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Does Big Mean Bad? The Economic Power of Corporations*

The public's perception of power and the profitability of large corporations often is exaggerated greatly in the minds of the public. Corporate after-tax profits are only about 5 percent of revenues, and the wage scales at large corporations tend to be above average. The Fortune 500 companies, for example, are not a monolith — their interests are diverse and often opposed to one another. Nor are they monopolists. That list is, in fact, quite dynamic, as individual companies rise and fall in competitive markets. Large corporations become and stay that way by serving the wants and needs of their customers, not by exploiting them.

Fortune magazine annually presents its "Fortune 500" list of the 500 largest corporations. To some people, the Fortune 500 is a twisted tribute to the most greedy and baneful institution that capitalism offers: the big corporation. Critics of capitalism and big corporations often assert that such companies have excessive economic power and use that power to exploit consumers and workers.

Of course, not everyone thinks big corporations pose an economic menace, but it is striking — at least to me — how many people think large firms exploit consumers and workers to one degree or another.

My wife and I once went to a dinner party at which the host and hostess, both nice people, spent half the evening talking about awful big corporations. The funny thing was that the food they prepared, the appliances they used to make the food, the plates on which they served the food, and the furniture on which we sat to eat the food were all produced by big corporations. I don't think it's fitting to fuss at folks when I'm a guest in their home, so I didn't point out these facts. Later, with my belly full and dignity intact, I drove home with my wife in our car

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that was built by, yes, a big corporation.

Do big corporations exploit consumers? I reckon that "exploit" in this context means producing inferior goods and selling them at prices that yield enormous profits. Do big corporations produce poor products? Compare the quality and variety of goods and services available today with those on sale five, ten, or 20 years

ago. Which would you prefer? The answer doesn't demand much thought. Of course, entrepreneurs are responsible for a great deal of innovation, but it takes only a casual shopping trip to see that big corporations have also brought a lot of new and better products to the market.

Do companies charge prices that yield enormous profits? Before we look at the empirical data, we should note that it really does not make sense to use, as do many business critics, profit or profit margin as measures of the extent that corporations "exploit consumers." Exchange is voluntary in a free market. If a consumer pays a price for a good, and a corporation is not shielded by laws that restrict competition and does not misrepresent its product, then there is no reason to conclude that the corporation is exploiting the consumer simply because it earns a profit on the exchange. (If profit is a measure of exploitation, are corporations that lose money being exploited by consumers?)

But assume that charging prices that yield enormous profits constitutes consumer exploitation. The Fortune 500 informs us that the firm with the most profit

A Whiff of Sanity?

Absolutism is a failing of many self-described "environmentalists," especially their denial of trade-offs. For example, those who decry the disposal costs of the elaborate packaging used in our consumer economy generally ignore the potentially much larger costs of the damage and spoilage that such packaging prevents. Similarly, many activists disregard the ancient principle that "the dose determines the poison" — any substance can be lethal in sufficiently large amounts, while small amounts may be harmless or even essential for health. This absolutism is most notably enshrined in the Delaney Clause, which prohibits any amount of a known carcinogen in food products. The carcinogenic properties of a substance can be established by testing the effect of a substance (even an exclusive diet of that substance) on laboratory animals. Only amounts too small to detect with the available technologies are implicitly allowed. It has become possible to detect infinitesimal quantities (down to a few parts per billion) since the law was enacted in 1958, and application of the law has threatened the continued use of many useful substances (such as fumigation of peanuts with methyl bromide gas to prevent growth of molds that produce deadly toxins). It is now widely expected that Congress will soon change the standard from absolute prohibition to a "reasonable certainty of no harm." Perhaps this could mark the start of more realism and less fanaticism on environmental questions.

in 1994 was Ford, with \$5.3 billion in profits. That's a lot of money, but it came from revenues of \$128.4 billion. Ford's profit amounted to only 4.1 percent of its revenues. General Motors, the largest corporation in 1994, earned \$4.9 billion in profits — 3.2 cents of each dollar of revenue. How about those big oil companies? Out of every dollar received by Exxon, the largest oil producer, 5 cents went to profit. Mobil, the next in size, kept only 1.7 cents out of each dollar of revenue as profit.

For the Fortune 500 companies in 1994, the median profit as a percentage of sales revenue was 4.6. The other 95.4 percent covered costs: wages and salaries of workers, costs of other inputs, and taxes. The year 1994 was no anomaly. Over the last ten years, median profit as a percentage of revenue for the largest 500 companies has ranged from 2.4 in 1992 to 5.5 in 1988. Those numbers just don't seem to add up to corporate exploitation of consumers.

What About Workers?

Do firms exploit workers? Exploit here traditionally means that owners of capital — stockholders — employ workers to produce goods but expropriate much of the income generated when the goods are sold, leaving little income for workers. Does the bulk of corporate income available for distribution go to owners of capital? In 1992, after-tax profits of all U.S. corporations totaled \$249.1 billion. In the same year the compensation of employees of U.S. corporations was \$2,337.4 billion. Workers received 90.4 percent of the total corporate income available for distribution. The 1992 income shares are not extraordinary: workers received at least 90 percent of the corporate income available for distribution in every year between 1985 and 1992. In short, the bulk of corporate income goes to workers, not owners.

The notion that corporations exploit consumers and workers is part of the larger charge that big companies have excessive economic power. Do they? What would properly be considered "excessive"? True, in 1994 the largest 500 corporations had \$9.6 trillion in assets, \$4.3 trillion in revenues, and \$215 billion in profits, figures that are significant by any measure. But to conclude that economic power is therefore concentrated in big corporations is mistaken. Why? Because individual firms act in their own interest, not the interests of big corporations as a group. Companies have disparate interests, and they compete with each other. Consider the top three companies in the Fortune 500: GM, Ford, and Exxon. GM wants what is best for GM, not what is best for the Fortune 500. It would be best for GM if oil and

gas prices were very low; GM's production costs would be less and its cars would be more attractive to consumers. But low oil and gas prices would not be in Exxon's interest. Exxon would prefer high oil and gas prices. GM and Exxon have conflicting interests, and what is good for one is not necessarily good for the other.

Firm vs. Firm

The divergence in interests between GM and Ford is even more apparent: these corporations directly compete with each other. When GM expands its market share, it does so at the expense of its competitors, particularly Ford. GM would like nothing more than to develop cars that put its competitors' products to shame in the marketplace. Given the nature of the competition between GM and Ford, how can one conclude that there is excessive economic power in the auto industry simply because GM and Ford are the two largest U.S. corporations?

The rivalry between firms can be extraordinary. The *Wall Street Journal* recently ran a story about how big oil corporations — that's right, oil corporations — each spend millions of dollars testing the products of their competitors to determine whether the claims made by competitors in their advertising are accurate. When Chevron discovered that Texaco was making a false statement about its CleanSystem3 gasoline, Chevron made it public, and Texaco withdrew its \$40 million ad campaign.

The point is not that large companies are pure, innocent babes in the economic woods. They are not. But the economic power of big corporations cannot be accurately gauged without considering the generally fierce competition between firms. Businesses compete with each other for consumer dollars and skilled workers. A corporation cannot force customers to buy its product; when it attempts to "exploit" consumers by bringing a shoddy product to the market at a high price, it soon loses customers to a competitor who offers a better deal. Nor can a company force people to work for it. When it attempts to "exploit" workers by paying them little, the workers leave for employers who pay workers more. Competition between corporations (and entrepreneurs) constrains the power firms have over consumers and workers by punishing businesses that exploit consumers and workers.

Some critics of capitalism believe that being "big" makes a corporation impervious to market competition. But alongside the trail of American economic history you will find plenty of fallen corporate giants, emaciated or wasted entirely by

market competition. Where are American Motors, Continental Bank, Eastern Airlines, and Kaiser Steel today? They don't exist. They were among the largest companies in the country not long ago. In his *A History of American Business*, C. Joseph Pusateri, presents the lists of the 25 largest U.S. corporations in 1917, 1957, and 1986. If being "big" shielded firms from market competition, the three lists would be about the same. The 25 big corporations of 1917 could charge high prices for mediocre products without losing customers and revenues, pay poor wages without losing workers and increasing costs, ignore the marketing strategies of their smaller competitors and the innovations of entrepreneurs, and grow and remain at the top of the economic pecking order year after year. But the lists are not the same. Of the 25 corporations in the 1917 list, 13 made it onto the 1957 list. Only seven — if we treat U.S. Steel and USX as the same firm — made it onto the 1986 list. Only 12 firms on the 1957 list made it to the 1986 list. Competition between corporations exists and is effective.

At the top of the 1917 list is U.S. Steel. When formed through the merger of eight large steel firms in 1901, U.S. Steel became the world's largest private business: it had a total capitalization of \$1.4 billion and accounted for 65.7 percent of all steel sales in the United States. By 1917, U.S. Steel had assets valued at over \$2.4 billion, more than four times the assets of Standard Oil of New Jersey (Exxon), the next largest corporation. But U.S. Steel's market share was down to 45 percent. Forty years later, U.S. Steel was only the third largest company and its market share was less than 30 percent. Today U.S. Steel is no longer U.S. Steel but USX, and has a market share in steel of less than ten percent, receives more revenue from petroleum than steel, and is number 121 in the list of the largest U.S. corporations, ranked by assets. The moral of the U.S. Steel story applies to all corporations: no firm is impervious to market competition.

Those who worry about the economic power of big corporations would do well to think about how it was those corporations got big. GM and the other members of the Fortune 500 did not achieve their status by exploiting consumers and workers. In 1994, GM earned \$155 billion in revenues and employed 692,800 workers. A corporation does not collect \$155 billion in revenues by persistently ripping off consumers and does not retain 692,800 workers by abusing them. How powerful are big corporations? Not nearly so powerful as the competition that keeps them in check. □

BUSINESS-CYCLE CONDITIONS

Although the percent expanding of the leading indicators decreased slightly, the number of leaders appraised as expanding increased and the number of cyclically indeterminate series decreased. These are favorable developments.

Among the primary leading indicators of business-cycle conditions, the *index of 500 common stock prices* increased to a new high for the cycle in June as it did the previous month. This series is the 2-month moving average of the monthly average of the Standard and Poors' index of 500 common stock prices, deflated by the Consumer Price Index (CPI). On the basis of daily closing prices, the current-dollar S&P 500 index decreased during June and the first half of July to a level that was almost 7 percent below the peak reached in late May. In addition, the Dow Jones Industrials Average in mid-July was about 7 percent below the peak reached in May.

Last year, of course, common stock prices posted large gains while most of the other leading indicators decreased. Now, judging from the latest batch of data, it appears that common stock prices may be contracting even as the rest of the leaders continue to rebound from the weakness observed last year and earlier this year. If stock prices decrease further, a new appraisal of the series may be warranted, but for now it is appraised as clearly expanding.

Contracts and orders for plant and equipment, the index of new housing permits, and the ratio of manufacturing and trade sales to inventories increased to new highs for the cycle this month. The increases removed doubt about the latter two series' cyclical trends, and all three are now appraised as clearly expanding. *Manufacturers' new orders for consumer goods and materials* increased to its highest level in 16 months, and the base series for this 3-month moving average increased to an all-time high in May. It is now clearly expanding (last month its status was indeterminate).

Vendor performance, the percentage of purchasing managers reporting slower deliveries from their suppliers, increased in June. While this series has been in an upward trend for 6 months, it remains well below the peak reached in October 1994, and the latest increase was not sufficient to remove doubt about its cyclical status. It remains indeterminate.

The *average workweek in the manufacturing sector* increased to 41.8 hours in June. The moving average continues to rebound from January's presumably weather-related trough, and it remains appraised as probably expanding. *Average weekly initial claims for unemployment insurance* (inverted) increased to 349,000 in May. The moving average has fluctuated narrowly during recent months, neither increasing to a new high nor decreasing sufficiently below its September 1994 high to establish a downward trend. Its cyclical status remains indeterminate.

The cyclical status of the 3-month percentage *change in sensitive materials prices* also remains indeterminate. This series increased rapidly in 1994 and remained above zero in 1995, driven by soaring prices for paper materials. For example, during the 12 months through May 1995, the price indexes for three types of wastepaper — mixed, news, and corrugated — increased an astonishing 675, 475, and 200 percent, respectively. During the past year, however, paper prices have plummeted just as rapidly, and now are below what they were prior to the spike — the price of mixed wastepaper in May was 93 percent below its level a year earlier. In recent months prices have contin-

ued to fall but at a slower rate, which accounts for the increase in our rate-of-change series since February.

The two monetary series, the *M1 money supply* and the *M2 money supply*, both decreased this month. M1 is clearly contracting, and the decrease in M2 was sufficient to raise doubt about its cyclical trend. It is now appraised as probably expanding (last month it was clearly expanding). The 3-month percentage *change in consumer debt* also decreased in May. As noted last month, this series is based on consumer debt data that the Federal Reserve Board redefined and revised in June. The new debt series includes not only installment debt (defined by the Fed as debt that is scheduled to be repaid or has the option of repayment in two or more installments) but noninstallment debt, which accounts for about 6 percent of total consumer debt. The revisions to the data eliminated an apparent upturn on our series; according to the new data, the moving average of the rate of change in consumer debt decreased in May for the ninth consecutive month. Indeterminate last month, it now is appraised as clearly contracting.

As a result of the upgrade of our appraisals of two leaders (new orders for consumer goods and materials, and the index of new housing permits) and the

Statistical Indicators of Business-Cycle Changes

Change in Base Data				Primary Leading Indicators	Cyclical Status		
Mar.	Apr.	May	Jun.		May	Jun.	Jul.
+	-	-		M1 money supply	-?	-	-
+	-	-		M2 money supply	+	+	+?
+	-	+		Change in sensitive materials prices	?	?	?
-	+	+		New orders for consumer goods	?	?	+
+	-	+		Contracts and orders for plant and equipment	+	+	+
+	+	-		Index of new housing permits	?	?	+
+	+			Ratio of manufacturing and trade sales to inventories	?	+?	+
-	-	+	+	Vendor performance	?	?	?
-	-	+	+	Index of common stock prices (constant purchasing power)	+	+	+
nc	+	+	+	Average workweek in manufacturing	?	+?	+?
-	+	+		Initial claims for unemployment insurance (inverted)	-?	?	?
+?	-	-		Change in consumer debt	?	?	-
<i>Percentage expanding cyclically</i>					60	83	78
				Primary Roughly Coincident Indicators			
+	+	+	+	Nonagricultural employment	+	+	+
-	+	+	+	Index of industrial production	+	+	+
-	+	+		Personal income in manufacturing	-	-	-?
-	+			Manufacturing and trade sales	+	+	+
+	-	+	+	Civilian employment to population ratio	+?	+?	+
+				Gross domestic product (quarterly)	+	+	+
<i>Percentage expanding cyclically</i>					83	83	83
				Primary Lagging Indicators			
-	-	+	-	Average duration of unemployment (inverted)	+?	?	?
-	+			Manufacturing and trade inventories	+	+?	+?
+	-	-		Commercial and industrial loans	+	+	+
+	+	-		Ratio of consumer debt to personal income	+	+	+
+	+	nc		Change in labor cost per unit of output, manufacturing	-?	-?	?
+	+	nc	+	Composite of short-term interest rates	?	?	?
nc No change. ? Revised.					<i>Percentage expanding cyclically</i>		
					75	75	100

Under "Change in Base Data," plus and minus signs indicate increases and decreases from the previous month or quarter and blank spaces indicate data not yet available. Under "Cyclical Status," plus and minus signs indicate expansions or contractions of each series as currently appraised; question marks indicate doubtful status when shown with another sign and indeterminate status when standing alone.

Change in Unit Labor Cost and Consumer Price Index (Percent change from a year earlier)



downgrade of one (the change in consumer debt), the number of leaders whose cyclical status is indeterminate decreased from six to three this month. As a result, the percentage expanding (among those for which a cyclical trend is evident) decreased from 83 (five out of six) to 78 (seven out of nine). Despite this decrease, the percentage remains at a level that suggests a recession is not imminent. Indeed, we are more confident in this smaller percentage, given that it is based on a larger number of series with established trends (nine, compared with six last month). The cyclical score, AIER's separate statistical measure of the leaders, increased to 61 this month from the score of 60 reported last month, another sign that a recession is unlikely.

Five primary roughly coincident indicators, *nonagricultural employment*, the *ratio of employment to population*, *manufacturing and trade sales*, the *index of industrial production*, and *Gross Domestic Product* are at their highs for this cycle and are clearly expanding. Payrolls increased by 239,000 in June, with the largest gains occurring in the services and retail trade industries. In contrast, the number of jobs in the manufacturing industries shrank by 7,000.

Personal income in the manufacturing sector increased in May, and its moving

average increased sufficiently to warrant changing its cyclical appraisal from clearly to probably contracting. Overall, 83 percent (five out of six) of the coinciders are appraised as expanding. This is unchanged from last month.

Among the primary lagging series, *commercial and industrial loans* and the *ratio of consumer debt to personal income* decreased, but not sufficiently to warrant changing their cyclical statuses. They remain appraised as clearly expanding. *Manufacturing and trade inventories* increased, but doubts remain as to whether the series is expanding because it still is below the peak reached last November.

Among the three remaining laggings, the *average duration of unemployment* (inverted) and the *composite of short-term interest rates* changed little and their cyclical statuses remain indeterminate. The 12-month percentage change in labor cost per unit of manufacturing output was unchanged in May, but an increase in its

moving average was sufficient to raise further doubt about whether the series is still contracting. It, too, is now indeterminate. As a result of this change, the percentage of laggings appraised as expanding (among those for which a cyclical trend is evident) increased to 100 (three out of three) from 75 (three out of four) last month.

The near-term prospects for the economy in general, and the stock market in particular, will be influenced by what policymakers at the Federal Reserve Board do at their next meeting on August 20th. Many analysts contend that if Fed policymakers think price inflation is poised to accelerate, they will act to raise short-term interest rates. Thus, signals of price inflation are widely studied for clues to the likely direction of monetary policy. One statistic that is often cited as a harbinger of price pressures is the rate of change in the cost of labor. If the cost of labor accelerates, analysts contend, this increase eventually will be passed on to consumers in the form of higher prices for goods and services.

Based on the change relative to a year earlier, labor cost per unit of output in the manufacturing sector has been decreasing during most of the past 4 years. The rate of change has been in a downtrend even longer, since 1990. In the broader business sector, unit labor cost has increased by less than 3 percent a year since 1992, but the rate of change increased in 1994. As can be seen in the accompanying charts, there is a rough correlation between these rates of change and the year-over-year change in the Consumer Price Index.

Therein lies the problem for price forecasters. The rate of change in unit labor cost is *not* a leading indicator of price inflation. If anything, it is a coincident indicator. Indeed, the price series sometimes has peaked first and other times has bottomed out first. Thus, the recent changes in unit labor cost are not helpful in forecasting future price inflation. They broadly echo the moderation in price inflation that has occurred during the past 5 years, but they tell us nothing about the likely future trend. In this respect, they would seem to be poor tools both for forecasting price inflation and for guiding monetary policy. □

PRICE OF GOLD

	1994 July 21	1995 July 20	— 1996 — July 11	July 8
Final fixing in London	\$385.90	\$396.85	\$382.70	\$383.85

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