Part 3: Evaluating some real world systemic solutions from the personalist perspective

Chapter 9 Capital companies as legal persons

9.1 Preliminary remarks

In the real world, in which social and economic relations are regulated by the law made by people in power, next to the real, natural subject, which is a human being, there appeared at a certain stage of the development of civilization a fictitious legal entity in the form of a legal person. Such a "person" can come into being when the circumstances provided for by the applicable law are present and the conditions required for its creation are met. Without going into the essence, nature and types of legal persons functioning in the world, let us consider here the consequences of the fact that in addition to natural persons, we are dealing with legal persons, which are granted by law the same rights as people in many areas of socio-economic life. In particular, legal persons have in the real world legal capacity and the ability to perform legal acts, as well as - the most important from our point of view - the right to incur obligations. Let us consider, then, what consequences will result in our model by abrogating the basic assumption of personalist economics, that the only person who can be the subject of rights and obligations is the human person, and introducing collective entities to which the law grants legal personality. For a start, let these be enterprises operating in the legal form of a capital company. We do not change the other assumptions of the model for the time being. Thus, we are still dealing with the model analyzed in the previous chapter, that is, the model of a "stateless state" in which all economic transactions are settled according to the rules of the credit money system.

As we recall, the previous principles of the credit money system guaranteed that as long as even one participant in the system had a positive balance in his settlement account, other accounts (at least one) had to have a negative balance of the same value. This meant that all entitlements to receive in the market the equivalent in goods of a given monetary value, which resulted from having a positive balance, had to be covered by obligations to deliver goods of such value by those who had negative balances[1]. The established limits on debts in the clearing account, combined with the principle of unlimited succession of both assets and liabilities, meant that no market participant

[1] This is essentially Say's law of markets, according to which "products are paid for by products" (Blaug 2000, p.161), except that with the relationship reversed. According to Say, it is supply that creates corresponding demand. In fact, however, as shown in Section 7.12, the opposite is true: it is demand that generates the corresponding supply. This is because no one comes to the market with a supply of anything if he has no intention of buying anything there The fact that expenditures were made to produce a particular good, which are a source of income for the suppliers of the goods and services needed for that good, has no relation to the demand for either that good or any other one. The example of the blacksmith, given in the previous chapter, who did not manage to sell a single horseshoe, may serve as a proof.

could suffer a loss as a result of imprudent or fraudulent behavior by other market participants[2].

The second effect of the principle that only individuals have the right to incur debt in the clearing account has hitherto been that the beginning of the next production cycle in any enterprise was possible in the model only if the income from the sale of goods from the previous cycle was at least sufficient to cover the costs of producing goods in the next cycle. Otherwise, the enterprise's account would have to run out of funds to finance the costs of further production. Thus, if the entrepreneur wanted to continue his business in such a case, he had three possibilities to choose from:

- to cease production and wait until he had “cashed in” his inventory and then resume production,

- to subsidize his company from his personal account and continue production,

- to subsidize his business from his personal account and switch to the production of something else.

This applied both to individual ownership of the company and to any form of group ownership. It should be added here, however, that the endowment (recapitalization) of the company by the owner(s) was only possible in the model if he or she had sufficient funds in his or her personal account, including the unused debt limit in that account. Otherwise, no endowment was possible.

Thanks to such a principle of operation of the model, no outsider can suffer losses due to an unsuccessful investment of the entrepreneur. But also the business owner himself in such a case is not in the worst situation, because at the moment of depletion of funds on his company's account he still has all the company's assets, including unsold products.

It can be seen, therefore, that in a model world in which only people may be debtors there is no problem with reciprocity, as this is guaranteed by the settlement system and debt limits applied. In the worst case scenario, when someone evades such obligations, he loses the opportunity to make purchases, i.e. ceases to be a market participant, and when he does not manage to settle his obligations during his lifetime, the legal system transfers them to his heirs. Therefore, when someone fails to sell his goods or services, in order to compensate for the negative balance in his account, he must either change his offer or give up using the market and switch to a second way of acquiring goods, i.e., self-sufficiency.

[2] We are, of course, talking about the effects of buying and selling goods that are settled according to the rules of the system. The credit money system prevents the theft of money, but it cannot prevent the theft or extortion of goods. The latter can only be prosecuted ex post on the basis of other legal titles.

9.2 The essence and purpose of corporations and the consequences of their existence

The introduced modification of the model does not change anything in the very essence of the enterprise. It is still just an appropriately organized set of assets separated from the owners' property appearing under some firm, and intended for conducting business activity. It is worth adding that such or similar definition can be found in every real contemporary economy. Therefore, the conclusions we will come to here will also apply to any enterprise functioning in the real world.

According to the above definition, every enterprise belongs to the world of goods and is a tool, only that after modification of our model, its formal owner, similarly as in any real national economy, can now be both a natural person and a legal person. The difference between the two formal owners is only that a natural person, as the actual owner, has consciousness and will and thus has the ability to make decisions, whereas a corporation has neither of these human qualities. As a fictitious legal entity, a corporation can only act through people. Thus, if anywhere there is a statement that a company or partnership does this or that, it only means that under the name of the corporation there is a person or a group of people making decisions on behalf of those who created the corporation and provided it with the capital necessary to act. It is the founders of the corporation who are the real owners of everything that belongs to the corporation, so they are also the owners of the enterprise formally managed by the authorities of the corporation.

When establishing a capital company, the founders take up shares in it in proportion to the value of cash and in-kind contributions made to the capital of such company. In this way the company's initial capital is created, which constitutes the source of financing of its assets. In a formal sense it is a source connected with the company, but in reality this capital is derived from the shareholders' income.

By gaining legal personality, the company also gains the right to incur liabilities. Under the original principles of the model, when there were no funds on the account of the company, its owner - individual or collective - had to either stop its activity or capitalize the company by transferring additional funds from the personal account(s) to the account of the company. Once legal persons with all their powers are included in the model, this need no longer exists, since a company - just like an individual - can incur obligations on its account within the limits granted[3]. In this respect, the company becomes independent of its shareholders. Moreover, the shareholders lose direct influence on the current activities of the company and related decisions, and these competences are taken over by the board of directors - a collective body appointed either directly by the shareholders or, more often, by another collective body such as the supervisory board appointed by the shareholders through voting at the general meeting. The only way to influence the company's management is to vote on resolutions adopted

[3] The amount of such indebtedness in the case of a company could, for example, depend on the value of its equity or assets.

at the general meeting, but the strength of this influence also depends on the number of votes held on account of the contributed capital. This has multiple consequences, which will be discussed later in this work.

The introduction to our model of capital companies as business entities running their enterprises results in a certain number of fictitious persons appearing next to the real existing natural persons, and each of these so-called persons appears on the market both as a buyer and a seller. As purchasers, enterprises belonging to capital companies buy goods and services, including services of employees, needed for production of commodities or for rendering services. As sellers, enterprises offer their own goods and services on the market.

The modification does not, of course, change the rules of settlement of concluded transactions. As before, when the transaction is completed, the amount established in the contract is debited to the account of the buyer and credited to the account of the seller so that the sum of positive balances on all accounts should be equal to the sum of negative balances. Therefore, it seems that despite the modification of the model, there is still no threat to reciprocity.

This would be the case if it were not for the fact that, unlike natural persons, companies have no heirs. The main reason why legal person was introduced into the real economy was precisely to limit the liability of shareholders for the debts of their company to the amount of the contributed capital. This applies to limited liability companies as well as joint stock companies and their various hybrids. By providing for unlimited participation in profits and limiting participation in losses, the intention was to encourage owners of savings to convert them into capital necessary for increasing the scale of economic activity. Thanks to this legal construction, when such a “person” goes into liquidation, only the assets it has left can be used to settle its debts, on the obvious condition that these assets are sold in their entirety and that the proceeds from the sale are sufficient to offset its debts. And this is where the real danger of breaking the fundamental principle of reciprocity of market exchange arises.

To demonstrate this, let's assume that a number of companies operating in a model economy do not achieve sales revenue at a level that ensures financing of the next production cycle. Nevertheless, their boards of directors, formally independent of shareholders in matters of day-to-day management, do not stop production, but finance further expenditures from debits on company accounts, counting on an imminent increase in demand. Let us further assume that, contrary to expectations, the situation does not improve and it comes to the point where the debit balance on the accounts of each of these companies reaches an acceptable limit, which can no longer be exceeded, and the shareholders do not want to recapitalize them. As a result, these companies must be liquidated.

Each company obviously has some tangible assets financed partly by equity and partly by the only type of liability in our model, which is the debit on the account. This debit, let's recall, can only be compensated by income from the sale of goods or services.

Assuming further that there is no legal basis for proving to management boards that they are acting to the detriment of companies, their liquidation will only result in their formal deletion from the relevant corporate register, i.e. the disappearance of these “persons” from the market.

However, before this happens, the liquidator must sell the tangible assets of the liquidated companies, i.e. fixed assets, stocks of goods overdue in the warehouses of the liquidated companies, stocks of raw materials and production in progress. If these assets can be sold for a total amount not less than the value of the negative balance on the accounts of these companies (let us remind that this is the only type of liabilities in our model) plus liquidation costs, then the debit on the accounts will disappear and there will be no problem. Worse, if the proceeds from the liquidation sale are not enough to offset the existing debits. In that case, the outstanding debit amounts will remain in the system forever, but will only exist as a positive net balance of all existing settlement accounts together. The negative balances of the liquidated companies must disappear with them when they are deleted from the register and their accounts are closed. As a consequence, a number of anonymous entities will remain on the “other side” of the model economic system, which have receivables (positive balances on their accounts) entitling them to receive market goods, but there are no entities to deliver them. The sum of these claims therefore represents the value of “empty” claims.

The fact that there is such a positive net balance of all accounts in our credit money system, i.e. these “empty” claims, need not be noticed and may not even influence the economic processes in this model economy in the short run. As explained in section 7.12, it is not the financial situation of individuals that determines the demand for individual goods and services, but there is an inverse dependence: the timing and amount of an individual's spending, i.e., his or her demand, is determined solely by when the need for particular goods arises. Then, and only then, are expenditures made that lead to changes in the financial situation of the person concerned. From this point of view, it is therefore irrelevant that a number of individuals have positive balances on their accounts for which there is no debit balance in the system.

The negative effects of such “empty” claims could only materialize if all participants in our model market who have debit balances settled their obligations by supplying the market with a sufficient amount of their own products, and after reaching zero balance on their accounts withdrew from the market, moving to self-sufficiency. It would then turn out that there are still a number of people with positive balances in their accounts, but “on the other side” there are no people obliged to deliver the products they needed. These are the ones who became “orphans” after the liquidated companies. Their savings, which are positive balances, would turn out to be worth nothing, because they cannot be exchanged for goods.

Such empty claims, of course, do not arise “from nothing”. The perpetrators of such claims are the shareholders of each of the liquidated companies, after which the liabilities were unpaid. Regardless of how much influence they had on the decisions that led to the liquidation of the companies they set up, they received an undue benefit inscribed indirectly in the construction of that legal entity. This undue advantage is the fact that shareholders are not burdened with losses exceeding the value of the company's assets. In such a case, however, these losses are borne by those who have not contributed in any way to the situation, and are not aware of the existence of such a threat and cannot protect themselves from it in any way. Such a solution is therefore intrinsically immoral, even if its consequences are not immediately visible.

Exactly the same effect is brought about by the liquidation of bankrupt capital companies in every real economy in which classical money in any form is used. If the proceeds from the sale of the assets of such a company are not enough to pay off all of its liabilities and these cannot be settled through the assets of the shareholders or other responsible persons, the creditors of such a company suffer losses for which they are not responsible. The only difference is that in the real world we are dealing with specific creditors known by name whose claims have not been satisfied, and not - as in the model - with the claims of anonymous creditors who cannot be identified by name.

The only way to counteract such situations in real economic life is to strictly adhere to the principle that a company that is no longer able to pay its liabilities is immediately declared bankrupt. Otherwise, there is a growing risk that the assets of such a company will not be sufficient to satisfy the legitimate claims of its creditors. Unfortunately, practice shows that this principle is not always respected. As a result, there is an increasing number of cases where the claims of creditors of liquidated companies remain unsatisfied.

9.3 Sources, manifestations and effects of pathology in capital companies

The reasons for state of affairs described above lie both in the pathological behavior of some people in real economic life and in the existing systemic solutions. Pathological are cases of people setting up companies with a premeditated intention of defrauding creditors. Systemic causes, on the other hand, include actions resulting from the so-called “too big to fail” doctrine. In the first case, creditors have no chance of recovering their claims at all, because such a company has no assets, so sometimes the court cannot even declare it bankrupt. In the second case, the condition for recovering a certain part of receivables from a company that has fallen into a debt spiral is usually agreeing to an arrangement that provides for remission of the rest or conversion of receivables into shares.

Conducting business activities in the legal form of capital companies has yet another pathological effect in real economic life. One of them is the creation of business-political links through the fact that politicians are hired in private companies as members of supervisory boards or advisors or “directors for different matters”, which are created only so that there is a formal basis for the payment of high salaries. Delegating such functions to politicians of various levels in companies with a dominant or exclusive shareholding of the state or local governments might be at least considered a way of exercising ownership control, although the number of such functions and the fact that the persons holding them are replaced after each election by a different political option unambiguously indicates that these are party sinecures. On the other hand, employing politicians in such a capacity in private companies can hardly be considered anything other than a way for the main shareholders to secure the so-called “goodwill” and favor of those in power[4]. In today's world it is difficult to find areas of economic life that are not dependent on decisions of public officials.

There is also little in common with normalcy in the real world in the fact that the salaries of CEOs and board members of large corporations are sometimes 500-1000 times greater than the salaries of ordinary employees of such companies, and there are some record holders who exceed these multiples[5]. Such differences can be justified neither by differences in competence nor by differences in responsibility, which are borne by managers of large corporations in the sphere of industry, services or finance.

One can boldly bet diamonds against nuts that such disproportions did not exist even during the formation of the capitalist system, which leftist ideologists consider the darkest period in the history of the market economy. Such disproportions became possible only when the law created under the influence of the etatist ideology began to eliminate market mechanisms. Their place has been taken by regulations that increasingly restrict the freedom of economic activity and the freedom to conclude contracts, while fostering the growth of large corporations and the creation of pathological systems described in the previous paragraph. Such processes take place under the slogan of correcting the alleged market imperfections.

It is worth reminding in this context that when a company is managed by its owner, his income is the net profit. This profit is the residual amount from the deduction from the sales revenues of products by the costs of their manufacture or acquisition and by the costs of selling those products. It is, as shown in Section 7.9, the owner's compensation for his successful actions as a salesperson. If these actions are not effective, there is no profit, so the owner does not earn income from them. For this principle, it does not matter whether the owner of the business is one person or there are more owners (partners).

It looks completely different in any real capital company. There, salaries paid to management board members are the same element of costs as salaries paid to employees. And just like other remunerations, the salaries of members of the management and supervisory boards of companies are paid on an ongoing basis, irrespective of sales results. As a cost item, these remunerations - ceteris paribus –

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[4] The best proof of this is the composition of the supervisory board and the corps of directors of the various divisions of, for example, Nordstream 2, which is currently the most talked about company. It is easy to find hundreds of such examples in every country among the largest private corporations listed on stock exchanges.

[5] For example, in the U.S. in 2017, the spread between CEO pay and median employee pay was as high as 5,800:1 Source: https://www.nytimes.com/interactive/2018/05/25/business/ceo-pay-2017.html accessed July 19, 2018. It is no different in other countries, Poland not excluded.

reduce a net profit, which means that the members of the management bodies thus take a share of the profits that would otherwise be distributed to all shareholders. And given that the members of a corporation's board of directors and its supervisory board are the main shareholders, these individuals derive much more benefit from the co-ownership than the other shareholders, even if one takes into account the fact that they are more involved in the day-to-day management of such a corporation[6].

In extreme cases, when remuneration of the management board is set at a high enough level, and when intangible costs such as fees for brand rights, licenses and patents are managed appropriately, it may turn out that the company does not make a profit at all, or even makes a loss. In that case, of course, ordinary shareholders receive no income at all. To see that such practices are not isolated, it is enough to take a close look at the financial statements of companies that are preparing for their IPO and compare them with what they show in later reports.

To the sphere of pathology in the real world belongs also the creation of complicated and difficult to unravel connections within the so-called capital groups. Due to the fact that a capital company is a legal person possessing full legal capacity, each of such “persons” may establish - independently or together with natural persons or other companies - so-called subsidiary (daughter) companies. Subsidiary companies, in turn, may acquire and dispose of shares in other companies, (“grandchild companies”?), including shares in the parent company. As a result, peculiar arrangements are created, whereby a company formally dominant within a given capital group turns out to be controlled by its “daughter and grandchild companies”. Using the right to acquire shares in other companies, each of such subsidiaries may purchase such a block of shares in its parent company, the acquisition of which does not require the consent of the Financial Supervision Authority. As a result, several such subordinated companies may in fact jointly hold a controlling block of shares in the formally dominant company, taking actual control over it. Thanks to such possibilities, the initiators of many capital groups, which are always concrete natural persons, by conducting complicated operations with financial market instruments connected with issuing subsequent series of shares and with ownership transformations of particular companies being a part of the capital group, are able to extort huge amounts of money both from unaware small market participants and from the financial institutions operating there, which are also corporations with legal personality. If we assume that these institutions are run by experts in management and financial markets, it is rather difficult to believe that they acted in good faith when participating in such financial operations.

That acting according to such a scenario is not an idle fancy is evidenced by a verifiable fact on any stock exchange where penny stocks are traded. It is enough to confront the history of quotations of such companies' shares from the day when their price was the highest until now with the official announcements made to the stock exchange and with

[6] It is obvious that members of the management board perform work for the company, while other shareholders do not. However, as already mentioned above, the amount of remuneration charged for this has nothing to do with the actual involvement in the process of managing the company.

periodical financial reports in order to find dates and ways by which the dominant shareholders took funds out of such companies to the detriment of the others. Let us add that in the great majority of such cases, these ways were legal or on the verge of legality.

Summing up, allowing the creation in the real world of any fictitious legal entity in the private sector, whose creators are not fully responsible for the consequences of their actions, stands in clear contradiction to and thus destroys the principle of reciprocity, which is the foundation of the operation of an economy based on market exchange. Violation of this principle means that a number of people have the legal possibility to derive undue benefits at the expense of others. The latter are usually completely unaware of this. It does not seem to be a particularly difficult task to prove that many pathologies in the activity of contemporary capital companies, as well as many fortunes that have been made in a relatively short period of time, have their source precisely in the possibilities created by the legal construction of these companies and the practice of their operation.

An important caveat should be added at the end of this thread. Well, the subject of consideration in this section - in keeping with its title - has been the sources, manifestations, and effects of pathology in capital companies. By focusing on pathology, I do not claim that all companies in the real world operate according to the mechanisms described here. However, my point is to highlight the fact that such opportunities exist and are used in many places around the world and to eliminate such systemic solutions that enable pathological activities. As long as the legal system creates such opportunities, there will always be someone who will take unfair advantage of them.

9.4 State and local government enterprises

The case of capital companies and enterprises created by the state and local authorities is slightly different than that described in the previous section. In the case of any capital company from the private sector, at the beginning there is always at least one natural person who establishes such a company[7]. However, in the case of state-owned and municipal enterprises, even if the formal owner of the enterprise is a joint-stock company, a limited liability company, or a limited partnership, there is no individual as the founder. In the case of state-owned or municipal companies the founders are legal entities of the public sector, and the founding capital of such companies does not come from contributions made by private persons but from budget funds originating from public levies. Thus the founder of a fictitious legal person such as a state-owned enterprise or a joint stock company or a limited liability company is another fictitious legal person such as a municipality or the state. In this case, therefore, we are dealing

[7] There is a curiosity worth noting in this context. The word "company" implies the existence and cooperation of at least two persons. Thus, the very fact that a company can be legally established by one person is evidence of a particular kind of logic that lies at the heart of the reality created by statutory law.

with a complete and double separation of ownership of the enterprise and the related effects of its operation from any natural persons.

People appear in this case only as representatives or proxies of a legal entity such as the state or the municipality. They first appear as members of a voting body on an application for the establishment of a company and on the authorization of the executive body to implement the application. Then the role of the persons who act in the executive bodies of the state or municipality begins. When they implement the decisions of their constituting bodies, these persons, or their appointed proxies, sign the legal act establishing the undertaking. Finally, the persons appointed in the manner prescribed by law act as members of supervisory and executive bodies of the established state enterprise or public company. In any event, however, they act only as representatives of an abstract legal person such as the state, the municipality or the company and do not bear any personal responsibility for that[8].

This is of fundamental importance because the problem of the economic link between the material situation of those involved in some role in the process of setting up a company and its results disappears completely. Only members of management bodies and possibly employees can be interested in the company's performance, but only if performance bonuses are provided for in the relevant contracts or internal regulations.

Most often, however, the main purpose of creating enterprises by the public sector is not to make profits from their activities, but to achieve goals of a political nature. These include objectives of broadly defined economic policy, but also foreign and defense policy. In this case, the economic calculation becomes less important and often does not count at all. The most frequently used argument for creating enterprises in the public sector or nationalizing existing private enterprises is the strategic interest of the state. In the face of such an argument, any attempt to discuss the advisability of such a solution is doomed to failure.

Leaving aside the slogans and the actual purposes for which such companies are created in the public sector, their existence and operation carry the same dangers as those described above in relation to the private corporations sector. Only the umbrella of protection for financially loss-making activities is stronger. Due to their strategic importance, such companies can generate losses for any length of time without any consequences for both their management and the originators of such companies. These losses are, of course, covered by budget subsidies and thus burden all taxpayers.

[8] Unless they exceed their authority or fail to fulfill the duties of their office.