even as they sleep) is extended individually on market principles to all people even if they have no savings (or collateral to secure credit) to invest.

The establishment of a binary economy is accomplished as a legal matter entirely through traditional and largely well-settled means: by the revision of a few national laws related to banking, corporations, employment, insurance, and taxation, and by the reliance on traditional corporate, trust, financial, and insurance principles and institutions. According to binary theory, the effect of these revisions is to extend to all people the competitive right to participate in capital acquisition with the earnings of capital on market principles. It is this broadening ownership participation in the right to acquire capital with the earnings of capital that provides the basis for “binary growth,” which is explained more fully in Section IX below.

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<sup>16</sup> Kelso, Louis O., and Patricia Hetter, pp 70-73, 108. (1986). *Democracy and Economic Power: Extending the ESOP Revolution through Binary Economics*. Cambridge, MA: Ballinger Publishing Co.

All these changes may seem substantial, it is important to bear in mind that all of them are presently being employed, along with others to promote economic recovery, but are being implemented in a way that facilitate capital acquisition with the earnings of capital for people primarily in proportion their existing wealth, thereby (1) structuring the distribution of capital acquisition in a way that concentrates future earning capacity for the benefit of people who already earn far more than they will spend on consumption and (2) excluding people with little or no capital income from the process of acquiring it so that the can begin to supplement their already inadequate labor earning capacity. This is no way to increase present confidence in the future distribution of adequate earning capacity. As has been observed in other contexts, when you find yourself in an undesirable hole, it helps to stop digging.

## **IX. Binary Growth**

The logic supporting the binary property/economic paradigm indicates that the voluntary operation of a national binary economy on market principles will provide not only a broader distribution of wealth and income, but also substantially more real growth than would a traditional economy. As previously noted, because demand for capital investment is dependent on demand for consumer goods in a future period, a voluntary pattern of steadily broadening ownership promises more production-based consumer demand in future years and therefore more demand for investment in earlier years. Thus, a broader distribution of capital acquisition, ownership, and income strengthens the promise of capital to pay for itself out of its future earnings, and makes profitable the employment of more (and increasingly more productive) capital.

**Eligible Companies:** The primary, practical application of the principle of binary growth can be understood by considering the three thousand largest or so companies in the USA, and then focusing on a subset comprised of the most credit-worthy companies. At diminishing unit costs, most of these companies can produce much more of the goods and services people dearly need and want; but there is lacking the consumer demand to render more production profitable even at greatly diminishing unit costs.

As previously noted, presently through these corporations, almost all new capital is acquired with the earnings of capital, and much of it is acquired with borrowed money.<sup>17</sup> At the same time, the ownership of this corporate wealth is highly concentrated so that approximately 1% of the people own 50% of the wealth and 10% own 90% of the wealth, leaving 90% people owning little or none.<sup>18</sup> Thus, capital returns its value at a rate reflective of its long-term (suppressed) earning capacity as it buys itself for a small minority of the population. According to binary economics, if the techniques of corporate finance presently used to enable existing

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<sup>17</sup> See note 3, *supra*.

<sup>18</sup> Edward N. Wolff, *Top Heavy: A Study of Increasing Inequality in America* (New York, Twentieth Century Fund, 1995) and Edward N. Wolff, "How the Pie is Sliced: America's Growing Concentration of Wealth," *The American Prospect*, No. 22, (Summer 1995), pp. 58-64.

owners to acquire capital with the earnings of capital were opened competitively to all people then, the present demand for capital investment and employment would increase in anticipation of the broadening distribution of capital income to poor and working people with unsatisfied needs and wants.

**Projecting Ownership-Distribution-Based Demand:** Figure 2, set forth below, illustrates the distributive, growth-sustaining feature of an ownership-broadening binary economy. For simplicity, Figure 2 assumes a seven-year cost recovery period for capital investment, and it shows the number of years of annual acquisitions that will have paid for themselves over time. Figure 2 assumes that in every year after the implementation of the binary economy, some number,  $N$ , of an economy's largest prime credit-worthy companies have profitably utilized binary financing to acquire in the aggregate some percentage,  $X$ , of their capital investments. Figure 2 also assumes that the capital credit insurance is properly priced to pay for those financings that fail to repay the acquisition loans so that  $N$  and  $X$  are net of those failures. Figure 2 also assumes for simplicity, as a first iteration, that  $N$ ,  $X$ , and the rate of return on capital remain constant throughout the period.

Although beginning slowly, the broadening distribution of capital ownership and income will increase steadily and thereby provide the basis for binary growth. Each year after the initial cost recovery period of the most productive capital, more binary capital will have paid for itself and will be distributing capital income to poor and working people. Consistent with the conservative assumption of a seven-year capital cost recovery period, Figure 2 shows the steady growth in annual capital acquisitions. In the eighth year, the first annual acquisition of capital will have paid for itself and will begin paying its full return to the new binary owners. In the ninth year, the second annual capital acquisition will be fully paid for and will therefore begin paying its full return to the new binary owners. In fourteen years, 50% of the annual capital acquisitions will have paid for themselves, and will have begun paying their full annual return to the new binary owners. In the 28th year, 75% of the acquisitions will have paid for themselves; and so on. In the long run, the linkage between supply (in the form of the incremental productive power of capital) and demand (resulting from the widespread market distribution of capital income to consumers) approaches 100%. The more binary financing that is undertaken, the greater the distributional growth effects.

**Maintaining Market Share in a Growing Economy:** To maintain market share in the projected growing economy, producers will have to increase production and productive capacity (more fully utilize existing capacity and acquire more capacity) *before* binary income begins to be distributed to its new owners. Because present demand for capital goods is positively affected by anticipated future demand for consumer goods, the broader pattern of capital acquisition and resultant broader distribution of capital income should be reflected in increased capital spending within the time frame required to acquire and employ the added capital necessary to increase production to satisfy the additional anticipated consumer demand. Thus, for example, with a capital cost recovery period of seven years, and a capital planning investment horizon of five years, market incentives for increased capital spending by producers of consumer goods and services might materialize in the third year. Furthermore, market incentives for increased capital spending and labor employment by producers of producer goods and services might

materialize in the first year.

Moreover, for additional reasons, the growth process might start as early as the first year. First, to the extent that the return on the equity represented by the binary shares exceeds the debt-servicing requirements, income will be available for payment to the binary beneficiaries before completion of the capital recovery. Second, to the extent that consumers feel wealthier by reason of their capital ownership, their marginal savings and consumption rates will shift towards more consumption even before they begin to receive binary income. Furthermore, the terms of the loan agreements may provide for increasing partial dividend payments directly to the beneficial owners as specified percentages of the loans - and shares - become fully paid.

**Demand and Supply In a Binary Time Frame:** The logic supporting binary growth is best understood within a "binary time frame"--the time expected for well-managed capital to pay for its acquisition costs (a period usually no longer than seven years) and then to begin earning a net income for its owners. This is a time period in which capital investment is variable rather than fixed. Thus, within the context of perhaps a seven to fourteen years, if members of the poor and middle classes are enabled to compete with existing owners for the acquisition of corporate stock representing the capital requirements of companies worthy of prime credit, they would bring to the bargaining table a chip not possessed by existing owners: a pent up appetite for the necessities and simple luxuries of life that the rich have long enjoyed from capital income. After the acquisition debt obligations have been satisfied, the earnings of capital acquired by members of the poor and middle class, if fully paid to them, will create more production-based consumer demand than if that capital had been acquired by the rich. If acquired by the rich, most of the capital earnings would seek investment opportunities but in the context of weaker consumer demand.

**Broader Ownership Reduces Systemic Risk:** The growing capital-based consumer demand generated by binary financing over a binary time frame will make more capital investment credit-worthy and profitable. The growing capital-based consumer income will also make investment less risky, and therefore more insurable, less expensive, and more profitable. Over the same period of time, in a traditional economy, with relatively less capital-based consumer demand, capital investment will be riskier, and therefore more expensive, and less capital investment will be credit-worthy and profitable.

**Some additional affects of broader capital acquisition.**

1. As capital income is more broadly distributed to welfare dependent people, government transfer payments can be reduced, and corporations whose shares provide that income can be given a tax deduction.
2. As capital income is more broadly distributed to taxpayers, they will pay more in taxes thereby increasing government revenues and providing a basis for tax deductions for corporations whose shares provide that income and/or general tax rate reductions

3. As poor and working people are provided a more competitive means of acquiring the least risky, most insurable capital acquisition, well-capitalized people will have incentive to move further out on the investment risk curve, thereby providing more financial capital for entrepreneurial activities, the development of new technologies, start-up companies, and smaller companies,
4. With a broadening distribution of capital ownership and income so that the supply generated by technological change and increased investment will be increasing balanced by a corresponding increase in demand, the amplitude of the booms and busts of business cycles will be reduced.

**Growth and Broader Distribution Without Redistribution:** From a binary perspective, the incremental binary consumer income is neither inflationary nor *redistributionary*. It exists only as a result of voluntary transactions and only if the underlying capital has earned income sufficient first to return its acquisition cost and then to pay net income to its owners. Any incremental consumer income generated in a binary economy is balanced by the antecedent incremental production of goods and services of equal value.

By financing the ownership of productive capacity for people with substantial unsatisfied needs and wants (essentially most people who presently earn little or no current consumer income from capital ownership), participating companies may satisfy their projected credit-worthy capital requirements while simultaneously encapitalizing their employees consumers, neighbors, and others, thereby establishing a long-run self sustaining basis for growth. This is a growth that does not require anyone to work harder or smarter. It is not caused by an increase in capital investment, advancing technology, or any other traditional basis for growth. It is not the result of a *redistribution*, because it only materializes from the broader pattern of capital acquisition generated by the voluntary operation of the binary economy that enable all people to acquire capital with the earnings of capital.

Thus, although the reforms indicated by binary theory may be criticized as an unwise intervention in the market, the binary approach may be more fairly viewed as an opening of the capital markets to all people; and a strong case can be made that a binary economy will operate more openly and efficiently on market principles than any existing economy.

## **X. The Ownership-Broadening Interest of Major Publicly-Traded Corporations and the Fiduciary Duties of their Directors and Officers**

The foregoing principles of binary economics can be understood to reveal an important aspect of the interests of major publicly traded corporations and the duties of their directors and officers.

To the extent that such corporations have unutilized productive capacity to produce more of what they are presently producing at lower unit costs if only there were increased demand for that production, then they have an untapped earning capacity that could be realized and a suppressed rate of return on investment that could be increased if the earning capacity of their potential customers

could be increased. Substantial unutilized productive capacity (“UPC”) is precisely the condition faced by many major corporations in the current economic crisis.

Mainstream economic analysis generally employs a narrow and frequently documented “static” approach to UPC that focuses primarily on existing assets and available labor at a given wage. The presently unemployed portion of each existing or available factor is the “static UPC” for that factor. In considering the question of UPC, however, a corporate fiduciary cannot think merely in terms of existing capital and available labor. A definition of unutilized capacity which looks only to existing assets and available labor is a limited conception that ignores the competitive and wealth-enhancing implications of advancing technology, major capital investment, changes in skills, preferences, and environmental factors and a broader pattern of capital acquisition over time. This broader time frame—in which technology, major capital investment, skills, preferences, environmental factors and ownership distribution are variable—is an essential foundation for much of the corporate planning required of corporate fiduciaries.<sup>19</sup>

Thus, from the perspective of corporations and corporate fiduciaries, a central question is: What business strategy should be pursued to most profitably acquire, employ, and dispose of corporate assets over time? With respect to those assets, if any substantial amount of unutilized productive capacity exists and could be profitably employed, corporate profits and shareholder wealth would increase accordingly.

Binary analysis offers an entirely voluntary means that enables major credit-worthy corporations to meet any portion of their capital requirements while simultaneously increasing their pool of potential empowering their employees, customers, neighbors and others to acquire shares in participating corporations with non-recourse credit, and pay for those shares with the earnings of the capital acquired. In other words, once the relationship between broadening the right to acquire capital with the earnings of capital and enhanced markets for corporate production is recognized, corporations will also recognize a natural wealth-enhancing incentive to broaden their ownership.<sup>20</sup>

Admittedly, no one corporation could expect its newly encapitalized shareholders to spend all of the their increased capital earnings on its products. There is, in other words, a “collective action problem” in the incentives to broaden ownership. If, for example, Coca Cola, Ford, A.T.& T, Toshiba and others encapitalize people, those people may spend their earnings on products of Pepsi,. General Motors, Verizon, Apple, or still others. But so is there a collective interest of all such American corporations to increase the earning capacity of all potential customers especially in circumstances like the present economic crisis. Thus, if all such companies begin to participate

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<sup>19</sup> Paramount Commc’ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

<sup>20</sup> Robert Ashford, *Binary Economics, Fiduciary Duties and Corporate Social Responsibility: Comprehending Corporate Wealth Maximization and Distribution for Stockholders, Stakeholders, and Society*, 76 TUL. L. REV. 1531 (2002), and Robert Ashford “Memo On Binary Economics to Attorneys for People of Color and Women Re: What *Else* Can Public Corporations Do For Your Clients?,” 79 *St. John’s Law Review* 1221 (2005)

in a national program of broadening the capital acquisition with the earnings of capital, the collective action problem may be dwarfed by the benefit of increased confidence in the structural promise of widespread increased capital-based earning capacity. In a crisis where the CEOs of major auto makers come together before Congress to collectively ask for government assistance, there is no reason that this collective action problem could not be substantially overcome.<sup>21</sup>

Of course, even if corporate officers and directors determine that it is in the interest of their corporations to broaden their ownership, as with any extraordinary transaction, shareholder approval will usually be necessary and may sometimes be withheld. Shareholders, including many institutional shareholders that represent the holdings of public and private employees, unions, religious and charitable foundations and others with both economic and social interests in the economy, will have to evaluate their interests and responsibility. Whatever such shareholders, decide, their analysis will be enriched and their true interests better served with the benefit of the binary economic perspective.

## **XI. Duties of Public Officials**

Just as the binary perspective may affect the discharge of important fiduciary duties of directors, officers, and institutional shareholders of major corporations, so may it affect the duties of government officials responsible for formulating the government's strategies for promoting economic recovery. Although the right to acquire property was of central importance to the founders of our nation for reasons pertaining to the conditions necessary for a functioning democracy and a free and prosperous economy,<sup>22</sup> the political discourse to date has revealed no awareness of the importance of the right to acquire capital with the earnings of capital to

- (1) the economic plight of poor and working people,
- (2) the current economic crises,
- (3) the road to economic recovery, and
- (4) the economic foundation for sustainable economic growth.

Hopefully this article will encourage advocates for the poor to carry its message to elected and administrative officials who profess to champion the interests of the poor. Clearly any substantial benefits to private corporations can be conditioned on economically prudent ways of extending to

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<sup>21</sup> Some aspects of this collective action problem can be minimized.

Encapitalization of consumers can be in direct proportion to the consumers patronage of the particular producer. Moreover, to the extent that welfare recipients are encapitalized and thereafter receive somewhat reduced welfare payments, and to the extent that other individuals pay higher individual taxes, some measure of tax reduction to the corporations whose shares produce the new owners' incomes can be legislated.

<sup>22</sup> Geoff Korff, "Reviving the Forgotten American Dream," 113 *Penn State Law Review* 417 (2008) forthcoming.

poor and middle class people participation in capital acquisition with the earnings of capital.<sup>23</sup>

## **XII. Conclusion: Using the Binary Economic Approach to Better Understand the Cause of the Current Economic Crisis and Promote Economic Recovery**

In an economy characterized by advancing technology in which it is increasingly possible to produce much more with increasingly more productive capital and ever less labor, the binary approach is important as a means of explaining in way more helpful than analysis based on the conventional wisdom how it is that phenomena like the following continue:

1. most people remain poor, no matter how hard, how long, and how many jobs they work, no matter how much help they are given by way of skill training and education, and no matter how much other conventional social support they are given;
2. most middle class people are finding themselves deeper in debt and increasingly hard pressed (with multiple jobs) to maintain a middle-class life style;
3. every generation of student graduates deeper in debt;
4. consumer debt is ever rising;
5. personal savings and home equity are dwindling;
6. home foreclosures are mounting;
7. in the boom times that preceded the present bust, only the top strata of wealth owners grew wealthier;
8. speculation in economic bubbles abound;
9. jobs are exported;
10. banks are afraid to lend; and
11. there is an eroding lack of confidence that there will be sufficient future earning capacity to produce a sustainable economic recovery.

The binary economic approach also can be understood to reveal an important connection among

1. a major cause of poverty (inadequate earning capacity);
2. the spread of inadequate earning capacity upward through the economic strata;
3. the credit freeze;
4. major business failures and the prospect of more, despite increasing productive capacity;
5. the inability to profitably employ substantial and growing unutilized productive capacity (including the unused capacity to create more capacity);
6. the current economic crisis; and
7. the concentration of the right acquire capital the earnings of capital which could be remedied merely by opening to all people the very business and markets institutions and government facilitation that enable primarily well-capitalized people to acquire capital with the earnings of capital.

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<sup>23</sup> There is precedent for this in an earlier era when federal loans to Chrysler Corporation were conditioned on the establishment of an Employee Stock Ownership Plan.

With an understanding of the foregoing, the binary approach can also assist advocates for poor and working people, along with representatives of business and government concerned about reviving the economy to take a fresh look at the economic theories that shape their analysis. With the apparent problems caused by the political climate of deregulation, lax enforcement, perverse incentives and unwarranted, excessive faith in the self-regulating discipline of the market that prevailed under the G.W. Bush Administration, there is an apparent, renewed respect for the positive role the government can play in restoring, shaping, and enhancing the wealth-creating power of the private-property, capitalist system. In terms of economic theory, the shift in political orientation represents a turning away from the laissez faire approach that is roundly embraced by most politicians “on the right” and a turn toward the more pro-active government approach of Keynesian economic which is embraced by most politicians “on the left.”

In important respects, compared to the classical and neoclassical, approaches, the Keynesian approach will better serve the interests of poor and working people because it recognizes the persistent problem of unutilized capacity and a persistent shortfall in the “effect demand” distributed by the market (as it is presently structured). The Keynesian analysis also acknowledges the distribution of income and wealth matters not only normatively but positively. Based on their approach, government strategies to boost consumption and government spending is a part of the solution rather than a part of the problem. However, the Keynesian approach fails to attach sufficient importance to the necessary conditions for sustainable economic recovery and growth that derive the broadening distribution of capital acquisition with the earnings of capital..

As previously noted, based on the re-emergence of Keynesian strategies, apparent even in the waning days of the G.W. Bush Administration and championed by the new Obama Administration, the strategies that are now central to the Government’s efforts to revive the economy include:

1. government purchase of toxic mortgages,
2. government investment in banks,
3. government loans and/or loan guarantees to private industry,
4. government insurance and/or reinsurance programs,
5. a lowering of interest rates and taxes,
6. increasing the money supply through monetization, and
7. a major increase in public spending.

Based on Keynesian economic analysis, these proposals may help to “jump-start” and they may succeed in providing some short and immediate relief to poor and working people by way of reduced taxes, increased access to credit, job creation and increased public spending, but they provide little comfort by way of a structural change in the long-term market distribution of earning capacity. The proposed solutions will not reverse the fundamental cause that led to the current economic crisis because it will continue to exclude poor and working people from participation in the government supported system of corporate finance whereby capital is acquired with the earnings of capital primarily for well-capitalized people.

With advancing technology and increasing capital investment, and the resultant shift from more labor-intensive production to more capital-intensive production, the erosion in the labor earning

capacity of poor and working people cannot be fully restored by higher wages and more welfare. Such an approach may boost production and the earning capacity of some, and even for many, for the short and intermediate term; but in the long run, it will not unleash the full potential of profitable employment of capital that results from broadly distributing its earning capacity.

Binary economics teaches that as technology continually shifts production from the work of labor to the work of capital – as production becomes increasingly capital intensive – the way in which each person participates in production must also shift from labor intensive to capital intensive. This shift can naturally voluntarily occur if the highly government supported system of corporate finance is opened to include all people individually so as respect and facilitate for all people individually, the right to acquire capital with the earnings of capital.

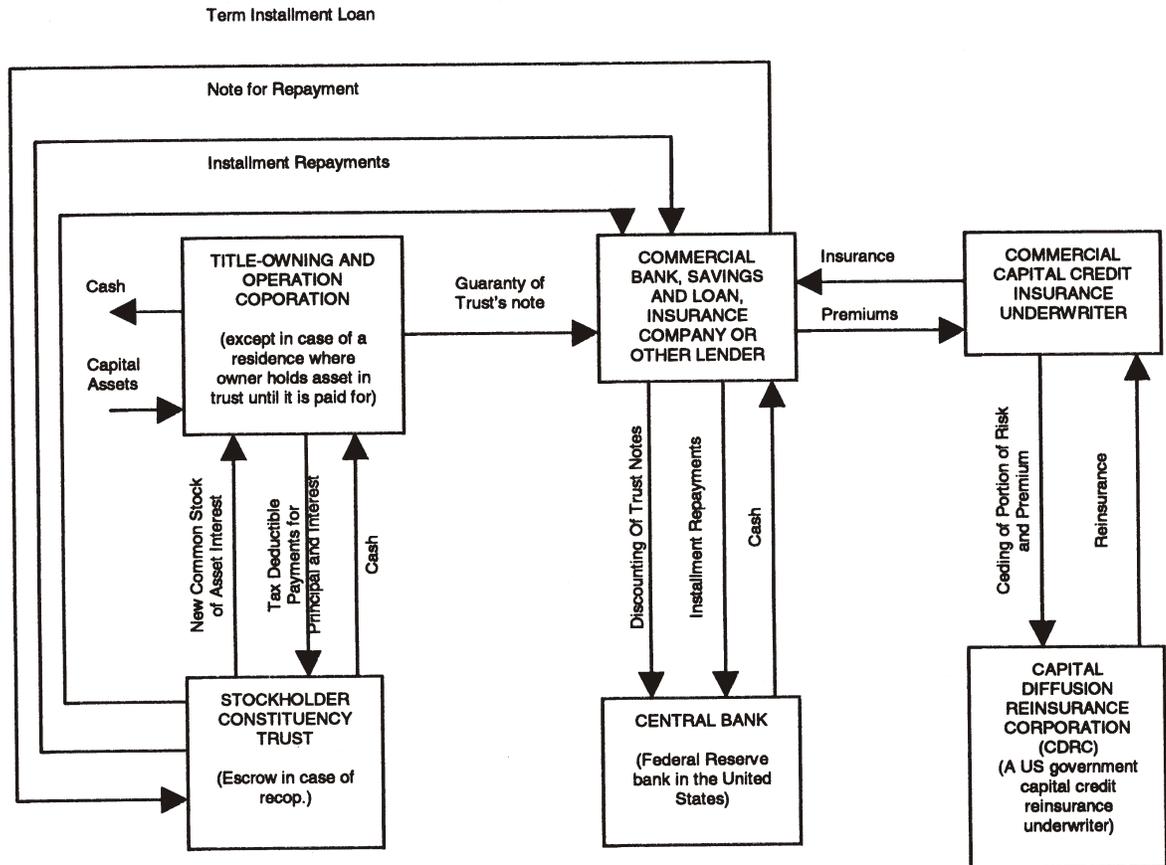
If this shift does not occur, as capital does ever more of the work and labor's claim on total production therefore decreases, people dependant wholly on their labor for earnings will experience a decline in their earning capacity compared to what can be produced by the combination of increasingly productive capital and labor . They will thereby suffer an increasing impoverishment in the future as they have in the past no matter how hard, how long and how may jobs they work. The increasing concentration of capital acquisition with the earnings of capital will increasingly result in a failure to distribute capital-earned demand necessary to purchase what could, with broadening capital acquisition, be profitably produced.

Conversely, with the binary reforms any and all of the foregoing programs can proceed with enhanced prospects of success, if only the simple steps proposed above were taken to universalize the right to acquire capital with the earnings of capital so that:

- (1) our nation's productive capabilities be fully and voluntarily employed in system of more equal capital acquisition rights,
- (2) poor and working people can begin to enjoy the full benefits (not just the labor and welfare benefits, but also the capital benefits) of the industrial revolution,
- (3) a sound, structural, market foundation for hastened and sustainable economic recovery can be established, and
- (4) markets can structured to increasingly provide a fuller and more productive means of employing labor and capital to produce and distribute more economic prosperity for all.

It is my hope that lawyers and other advocates for poor and working people study, learn, master, teach, and advocate the principles and reforms set forth in this article.

Figure 1  
General Theory Diagram



Source: Kelso & Kelso (1989). Reproduced with permission

Figure 2  
Linking Supply With Demand Through Broadening Ownership

