

# Abolish Human Rentals

## Support Worker Cooperatives

David P. Ellerman

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Welcome to AbolishHumanRentals.org home of the modern abolitionist movement. This site examines the standard employment relationship, the human rental, and shows that it is invalid on inalienable rights grounds. The human rental today manifests itself as the voluntary exchange of personal labor for a salary or wage. A legitimate arrangement requires workplace democracy and worker ownership whenever human labor is involved. This site is an educational resource that seeks to promote public awareness and understanding of the problems associated with human rentals. Inquiry into the legitimacy of human rentals has long been buried by a barrage of propaganda with the complicity of the economic establishment.

Such a fundamental question is notably absent from our education system and ignored by the mass media. These ideas must be revived in public discourse. The theory of inalienable rights is only useful to the extent it is widely known and consistently applied in practice. Inalienable rights are based on the already broadly held principle of the non-transferability of responsibility for one's actions. That principle, taken to its logical conclusion, means the rental of humans have no more legitimacy than their sale. The issue is not one of coercion, willfully choosing to be rented, or the treatment and compensation of workers. Humans cannot choose to be rented for the same reason people cannot choose to sell themselves into slavery or sell their vote, regardless of their consent or how much they are paid. The abolition of human rentals will be no small task given their widespread prevalence and firm entrenchment in the economic system. The modern abolitionist movement must begin by destroying the false perception of legitimacy that human rentals currently maintain.

Inalienable rights arguments pose a lethal threat to the practice of renting humans. At stake is nothing less than the employment system, the labor market,

and the stock market through which ownership of human rental contracts are exchanged. As with slavery, inalienable rights issues cannot be addressed directly by proponents of human rentals without inviting destruction of the system. There are only two possible responses: Silence in the hope that inalienable rights are never widely understood, or vilification and harassment of the advocates in the event they gain traction. The strategy has thus far been successful in diverting attention from a profound idea and its revolutionary implications.

The alternative to human rentals is universal self employment in democratically managed worker owned businesses, or worker cooperatives. Workplace democracy eliminates the alienation of decision making power, and worker ownership means workers appropriate any resulting profits or losses, thus bearing financial responsibility for their actions.

What is a human rental?

Human rentals describes how most people earn a living, they rent themselves in exchange for a salary or wage. The self rental typically describes the state of being employed by a firm. Human rentals involves two key features.

The first aspect is the agreement to follow orders within terms of the rental. For example some standard orders would be: produce this, provide this service, design this, or manage these people. The employee generally concedes authority over how the work is performed and under what conditions. The main issue is the delegation of positive governing control. The employer has the ability to command the worker to perform certain actions: work faster, work harder, produce higher quality parts, etc. Or more commonly today, dump these toxins, deny these medical claims, issue these predatory loans, or manage public relations so we can continue doing these things. The rented person must obey, or risk being fired.

The second aspect of a human rental is the transfer of responsibility for the actions of the person while at work. The most obvious is the transfer of responsibility for any profit or loss that results from the worker's actions. That responsibility is shifted to the owners of the business.

It is important to note that both the alienation of governing control at work and the transfer of responsibility cannot in fact take place. A person can not alienate their authority to a state or firm without a say in the governance, at least if one believes in inalienable rights and democratic theory. At best a

person can choose to cooperate, which the legal system then pretends is an actual alienation of authority and fulfillment of the rental contract. This is precisely what our judicial system does with regard to human rentals today.

The transfer of responsibility for personal actions is clearly inalienable as illustrated by the commission of a crime. The judicial system correctly traces criminal responsibility back to all persons involved. It matters little if a person is “hired” to commit a crime. Being contracted to provide services in a crime does not shift responsibility and get a hired criminal off the hook. However, responsibility cannot be transferred in the positive case either, that of productive labor. In this case the legal system closes its eyes and pretends that the employment contract actually transfers responsibility between parties. It thus allows the transfer of profit resulting from labor to be appropriated by another party not responsible for its creation.

## Quotes

While rare, the description of the standard labor relationship as a human rental is not new. Here’s what a few well known economists have said.

Paul Samuelson in Economics 1976 (10th edition).

One can even say that wages are the rentals paid for the use of a man’s personal services for a day or a week or a year. This may seem a strange use of terms, but on second thought, one recognizes that every agreement to hire labor is for some limited period of time. By outright purchase, you might avoid ever renting any kind of land. But in our society, labor is one of the few productive factors that cannot legally be bought outright. Labor can only be rented, and the wage rate is really a rental. [p. 569]

Here is the image of the relevant part of that page.

Samuelson's Economics, 10th ed., p. 569

Samuelson also points out:

Interestingly enough most of society's economic income cannot be capitalized into private property. Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself: he must rent himself at a wage. [p. 52, his emphasis]

And here is the direct image.

Samuelson's Economics, 10th ed., p. 52

The inability to capitalize labor is not strictly correct. The "marvel" of modern finance is that labor is capitalized whenever businesses are sold for more than their net asset value (for example a publicly traded firm whose market value is greater than its net asset value). The value of a firm in excess of its net asset value represents the capitalized value of the labor of future employees. It is the prearranged theft of the profits of future workers. A similar scheme in the past may have involved trading shares of a slave owning firm, a deceptive way to deprive slaves of their inalienable rights by packaging the transaction as the sale of a firm in a free market. It is an old trick with continued application.

James Mill in Elements of Political Economy 1844.

The labourer, who receives wages, sells his labour for a day, a week, a month,

a year, as the case may be. The manufacturer, who pays these wages, buys the labour, for the day, the year, or whatever period it may be. He is equally well the owner of labour, with the manufacturer who operates with slaves. The only difference is, in the mode of purchasing. The owner of the slave purchases, at once, the whole of the labour, which the man can ever perform: he, who pays wages, purchase only so much of a man's labour as he can perform in a day, or any other stipulated time. Being equally, however, the owner of the labour, so purchased, as the owner of the slave is that of the slave, the produce, which is the result of this labour, combined with his capital, is all equally his own. In the state of society, in which we at present exist, it is in these circumstance that almost all production is effected: the capitalist is the owner of both instruments of production: and the whole of the product is his.

Fischer, Dornbusch, and Schmalensee in Economics 1988.

The commodity that is traded in the labor market is labor services, or hours of labor. The corresponding price is the wage per hour. We can think of the wage per hour as the price at which the firm rents the services of a worker, or the rental rate for labor. We do not have asset prices in the labor market because workers cannot be bought or sold in modern societies; they can only be rented. (In a society with slavery, the asset price would be the price of a slave.) [p. 323]

Fischer, Dornbusch, and Schmalensee included a useful table.

Note that none of them, as well as most academics, can find anything wrong with the rental of humans. As John Kenneth Galbraith said in *The New Industrial State* 1967:

One of the small but rewarding vocations of a free society is the provision of needed conclusions, properly supported by statistics and moral indignation, for those in a position to pay.

A perceptive comment which certainly applies to the economic establishment, and to which volumes of literature attest. Why question something as fundamental as

the validity of human rentals, when the foundation of the entire framework is at stake.

As David Ellerman says

The “beauty” of an institutionalized fraud like the employment contract is that there is no de facto transfer that fulfills the contract. The pseudotransfer of labor (i.e., voluntary co-operation with the employer) has been accepted for centuries by the legal authorities themselves as fulfilling the contract. The “discovery” of the fraud thus requires extensive analysis to see that labor is not de facto transferable after all. And any responsible scholar and respected businessperson—being embedded in the institutions of the employment system—has every incentive not to make that discovery.

The Great Debate

David Ellerman

The Great Debate between Capitalism and Socialism is at last over. The free market and private property have decisively won. Does that mean the “end of ideology” or the “end of history”? Can we rest assured that there are no fundamental structural flaws in the western-style economy? Our legal system is structured to forbid discrimination on the basis of race, but racism persists. Is that the only type of social problem that remains—where the structure is correct in principle but the implementation is flawed?

We shall argue that the current western-style economic system is fundamentally and structurally flawed. The problems are not just in the implementation of sound principles. Moreover, we shall argue that the system is flawed because it violates the principles of the institutions that are usually associated with capitalism. That is, it violates the basic principles of both private property and democracy. From the conventional point of view, this will seem to be a strange position. Isn't capitalism usually identified with private property and democracy? That identification has been based on the Great Capitalism-Socialism

Debate, on assuming that “the alternative” to capitalism is state ownership of businesses and one-party dictatorships. But that debate is over, and accordingly capitalism can now be evaluated in a new light.

Since “capitalism” is so often definitionally identified with a private property market economy, we must give a more precise definition of “capitalism” so that we are not just arguing about definitions. By “capitalism” we mean production organized on the basis of the employer-employee relationship. We shall also use “the employment system” or “employer-employee system” as more accurate but less known names of the system based on the employer-employee relation. The alternative is a private property market economy where everyone is self-employed (individually or jointly) in their workplace. A firm where the managers and workers are jointly working for themselves will be called a “self-employment firm,” a “worker-owned firm” (where “worker” always includes all who work in the business enterprise), or a “democratic firm” in contrast to the conventional “capitalist firm” or “employment firm.” The basis question is this—the employer-employee relation or universal self-employment in the workplace?

We shall have more than one occasion to use a slavery analogy. Consider a private property market economy where the workers were largely privately owned slaves, like the American economy before the Civil War. Suppose the defenders of such a system managed to restrict consideration of an alternative to a system of state businesses with state or socially owned slaves. The “Great Debate” would be between the “Athenian” model of privately owned slaves and the “Spartian” model of publicly owned slaves. The Athenian model would most likely be more efficient. Over the years, it would demonstrate its superior efficiency while the Spartian model might eventually collapse under its own weight. Would the victory of the Athenian model of private slave ownership signal the “end of history”? Would the victory mean that the Athenian model contained no structural flaws, only problems of implementing otherwise correct principles?

The Great Debate of our day has been similar except that the question has been the voluntary private or public hiring (or renting) of workers instead of the private or public ownership of workers. In spite of its political importance, the public-private debate has been conceptually wrong-headed from the beginning. The real question about slavery is not the public or private ownership of slaves but whether the master-slave relationship should be allowed (involuntarily or voluntarily) or should people always be self-owning (which implies that the right of self-determination should be inalienable even with consent). Today, the real question is not about the public or private employment of workers (as it was in the capitalism-socialism debate). The question is: should the hiring or renting of people be allowed at all or should people always be self-employed in their place of work?

Some would say that the universal self-employment system should be presented as a variant of capitalism rather than an alternative. That may be; there is no need to argue only about words. But there are conceptual and historical reasons to use the word “capitalism” exclusively to represent the employer-employee system so long as one is clear, precise, and explicit about that usage. When people are self-employed in their firms, then the suppliers of capital are not hiring the workers. Labor (in the sense of all the people, managers and blue-collar workers, who work in the firm) is hiring capital. Since Labor would then be the “residual claimant” (the party receiving the profits left from the revenues after the costs are covered), it would be odd to call that arrangement a variant of “capital-ism.”

In any case, the reader has been forewarned; “capitalism” herein refers to the use of the employer-employee system. The alternative is a private property market economy based on universal self-employment.

#### Intimations of Structural Flaws

The end of the capitalism/socialism debate also signals the triumph of neo-classical economics over Marxian economics. Neo-classical economics now reigns as a self-contained and virtually unchallenged scientific theory. How could there be any deep-lying structural flaws in the capitalist (employment) system without neo-classical economic theory discovering them? The answer is that basic flaws in the paradigm have always been fairly clear but that neo-classical economics has simply decided not to investigate them.

Take for example the simplest and most fundamental of insights in economics, the mutual gains of voluntary trade between two or more parties. In the absence of externalities that violate the rights of others, economics finds no reason to prohibit a voluntary exchange between knowledgeable and consenting adults. Yet no capitalist economy allows citizens to sell or buy their political votes. Why not? There are certainly willing buyers and willing sellers so there would be mutual gains from a voluntary exchange. It is easy to understand why representatives are not allowed to sell their votes (since it would violate their representative function). But why shouldn't the ultimate primary citizens be allowed to sell their votes?

The prohibition of vote selling is in direct contradiction with the simplest recommendation of economic theory. Is the prohibition just an arcane practice that should be removed in the interests of greater efficiency, or does it hint at some deeper flaw in economic theory? What is the position of economics on this conflict between received theory and the legal system? Does economics give an uncontrived explanation of this prohibition as an “exception” to the

efficiency rule, or does economics recommend that citizens be allowed to sell their votes? The reader is invited to inspect the economics texts of our day to answer the question. We fear the reader will find little or no discussion of vote selling. Economics tends to duck the issue.

Consider the voluntary contract to sell labor by the lifetime. The usual employer-employee contract is a short-term contract to buy and sell labor. The employer is hiring, renting, or employing the employee for some limited time period. But just as one can rent or buy a car or an apartment, why can't we have the same choice with people? Buying a car is essentially buying all the services the car can provide (like rental for the lifetime of the car) instead of buying only a certain segment of services. Applying the same option to workers, there could be a voluntary contract to "buy" a worker in the sense of buying all the services (within the scope of the contract) the worker could provide over his or her working lifetime. That would be a modern civilized form of the old voluntary self-sale or self-enslavement contract. Yet such a contract between knowledgeable and consenting adults is forbidden in all capitalist economies.

Here again, does economic theory give any coherent account of the drastically different treatment of short-term and long-term rental contracts (applied to people)? Why is the long-term contract strictly forbidden when the short-term contract is the foundation of the system? Do economists recommend consistently with free market principles that lifetime labor contracts be allowed [like Nozick 1974 and Philmore 1982], or do they give a coherent and uncontrived explanation of this "exception"? The reader is again invited to consult the economics books of our day, but we fear that economics again ducks the issue.

Or consider the voluntary collective contract for a people to give up and transfer their right to govern themselves to an emperor or autocrat. In the employment contract, the employees give up and transfer their right to manage their activities within the scope of their employment to the employer or "master" (the original legal name was "master-servant relation"). Why not allow the same sort of collective contract in the political sphere? Indeed the postulation of such a *pactum subjectionis* (pact of subjugation) was the traditional sophisticated justification offered for nondemocratic governments [e.g., Thomas Hobbes].

In the western political democracies, the right of political self-government is considered to be inalienable (cannot be alienated even with consent) and is vouchsafed in the political constitutions. If the analogous right was considered inalienable in the workplace, then it would imply the adoption of the system of universal self-employment. Collective self-employment in the firm is the economic analogue of political self-government or democracy. Yet the same societies consider it quite routine for the citizen-as-worker to alienate

that right in the workplace (the employer is not the representative or delegate of the employees). Does economics give any coherent and uncontrived explanation of how society can be partitioned into “spheres” [e.g., the political sphere and the economic sphere] so the right to self-determination is inalienable in one sphere while being routinely alienated in another sphere? Or does economics consistently advocate that citizens be allowed the same latitude in “collective bargaining” as workers? The reader is again invited to consult the texts of our day to see whether or not economics avoids the issue.

Or consider the position of economics on the distinction between persons and things. Economics recognizes no theoretically relevant distinction between the actions of persons (namely, “labor”) and the services of things such as capital goods and natural resources. Microeconomic models routinely do not even recognize the distinction in their notation [e.g., in a production function notation  $y = f(x_1, \dots, x_n)$ ]; much less in the substance of the models. The services of humans and the services of things are both causally efficacious; both have a “marginal productivity” in the sense that production would decrease if the services were withdrawn. Thus contemporary economics has dismissed as misguided the earlier theoreticians who reserved a special place for the actions of persons [e.g., in “the labor theory”].

Yet it is quite simple to differentiate human actions from the services of things. Look at a court of law. The “tools” used in a crime are of course causally efficacious. They have a “productivity”; otherwise there would be no reason to use them in the commission of crimes. But the responsibility for the crime is traced back through the tools to the human being who used them to commit the crime. Only humans can be eligible for responsibility; not things. The court of law attempts to insure that the legal responsibility for a crime is imputed to the correct people, to the people who were de facto responsible for the crime. No liability attaches to the tools, regardless of their productivity. The people who commit crimes are to be made liable for the negative fruits of their labor. This principle at the root of juridical imputation is also at the root of private property. People should also have the rights to the positive fruits of their labor. In this form, the principle is called the “labor theory of property” and it is associated with John Locke, not Karl Marx.

The “labor theory” is a standard topic in the history of economic thought, and the question of “imputation” is part of the subject matter in the economic theory of the firm. Yet the reader is invited to scan the entire corpus of contemporary economics texts to find one which even mentions the basic legal distinction between the actions of persons and the services of things—which even mentions that only persons, never things, can be responsible for anything. Responsibility seems to be the R-word which cannot be uttered (except perhaps metaphorically). We have considered a number of areas where conventional

economics is directly at odds with the legal structure of the western democracies. Modern legal systems

- prohibit vote-selling by citizens,
- prohibit voluntary self-sale contracts between adults,
- take basic political rights of self-determination to be inalienable,
- would not recognize any political pactum subjectionis, and
- impute responsibility only to persons (never to things regardless of their “productivity”).

All these practices are in direct conflict with the most fundamental recommendations of conventional economics. On the one hand, economics does not advocate that these practices be changed to be consistent with economic theory and, on the other hand, it does not give a coherent and uncontrived explanation of why these practices should be considered as “exceptions.” In short, economics tends to duck these basic issues. There have always been these intimations of structural shortcomings, lacuna, and flaws in conventional economics. Economics has only seemed to be coherent and complete theory because it chooses to ignore the paradigm-threatening discrepancies between the theory and the legal structure of the modern western democracies.

## The Fundamental Myth of Ownership of the Firm

David Ellerman

We are presenting an analysis of economic organization quite different from the perspective of the Great Debate between capitalism and socialism. The Great Debate has focused on whether workers should be rented privately for profit or should always be rented by the government and employed for the public good. The view that people should not be rented at all was not a topic in the classic capitalism/socialism debate.

We present an alternative analysis that juxtaposes employment in a private capitalist or government-owned firm to membership in a democratic firm. There are powerful barriers to this conceptual reconfiguration. There are fundamental but flawed presuppositions shared by both sides in the classic capitalism/socialism debate. Thus there has been little pressure to overthrow those common assumptions. But it is only by moving beyond the shared myths of the Great Debate that the ground can be cleared for a fresh start.

The Fundamental Myth is that the identity of the legal party undertaking a given production opportunity is determined by a property right called “ownership of the firm” or, in the Marxist tradition, “ownership of the means of production.”

Both sides to the Great Debate shared the assumption that “firmhood” (the identity of the firm) is determined by the “ownership of the firm.” The firm is a “piece of property.” The difference of opinion was over who should own that property. State socialists argued that only the government should own the firms, while capitalists defended the private ownership of firms. Today, that debate is replaced by the “privatization debate” [see Ellerman, Vahcic, and Petrin, 1991] over how best to establish private ownership of the firms.

But firmhood is not determined by a property right; it is determined by the pattern of contracts between factor suppliers. Being the firm is a contractual role, not a property right.

Here again, there are many ways to misinterpret the argument. The assertion is quite sensitive to the meaning of words and phrases such as “firm,” “company,” “corporation,” “means of production,” “capital,” and so forth. The word “firm” has a specific technical meaning in the assertion “There is no such property right as the ownership of the firm.” The assertion would be nonsense if by “firm” one meant “corporation” since clearly corporations are owned by their shareholders.

#### A Corporation is Not Necessarily a Firm

Corporations are owned; that is no myth. But corporate capital can be hired out just as labor and other factors can be hired in, so the corporation is not necessarily the firm (i.e., the party undertaking production) even with respect to its own plant and equipment. It is the pattern of those hiring contracts that determines who is the firm.

Consider a production process for manufacturing widgets. The process is currently being undertaken by a corporation, Widgets Unlimited, which owns the

land, factory building, and machinery. Finance is borrowed from a bank, raw materials and subcomponents are purchased from suppliers, and labor services are purchased from the employees. By the “firm” we mean the legal party undertaking this widget production process. Widgets Unlimited is undoubtedly the firm in the example. But why? Because of the ownership of the corporation or because of the company’s contractual role of hiring (or already owning) the requisite inputs to the widget production process?

The question is easily answered by considering a rearrangement or reversal of the input contracts without any sale in Widgets Unlimited shares. Suppose the workers (including managers) get together, borrow the money, lease the production facilities for Widgets Unlimited, purchase the other inputs from the suppliers, and undertake the widget production process. Then the firm (= widget producer) changed hands from Widgets Unlimited to the new legal party of the associated workers without any sale of corporate shares. The Widgets Unlimited still own the same shares, but the corporation is no longer the firm (= the widget producer). It is a factor supplier to the firm. Thus the ownership of the corporation Widgets Unlimited was not the “ownership of the firm.”

#### Firmhood as a Contractual Role, Not a Property Right

There is no “ownership of the firm.” Being the firm (e.g., the widget producer) is a contractual role, not a property right. What is the contractual role that is equivalent to firmhood? It is being the party that has hired or already owned all the factor services used up in production so that party bears those costs and thus has the defensible claim on any appropriable products (e.g., widgets) produced in the process. That contractual role is called the role of the hiring party (since it hires the other factors) or the residual claimant (since it nets the value of the appropriable products minus the costs of the inputs).

In a private property free enterprise market economy, firmhood is determined by the outcome of the contest or conflict—the “hiring conflict”—over who hires what or whom in the factor markets. In abstract terms, if Capital (= the capital-owners) hires Labor (= the workers including the managers), then Capital is the firm. If Labor hires capital, then Labor is the firm. A contract reversal between Capital and Labor reverses who is the firm. There is no need for Labor to “buy the firm”; it suffices to rent the capital. And if some third party, an entrepreneur or the state, hires both the capital and the workers, that party is the firm.

The winner of the hiring conflict is the hiring party, the party which becomes the firm. If not already a corporation, the hiring party will organize the “spoils of victory” by forming a corporation which it owns. For example, if the widget workers successfully hired the other factors to undertake production,

they would legally encapsulate their operation in a corporation of some type. If the workers lost the hiring conflict and remained employees, they would most likely not form a corporation. In a free market economy, one tends to find a one-to-one correlation between being the firm and ownership of a corporation just as there is a perfect correlation between winning an Olympic event and owning an Olympic gold medal. But it would be a mistake to think that someone won the event because they own a gold medal. The causality was the reverse.

#### Examples of Contract Reversals

A major oil company might own the facilities of a gas station but not operate the station as a business. The gas station facilities would be leased to an individual who would run the station as an independent operator. In other cases, an oil corporation might operate the station by hiring in the people to run it. Following the Mideastern oil crisis of a few years back, gas prices escalated and the profit potential of gas station operation increased. Some major oil companies which had previously leased out their stations decided to reverse the contracts and hire in the labor. The independent operators were notified that their leases would not be renewed when they expired. However, the oil company would be happy to hire them as employees to continue running the gas stations.

One independent operator in the Southwest staged a protest that made national television news. He barricaded himself into the station with a shotgun and issued statements to the press. He said the oil company was “stealing my business.” It couldn’t “just hire me”; it had to “buy me out.” The poor fellow had bought the myth; he thought he “owned the firm.” In fact, he only had the contractual role of being the firm, and more powerful market participants could change that contractual role when they pleased. The oil company correctly pointed out it didn’t need to “buy the firm” to take over the operation of the station; it only needed to hire in the labor.

In another example, the owner of a department store chain decided to endow his employees with “ownership.” But his shares were already locked into trusts for his family and heirs. Thus he set up another corporation which was 100% employee owned through an employee share ownership plan (ESOP). Then he leased all the fixed assets of his company and sold the inventory to the new employee owned company. All the employees switched over to the new corporation which also acquired the contractual right to do business under the original tradename. By these contractual rearrangements, the firm changed hands but the original corporation didn’t. The shares were still in the family trusts. The original corporation changed from being the firm (= the department store operation) to being a factor supplier to the firm.

Yet another example is the leasing movement in the Soviet Union and some other

socialist countries [see Ellerman 1990]. Over a thousand state sector enterprises in the USSR have leased their fixed assets to be operated by the collectivity of workers from the original enterprise. The new legal entity with the workers as its members takes over the role of being the residual claimant (i.e., is the firm) even though the state still holds the ideological fetish of the “ownership of the means of production.” The contract reversals in both capitalist and socialist countries reveal the falsity of the common assumption that “being the firm” is part and parcel of the ownership of the means of production.

### The Role of Bargaining Power

The argument that firmhood is determined by the contractual role does not assume that factor suppliers actually have enough market power to change the direction of the contracts. The argument is about the structure of the legal institutions. It makes no assumption whatever about the respective bargaining power of the market participants. That is entirely another question.

Typically large accumulations of capital have the market power to hire in labor whenever desired. Democratic worker ownership within capitalist society is often restricted to the nooks, crannies, and backwaters of the economy. The bargaining power of the capital-owning class includes the social power of having successfully indoctrinated workers and the workers’ trade union representatives that “their role” is to hire out labor, not to hire in capital and go into business. Thus the capital owners are the firm, but “being the firm” is not an attribute of capital. The accumulation of capital and the social conditioning give capital owners the power to win the hiring conflict (which Labor rarely contests) by hiring in labor and becoming the firm.

Having a position of market power is not itself a property right. Parties often lose positions of market dominance. This is the free play of market forces, not a violation or confiscation of property rights. Capital’s actual property rights (as opposed to imagined property rights) would not be violated if the capital owners lost the market power to hire in the other factors, and thus they had to hire out their capital in order to secure an economic return.

We are now in a position to appreciate the powerful ideological role of the ownership-of-the-firm myth. Capital owners quite naturally do not want their dominant social role as being the firms to be perceived as the result of mere market power which could well be otherwise without violating their “property rights.” They are accustomed to their contractual role as the firm so, like the dominant classes of the past, they see it as their right, their “ownership of the firm.” Capital is the firm because Capital “owns the firm.” Any change in Capital’s role as the firm would violate “sacred private property rights.”

The ownership-of-the-firm myth has a fundamental role in capitalist ideology; it transfigures a mere contractual role into a “sacred property right.” That, in turn, allows a most miraculous transformation of capitalism into the defender of the principles of private property. The natural basis for private property appropriation is labor. Yet the employment system is founded on denying people the right to the fruits of their labor by virtue of the employment contract. The ownership-of-the-firm myth allows the system founded on denying the labor basis for private property appropriation to present itself as the embodiment of private property.

### The Symbiotic Role of Marxism

Since the firm-ownership myth can be exposed by a simple contract reversal argument, how has it been such a stable part of capitalist ideology? As if the social power of Capital was insufficient to vouchsafe the myth, Marx vastly increased its credibility by giving his imprimatur. In feudal times, the governance of people living on land was taken as an attribute of the ownership of that land. The landlord was Lord of the land. As Gierke put it, “Rulership and Ownership were blent” [1958, 88]. Marx mistakenly carried over that idea to capital. The command over the production process was taken as part of the bundle of capital ownership rights.

It is not because he is a leader of industry that a man is a capitalist; on the contrary, he is a leader of industry because he is a capitalist. The leadership of industry is an attribute of capital, just as in feudal times the functions of general and judge were attributes of landed property. [Marx 1977, 450-451]

Marx bought the myth.

Marx’s “ownership of the means of production,” indeed Marx’s notion of “capital,” involves the mythical “ownership of the firm.” By “capital” Marx did not simply mean financial or physical capital goods; he meant those goods used by wage labor in capitalist production. Outside of capitalist production, “capital” becomes just the “means of labor.”

In short,

Marx’s “capital” = “means of labor” + “contractual role of being the firm.”

If one wishes to use the word “capital” in that sense, then not all of what is included in “capital” can be owned. There is the ownership of the means of

labor (financial and physical capital goods directly owned or indirectly owned through the legal shell of a corporation), but there is no “ownership” of the residual claimant’s contractual role of being the firm.

By agreeing that there is the ownership of “capital” (which includes being the firm), Marx swallowed the Fundamental Myth of capitalist ideology even though he took great pride and joy in exposing other aspects of capitalist mythology. It should be carefully noted that this analysis of the “ownership of the firm” is entirely descriptive; it is not normative. The point is not that the “ownership of the firm” should not exist; the point is that it does not exist. Marx accepted that the “private ownership of the firm” does exist as a part of the capitalist system, and he argued that it should not exist.

By accepting the Fundamental Myth as a point of fact, Marxism becomes the perfect symbiotic partner and the ideal foil for capitalist ideology. Then the battle could rage without touching on the shared but mistaken assumption about the nature of the capitalist system. Like Voltaire’s god, if Marxism didn’t exist, capitalism would have to invent something like it as an ideological foil. Autocrats find real or imagined bugbears to justify their power, and the same psychological dynamic operates in the realm of ideology.

Marxism, which in governments means Marxist-Leninism, has been the perfect foil for capitalism for other reasons as well. Perhaps another slavery analogy will illustrate the point. The present-day capitalism/socialism debate is analogous to a debate over slavery where the alternative proposed by the “abolitionists” was the public ownership of the slaves. That would be a debate with real stakes since the nationalization of the slave plantations would break the social power of the private slave-owners. But this “Great Debate” over the private or public ownership of the slaves would nevertheless miss the point; the real alternative is for the slaves to be free and self-determining. Similarly, the current Great Debate over whether workers should be privately or publicly rented misses the point; the real alternative is for people to be jointly working for themselves in democratic firms.

### The Firm Ownership Myth in Democratic Theory

The argument for democratic worker ownership rests on two legs, democratic theory and property theory. Our purpose here is to foreshadow how the firm ownership myth has previously distorted both democratic theory and property theory by shutting off certain avenues of investigation and shunting the debate into irrelevant detours. The idea of applying democratic principles to the economic enterprise is hardly a new idea. What principles behind the capitalist firm must be changed in order to apply democratic principles? Where is the conflict? If “rulership and ownership are blent” in the capitalist firm, then replacing capitalist rulership with workplace democracy entails eliminating the

capitalist “ownership of the firm.” Thus democracy is perceived to be at war with property rights in the capitalist firm.

Most modern political theorists ignore the question of applying democratic principles to the firm. They are intellectually placated by being told that the firm is “private” whereas democracy is “public.” The inalienable human rights at the foundation of our political democracy do not reach the “private sphere.” Those political theorists who take democratic principles seriously enough to apply them to the firm still tend to misinterpret property rights by accepting the firm ownership myth.

The owner of capital resources, or the agent who acts on behalf of the owner or a number of associated owners, controls and determines, in virtue of such ownership, the process of production and the action of the workers who are engaged in the process. In its unqualified form, capitalistic organization is a form of autocracy or absolutism. In practice it is never unqualified. . . We may call it ... a limited absolutism, which naturally seeks to escape its limits, and on which (so long as it exists) combinations of workers will as naturally seek to impose new limits. [Barker 1967, 105-106, emphasis added]

The preeminent democratic theorist, Robert Dahl, presented essentially this analysis of democracy in conflict with the “ownership of the enterprise” in his otherwise excellent book *Preface to Economic Democracy* [1985]. In this conflict, Dahl holds that democratic principles should take precedence over property rights, and thus he develops the case for economic democracy.

That analysis takes a contractual role as a property right. The firm ownership myth includes the idea that the management rights (rulership) over the people using capital goods are part of the ownership of the capital. But those positive control rights over people are not included in capital ownership. The negative control rights to exclude other people from using the property are part of the property rights so we must digress on the distinction between positive and negative control rights.

Another person may not use one’s property without the owner’s consent. Thus ownership does give a right of negative control over other people’s actions, the right to withhold consent and thus to specify how they will not use the property. The owner can decide what others will not do with his or her property. But that is quite different from the right to control what others will do. They may have many other options not involving that property, and those property rights give the owner no control rights over which of those options the others will choose.

The right to tell others what not to do with one's property is a negative control right. The right to tell others what to do is a positive control or management right. The negative control right over other's activities is a part of property ownership, but the positive control right to tell others what to do is not a part of property ownership. How does one acquire the positive control right over another person's behavior—the right to tell them what to do? The employment contract. Hire them.

If labor and land are to be mixed in productive work, there is no pre-existing property right which specifies whether the labor-owner or land-owner directly controls the process. Absent any contracts or agreements between the two parties, the land-owner's negative control rights can make the worker into a trespasser if he tries to use the land without consent. But symmetrically, the worker can make the land-owner into a kidnapper if he tries to force the worker to work the fields without consent. Thus when the labor and land are mixed, there must be a hiring contract one way or the other to determine positive control of the process. If the worker rents the land, he manages the work process. If the land-owner hires the worker, the land-owner manages the work. In either case, it is the hiring party which controls the use of the commodities in the production process. In neither case does the prior ownership of one of the factors by itself give management rights over the production process mixing the factors.

Or consider a factory owner who issues orders to the people working in the factory. What is the legal basis for his positive control rights over the workers' actions? Absent an employment contract, the ownership of the factory gives the factory owner the right to make the workers into trespassers by denying consent. It does not automatically make the workers into servants or employees; that requires the employment contract. The positive control rights over the workers are not an attribute of capital; the employer buys those rights in the employment contract.

Here again, many social theorists are misled by hastily evoking that universal explanatory factor, "power relations." The ownership of the factory may well give the factory owner the bargaining power to hire in labor. The sequence is:

factory ownership => bargaining power => positive control via employment contract.

Some theorists collapse the sequence and infer that factory ownership is "tantamount" to owning the positive control rights.

Returning to democratic theory, we find no structural conflict between

democratic principles and the negative control rights which are part of private property ownership. In an economy run entirely on democratic principles, consent would of course be required as usual to use other people's property. The alleged conflict between democracy and property is really a conflict between democracy and the employment relationship.

Democracy is at war with the renting of human beings, not with private property. In the mythical picture painted by capitalist ideology, private property rights are the center of the capitalist universe. Our analysis shows that the actual center of the capitalist universe is the employment contract. The economic application of democratic theory (and the labor theory of property) presented here is based on the Copernican paradigm shift to seeing capitalism as revolving around the employment contract instead of around the "private ownership of the means of production."

### The Firm Ownership Myth in Property Theory

The Fundamental Myth also distorted thought about property rights. It influenced not only the "answers" but the way in which questions were posed, or rather, ill-posed.

The basic property question about production is about the ownership of the product.

How is it that one legal party rather than another owns the outputs of a production process?

Where the firm ownership myth holds sway, the answer is simple; the "owner of the firm" owns the product. The product ownership rights are part of the ownership of the firm. That answer detours inquiry off in the direction of "How is the ownership of the firm acquired?" And the standard answer is that the owners bought it, inherited it, or started the firm from scratch. Even firms which were bought or inherited must have been previously created. And thus all questions about property ownership in products or firms are traced back to the initial creation of property rights.

The creation or initiation of a property right is called the appropriation of the property. Philosophical treatments of appropriation (e.g., John Locke's treatment) are usually set in some rather mythical original state of nature when property was first privately appropriated from the common patrimony of Nature. There is also the symmetrical matter of terminating property rights,

but that is ignored in the philosophical treatments which tend to be non-technical and elementary.

That is the conventional story which begins by holding that the ownership of the produced outputs is part of the “ownership of the firm.” But the “ownership of the firm” is a myth. In the previous example, the widgets produced by the same workers using the same machines and raw materials would be owned by another party if there had been a prior rearrangement of the hiring contracts. The product is owned by the party with the contractual role of the hiring party. So how did the hiring party get the ownership of the outputs? Did that party buy the outputs from a prior owner? No, there was no previous owner of the outputs. The hiring party is the first owner. In other words, the hiring party appropriated the outputs.

Thus the recognition that there is no “ownership of the firm” leads to the recognition that normal day-to-day production is a site of appropriation. That recognition changes the debate. It means traditional theories of appropriation such as the labor theory of property can be applied to normal production, not just to some original Lockean state of nature.

Why don't the workers have the labor claim on the produced outputs (as well as the symmetrical claim against them for the used-up inputs)? The firm ownership myth is only the first line of defense. The real defense is the employment contract which puts the employees in a non-responsible position of a hired factor “employed” by the employer. But the labor theory of property is the property theoretic expression of the usual juridical canon of assigning legal responsibility in accordance with de facto responsibility. We shall see in an intuitive example of the criminous employee how de facto responsibility is not transferable and how the law only pretends that labor has been alienated (until a crime has been committed). Thus the capitalist appropriation of the product (including the liabilities for the used-up inputs) is based not on the “private ownership of the means of production” but upon the legal validation of an inherently invalid contract which pretends that human actions are transferable like the services of things.

The discussion here is a prelude to show how the recognition that the “ownership of the firm” is a myth opened up the intellectual space for the analysis of appropriation.

## Summary

There is a “fundamental myth” accepted by both side in the Great Debate between capitalism and socialism. The myth can be crudely stated as the belief that “being the firm” is part of the bundle of property rights referred to as “ownership of the means of production.” Any legal party that operates as a

conventional capitalist firm actually plays two distinct roles:

- the capital-owner role of owning the means of production (the capital assets such as the equipment and plant) used in the production process; and
- the residual claimant role of bearing the costs of the inputs used up in the production process (e.g., the material inputs, the labor costs, and used-up services of the capital assets) and owning the producing outputs

The fundamental myth can now be stated in more precise terms as the myth that the residual claimant's role is part of the property rights owned in the capital-owner's role, i.e., part of the ownership of the means of production.

It is simple to show that the two roles of residual claimant and capital-owner can be separated without changing the ownership of the means of production. Rent out the capital assets. If the means of production such as the plant and equipment are leased out to another legal party, then the lessor retains the ownership of the means of production (the capital-owner role) but the lessee renting the assets would then have the residual claimant's role for the production process using those capital assets. The lessee would then bear the costs of the used-up capital services (which are paid for in the lease payments) and the other input costs, and that part would own the produced outputs. Thus the residual claimant's role is not part of the ownership of the means of production.

This "rent out the capital" argument is very easy to understand. But it is astonishing how difficult the argument is to understand when the capital-owner is a corporation. If an individual owns a machine, a "widget-maker," then that ownership is independent of the residual claimant's role in production using the widget-maker. The capital owner could hire in the workers to operate the widget-maker and to produce widgets—or the widget-maker could be hired out to some other party to produce widgets.

Now suppose the same individual incorporates a company and issues all the stock to himself in return for the widgetmaker. Instead of directly owning the widget-maker, he is the sole owner of a corporation that owns the widgetmaker. Clearly this legal repackaging changes nothing in the argument about separating capital ownership and residual claimancy. The corporation has the capital-owner's role and—depending on the direction of the hiring contracts—may or may not have the residual claimant's role in the production process using the widget-maker. The corporation (instead of the individual) could hire in workers to use the widget-maker to manufacture widgets, or the corporation could lease out the widget-maker to some other party. The process of incorporation does not miraculously trans-substantiate the ownership of a capital asset into the ownership of the (net) products produced using the

capital asset.

The residual claimant's role is a contractual role, not a property right. The identity of the "firm" (in the sense of the residual claimant) is determined by who hires what or whom in the markets for inputs. The "firm" is the legal party which hires or already owns all the inputs to be consumed in production and which bears those costs as the inputs are used up. Another party could take over that contractual role through contract reversals (e.g., Labor hiring capital) without having to "buy the firm."

Traditional democratic theory and property theory have both been distorted by the uncritical acceptance of the fundamental myth that residual claimancy was a property right. There is in fact no structural conflict between private property rights in capital and democratic principles. The conflict is between the employment contract and democratic principles.

## The Labor Theory of Property

Is Labor Peculiar?

David Ellerman

It is remarkable that the human science of "Economics" has not been able to find or recognize any fundamental difference between the actions of human beings (i.e., "labor") and the services of things. Attempts by economists to recognize the "peculiarities" of labor have been noticeably barren. For instance, Alfred Marshall [1920, Chapter IV and V of Bk. VI] noted a number of peculiarities:

1. workers may not be bought and sold; only rented or hired,
2. the seller must deliver the service himself,
3. labor is perishable,
4. labor-owners are often at a bargaining disadvantage, and

5. specialized labor requires long preparation time.

Professor Samuelson has also recognized the first peculiarity.

Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself; he must rent himself at a wage. [1976, 52 (emphasis in the original)]

Instead of being a characteristic of labor itself, Marshall and Samuelson only give an observation about present-day legal institutions; it did not hold a century and a quarter ago [see Philmore 1982]. Neither Marshall nor Samuelson offer any basic institution-free differentiation of labor from machine services which would account for why the services of a person may not (now) be sold all at once. Quite to the contrary, the (first) “fundamental theorem of welfare economics,” the theorem that a competitive equilibrium is allocatively efficient (“Pareto optimal”), must assume away the first peculiarity by presupposing that labor can be sold all at once. Complete future markets must be assumed for all commodities to yield the optimality of competitive equilibrium, and “labor is a commodity.”

Now it is time to state the conditions under which private property and free contract will lead to an optimal allocation of resources.... The institution of private property and free contract as we know it is modified to permit individuals to sell or mortgage their persons in return for present and/or future benefits. [Christ 1975, 334; quoted in Philmore 1982, 52].

Far from providing any analysis or rationale for Marshall’s first peculiarity of labor, modern economics bases one of its proudest achievements (“A competitive equilibrium is allocatively efficient”) on the assumption that the perfectly competitive capitalist model incorporates what is essentially a voluntary contractual form of slavery [see Philmore 1982].

The second peculiarity of labor, that the seller must personally deliver the services, has no profound import. The employee plays two roles: the owner of the entity being hired out, and the entity which is hired out. Thus the services of the entity are the services of the owner of the entity. Marshall notes how this peculiarity makes the laborowner particularly concerned with the conditions under which the labor is employed. Moreover, the mobility of labor is thereby as limited as the mobility of the laborer. But neither of these consequences is of great importance. In addition, this peculiarity does not

even hold when there is a resale market for labor as in the ancient practice of laborganging contracting—which in modern times is called “employee leasing.” The ultimate employer contracts not with the workers but with the intermediate agency or contractor who, in turn, hires the workers. The contractor selling the labor to the employer does not personally deliver the services.

The third, fourth, and fifth “peculiarities,”

that labor is perishable,

that labor-owners are often at a bargaining disadvantage, and

that specialized labor requires long preparation time,

are not really unique to labor at all (as Marshall even indicates).

The inability of capitalist economics to recognize any unique and relevant characteristic of labor is an ideological blind-spot based on the desire to theoretically reflect the symmetrical fact that both labor services and the services of land and capital are salable commodities in the employment system. Any fundamental differentiation of labor from the other factor services would threaten that symmetry.

Radical economists have also attempted to find a unique and relevant characteristic of labor (“Only labor is creative”) that would differentiate it from the other factor services. These attempts have not been particularly fruitful.

Marx attached great importance to his “discovery” of the distinction between labor power and labor time. Yet that distinction is not even unique to labor. When one rents a car for a day, one buys the right to use the car (“car power”) within certain limits for the day. The actual services extracted from the car are another matter. The car could be left in a parking lot, or driven continuously at high speeds. To prevent being “exploited” by heavy users of “car time,” car rental companies typically charge not just a flat day rate but have also a “piece-rate” based on the intensity of use as measured by mileage.

Marx touched on deeper themes when he differentiated human labor from the services of the lower animals (and things) in his description of the labor process.

We presuppose labour in a form in which it is an exclusively human characteristic. A spider conducts operations which resemble those of the weaver, and a bee would put many a human architect to shame by the construction of its honeycomb cells. But what distinguishes the worst architect from the

best of bees is that the architect builds the cell in his mind before he constructs it in wax. At the end of every labour process, a result emerges which had already been conceived by the worker at the beginning, hence already existed ideally. [Marx 1977, 283-284]

This conscious directedness and purposefulness of human action is part of what is now called the “intentionality” of human action [see Searle 1983]. This characterization does have significant import, but Marx failed to connect intentionality to his labor theory of value and exploitation (or even to his labor-power/labor-time distinction). This is in part because Marx tried to develop a labor theory of value as opposed to a labor theory of property.

Other radical political economists of Marx’s day such as Pierre-Joseph Proudhon, William Thompson, and Thomas Hodgskin were less successful at developing a theoretical superstructure. But they did move in the right direction by trying to develop the labor theory of property as expressed in the claim of “Labour’s Right to the Whole Product” [see Hodgskin 1832 or Menger (Anton) 1899].

#### Only Labor is Responsible

If we move from the artificially delimited field of “Economics” into the adjacent field of Law and Jurisprudence, then it is easy to recognize a fundamental and unique characteristic of labor. Only labor can be de facto responsible. The responsibility for events may not be imputed or charged against non-persons or things. The instruments of labor and the means of production can only serve as conductors of responsibility, never as the source.

An instrument of labour is a thing, or a complex of things, which the worker interposes between himself and the object of his labour and which serves as a conductor, directing his activity onto that object. He makes use of the mechanical, physical and chemical properties of some substances in order to set them to work on other substances as instruments of his power, and in accordance with his purposes. [Marx 1977, 285]

Marx did not explicitly use the concept of responsibility or cognate notions such as intentionality. After Marx died, the genetic code of Marxism was fixed. Any later attempt to introduce these notions was heresy. Moreover, these notions would not supply an apologia for state ownership so they were of little use to Official Marxism.

Nevertheless, while Marx did not use the word “responsibility,” he clearly describes the labor process as involving people as the uniquely responsible agents acting through things as mere conductors of responsibility. The responsibility for the results is imputed back through the instruments to the human agents using the instruments. Regardless of the “productivity” of the burglary tools (in the sense of causal efficacy), the responsibility for the burglary is imputed back through the tools solely to the burglar.

The human actor has the role of the “prime mover” without being a first cause. Clear thinking in jurisprudence requires differentiating between responsibility and causality.

If we say that a definite consequence is imputed to a definite condition, for instance, a reward to a merit, or a punishment to a delict, the condition, that is to say the human behavior which constitutes the merit or the delict, is the end point of imputation. But there is no such thing as an end point of causality. The assumption of a first cause, a *prima causa*, which is the analogon to the end point of imputation, is incompatible with the idea of causality, at least with the idea of causality implied in laws of classical physics. The idea of a first cause, too, is a relic of that state of thinking in which the principle of causality was not yet emancipated from that of imputation. [Kelsen 1985, 365]

The natural sciences take no note of responsibility. The notion of responsibility (as opposed to causality) is not a concept of physics and engineering. The difference between the responsible actions of persons and the nonresponsible services of things would not be revealed by a simple engineering description of the causal consequences of the actions/services. Therefore when economists choose to restrict their description of the production process to an engineering production function, they are implicitly or explicitly deciding to ignore the difference between the actions of persons and the services of things [see Mirowski 1989 for the use of physics as a model for the human sciences].

#### The Juridical Principle of Imputation

The pre-Marxian classical laborists (“Ricardian socialists”) such as Proudhon, Thompson, and Hodgskin tried to develop “the labor theory” as the labor theory of property. The most famous slogan of these classical laborists was “Labour’s Claim to the Whole Product.” This claim was hobbled by their failure to clearly include the negative product in their concept of the “whole product.” This allowed the orthodox caricature, “all the GNP would go to labor and none to property” [Samuelson 1976, 626], as if there were no liabilities for the used-up inputs. If Labor appropriated the whole product, that would include

appropriating the liabilities for the property used up in the production process. Present Labor would have to pay Property (e.g., past Labor) to satisfy those liabilities.

The classical laborists' development of the labor theory of property was also hindered by their failure to interpret the theory in terms of the juridical norm of legal imputation in accordance with (de facto) responsibility. A person or group of people are said to be de facto or factually responsible for a certain result if it was the purposeful result of their intentional (joint) actions. The assignment of de jure or legal responsibility is called "imputation." The basic juridical principle of imputation is that de jure or legal responsibility is to be imputed in accordance with de facto or factual responsibility. For example, the legal responsibility for a civil or criminal wrong should be assigned to the person or persons who committed the act, i.e., to the de facto responsible party. Ronald Dworkin notes that this is

a principle about natural responsibility, and so, as a guide for adjudication, unites adjudication and private morality and permits the claim that a decision in a hard case, assigning responsibility to some party, simply recognizes that party's moral responsibility. [Dworkin 1980, 589]

In the context of assigning property rights and obligations, the juridical principle of imputation is expressed as the labor theory of property which holds that people should appropriate the (positive and negative) fruits of their labor. Since, in the economic context, intentional human actions are called "labor", we can express the equivalence as:

The Juridical Principle of Imputation: People should have the legal responsibility for the positive and negative results of their intentional actions.

The Labor Theory of Property: People should legally appropriate the positive and negative fruits of their labor.

In other words, the juridical principle of imputation is the labor theory of property applied in the context of civil and criminal trials, and the labor theory of property is the juridical principle applied in the context of property appropriation.

Some individuals, such as infants or the insane, are not capable of de facto responsible actions.

The statement that an individual is zurechnungsfähig (“responsible”) means that a sanction can be inflicted upon him if he commits a delict. The statement that an individual is unzurechnungsfähig (“irresponsible”)– because, for instance, he is a child or insane–means that a sanction cannot be inflicted upon him if he commits a delict. ... The idea of imputation (Zurechnung) as the specific connection of the delict with the sanction is implied in the juristic judgment that an individual is, or is not, legally responsible (zurechnungsfähig) for his behavior. [Kelsen 1985, 364]

Regardless of their causal efficacy, things are, a fortiori, unzurechnungsfähig.

De facto responsibility is not a normative notion; it is a descriptive factual notion. The juridical principle of imputation is a normative principle which states that legal or de jure responsibility should be assigned in accordance with de facto responsibility. In the jury system, the jury is assigned the factual question of “officially” determining whether or not the accused was de facto responsible for the deed as charged. If “Guilty” then legal responsibility is imputed accordingly.

Economics is always on “jury duty” to determine “the facts” about human activities. These are not value judgments (where social scientists have no particular expertise). The economist-as-juror is only required to make factual descriptive judgments about de facto responsibility. In this chapter we are not concerned with the normative principle of juridical imputation (i.e., the labor theory of property applied in the courtroom), only the descriptive question of responsibility. The normative and descriptive questions should be kept conceptually distinct. That separation is difficult since, given the juridical principle, de facto responsibility implies de jure responsibility.

In a given productive enterprise, the descriptive question asks what set of people are de facto responsible for producing the product by using up the various inputs? The economist-as-juror faces that question. The marginal productivity of tools (machine tools or burglary tools) is not relevant to this factual question of responsibility either inside or outside the courtroom. Only human actions can be responsible; the services provided by things cannot be responsible (no matter how causally efficacious). The original question includes the question of who is responsible for using up those casually efficacious or productive services of the tools .

The question of de facto responsibility, whether posed in a courtroom or outside, presupposes the understanding that persons act and things don't. Yet it is precisely the presupposition that is "overlooked" in economic theory which treats both the services of human beings and the services of capital and land symmetrically as "input services." Economists choose to limit their description of the human activity of production to an engineering description of the causally efficacy of the various types of input services. The unique responsible agency of human activities is not acknowledged.

Contract

What is the Employer-Employee Relationship?

David Ellerman

Since we contend that the whole capitalism/socialism debate has been wrong-headed, it is incumbent on us to answer the questions:

- (1) what is the root problem in both capitalism and socialism, and
- (2) how would the third alternative variously called economic democracy, democratic worker ownership, or universal self-employment solve that problem?

The problem is the employer-employee relationship itself. Both capitalism and socialism (as public enterprise capitalism) have assumed that basic relationship and have debated whether workers should all be employed by the government for "the Public Good" or whether they could also be privately employed "for private greed." Since the employment relation is so pivotal for the negative appraisal of both capitalism and socialism, this chapter gives a preliminary analysis of the employment relation.

The basic normative distinction is between:

- (1) the democratic worker-owned firm (or self-employment firm) where labor

hires capital and the workers are jointly working for themselves, and

(2) the employment firm where capital hires labor using the employer-employee relationship and where the equity capital can be privately owned (including employee-owned) or publicly owned by the government.

The difference is the hiring relationship, capital hiring labor or labor hiring capital. Capitalism is capital-ist not because it is private enterprise or free enterprise, but because capital hires labor rather than vice-versa. Thus the quintessential capital-ist aspect of our economy is neither private property nor free markets but is that legal relationship wherein capital hires labor, namely the employer-employee relationship. There is astonishing false consciousness concerning the employment relationship in our society. This can be illustrated by an experiment conducted with beginning Economics students.

First the students are told about the system of chattel slavery where workers are bought and sold as movable property. But just as a house or a car can be bought and sold, so one can also rent a house or car. Now instead of buying workers as in a slavery system, suppose we consider a system of renting workers. The students are asked if anyone knows an economic system based on the renting of workers. There is usually a puzzled silence. A Black student points out that during slack times, plantation slaves were rented out to work as stevedores, as hands in factories (for example, turpentine or sugar mills), or as common laborers. The Professor agrees that this happened but notes that it was the exception rather than the rule. We need an example of a whole economic system based on renting people. After another pause, some students offer, "Well, what about feudalism?" The Professor responds that feudalism was a system of indirect ownership of workers. Instead of being owned as chattel or movable property, serfs had the security of being attached to the landed estate which was then owned as real property. Thus we still need an example of a system of renting people. After more embarrassed silence and shuffling feet, finally a student, by the process of elimination if by no other logic, offers the answer: "Well, isn't that sort of like what we have now?"

Yes, the system of renting people is our system, the employer-employee system. Of course, we do not say people are rented; we say people are "hired." The students would have had no difficulty thinking of an economic system where workers are hired. The difference a word makes! When applied to things rather than persons, the words "rent" and "hire" are synonyms. One could say either "rent a car" or "hire a car" with the only difference being that Americans favor "rent a car" while the British will tend to "hire a car." But American and British usage agrees that when people are rented, one says "people are hired."

From an abstract economic-legal viewpoint, the employer-employee relation is the rental relation applied to persons. What do you buy when you rent something? You buy its services, the right to employ or use the entity within certain limits for a given time period. In terms of the stock-flow distinction in economics, to rent the stock is to buy a flow of services from the stock. When one rents an apartment or a car, one buys not the apartment or car itself but some of its services. If one rents a car for three days, one buys three car-days. If one rents an apartment for six months, one buys the services, six apartment-months. Similarly when one rents a person for eight hours, one buys the labor services of eight man-hours (or person-hours), i.e., the right to employ or use the person within the limits of the contract for an eight hour period.

The labor market is the market for the renting of human beings. Of all rental contracts, the employment contract has been the most modified and attenuated by social constraints. Labor legislation and the countervailing power of unions have both worked to mitigate the commodity nature of labor services and to insure that people are rented in a manner as “human” as possible. But all of these socially mitigating circumstances should not be taken as an excuse to obfuscate the basic fact that the employment contract to buy labor by the day, the week, or the year is the contract to hire or rent the person by the day, the week, or the year.

#### Wages as Rentals

We say that employees are “rented” rather than “hired” to awaken people (like the Economics students) from the dogmatic slumber in which they do not realize they live in an economic system based on the renting of human beings. Often this statement is intentionally or unintentionally misinterpreted as being hyperbole. For instance, the statement might be “embraced” as follows:

Yes, employees are rented and, indeed, we all sell our souls in this system of wage slavery.

This misinterprets the rental assertion as an example of hyperbole like “selling our souls” or “wage slavery.” But by the standard economic notion of a rental contract, the rental assertion is only a statement of fact couched in jarring language so one might see an old reality from a different perspective. When capital hires labor, the wage or salary payment is the rental payment.

One can even say that wages are the rentals paid for the use of a man’s personal services for a day or a week or a year. This may seem a strange use of

terms, but on second thought, one recognizes that every agreement to hire labor is really for some limited period of time. By outright purchase, you might avoid ever renting any kind of land. But in our society, labor is one of the few productive factors that cannot legally be bought outright. Labor can only be rented, and the wage rate is really a rental. [Samuelson 1976, 569]

Much of the traditional criticism of the wage contract has centered on the size of the wage payments or human rentals. However, the amount of the wages will play no role whatsoever in our analysis. Indeed, one could imagine an equally dehumanizing relationship where the payment would go from the employees to the employer. That is, apply the idea of the employment contract to consumption rather than production.

#### A “Consumption Employment Relationship”

Workers take inputs and add value to produce the outputs. Consumers do the opposite; they take their consumer goods, consume them, and thereby produce scrap or used goods of lower market value. Ordinarily consumptive labor is self-managed; the consumers buy the inputs, make their own consumption decisions, and own the outputs (scrap or used goods). Consumption could be organized using the employment relationship. Since consumptive labor reduces value, the consumers would have to pay someone to employ them to consume goods. Instead of buying a turkey, consuming it, and owning the scraps, a family unit would pay someone to employ them to consume a turkey. The family would not buy the turkey or own the scraps. The analysis and critique developed here of the employment relation in production can be applied, *mutatus mutandis*, to this hypothetical consumption employment relation. The essence of the analysis is the role of human beings in the relationship, not the money payments one way or the other.

#### Human Leverage

Some of the implications of the employment relation can be appreciated by considering the notion of capital “leverage.” If the owner of \$5,000 can hire or borrow \$10,000 and put it all to work in an enterprise, the original \$5,000 is called “equity capital” while the borrowed \$10,000 is “debt capital” or “loan capital.” The borrowing amplifies or magnifies the effects of the equity capital. With only \$5,000 invested, \$15,000 is put to work. The equity holder gets the profits and losses from three times the equity capital. Suppose the net income before 10% interest on the loan capital is \$2,000. Subtracting the \$1,000 interest (10% of \$10,000) leaves a \$1,000 profit on \$5,000 equity for a 20% rate of return. If there was no leverage (i.e., all the \$15,000 capital was equity capital), then the \$2,000 return on the \$15,000 capital would be only a

13.3% rate of return (rather than 20%).

This amplification due to using hired capital is called “financial leverage” (or “gearing” in England). It should be noted that losses are also amplified by leverage. With less leverage, there are less interest expenses and the remaining losses are thinned out over more equity capital. Who’s in, and who’s out? Loan capital, like equity capital, is being used in an enterprise, but the suppliers of the loan capital are outsiders to the enterprise. They are creditors of the enterprise, while the suppliers of equity capital are the “insiders” (from the legal or de jure viewpoint).

The same considerations can be applied to any resources including “human resources” (to use a popular and telling expression from modern business jargon). Since human beings may also be rented, there is the phenomenon of human leverage. The net results of many peoples’ efforts can count as the results of one person’s effort if the one hires the many. The employment relation allows one or a small number of people to “leverage” their enterprise by hiring tens, hundreds, or thousands of other people. The results of human leverage show up in the income distribution. Some researchers found the income distribution of the highest 1% of the population distinctly shooting off with a different trend than the other 99%.

No one would dispute the fact that the wealthy differ from the lower 99% in the manner that they accumulate income. While most people are paid by the hour, or the number of widgets they produce, the wealthy frequently accumulate their extra wealth by some amplification process; that process varying from case to case. ... Perhaps one of the most common lower-level modes of amplification is for an individual to organize an operation with others working for him so that his income is amplified through the efforts of others (a modest-sized business, for example). [Montroll 1987, 16-17]

Using income data for 1935-36, the average amplification factor was estimated at 16.8.

This number is not surprising since one of the most common modes of significant income amplification is to organize a modest-sized business with the order of 15-20 employees. [Montroll 1987, 18]

In fact, the business is carried out by all the people working there, but in law it is the enterprise of only the employer. The employees have a legal role like that of an instrument, indeed that of a human lever, working as a means to leverage or amplify the ends of the employer. The employees are not part of the ends of the enterprise. The employer does not act as the representative of the whole group of people working in the firm. The employer acts only in his own name, and the employees are “employed” to that end. The possibility of human leverage also supplies the simplest and most direct explanation for the prevalence of employment firms in a free enterprise economy which allows the employment relation and where there is a sufficient supply of labor willing to accept the employee’s role. The choice of firm structure is exercised by the entrepreneur or entrepreneurial group who organizes the firm. Since (by hypothesis) the firm is expected to be profitable, it is in the self-interest of the organizers to leverage the other people involved in the firm by employing them.

#### The Comparison with Slavery: Voluntariness

It is crucial to understand the similarities and differences between the employment system and slavery. When the details are stripped away, there are two important differences (in spite of the rhetoric about “wage slavery”): the voluntariness and the duration of the relationship.

In the conventional understanding, slavery was involuntary and the employment relation is voluntary. We accept this standard understanding of the historical facts. However, it is important to see how both assertions have been challenged in various ways. On the one hand, there is a whole school of liberal thinkers who argued that slavery was or could be considered as deriving from voluntary contractual arrangements [viz. Philmore 1982]. On the other hand, there is an old tradition prominently including Karl Marx which argued that the worker’s “choice” to sell his or her labor was a Hobson’s choice, and that the employment contract was “socially involuntary.” But the claim that slavery was voluntary as a matter of historical fact is absurd. And the argument that employment is “socially involuntary” is a rather weak special plea. The labor contract would satisfy any workable juridical notion of voluntariness. The worker, particularly the unionized worker, has considerably more bargaining power than, say, the unorganized consumer who must take price as given.

The involuntariness argument is also not necessary for a critique of the employment contract because voluntariness is a necessary but not a sufficient condition for the juridical validity of a contract. Indeed, if slavery was wrong because it was involuntary, then what about a system of voluntary contractual slavery? In the years prior to the Civil War, there was explicit legislation in six states “to permit a free Negro to become a slave

voluntarily” [Gray 1958, 527; quoted in Philmore 1982, 47]. But when slavery was abolished, both involuntary and voluntary slavery was prohibited. The contract to voluntarily sell oneself is no longer considered a juridically valid contract.

We shall argue that the contract to voluntarily rent oneself out, i.e., the employment contract, should also be considered a juridically invalid contract. The immediate retort is that the abolition of renting people would violate the “freedom of contract.” When one thus hears the rhetoric of liberal capitalism, it is important to remember the invalidity of the self-sale contract. For example, there is Sir Henry Maine’s high-minded dictum that the movement of progressive societies has hitherto been a movement from Status to Contract [1861, reprinted 1972, 100]. Yet the abolition of the self-sale contract means precisely that one’s social position as a free person unowned by another person is a matter of status and is not a question of contract. Do free marketeers consider the invalidation of the self-enslavement contract as being retrogressive rather than progressive because it moved personal freedom from the realm of Contract to the realm of Status?

Or consider the oft-heard rhetoric about “free enterprise.” Several centuries ago, enterprise was based on the freedom to own other human beings. And workers even enjoyed the freedom to sell themselves. Those freedoms have now been abolished. Enterprise isn’t as free as it used to be.

Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself: he must rent himself at a wage. [Samuelson 1976, 52 (his italics)]

This quotation from the predominant liberal capitalist economist of our time is important for several reasons. Samuelson acknowledges a major limitation on the “free enterprise” rhetoric, and he forthrightly recognizes that a person rents himself out in the employment relation. Testimony against one’s own interest is particularly valuable. Samuelson is not attacking the employment relation in favor of democratic worker ownership. He is simply giving a no-nonsense description of the employer-employee relation without the usual linguistic sugar-coating involved in saying employees are “hired,” “employed,” “given a job,” or “invited to join the firm. Given the conventional enthusiasm for the freedom of enterprise to rent human beings, one might expect capitalist philosophers and economists to promote extending these freedoms by revalidating the self-sale contract. Robert Nozick of Harvard University, a leading moral philosopher, has argued on libertarian grounds to allow all “capitalist acts between consenting adults.” This includes the contract of political subjugation, the Hobbesian pactum subjectionis, wherein people renounce their

democratic rights and voluntarily become the subjects of a ruler or ruling association. A group of people might sell the right to self-government to a “dominant protective association” and an individual might do likewise.

The comparable question about an individual is whether a free system will allow him to sell himself into slavery. I believe that it would. [Nozick 1974, 331]

Conventional economists constantly make social recommendations based on a utilitarian social philosophy that views all rights actually or potentially as marketable property rights (ignoring inalienable personal or human rights) and that views the efficiency gained from market exchange as the primary criterion of institutional choice. As Nobel laureate James Tobin has noted:

Any good second year graduate student in economics could write a short examination paper proving that voluntary transactions in votes would increase the welfare of the sellers as well as the buyers. [Tobin 1970, 269]

Indeed, conventional economic philosophy implies: (1) that people should be allowed to sell their political votes, (2) that people should further be allowed to individually or collectively sell all their democratic rights in a pactum subjectionis, and (3) that people should be allowed to sell all their labor in a voluntary self-enslavement contract. All of these contracts could find willing buyers and sellers among fully informed adults so they should be permitted according to capitalist social philosophy. Yet there is enough social acceptance of the natural rights philosophy descending from the political democratic revolutions of the past that capitalist economists and philosophers usually refrain from actually making such recommendations. Robert Nozick is the exception either because he is more intellectually forthright or perhaps just more fashionably naughty.

#### The Comparison with Slavery: Duration and Extent

In addition to voluntariness, the employment relation is distinguished from the historical master-slave relation by the duration and extent of the relationship. The difference is essentially the difference between renting and buying. Buying a house gives one the right to the entire future stream of services provided by the house, while renting only procures the housing services for a discrete time period. The slave owner owned all of the slave’s labor, while the employer only purchases certain labor services over a given time period. This relation between owning and renting people has been understood at least since antiquity. In the third century, the Stoic

philosopher, Chrysippus, held that

no man is a slave “by nature” and that a slave should be treated as a “laborer hired for life,” ... . [Sabine 1958, 150]

The comparison between slaves and “hirelings” was commonplace in the South during the antebellum debate over slavery.

Our property in man is a right and title to human labor. And where is it that this right and title does not exist on the part of those who have money to buy it? The only difference in any two cases is the tenure. [Bryan 1858, 10; quoted in Philmore 1982, 43]

James Mill expounded on the distinction between buying and renting people from the employer’s viewpoint.

The only difference is, in the mode of purchasing. The owner of the slave purchases, at once, the whole of the labour, which the man can ever perform: he, who pays wages, purchases only so much of a man’s labour as he can perform in a day, or any other stipulated time. [James Mill 1826, Chapter I, section II]

If the employment contract is compared not to the historical master-slave relation but to a hypothetical self-sale contract, then the only basic difference is the duration and extent of the two voluntary contracts. Accordingly, a number of classical liberal writers condoned civilized versions of the self-sale contract prior to the actual abolition of all slavery. In John Locke’s influential *Two Treatises of Government* (1690), he would not condone a contract which gave the master the power of life or death over the slave.

For a Man, not having the Power of his own Life, cannot, by Compact or his own Consent, enslave himself to any one, nor put himself under the Absolute, Arbitrary Power of another, to take away his Life, when he pleases. [Second Treatise, section 23]

But once the contract was put on a civilized footing, it would be a rather severe form of the master-servant relationship.

For, if once Compact enter between them, and make an agreement for a limited Power on the one side, and Obedience on the other, the State of War and Slavery ceases, as long as the Compact endures.... I confess, we find among the Jews, as well as other Nations, that Men did sell themselves; but, 'tis plain, this was only to Drudgery, not to Slavery. For, it is evident, the Person sold was not under an Absolute, Arbitrary, Despotical Power. [Second Treatise, section 24]

With the exception of Nozick's libertarian atavism, the self-sale contract has not been a topic of active discussion since the abolition of slavery. Yet the self-sale contract as a sell-labor-by-the-lifetime employment contract has had a curious secret life in economic theory. A capitalist market economy cannot be fully efficient if there are restrictions on trade for any commodities with willing buyers and sellers. By removing the restrictions, trade will make the buyers and sellers better off and efficiency will be improved. There is one basic theorem which is so important in capitalist economics that it is called the "Fundamental Theorem of Welfare Economics," namely the theorem that a competitive equilibrium in a capitalist economy is allocatively efficient. If the sale of future-dated labor services was forbidden, the Fundamental Theorem would not hold. A buyer and seller might each be made better off if labor were sold over arbitrary time periods, e.g., by the lifetime. In theoretical models of competitive capitalism, complete future markets are assumed to exist for all commodities including labor. A consumer/worker

is to choose (and carry out) a consumption plan made now for the whole future, i.e., a specification of the quantities of all his inputs and all his outputs. [Debreu 1959, 50]

In such Arrow-Debreu models [Arrow and Debreu 1954], a consumer/worker is viewed as making a lifetime of labor contracts all at that initial time (not necessarily all with the same employer). Restrictions on the sale of future-dated labor services would be market imperfections precluding the allocative efficiency of competitive equilibrium. The fundamental efficiency theorem of capitalist economic theory must assume that the self-sale or lifetime labor contract is legally valid, even though the contract is now legally invalid. It is not surprising that capitalist economists absolutely loathe to admit this. One exception is the economist and econometrician Carl Christ who made the point in no less a forum than Congressional testimony.

Now it is time to state the conditions under which private property and free contract will lead to an optimal allocation of resources.... The institution of

private property and free contract as we know it is modified to permit individuals to sell or mortgage their persons in return for present and/or future benefits. [Christ 1975, 334; quoted in Philmore 1982, 52].

The efficiency of perfect competition is surely the most thoroughly analyzed and discussed topic in mainstream economics. Yet in the textbooks or literature of the “science” of economics, the author has not been able to find a single other admission that capitalist efficiency requires that contract law be “modified to permit individuals to sell or mortgage their persons in return for present and/or future benefits.” In a society allegedly free of thought control, one would expect to find at least one textbook that would mention such a point.

### The Language of the Employer-Employee Relation

This preliminary analysis of the employment relation must include consideration of the language of employment because “words tell a story.” We previously noted that a good many people are not even aware that they live in a society based on the renting of human beings. But before we suggest that “The Big Lie” or ideological false consciousness may also exist on this side of the erstwhile Iron Curtain, we should check if people at least know the traditional legal name of the employment relation. Slaves knew they were slaves, but do employees know their legal name? “Employer-employee” is not the traditional name; it is newspeak which has only come into English usage within the last century. Society seems to have “covered up” in the popular consciousness the fact that the traditional name is “master and servant.” Without special legal or historical education, one would think “servant” refers only to domestics. But domestic servants are only domestic servants, while all employees are servants in the technical legal sense of the word. The master-servant language was used by the 18th century Blackstone, but in the 19th century it had acquired such negative connotations that it had passed out of common usage. For instance, John Stuart Mill has no standard name for employee/servants in his classic *Principles of Political Economy* (1848) since the oldspeak of “servants” was unacceptable but the newspeak of “employees” had not yet been imported from the French. Mill referred to employees as hired “operatives,” “workpeople,” “labourers,” or even “the employed.” Even around the turn of this century, the English version “employee” of the French “employ” was not fully accepted. In 1890, Webster’s Unabridged Dictionary notes:

The English form of this word, viz., employee, though perfectly conformable to analogy, and therefore perfectly legitimate, is not sanctioned by the usage of good writers.

The traditional language of master and servant is still used today in the area of agency law, the law governing the relationships between principal and agent, and any involved third parties. The relevant distinction is between a servant (i.e., an employee) and an independent contractor. A lawyer or plumber in independent practice is an independent contractor while a lawyer or plumber on the staff of a corporation would be a servant or employee. The Chicago economist, Ronald Coase, quoted from a lawbook to describe the “legal relationship normally called that of ‘master and servant’ or ‘employer and employee’” [Coase 1937, 403].

The master must have the right to control the servant’s work, either personally or by another servant or agent. It is this right of control or interference, of being entitled to tell the servant when to work (within the hours of service) or when not to work, and what work to do and how to do it (within the terms of such service), which is the dominant characteristic in this relation and marks off the servant from an independent contractor, or from one employed merely to give to his employer the fruits or results of his labor. [Batt 1967, 8; quoted in Coase 1937, 403]

In addition to not being independent (e.g., not paying for one’s inputs), the servant is marked off from the independent contractor by the employer’s control over the execution of the work. An agent could be either a servant or an independent contractor. In agency law, the distinction is quite important for the imputation of legal liability when a third party is injured within the scope of the agent’s work. If the agent worked as a servant rather than as an independent contractor, the injured party can also sue the master or employer who would have a “deeper pocket” than the employee. The legal responsibility of the employer is called “strict liability” or “vicarious liability” since the injury to the third party was not actually the fruits of the employer’s labor. Modern labor legislation uses the newspeak of “employer-employee.” The continuing use of the traditional “masterservant” language in agency law is not without controversy. Some writers consider the “master-servant” language to be so archaic that it can be used as technical terminology without any undue negative connotations. Other writers disagree.

Another interesting variation in the literature of vicarious liability relates to the language in which the subject is discussed. Justice Holt spoke of “masters” and “servants,” which were current coin in 17th century speech. These terms are perpetuated today in many judicial decisions, and in the Restatement of Agency. Students should be familiar with them but should not, we think, acquire the habit of using them. Defenders of the Restatement contend that

these words, precisely because they are archaic, are neutral tokens of communication. It is clear, however, that the terms are still alive enough to be offensive to laborers and labor representatives. [Conrad, et.al. 1972, 104]

For our purposes it suffices to highlight the social adjustment mechanism involved in the evolution from “masterservant” to “employer-employee.” When the social role of being rented acquired excessive negative connotations, society changed the name rather than change the relationship itself. There are other examples of proposed or actual language changes to alleviate social stress. For instance, in the slavery debates before the Civil War, some planters were quite willing to admit that the “master-slave” language could be objectionable so they suggested some newspeak.

Slavery is the duty and obligation of the slave to labor for the mutual benefit of both master and slave, under a warrant to the slave of protection, and a comfortable subsistence, under all circumstances. The person of the slave is not property, no matter what the fictions of the law may say; but the right to his labor is property, and may be transferred like any other property, or as the right to the services of a minor or apprentice may be transferred.... Such is American slavery, or as Mr. Henry Hughes happily terms it, “Warranteeism.” [Elliott 1860, vii]

The “warrantor-warrantee” newspeak for “master-slave” did not take hold since the relationship itself was soon abolished. The same social pressures are at work today. It “sounds bad” to say that people are rented so one is supposed to say something else.

Labor History: Servus, Serf, Servant

The etymology of the word “servant” is of interest. Western history has seen three general types of economic systems: slavery in ancient times, feudalism in the Middle Ages, and capitalism (private and public) in modern times. The worker’s role in this evolution can be traced in the evolution of his name. The Latin word for slave “servus” evolved into the French “serf” (and Italian “servo”) under feudalism, which in turn became “servant” under capitalism. If the three word version of Economics is “Supply and Demand,” the three word version of Labor History is “Servus, Serf, Servant.” During the Middle Ages in France and Italy, there were a few slaves, often of Eastern European origin, in addition to the multitude of serfs. The presence of the lowly slaves caused some linguistic dissonance since “serf,” “servo” and sometimes even the original “servus” were used to refer to the serf who had a higher station. In

this case, language readjusted by renaming the actual servi as “slaves.”

By the end of the thirteenth century and perhaps in imitation of the Italians, they were called by a name that recalled the origin of many of them and that gradually slipped from its ethnic meaning to a purely juridical one: slaves, i.e., Slavs. [Bloch 1975, 64]

The disturbing linguistic association of “serf” and “servus” also led to newspeak for “serf.”

In order to prevent any misunderstanding and although everyday language, unafraid of confusion with Roman law, continued to use daily the word serf, many notaries henceforth carefully avoided servus, judged inconveniently equivocal, and replaced it in deeds by various synonyms, notably homme de corps. [Bloch 1975, 63-64]

In the course of its career, the word “servant” has denoted workers from the slave to the modern employee as if its own ontogeny had to recapitulate the servus-serf-servant phylogeny. Although servants are never called “slaves” (except as hyperbole), slaves were often called “servants” in premodern times. Even within recent decades, some dictionaries such as the 1959 Webster’s New Collegiate lists “A slave” as a second definition of “servant.” At the same time, lawbooks use “servant” as the technical legal term for the modern employee. Thus the three word version of Labor History could be shortened to one word, “Servant.”

## Summary

Most people who work, work as employees. Yet they do not know employment is the rental relation applied to persons and they do not know the traditional name of the relationship. The system of social indoctrination has been so successful that the employer-employee relation is not even perceived as something that could be different. “To be employed” has become synonymous with “having a job,” to be “unemployed” is to be without work so “employment” has become the same as work. The employment relationship is accepted as part of the furniture of the social universe. We have even described the opposite system without the employment relationship as “universal self-employment” [which is akin to describing the opposite of the slavery system as universal self-ownership].

How could this happen? Part of the answer must be Marxism. Capitalism has been able to define its distinguishing features by the contrast with Marxism. The

debate with Marxism has been focused on so many sideline issues that it gives new meaning to the phrase “red herring.” Since Marxist socialism models the economy as one big capitalist firm, the worker has the choice of being a cog on a private wheel or a cog on one big public wheel. It is as if slavery apologists had been able to successfully redefine the issue as the choice between public or private slave plantations. By diverting the debate, Marxism has been an absolute godsend to capitalist apologetics. If Marxism did not exist, capitalist ideology would have to invent it. The capitalism/socialism debate has not only diverted attention away from the renting of human beings, it has allowed capitalism to be positively identified with democracy, equality, justice in property, and treating people as persons rather than things. Yet the employment relation inherently denies all these ideals in the workplace. Slavery has been abolished both as an involuntary or as a voluntary relationship. But instead of creating a form of enterprise where people are treated as persons rather than things, we only have a system where workers are rented rather than owned. The transition from workers being an owned input to their being a hired input was certainly a moral improvement. But the capitalism/socialism debate has paid little attention to the alternative form of work where the human element is not “employed” at all by public or private employers where people rent only things rather than the owners of things renting people.

Consider equality. There is a basic equality of rights in the political sphere. But prior to the democratic revolutions, there was a fundamental political inequality between ruler and the ruled where the ruler governed in his own name, and was not selected by and did not represent the ruled. Today in the economic sphere, that same type of authority relationship exists between the master and servant where the employer governs in his own name, and is not selected by and does not represent the employees. Or consider democracy. The capitalist democracies stands for democracy, but not in the workplace [viz. Dahl 1985].

In the next chapter, we will review the non-democratic tradition of liberal thought which founded autocracy on a voluntary contract, the pactum subjectionis. With the triumph of the democratic revolutions inspired by the natural rights philosophy of the Enlightenment, that non-democratic liberalism retreated to the capitalist workplace where it has flourished ever since as part of capitalist ideology. The employment contract is the pactum subjectionis of the employment firm. Or consider justice in the private property system. Under capitalism, doesn't everyone get what they produce, the fruits of their labor? We will see quite the opposite, that when labor is hired, the fruits of labor go elsewhere. Labor is the natural basis for the appropriation of newly produced property; the natural “wages” of labor are the fruits. Instead of somehow being the economic system realizing justice in private property, capitalism systematically violates the basic labor principle of private

property appropriation. It is again the employment relation which sets up the misappropriation of private property. In each case, we trace the root cause of the problem to be the renting of human beings, the employer-employee relationship.

The alternative to the employment relation is not having everyone employed by the state. It is having everyone working for themselves (individually or jointly). This means restructuring companies so the membership rights are personal rights attached to the functional role of working in the firm. Then there is no human “employment” since working in the firm makes one a member so people are always jointly working for themselves.

### Capitalization of Labor

#### The Marvel of Modern Finance

Since the abolition of slavery, humans ownership has been banned. People are no longer allowed to sell their labor by the lifetime. Instead they must rent themselves temporarily for a salary or wage. As Paul Samuelson says in Economics

Interestingly enough most of society’s economic income cannot be capitalized into private property. Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself: he must rent himself at a wage. [p. 52, his emphasis]

We focus here on the capitalization of labor which Samuelson says is legally forbidden. However, the statement that labor cannot be capitalized is not strictly true. Human labor is forbidden to be capitalized through direct human ownership. But through the marvel of modern finance human labor continues to be capitalized. Labor capitalization today is carried out through the ownership of businesses. The most familiar example today is the stock market where pieces of businesses are regularly bought and sold.

Labor capitalization is also present in private (non worker-owned) business that are not actively traded on a public exchange. Labor which was once sold

through slave markets, is today packaged with other assets and sold as a business. By owning a business, human labor can now be owned, sold, and traded. The clever packaging of labor and assets into business ownership is the marvel of modern finance through which labor is currently capitalized. It also serves another function useful to maintaining the perception of legitimacy of the employment system, obscuring the ownership of labor. It is fairly straightforward to see that owning a slave is owning the labor of person. But intermixing the labor of many people on an interchangeable basis and combining it with other assets in a firm diverts attention from the underlying labor ownership. Owners (stockholders) of a typical business today own the labor of the employees. The value of the employees' future labor is incorporated in the price of the business. Labor ownership is represented by the difference between the market value of a business (the number of shares outstanding times the current price) and its net asset value (assets minus liabilities). That difference, called "goodwill" is the capitalized value of labor. A few examples will clarify the issue.

First consider a business with some assets and liabilities, but no employees. What is the value of the business? In this case the answer is obvious, the business is worth its net assets value (assets minus liabilities). A business with no employees cannot produce any goods or services, and therefore had no expected future profit. This is true both under the current system of human rentals or if they were abolished.

Now consider a business with no assets or liabilities but with employees. What is the value of the business? Under the current system of human rentals the value of the business is equal to the future stream of profits discounted to its present value. This can be calculated if one assumes the future profits are known along with a risk free interest rate. With the abolition of human rentals the value of the business would be identically zero since only the members (employees) of the business could appropriate the profit.

More generally, the value of any business in the absence of human rentals is equal to its net asset value. This has significant implications for the stock market as share prices would collapse to net asset value with the abolition of human rentals. By analogy, one can imagine the impact of the abolition of slavery on the share price of a slave owning firm. The assets of the firm would be reduced by the value of the slaves, thus lowering the net asset value. Other (non-human) assets of the firm would still be owned. In a market economy the value of the slaves would already account for the expected future value of labor over their lifetime.

## Goodwill Accounting I

The implications from applying simple inalienable rights arguments are far reaching. Take for example the requirement of worker profit appropriation. In a firm, only the current workers (members) are allowed to appropriate the profit. This has dramatic implications regarding the valuation of businesses. Standard finance theory teaches that the present value of a business equals the discounted future stream of profits. But this assumes the current “owners” are going to appropriate the future profits, not the current members at that time. Clearly the profits from the future labor of workers cannot be owned in the present, so the standard valuation method is not correct. If the future profits cannot be owned in the present, then what is the value of a business? The only possible answer is that a firm is worth its net asset value, or the value of its assets minus its liabilities. This is sometime approximated at the book value of a firm for accounting purposes. The supposed value of a firm above its net asset value is called goodwill. Goodwill is an intangible asset, and as we have seen it can't actually exist if member are to appropriate profit. Generally goodwill is linked to the reputation of the firm, its brand name, or customer loyalty which is assumed to enhance future profits. Whether these profits materialize is uncertain and in any case cannot be appropriated in the present before they are earned. In our “market” economy the sale of goodwill through equity trading is actually the prearranged theft of the labor of future workers, in violation of their inalienable rights. Accounting practices are inconsistent on the issue of goodwill. Earned goodwill is not permitted as an asset on a firm's the balance sheet. This makes sense because a firm can't record its future expected profits as a current asset. Yet purchased goodwill (when another firm is acquired for more than its net asset value) is counted as an asset. Something than cannot be earned in the first place obviously can't be sold, but this is exactly what the accounting permits. For illustrative purposes, take the example of a sole proprietorship, a single person firm. Let's say the sole proprietor built up a good reputation and decided to sell their firm under the current valuation methods based on the expected future stream of profits. After the sale the sole proprietor (also the sole employee) decides to quit. The firm's value immediately collapses to the net asset value since there are no longer any expected future earning. Adding employees and wrapping the firm in a formal legal entity has allowed the underlying transactions to be obscured. The inalienable rights arguments dictate that future earnings must be appropriated by the current workers, so the value of all legitimate (worker owned democratically managed) businesses should be their net asset value. Were inalienable rights of workers to be protected, the value of common stock would be converted to debt equal to the net asset value of the businesses and stripped of voting rights. Of course enormous reparations to past workers should also be paid.

## Goodwill Accounting II

### Property rights versus going-concern contractual roles

David Ellerman A basic characteristic of a property right is that it may not rightfully be taken away from a person without the person's consent. A going-concern business is typically at the center of a nexus of market contracts which have a rather limited duration. When a current contract expires, then a customer or supplier may decide for whatever reason to terminate the contract and take their business elsewhere. This does not require the consent of the business operator. The business operator has no property right to force customers and suppliers to continually renew past contracts. Future profits may have been anticipated from the continuation of the old contracts, but no rights were violated if the customers or suppliers decided not to renew the contracts. The anticipated future property rights that would result from the continued contracts, e.g., future profits, might not materialize but that is quite different from some present property right of the business operator being violated. The root of the controversy about "goodwill" is this basic distinction between:

presently owned property rights, and

possible future rights (presently not owned) resulting from a contractual position.

Unfortunately the confusion has been "canonized" into the basic capitalization formulas of finance theory. The standard formulas for the capitalized value of a capital asset routinely capitalize into the value of the asset the possible future profits that depend on a "non-owned" contractual position of the residual claimant in some productive opportunity. Hence our task to tease apart the two parts of the so-called "capitalized value" into:

the part that does represent present property rights, and

the part representing anticipated but not presently owned future profits.

It is this latter part, the capitalized value of anticipated future profits, that is called goodwill.

The capitalized value of an asset

Consider a simple example of a capital asset, e.g., a widget-maker machine, providing capital services  $K$  per period with which the labor services  $L$  will produce  $Q$  units of the product per period. Assume the asset provides these services for  $n$  periods with no maintenance required and then is finished with no salvage value. Let  $r$  be the competitive rental rate per unit of capital service so  $rK$  would be the competitive rental for the asset's services per period. Anyone desiring to use the asset's stream of capital services,  $K, K, \dots, K$ , for  $n$  periods would have the market choice to rent or buy. Competitive arbitrage would equate the present value of the rentals and the market cost  $C$  of the asset. If  $i$  is the interest or discount rate per period, then the equation of the market cost and the discount present value of the rentals is:

Market cost of the asset = Present value of rentals (no salvage value)

What is the "value" of such a machine to the its owner? If no other contracts were available, then the owner might have to rent out the machine at its rental rate and then the value  $C$  would accrue to the owner. But suppose the machine owner, for whatever reason, is able to make another set of market contracts, namely to hire in the labor  $L$  per period at the wage rate  $w$ , and to sell the outputs of  $Q$  per period at the unit price  $p$ . Then the net revenue accruing to the business operator per period is  $pQ - wL$ . Assuming the continuation of these supplier and customer contracts for  $n$  periods, the net present value accruing to the business operator is:

Present value of anticipated business operation to asset owner

So far the analysis is straightforward and unproblematic. But now a subtle error creeps into the standard treatment in capital theory and finance theory. The present value  $V$  is characterized as the "capitalized value of the asset" as

if the combined results of using the asset's services  $K$  per period and the assumed supplier and customer contracts were all part of the property rights of the asset owner. The standard formulas for capitalized asset values and business valuation are all more complex versions of this simple formula. To make the point explicit, one has to parse the formula into the two parts: the present value representing (the future recovery of the value of) present property rights plus the present value of future profits resulting from the assumed "going concern" continuation of beneficial supplier and customer contracts, i.e., the goodwill. In our simple example, the profit each period is:

Anticipated profit per period

so the discounted present value of the profit, namely the goodwill, is:

Goodwill = Present value of future anticipated profits

Then since  $pQ - wL = rK +$ , the capitalized value  $V$  is easily parsed into the sum of the asset's market value  $C$  plus the goodwill  $GW$ :

"Capitalized value of asset" = market value of asset + goodwill. Thus the standard capitalized value formulas for business assets or businesses are not just the value of present property rights but include the value of certain anticipated but presently not owned future profits.

Examples in the literature

The confusions about capitalized value are also expressed in the rather muddled idea that these anticipated future profits are somehow "attached" to the physical assets or the "business."

When a man buys an investment or capital-asset, he purchases the right to the series of prospective returns, which he expects to obtain from selling its

output, after deducting the running expenses of obtaining that output, during the life of the asset. [Keynes 1936, 135]

But the buyer of the asset buys no such right against the customers and suppliers who may freely decide not to continue the past contracts and thus to change the “series of prospective returns” which the asset owner “expects to obtain”. Unfortunately these confusions about the property rights involved in owning a capital asset are carried over in modern corporate finance theory to the valuation of an entire going-concern business as an “asset”.

There, in valuing any specific machine we discount at the market rate of interest the stream of cash receipts generated by the machine; plus any scrap or terminal value of the machine; and minus the stream of cash outlays for direct labor, materials, repairs, and capital additions. The same approach, of course, can also be applied to the firm as a whole which may be thought of in this context as simply a large, composite machine. [Miller and Modigliani 1961, 415]

Miller and Modigliani [1961] give four equivalent formulas for corporate valuation. The formulas can be shown equivalent [Ellerman 1982, 154-5] to a fifth formula that gives the parsing of the capitalized value into the value of the property rights in the underlying assets plus the goodwill (present value of assumed future profits). The essentials of the proof are captured in the simple example used here.

#### Accounting for goodwill

Accounting rules typically do not allow “unpurchased” goodwill to be listed on the balance sheet as an asset, and our analysis indicates this is correct if the balance sheet is to give the value of present property rights. But some accounting rules rather mysteriously allow “purchased goodwill” to be recorded as an asset. This is reminiscent of the old joke about a country bumpkin who comes to New York where a con man sells him the Brooklyn Bridge. Can the buyer then put the Brooklyn Bridge on his balance sheet since he “purchased those rights”? Surely the point is that the buyer cannot purchase a right which the seller does not own in the first place. Hence “purchased goodwill” is no more a present property right than unpurchased goodwill since the seller had no such property right to sell. Capital expended to “purchase” such a non-right should not be recorded as an owned asset but as a debit to equity. Some accountants have courageously argued for this correct procedure, e.g., George Catlett and Norman Olson in Accounting for Goodwill.

The amount assigned to purchased goodwill represents a disbursement of existing resources, or of proceeds of stock issued to effect the business combination, in anticipation of future earnings. The expenditure should be accounted for as a reduction of stockholders' equity. [Catlett and Olson 1968, 106]

The debit to equity would then be replenished if and when the anticipated future profits were earned, i.e., were realized as present property rights. However, one should not expect conceptual clarity in the standard literature on this issue anytime soon. It is not just an issue about accounting for goodwill. As we have noted, the issue involves very basic ideas about just what is owned in the ownership of an asset or a corporation, and the confusion is embedded in the standard asset capitalization formulas of finance theory.

## References

## Personal Responsibility

The inalienability of personal responsibility is the foundation of the abolitionist argument from which all else follows. If one believes in the principle of personal responsibility the rest can be deduced in a straightforward manner. The basic idea is that responsibility for a person's actions cannot be transferred to another party. This distinguishes humans who have personal responsibility for their actions from things which don't. The responsibility for the action of things are imputed to their human user. To transfer responsibility from a person would be to make them less than human. The legal system clearly recognized this principle in the prosecution of crimes. All participants in a crime are held responsible. The law does not excuse a hired criminal because they were following orders. Hiring contracts cannot negate responsibility for participating in a crime because a human cannot alienate control of their actions, at best they can choose to cooperate. The inalienability of responsibility for one's actions does not disappear when a crime is not being committed. It holds in all cases where human action is involved. In particular it applies to productive labor. However, the legal system pretends otherwise when production is involved. It allows financial responsibility for profits or losses resulting from labor to be contractually

transferred violating a principle it readily acknowledges in the commission of a crime. It is a massive institutional fraud on par with the judicial support of slavery. With regard to human rentals the fraud is much more extensive, being truly global in scope.

Consent

“Inalienable” Means Inalienable Even With Consent

David Ellerman

Many political theorists have taken natural rights to be alienable. The last chapter sketched an intellectual history of the non-democratic alienist liberal tradition which emphasized the transferability of natural rights. That pervasive tradition has tried to reinterpret and appropriate the phrase “inalienable rights” to mean rights which cannot be taken without the consent of the owner.

If rights were viewed as property, then inalienability might mean only that a man must consent to what is done with them. [Lynd 1968, p. 45]

Thus theorists professing “inalienable natural rights” could actually be laying the groundwork for slavery and autocracy.

And as Rousseau shrewdly observed, Pufendorf had argued that a man might alienate his liberty just as he transferred his property by contract; and Grotius had said that since individuals could alienate their liberty by becoming slaves, a whole people could do the same, and become the subjects of a king. Here, then, was the fatal flaw in the traditional theories of natural rights. [Davis 1966, 413]

In our own time, Robert Nozick's opening proclamation, Individuals have rights, and there are things no person or group may do to them (without violating their rights) [Nozick 1974, ix] is often taken as a declaration of inalienable natural rights. But the significance is just the opposite as Nozick goes on to condone both voluntary slavery [331] and voluntarily alienating the right of self-determination to a nondemocratic "dominant protective association" [e.g., 15]. Nozick has no notion of rights that are inalienable in spite of consent. A right which requires consent to be alienated is not an "inalienable right"; it is a right as opposed to a privilege. Any legal capacity which could be taken away without the consent of the bearer would hardly qualify as a "right" at all; it would only be a privilege granted and removable by others. In what follows, "inalienable rights" will, unless otherwise indicated, always mean rights which may not be alienated even with the consent of the holder of the rights.

#### The Case of the Criminous Slave: An Example of Inalienability

The theory of inalienability presented here will be illustrated with several intuitive examples of inalienability. Examples that illustrate a point in an intuitive and paradigmatic fashion are called "intuition pumps." When analyzing the employment system, analogies with slavery can provide powerful intuition pumps. We have not been socialized into accepting slavery as part of the furniture of the social universe so we should be able to see it dispassionately and objectively. A legal system of chattel slavery is but one example of a legal system of a system that legally treated persons as nonpersons or things. The ethical condemnation of the system should be based not on utilitarian considerations about how well or poorly the slaves were treated but on that fundamental contradiction or mismatch between the slave's legal role as a thing and the underlying fact of the slave's personhood. Did the legal system really believe that slaves were in fact not persons, or was it an official pretense or fiction? The fraudulent nature of the legal system was openly realized when the slaves committed criminal wrongs. For instance, an antebellum Alabama court asserted that slaves

are rational beings, they are capable of committing crimes; and in reference to acts which are crimes, are regarded as persons. Because they are slaves, they are ... incapable of performing civil acts, and, in reference to all such, they are things, not persons. [Catterall 1926, 247]

The pretense of the slave's thinghood was the basis for the economic system of slavery. But that pretense served no purpose when slaves stepped outside the appointed role and committed crimes.

The slave, who is but ‘a chattel’ on all other occasions, with not one solitary attribute of personality accorded to him, becomes ‘a person’ whenever he is to be punished! [Goodell 1853, 309]

The “talking instrument” in work becomes the person in crime. There are two contradictions here which should not be confused: (1) the formal “inconsistency” in a legal system that treats the same individual legally as a thing in normal work and legally as a person when committing a crime (in the diagram, the formal inconsistency is trying to fit the same peg in both a round hole and a square hole), and (2) the substantive contradiction in a legal system that accepts a de facto person as fulfilling the de jure role of a thing (in the diagram, the substantive contradiction of trying to fit the square peg in the round hole). The merely formal inconsistency could be resolved by always legally treating a slave as a thing, e.g., by treating a criminous slave like an errant beast of burden that caused an injury. The problem of the two contrasting legal roles for the self-same slave is different from the substantive inconsistency between the legal role of the non-criminous slave and the factual status of the slave as a person. The legal-role/legal-role contrast is highlighted not to register any moral complaint but to point out the system’s selfincriminating testimony about the factual-status/legal-role mismatch for the non-criminous slave. In a court of law, testimony against one’s own interests will tend to have the most credibility. In the case of the criminous slave, the legal system of slavery revealed the bankruptcy of its own juridical foundations; it acknowledged that the slave was in fact a responsible person in spite of the slave’s usual legal role as a thing. Sir Henry Maine asserts that “the movement of the progressive societies has hitherto been a movement from Status to Contract.” [1861, reprinted 1972, p. 100], so let us progress to the case where the slave’s legal role resulted from a self-enslavement or self-sale contract. That would not change the essentials of the case. The voluntary contractual slave, like the involuntary slave, would still be legally treated as a person when charged with a crime, and would still embody the fundamental contradiction between the legal role of the non-criminous (contractual) slave and the slave’s factual status as a person.

#### Outline of the Theory of Inalienability

Here is the core of the theory of inalienability. A person cannot in fact by consent transform himself or herself into a thing, so any contract to that legal effect is juridically invalid—even though it might be “validated” by a system of positive law (e.g., the antebellum South). A right is inalienable (even with consent) if the contract to alienate the right is inherently invalid. The self-enslavement or self-sale contract is an old example of such a

contract, while the self-rental or employment contract is a current example. In general, any contract to take on the legal role of a thing or non-person is inherently invalid because a person cannot in fact voluntarily give up and alienate his or her factual status as a person. I can in fact give up and transfer my use of this pen (or computer) to another person, but I cannot do the same with my own human actions—not for a lifetime and not for eight hours a day. The “square peg” can consent to fit into the “round hole” but it nevertheless does not fit. Yet a legal system can “validate” a contract treating human activity as an alienable commodity, and the system can also pretend that obedient co-operating workers “fulfill” the contract—until the revealing moment of unlawful activity. That is, the legal system can pretend that the “square peg” fits into the “round hole.” This argument is called the de facto inalienability argument since it is based on the factual inalienability of essential human characteristic such as responsibility and decision-making.

#### The Case of the Tortious Servant

When an employee or servant commits a tort out of negligence, the employer or master can be held liable. The controversy in the field of agency law surrounding this “vicarious liability” of the employer affords us another illuminating example of the peculiarities of the employer-employee relationship. Justice Oliver Wendell Holmes Jr. outlined the usual norm of imputing or assigning legal responsibility to the de facto responsible party—a norm which emerges as the labor theory of property when applied to property appropriation.

I assume that common-sense is opposed to making one man pay for another man’s wrong, unless he actually has brought the wrong to pass according to the ordinary canons of legal responsibility,—unless, that is to say, he has induced the immediate wrong-doer to do acts of which the wrong, or, at least, wrong, was the natural consequence under the circumstances known to the defendant. [1952, 101]

But in the doctrine of respondeat superior, the master may be held liable for the negligence of a servant even if the wrongful act was not commanded by the master and the master exercised due caution in hiring and instructing the servant. The servant’s act is manifestly not the master’s act, so the master is not de facto responsible for the act. The assignment of legal responsibility to the master does not follow the usual canon of legal responsibility so it is called “vicarious liability” or “strict liability.” The controversy over vicarious liability is not as live today as in the past due to workers’ compensation insurance. But there are several points of interest both in what

is said and in what is not said by the jurists commenting on vicarious liability. We begin by reviewing the legal responsibility of the employer and the employee in normal lawful work. Employees bear no legal responsibility for the positive and negative results of their actions within the scope of their employment. The employer bears all the responsibility. Employees are “employed” as if they were instruments which serve as “perfect conductors” transmitting the responsibility back to the employer. When the employer is a corporation, the natural persons who legally fill the employer’s role are the members or owners of the company, the shareholders. Absentee shareholders, particularly in a corporation with publicly traded shares, have only a notional connection with the productive process in the corporation. Yet the shareholders are the final residual claimants in the corporation; they have the ultimate legal responsibility for the positive and negative results of the lawful actions of the hired hands and heads of the people (managers and workers) working in the firm. What happens when an employee commits a negligent tort? As one would expect from the case of the criminous slave, the tortious servant emerges from the cocoon of non-responsibility metamorphosed into a responsible human agent.

That is to say, although it is contrary to theory to allow a servant to be sued for conduct in his capacity as such, he cannot rid himself of his responsibility as a freeman, and may be sued as a free wrong-doer. This, of course, is the law to-day. [Holmes 1952, 79]

An employee may be sued for a tort or civil wrong and “being an employee” is not a defense or shield against legal responsibility for wrongful actions. The law also allows the victim to sue the employer or master, although the plaintiff cannot collect damages twice. If the employer is found legally liable, then it is only liability in a “strict” legal sense since the master was presumed not to be de facto responsible. Justice Holmes attacked strict liability—“I therefore assume that common sense is opposed to the fundamental theory of agency” [1952, 102]—because it violated the usual juridical principle of assigning legal liability in accordance with de facto liability, a liability established strongly by intentional action or weakly by negligent behavior. Others supported vicarious liability because the employer has a “deeper pocket” and because liability for employee negligence should be part of the costs of modern business enterprise [e.g., “The Basis of Vicarious Liability” in Laski 1921]. There has been such a focus on the employer’s liability that one is apt to forget the employee’s liability.

We have noticed that students sometimes slip into the fallacious assumption that because the employer is liable, the employee is not. This idea is wholly false. The law of agency, which makes employers liable, does not repeal the law of torts, which makes negligent individuals liable. [Conrad, et. al. 1972, 168]

The employee, after all, is the de facto responsible person. Perhaps the most astonishing aspect of the vicarious liability debate is the complete failure to apply the “ordinary canons of legal responsibility” to the normal employment relation. Jurists are perturbed when legal liability is assigned to the employers who have no de facto responsibility. But there is not a word about the fact that the employees are jointly de facto responsible, together with a working employer, for the results of normal lawful work, and yet the employees have zero legal responsibility for the results of those actions. The employer has all the legal responsibility for the positive and negative results of the employees’ actions within the scope of lawful employment. No one in the debate notices that the employment relation seems to “repeal” the ordinary canons of legal responsibility. No deep analysis of the sociology of knowledge is required to fathom this blind spot in legal analysis. The basic social institutions structure the horizons of thought. The application of the ordinary canon of legal responsibility would reveal an inherent flaw in the employment relation—a result clearly beyond the pale of responsible jurisprudential analysis in an economic civilization based on that relationship.

#### Employees Versus Independent Contractors

Normative principles such as the ordinary canon of legal responsibility (a.k.a. the labor theory of property) and the principle of democratic self-determination all converge to attack the institution of renting human beings, viz. the employer-employee relationship. The alternative to employment is (individual or joint) self-employment. That is, the alternative to the private or public enterprise employment firm is the democratic business enterprise where working in the firm qualifies one for membership in the firm. The smallest examples of democratic businesses are independent business-people operating without the benefit of hired labor. If those independent operators produce and/or sell a tangible appropriable product, there is no possibility of considering them as employees of their customers. When one buys a pumpkin from a farmer, there is no possibility of taking the farmer as one’s employee. When the product, however, is not a separate, tangible, and appropriable commodity, then the possibility does arise of confusing the independent contractor with the employee. The two legal roles are fundamentally different in theory even though some grey-area cases can arise in practice. It will be useful to review the distinction which is particularly important in agency law since the customer is not vicariously liable for the negligent torts of an independent contractor. The legal role of the independent contractor does not violate democratic principles or the labor theory of property. The independent contractor self-governs his or her work. Indeed, the “control test” (testing non-self-government) is one of the most important legal tests used to

distinguish employees from independent contractors. Ronald Coase quotes from a legal reference book in his classic article on the nature of the (employment) firm.

The master must have the right to control the servant's work, either personally or by another servant or agent. It is this right of control or interference, of being entitled to tell the servant when to work (within the hours of service) and when not to work, and what work to do and how to do it (within the terms of such service) which is the dominant characteristic in this relation and marks off the servant from an independent contractor, or from one employed merely to give to his employer the fruits of his labour. In the latter case, the contractor or performer is not under the employer's control in doing the work or effecting the service; he has to shape and manage his work so as to give the result he has contracted to effect. [Batt 1929, 6]

The individual independent contractor is self-managing so that legal role does not violate the principle of democratic self-determination. The independent contractor does not alienate or transfer control over his or her actions. The employee sells his capacity to work during a certain time period, or, in Marxian terms, his labor power; the employer controls the execution of the services. An independent contractor is not rented by the customer; only a certain service or effect is sold. This is particularly confusing because the word "hired" is sometimes applied to independent contractors as well as to employees. When someone "hires" a lawyer in independent practice, that lawyer is an independent contractor. If a corporation hires a lawyer onto its legal staff, that lawyer is an employee of the corporation. The independence of the role of independent contractors means that they legally appropriate the positive and negative fruits of their labor. They appropriate and sell the positive fruits, typically an intangible service or effect (e.g., repairing a faucet or painting a house). They also directly bear their costs (appropriate the negative fruits of their labor) even though the costs are passed on to the customers as part of the price of the product. For instance, an independent house painter might present the home owner with a bill itemizing so many hours of labor and so many gallons of paint. But the homeowner has not purchased the painter's labor as an employer; the painter has simply itemized the labor and paint to "justify" the price of the entire paint job.

### The Identity Fiction

The case of the tortious servant also gives us the occasion to examine some of the legal fictions surrounding the employer-employee relationship. We saw in the case of slavery how jurists could be quite explicit in describing the slave as having the legal role of a thing (for lawful activities). Such candor is the

exception. There are more subtle ways to legally treat a person as a non-person. One legal strategy to deny an individual's legal personality is to "identify" the individual with another person. The baron-feme relationship established by the coverture marriage contract exemplified the identity fiction in past domestic law. A female was to pass from the cover of her father to the cover of her husband; always a "feme covert" instead of the anomalous "feme sole." The identity fiction for the baron-feme relation was that "the husband and wife are one person in law" with the implicit or explicit rider, "and that one person is the husband." A wife could own property and make contracts, but only in the name of her husband. For the employment relation, the identity fiction states that "the master and servant are considered as one person" or "the act of the servant is the act of the master."

The identity fiction expresses an older mode of legal thought about the employment relation; it is not needed to understand or explain the employment relation in modern terms. But it does catch the sense of the employee's instrumentality. Within the scope of lawful employment, an employee does not have the legal role of a responsible person. The employer has all the legal responsibility for the results of the acts of the employees so "the acts of the servants are the acts of the master." A variation on the identity fiction is given by the phrase: *Qui facit per alium facit per se* (that which is done through another is done oneself). This also captures the instrumental role of the employee. The employer "acts through" the employees. For the sake of legal clarity, it is unfortunate that the identity fiction is also applied to situations where no fiction is appropriate and it is quite unnecessary. The master-servant relation is usually defined to be a subset of the principal agent relation (hence the name "agency law") so that a blue-collar production worker is technically an "agent." But an independent contractor, such as a lawyer in private practice, can also be an agent. When a lawyer acts as a properly authorized agent to negotiate a contract, the principal is also said to "act through" the agent. A principal, however, "acts through" an independent lawyer in quite a different sense than an employer acts through, say, a production worker. The lawyer conveys information and can perform symbolic legal acts (e.g., signing a contract) for the principal. The direct physical act of an independent contractor would, however, never count as the direct physical act of the principal. As Justice Holmes observed, "the precise point of the fiction is that the direct act of one is treated as if it were the direct act of another" [1952, 111-112]. Therefore the identification fiction is not required to account for the relationship between a principal and an independent contractor as agent—even though sloppy habits of legal thought might apply identification language to that case. The identity fiction only has a role when the legal personality of an individual (e.g., an employee or a feme covert) is "subsumed" under the legal personality of an alien legal party ("alien" in the sense that the individual is not included in the legal party).

What is the alternative to the employment contract or to any other contract to alienate and transfer control over certain of one's activities such as the now-abolished self-enslavement contract or the coverture marriage contract? The alternative is membership—so the individual is not alien to the redefined broader legal party. For instance, the alternative to coverture is marriage as a type of domestic partnership. Each spouse is an equal partner and can make contracts for the partnership. The alternative to the employment contract is the democratic firm (also a type of generic “partnership”) where work gives membership. In a democratic firm, there is identification without fiction; the worker/member is a part of the firm.

The case of the tortious servant has given us the opportunity to make a number of points. It allowed us to introduce the distinction between employees and independent contractors. It also showed how the identity fiction was used in the legal conceptualization of relationships which depersonalized certain individuals by identifying them with another individual or an alien legal party (of which they are not a part). Historical examples include the master-slave, baron-feme, and employer-employee relationships. The overall theme of this chapter is inalienability. The employee contracts into a legal role where some other alien party has all the legal responsibility for the results of the employee's lawful actions. The ordinary canon of assigning legal responsibility in accordance with de facto responsibility is violated. But when the employee commits an unlawful act such as a tort or civil wrong, the law sees no point to insulating the employee from that responsibility. The employee is said to have stepped outside the employee's role. Then the usual legal canon applies and the employee may be sued for the tort. In de facto terms, the employee is, if anything, more responsible for the fruits of the perfectly deliberate and intentional actions of lawful work than for an unintentional but negligent tort. That capacity for de facto responsibility is in fact inalienable. The law pretends it has been alienated. The law pretends the act of the servant is the act of the master so long as the pretense is not abused by unlawful actions.

#### The Case of the Criminous Employee

The unique property of labor, namely responsible agency, is not factually transferable. The case of the criminous employee is another parable or “intuition pump” which illustrates that key idea in the theory of inalienability. Suppose that an entrepreneur hired an employee for general services (no intimations of criminal intent). The entrepreneur similarly hired a van, and the owner of the van was not otherwise involved in the entrepreneur's activities. Eventually the entrepreneur decided to use the factor services he had purchased (man-hours and vanhours) to rob a bank. After being caught, the entrepreneur and the employee were charged with the crime. In court, the worker argued that he was just as innocent as the van owner. Both had sold the services of factors they owned to the entrepreneur. “Labor Service

is a Commodity” [Alchian and Allen 1969, 469], as one can learn from economics texts. The use the entrepreneur makes of these commodities is “his own business.” The judge would, no doubt, be unmoved by these arguments. The judge would point out it was plausible that the van owner was not responsible. He had given up and transferred the use of his van to the entrepreneur, so unless the van owner was otherwise personally involved, his absentee ownership of the factor would not give him any responsibility for the results of the enterprise. Absentee ownership of a factor is not a source of responsibility (a point which should not be forgotten in our later discussion of marginal productivity theory in economics). The judge would point out, however, that the worker could not help but be personally involved in the robbery (unless he, per imp ossible, was totally unaware of what he was doing, or rather as an economist might say, of what was being done with his man-hours). Man-hours are a peculiar commodity in comparison with van-hours. The worker cannot “give up and transfer” the use of his own person, as the van owner can the van. Employment contract or not, the worker remained a fully responsible agent knowingly co-operating with the entrepreneur. The employee and the employer share the de facto responsibility for the results of their joint activity, and the law will impute legal responsibility accordingly.

All who participate in a crime with a guilty intent are liable to punishment. A master and servant who so participate in a crime are liable criminally, not because they are master and servant, but because they jointly carried out a criminal venture and are both criminous. [Batt 1967, 612]

It should be particularly noted that the worker is not de facto responsible for the crime because an employment contract which involves a crime is null and void. Quite the opposite. The employee is de facto responsible because the employee, together with the employer, committed the crime (not because of the legal status of the contract). It was his de facto responsibility for the crime which invalidated the contract, not the contractual invalidity which made him de facto responsible. The commission of a crime using a rented van does not automatically invalidate the van rental contract. The legality or illegality of a contract cannot somehow create de facto responsibility that would not otherwise exist.

Defenders of the Received Truth about the employment system will have much difficulty understanding this argument. They might take the legal superstructure as the reality, and thus they would lose sight of the underlying factual situation. It is as if one identifies guilt and innocence with what is decided in a court of law (i.e., with legal guilt or innocence). Such a “legalistic” viewpoint ignores the factual question of whether the defendant was de facto responsible for the accused act. It is a miscarriage of justice

when there is a mismatch between legal and factual responsibility, i.e., when an innocent person is found legally guilty or when a guilty person is found legally innocent. A similar neglect of the underlying factual reality is involved in the standard argument that “responsibility” is determined by the employment contract (when only legal responsibility is so determined).

Employees voluntarily give up their responsibility for the products of their labor in the employment contract. There is no inconsistency involved in holding the “criminous employee” responsible because he is not really an employee. A contract involving the commission of a crime is null and void, so he stepped outside of the employment contract when he committed the crime. In the democratic firm, the workers don’t give up their responsibility to an employer; they are jointly selfemployed. Thus it is quite proper in that case for them to have the ownership of the product, but not in the case of a normal capitalist firm.

That argument stays at the legal level of responsibility and does not touch the question of the underlying factual responsibility. The point is that de facto responsibility is not transferable; the non-criminous employee in a normal firm is just as de facto responsible as the criminal. It might be helpful to (roughly) translate the above argument into pegs-and-holes language.

Square pegs consent to fit into round holes in the employment contract. There is no inconsistency involved in holding the criminous peg responsible (i.e., being in the square hole) since he was not really in the round hole. By committing the crime, he stepped outside the round hole and thus fit in the square hole. In the democratic arrangement, the square pegs do not agree to fit in the round holes, so it is quite proper in that case for them to be in the square holes—but not in the normal capitalist arrangement (where they have agreed to be in round holes and have not stepped outside by committing crimes).

“Consent” does not improve the fit of the square peg in the round hole. The point is that the square peg does not fit into the round hole regardless of whether it is legally agreed to or not. It is again helpful not to confuse (1) the formal “inconsistency” in a legal system that treated the same individual legally as a thing (e.g., in normal work) and legally as a person when committing a crime, and (2) the substantive contradiction in a legal system that accepts a de facto person as fulfilling the de jure role of a thing (e.g., the employee in normal work). By rendering the criminous employment contract null and void, the law escapes the formal “inconsistency” of having an individual simultaneously in the legal role of a responsible person and in the

legal role of an employed instrument. That keeps the bookkeeping straight at the legalistic level. The problem is not with the imputation of legal responsibility to the criminous employee. That is a correct assignment since the worker was de facto responsible together with the entrepreneur for the results of their joint activity. The problem is with normal work when the employment contract is treated as being “valid.” When the “venture” being “jointly carried out” is non-criminal, the employee does not suddenly become an instrument like the van. The worker is still jointly de facto responsible, but then the employer gets all the legal responsibility. The problem is that substantive contradiction in the normal employment relation wherein a de facto responsible person has the legal role of a “non-responsible” instrumentality being “employed” by the employer.

Those who place great stock in the voluntariness of the labor contract should heed these examples of inalienability. The criminous employee would most certainly voluntarily alienate his responsibility for the fruits of his labor, i.e., for robbing the bank. He would love, for once, to be legally treated as just an instrument employed by the employer. But the law says no. The law would not validate such a contract, and yet, with no hint of personal involvement, there is no reason to invalidate the van owner’s contract. Why the difference? Does the law arbitrarily decide to validate some contracts and to invalidate others? No, the difference is quite clear. The van owner can in fact give up and alienate the use of his van; the worker cannot do the same with his person. It is that factual inalienability and nontransferability of the responsible agency of human action (a.k.a. labor services) that is the foundation of the de facto theory of inalienable rights.

#### The Case of the Part-time Robot

The example of a person who functioned as a part-time robot is another intuition pump to illustrate the de facto inalienability argument. Since the argument is based on the facts about human nature, we might assume that science fiction technology can modify human nature enough to defeat the argument. Suppose that it were possible to electronically implant a small computer in a person’s brain so that by flipping a switch the individual was “taken over” and “driven” by the computer under the control of an external user or employer. When in the robot mode, the individual would have no ability to deliberately terminate or even influence his or her “actions” (or rather behaviors). When the computer was externally switched off, the individual would regain conscious control and be able to act in the usual deliberate and responsible manner. One could vary the example by imagining some drugs that would temporarily turn a person into a part-time zombie, but we will stick to the high-tech imagery of a computer-driven part-time robot. The part-time robotization would change human nature to make it safe for the employment system. The person as a part-time robot would not be de facto responsible for the positive or negative fruits of

“its” services. The person as a part-time robot would not have decision-making direct control over “its” services. Those labor-services would be de facto transferable like the services of a van—so the legal validation of the employment contract for the transfer of those robot services would not be an institutionalized fraud. The example of the part-time robot is illuminating from another viewpoint. Since the employment contract fits the part-time robot without involving any fraud, that means the employment contract applied to ordinary persons treats them as if they were such part-time robots within the scope of their employment. That is, the employment contract imputes zero legal responsibility to the employees for the positive or negative fruits of their labor as if they were part time robots employed by an employer. In short, renting people treats them as if they were things.

### The Inalienability of Decision-Making

The inalienability of de facto responsibility is central to the labor theory of property and to the analysis of the employment contract as it affects the property relations of the firm. But the labor theory of property is only one leg of the analysis of the employer-employee system and of the alternative of democratic worker ownership or universal self-employment. The other leg is democratic theory. It analyzes the employment firm and the democratic or self-employment firm as governance systems, and it views the employment contract in the employment firm as an instrument of governance. The general point of the de facto inalienability analysis is that a person’s factual status as a person is unchanged by consent or contract. Hence any legal contract to take on the legal role of a non-person or thing cannot be fulfilled and is inherently null and void. The law can only pretend that certain appropriate behavior “fulfills” the contract— and that pretense is dropped when the person commits a crime. The intuition pumps of the criminous slave, the tortious servant, the criminous employee, and the part-time robot have illustrated the argument by focusing on responsibility, the central theme in the labor theory of property. The inalienability argument can also be illustrated by focusing on decision-making, the central theme in democratic theory. The employment contract does not “short-circuit” or bypass an individual’s decision-making capacity just as it does not bypass the person’s responsible agency. The employee is inexorably a co-decision-maker just as he or she is inexorably co-responsible for the results of voluntary joint activity with the employer. For instance in the bank robbery example, the entrepreneur may well have taken the initiative to rob the bank. But the employee participates in the robbery as a (by assumption) conscious voluntary human activity. Thus the employee must have also made the decision to participate in that activity. “Taking orders” to do X is only another way of deciding to do X. The van owner, by way of contrast, can in fact alienate the decisions about the specific uses of the van. In the example of the part-time robot, the person qua person has the role of the van-owner, and the part-time robot has the role of the van. The

entrepreneur makes the decision to use the van to rob a bank rather than, say, to move furniture, and the van owner is not involved in that decision. Both the employee and the van owner alienate the legal control rights over the specific uses of their man-hours and van-hours (within certain limits) in their respective rental contracts. The difference is at the factual level, not the legal level. The van owner can in fact give up any involvement in those specific use decisions; the employee cannot.

The legal relationship of hiring an entity (i.e., buying the entity's services) may be applied without any inherent fraud to the hiring of a van (or part-time robot); it cannot be similarly applied to hiring a responsible human being. In a joint or social human activity such as most production processes, individual responsibility may be difficult or impossible to determine, and individual decision-making may be equally infeasible. Responsibility is joint, and decision-making needs to be coordinated, often around a unified center. How then should a joint human activity be organized recognizing that all human participants are de facto co-responsible and de facto co-decision-makers? There needs to be a unified legal party to be legally responsible for the results of the joint activity and to be the locus of unified decision-making authority. The employment firm provides a unified legal entity for the joint human activity of production, but it legally denies the employees' co-responsibility and their co-decision-making (for lawful activities). It is not "their business." The alternative to employment is membership in a jointly self-employed group or team. The alternative to the nonresponsible instrumental role of the employee is not individual legal responsibility (since it is a joint activity) but membership in the unified legal party that is legally responsible for the results of the joint activity. Thus the analysis focusing on responsibility leads to the notion of the democratic worker-owned firm, a firm where the members are the people working in the firm. The analysis of decision-making leads to the same conclusion. The employment contract legally alienates decision making just as it legally alienates responsibility—even though both are factually inalienable. The alternative to alienating ("translatio") decision-making is the delegation ("concessio") of decision-making authority to a unified center such as the management in a democratic firm. Then the decisions are made for and in the name of those who are managed. Thus the alternative to non-democratic management in the employment firm is not the chaos of individual decision-making but democratic management which unifies and coordinates decision-making using authority delegated from those who are managed. By delegating that authority and ultimately accepting and ratifying the decisions in action, the workers are jointly (not individually) self-governing their activities in a democratic firm.

## Misinterpretations of the De Facto Inalienability Argument

David Ellerman

There are a number of common misunderstandings of the de facto inalienability argument. For example, it is possible to misunderstand the point of the case of the criminous slave particularly when stated in contractual terms. A contract which involves the commission of a crime is not enforceable and is null and void. Hence when a contractual slave committed a crime, he or she voided the contract and thus stepped outside of the contractual role of a thing. Thus the legal system could without any actual inconsistency or embarrassment hold the person legally responsible for the crime. There is a right and proper legal reason to move the square peg from the round hole to the square hole. This point is quite correct but irrelevant to the substantive mismatch, the contradiction between the legal role of the non-criminous contractual slave and factual status of the person [the square peg not fitting in the round hole in the first place]. Obviously the non-criminous slave was not in fact a thing that (who?) suddenly blossomed into personhood when he, she, or it detoured into crime. The non-criminous contractual slave had the factual status of a person just as the criminous slave. The real issue is the factual-status/legal-role mismatch for the contractual slave (square peg/round hole mismatch). When a legal system recognizes such a contract as valid, then the legal system is adopting a pretense or fiction. There always seem to be other misunderstandings of the inalienability argument.

Surely you are arguing that the self-sale contract is invalid because the worker is paid too little. What adequate compensation can there be for a lifetime of labor? Freedom is priceless so there can be no real quid pro quo in a self-sale contract.

That is a complete misunderstanding of the de facto inalienability argument, an argument which never considers the terms of the contract. The argument is similarly independent of assertions that slaves or servants were or are mistreated, overworked, and exploited. The mistreatment arguments are only qualitative variations on the more quantitative underpayment argument. The underpayment analysis of the self-sale contract is as superficial as the

official Marxist argument that the problem with renting human beings is that they are not paid the full value of the labor they actually perform. Another misunderstanding concerns the role of voluntariness in the inalienability analysis.

Surely you are arguing that a self-sale contract is invalid because it is really involuntary in spite of the surface characteristic of formal consent. Look at the historical examples. Fearing the example set by free blacks, there was agitation in several slave states in the years immediately preceding the Civil War to require that free blacks select a master and voluntarily resubmit to slavery or else leave the state [see Franklin 1969; Gray 1958]. Any such re-enslavements would hardly pass muster as “voluntary contracts.”

The analysis is totally independent of the historical question of the degree of involuntariness in the self-sale contracts of the past. The de facto inalienability critique assumes a perfectly voluntary contract. An involuntary “contract” would be a fortiori null and void. If “the problem” with historical self-sale contracts was their involuntariness, then the presupposition is that the contract would be acceptable if it were genuinely voluntary. Because if the contract embodied some deeper flaw that would render it invalid even if perfectly voluntary, then there is no need to consider degrees of historical voluntariness. Yet the alienist liberal tradition that reached its apogee in Nozick’s acceptance of voluntary self-sale contracts [1974, 331] sees no deeper flaw, and thus it focuses on voluntariness. The mirror-image of this liberal superficiality is the official Marxist fallback argument that the wage labor contract is socially involuntary. If the labor-theory-of-value argument that wage workers are exploited because they are paid too little is found unconvincing, then perhaps one will accept the backup argument that the contract is socially involuntary because workers born with only their labor power to sell have no other real choice. Yet another misunderstanding of the argument concerns the rationality of the contract.

Surely you are arguing that a self-sale contract is invalid because no rational person would enter into such a contract. Only a person not in possession of their faculties would agree to the contract, and a contract by a legally incompetent person is invalid.

Again, the de facto inalienability argument makes no presumption about which contracts are considered “rational” or “irrational” by the standards of the day.

Surely you are expressing a value judgment that a self-sale contract should be invalid, and thus that the right to self-determination should be inalienable.

The de facto inalienability argument is rooted in facts—not in value judgments. It is a fact that I can voluntarily alienate the use of this writing instrument (my pen or my computer), and it is a fact that I cannot do the same for my own personal actions. To use the language of the employment contract, I am inexorably the “employer” of my intentional actions (a.k.a. “labor services”). I can at most agree to co-operate with other people, and then we are jointly responsible for the results. Yet the contractual framework for the sale and transfer of a commodity is applied to human labor as it is applied to pens and computers. The law pretends that the responsible co-operation of the employee with the employer “fulfills” the contract for the transfer of labor. The employer enjoys the sole de jure responsibility for the (positive and negative) results of the human actions. But the legal fiction of the transferred labor must not be abused for the commission of a crime. Then the fiction is set aside in favor of the facts. The worker whose labor was sold by the lifetime or by the hour is now recognized as co-responsible with the master for the results of their joint activity. The instrument in work is promoted to a partner in crime.

#### A Misunderstanding of the Criminous Employee Example

One of the principal intuition pumps of de facto inalienability theory is the criminous employee example. There is not one but two “inconsistencies,” and they should not be confused; (1) the formal or legalistic inconsistency of treating the same person legally as a thing (e.g., in the normal employee’s role) and legally as a person (e.g., when committing a crime), and (2) the substantive inconsistency in a legal system that accepts a de facto person as fulfilling the de jure role of a thing (e.g., the employee in normal work). These inconsistencies could be restated using the analogy of the square peg (de facto person), the round hole (legal role of a thing), and the square hole (legal role of a person). In terms of the hole/peg analogy, one should not confuse: (1) the formal or legalistic inconsistency of treating the same peg as fitting in both a round hole and a square hole, and (2) the substantive inconsistency in a legal system that accepts a square peg as fitting in the round hole. It is argued that once the employer and employee commit a crime (or conspire to do so), they step outside of and invalidate the employment contract. They become partners carrying out a joint venture, and the law treats them both as being legally responsible for the results of their actions. Thus there is no legal inconsistency in treating the criminous ex-employee as being legally responsible. That is correct, and that was not the point of the example of the criminous employee. The fact that the criminous activity invalidates the employment contract does indeed keep the legal bookkeeping straight. The

substantive inconsistency is the point of the criminous employee example. The employee does not suddenly burst into personhood when committing a crime and then lapse into automatism in normal work (e.g., as in the hypothetical part-time robot example). The person is just as much de facto responsible for non-criminous work as for committing a crime in co-operation with the employer. It is a factual point, not a legal point. The example of the criminous employee forcefully brings this fact to light. The foundation of the legal framework for the employment system is the legal validation of the employer-employee contract, the acceptance of the employees' de facto responsible cooperation with their employer as fulfilling the labor contract. It is an institutionalized fraud. There is no testimony about this fraud as telling as the testimony of the legal system itself in the case of the criminous employee. In order to hold the employee legally responsible for his or her de facto responsible actions, the legal system has to render that employment contract null, void, and invalid. That is the correct juridical response, and we have only argued that it should be extended to all employment contracts. People should always be held legally responsible for the positive and negative results of their de facto responsible actions, and thus the employment contract should always be considered null, void, and invalid.

#### De Facto Inalienability Theory as a "Value Judgment"

Economists are much more comfortable about a normative argument if they can label it as a "value judgment"—as in "I hate pink plastic flamingos." Then the interpretation of the de facto inalienability argument is as follows.

Everyone has a right to their value judgments. You think that pink plastic flamingos should be banned, that anchovy pizzas should be banned, and that employment contracts should also be banned. There are already laws against selling various items (e.g., certain controlled drugs, rare animals, and dangerous firearms), and you are expressing the value judgment that labor should also be made non-transferable.

That is a misunderstanding of the de facto inalienability argument. Controlled drugs, rare animals, and dangerous firearms are all de facto alienable and transferable. The de facto inalienability argument was never used as an argument against the legal sales of those items [see Rose-Ackerman 1985 for some of the arguments]. Labor is different. It is not a value judgment that labor is de facto inalienable and nontransferable; that is an empirical factual judgment. If true, then the legal contract to transfer that which is inherently non-transferable would be fraudulent. There is a value judgment involved here, namely that inherently fraudulent contracts should not be legally validated. But the Defenders of the Received Truth would rather not defend the employment

contract by taking issue with that value judgment.

### “Interpreting” Employees as Independent Producers

One strategy for the Defense is simply to “reinterpret” the employment contract in some more palatable form—as if the contract was putty that could be remolded at will. For example, let’s “say” the workers are selling their outputs instead of their labor. However, that is not the way the employment firm is legally structured. In order to sell their outputs, the workers must first own them, and that requires paying for the inputs. One could also “say” the workers bought the inputs—but that is only more “flapping one’s wings in the void”—so let’s try another tack. Another flight of fancy is to “interpret” all employees as independent producers of labor. The labor services themselves are “interpreted” as the only fruits of their labor, so in that sense the workers can be “said” to produce, own, and sell the fruits of their labor. In terms of the stylized model, the labor services *L* are taken as the only fruits of the workers’ labor; the tangible product *Q* is taken as being produced by the employer who set up all the contracts. The basic idea is to sever—at the level of legal interpretation—the connection between the performance of the labor *L* and the production of the product *Q*. The employees produce only *L*, while the employer produces *Q*. Independent producers pay for their own inputs. Thus to continue the “reinterpretation,” one must also sever the connection between performing *L* and using up the non-labor inputs *K*. Let’s “say” the employer uses up *K*. The only activity the employees are performing is the production of the labor services *L*, and they do pay for the food, clothing, and shelter involved in producing that labor. Independent producers also have direct control of their services. Therefore, let’s “reinterpret” the employment relationship as not involving authority.

To speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties. Telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread. I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue their relationship. [Alchian and Demsetz 1972, reprinted in Putterman 1986, 112]

Thus each employee is interpreted as an independent self-employed job shopper producing either typing-labor or filing-labor according to what the customer wants. This continuous-renegotiation view of the labor contract goes back to John R. Commons.

The labor contract is not a contract, it is a continuing renewal of a contract at every successive moment, implied simply from the fact that the laborer keeps at work and the employer accepts his product. . . [The employee] does not own the job—his employer is under no duty to keep him—he owns the liberty to be continuously bargaining with his employer to be kept on the job by virtue of continuously delivering a service which the employer continuously accepts, thereby impliedly renewing continuously the contract. [Commons 1968, 285-286]

This is true of any at-will rental contract, such as an at-will lease of an apartment, so it does not address the specific critique of the labor contract. The important part of the Alchian-Demsetz argument is not the point about continuous renegotiation but the reinterpretation of the employment relation as a non-authority relation like a contract with an independent producer. The customer is not in an authority relationship with the grocer. The typing-labor or filing-labor is the only product of the worker that the employer decides to buy (like the can of tuna or the loaf of bread). The worker produces and sells that labor in a made-to-order fashion in his or her labor-job-shop. This interpretation of the labor contract can be stated using our description of Labor's Product.

$$\text{Labor's Product} = (Q, -K, 0) = (Q, -K, -L) + (0, 0, L) = \text{Whole Product} + \text{Labor.}$$

The interpretation of the employees as independent producers of labor, in effect, makes an incision and cuts the causal connection between the labor  $(0, 0, L)$  and the whole product  $(Q, -K, -L)$ . The workers are pictured as only producing and selling the labor  $L$ ; the whole product is produced by the employer. Like the watchmaker who assembles the watch so that it will run correctly, the employer makes all the right contracts for  $L$  and  $K$  so that the whole product  $(Q, -K, -L)$  will be produced as the result. This independent-producer interpretation of the employee's role looks, at first, like a novel theory, but it turns out to be only an ingenious and elaborate restatement of the conventional theory. The usual theory is that the employees sell the labor  $L$  as a commodity, and that the employer employs the labor  $L$  and the other inputs  $K$  to produce the product  $Q$ . The problem with the theory never was its legal coherence; it hangs together beautifully. The problem was at the factual level. Labor did not fit the mold of a transferable commodity; labor services are not transferable like a can of tuna, a loaf of bread, or the services of an apartment or a van.

Take, for example, the idea of severing the connection between performing the labor L and producing the product Q. There are times when an individual wants to be severed from the results of his actions. For instance, the hired killer does not want responsibility for the fruits of his labor. That even shows in the language; he is a “trigger-man.” The hired killer bears no personal animus against the victim; he is only hired to “pull the trigger.” He would like to sever the labor—“pulling the trigger”—from the resulting murder. But the facts cannot be so easily “reinterpreted.” He together with the “entrepreneur” is de facto responsible for the murder. In contrast, consider the de facto transferable services of a truck or van. A van and its owner can be parted. The services of the van can be severed from the owner and de facto transferred into the employment of another person. The van user’s employment of the van is not an authority relation over the will of the van owner. If the van owner chooses to continue the at-will rental contract when the van user chooses to use the van to go shopping for a can of tuna instead of going to mail a letter, then the van owner is, in effect, supplying the van user with tuna-shopping-van-services rather than letter-mailing-van-services. If labor services could in fact be similarly severed and de facto transferred into the employment of another person, then there would be no de facto inalienability critique of the contract. But that is not the case. The imaginative restatement of the employee as an independent producer of labor does nothing to change those facts.

#### “Voluntary Acts Between Knowledgeable Consenting Adults”

Liberalism, and particularly libertarianism, argues that at least a prima facie case can be made for allowing any voluntary acts between knowledgeable consenting adults. Does the de facto inalienability argument rule out any such voluntary acts between consenting adults? The (surprising) answer is “No” [at least not at the underlying noninstitutional level]. Understanding this answer requires a keen appreciation of the difference between the institutional (de jure) overlay and the underlying non-institutional (de facto) realities. The de facto inalienability argument does not rule out the de facto transfer of labor since it takes that to be impossible in the first place. What it rules out is the institutional overlay of the employment contract superimposed on the reality where labor has in fact not been transferred. What the argument excludes is at the institutional level, not at the underlying non-institutional level. It forbids the legal validation of an inherently unfulfillable contract. It does not forbid any non-institutionally described voluntary acts between knowledgeable consenting adults. Nozick pointedly uses the expression “capitalist acts between consenting adults” [1974, 163]. The adjective “capitalist” is institutional so Nozick is not simply arguing for allowing voluntary acts between knowledgeable consenting adults. He is arguing for certain institutional superstructures to be laid over those voluntary acts. Nozick,

with admirable consistency, argues not only for “capitalist acts” but also for the slavish acts involved in the voluntary self-enslavement contract [331]—as if there were no problem for a person to de facto fit the legal role of a non-person. The abolition of the employment contract, like the abolition of the self-sale contract, does not infringe on the freedom to make (non-fraudulent) contracts; it only restricts the “freedom” to make inherently unfulfillable and naturally invalid contracts. The employment contract is, like the self-sale contract was, a subtle fraud vouchsafed by the legal system itself. Yet the point about “voluntary acts” can be illustrated by considering a simple fraud. There are widgets and cheap pseudo-widgets, and it is difficult to tell them apart. A buyer B legally buys a widget from the seller S and pays its price, but S transfers a pseudo-widget to B to “fulfill” the contract. There is a mismatch between the legal transfers and the factual transfers. In this case, there are two ways to restore a transfer matching:

change the factual transfers—S furnishes a genuine widget to replace the pseudo-widget—or,

change the legal transfers—rewrite the legal contract as a contract to buy a pseudo-widget—which may or may not be agreeable to B.

The point is that there is no fraud involved if B knowingly agrees to the rewritten contract to buy the pseudo-widget for the same money (the price of a real widget). If the same de facto transfers could be carried out with no fraud involved, then what is the point of a fraud? The point is that—without the fraud—the defrauded party would very likely not agree to the same de facto transfers. For example in a democratic firm, Labor might not want to make a gift of the profits to Capital. What in fact is ruled out by the prohibition against frauds? No voluntary acts between knowledgeable consenting adults are prohibited. It is the mismatch between the legal transfers and the factual transfers to fulfill the contract that is prohibited. In the example, the voluntary act of knowingly exchanging the price of a genuine widget for a pseudo-widget was not prohibited. While the de facto inalienability argument does not rule out any voluntary acts between knowledgeable adults, it does rule out “capitalist acts between consenting adults.” The employment contract involves a transfer mismatch. But, since labor is de facto non-transferable, there is only one way to remedy the mismatch, namely rewrite the legal transfers in some fulfillable form. Consider the simple model of the employment firm involving the parties Labor and Capital. In the non-institutional factual description of the transfers, the non-labor inputs  $K$  and a sum of money  $M$  (e.g., the wages  $wL$ ) are factually transferred from Capital to Labor, and Labor

produces the outputs  $Q$  and factually transfers them away (say) to Capital. Let us now rewrite the contracts to fit these realities of “capitalist production,” and let us further suppose that both parties knowingly agree to these new contracts. Then there would be no fraud. What do we have? Not an employment firm, but an example of worker-managed production possibly with transactions at non-market prices. The non-labor inputs  $K$  have been legally purchased by Labor from Capital, and the outputs  $Q$  have been legally appropriated by Labor and sold to Capital. The net payment  $\$M$  goes from Capital to Labor. If the transfers were at market prices then  $\$M = \$pQ - rK$ , but parties may knowingly agree to exchanges at non-market prices. Or such non-market transactions can be interpreted as a market transaction followed by a voluntary gift. For instance, Labor could knowingly agree to buy  $K$  and sell  $Q$  all for the net payment of the money  $\$M = \$wL$ . That, in effect, is the market transaction with the net payment  $\$M = \$pQ - rK$  followed by the voluntary gift of the profits  $pQ - rK - wL = p$  from Labor to Capital. And that, in effect, is what the fraudulent employment contract induces Labor to do in conventional production. In a democratic firm, if the workers want to knowingly donate their profits to Capital or any worthy cause, they are free to do so. These points serve to mark the non-consequentialist nature of the de facto inalienability critique of the employment contract. With a different legal overlay, the same de facto transfers could knowingly and voluntarily take place without involving any fraud. This also serves to emphasize that there is no inherent conflict between the de facto inalienability argument and allocative efficiency or Pareto optimality (applied to non-institutionally specified states of affairs). In a simple garden-variety fraud, it is presumably always possible to ascertain that the de facto transfer does not correspond to the agreed-to legal transfer, e.g., to tell the difference between a pseudo-widget and the genuine article. The “beauty” of an institutionalized fraud like the employment contract is that there is no de facto transfer that fulfills the contract; in effect, there is no genuine widget to contrast with the pseudo-widget. The pseudotransfer of labor (i.e., voluntary co-operation with the employer) has been accepted for centuries by the legal authorities themselves as fulfilling the contract. The “discovery” of the fraud thus requires extensive analysis together with heavy use of intuition pumps like the case of the criminous employee to see that labor is not de facto transferable after all. And any responsible scholar and respected businessperson—being embedded in the institutions of the employment system—has every incentive not to make that discovery.

### Voluntarily Following Orders

The analysis has emphasized the property structure of production, but the same remarks can be applied, *mutatis mutandis*, to the parallel governance structure of production. In the employment relation, the worker  $W$  decides to do  $X$  because the employer or boss  $B$  says to do  $X$ . Here again, the problem does not lie in the factual reality of  $W$  choosing to do what  $B$  says; the problem lies in the

legal overlay. In the employment relation, the reality, namely a rather one-sided form of voluntary co-operation between autonomous decision-making individuals, is legally interpreted as B “employing” W with B as the sole decision maker. B is the “head,” W is the “hand.” The head makes the decision and then employs the hand to carry out the decision. The hired hand is the conductor of B’s intentions, the instrument of B’s will; it has no “head” of its own. In terms of the legal transfers between W and B, the employment contract transfers the use-rights over W’s time, the direct control rights over W’s services, to the employer B. It is a transfer, not a delegation, of decision-making authority. But the factual transfers cannot match that legal transfer. Short of some part-time robot concoction, W remains the de facto decision-maker over W’s actions. All W can do is to voluntarily co-operate with B by deciding to do as B says. The facts cannot be changed to eliminate the mismatch (science fiction aside); human decision-making capacity is not de facto transferable. The legal contract should be rewritten in a non-fraudulent form to fit the facts. The legal relationship between W and B is then one of delegation, not an alienation or transfer of decision-making capacity. W and all of W’s colleagues in the work process (including B) are the decision-makers; B acts as their delegate or representative. B’s decision initiatives are taken in the name of the whole group, in the name of the governed. When the workers decide to do X because the boss B says to do X, that would legally as well as factually be their decision—even when X is not a crime. Similar remarks apply to vote selling. The inalienability critique argued against W being permitted to sell his or her vote to B so that it became B’s vote. There was no inalienability critique of W casting W’s vote as B says. That may indicate what Hutcheson called a “weak mind” but it would not pretend to alienate the de facto inalienable capacity for decision-making. Would the abolition of the employment contract impair workers’ freedom? Workers would not be prevented from performing the same (non-institutionally described) voluntary acts as before, namely deciding to do what B says. But criminals are today denied the “contractual freedom” to voluntarily contract into the legal role of an instrument, the de jure role of a non-decision-making non-responsible tool employed by the employer. With the abolition of the employment contract, that “contractual freedom” would also be denied to all de facto responsible decision-making persons.

Slavery

Why was Slavery Wrong? Involuntariness or Treating Persons as Things?  
“Involuntariness” is the usual answer.

David Ellerman

Indeed, classical liberalism takes the most basic framing of a social question as: “consent or coercion?” In this view, democracy is characterized as government “with the consent of the governed” so slavery and non-democratic government were both condemned for the lack of consent.

This common condemnation of slavery on the basis of involuntariness has caused a large amount of intellectual history to just go “down the memory hole.” Those who routinely condemn involuntary slavery have either forgotten or never knew that from Antiquity down almost to the present there have always been those pro-slavery writers who: (1) presented a defense of slavery based on consent or contract, and (2) interpreted much of historical slavery as being based on implicit or explicit contracts.

My focus here is not on (2), the empirical question of whether or not any historical slavery could be interpreted as being voluntary, but (1), the fact of intellectual history that so many classical authorities defended slavery if based on consent.

Intellectual history of the voluntary slavery contract

The Old Testament of the Bible is a convenient starting point. The Old Testament law was that, after six years of service, any Hebrew slave was to be set free in the seventh year, the year of the Jubilee.

But if he says to you, “I will not go out from you,” because he loves you and your household, since he fares well with you, then you shall take an awl, and thrust it through his ear into the door, and he shall be your bondman for ever. [See Deut. 15:16-17; also Exodus 21:5-6.]

Much of Western jurisprudence was developed out of Roman law. In the Institutes of Justinian, Roman law provided three legal ways to become a slave.

Slaves either are born or become so. They are born so when their mother is a slave; they become so either by the law of nations, that is, by captivity, or by the civil law, as when a free person, above the age of twenty, suffers himself to be sold, that he may share the price given for him. [Institutes Lib.

I, Tit. III, 4]

In addition to the third means of outright contractual slavery, the other two means were also seen as having aspects of contract. A person born of a slave mother and raised using the master's food, clothing, and shelter was considered as being in a perpetual servitude contract to trade a lifetime of labor for those past and future provisions. In the natural rights tradition, Samuel Pufendorf (1632-94) explicitly gave that contractual interpretation.

Whereas, therefore, the Master afforded such Infant Nourishment, long before his Service could be of any Use to him; and whereas all the following Services of his Life could not much exceed the Value of his Maintenance, he is not to leave his Master's Service without his Consent. But 'tis manifest, That since these Bondmen came into a State of Servitude not by any Fault of their own, there can be no Pretence that they should be otherwise dealt withal, than as if they were in the Condition of perpetual hired Servants. [Pufendorf 2003 (1673), 186-7]

Manumission was an early repayment or cancellation of that debt. And Thomas Hobbes, for example, clearly saw a "covenant" in this ancient practice of enslaving prisoners of war.

And this dominion is then acquired to the victor when the vanquished, to avoid the present stroke of death, covenants either in express words or by other sufficient signs of the will that, so long as his life and the liberty of his body is allowed him, the victor shall have the use thereof at his pleasure. ... It is not, therefore, the victory that gives the right of dominion over the vanquished but his own covenant. [Hobbes 1958 (1651), Bk. II, chapter 20]

Thus all of the three legal means of becoming a slave in Roman law had explicit or implicit contractual interpretations.

In addition to giving a contractual interpretation to the slavery of a child born of a slave mother, Pufendorf noted that an explicit slavery contract was a lifetime version of the master-servant contract (employment contract in modern terms) where a servant could be hired or rented for a certain time and would receive wages.

But to such a Servant as voluntarily offers himself to perpetual Servitude, the

Master is obliged to allow perpetual Maintenance, and all Necessaries for this Life; it being his Duty on the other hand to give his constant Labour in all Services whereto his Master shall command him, and whatsoever he shall gain thereby, he is to deliver to him. [Pufendorf 2003 (1673), 185]

John Locke's Two Treatises of Government (1690) is a classic of liberal thought. Locke gave a ringing condemnation of a contract which gave the master the power of life or death over the slave.

For a Man, not having the Power of his own Life, cannot, by Compact or his own Consent, enslave himself to any one, nor put himself under the Absolute, Arbitrary Power of another, to take away his Life, when he pleases. [Second Treatise, §23]

Locke is ruling out a voluntary version of the old Roman slavery where the master could take the life of the slave with impunity. But once the contract was put on a more civilized footing, Locke saw no problem and nicely renamed it "drudgery."

For, if once Compact enter between them, and make an agreement for a limited Power on the one side, and Obedience on the other, the State of War and Slavery ceases, as long as the Compact endures.... I confess, we find among the Jews, as well as other Nations, that Men did sell themselves; but, 'tis plain, this was only to Drudgery, not to Slavery. For, it is evident, the Person sold was not under an Absolute, Arbitrary, Despotical Power. [Second Treatise, §24]

Moreover, Locke agreed with Hobbes on the practice of enslaving the captives in a "Just War" as a quid pro quo exchange based on the on-going consent of the captive.

Indeed having, by his fault, forfeited his own Life, by some Act that deserves Death; he, to whom he has forfeited it, may (when he has him in his Power) delay to take it, and make use of him to his own Service, and he does him no injury by it. For, whenever he finds the hardship of his Slavery out-weigh the value of his Life, 'tis in his Power, by resisting the Will of his Master, to draw on himself the Death he desires. [Second Treatise, §23]

Locke seemed to have justified slavery in the Carolinas by interpreting the raids into Africa as just wars and the slaves as the captives [See Laslett 1960, notes on §24, 325-26].

William Blackstone's (1723-1780) codification of common law was quite important in the development of English and American jurisprudence. Like Locke, Blackstone takes a seemingly modern moral stand to rule out a slavery where "an absolute and unlimited power is given to the master over the life and fortune of the slave." Such a slave would be free "the instant he lands in England."

Yet, with regard to any right which the master may have lawfully acquired to the perpetual service of John or Thomas, this will remain exactly in the same state as before: for this is no more than the same state of subjection for life, which every apprentice submits to for the space of seven years, or sometimes for a longer term. [Blackstone 1959 (1765), 72, section on "Master and Servant"]

#### The Debates about American Slavery

An interesting case study in the selectiveness of liberal intellectual history is the treatment of the proslavery writers in the American debates. The proslavery position is usually presented as being based on illiberal racist or paternalistic arguments. Considerable attention is lavished on illiberal paternalistic writers such as George Fitzhugh [See, for example, Genovese 1971; Wish 1960; or Fitzhugh 1960] while consent-based contractual defenders of slavery are passed over in (embarrassed?) silence.

For example, Rev. Samuel Seabury [1969 (1861)] gave a sophisticated liberal-contractarian defense of ante-bellum slavery in the Hobbes-Pufendorf tradition of alienable natural rights theory.

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